THE THRIVING

Business of Breakfast

Capstone Headwaters
A tremendous influx of capital targeted toward restaurant investments is transforming breakfast into one of the industry's most exciting and high-growth segments. The breakfast concepts that are winning the greatest consumer attention meet the rising demand for fresh, higher quality ingredients as well as new flavor combinations and an elevated dining experience.

— LEIGH HUDSON, MANAGING DIRECTOR, CONSUMER INVESTMENT BANKING GROUP, CAPSTONE HEADWATERS
Changing consumer preferences regarding what consumers want to eat, and how and where they want to eat, are causing a dramatic shift in the restaurant industry. For many reasons, that shift is also creating tremendous opportunities for restaurants in the business of breakfast.

From new restaurant concepts and formats to revamped menu selections, a virtual explosion in innovation is underway across the industry that is redefining the most important meal of the day. It is also extending the focus of the breakfast daypart beyond McDonald's, IHOP and other Quick Service Restaurants and chains to more completely reach the full range of restaurants across the US.

**INDUSTRY BRIGHT SPOT**

Today, breakfast has transcended its traditional daypart and become a more prominent and creative staple on restaurant menus, which is a significant achievement during a challenging time for the restaurant industry overall. While the industry is struggling with declining foot traffic and same-store sales, the thriving breakfast segment continues to defy industry trends.

Consumers are increasingly eating and ordering out breakfast at restaurants, with approximately 30.0% considering breakfast to be more of a destination meal compared to just two years ago.¹ Also, approximately 70.0% of US adults prefer that restaurants serve breakfast all day.² The result is that restaurant operators now recognize breakfast as the most in-demand meal for consumers — and a critical growth opportunity for them. Additionally, the halo effect of breakfast is having a positive and far-reaching impact on restaurants as it carries its consumer loyalty to other meals of the day.

Restaurant operators are responding to the segment's surge by increasing the number and choices of breakfast food items, and having them available throughout the day. In fact, Datassential reports that more than 60.0% of restaurants serve breakfast, with approximately 30.0% offering breakfast foods during dinner hours.³
APPETITE FOR GROWTH

Breakfast concept-based restaurants are gaining in popularity as more American consumers realize the value in starting their day with a meal. Consumers are also demanding more from their breakfast in terms of menu diversity, flavor and flavor combinations, convenience, and chef-inspired preparation methods, to name a few.

Breakfast has been the sole segment in the restaurant industry that has grown in the last several years in terms of meals per person and customer traffic. NPD Group research reveals that the segment is expected to grow at an annual rate of more than 5.0% over the next five years. It also shows that breakfast is the only time of day when restaurants have experienced traffic growth for the past three years, largely due to the fast-food industry. NPD Group predicts morning meal traffic will continue to climb as more restaurants add breakfast items to their menus.

The following are among the leading factors driving the segment’s strength and resilience:

- Consumers’ escalating demand for meat, dairy, eggs and other healthy protein-rich breakfast items throughout the day
- Rising popularity and preference for all-day breakfast menus
- Lower food and labor costs that translate to higher margins for breakfast-centric restaurants
- Consumers’, particularly millennials’, widening embrace of brunch, with its creative food and beverage selections, along with its social and experiential qualities

Among the indicators of how far breakfast, and also brunch, have progressed beyond their traditional beginnings is their entry into Korean, Mexican, Japanese and other internationally themed menus. Their rising popularity has reached high-profile restaurants such as New York City’s Momofuku Ssam Bar, which was once a Korean burrito restaurant serving lunch and dinner, and Los Angeles’s Sqrl, which prepares breakfasts using farm-fresh ingredients. There has also been a trend across restaurant sectors, from hamburger to pizza restaurants, to “put an egg on top” and create a value-added product that commands a higher price and incremental margin.

SELECT RESTAURANT CONCEPTS EV AS A MULTIPLE OF EBITDA

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<th>Fast Casual</th>
<th>Quick Service</th>
<th>Coffee, Breakfast and Snacks</th>
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<tr>
<td>2013</td>
<td>15.1x</td>
<td>Mean: 14.0x</td>
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<td>2014</td>
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<td>2017</td>
<td>14.2x</td>
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Source: CIQ. Segments weighted based on market cap values and represents most actively traded public restaurant companies. Coffee, Breakfast and Snacks segment includes Starbucks Corporation, Dunkin’ Brands Group and Jamba Juice.

“A term originally coined for Saturday night carousers who couldn’t wake up for breakfast, brunch has evolved into a sunny, social meal beloved by the world.”

—JESSICA COLE, JOURNALIST, THE TELEGRAPH
TRENDS TO WATCH

At a time when change is revitalizing the breakfast sector with new opportunities, and aligning it more closely with consumers’ more diverse preferences and lifestyles, we have identified top trends behind the revitalization:

• Restaurants are incorporating more chef-driven, higher quality breakfast foods into existing menus.

• Comfort foods and other familiar breakfast-menu items are being reinvented with on-trend global flavors, unique food combinations, and fresh, seasonal ingredients.

• Playful irreverence and craft cocktails are making breakfast the most fun daypart as concepts ranging from Eggslut and Not Your Average Joe to Snooze’s long list of morning cocktails find their way into a growing number of menus.

• Egg-centric restaurants are having tremendous success with their strong Millennial and Gen Z appeal, limited menus, great-tasting food, and high value proposition with reasonable prices.

Fried chicken and eggs, biscuit-centric restaurants, and craft donuts are other breakfast-food trends that are rapidly gaining favor among consumers, and demonstrate how consumers are favoring flavor and satiation over “healthy” and/or “low-fat” foods.

NPD Group named the biscuit as one of the fastest-growing menu foods in 2017. No other classic comfort food with Southern roots is more successfully spanning regional boundaries. Furthermore, its popularity is showing no sign of slowing down, as epitomized by its position on the “What’s Hot” culinary forecast lists for the past several years. Also, Statistica reports that doughnuts with nontraditional fillings are among the fastest-growing breakfast-food items.

Even if you’re eating maple syrup-smothered waffles, breakfast has a reputation as a smart and healthy way to start your day, rather than as an indulgence. There is a different feeling about breakfast than there is about food [served] later in the day. It’s sort of guilt-free food.

— DAVID JUST, PROFESSOR, BEHAVIORAL ECONOMICS, CORNELL UNIVERSITY
BREAKFAST BOOM

Investors are agreeing with mom as they target the most important meal of the day for investment returns. Breakfast is now widely recognized as the go-to segment in the restaurant industry due to its higher-than-average trading multiples above other segments, strong growth potential and attractive characteristics that include:

- Most habitual meal of the day
- Strong consumer loyalty
- Broad appeal and affordability
- Low food costs and a high value proposition
- Limited operating hours and generally high revenue per operating hour
- Attractive lifestyle and work/life balance for restaurant employees
- Higher check averages and margins, particularly where beer and craft cocktails are offered

McDonald’s is a case in point. The company’s share price traded at an average of $96.0 from September 15, 2014 to October 15, 2015, with essentially stagnant growth during that period. On October 16, 2015, McDonald’s, responding to consumer demand, introduced its all-day breakfast menu. The result was a substantial improvement in the company’s financial performance, which was reflected in a material increase in its share price.

Strategic buyers, such as JAB, are actively securing their position in the breakfast segment. The European investment fund is building a coffee and breakfast empire that includes Panera Bread, Krispy Kreme and Caribou. It also includes Peet’s Coffee, which controls Intelligentsia Coffee, Mighty Leaf Tea and Stumptown Coffee Roasters. First Watch, another breakfast chain owned by private equity firm Advent, has also acquired several regional breakfast chains.
Eating out is more than just food. It’s about the experience. It’s worth it to pay a little bit extra to go to a restaurant with a super cool roof deck or an outdoor patio.

— GRANT SABATIER, FOUNDER, MILLENNIAL MONEY

CONTACT US

For restaurant owners seeking growth capital and/or liquidity, there has perhaps never been stronger demand for restaurant investments, and the breakfast segment is clearly a sweet spot within the industry.

To learn more about industry trends, financing alternatives, and merger and acquisition opportunities, please contact:

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ENDNOTES

1 Technomic, 2017 Breakfast Consumer Trend Report
2 2016 NRA Restaurant Industry Forecast
3 Datassential Keynote on Breakfast 2016
4 NPD Group
5 Forbes, “Egg-based Restaurants Are All They Are Cracked Up to Be”

ABOUT CAPSTONE HEADWATERS

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