

QUICK SERVICE RESTAURANTS & PRIVATE EQUITY: A TASTY COMBO

As a historically resilient industry with strong growth prospects and a number of potential benefits, quick service restaurants may offer private equity investors an appetizing opportunity.

Quick service restaurants (QSRs) are a popular dining choice for consumers. Nearly 37% of American adults consume fast food daily.¹

With their relatively stable revenue streams, ability for strong cash flow and potential for expansion, QSRs have also long been a popular investment opportunity for private equity firms. Private equity firms may acquire a controlling interest in the company, implement operational improvements and, ultimately, sell the company for a profit, much to the benefit of the firm and its investors. While investing in QSRs through a private equity firm offers a trade-off of risks and benefits, it may be an attractive and viable option for certain investors.

WHAT ARE QUICK SERVICE RESTAURANTS?

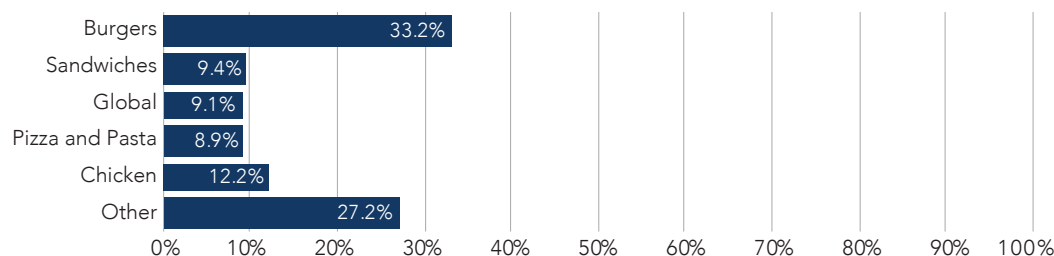
QSRs focus on providing quick, convenient and affordable meals and are a popular subcategory of the restaurant industry and account for more than half of the sales in the entire restaurant sector.² Globally, the QSR industry is worth \$907 billion³ with many U.S. QSRs expanding in the international market.

While QSRs are prevalent around the world, the country perhaps most associated with the industry is the United States. Market size is expected to continue to increase by 1.3% in 2023 to a total revenue of \$366.9 billion.⁴ This means the U.S. will account for approximately 40% of the QSR industry's global worth. With more than 200,000 fast food businesses in the U.S., QSRs are a large and growing market.⁵

Some of the most well-known QSR chains include McDonald's, Burger King and KFC, and, while fast food may be nearly synonymous with burgers, there is actually a diverse range of food types available, including pizza, sandwiches, tacos, Asian food and more. Many QSRs also offer options which align with current consumer trends, such as healthier menu items, plant-based menus or allergy friendly choices, to name a few.

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QSR Segmentation⁶

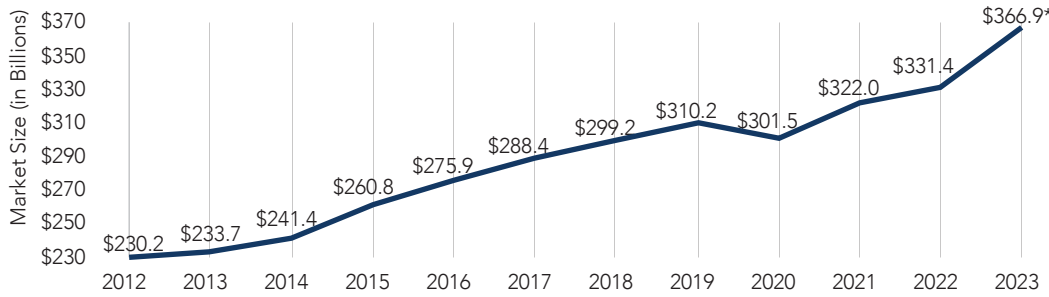


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 2. "Fast Food Industry Analysis 2020 - Cost & Trends." <https://www.franchisehelp.com/industry-reports/fast-food-industry-analysis-2020-cost-trends/>
 3. "Global Fast Food Restaurants - Market Size 2005-2028." IbisWorld. November 14, 2022. <https://www.ibisworld.com/global/market-size/global-fast-food-restaurants/>
 4. "Fast Food Restaurants in the U.S. - Market Size 2005-2029." IbisWorld. January 12, 2023. <https://www.ibisworld.com/industry-statistics/market-size/fast-food-restaurants-united-states/>
 5. "Fast Food Restaurants in the U.S. - Number of Businesses 2005-2029." IbisWorld. January 12, 2023. <https://www.ibisworld.com/industry-statistics/number-of-businesses/fast-food-restaurants-united-states/>
 6. Ristoff, Jared. "Fast Food Restaurants in the U.S. Industry Report." IbisWorld. June 2022.

INVESTING IN QSRS VIA PRIVATE EQUITY: THE POTENTIAL BENEFITS

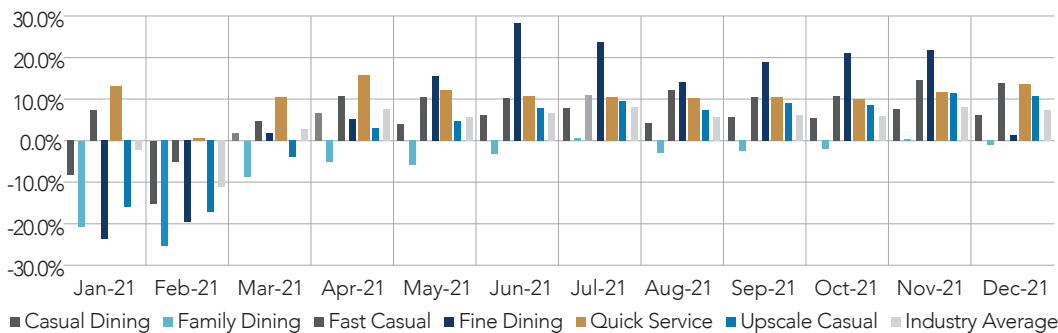
With its affordability and convenience, more than half of all American adults say that fast food is essential to the way they live.⁷ This may be why QSRs have shown themselves to be historically resilient during economic downturns. For example, during the COVID-19 pandemic, QSRs were considered an essential business, and many businesses did not close down. So, while the restaurant industry as a whole lost \$240 billion dollars in 2020,⁸ QSRs recovered quickly and have shown year over year growth.

U.S. Fast Food Industry Market Size Over Time⁹



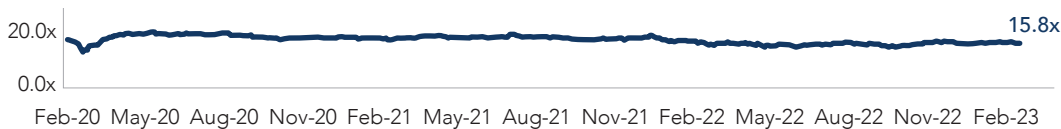
QSRs quick recovery may further be seen in the same-store sales growth, as compared to the previous 24 months, which included 2019 pre-COVID and the 2020 COVID pandemic. While fine dining saw a spike in the warmer summer months, QSRs recovered more quickly and generally increased at a consistent monthly rate.

Two-Year Same-Store Sales Growth¹⁰



Furthermore, QSRs' stability may be seen when looking at its valuation multiple evolution. Despite a small dip around March 2020, the beginning of the COVID pandemic, the industry recovered quickly and has remained relatively stable. As of February 2023, the current three-year FV/NTM EBITDA average is 15.8x.¹¹

QSR Multiple Evolution¹²



	3 Years	2 Years	1 Year	Current
3 Year FV/NTM EBITDA Averages	17.3x	16.8x	15.7x	15.8x

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NTM FV/EBITDA is a financial metric often used by buyers to assess the reasonability of a target's valuation.

7. "2022 State of the Restaurant Industry," National Restaurant Association. 2022. <https://restaurant.org/nra/media/research/reports/2022/soi2022-summary.pdf>

8. Klein, Danny. "Fast Food Emerges from COVID a More Resilient Industry than Ever." QSR. December 3, 2021. <https://www.qsrmagazine.com/consumer-trends/fast-food-emerges-covid-more-resilient-industry-ever>

9. Zippia. "20+ Fascinating US Fast Food Industry Statistics [2023]: Revenue, Trends, And Predictions" Zippia.com. Feb. 27, 2023, <https://www.zippia.com/advice/us-fast-food-industry-statistics/>

*Forecasted

10. Restaurant Sector Update. Kroll Corporate Finance. Winter 2022. <https://www.kroll.com/-/media/kroll/pdfs/publications/restaurant-sector-update-winter-2022.pdf>

11. "Restaurant Sector Trading Update." J.P. Morgan. March 2023. "FV"—firm value. "NTM"—next twelve months. "EBITDA"—earnings before income taxes, depreciation and amortization. FV/NTM EBITDA is a financial metric often used by buyers to measure the reasonability of a target's valuation.

12. Source: Company information, FactSet as of February 28, 2023. Quick service restaurants include Yum! Brands, Restaurant Brands International, Domino's, McDonald's, Starbucks, Wendy's, Jack in the Box, Krispy Kreme and Papa John's.

Additional potential advantages for investing in QSRs via a private equity firm may include:



STRONG CASH FLOW – QSRs typically have strong cash flow due to their high volume of sales and their efficient operation. In 2022, QSRs in the U.S. averaged nearly \$36.7 billion of sales per month.¹³ Additionally, while other sectors may struggle with employment shortages, QSRs are able to quickly adapt, utilizing meal delivery apps and additional drive-thru lanes to work efficiently with a smaller workforce, helping private equity investors to avoid labor shortage challenges and save on employee wages and benefits. All of this may combine to provide a stable revenue stream for private equity firms and the potential for regular dividends.



OPERATIONAL IMPROVEMENTS – Additionally, private equity firms often have expertise and resources that may not be available to individual investors. Private equity firms may then implement these advantages to create overall improvements in operations. These improvements may range from streamlining supply chains and reducing costs to revamped marketing strategies to physical improvements, such as updated signage or building design. All of these improvements may help increase profitability and add value to the company.



GROWTH POTENTIAL – From 2018 to 2023, QSR market size in the U.S. grew by an annual average of 2.5% per year.¹⁴ It is expected to grow at a similar annual rate of 2.3% through 2027.¹⁵ The global fast food market is forecasted to experience a growth rate of 2.9% as more U.S. chain restaurants expand internationally.¹⁶ As more people move to urban areas and become more strapped for time, it may be expected for this number to continue to grow.



DIVERSIFICATION – QSRs may also provide diversification benefits for an investor's portfolio. As mentioned, the industry is historically resilient and not heavily correlated with other industries. QSRs are typically a defensive category of consumer spending and an affordable option for many Americans during down economic times.

INVESTING IN QSRS VIA PRIVATE EQUITY: THE POTENTIAL RISKS

Like all investment opportunities, QSRs also carry risks. First, it is possible that an investor may lose their entire investment. Investors should invest responsibly and only invest that which they can afford to lose. Other risks may include:



COMPETITION – The restaurant industry as a whole is known for being competitive and QSRs are no different. With an excess of 200,000 QSR businesses across the country, fast food restaurants compete with each other on a variety of factors including price, quality, location, ambiance and customer service. QSRs may also face competition from the broader food services sector, including dine-in restaurants and meal delivery services, as well as a consumer's propensity to cook their own food. This competition is expected to increase over the next five years and may lead to pricing pressures and reduced profitability. This is where a private equity firm's expertise and experience in the sector is essential.

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13. "Monthly Sales of Quick Service Restaurants in the United States From 2019 to 2022." Statista. February 24, 2023. <https://www.statista.com/statistics/1232824/monthly-quick-service-restaurant-sales-us/>

14. "Fast Food Restaurants in the U.S. - Market Size 2005-2029." IbisWorld. January 12, 2023. <https://www.ibisworld.com/industry-statistics/market-size/fast-food-restaurants-united-states/>

15. Ristoff, Jared. "Fast Food Restaurants in the U.S. Industry Report." IbisWorld. June 2022.

16. "Global Fast Food Restaurants - Market Size 2005-2028." IbisWorld. November 14, 2022. <https://www.ibisworld.com/global/market-size/global-fast-food-restaurants/>



CHANGING CONSUMER PREFERENCES – Consumer preferences are constantly evolving and QSRs must adapt to stay relevant. In 2021, overall vegan food delivery orders increased by 17% and vegetarian orders increased by 55%.¹⁷ Consumers don't just change their preferences in regards to menu, however. Today, they also expect expanded delivery and ordering options, such as ordering from an app ahead of time. If a private equity firm invests in a QSR and fails to adapt its menu or its services, the company may succumb to the competition and lose valuable market share.



ECONOMIC DOWNTURNS – While QSRs have historically performed relatively well during down markets, a severe recession or economic crisis may still negatively impact the industry. Inflation may drive up the prices of food, beverages and labor. Private equity firms that invest in QSRs can benefit from industry knowledge in order to combat rising costs and understand consumer needs. In order to survive during economic downturns, private equity firms must make wise investments and maintain tight management practices.



REGULATORY RISKS – The QSR industry is regulated by the FDA in the U.S. and is subject to a host of regulations, including health and safety standards and minimum wage laws. Changes in regulation may increase costs and lower overall profitability.



LIQUIDITY RISK – Private equity investments are, in general, illiquid. When investing in QSRs through a private equity firm, investors should keep in mind that they may be unable to access their funds quickly, should they need cash.

QSRs MAY OFFER AN ENTICING OPPORTUNITY

Investing in QSRs through a private equity firm may provide several benefits for investors. QSRs typically offer strong cash flow, the chance for operational improvements, high growth potential and diversification benefits. As with all investments, however, there may be risks involved. The QSR landscape is competitive and subject to changing consumer preferences. While historically QSRs are resilient during down markets, they may still be impacted by a recession or economic crisis. Additionally, they are highly regulated and generally illiquid.

Today, more and more private equity firms are taking an interest in QSRs as an investment. For individual investors, this means more opportunity and greater access, but it also means more responsibility. Investors must perform their due diligence, remain disciplined and find high-quality managers with strategies that align with their goals. Although they may not be a fit for every portfolio, certain investors may find that investing in QSRs through an experienced private equity firm with the right strategy may provide a lucrative and rewarding opportunity.

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17. "Grubhub Releases Third Annual 'State of the Plate' Report." Grubhub. June 30, 2021. <https://about.grubhub.com/news/grubhub-releases-third-annual-state-of-the-plate-report/>

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