

July 16, 2016

Kona Grill, Inc. (KONA:NASDAQ)

Consumer Discretionary - Restaurants

Keep Calm and Go Long

Company Profile

Kona Grill, Inc. is a casual dining restaurant company based in Scottsdale, Arizona. Their diverse menu offerings feature contemporary Asian and American cuisine, served with over 40 signature sauces and dressings, as well as a readily available sushi bar and a wide selection of wine and cocktails. It currently operates 40 restaurants in 22 states and in Puerto Rico. Kona Grill creates a distinct atmosphere through their sleek, modern restaurant design, along with decorative fire and water elements, bevelled stone walls and ambient lighting.

Negative Earnings: A Temporary Side-Effect of Rapid Expansion

Kona Grill's aggressive expansion goal for 2016 entails a 25% increase in both restaurant sales and adjusted EBITDA, and a 20% growth in store count. The high costs associated with this strategy has caused Kona Grill to experience turbulence for the last couple years, which we believe is to continue for the next three or four years. However, after this period of high turbulence, Kona is expected to improve and see rapidly increasing positive earnings.

Favorable Trends and a Stable Restaurant Industry will Sustain Growth

Kona operates in a stable and predictable industry that has an established consumer base for cultural dishes and that is expected to grow in line with the economy. Although extremely competitive, the industry is still profitable and the macro-level trend towards health and higher-quality food will benefit Kona Grill.

Valuation & Recommendation

Due to the heterogeneity of dishes served by different restaurants in the casual and fine dining segment, we weighted the valuation as 75% of the discounted cash flow analysis and 25% of the comparable company analysis. The resulting implied share price is **\$18.51**, giving Kona Grill an overall **Buy** rating.

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Analyst: James Sun, BCom 2018

Contact@westpeakresearch.com

Equity Research US

Price Target	US\$ 18.51
Rating	Buy
Current Share Price, close	US\$ 11.26
Total Return	64.4%

Key Statistics

52 week H/L	\$9.90/\$22.00
Market Capitalization	\$122.99M
Net Debt	\$9M
Enterprise Value	\$128.36M
Net Debt/Enterprise Value	4.2%
Diluted Shares Outstanding	11M
Free Float %	88%
Dividend Yield	0%
LTM P/E	n/a
LTM EV/EBITDA	17.19x

WestPeak's Forecast

	<u>2016E</u>	<u>2017E</u>	<u>2018E</u>
Revenue	\$178M	\$218M	\$266M
EBITDA	\$9M	\$11M	\$11M
EBIT	-\$2M	-\$4M	-\$7M
Net Income	-\$3M	-\$5M	-\$9M
P/E	n/a	n/a	n/a
EV/EBITDA	14.5x	11.8x	12.1x
Price/Book	1.0x	0.8x	0.7x



James Sun | Contact@westpeakresearch.com

Business Overview/Fundamentals

Point of Differentiation

Kona Grill offers diverse food and beverage options including freshly-made Asian and American cuisines, a sushi bar, cocktails and wine, and over 40 complimentary signature sauces and dressings. The average check for a customer in 2015 was **\$26**. This amount places Kona in the casual dining segment.

Using their happy hour price-point strategy between 3 PM and 7 PM on weekdays and their reverse happy hour offerings, where select menu items are offered at a discount, Kona is able to increase traffic during non-peak hours. Another tactic Kona Grill uses to drive customer traffic is by ensuring that a wide selection of menu offerings is readily able to be ordered either individually or to be shared in a group, thereby encouraging dining during non-peak hours. As seen in our calculated table below, Kona Grill uses this strategy to attempt to maximize traffic during non-peak hours.

Average Occupancy per Restaurant by DayPart	2013	2014	2015
Lunch (Open to 3 PM), % of Total Occupancy	38.45%	40.05%	39.61%
Dinner (5PM to 9 PM), % of Total Occupancy	83.03%	83.65%	80.61%
Non-Peak (3 PM to 5 PM and 9 PM to Close), % of Total Occupancy	39.39%	40.64%	39.18%

Same-store sales grew **2%** year over year as a result of a 2.6% increase in the average customer check amount to \$26, offset by a 0.6% decrease in customer traffic. This implies that Kona may have tried to increase menu prices, and as a result, suffered a marginal decrease in customer traffic.

Growth and International Expansion

Kona Grill plans to grow organically, maintaining an annual **20% growth in store count** over the next several years. Their growth is primarily through opening company-owned stores within untapped states in the US. **Kona Grill does not franchise within America**; however they encourage franchising opportunities internationally. As such, there are development plans for **six franchised restaurants in Mexico** with Grupo Roma over the next seven years, and an agreement with Hakaya Collection, a subsidiary of RAK Hospitality Holding, to develop **six franchised restaurants in the United Arab Emirates** over the next seven years. Franchisees are beneficial to Kona, as they enable Kona to earn franchise fees without putting their capital at risk. This entails higher revenue levels without the additional expenses of expansion or operations.

Cash Flow from Comparable Stores

Kona Grill has stated that the major reason for its negative earnings during its most recent quarters is due to the higher pre-opening expenses from its aggressive expansion goals, the negative spillover effects that such expansion imposes on its other costs and the lack of brand awareness from operating in a new territory. They define their “ramp-up” period as **18 months**. Therefore, stores that are older than 18 months are considered “comparable”, and stores that are younger than 18 months are considered “non-

comparable”. However, in an effort to remain conservative and to allow for ease of comparability, we have defined a comparable restaurant to be one that is **24 months** old. An analysis below shows the free cash flow that an average comparable store is expected to generate over the next four years:

Comparable Restaurant Free Cash Flows	2016E	2017E	2019E	2020E
Restaurant sales	4,331	4,396	4,462	4,529
COGS	1,175	1,193	1,210	1,229
Gross Profit	3,156	3,203	3,251	3,300
Labor	1,472	1,495	1,517	1,540
Occupancy	303	308	312	317
Restaurant operating expenses	606	615	625	634
Total operating expenses	2,382	2,418	2,454	2,491
Restaurant EBITDA	774	786	797	809
Depreciation and amortization	252	252	252	252
Restaurant EBIT	522	533	545	557
Tax	104	107	109	111
Restaurant earnings after tax	417	427	436	446
less: Capital expenditures	0	0	0	0
Less: Change in NWC	75	75	75	75
Add: Depreciation and amortization	252	252	252	252
Restaurant Free Cash Flow	594	604	613	623

Cash Flow from Non-Comparable Stores

For newly opened stores still within the “ramp-up” period of 24 months, we made the assumption that a store needs a full year to construct. An analysis is shown below to detail the free cash flow generated:

Non-Comparable Restaurant Free Cash Flows	2016E	2017E	2019E	2020E
Restaurant sales	0	3,956	4,016	4,529
COGS	0	1,073	1,089	1,229
Gross Profit	0	2,883	2,926	3,300
Labor	0	1,644	1,669	1,540
Occupancy	0	308	312	317
Restaurant operating expenses	0	677	687	634
Pre-opening expenses	450	0	0	0
Total operating expenses	450	2,629	2,668	2,491
Restaurant EBITDA	-450	254	258	809
Depreciation and amortization	0	252	252	252
Restaurant EBIT	-450	2	6	557
Tax	-27	0	1	111
Restaurant earnings after tax	-423	2	5	446
Less: Capital expenditures	2,600	0	0	0
Less: Change in NWC	75	75	75	75
Add: Depreciation and amortization	0	252	252	252
Restaurant Free Cash Flow	-3,098	179	182	623

1) Sales per Restaurant

Sales per comparable restaurant was taken directly from the Revenue Drivers portion of the model, which is located in Appendix 4. Sales per non-comparable restaurant were taken as 90% of the sales per comparable restaurant for the first two years of operations, then reaching the sales levels of a mature restaurant in the fourth year.

2) Cost of Goods Sold, Labor, Occupancy, Restaurant Operating Expenses, and Pre-Opening Expense

COGS was taken as 27% of sales for each year in both the comparable and non-comparable scenario. Occupancy was taken as 7% of comparable restaurant sales for each year in both the comparable and non-comparable scenario. Labor and Restaurant Operating Expenses for comparable stores was taken as 14% of sales. For the non-comparable store scenario, both of these expenses were 1.1x the amount in the comparable store scenario; this was to reflect any operational inefficiencies that arise by opening a new restaurant. Pre-opening expense was taken as \$450,000, the amount stated in the most recent Annual Report.

3) Capital Expenditures, NWC, and Depreciation & Amortization

To find capital expenditures for non-comparable stores, we used the \$2.6 million initial cash investment stated in the recent Annual Report as a proxy. The capital expenditures of subsequent years are constant at 0. We assumed the \$2.6 million was an initial cash outlay that was needed in the first year of the project and that capital expenditures were only necessary for new stores. NWC was found by dividing the NWC amount in FY2016 with the amount of stores. A similar approach was used to find Depreciation & Amortization.

Hefty Initial Cash Outlay with Growing Cash Flows Further Down the Line

As seen above, the cash investment of a new restaurant is substantial at \$2.6 million. A new restaurant does not generate substantial positive cash flow until the 4th year of the project. For the years prior to management's goal of aggressive expansion, earnings were generally positive. However, as management began expanding aggressively to meet the 20% unit growth goal, the large initial capital expenditures, higher labor expenses, and higher restaurant operating expenses yielded losses. The table below shows the percentage of new restaurants to old restaurants and the corresponding EBIT to that fiscal year ended:

FY Ended	Beg. #	Change in #	End. #	% Change	EBIT, 000s
2007	12	4	16	33%	-261
2008	16	2	18	13%	-3818
2009	18	4	22	22%	-4265
2010	22	1	23	5%	-1061
2011	23	0	23	0%	2381
2012	23	0	23	0%	5234
2013	23	2	25	9%	3139
2014	25	4	29	16%	962
2015	29	7	36	24%	-4112

The correlation coefficient between the “% Change” (Change in # of Restaurants divided by Beg. # of Restaurants) and “EBIT” is **-0.596**. This indicates that there is a negative relationship between the number of stores opened and the earnings of Kona. It is important to note that each fiscal year end may not be

directly comparable to one another for reasons such as increased efficiencies with the new restaurant opening process over time, transitions of management, macro-level events (e.g. the 2009 Financial Crisis), and variance in each store opening. However, the data indicates that the inefficiencies and costs of new restaurant openings does temporarily hinder the profitability of the company.

The percentage of stores under construction over stores is expected to remain above 20% for the next few years. Therefore, the incremental positive cash flows from comparable restaurants are overwhelmed by the negative cash flows from the construction of new restaurants. However, as more restaurants mature and as Kona's unit expansion growth sinks below 20%, the percentage of restaurants under construction over mature restaurants will decline, entailing a higher ratio of stores with strong cash flows to those with weak cash flows, and also lower levels of capital expenditures. Therefore, it can be expected that Kona should experience positive earnings again after a few years.

Dividend Policy

Kona Grill has **never declared or paid a dividend** and has stated that they not intend to do so in the future.

Non-GAAP Measures

Below is the walk from consolidated (comparable and non-comparable) restaurant sales to Adjusted EBITDA for the last three fiscal years:

Consolidated Adjusted EBITDA Walk	2013	2014	2015
Restaurant sales	143,023	119,097	98,250
Cost of sales, labor, occupancy and restaurant operating expenses	119,811	97,719	80,177
Restaurant operating profit	23,212	21,378	18,073
Less: General and administrative	12,612	10,715	7,854
Add: Stock-based compensation	1,363	856	584
Adjusted EBITDA	11,963	11,519	10,803

Industry Overview

Industry Snapshot

The \$181.7 billion single location full-service restaurant industry in America is populated with over 250,000 businesses and is expected to experience an annual growth rate of 2.2% from 2016 to 2021. The industry is diversified among different ethnic cuisines, with Asian restaurants commanding 25.5% of the market share, American restaurants with 20.2% and European restaurants with 14.5%.

As technology continues to develop, restaurants find themselves pressured to have an active online presence as a means of promotion, communication and information sharing. According to the National Restaurant Association, 20% of consumers use technology when making a decision on dining at a restaurant and 67% of consumers use cellphones for restaurant directions. In response to this trend, Kona Grill is active on many social media sites such as Facebook and Twitter. By utilizing a customer loyalty program called

Konavore, Kona Grill is able to communicate new menu offerings, coming events, and other messages to over 245,000 of its members via email. Kona Grill also has an online ordering system, with select locations offering delivery services as well.

To cater to the growing demographic that favors healthier eating and demands food that is low in sugar, salt, cholesterol, Kona Grill's menu offering, which largely include sushi, seafood, and chicken, satisfies that need.

Industry Analysis

1) High Rivalry – Low Concentration

Concentration in the industry is extremely low, with no single company comprising more than 5% of the industry's revenue, and the degree of rivalry is extremely high. Restaurants may compete on prices, which entails razor-thin profit margins.

2) Strong Buyer Power

Customers have a very strong influence in this industry as there are no switching costs involved and the abundance of neighbouring restaurants entails more choices. Furthermore, customer reviews can significantly influence the restaurant's ability to attract new customers.

3) Low Supplier Power

Suppliers tend to have a weak influence in the industry, as restaurants source all their purchases from a few, if not one, suppliers for quality control and ingredient standardization purposes.

4) Low Barriers to Entry

Capital intensity is relatively low; according to IBISWorld, it is estimated that for every \$1.00 spent on labor, only \$0.07 is spent on the usage and replacement of property and equipment. This factor coupled with a low degree of concentration indicates that the barriers to entry in this industry are low. However, barriers to success remain high due to fierce competition.

The industry is mature and is expected to grow in line with GDP. Consumers are relatively price sensitive due to the abundance of other competitors and low switching costs. Low barriers to entry encourage new competition; however, if entrants fail to offer a point of differentiation or if they are inefficient with operations, they will be unable to remain competitive.

Kona Cost Structure vs. Industry Standard

A breakdown of the industry's estimated cost structure, derived from FY2015 data from select comparable firms in our comparable company analysis, versus Kona Grill's cost structure in 2015 is given below:

Cost Structure	Comparables	Kona Grill
COGS	27.35%	27.13%
Labor	31.64%	35.09%
Restaurant Operating Expenses & Occupancy	20.23%	21.55%
Pre-Opening Expenses	0.98%	3.32%
Depreciation & Amortization	4.58%	6.97%
General & Administrative	7.78%	8.82%

1) Cost of Goods Sold

Healthy eating and living has become an increasingly prevalent concept. According to IBISWorld, consumption of red meats has declined over the past five years at an annualized rate of 2.7%. The price of meat is expected to increase marginally over the next couple of years before decreasing for the following several years. As a substitute for red meats, white meats, particularly chicken, are expected to be in higher demand and therefore prices for those goods are expected to rise over the next several years. The price of seafood is more complex to forecast. Often viewed as a more expensive substitute to poultry, the demand for seafood exhibits a negative relationship with that of white meat. However, further research into health benefits of fish may alter consumer demand for seafood. Furthermore, complications regarding competition in the supply chain may have an unprecedented effect on the price of seafood. The consensus is that the price of seafood is expected to rise slowly over time. Kona's menu offerings involve a relatively equally distributed mix of chicken, beef, pork, and seafood. Therefore we would expect Kona's COGS to be marginally higher than its competitors; however this is not the case. This may indicate that the comparable restaurants use higher quality ingredients than Kona does or that Kona is more efficient with their kitchen processes.

2) Labor and Benefits

Recently, wages in the fast food industry have been increasing faster than wages in the private-sector. As employment and payroll increase, skilled workers holding restaurant jobs are diminishing. As such, the restaurant industry now finds itself competing with other industries for workers, making labor a scarcer resource now. It is unknown for how long this trend will continue. Kona's higher labor expense may be due to a combination of factors including, extra training attributable to newly opened stores and demand for more specialized cooking skills.

3) Occupancy, Restaurant Operating Expenses & Pre-Opening Expenses, and Depreciation

Although the Restaurant Operating Expenses and Occupancy appear identical between Kona and its comparable companies, this expense is a combination of two separate expenses on Kona's financial statements. Kona's Restaurant Operating Expense and Occupancy were 14.16% and 7.36% of sales respectively in FY2015. Typical Restaurant Operating Expenses include utilities, credit card fees, marketing and repair and maintenance. Kona's restaurant operating expense is expected to decrease as new restaurants mature and become more operationally efficient. Occupancy represent payments on the leases of restaurants. This expense may increase as a result of negotiation delays with landlords and conflict with

different state government regulations, which are both possible occurrences when expanding in new territories. Pre-Opening Expenses for Kona are significantly higher than its competitors, as Kona is pursuing and currently achieving an aggressive 20% annual unit growth rate. Kona's high depreciation expense can be traced to their equipment's relatively short estimated useful life. As such, Kona may also be subject to more frequent remodelling expenses and capital expenditures.

Catalysts

Health Hazards Traceable to Food Served at Kona Grill

If customers experienced a food illness related to food served at Kona Grill, revenues would be adversely affected.

Termination of Contracts Regarding Development of New Restaurants

As of now, international expansion is still underway. Cancellation of the contacts on behalf of the franchisee for whatever reason may harm future sales.

Management Team

Mr. Berke Ibrahim Bakay, Chief Executive Officer

Mr. Bakay has been the CEO of Kona Grill since January 30, 2012, and director of the company since 2009. Mr. Bakay is also the founder of BBS Capital Management and BBS Capital Fund, and serves as its Compliance Officer and Manager. Mr. Bakay has also covered publicly-traded restaurant companies during his time as a buy-side analyst. Mr. Bakay holds a Master of Science and Bachelor of Science degree with a concentration in Finance from Boston College Carroll School of Management. With years of experience as a director at Kona Grill and an understanding of the restaurant industry from his analyst coverage, Mr. Bakay can add value to Kona.

James Richard Jundt, Chairman of the Board

Mr. Jundt, CFA, is Chairman and Director at Kona Grill and Williston Holding Co., as well as President at JRJ Management. Prior to joining JRJ, Mr. Jundt was a portfolio manager at Jundt Associates. Prior, he served in analytical and portfolio management positions such as manager of IDS Progressive Fund, a large equity mutual fund. Mr. Jundt holds a Bachelor's degree from Gonzaga University and a Graduate degree from New York University. Mr. Jundt's extensive experience in investing can be a useful addition to his leadership capabilities to help maximize profitability and shareholder value.

Shareholder Base, Liquidity, Capital Structure

Shareholder Summary

As of March 31, 2016, there were 11,211,161 common shares outstanding and no preferred shares outstanding or issued. As of February 29, 2016, there were 16 holders of record of their common stock. As of FY2015, Kona's chief executive officer and two independent directors owned a total of 23% of the company's outstanding common stock.

Capital Structure

Kona does not have any corporate bonds outstanding. Instead, Kona sources its capital by drawing upon its \$35 million revolving credit facility with KeyBank National Association, maturing on November 7, 2019. As of FY 2015, Kona Grill had no outstanding borrowings. As of April 2016, Kona had **\$9 million in outstanding borrowings**. It is estimated that a pay-down on this facility will not occur in FY2016 as Kona will need substantial cash for its expansion plans.

Risks

Wage Increases Risk

The call to raise minimum wage to \$15 an hour in certain states may be felt by Kona Grill. A rise in wages can entail higher labor expenses.

Commodity Prices Risk

Kona Grill has not stated that it holds any hedges against commodity prices. Therefore, if the price of primary ingredients such as beef, chicken, pork, or shrimp were to increase, Kona's COGS would increase as well.

Foreign Currency Fluctuation Risk

As Kona expands its international presence through franchising operations, its revenues will be increasingly affected by changes in foreign currencies, particularly changes in the Mexican Peso and the United Arab Emirates Dirham. Assuming Kona opts to use a percentage of profits or revenues as its determining factor for fee collections in its franchise model, and assuming they do not engage in any foreign currency hedges, an appreciation in the US Dollar would have an undesirable effect on the revenues received by franchising operations.

Valuation

Revenue

Revenue was driven off of daily customer traffic per store, average check amount, days in operations and the amount of new restaurant openings and closures. Franchise fees were also taken into consideration. A Please see legal disclaimer at bottom.

detailed breakdown of operating statistics and how we drove revenue can be found in Appendix 4. The sum of the revenue from company-owned stores and franchise fees is taken as the total revenue.

1) Customer Traffic

We forecasted a stagnant customer traffic count due to historical results and the increased competitiveness of operating in the restaurant industry. Furthermore, increases in food prices, represented by growth in the average customer check amount, may make it difficult to simultaneously increase traffic.

2) Customer Check Amount

The average customer check amount was grown at **1.5%** annually to adjust for inflation and to reflect historical increases.

3) Restaurant Expansion

Restaurant openings and closures were forecasted based on management's goals and guidance. International franchise expansion was also taken into account. Based on Q12016, Kona Grill appears to be on track to meet their 20% unit growth for FY2016.

4) Franchise Fee

Management has not given information regarding the franchise fee to be charged onto international franchisees. Therefore a proxy of **5%** was used as the franchise fee earned as a percentage of gross revenues. The openings and closures of franchised restaurants are also illustrated in Appendix 4.

Direct Costs & Expenses

Rationale behind our cost assumptions may be found above in the "Kona Cost Structure vs. Industry Structure" section of the report. All costs and expenses were forecasted as a percentage of sales. COGS were forecasted as 26% for FY2016 and FY2017 and then as 27% from FY2018 and onwards. Labor was forecasted as 36% from FY2016 and onwards. Occupancy was forecasted as 7% from FY2016 and onwards. Restaurant Operating Expenses were forecasted as 14% from FY2016 to FY2018, then dropping down to 13% in FY2019 and onwards. General & Administrative expenses was forecasted as 9%, which is consistent with historical data, and Pre-Opening Expenses as 3% between FY2016 and FY2018, then dropping down to 2% between FY2019 and FY2021, and finally reaching 1% in FY2022 and onwards.

Capital Expenditures

Management expects between **\$33 and \$35 million** of capital expenditures will be used in FY2016. We used this range as a proxy. It is worth noting that, historically, after deducting the cash investments from new restaurants, approximately 50% of capital expenditures remain. We believe the remainder is primarily from costs incurred from the remodelling of old restaurants and investments in new corporate and technology infrastructures. For this reason, it was not appropriate to approximate capital expenditures by multiplying the number of new company-owned restaurants to be opened with \$2.6 million.

Revolving Credit Facility & Equity Issuances

Forecasted capital expenditures for FY2016 was within management's expected range. Due to the large

amount of capital needed, we projected that Kona would draw heavily upon its existing revolving credit facility, and that there would be no pay-down in 2016. Furthermore, we may also expect Kona to extend their credit facility limit to be between \$40 and \$50 million. Although credit is their primary source of capital, we may also expect Kona to participate in equity financing for capital, potentially issuing \$20 million in new equity.

Weighted Average Cost of Capital & Perpetuity Growth Rate

A WACC of **7.48%** was used as the discount rate. The cost of equity was calculated to be **7.90%** using the CAPM. An equity beta of **1.41** was found by regressing the weekly change in stock prices with that of NYSE Composite for the last twelve months. A standard **6%** equity risk premium was used. The current risk free rate of **1.36%** was taken from the yield on a 10-year US treasury bond. We recognize that although in FY2015, Kona had no debt outstanding, as of April 2016, they had approximately \$9 million in debt from their revolving credit facility; therefore, we have chosen to factor the presence of debt into our WACC calculation. The cost of debt was calculated as **3%**, based on their debt and credit agreements detailed in their annual report. A standard tax rate of **30%** was used. A **2.2%** perpetuity growth rate was used, taken from IBISWorld's estimated growth in the restaurant industry. A sensitivity analysis of the perpetuity growth rate and the discount rate can be found in the DCF Analysis, which is located in Appendix 5.

Comparable Company Analysis

The companies that were used in the comparable companies analysis all operated between the casual and upscale dining segment and have most of their operations in the US. As such, fast food chains and fast-casual restaurants were not used in this valuation. The **median EV/EBITDA multiple** was used in the valuation due to the nature of the restaurant industry and to account for the cost structure of each company. Only **25%** of the weighting was allocated to this valuation method for two reasons. Firstly, and perhaps most importantly, we believe the type of food served at restaurants is not homogenous. Restaurants, especially those in the fine or casual dining segment, serve dishes belonging to varying ethnic cuisines and individuals have varying food preferences. This entails that although the aggregate success of the restaurant industry is affected by macro-economic factors, individual restaurants are perceived more as differentiated businesses than commodities. As such, we were unable to find North-American publicly-traded companies that served a mixture of Asian and American dishes. Secondly, the firm generated a low EBITDA in FY2015, which we believe is more of an anomaly due to expansion than a typical occurrence. The median share price derived from that multiple was **\$6.45**. The analysis can be found in Appendix 6.

Recommendation

Trending now are healthy food options and higher-quality ingredients, both of which are represented in Kona's diverse menu offerings. Expanding at such an aggressive rate is temporarily hindering Kona's bottom line growth; however, its benefits are expected to pay off a few years later. We believe Kona Grill is currently undervalued based on our price target of **\$18.51**, implying a 64.4% upside. Therefore, we have issued a **Buy** recommendation for Kona Grill.

Appendix 1: Balance Sheet

BALANCE SHEET

Kona Grill Inc.

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Cash & Cash Equivalents	5,881	36,578	9,055	47	7,074	3,590	3,160	6,327	1,555	7,208	6,994	11,788	11,601
Other Current Operating Assets	2,521	2,687	4,309	5,350	6,559	8,008	9,571	11,044	12,419	13,689	14,850	15,970	17,045
Net Property, Plant & Equipment	40,352	53,934	87,252	114,070	139,568	168,006	179,614	191,052	201,101	204,231	209,298	210,685	213,690
Other Non-Current Assets	1,114	1,171	1,228	1,525	1,869	2,282	2,728	3,147	3,539	3,901	4,232	4,551	4,857
Total Assets	49,868	94,370	101,844	120,991	155,069	181,887	195,073	211,570	218,614	229,030	235,374	242,995	247,194
Short-Term Portion of Debt	3,500	0	0	2,000	2,500	2,500	5,000	5,000	5,000	10,000	10,000	15,000	0
Other Current Operating Liabilities	11,378	12,247	18,830	18,467	22,641	28,707	34,310	39,590	44,517	49,072	53,234	57,247	61,100
Long-term Debt	0	0	0	15,500	33,000	43,000	43,000	43,000	38,000	28,000	18,000	3,000	3,000
Other Non-Current Liabilities	12,632	16,697	20,323	24,180	29,645	37,588	44,924	51,838	58,290	64,253	69,703	74,957	80,003
Total Liabilities	27,510	28,944	39,153	60,146	87,786	111,795	127,234	139,428	145,807	151,325	150,937	150,204	144,103
Share Capital	-913	-887	-886	-886	-886	-886	-886	-886	-886	-886	-886	-886	-886
Additional Paid-In Capital (Share Premium)	54,083	96,422	98,182	98,545	108,908	119,271	119,634	124,997	125,360	125,723	126,086	126,449	126,812
Retained Earnings / (Accumulated Deficit)	-30,812	-30,109	-34,605	-36,814	-40,739	-48,293	-50,909	-51,969	-51,667	-47,132	-40,763	-32,772	-22,835
Total Shareholder Equity	22,358	65,426	62,691	60,845	67,283	70,092	67,839	72,142	72,807	77,705	84,437	92,791	103,091

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James Sun | Contact@westpeakresearch.com

Appendix 2: Income Statement

INCOME STATEMENT

Kona Grill Inc.

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Revenue	98,250	119,097	143,023	177,563	217,700	265,806	317,683	366,575	412,197	454,369	492,908	530,061	565,742
Cost of Goods Sold	26,853	32,964	38,803	46,166	56,602	71,767	85,774	98,975	111,293	122,680	133,085	143,117	152,750
Gross Profit	71,397	86,133	104,220	131,396	161,098	194,038	231,908	267,600	300,904	331,690	359,823	386,945	412,992
Operating Expenses	54,486	67,236	85,754	106,538	130,620	159,483	184,256	212,613	239,074	258,991	280,958	302,135	322,473
Selling, General and Administrative	7,854	10,715	12,612	15,981	19,593	23,922	28,591	32,992	37,098	40,893	44,362	47,706	50,917
Research & Development	0	0	0	0	0	0	0	0	0	0	0	0	0
EBITDA	9,057	8,182	5,854	8,878	10,885	10,632	19,061	21,994	24,732	31,806	34,504	37,104	39,602
Depreciation, Depletion and Amortization	5,918	7,220	9,966	10,470	13,688	16,748	20,161	21,554	22,926	24,132	24,508	25,116	25,282
EBIT	3,139	962	-4,112	-1,592	-2,803	-6,116	-1,100	441	1,806	7,674	9,996	11,988	14,320
Interest Expense (Income)	226	259	180	617	1,122	1,439	1,516	1,500	1,374	1,196	897	573	124
Other items	32	0	161	0	0	0	0	0	0	0	0	0	0
Pre-Tax Earnings	2,881	703	-4,453	-2,209	-3,925	-7,555	-2,616	-1,059	431	6,478	9,099	11,416	14,196
Tax	169	0	43	0	0	0	0	0	129	1,943	2,730	3,425	4,259
Net Income	2,712	703	-4,496	-2,209	-3,925	-7,555	-2,616	-1,059	302	4,534	6,369	7,991	9,937

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James Sun | Contact@westpeakresearch.com

Appendix 3: Cash Flow Statement

CASH FLOW STATEMENT

Kona Grill Inc.

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Net Income	2,712	703	-4,496	-2,209	-3,925	-7,555	-2,616	-1,059	302	4,534	6,369	7,991	9,937
Depreciation, Depletion and Amortization	5,708	7,176	9,781	10,470	13,688	16,748	20,161	21,554	22,926	24,132	24,508	25,116	25,282
Changes in Current Operating Assets	-924	-165	-1,622	-1,041	-1,209	-1,449	-1,563	-1,473	-1,374	-1,271	-1,161	-1,119	-1,075
Changes in Current Operating Liabilities	1,112	5,987	5,002	3,493	9,640	14,009	12,939	12,194	11,379	10,518	9,612	9,266	8,899
Change in Net Working Capital	188	5,822	3,380	2,452	8,431	12,560	11,376	10,721	10,004	9,248	8,451	8,147	7,824
Other Non-Cash Adjustments	852	1,043	1,629	1,363	1,363	1,363	1,363	1,363	1,363	1,363	1,363	1,363	1,363
Cash from Operations	9,460	14,744	10,294	12,077	19,557	23,116	30,284	32,579	34,595	39,277	40,691	42,617	44,407
Capital Expenditures	-14,445	-21,855	-38,077	-37,288	-39,186	-45,187	-31,768	-32,992	-32,976	-27,262	-29,574	-26,503	-28,287
Dispositions	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Investing Activities	-91	-3	-138	-297	-345	-413	-445	-420	-392	-362	-331	-319	-306
Cash from Investing	-14,536	-21,858	-38,215	-37,585	-39,531	-45,600	-32,214	-33,412	-33,367	-27,624	-29,905	-26,822	-28,593
Dividends	0	0	0	0	0	0	0	0	0	0	0	0	0
Change in Debt	2,774	-3,698	0	17,500	18,000	10,000	2,500	0	-5,000	-5,000	-10,000	-10,000	-15,000
Change in Equity	194	41,509	398	-1,000	9,000	9,000	-1,000	4,000	-1,000	-1,000	-1,000	-1,000	-1,000
Cash from Financing	2,968	37,811	398	16,500	27,000	19,000	1,500	4,000	-6,000	-6,000	-11,000	-11,000	-16,000
Beginning Cash Balance	7,989	5,881	36,578	9,055	47	7,074	3,590	3,160	6,327	1,555	7,208	6,994	11,788
Changes in Cash	-2,108	30,697	-27,523	-9,008	7,027	-3,484	-430	3,167	-4,772	5,653	-214	4,795	-187
Ending Cash Balance	5,881	36,578	9,055	47	7,074	3,590	3,160	6,327	1,555	7,208	6,994	11,788	11,601

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James Sun | Contact@westpeakresearch.com

Appendix 4: Revenue Drivers

REVENUE DRIVERS

Kona Grill Inc.

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Total Revenue	98,250	119,097	143,023	177,563	217,700	265,806	317,683	366,575	412,197	454,369	492,908	530,061	565,742

Growth Analysis

	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Lunch Revenue Growth, %	23.6%	22.4%	24.1%	22.5%	22.0%	19.4%	15.3%	12.4%	10.2%	8.4%	7.5%	6.7%
Dinner Revenue Growth, %	19.5%	19.3%	24.1%	22.5%	22.0%	19.4%	15.3%	12.4%	10.2%	8.4%	7.5%	6.7%
Non-Peak Revenue Growth, %	22.4%	19.4%	24.1%	22.5%	22.0%	19.4%	15.3%	12.4%	10.2%	8.4%	7.5%	6.7%
Total Revenue Growth, %	21.2%	20.1%	24.1%	22.6%	22.1%	19.5%	15.4%	12.4%	10.2%	8.5%	7.5%	6.7%
Average Customer Check Amount Growth, %	0.0%	4.0%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Average Daily Number of Customers ¹ During Lunch (per restaurant) Growth, %	5.9%	-1.4%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Average Daily Number of Customers During Dinner (per restaurant), Growth %	2.4%	-3.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Average Daily Number of Customers During Non-Peak (per restaurant), Growth %	4.9%	-3.9%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Revenue Breakdown - Sales by DayPart

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Lunch Revenue (Open to 3 PM)	23,486	29,025	35,540	44,123	54,069	65,967	78,773	90,805	102,022	112,377	121,827	130,928	139,659
Dinner Revenue (5 PM to 9 PM)	50,710	60,622	72,331	89,799	110,042	134,257	160,318	184,807	207,634	228,711	247,941	266,464	284,234
Non-Peak Revenue (3 PM to 5 PM and 9 PM to Close)	24,054	29,450	35,152	43,641	53,479	65,247	77,913	89,814	100,908	111,151	120,497	129,498	138,135
Franchise Fee Revenue	0	0	0	0	110	335	679	1,149	1,633	2,131	2,644	3,171	3,714
Total Revenue	98,250	119,097	143,023	177,563	217,700	265,806	317,683	366,575	412,197	454,369	492,908	530,061	565,742

Operating Stats - Schedule of Restaurant Expansions

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Number of Company-Owned Restaurants - Beginning of Period	23	25	30	37	45	54	65	75	84	92	99	105	111
Change in Number of Company-Owned Restaurants	2	5	7	8	9	11	10	9	8	7	6	6	5
Number of Company-Owned Restaurants - End of Period	25	30	37	45	54	65	75	84	92	99	105	111	116
Average Number of Existing Company-Owned Restaurants ²	24	28	34	41	50	60	70	80	88	96	102	108	114
Number of Franchised Restaurants - Beginning of Period	0	0	0	0	0	1	2	4	6	8	10	12	14
Change in Number of Franchised Restaurants	0	0	0	0	1	1	2	2	2	2	2	2	2
Number of Franchised Restaurants - End of Period	0	0	0	0	1	2	4	6	8	10	12	14	16
Average Number of Existing Franchised Restaurants	0	0	0	0	1	2	3	5	7	9	11	13	15
Franchise Fee, % of Annual Gross Revenue ³				5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Number of Systemwide Restaurants	25	30	37	45	55	67	79	90	100	109	117	125	132
Systemwide Unit Growth, %	8.7%	20.0%	23.3%	21.6%	22.2%	21.8%	17.9%	13.9%	11.1%	9.0%	7.3%	6.8%	5.6%

Operating Statistics - Days in Operations & Customer Traffic by DayPart

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Total Operating Weeks ⁴	1,203	1,404	1,676	2,050	2,500	3,050	3,650	4,225	4,750	5,225	5,650	6,050	6,425
Average Days in Operation	351	357	350	350	350	350	350	350	350	350	350	350	350
Average Customer Check Amount, \$	\$ 25.00	\$ 25.00	\$ 26.00	\$ 26.39	\$ 26.79	\$ 27.19	\$ 27.60	\$ 28.01	\$ 28.43	\$ 28.86	\$ 29.29	\$ 29.73	\$ 30.17
Average Daily Number of Customers During Lunch (per restaurant)	111.6	118.1	116.5	116.5	116.5	116.5	116.5	116.5	116.5	116.5	116.5	116.5	116.5
Average Daily Number of Customers During Dinner (per restaurant)	240.9	246.7	237.1	237.1	237.1	237.1	237.1	237.1	237.1	237.1	237.1	237.1	237.1
Average Daily Number of Customers During Non-Peak (per restaurant)	114.3	119.9	115.2	115.2	115.2	115.2	115.2	115.2	115.2	115.2	115.2	115.2	115.2
Average Daily Revenue per Restaurant, \$	\$ 11,667	\$ 12,118	\$ 12,191	\$ 12,374	\$ 12,559	\$ 12,748	\$ 12,939	\$ 13,133	\$ 13,330	\$ 13,530	\$ 13,733	\$ 13,939	\$ 14,148
Average Annual Number of Customers During Lunch (per restaurant), 000s	39.1	42.2	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8	40.8
Average Annual Number of Customers During Dinner (per restaurant), 000	84.5	88.2	83.0	83.0	83.0	83.0	83.0	83.0	83.0	83.0	83.0	83.0	83.0
Average Annual Number of Customers During Non-Peak (per restaurant), ¹	40.1	42.8	40.4	40.3	40.3	40.3	40.3	40.3	40.3	40.3	40.3	40.3	40.3
Average Annual Revenue per Restaurant, k\$	4,093.8	4,330.8	4,269.3	4,330.8	4,395.8	4,461.7	4,528.6	4,596.6	4,665.5	4,735.5	4,806.5	4,878.6	4,951.8

¹Calculated by dividing sales by DayPart with the average number of restaurants per store, then dividing by the average check amount and adjusting for days in operation

²Calculated by adding number of existing stores in the beginning of the period with the change in store count divided by 2, to account for staggered restaurant openings throughout the fiscal year

³Since no information on a potential franchise fee was given. An average industry-wide franchise fee was used.

⁴Represents the aggregate number of weeks in operation among all existing restaurants. Calculated as the sum of two reported items in the Press Release: Operating Weeks of Comparable stores and Operating Weeks of Non-Comparable stores. For forecasted periods, we incorporated franchised restaurants as well

Appendix 5: Discounted Cash Flow Analysis

DISCOUNTED CASH FLOW ANALYSIS

Kona Grill Inc.

Current Debt to Total Capitalization	7.32%
Current Tax Rate	30.00%
Current Weighted Average Debt Yield-to-Maturity	3.00%
Current LTM Equity Market Return	6.00%
Current Risk Free Rate	1.36%
Current LTM Equity Beta	1.41x
Current Weighted Average Cost of Capital (WACC)	7.48%

Long-term Perpetuity Growth Rate 2.20%

	2016E	2017E	2018E	2019E	2020E	2021E	2022E	2023E	2024E	2025E
EBIT	-1,592	-2,803	-6,116	-1,100	441	1,806	7,674	9,996	11,988	14,320
Tax Rate	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Depreciation, Depletion and Amortization	10,470	13,688	16,748	20,161	21,554	22,926	24,132	24,508	25,116	25,282
Capital Expenditure	-37,288	-39,186	-45,187	-31,768	-32,992	-32,976	-27,262	-29,574	-26,503	-28,287
Change in Net Working Capital	2,452	8,431	12,560	11,376	10,721	10,004	9,248	8,451	8,147	7,824
Unlevered Free Cash Flow	-25,480	-19,029	-20,160	-1,002	-408	1,219	11,489	10,381	15,152	14,843
Discounted Unlevered Free Cash Flow	-23,707	-16,473	-16,238	-751	-285	791	6,935	5,830	7,918	7,217

		Discount Rate (WACC)								
		5.50%	6.00%	6.50%	7.50%	8.00%	8.50%	9.00%	9.50%	
Present Value of Projected Cash Flows	-\$ 28,764									
Present Value of Perpetuity Cash Flows	\$ 281,238									
Total Enterprise Value	\$ 252,475									
Total Debt	\$ 9,000									
Cash	\$ 9,055									
Total Equity Value	\$ 252,530									
Shares Outstanding (millions)	11.210									
Price/Share	\$ 22.53									

Long-term Growth Rate	0.00%	\$21.77	\$19.69	\$17.93	\$15.09	\$13.93	\$12.91	\$12.00	\$11.18
	0.50%	\$24.17	\$21.70	\$19.62	\$16.35	\$15.04	\$13.88	\$12.86	\$11.96
	1.00%	\$27.12	\$24.10	\$21.63	\$17.81	\$16.30	\$14.99	\$13.84	\$12.82
	1.50%	\$30.79	\$27.05	\$24.04	\$19.50	\$17.75	\$16.25	\$14.94	\$13.80
	2.00%	\$35.52	\$30.72	\$26.98	\$21.51	\$19.45	\$17.70	\$16.20	\$14.90
	2.50%	\$41.83	\$35.45	\$30.66	\$23.92	\$21.46	\$19.40	\$17.66	\$16.16
	3.00%	\$50.65	\$41.76	\$35.39	\$26.86	\$23.87	\$21.41	\$19.36	\$17.61
	3.50%	\$63.90	\$50.58	\$41.69	\$30.54	\$26.81	\$23.82	\$21.36	\$19.31

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James Sun | Contact@westpeakresearch.com

Appendix 6: Comparable Company Analysis (in millions of \$)

TRADING COMPARABLES ANALYSIS

Kona Grill Inc.

Company	Symbol	Price	Currency	Shares Outstanding	Market Cap.	Total Cash	Total Debt	Enterprise Value	LTM				EV/Sales	EV/EBITDA	P/E	Dividend Yield
									Sales	EBITDA	Net Income	Dividends				
Ark Restaurants Corp.	ARKR	22.82	USD	3.42	78	6	6	78	150	13	6	4	0.52	5.90	13.06	5.46%
BJ's Restaurants, Inc.	BJRI	43.65	USD	24.12	1,053	27	96	1,122	938	127	47	0	1.20	8.82	22.24	0.00%
Bravo Brio Restaurant G	BBRG	8.56	USD	20.38	174	0	46	220	425	35	4	0	0.52	6.20	40.61	0.00%
Chuy's Holdings, Inc.	CHUY	34.12	USD	16.54	564	5	0	559	298	25	14	0	1.88	22.38	39.76	0.00%
Del Frisco Restaurant G	DFRG	14.64	USD	23.52	344	2	0	342	338	47	16	0	1.01	7.28	21.50	0.00%
Fogo de Chao, Inc.	FOGO	13.39	USD	28.09	376	21	160	515	276	43	29	1	1.87	12.02	12.81	0.25%
J. Alexander's Holdings	JAX	9.89	USD	14.95	148	11	20	158	219	6	3	0	0.72	25.44	51.47	0.00%
Ruby Tuesday, Inc.	RT	3.64	USD	60.19	219	52	229	396	1,109	5	-19	0	0.36	79.16	n.a.	0.00%
Kona Grill Inc.	KONA	11.35	USD	11.21	127	3	9	133	149	7	-5	0	0.89	17.78	n.a.	0.00%
Mean													1.01x	20.90x	28.78x	0.71%
Median													0.87x	10.42x	22.24x	0.00%
Implied Price Per Share Mean													\$12.96	\$13.43	-\$13.42	\$140.14
Implied Price Per Share Median													\$11.07	\$6.45	-\$10.37	#DIV/0!

Appendix 7: Valuation Summary

VALUATION SUMMARY

Kona Grill Inc.

Market Capitalization Valuation	Low	High
Discounted Cash Flow	21.46	24.04
EV/Sales	11.07	12.96
EV/EBITDA	6.45	13.43
P/E	-13.42	-10.37
Dividend Yield	140.14	#DIV/0!



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James Sun | Contact@westpeakresearch.com

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James Sun

Analyst

WestPeak Research Association
contact@westpeakresearch.com