

Healthy Returns

**Fast Casual rides high on the
American health wave**

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Riding the Health Wave

Over the years various health trends in the United States have come and gone, however one of the more recent fads that has stayed the course has been the focus on fresh and natural foods. As a recent Nielsen study suggests, 60% of North Americans stated they focus more on eating natural/fresh foods when trying to lose weight¹. This consumer demand created an opportunity for select industries to shift their focus to fresh foods.

Restaurants have been one such industry that has seized the opportunity, which over the past decade has seen different types of companies enter the market. No longer are there just Fast Food/Quick Service restaurants or Sit-in/Full Service restaurants, there has emerged what is known as the **Fast Casual** restaurant.

With a higher quality of food that is usually advertised as fresh or natural and a slightly higher price level (usually in the \$8-\$15 range), Fast Casual restaurants have differentiated themselves from their traditional Fast Food cousins while still retaining the quick service and pay before receiving features^{2, 3, 4}. For these reasons, the Fast Casual model sits in the middle of the spectrum between Fast Food and Sit-in, which has led to several new and diverse models enter the industry. Some examples for Fast Casual restaurants include: Chipotle, Shake Shack, Zoe's Kitchen, Potbelly, Noodles & Co, and Habit Restaurants.

As Fast Casual restaurants have ridden this health wave and grown in number, so too has their performance. Fast Food and Sit-in restaurants have stagnated and in some cases seen a deterioration in performance.

¹ Nielsen: We Are What We Eat [<https://www.nielsen.com/content/dam/nielsen-global/eu/nielseninsights/pdfs/Nielsen%20Global%20Health%20and%20Wellness%20Report%20-%20January%202015.pdf>]

² Davis, Lea: Confounded by Fast Casual [www.qsrmagazine.com/articles/features/115/fast-casual-1.phtml]

³ Blank, Christine: High Prices? No Problem [www.qsrmagazine.com/exclusives/high-prices-no-problem]

⁴ Bodnar, Matt: Why fast casual is not the future of restaurant business [www.pdco.com/node/88828]

Fast Casual a Bright Spot for Restaurant IPOs

When it comes to IPOs, the restaurant industry may not be the standout performer but it is still an active one with room for growth. In the past decade, Fast Casual restaurants have seen significant increase in revenue and several of these companies have gone public.

The most recognizable Fast Casual restaurant is **Chipotle Mexican Grill Inc.**, which went public in 2006 and has seen the best stock performance in the restaurant industry since 2000, according to Dealogic figures. Early 2016, however, saw a decline in Chipotle's performance due to hygiene concerns, which can be a common issue in the restaurant industry.

Chipotle isn't alone when it comes to strong share price performance in the Fast Casual space. A look at the biggest percentage change in price from offer to open in the restaurant industry shows that the top 6 are all Fast Casual restaurants (see Exhibit 1), led by **Shake Shack** which went public in January 2015. Fast Food and Sit-in restaurants on the other hand, have not performed as well upon going public.

Restaurants that Have Seen the Biggest Percentage Change
in Share Price Offer/Open

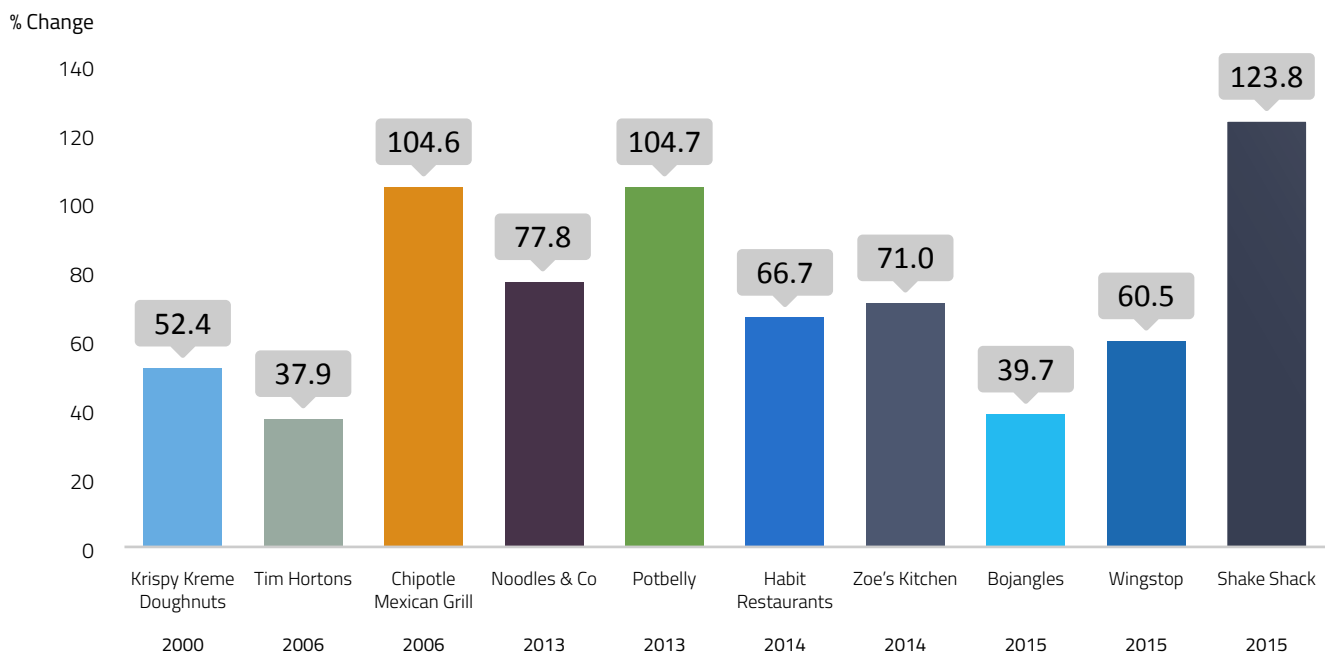


Exhibit 1 – The best performers at open in the restaurant industry since 2000
Source: Dealogic

Fast Casual restaurants have been the standout segment in share price performance.

Also a Standout in Short Term Stock Performance

Dealogic figures show there have been 44 IPOs within the restaurant industry since 2000. The selected 6 restaurants shown in Exhibit 2 represent the 3 segments mentioned earlier: Fast Casual (Shake Shack and Chipotle), Fast Food (Burger King and Wingstop), and Sit-in restaurants (Ruth's Chris Steak House and Fogo de Chao).

Additionally, Chipotle, Burger King, and Ruth's Chris Steak House went public close to the same time in 2005 and 2006; and Shake Shack, Wingstop, and Fogo de Chao all went public in 2015, therefore we can make accurate comparisons between these companies.

It is clear that for the Fast Casual restaurants, share price grew rapidly in the first 6 months of going public. Both Fast Food and Sit-in restaurants saw a much smaller increase and in the case of Fogo De Chao, even a decrease in share price 6 months after its IPO (see Exhibit 2).

6-Month Aftermarket Performance: Fast Casual, Fast Food, Sit-In

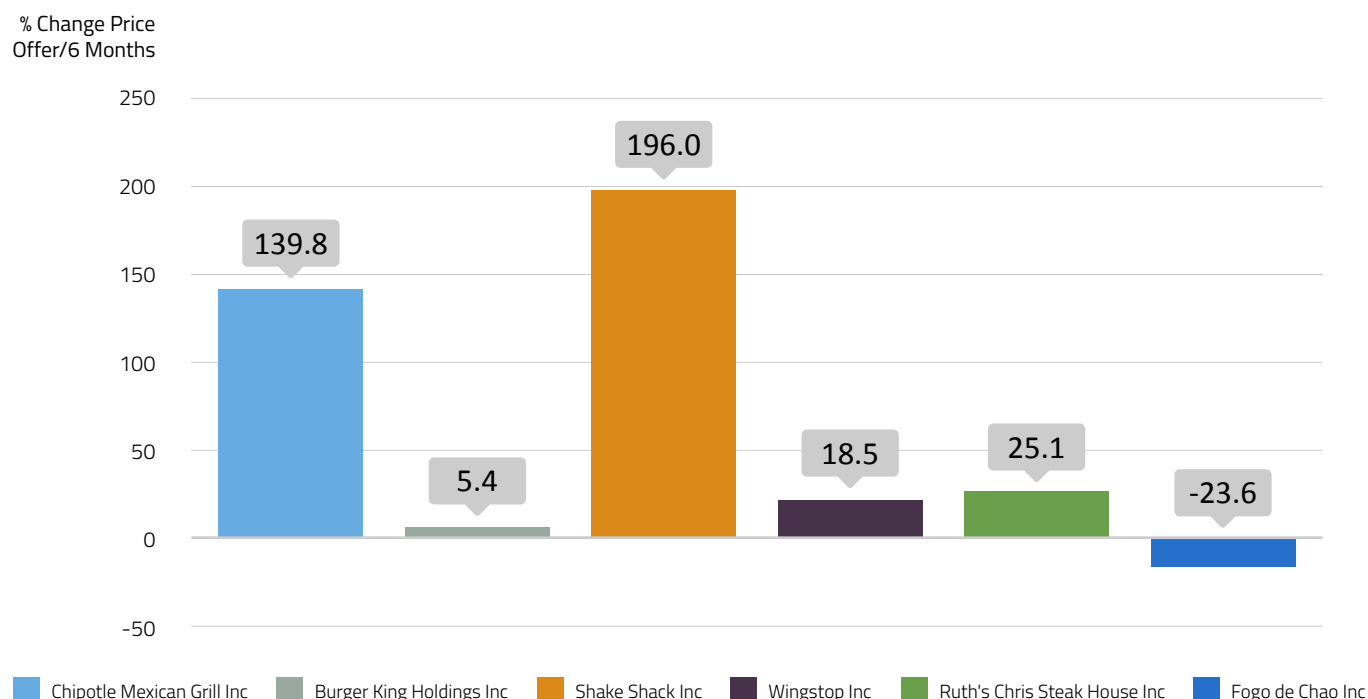


Exhibit 2 – Comparing the percentage change in share price after 6 months to the offer price, for select restaurants.
Source: Dealogic

Fast Casual restaurants have been the standout segment in short term stock performance.

What About Profit?

Shake Shack and Chipotle have seen tremendous growth in profit since their IPOs. Since 2007, Chipotle's annual profit before interest (EBIT) has grown from \$114m to \$777m⁵ (an overall growth rate of 579%, see Exhibit 3).

Annual EBIT: Ruth's Chris Steakhouse, Chipotle, Burger King

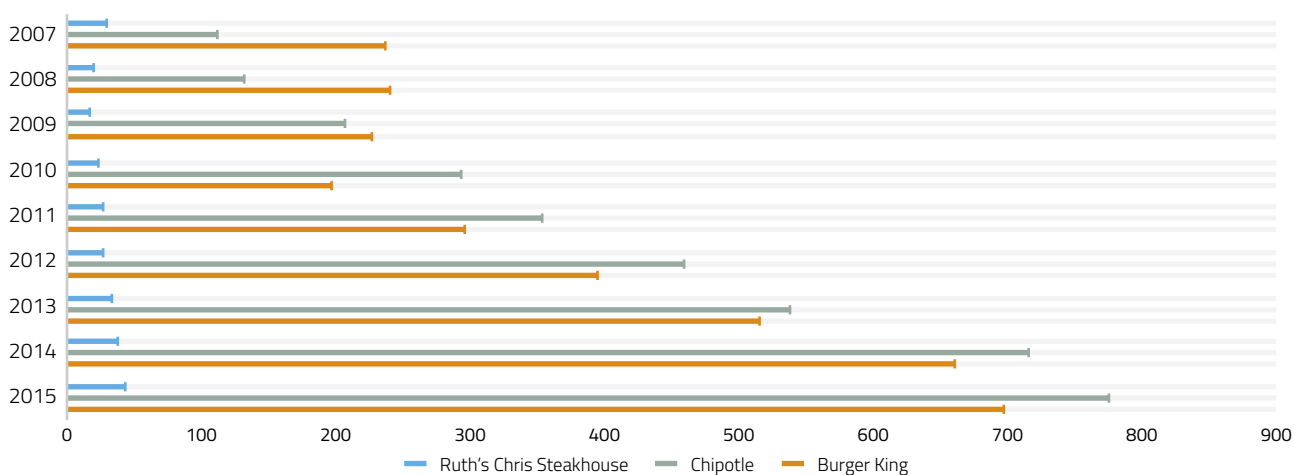


Exhibit 3 – Comparing EBIT between select Sit-In, Fast Casual, and Fast Food restaurants. Source: S&P Capital IQ

Similarly, Shake Shack saw a 94% growth in profit in the past year (IPO in 2015, see Exhibit 4). As for the Fast Food restaurants, Wingstop's EBIT only grew by 14% in the year following its IPO; and Burger King increased and decreased annually during this 9 year time span, with only a 6% increase between 2014 and 2015.

The Full Service restaurants saw similar results as Fast Food. Ruth's Chris Steakhouse (2005 IPO) had an increase of 47% between 2007 and 2015, and Fogo De Chao's operating profit decreased 18% during the year following its IPO.

2015 Quarterly EBIT: Shake Shack, Wingstop, Fogo De Chao

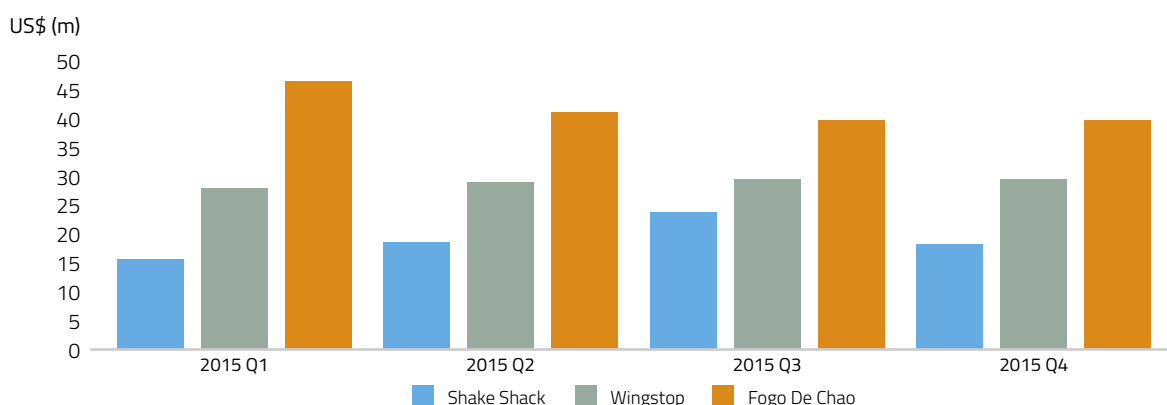


Exhibit 4 – Comparing quarterly EBIT for select Fast Casual, Fast Food, and Sit-In restaurants. Source: S&P Capital IQ

With Fast Casual restaurants tapping the demand for fresh and natural foods, parallels can also be seen in the natural/organic food segment where distributors Hain Celestial Group, United Natural Foods, and Whole Foods Market have also seen excellent growth in profit since 2007 (see Exhibit 5).

Annual EBIT: Whole Foods, United Natural Foods, Hain Celestial

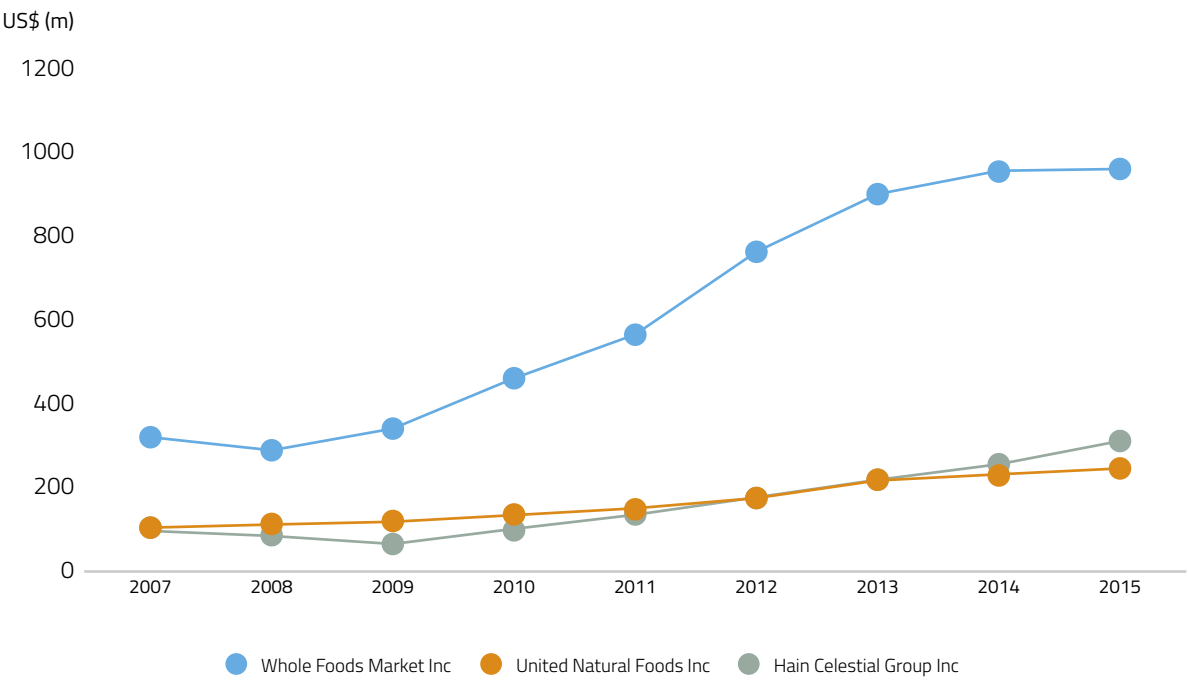


Exhibit 5 – Comparing annual EBIT for select Natural Food companies. Source: S&P Capital IQ

Future of Fresh Foods

Health trends may be cyclic, but it appears the demand for natural foods will continue. Along with the restaurant industry, natural/organic food distributors have also taken advantage of this trend.

Looking at various indicators, it is obvious that Fast Casual companies have successfully entered the restaurant business. However, there are several variables that can impact the entire restaurant industry such as hygiene concerns, as shown by the recent case of Chipotle, which was negatively affected both in sales and stock performance during the first quarter of 2016.




While there are many different factors involved in the success of certain Fast Casual restaurants, the shift towards fresh food and away from Fast Food appears to be here to stay.

Dealogic Research Paper, written by Daniel Zambrano

Daniel Zambrano is a Research Associate in our Corporate Analytics team in New York, where he conducts in-depth research into US companies across a broad spectrum of industries.

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