

INTRODUCTION

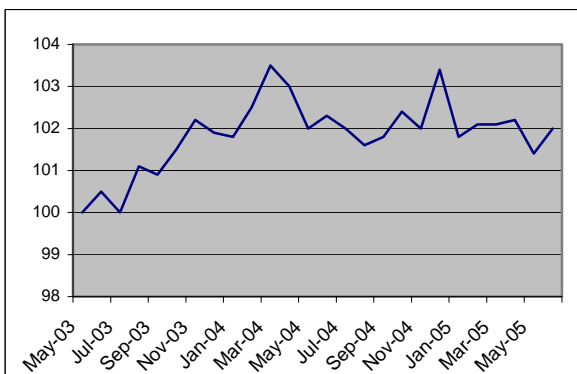
The restaurant IT industry is currently experiencing positive gains in growth as restaurant operators continue to increase spending in information technology (IT). Coupled with expected cost savings, operations integration and a positive regulatory environment, we expect the restaurant IT industry to post double-digit returns over the next 24 months.

INDUSTRY OVERVIEW

The restaurant industry is presently experiencing growth rates comparable to that of the late 90's, as expectations continue to grow due to a favorable shift in demographics and the desire for convenience continuing to rise. The National Restaurant Association (NRA) expects that restaurant-industry sales will grow from \$452.5 B in 2004 to \$475.8 B in 2005, a growth rate of 4.9%.

The Association's Restaurant Performance Index – a monthly composite index that tracks the health of and outlook for the U.S. restaurant industry – has been above the 100 base point for the last 26th consecutive months. Any value over 100 indicates that the key indicators (same-store sales, customer traffic, labor, capital expenditures, staff and business conditions) are in a period of expansion; whereas values fewer than 100 represent a recessionary period. This trend is indicative of the growth experienced in the restaurant industry.

Restaurant Performance Index

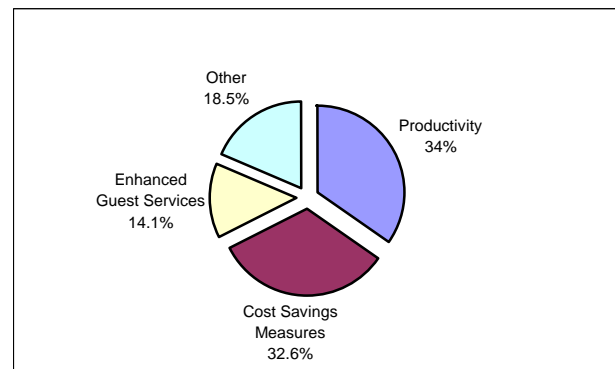


Source: National Restaurant Association

As revenues in the restaurant industry increase, restaurant operators will have more resources to invest in information technology (IT) as a means of reducing cost and enhancing operations. It is important to note that restaurant IT providers will be able to capitalize on this growth. IT

products such as point of sale (POS), customer relationship management (CRM), credit card processing, and restaurant infrastructure, will become very useful in handling the additional capacity. Hospitality Technology concluded from its poll that three major drivers for implementing IT are increased productivity, cost savings measures and enhanced guest services.

Top Drivers for IT projects



Source: Hospitality Technology

They also report that increases in IT investment will likely **focus on systems enhancements, new innovations in technology uses, replacement of aging systems, and systems maintenance.** Therefore, the prospect looks bright for restaurant IT providers as more attention and resources are being plowed into IT solutions.

Victory Partners views this market as an attractive long-term opportunity based on several industry driven factors. The recent growth in the restaurant industry, coupled with the increase in restaurant operators' willingness to invest in IT, will allow restaurant IT providers to organically grow in conjunction with the industry. Furthermore, with the advent of the Sarbanes-Oxley Act, restaurant IT providers will be able to offer compliance services to publicly-owned restaurant companies. Finally, restaurant information technology provides increased efficiency, greater cost savings and improved capabilities in customer service, resulting in an inherent demand for restaurant IT providers.

RISK FACTORS

Even though IT spending is on the rise, there are still many barriers that could hinder the growth in restaurant IT expenditures where *the inherent risk focuses on the support and usage of the technology*. One of the first impediments is the complex integration and networking between the new IT with the current existing systems. New software and hardware technology may not have the interface or protocols to integrate with the existing structures. There is also the intrinsic risk of the initial capital expenditure, or the financial risk, associated with implementing a new technological system. It is difficult to implement a cost-benefit analysis of the new IT system since most of the benefits derived are not easily quantifiable such as improved customer service, increased efficiency, enhanced productivity...etc. Since these benefits are difficult to measure, it becomes problematic for restaurant operators to defend the additional costs of implementing IT into their establishments. Finally, without the proper training and employee acceptance, the new IT systems will not be utilized to their full potential, as first anticipated. Even though these are influential risk factors, the acceptance for IT implementation is on the rise, as evident by the current and expected increase in IT expenditures.

IT Budget as a Percentage of Sales

IT % of Sales	Today	In 3 Years	% Change
1% or Less	58.1%	45.1%	(13.0%)
2%	8.8%	13.6%	+ 4.8%
3%	17.6%	8.9%	(8.7%)
4%	0.0%	9.6%	+ 9.6%
5%	3.7%	0.0%	(3.7%)
6%	3.0%	4.9%	+ 1.9%
7%	0.0%	4.9%	+ 4.9%
8% or more	8.8%	12.9%	+ 4.1%

Source: Hospitality Technology

Projected increase in IT spending relative to sales

INDUSTRY REGULATION

The 2002 Sarbanes-Oxley Act was created in order to rebuild consumer confidence in regards to monitoring the reliability and examining the business activities of corporations. The Act covers a multitude of issues such as establishing an advisory oversight board, auditor independence, corporate responsibility, internal controls and enhanced financial disclosure. The restaurant IT industry is particularly sensitive to the mandate specified under the internal controls section. Section 404 of the Act, requires management to document and assess the effectiveness of their internal controls over financial reporting. This presents new challenges to restaurant operators since in order to comply with the Sarbanes-Oxley Act, operators may need to upgrade their point-of-sales or transaction systems, which would then be incorporated into their financial reporting.

Deloitte reports, in its 2005 Tourism, Hospitality and Lesiure industry executive report, that under the Sarbanes-Oxley Act, for companies with an total market value of US \$75 million or greater, they are required to comply with the internal control reporting and disclosure requirements for fiscal year ending on or after November 15, 2004. Other companies have until fiscal years ending on or after July 15, 2005. These mandates are an on-going concern to the restaurant industry as operators (under a strict guideline) attempt to find solutions to comply with the Act. As the restaurant industry conforms with the new standards, this represents a huge short to intermediate term opportunity for restaurant IT providers.

RECENT TRENDS IN THE RESTAURANT IT M&A MARKET

There has been a lot of activity in recent months as the growth in the industry continues to develop. Victory Partners believes that growth in the industry will continue to rise, as increased competition will lead to rapid consolidation over the short term with a handful of well-capitalized companies emerging as clear leaders. Two recognized companies (SAP and Oracle) have been in heated bidding wars, targeting potential IT providers, in an effort to increase capacity and/or penetrate markets. In spring of 2005, Oracle acquired the well-known software CRM provider, Peoplesoft, Inc.; in addition, they purchased Retek, Inc., another CRM and consulting IT provider. Both of these transactions were widely sought by their rival, SAP. In addition, Oracle purchased Profitlogic Inc., another IT provider offering customer demand pattern analysis software in order to improve inventory, pricing and merchandising demands. Due to the recent growth in activity, the acquisition price to revenue multiple has increased over the past year from (0.75 – 1.50X) to (2.50 - 4.75X) revenue. The high trailing EBITDA multiple (30 -33X) may not only have been the result of overzealous bidding, but also an expectation of higher growth in the industry. Other IT providers, such as IBM and Agilsys, Inc., have recently acquired key competitors in an attempt to capitalize on the expected growth in the industry.

Victory Partners, LLC is actively involved in analyzing and representing companies in the restaurant IT industry having provided financial advisory services, performed recapitalizations, and completed M&A transactions for middle market companies.

For additional information, please contact Blaine Kauk at blaine@victorypartnersllc.com.