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OUTLOOK

A Real Estate Epiphany

Long-time readers of the Monitor will easily recognize these recurring themes: 1. Real estate ownership is good; 2. High leverage and expensive leases are bad.

There is a correlation here. I have never seen a restaurant business that owns more real estate than it leases go out of business. Yet, I've observed hundreds of companies with no real estate ownership, expensive leases and high leverage, that have.

Perhaps my love affair with owned real estate stems from fond memories I have of the pre-private equity and family office days, when a restaurant owner's sole blueprint for building long-term value was to go public or own the dirt. It's always been a homerun in my book when a franchisee or multi-unit independent sells the restaurant operation to another operator, yet continues to own the real estate and collects rent in retirement.

Yes, I'll admit these round-tripper transactions are few and far between these days. Over the many years I've published the Monitor, and despite my incessant cheerleading for real estate ownership, I've come to realize most multi-unit restaurant operators neither have the capital nor the desire to own real estate. Real estate for most operators is a means to an end, not the end. Yes, Ray Kroc would be turning in his grave.

The main argument against real estate ownership is it's expensive and ties up capital that might otherwise be invested in new units or acquisitions. Good commercial real estate is also difficult to find, especially when everyone in the business is pin-seeking the same high-profile sites near busy trade areas.

In addition to the cost, low cap rates and relatively low inflation over the past 25 years have made it advantageous to lease. Consider that cap rates back then were in double digits: A $2 million restaurant property leased back at a 10% rate would initially cost $200,000 per year in annual base rent. At a 5% cap rate, the rents are half that amount. Low cap rates give operators plenty of options. Most have chosen to rent versus own.

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Fifth Third Bank Leads Large Panera, Planet Fitness Deals

In the first quarter, **Fifth Third Bank's Restaurant & Franchise Team** acted as Left Lead Arranger and Administrative Agent on two meaningful transactions for franchisees in the restaurant and fitness industries.

The Fifth Third team closed $260 million of credit facilities for **Manna Development Group**, which was started in San Diego in 2003 by **Paul Saber** and **Patrick Rogers**. Manna began with a single Panera Bread bakery café, and now operate over 160 Panera Bread bakery cafés and three Caribou Coffee units across 10 Western and Midwest states.

Capital One (joint lead arranger), Huntington National Bank (joint lead arranger), Pinnacle Financial Partners (documentation agent), Bank of Hope, California Bank & Trust, Umpqua Bank and BMO all participated in the Manna Development Group credit facilities.

The Fifth Third team also closed $250 million of credit facilities, backing the acquisition of **Baseline Fitness** by **Mayfair Capital Partners**. Baseline Fitness was founded by the Majkrzak family in 2009, and is a Planet Fitness franchisee that has grown from a single club in Fargo, North Dakota to over 100 clubs across nine Midwest and Western states. MUFG Bank (joint lead arranger), Pinnacle Financial Partners (joint lead arranger), Bank of America, Celtic Bank, NBH Bank, Wintrust Franchise Finance, First Merchants Bank and Farmers & Merchants Bank all participated in the Baseline Fitness credit facilities.

According to **Jeff Poe**, Fifth Third Bank's Head of Restaurant & Franchise Corporate Banking, "We have served as Left Lead Arranger and Administrative Agent on over 75 transactions for restaurant and fitness franchisees and have great relationships with the franchisees, sponsors, franchisors and lenders active in the segments we focus on. When you add up all of these things, it creates great outcomes for everyone involved."

Poe said he is seeing M&A activity picking up with both financial and strategic buyers, and being a lead arranger takes some finesse in the current market. "Bank lenders are constructive, but arrangers are working off of a new playbook post-Silicon Valley Bank, as commercial banks remain focused on return hurdles and how they achieve them," he said.

He added that leading the efforts to distribute titles, fee income, deposits and other ancillary business to the participating lenders, "as well as the relationship each institution has with the borrower are all key to successful execution" of the transaction. You can reach Jeff Poe at jeffrey.poe@53.com, or at 312-590-7072.

Shake Smart Gets Equity Investment; Brookwood Advises

"There was a lot of hesitation, bringing on a student-led brand," said **Kevin Gelfand**, president with Shake Smart, a concept that offers healthy on-the-go food and protein shakes. "They ended up giving us a concrete slab outside the student rec center."

It was 2011, Gelfand was a junior at San Diego State, and he was looking for healthy options on campus. "There were very little for the on-the-go college lifestyle," he told the Monitor. He and fellow student Martin Reiman decided to take matters into their own hands, and convinced a somewhat skeptical college foodservice committee to give them that concrete slab.

He and Reiman continued to go to class and did graduate, all the while launching and working that first location. "It was a tough year," he said.

It seems to have paid off. Thirteen years later, the company has some 45 locations on college campuses around the country. And Gelfand, as CEO, just landed an equity investment in the company from **NewSpring Franchise**, a PE firm that focuses on franchise brands. Investment banking firm Brookwood Associates provided advisory to Shake Smart regarding the investment. Amount of the investment was undisclosed.

"We knew of and were tracking this brand for a long time," said **Anish Gandhi**, managing director with Brookwood. "When we first met them, the brand was small, but I knew there were legs on this business. They did grow, and when they were big enough, it was time to bring on institutional investors."

Satya Ponnuru, general partner with NewSpring, was attracted to the brand for a variety of reasons, including its unit economics and the customer value proposition.

"They have a differentiated product, shakes and smoothies, and they are filling in that meal replacement," he said. "Shake Smart has incredibly balanced dayparts, too: Breakfast and lunch, in-between snacks, and even dinner. It was impressive to us."

Today, those 45 locations are split 50/50 between corporate owned and licensees. The investment from NewSpring is going to help them grow into other non-traditional locations, like hospitals and airports. Today, they have one location on a military base.

"We know the university space well, but not other markets," Gelfand explained. Now, "we have a partner with that access. Plus, it's more financial support, and having a board, that will help us ramp up growth. The big picture: It's a perfect alignment. They understood our vision of the future. We were on the same page, day one."

The plan is to open 12 more locations this year, one of those within a hospital. Gelfand said some of these will be second locations on some of the college campuses, and, in a full circle moment, he reported, "we have a third location opening up at San Diego State. That's pretty exciting."

And, there are other avenues of growth. "There's a clear road map to franchising," said Ponnuru. "That's really where we're heading."

Gandhi noted that after college kids have formed a daily habit of visiting Shake Smart, they then leave school and go out into the world. "The company is in a unique position where they have built that customer base early, and now they are getting into other venues. When there are brick-and-mortar locations someday, consumers will already know the brand."

For more information, contact Brookwood Associates' Anish Gandhi at 678-596-7318, or at ag@brookwoodassociates.com.

CrossFirst Bank Sees Growth Since Launching; Hires Portfolio Manager

CrossFirst Bank recently added **Matt Bonfiglio** as portfolio manager within their Restaurant Finance Group. He was previously a financial analyst with a healthcare company which had invested in joint venture dialysis clinics.

CrossFirst Executive Director and Restaurant Finance Group head **Bobby Oliver**, said, "Matt will primarily be responsible for screening new credit opportunities, underwriting and portfolio monitoring as we grow the portfolio. He's part of the growth plans for the team." In his new role, Bonfiglio will report to **Josh Taylor**, Director in the Bank's Restaurant Finance Group.

"We are a $7.4 billion bank, so the development of this specialty vertical is impactful," Oliver continued. "We're not looking to be the biggest lender. We are in a handful of syndications and club deals, and we are focused on direct banking relationships with our clients." Since its inception in March 2022, Oliver has led the group to $200 million in originations.

In fact, Oliver highlighted a recent deal: the financing of a 7Brew Drive Thru Coffee franchisee, Tejas Brewistas, LLC. Tejas developed five locations in 2023, with plans to continue at a similar pace going forward.

"We came in and put in place a $10 million development line and look forward to supporting their growth in the future," he said.

According to Mason Matlock, manager with Tejas Brewistas, "CrossFirst Bank was wonderful to work with as they came in and structured a development facility that aligned perfectly with our growth plans."

CrossFirst is targeting some of those emerging brands like 7Brew, where there is white space to grow. "Our senior management team has been very supportive since we launched the group in 2022," Oliver said. "We continue to seek opportunities for growth in attractive brands." For more information, contact him at bobby.oliver@crossfirstbank.com, or 770-540-9733.

Unbridled Capital Advises on 33-Unit Little Caesars Sale

Boutique investment banking firm **Unbridled Capital** recently advised on the sale of 33 Little Caesars restaurants to franchisee **Pizza Partners, LLC**. The sale price and the name of the seller were not disclosed. Pizza Partners is owned by **Andy Abbajay**, and is now the sixth largest franchisee in the system after the acquisition.

"You don't often see Little Caesars deals of scale like this," said **Rick Ormsby**, managing director of Unbridled Capital. "You'll occasionally see a franchisee selling just two or three units; this was an uncommon opportunity, and we did have a number people who were interested in it."

But, he added, not private equity. "We have seen a big drop in private equity and family office interest in deals across all brands."

In 2021, he said 14% of the deals on which Unbridled advised had strategic buyers. In fact, fom 2022 to 2024, 18 of their 35 deals went to strategic buyers. And, "zero of the PE acquisitions were new PE entrants to the space."

He says those new entrants are sitting on the sidelines because of higher interest rates, for one, but also "questionable exit returns and failed sell-side processes for private equity who are in the business now," and ballooning construction costs for new unit development.

"Those PE analysts who are sitting in the tall buildings and looking at those metrics will need at least two of those three factors to resolve" before they jump in the market, Ormsby predicted.

And while this may depress prices a bit from their highs of three years ago, "as long as the seller has a realistic view of their valuation, you have a pretty liquid market out there of buyers," he explained.

Plus, it's just a bit easier to sell to another franchisee. Private equity will do more stringent due diligence, and "an existing franchisee doesn't answer to anyone, so you can just pick up the phone and call your neighbor and work out the problems more easily." For more information, contact him at rick@unbridledcapital.com, or at 502-252-6422.

Auspex Capital Secures $110.75 Million in Financing for Fulenwider Enterprises

Restaurant industry investment banking firm **Auspex Capital** was the debt placement and financial advisor to **Fulenwider Enterprises, Inc.** and its affiliated entities on their latest financing.

The company secured a total of $110.75 million of new loan commitments from **Wells Fargo Bank**, including a $97.75 million term loan, an $11 million development line of credit and a $2 million revolving line of credit. The loans were used to refinance the company's existing debt, finance the acquisition of one KFC store and provide capital for remodels and development of new restaurants.

Fulenwider is a Morganton, North Carolina-based KFC and Taco Bell franchisee, and operates 157 restaurants, including 88 KFC, 53 Taco Bell and 16 co-branded KFC/Taco Bell restaurants throughout the Southeast. For more information, contact Auspex Managing Director **Chris Kelleher** at 562-424-2455 or email ckelleher@auspexcapital.com.

Northwest Bank Taps Record to Lead New Franchise and Restaurant Finance Group

Restaurant lending veteran **Mike Record** joined **Northwest Bank** in February as Executive Vice President-Head of Franchise Banking. Prior to joining Northwest, Record served as senior vice president, head of McDonald's Lending Group at City National Bank. He previously held additional restaurant and franchise finance leadership roles at Bridge Funding Group, Wells Fargo, TD Bank and GE Capital Franchise Finance.

In fact, years ago, GE Capital was where Record worked alongside Jay DesMarteau, who joined Northwest Bank as Senior Executive Vice President and Chief Commercial Banking Officer in 2023.

Northwest Bank is a regional bank with $14.4 billion in assets and 134 full-service branches in four states: Pennsylvania, Ohio, Indiana and New York. Historically, the bank had been focused on consumer banking, and had grown mainly through acquisitions. Now, the bank's senior management's mandate is to transition the organization to be a balance of both consumer and commercial banking. Enter DesMarteau last year, and then Record a few weeks ago.

"Jay was brought in as the commercial leader here, and he's tapped experts to join the bank for SBA, sports finance and sponsor finance," said Record. When DesMarteau needed someone to head up the new restaurant and franchise finance vertical, he thought of Record. The various verticals, including Record's, will have national reach.

"It's a great opportunity for a lot of reasons," Record said. "One of the things that attracted me to Northwest Bank is the vision for the bank and where it's going. And, it's backed by a tremendous amount of talent they have at the senior management level in anticipation for the bank's growth."

Northwest Bank will target QSR operators who have about 10 units and $2 million of EBITDA. They will finance non-QSR brands for stronger operators, he added. And, they will lend to non-restaurant concepts, like fitness, personal services and automotive for larger, experienced franchisees.

Their deal size will be $5 million and above, and they will also participate in club deals and syndications. "We would be a great partner on the syndication side," he said, "based on level of expertise, our ability to fund and our access to capital."

And while the industry is moving toward banks requiring deposits and other services from their borrowers, Northwest Bank isn't tied to that. "We would like to have the whole relationship, but it isn't a deal breaker for us if the pricing makes sense," Record said about participating in club deals and syndications. Services like treasury management can be added later as the relationship develops.

"We understand the issues surrounding multi-unit operators and moving their treasury management," he said. "We want to address that with our customers and when the time is right, we can look at doing that."

Record said he's already seeing deals come his way, and job one is staffing up so he'll be able to meet that demand. Over the next year or so, they will be hiring several relationship managers, underwriters and closers, "all seasoned franchise people, with extensive experience in the industry. We will be fully ramped up here shortly with very strong talent."

That experience is paramount, because "we won't be wasting the client's time in that we'll have the experience to very easily and quickly vet deals, and provide quick turnaround times and underwriting," he said. And he can provide access to capital and certainty of close during a time when other lenders are facing the headwinds of a tumultuous banking environment.

He's been in the sector for many years, and part of that is because it keeps him engaged. "The industry is changing every single day," Record said, "whether that's at a macro or micro level. I have the opportunity to learn something new all of the time, and that's fascinating and exciting."

For more information, contact Mike Record at 480-980-9849, or at Mike.Record@Northwest.com.

Philbin, Lipson Form Restaurant Group at Real Estate Firm Northmarq; Data Points Bring New Tools to Restaurant Operators

"We aren't just data curators," said **Matt Lipson**, vice president and co-founder of the newly formed restaurant group at **Northmarq**, a national provider of commercial real estate debt, equity, investment sales and loan servicing. "We're utilizing our data and expertise to help franchisees make pinpoint decisions and avoid unnecessary, costly mistakes. There's more money in less unnecessary mistakes."

Lipson, along with Northmarq restaurant group co-founder and senior vice president, **Mike Philbin**, support restaurant franchisees and developers with buying and selling existing real estate, as well as expansion consulting. With extensive experience specializing in restaurant commercial real estate between them, they've dedicated the past year into publishing cap rate guides for the top franchised restaurant brands in the U.S., pulling data from 2018 to 2023, and breaking down the data points by the quarter.

According to Lipson and Philbin, each QSR and casual dining brand report tracks data such as lease term remaining, list vs. sold cap rates, supply and demand of that brand's real estate, cap rate by guarantor (corporate vs. franchisee, and size of franchisee), cap rate by market size, cap rate of ground leases vs. fee simple and finally, days to close.

"We have a full team tracking these comps," said Philbin. "So, we have that database of any type of single- or multi-unit tenant comp located anywhere in the country. As long as the listing hits the market, we'll track it. Basically, the report tells our clients right where their properties will sell."

Lipson gives an example of how the lease-term remaining data point could be used: "The data in our reports clearly shows us you are going to sell for less if there is a shorter lease term remaining on your property," he explained. "You are losing basis points by putting a 15-year lease on a business, versus a 20-year. The data is in front of you to make a decision. In setting a sale-leaseback, what does five years of lease term mean to you? Your decision could lose or gain 40 basis points, resulting in hundreds of thousands of dollars."

Or, how about size of the guarantor? "Let's say someone has 150 Burger Kings in a larger entity, and they want to buy up 13 more in a certain market in Iowa," Lipson said. "They may want to keep the 13 units in a smaller entity for tax purposes. I can see what cap rate they'll average if they keep them in the state-focused entity, or what the cap rate would be if they were part of the larger organization." Yes, there could be tax savings with a smaller entity, but is it worth the 40 to 60 basis points one will lose off of the exit cap rate on a sale-leaseback, he explained, saying again, it's hundreds of thousands of dollars difference.

"This is powerful," said Lipson. "That's a lot of money to be making decisions on just a whim."

And, it will be a helpful tool for developers, private equity, REITs and franchisors, Philbin added. For developers, let's say you are talking to three tenants about a property: Dutch Bros corporate, a 15-unit Taco bell franchisee, or a 100-unit Wendy's franchisee, they have the data in to show the pinpoint cap rate from each brand and size of franchisee.

For private equity, who want to scale businesses quickly and often use sale/leasebacks to do so, "this is their guide in how to go about doing that," he said. "And REITs are buying and selling all of the time. They have to report their average disposition and acquisition cap rates. That directly affects their stock price. If you're an asset manager at a REIT who needs to sell 100 properties over the next year, these guidelines can be part of your road map."

Franchisors also can use the cap rate guides to help incoming franchisees. "It's actually a great way to help franchisees compete with private equity," Lipson said. "If you lay out a map for incoming franchisees, you can increase the quality of the franchisees. They'll see what properties are worth. Or how sale/leasebacks could help franchisors' efforts to refranchise sites."

"It's putting together a puzzle," adds Philbin. "And knowing how it will look at the end. This could change the market."

Teaming up

Lipson and Philbin came together to work on restaurants a few years ago at real estate firm Stan Johnson & Company. When Northmarq acquired Stan Johnson at the beginning of 2023, the duo decided to make a mark in the restaurant sector by forming a formal industry group. Each have left behind other asset classes and are now focused solely on restaurants.

"We've built up our resources and are a one-stop shop, buying, selling and developing restaurant properties," said Lipson. "We've been intentional about lining up our resources. By staying focused, we know who's buying and who's selling. We're getting a lot more deals done, and it's bringing more value to our clients."

For more information, contact Matt Lipson at mlipson@northmarq.com, or at 503-468-7503. Or contact Mike Philbin at mphilbin@northmarq.com, or at 858-539-3273.

Culver's finished 2023 with seven company locations and 937 franchised stores in the U.S. Average unit volumes for the 884 Culver's franchised stores open for the entire year was $3.5 million. **Shake Shack**, which is publicly held, had 295 corporate locations and licenses another 223 internationally. Shake Shack's average unit volume for U.S. company-operated stores was $3.9 million in 2023. Culver's revenue from franchise fees and royalties was $236.2 million for 2023 versus Shake Shake's $40.7 million in licensing revenue. Culver's had net income of $106.3 million, five times that of Shake Shack's reported net income of $20.3 million. The stock market values Shake Shack at roughly $4.3 billion. What does that make Culver's worth with twice as many stores, almost six times the franchise revenue and five times the net income?

Wall Street restaurant analyst **Mark Kalinowski** published a survey of California restaurants before and after the implementation of the $20 minimum wage, indicating the level of price increases operators are taking to cover the wage. So far, according to Kalinowski, Burger King's approximate +2% menu-price increase is the lowest. Kalinowski reports Wendy's is at +8%; Chipotle at +7.5%; Starbucks at +7%; and Taco Bell at +3%.

Speaking of the crazy $20 California minimum wage for fast food establishments: The casual dining **Chili's** in Elk Grove, Calif., owned and operated by Brinker International, is offering on Indeed.com to pay $15 to $18 per hour to line cooks, while the **Arby's** in Elk Grove owned by multi-unit franchisee **Tony Lutfi** must pay his cooks at least $20 per hour.

More unintended consequences of the $20 minimum wage: 1. A business broker told the Monitor they are seeing an uptick in interest from California QSR operators wanting to talk about selling their locations; 2. California franchisors are already getting requests for royalty relief. Landlords are next. More to come.

Despite all the restaurant gloom and doom emanating from California, the 10-unit **Finney's Crafthouse** is finding success and looking to grow. Twin brothers **Greg and Brad Finefrock** founded Finney's in 2016 in Westlake Village. Finney's, with AUVs of $5.5 million, is a family friendly gastropub with 55 menu items and 30 craft beers on tap (36% liquor mix). Brad Finefrock told the Monitor he believes as others have taken big price increases, Finney's emphasizes value and has only taken 8% price. Four more stores are set to open in California in 2024 and the Finefrocks will take the concept on the road to Arizona, Nevada and Texas.

When you think of **Ben & Jerry's**, you think premium ice cream sold in grocery stores and ice cream shops and the progressive politics of its founders **Ben Cohen** and **Jerry Greenfield**. Cohen and Greenfield, capitalists at heart, took Ben & Jerry's public in 1985 and then engineered a sale to Unilvever in 2002 for $326 million. How big is their ice cream shop business? Not very. The number of Ben & Jerry shops peaked at 600 scoop shops and around $500 million in revenue. Today there are approximately 200 stores. Unilever has announced they are selling their entire ice cream business (Ben & Jerrys, Breyers, Talenti, Good Humor, Klondike and Popsicle), which last year generated almost $8 billion in revenue.

Since **Brian Niccol** joined **Chipotle** in 2018 as CEO from Taco Bell, he's made $334.5 million from the exercise of stock options and the value realized on the vesting of his stock awards.

Bernstein analyst **Danilo Gargiulo** expects **Chipotle** to reach $4 million in average unit volume per store by 2029 or 2030 and achieve a 28% store-level margin. Last year Chiptole averaged $3 million per location and had a store-level margin of 26.2%. Chipotle's target is to eventually operate 7,000 restaurants in North America.

Last year, **Chipotle** spent $561 million on leasehold improvements, property and equipment. **Chick-fil-A** spent $2.4 billion.

Interesting stat: The highest-volume, free-standing **Chick-fil-A** generated $19.1 million in sales in 2023, according to the company's recently released franchise disclosure document.

A survey of private restaurant chains conducted by **Baird** analyst **David Tarantino** shows delivery sales per location in 2023 increased by 11% in fast casual, but decreased by 4% for QSR and 1% for casual dining. Tarantino cites a change in consumer behavior/mobility and/or a pullback in the willingness of certain consumers to pay a substantial premium for delivery occasions. He estimates restaurants in his survey universe are charging consumers a premium of 23% on delivery orders versus instore purchases. One of Tarantino's survey participants was quoted as saying third party delivery "is increasingly a less-profitable channel for our business, even with price markups, than internal ordering platforms or in-restaurant orders."

UBS restaurant analyst **Dennis Geiger** says valuations of private company franchisee transactions between the first and second half of 2023 increased only slightly by .6%, driven by sales growth, moderating cost inflation and improved profitability. Geiger reported franchisee multiples for chains in excess of $1 billion in systemwide sales to be approximately 5.1x EBITDA for QSR and 4.4x EBITDA for casual dining.

Gordon Hasket analyst **Jeff Farmer** says that of the 33 companies he analyzes that offer delivery, 32 of them charge a premium, with the exception of **Marco's Pizza**.

Former **Papa John's** and new **Shake Shack** CEO **Rob Lynch's** employment agreement entitles him to receive a signing bonus of $1.5 million, provided he sticks around until February 1, 2025. If not, it's pro-rated.

KFC's average unit volume for 2,941 single-brand franchise and company stores open for more than one year was $1,385,780 in 2023, compared to $1,341,385 in 2022.

Raymond James real estate analysts estimated that commercial real estate lending commitments across U.S. banks of all asset sizes was down 17.6% in 2023. Banks in the $50 billion-to-$100 billion asset range saw the largest pullback over the past year, down 34.8% versus a year ago. Commitments were down only 6.7% in banks with assets in the $1 billion to $10 billion range.

DiVall Insured Income Properties 2 Limited Partnership is continuing to liquidate its net lease properties and has up for sale three **Wendy's** in South Carolina. **Matthews Real Estate** is handling the marketing. DiVall, founded by a Wisconsin real estate developer named Gary DiVall in 1988, was an active buyer of restaurant net lease properties in the late '80s and '90s. However, DiVall was sued by investors in 1993 for siphoning off funds for other real estate investments and diverting approximately $4.5 million for personal use. They were eventually charged criminally by the State of Wisconsin. **The Provo Group** took over the operations of the DiVall partnerships in 1993.

Burger Fi's (108 BurgerFi and 60 Anthony's restaurant locations) outstanding term loan sits in default at roughly $52 million at the end of 2023. The company was not in compliance with the minimum liquidity requirement of the agreement, which required it to maintain a $12.5 million cash reserve.

Four Corner Property Trust (FCPT) is Darden's largest landlord with 314 **Olive Gardens**, 115 **LongHorn Steakhouses**, 13 **Cheddar's** and 10 **Bahama Breeze** restaurants under lease. FCPT, unusual for a real estate investment trust, is also the franchisee of seven LongHorn Steakhouses in San Antonio.

Founder **Audley Wilson** is pitching his robotic burger maker, **RoboBurger**, on ABC's **Shark Tank** on April 19. RoboBurger is a vending machine that cooks a burger, toasts the bun and adds condiments in about four minutes.

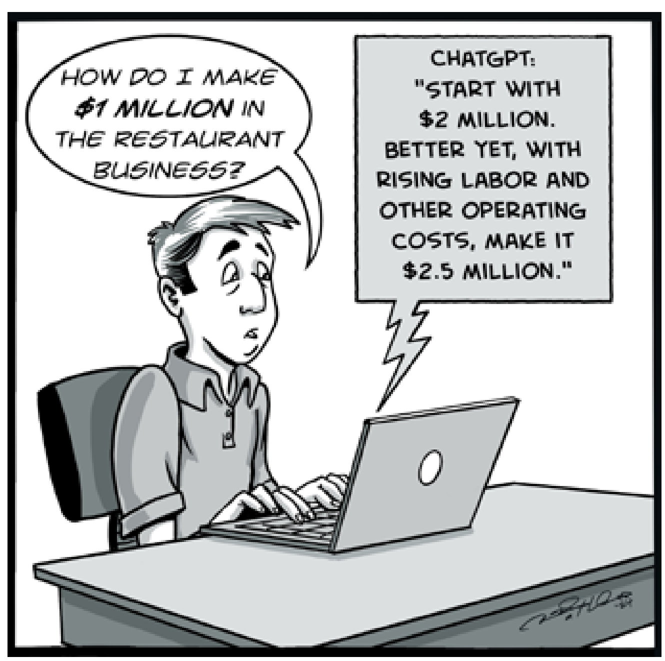
Landry's CEO and Houston Rockets owner **Tilman Fertitta** was one of the first to embrace the SPAC (special purpose acquisition company) movement in 2018 when he and Jefferies CEO **Richard Handler** merged their Landcadia Holdings SPAC with **Waitr**, the fast-growing food delivery firm. Earlier this month, Waitr ceased operations and filed Chapter 7 liquidation.

Franchise business advisor **Alicia Miller** has authored the definitive book on franchise investing and public equity. It's entitled "**Big Money in Franchising: Scaling Your Enterprise in the Era of Private Equity**" and it is available on Amazon. Miller writes a regular business column for **Franchise Times**.

Crumbl Cookies, now known as just Crumbl, is seeing its average unit volumes "crumble." Its 2024 franchise disclosure document reports average store revenue last year from 571 stores reported was $1.16 million, down from $1.8 million in 2022. Crumbl added 281 franchise locations last year in the U.S. Franchisees, by the way, pay royalties of 8% of gross sales.

Dine Brands Global, parent company of **Applebee's** and **IHOP**, is off to a slow start after paying $80 million in cash in December 2022 to acquire the 137-unit **Fuzzy's Taco**. Dine said the acquisition was part of the company's goal to "invest in a high growth concept to accelerate growth." Last year, Fuzzy's had net closures of five locations.

There's still time to register for the all-things off-premise **Food on Demand Conference** May 8-10 at the Bellagio in Las Vegas. **Uber** founder **Travis Kalanick** is the keynote speaker. Go to foodondemand.com to register.



Stagflation: As Good as it Gets? Plus, Roger Goes Value Hunting!

The world economy is in a holding pattern. Interest rates, heavily influenced by central banks, have stabilized at rates that seem high compared to the level of the last dozen years, but are in a fairly normal historical range. The politicians and bankers are relatively calm for the moment; "data dependent" as the rate of inflation has receded to the 3% to 4% range while pundits, including myself, debate the state of the economy. I have trouble ignoring the fact that virtually all job creation is part-time in nature, a function of the need by lower- and middle-class families to maintain two or three jobs to pay household bills that are up 20% to 30% from several years ago.

Even under the doubtful assumption the Federal Reserve can control interest rates, the most appropriate path is far from clear. The enormous continuing supply of government debt, refinancing the maturation of very low interest rate paper as well as new deficits, precludes materially lower interest rates, and last week's slightly higher CPI reading doesn't help. Even the current "normal" rates exacerbate the deficit spending since interest on the U.S. debt was $76 billion in the month of February alone, $433 billion through five months of the current fiscal year, and well on its way to a trillion-dollar annual interest expense. In essence, there is no graceful way out of the fiscal and monetary mess that is four decades in the making. Don't forget: This is still an election year, so the Fed will be careful not to appear to play politics in one direction or another. As business operators, investors and consumers, ongoing stagflation is as good as it is likely to get.

Equity valuations, both public and privately held, are far from peak levels. For example: Bloomin' Brands (BLMN), here to stay for sure, and in spite of activist Starwood Value's involvement, is trading with an enterprise value of little more than 5x 12-month trailing adjusted EBITDA.

The One Group Hospitality (STKS) planned purchase of Benihana (a 60-year-old "iconic" brand) at just over 5x 12-month trailing adjusted EBITDA is another example of today's "show me" environment. If you are not Wingstop or Chipotle with very strong recent growth, or Darden or McDonald's or Texas Roadhouse with best-of-breed, long-term credentials, you need a long-term growth plan that offers investors too much upside to ignore. Since traffic growth is non-existent for almost everyone, if the valuation is modest enough, analysts may even overlook lackluster same store sales, even modestly negative traffic, and allow for a re-rating.

Dave & Buster's (PLAY) is an example of just such a situation. I suggested PLAY as my "stock recommendation of the month" back in August and it's up 75% because margins have begun to improve, though same store sales and traffic are still negative. So management's long-term plan seems credible, cash flow has allowed for retirement of almost 20% of the shares and the enterprise value has improved from under 5x all the way up to 7x. A numerically interesting part of the PLAY equation is that there were only 50 million shares outstanding, with over $500 million of annual EBITDA, so every turn of the EBITDA multiple would be worth $10 per share. If investors were to take PLAY's enterprise value from 4x to 5x, the stock would go from $36 to $46, which it has, and then some.

Opportunistically, two similar situations today are Driven Brands (DRVN), the stock depressed for short-term reasons, and The One Group Hospitality (STKS), which is in the process of acquiring Benihana Inc. Both companies are trading with enterprise values at low multiples of adjusted EBITDA, and EBITDA is a large multiple of the shares outstanding.

Driven Brands, currently at about $15 per share has over $500 million of EBITDA and 164 million shares outstanding. The story revolves around the growth of their Take 5 Oil Change concept, with 700 company locations (growing at 60 per year) and 300 franchised stores (growing at 100 per year). Unit-level economics at Take 5 are attractive, which combined with the uniquely progressive franchising structure, have created an award-winning franchised concept. Every turn of EBITDA (currently about 10x, a modest multiple for a growing franchisor) is worth over $3 per share to DRVN's $15 stock.

The One Group Hospitality (STKS), currently in the process of merging with Benihana, will have about $70 million to $90 million of EBITDA, compared to 33 million shares outstanding. I view Benihana as a long-established, well-positioned brand, selling a relatively healthy menu with a modest average ticket price, while providing experiential dining. I have been impressed with STKS' dramatic improvement of their STK brand over the last five years, and their successful absorption of the best of the Kona Grill brand. If STKS management can build upon Benihana's long history, every turn of EBITDA, currently under 6x, will be worth about $2.50 per share on top of STKS's $5.70 stock price. As with PLAY, the large opportunity as suggested by management puts the "Fear" into the FOMO—Fear of Missing Out—investment equation.

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STATS AND QUOTES

ALL THE RESTAURANT SCUTTLEBUTT THAT'S FIT TO PRINT	
1.	Restaurant industry folks are still buzzing about **Chick-fil-A's** $9.37 million AUV in 2023. QSR executives might be coming to the realization that may be why their own traffic is challenged.
2.	Bernstein analyst **Danilo Gargiulo** initiated coverage of **McDonald's** with a "market perform" rating. He says McDonald's is struggling with low-income consumers and is losing its value perception.
3.	Speaking of low-income consumers, **Family Dollar** reports lower SNAP benefits as responsible for its negative comps, while **Dollar Tree** stores are now targeting households earning over $125,000 a year.
4.	Smart restaurant operators have concluded technology alone won't solve the labor cost issues in California. The operators who survive and prosper will be the creative ones who build sales.
5.	Guggenheim analyst **Greg Francfort** has a "buy" rating on **Darden**, despite it reporting soft sales in the recent quarter. He thinks Darden has created a "big pricing value gap" compared to other brands.
6.	**Cal-Maine Foods**, America's largest egg producer, temporarily shut down their Texas plant last month due to chickens testing positive for the bird flu. Egg prices have risen since last fall and may rise more.
7.	Investment firm **Strategas** computes a common CPI made up of items consumers must buy—food, energy, shelter, clothing, insurance, utilities. It grew at 3.9% in March, versus the government's 3.5%.
8.	What's up with QSR? According to **Revenue Management**, QSR traffic was down 3.5% in the first quarter of 2024. Perhaps it's due to stories such as a Big Mac combo meal going for $16.89 in Connecticut.
9.	According to **Delaget**, QSR orders from kiosks, mobile phones and delivery are climbing. Drive-thru orders, however, were down in 2023.
10.	Business owners beware: That **20% Qualified Business Income deduction** that was part of the 2017 Tax Cuts and Jobs Act is due to sunset at the end of 2025.

INTEREST RATES (%)				
	04/12/24	**Last Month**	**A Year Ago**	**Trend**
Fed Funds Rate	5.50	5.50	5.00	↑
30-Day BSBY 1M*	5.32	5.39	4.91	↔
90-Day BSBY 3M*	5.38	5.38	5.15	↑
30-Day SOFR**	5.31	5.31	5.05	↑
90-Day SOFR**	5.31	5.31	5.05	↑
1-Year Treasury	5.15	5.02	4.68	↑
5-Year Treasury	4.55	4.15	3.48	↑
10-Year Treasury	4.52	4.16	3.42	↑
30-Year Treasury	4.62	4.31	3.66	↑
Prime Rate	8.50	8.50	8.00	↑

*Bloomberg Short Term Bank Yield Index **Secured Overnight Financing Rate

Economist David Rosenberg appearing on the On The Tape podcast with CNBC's Guy Adami and Dan Nathan: "The stock market is behaving as though interest rates were back at zero as opposed to the risk-free rate being four or five percent. It is the top 10% price market of all time."

Neel Kashkari, president and CEO of the Federal Reserve Bank of Minneapolis, spoke April 4 on a webinar produced by the magazine Pensions & Investments: "If we continue to see inflation moving sideways, then that would make me question if we need to do those rate cuts at all. There is a lot of momentum in the economy right now."

Newedge Wealth Chief Investment Officer Cameron Dawson speaking on a recent Bloomberg Surveillance episode about the risk of higher commodity prices and that it will contribute to a rise in core inflation: "The thing to watch is the forecast for household consumption. They've gone up significantly over the last six months. They are now at 2% growth for 2024, up from just above 1% a few months ago. If you have oil prices continue to move higher, that could pinch consumer spending, household consumption rolls over, that's 70% of GDP, GDP forecasts roll over and that's when you would see a broader risk off move. That's something to watch."

JP Morgan CEO Jamie Dimon discussing the financial condition of businesses during the bank's first-quarter conference call: "Businesses are in good shape. If you look at it today, their confidence is up, their order books are up, their profits are up. But I caution people, these are all the same results of a lot of fiscal spending, a lot of QE, et cetera. And so, we don't really know what's going to happen."

Getting Ready to Refinance

By Dennis Monroe

Lately, we've seen a growth in the number of restaurant companies either getting ready or already actively involved in the process refinancing their senior debt. There has been some hesitation due to interest rates that remain high: Borrowers who have a favorable interest rate are waiting to refinance when we see lower rates.

The need to refinance may be accelerating, however, if the business owner has decided it's time to expand and needs to refinance growth with embedded equity. In either scenario, here are some key points to consider in preparing to refinance your debts.

1. The right legal structure: Make sure your legal structure clearly separates the assets and concepts that will be available for refinancing. Be wary of cross collateralization, particularly among different concepts. This is important, in part, because lenders have become much pickier about the concepts they'll finance. We've seen lenders that specialize in restaurants decide they no longer want to finance a significant restaurant chain if it isn't a franchise. So it's important that you structure non-franchise assets in a separate entity. In terms of structure, place the real estate in separate entities so you have options after you complete the refinancing, such as a sale-leaseback or even a like-kind exchange. If you plan to take a distribution after the refinance, make sure the entity has enough basis to make a tax-free distribution.

2. Clean up the financials: It's always important to clean up balance sheets and P&Ls so they adequately reflect the economics of the company. Starting with balance sheets, clean up such things as shareholder or intercompany loans. Make sure your equity is clearly stated, and if you have preferred classes of membership or stock that have buyout obligations, this associated liability must be booked. There are other things to consider, such as deferred compensation and phantom-type ownership that create GAAP liabilities, that must be booked.

As it relates to P&Ls, have financial statements clearly identify the general administrative expenses. Sometimes using a management company or applying a percentage of sales can be helpful so you have a reasonable management fee, usually in the 3% to 6% range. Owner's personal expenses or extraordinary expenses should be reclassified and, if necessary, shown as distributions.

3. Look at Your Ability to Leverage. Given shorter amortization and with the current interest rates, make sure you calculate your proforma fixed charge coverage ratio (FCCR) and also find out what kind of cashflow coverage a prospective bank is expecting so you can see if you meet these expectations. Also realize the difference between the FCCR and Debt Service Coverage Ratio (DSCR). The FCCR measures a company's ability to cover fixed charges, such as lease payments, while a DSCR measures a company's ability to cover its debt obligations, including principal and interest payments.

Additionally, look at the liquidity the lender may require and the leverage requirements of debt to equity. You don't want to violate covenants. Further, if you are a franchise company, check your franchise agreements and expirations dates, along with your lease terms, to see if these dates exceed the term of the debt. You also need to understand from your franchisor what kind of remodel obligations you'll have during the term of the debt repayment so you can have the refinancing or liquidity to satisfy those obligations.

4. How do I find the right bank? If you can wait until November, I'd recommend you attend the Restaurant Finance & Development Conference in Las Vegas where all the potential lenders will be. In the meantime, start with your existing lenders and others that have made loans to your franchise system. If you are at a fairly high loan amount, there are lenders that like loans over $30 million or $40 million dollars. There are other creative approaches, including institutional financing and multiple-tranche financing, which is a combination of equity, mezzanine and/or debt. So, you need to find a lender that has the products you are looking for, including sale/leasebacks. If real estate is available, a sale/leaseback can be a good way to combine with a refinancing or acquisition financing. Talk to your fellow franchisees and other people who are in a similar situation for their input. Don't forget to include your CPA and attorney in these discussions.

But just because financing is available doesn't mean you should jump in with both feet. Make sure you are ready for a refinancing and be realistic as to satisfying on a proforma basis the expected cash-flow covenants. Finally, look at prepayment options, interest rate hedges and minimization of personal guarantees. And most of all, channel that inner optimist and plan for a better future with hopefully, lower rates.

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Thoughts on Consumer Spending and the Labor Market

By Jim McFadden

Predicting the direction of the economy seems more difficult today than before. Twelve months ago, a recession was a near certainty. Today, most economists' baseline forecasts call for either a soft landing or no landing at all. In the paragraphs below, I examine several key topics, including the potential reasons for the Fed's recent dovish interest rate stance and the strength of the labor market.

Why is the Fed still calling for three rate cuts this year while inflation remains high?

Fed Chairman Powell signaling three 75-basis point rate reductions are still likely in 2023 in his March 20 press conference triggered another rally in the stock market. Many investors had feared the Central Bank would suggest the cuts could be postponed until 2025 after hotter-than-expected retail and wholesale inflation readings in January 2024 and February 2024.

In maintaining this market-friendly stance, the Fed apparently expects that recent improvements in supply chains and worker availability will continue, a Goldilocks-type environment where inflation eases, GDP rises, and the overall labor market remains strong. Another factor could be indirect pressure from the Biden Administration not to enact policies that would hurt the President's re-election chances. It is of course difficult to predict whether this quite-optimistic take on the future will be what occurs.

Is the labor market not as strong as headline numbers suggest?

The Consumer Employment Statistics (CES) or payroll survey, published by the U.S. Bureau of Labor Statistics (BLS), showed U.S. jobs grew impressively in February. Nonfarm payrolls increased 275,000 during the month, ahead of economists' estimates of around 200,000 and well ahead of the roughly 100,000 jobs that must be created each month to keep up with the growth in the working-age population.

However, the employment situation is markedly less constructive, according to data from a second monthly BLS survey, the Current Population Survey (CPS). Per the CPS, also called the household survey and the survey from which the headline U.S. unemployment rate is derived, household employment declined by 184,000 in February. Even more worrisome, if the CPS data were computed the same way that the CES employment data (the payroll survey) is, CPS household employment would have declined in February by 271,000, which represents its third consecutive monthly decline.

The enormous gap between payroll (CES) and household (CPS) survey data is causing concern for at least some analysts. Richard de Chazal, a macro analyst at William Blair said, "The labor market on the whole is still tight, but the household survey is very clearly telling us that momentum is waning."

Implications of Sharp Decline in Money Supply

The U.S. money supply is declining at its fastest rate in about 75 years, as the Fed shrinks its balance sheet and as the U.S. personal savings rate has fallen to 3.6% in February from 4.0% in November 2023, per the Bureau of Economic Analysis. The Fed's current holdings total around $7.5 trillion, down from a peak of $9 trillion in April 2022. On the surface, this development sounds ominous, but the drastically different way the current economy functions versus the one from 15 to 20 years ago seems to blunt the seriousness of this news. I note the following points:

• Traditional economic theory holds the money supply is one of the important factors in driving economic performance and business cycles. The most common measure of money supply is called M2, which is the Fed's estimate of the total cash people have on hand, plus all the funds deposited in checking and savings accounts, plus short-term savings vehicles like money market funds and certificates of deposit (CDs).

• Rising money supply typically causes interest rates to fall, prompting businesses to invest and stimulating consumer spending and demand for mortgages and car loans. Declining money supply is generally linked to the (less desirable) inverses of these scenarios. Furthermore, money supply levels which are too high can lead to inflation, and a low M2 figure can cause deflation. (As a side note, the Fed's M2 announcements in the 1980s were greatly anticipated and closely analyzed, much as the BLS' CPI announcements are currently.)

• Today, consumers' heavy use of credit and debit cards, PayPal, and Apple Pay drastically reduces the amount of cash needed to buy goods and services. In addition, financial innovators have made it much easier and cheaper for households to buy financial assets like bonds. All this means that a smaller share of a household's savings is reflected in bank deposits, and therefore in M2 calculations. Lin Tien, a professor of economics at George Washington University, summarized these changes in an interview with marketplace.org: "These days, very few of us carry cash. These new financial innovations really blur the line on what counts as monetary assets."

Jim McFadden is a CFA and has 25 years of experience as a Wall Street analyst and portfolio manager.

Continued from page one

Cap rates are slowly rising due to higher interest rates, but that probably won't change the dynamic. For risk-on operators willing to pay that same $200,000 in annual rent, a QSR property could be flipped for around $3 million (a 6.5% cap rate), with a nice profit to be reinvested in more leased locations.

Plus, there is plenty of capital available for new units. Shopping center developers, real estate investment trusts and private property owners are still willing to ground lease, build to suit, remodel or acquire a first- or second-generation site for a restaurant operator. At a higher price, of course than two years ago.

Multi-unit franchisee and real estate investor Greg Flynn told Fransmart's Dan Rowe on Rowe's Smart Franchising podcast that he buys a restaurant property when he can, but then always sells it and leases it back.

"I have no interest in owning low-yielding net-leased real estate, so when we buy them we'll build a restaurant, let it stabilize for a few years, make sure it is profitable, and then typically sell the real estate and lease it back. And, we've done that hundreds of times," said Flynn.

The key to a new lease or a sale-leaseback transaction of an existing location, of course, is to keep the rent affordable. When occupancy costs (rent, taxes and insurance) exceed a certain percentage of sales, (8% of sales or less is a reasonable target), there are only two options: Get the sales up, or the rents down.

If a company has a large number of restaurants with high occupancy costs as a percentage of their sales, the net effect is to "leverage" up the income statement. High, fixed-cost rents become a burden on profits and a drag on the enterprise value of the company. Add in some leverage on the business and you are asking for trouble.

Some operators argue they'll pay higher rents to get better sites. The better the site, the logic goes, the higher the sales. Not always I would add, and that's why there's always risk for restaurant companies that lease more property than they own.

The Lease Renegotiator

The value of a restaurant business is tied to its leases and an operator needs to manage them just like they do food and labor costs to keep their lease expense in check. Rents must be in a certain range as a percentage of sales or the leases must be renegotiated. Stores that lose money despite turnaround efforts should be on a closure list and the leases terminated. The role of a lease renegotiator to manage existing leases is becoming more commonplace in multi-unit restaurant businesses.

The Monitor recently gathered a group of these lease specialists for a series of webinars to discuss rent renegotiation and lease terminations. Master lease negotiator Lew Gelmon, told attendees that leasing is serious business and not to forget landlords have the best experts, lawyers and negotiators on their side. "Be prepared," was Gelmon's advice.

Gelmon gave the example of a 19-unit franchisee he represented with three of the stores losing money. The rents had gone up each year as the sales came down. He recommended withholding rents from the landlords and shutting the stores down. Then, open up termination negotiations.

Why not just contact the landlord and have a general discussion first? Gelmon believes most landlords will delay and ask for more financial information. He says by shuttering stores, it sends a clear message to the landlord there is a problem and they have to deal with it now. In most cases, according to Gelmon, the store was going to be shut down eventually. This gets their attention. "In a worst case scenario, you pay the rents current and the default goes away," said Gelmon.

What does it take to buy out a lease? Gelmon believes three to six months of rent, plus the arrears, plus one month's worth of rent for every year left on the term. He says most landlords don't want to deal with a tenant in trouble, and they feel "the best thing they can do is get the space back, get a quick settlement and move on."

Thoughts? Owning your locations is much easier.

—John Hamburger

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