RESTAURANT FINANCE MONITOR®

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OUTLOOK

The Next Chipotle

The very first cartoon we published in the Restaurant Finance Monitor was that of a banker in a three-piece suit reacting to a presentation from two exuberant restaurant owners who guaranteed their new concept would become the next McDonald's. Fat chance, thought the banker. His quip was that if he'd received a nickel every time he heard a similar pitch, he'd be rich.

Restaurant owners are an optimistic lot for sure, but it took a certain naivety for an owner of a new concept to compare their brand to McDonald's. However, as the burger giant's momentum stalled out in the mid to late '90s, the door was opened for the fast-casual restaurants that were serving higher quality food. McDonald's made a smart investment in fast casual, with an investment in Chipotle in 1998, at the time operating only 14 units.

When Chipotle's unit count reached major chain status with 489 stores, McDonald's spun a portion of the company's (they held 91%) shares to investors in 2006. What the new investors loved about Chipotle was its stellar unit economics. Its $1.6 million average unit volume produced store-level profits of 20% plus. It was a same store sales machine too, increasing same sales by 10.2% in 2005, 13.3% in 2004, 24.4% in 2003 and 17% in 2002.

Back in 2006, fast casual's primary customer, the millennial, had been crowned as the be all, end all, of consumers shaping future restaurant demand. The trends moving towards fast-casual and the strong Chipotle numbers changed the industry's success moniker from "the next McDonald's to "the next Chipotle."

Chipotle has been the standard bearer for restaurant success for at least 15 years running. Like McDonald's before them, way too many restaurant brands have either described themselves as the "next Chipotle" or been anointed by reporters and pundits as the "next Chipotle." And, like the banker in the cartoon, I wish I had a nickel every time I've heard this concept, or that, was going to be the next Chipotle.

Continued on the back page

Don't Delay. Register Today!
Restaurant Finance & Development Conference
November 13-15, 2023 • The Bellagio • Las Vegas

The Restaurant Finance & Development Conference annually draws the top growth-minded restaurant operators in the country. They attend because of the focus on finance and the benefits of networking with the leading lenders and investors in the restaurant business.

RFDC is all about the business side of the restaurant industry and an opportunity to get "up to speed" with what's happening in restaurants and the capital markets. Attendees gain key insight by attending expert educational sessions covering a wide variety of financial, economic, accounting, technology, strategy, real estate and restaurant operations topics.

The year's educational program at RFDC is best in class and features top restaurant operators. Our keynote speakers this year include Restaurant Brands International executive chair **Patrick Doyle**. Doyle was CEO of Domino's Pizza from 2010 to 2018 and led the transformation of that pizza brand into a digital powerhouse.

Other speakers at RFDC this year include:

Stanford University economist **Nicholas Bloom**, co-director of the Productivity, Innovation and Entrepreneurship program at the National Bureau of Economic Research, and an expert on remote work.

Jason DeSena Trennert, CEO of Strategas and one of Wall Street's top thought leaders on the markets and economic policy and a regular guest on CNBC, Fox Business and Bloomberg TV, among others.

And last, and certainly not least, **Jerry Rice**, the former San Francisco 49er and NFL Hall of Fame receiver will attend a meet and greet at the Finance & Development Mall on Tuesday, November 14 and speak at the Wednesday, November 15 Success Breakfast.

We look forward to hosting you at this year's conference. **Register today at www.restfinance.com.**

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Hoffmann Joins Flagstar; Renews Franchise Finance Efforts with Dedicated Vertical

When we talked with **Jeff Hoffmann** in June, **Flagstar Bank's** new franchise finance group had committed to more than $200 million in financing since the beginning of 2023. "Another couple of deals that will close tomorrow—that'll add another $50 or $60 million to that," he said.

Hoffmann has been in corporate finance for 40 years; 30 of those in specialty finance—namely restaurant finance, with names like Fifth Third Bank, CIT and PNC Bank, to name a few. He was tapped in January to lead the enhanced effort at Flagstar to grow the restaurant vertical as Managing Director/SVP-Head of Franchise Finance.

Since 2016, Flagstar had an effort underway to lend to restaurant franchisees, and were financing smaller operators in QSR brands, he said. "But it was really in the last couple of years or so when they bought paper from other banks and started to get into larger transactions that they wanted to branch out," growing from a one-person effort to a "real vertical."

New York Community Bank's acquisition of Flagstar in 2022 slowed that effort a bit, but with the acquisition of Signature Bank in March, "We became a $125 billion bank (in assets)," said Hoffmann. "With a strong balance sheet and high loan-to-deposit ratio, it was really a nice evolution for the bank. It accelerates the growth that is on the table for the strategic plan in 2023, and going into 2024 and 2025."

He's added experienced relationship managers to the roster to move that growth forward: **Michael Keith** has joined Hoffmann's team as SVP, Franchise Finance, and will cover the Western part of the U.S. Keith has franchise finance experience, including with Fifth Third Bank. **Patrick Lucas** was brought on as Managing Director, and will cover the Midwest. He most recently was with BMO Harris Bank.

Flagstar has also hired two underwriters. Hoffmann said they will continue to round out the team with a third underwriter and relationship manager who will cover the Eastern third of the U.S.

Where they play

Flagstar targets multi-unit franchisees who have a history of restaurant experience, some in multiple brands, Hoffmann said. Their target deal size is about $10 million to $50 million, but they can go higher for the right circumstances.

Out of the gate, "our first two deals were $50 million each," he said. "We have the ability to write significant checks." Flagstar can lead syndications or participate in syndications and club deals.

He sees them mostly working with QSR and fast casual brands, but again, will consider family and casual dining if it fits their criteria. They offer financing for acquisitions, expansion, refinancing, development lines of credit and revolving lines of credit. "Real estate and enterprise value loans both," he added.

Part of their calling card is that they have a clean balance sheet. For Flagstar that means they don't have exposure constraints in certain brands.

And, he and his team are well-known in the industry. "In good times and bad times, we know how these businesses will react," Hoffmann said. "We don't have to be educated in depth by operators on the restaurant industry. We understand how to structure deals to meet their growth needs. Do they need capital layers, like mezzanine, for instance? We can be an advisor."

The advisor component is especially important in a challenging operating environment. Restaurant operators, he said, should look for that. "They should want people who are committed to the industry and support their growth." For more information, contact him at Jeffrey.Hoffmann@flagstar.com, or at (847) 226-0390.

Trinity Helps Legacy Franchisees Sell Stores

Restaurant investment banking firm **Trinity Capital**, a division of Citizens Capital Markets, recently completed sell-side advisory on two transactions.

"It hopefully speaks to the M&A markets for restaurants ramping back up," said Trinity Managing Director and department co-head **David Stiles** about the M&A market. "We're observing more activity as the months tick away. That door of opportunity is beginning to re-open."

The firm helped the **Lutfi Family** sell 48 Arby's restaurants located in Washington, Oregon and Southern California. The buyer was **Luke Pisors**, owner of **Ambrosia QSR Beef**, based in Vancouver, Wash. Pisor's résumé includes tenure as a regional VP for the brand.

Tony Lutfi and family first divested of their Jack in the Box restaurants just prior to the pandemic. They intended to sell the Arby's in a second divestiture, but even in 2022, the after effects of Covid "wreaked havoc" on getting it completed, said Stiles.

For one, "the business had experienced some challenges with staffing that led to less-than-normal operating hours and outsized overtime," he explained. "Which further led, just like many operators, to less-than-optimal topline and margin results, only to be further impacted by incredible inflation pressure. That was a challenge present through the whole transaction."

Then, "at what was the 11th hour, the buyer's lender fell out of favor. I had to scramble to get them connected to a lender that could step in and move quickly," Stiles said. "Despite the disruption, it was still a great outcome."

Trinity was also exclusive advisor to **The RC Group**, owned by longtime franchisee **Bob Carlucci**, which sold 58 Taco Bell restaurants and one KFC to franchisee **ABTB Atlanta** and **JAI Taco Atlanta**.

Carlucci hired Trinity a few years ago to sell his entire business, and in 2021, only the mid-Atlantic restaurants were ultimately sold. "Franchise M&A transactions have the unique element of aligning three parties: the seller, the buyer and the franchisor," said Trinity Managing Director **Zach Olson**, who led the deal. "Ultimately, we finally reached common ground on all fronts and were able to complete the Atlanta market transaction in 2023" he added.

Stiles added that in some circumstances, franchisors suggest operators they'd like to partner with for a specific market. "When that happens, navigating a transaction that delivers the outcome that meets each of the party's needs can be very tricky.," he said.

Olson said the valuation multiple "was consistent with the premium the brand has commanded over the last couple of years." The buyers, he said, will have an opportunity to continue to expand in the market.

And while there is still disruption in the M&A marketplace, "buyers are still able to secure the capital needed to close," said Stiles. "There are private finance organizations that have provided solutions for buyers—plus, there is still a lot of equity overhang that is out there needing to be deployed. They may manifest in more equity than leverage to get the deals to work."

And, said Olson, buyers are facing reality with the current debt environment. "Broadly speaking, most of the groups I've been talking to are willing to put in more equity for the right deals, noting they can refinance later. They will do what it takes to win quality deals rather than lose it over the capital structure."

For more information, contact David Stiles at david.stiles@citizensbank.com, or at (310) 488-0884. Contact Zach Olson at zach.olson@citizensbank.com, or at (312) 498-9322.

Reimagine CRE Advocates for Restaurant Tenants

"Six years ago, our partner, Carlie, found a good niche in the franchise sector," said **Jackson Hill**. "We dove in 100%. In fact, we've turned away business not in that sector."

Hill and his partners, **Carlie Wilmes** and **Jeremy Wright**, launched **Reimagine CRE** earlier this year after working together at another real estate firm for seven years. Between the three of them, they have completed 750 transactions that account for 2.5 million square feet in leased space. Reimagine CRE represents tenants only, and specializes in strategic market planning, site selection, negotiations and franchisee portfolio management.

Reimagine can be a franchisor's out-sourced real estate department, or offer services to an in-house real estate team. Their goal is to help the brand's franchisees find the right locations and secure the best lease terms.

They have a seven-point process "we stand by," said Hill, "but we can adjust it for each brand. Some brands have robust development teams. Other groups lean on us more. We can adjust to where they are on their growth model."

Tenant-only representation is key: "We don't have that conflict of interest," said Hill. "You can't be a staunch brand advocate if you are trying to get shopping center listings, too. And, we've seen competitors linking up with a brand, and then they farmed out the deals to outside brokers, but kept the commission. We don't pass off the deals. One of our partners is always the point person. We have skin in the game with every deal."

The group has experience working with both emerging and larger brands. Emerging concepts often need extra support in selling their viability to landlords, said Wright.

"When we are negotiating a deal with a landlord, we have to sell both the tenant and the brand," he said. "We have creative solutions to get landlords excited about that tenant. We're the brand ambassadors."

The Reimagine partners like to bring multiple locations to the table for each franchisee to consider, as well. "We are negotiating for the franchisee in as many locations as possible," to get to the right location in the end, Hill explained. "Because we have no interest in being the landlord broker, we are able to dig and push and get the best deal possible. We fly in and negotiate as aggressively as we can. We also have brokers reach out to us, too, when they think they have a good fit for one of our clients."

For Wright, part of the excitement is working with entrepreneurs "who are putting their life savings on the line. They are excited, and I'm helping facilitate opening up their dream," he said.

Hill said it's enjoyable to be part of expanding "vibrant communities around the nation. Five years ago, we weren't talking about the Columbus, Ohio, suburb of Powell. It was a sleepy suburb, but now a chip manufacturer is going there and brands need to be there. That's the part I like—the macro part."

But also, both like to problem solve. "When something has gone wrong and a space won't work, we are able to find a solution," said Hill. "Whether it is changing the space layout, or the landlord. Or, working with the landlord to get the brand in, and then you get to share that news with the client—that's fun."

For more information, contact Jeremy Wright at 314-740-9001, or at Jwright@reimagineCRE.com. Or contact Jackson Hill at 214-683-0543, or at Jhill@reimagineCRE.com.

Unbridled Advises on Sale of High-Valuation Wingstop

"The market responded with Taco Bell-like multiples," said **Rick Ormsby**, CEO of investment banking group **Unbridled Capital**. The firm recently closed on the sale of 20 Wingstop restaurants in Ohio for the seller, **Buckeye Restaurant Group**, to an undisclosed buyer.

"The multiples suggest that Wingstop is the second most valuable brand in the M&A space," he said. "Prior to this, people in the industry would have said that Taco Bell was in its own league," with whatever brand was in second place being significantly far behind. No more, he said.

Wingstop's recent heightened valuation can be attributed to the fact that larger franchisees just recently bought into the brand, and so there aren't many sellers of scale yet. Plus, Wingstop franchisees have the opportunity to grow through developing a large number of new units.

"If you have money and you are aggressive, you could potentially take a 20-unit acquisition and build it to 50 with new unit development," he said. With legacy brands, "you might buy 20 and develop one or two. Your growth would come mostly through acquisitions."

And, it doesn't hurt that the brand is hitting the cover off the ball. "Wingstop sales have been crazy high," Ormsby said. "Same store sales are strong; stronger than a lot of other brands. And there has been major movement in wing deflation which you can see in the trailing P&Ls."

He said it was a fast closing: 45 days from the LOI. "We were able to find a buyer quickly who was motivated. Plus, our team brought a complete process to the table, exposing the fact that Wingstop can achieve those Taco Bell-like valuations," he said.

MMC Sells Taco Bell locations

Unbridled also recently advised **MMC Enterprises** and its owner, **Jeff Firari**, on the sale of six Taco Bell locations in the Midwest to **Shamrock TBC**, led by **Dan McGue**.

"What's notable about this transaction is the buyer, Dan, is a young, mid-sized franchisee who is taking over as the second generation in the business," Ormsby reported. "That's unique."

He said over the last few years, his team at Unbridled has been working with 30-somethings who are backed by family offices. These young leaders raise the money, and are the face of the business to the lenders and their franchisor. However, they find an experienced individual to bring on to operate the network of stores they've built.

"Dan is different," said Ormsby. "He's the operator, and it's a family business. He has about 30 Taco Bell locations and some Wingstops. He's actually looking to grow." For more information, contact Rick Ormsby at rick@unbridledcapital.com, or at 502-338-0162.

Amur Aims to Fill Void in Marketplace

"When I got into the industry, I realized I loved it from the start," said **Casey Mitchell,** SVP of sales for **Amur Equipment Finance**. Mitchell, a 25-year industry veteran, owned his own loan brokerage company, and became familiar with Amur in 2004, then Axis Capital. At the time, they were a "common sense-type lender," funding hard assets for manufacturing, construction, transportation and agriculture.

"Fast forward through the Great Recession, and the company was still doing business, when a lot of other lenders headed to the sidelines," Mitchell recalled. "They came to me in 2010 and told me they were expanding." Those conversations continued and in 2012, they acquired Mitchell's company, and he joined the management team.

Amur continued to grow, and as he described it, they were intent on taking it from a small boutique lending company to one with larger aspirations. "The company has grown to $1 billion in annual originations," he said. "And we have no intention of slowing down."

Franchise finance is a big focus for Amur. "Over the last couple of years, we have become more and more active in the franchise space, listening and learning about the nuance of lending here," said Mitchell. "And now it might be underserved due to the constraints other lenders may be under. We are excited to fill the need."

Amur finances construction, FF&E, soft costs, franchise fees and all other things that go into a site, with the exception of the real estate. "At our core," he explained, "we're best at a project that has some FF&E component—new kitchen equipment, technology upgrades, redoing the signage, reimaging, remodeling."

And, he said they can finance up to two times the equipment. "So, we can include that install cost, the permitting, the franchise fee," he added. "Those costs are real to the franchisee, so we want to be as helpful as we can be."

Amur is currently targeting 150 brands. Top-tier brands, to Amur, are those that own both corporate and franchised locations, and are going to help support locations that struggle, either by corporate operating them, or replacing them with a successful franchisee.

For Amur, Tier 1 brands have at least 150 locations, are present in a cross section of U.S. markets, have a less-than-5% closure rate, and have shown positive same store sales growth. Tier-two brands have at least 75 locations, and are growing.

Their application-only process funds transactions from $500,000 on up to $3 million for any one tax I.D. "From a growth perspective, we can take a small operator and continue to go up to that $3 million," Mitchell said. "We'll do a store this year, and the next, and the next.

As they become more marketable for the broader lending space, we do have the full-service syndication desk that can manage that process and can create dry powder for the borrower."

Amur's program is built to help franchisees and franchisors alike, he said. They can build a program around a franchisor's objectives, and partner with them to help market it to the franchisees at conventions and trade shows, for example. "We can really be an extension of the brand," said Mitchell.

He's excited about the growth opportunities for Amur, adding that they are still hiring sales origination and underwriting positions for their franchise efforts.

"We have a great opportunity here, because there is a void in the marketplace," said Mitchell. "Capital has become constrained. We are not going anywhere. We can provide some much-needed help." For more information, contact Casey Mitchell at CMitchell@amuref.com, or at 914-346-4152.

K2 Real Estate Provides Brokerage to Restaurants

It's not all about the money, said **Kaveh Ebrahimi**, founder and managing principal of **K2 Real Estate Capital**. "There are things that I've always felt passionate about when it comes to building a business. I want to build and grow it in a way where I can give back to the people who work here, and then they can grow their own real estate career. And, I want to build something for my family. Real estate is in my blood."

Indeed. Ebrahimi grew up watching his dad build custom homes, and "you can't just get into real estate and see how it goes," he said. "You really have to live it seven days a week."

Ebrahimi launched K2 Real Estate Capital in January 2022 after a 10-year career with Sands Investment Group. "I started in restaurants when I got into this business," he said. "And I always thought they were recession proof. I'm a big believer in the restaurant space."

K2 Real Estate Capital provides investment brokerage services to multi-unit restaurant operators, including real estate dispositions, acquisitions, sale-leaseback structuring, 1031 exchanges, build-to-suit development and tenant expansion. "We partner with the client to help them achieve their growth goals," Ebrahimi said.

For sale/leaseback financing, he said they work with the operator to find that healthy rent-to-sales ratio. "We want a happy medium for the tenant and the buyer," he explained. "With that intent, we can establish what is healthy for the restaurant operator in the long term."

He and the K2 team have long-term relationships with developers, as well, partnering with them, he said, "to lower the occupancy costs for the operator."

Ebrahimi said they are seeing less development right now because of high construction costs. Between land, materials and labor costs, and the cost of capital, "it's a more difficult landscape to make the numbers work."

His advice to operators is to find a good partner. "Be strategic about it. Find a partner that can help you identify more competitive land," he said. "We'll find that opportunity over someone with less experience."

Having that experience helps him know what works, and what doesn't, for clients, plus moving them toward the best deal possible.

"I love the wheeling and dealing," he said, and the variety. "I like that feeling of coming into the office not knowing what the day will bring."

But most of all, he likes the feeling of creating relationships built on trust and integrity. "If you show people that you are in this for them, the rewards—both emotional and monetary—will follow." For more information, contact him at kaveh@k2recapital.com, or at 805-889-7837.

Auspex Completes Financing and Sell-Side M&A Advisory for QSR Locations

Investment banking firm **Auspex Capital** recently provided M&A and financial advisory for the following transactions:

Debt Placement Advisory: Legacy Capital Partners, a Wendy's franchisee owned and operated by **Aneil Lala** and **Neal Wadhwa**, has secured a total of $11 million in new loan commitments from **Manufacturers Bank**. The financing included a $10.5 million business term loan and a $500,000 development line of credit, which were used to finance the acquisition of nine existing Wendy's restaurants and provide capital for remodels. Legacy now owns and operates 19 Wendy's restaurants.

Debt Placement Advisory: Auspex secured property financing for a high-net-worth family based in the Los Angeles area. The family's triple net lease portfolio includes Carl's Jr and Popeye's restaurants in three western states. The total loan commitment for the two properties was $3.43 million. **Bremer Bank** provided the financing.

Sell-Side M&A Advisory: PHIG Houston Properties, a La Palma, California-based commercial real estate investment company that specializes in tier-one, QSR properties, has completed the sale of two Pizza Hut properties in and around Houston, Texas, to an individual 1031 exchange buyer. **CBRE**'s Newport Beach, Calif. office managed the sale process for PHIG. The aggregate sale price was $3.1 million. Following the sales, PHIG still owns and leases 89 QSR properties in 11 states.

For more information, contact **Chris Kelleher**, Auspex managing director, at 562-424-2455 or at ckelleher@auspexcapital.com.

Darden CEO **Ric Cardenas** described the difficulty of restaurant development in a post-Covid world. "If you think about our pipeline for this year, you have to have already started construction by the time the year started to get them open because it takes a little longer to open a restaurant or build a restaurant today than it did before COVID. So if it's not started by the end of Q1, it probably doesn't open this year."

It didn't take long for the former **Ruth's Chris** CFO, **Kristy Chipman,** to find a position. Chipman departed the steakhouse chain after it was acquired by Darden in June. She has joined the retailer Five Below as CFO and will oversee the company's finance and accounting operation.

Brinker International shareholders are paying the price for the company's profligate share buybacks as interest rates jump and debt now exceeds 4.5x EBITDA. "Reducing debt is a key priority for the company for the next three years," said Brinker CFO **Joe Taylor** during its June 7 investor day. Taylor said the company is targeting debt-to-EBITDA of less than 2x. The Chili's and Maggiano's restaurant operator just issued $350 million of 8.25% senior unsecured notes due 2030 to replace an equal amount of notes that yielded 5.875%. Taylor said the company would expend approximately $10 million in additional interest expense in its fiscal 2024. From 2013 to 2022 Brinker bought back shares totaling almost $2 billion and now finds itself with over $1 billion in outstanding debt.

Gen Restaurant Group, the 34-unit Korean BBQ chain that recently completed an initial public offering, received $23 million in Paycheck Protection funds in 2020 and 2021 and $16.8 million from the Restaurant Revitalization Fund.

Restaurant guru **Danny Meyer** says most tipped employees in full-service, fine dining restaurants in New York are making between $35 and $50 per hour. "Tipped employees are making a percentage of menu prices which means that their wages have appreciably gone up over the last year and half, Meyer recently told Andrew Ross Sorkin on CNBC Squawk Box.

Speaking of Danny Meyer, **Hedgeye** restaurant analyst **Howard Penney** calls the 334-unit **Shake Shack** (SHAK-NYSE) his best short sale idea, citing declines in average unit volumes and restaurant-level margins since 2017. Shares are up almost 90% year to date. Penney says Shake Shack's underperformance is due to operating in many states with so few stores in each of them and "zero synergies"in the logistics supply chain. Shake Shack activist Engaged Capital, which recently named former Domino's CFO Jeff Lawrence to Shake Shack's board, says it has determined ways to double the company's profitability within two years.

Burger Fi owes a consortium of lenders approximately $54 million, and its latest credit amendment mandates it hire a consulting firm to help dispose of abandoned restaurants and leases, franchise company stores and provide projections so long as its fixed-charge coverage ratio is less than 1.15 to 1 or the lease-adjusted leverage ratio is greater than 7 to 1. Burger Fi just raised $3.5 million, selling 2,868,853 shares to Walleye Capital at a price of $1.22 per share. There are 112 BurgerFi locations—27 corporate and 85 franchised—and 60 Anthony's corporate locations.

Taco Bell is the "crown jewel" of the **YUM Brands** restaurant portfolio, writes UBS analyst **Dennis Geiger** in a recent report. However, when consumers were asked in a UBS survey to name their favorite QSR restaurant brands, **KFC** actually scored higher than Taco Bell.

Gordon Haskett analyst **Jeff Farmer** pointed out in a recent research piece that **Texas Roadhouse's** first quarter off-premises average weekly sales were $19,200, which was up 156% versus the same period in 2019. That number is strictly takeout and catering. Founder and CEO Kent Taylor told a shareholder call in 2017 that Texas Roadhouse would never deliver because "he wasn't interested in delivering lukewarm food to customers." Taylor passed away in 2021.

Of the eight top-bracket investment firms that brought **Cava** public on June 15, seven of them have initiated research coverage with either a Buy, Outperform or Overweight recommendation on the stock. Only Citigroup has a neutral rating.

The offers are in on **Summit Holdings**, the 145-unit **Hardee's** franchisee that filed bankruptcy in May and then closed 39 stores. ARC Burger, formed by PE firm, **High Bluff Capital**, will acquire 81 of the restaurants for $16.2 million. The franchisor, CKE Restaurants, will buy nine restaurants for $672,000. Franchisee Ozark Stars will buy one restaurant for $68,000.

STATS AND QUOTES

HERE'S HOPING THE CONSUMER HANGS IN THERE IN Q3 AND Q4	
Ted Decker, CEO, Home Depot	"We are seeing more of a 'break, fix, replace' than upgrade [in appliances] and a little sensitivity to these single, larger-priced discretionary items."
Mike Graziano, Consumer Products Senior Analyst, RSM US	"We've seen evidence that middle- to lower-income consumers are cutting back on discretionary spending. Given the student loan relief plan was aimed at this customer cohort, any additional fixed monthly costs will result in additional financial pressure."
Chip Bergh, CEO, Levi Strauss & Co.	"We're competing now for other dollars that are being spent out of the consumer's wallet, and that moderate-income consumer is having to make some tough choices."
Corie Barry, CEO, Best Buy	"Not every industry is seeing the exact same customer behavior because the customer is in control and making trade-off decisions based on how that inflation is affecting them personally."
Rosalind Brewer, CEO, Walgreens Boots Alliance	"Our customer is feeling the strain of higher inflation and interest rates, lower SNAP benefits and tax refunds and an uncertain economic outlook. They are pulling back on discretionary and seasonal spending and responding strongly to promotional activity."
Brian Moynihan, CEO, Bank of America	"They were earning more money and they were spending it, what you're seeing is that's dipping down."
Sal Guatieri, Senior Economist BMO Capital Markets	"The recent stalling of consumer spending and somewhat better inflation news validate the Fed's decision to skip a meeting this month (June), though continued stickiness in core prices likely warrant another tap on the brakes in July."

INTEREST RATES (%)				
	07/14/23	**Last Month**	**A Year Ago**	**Trend**
Fed Funds Rate	5.25	5.25	1.75	↑
30-Day BSBY 1M*	5.26	5.22	1.82	↑
90-Day BSBY 3M*	5.50	5.48	2.47	↑
30-Day SOFR**	5.06	5.05	1.54	↑
90-Day SOFR**	5.06	5.05	1.54	↑
1-Year Treasury	5.33	5.22	3.11	↑
5-Year Treasury	4.05	3.92	3.05	↑
10-Year Treasury	3.83	3.73	2.93	↑
30-Year Treasury	3.93	3.85	3.09	↑
Prime Rate	8.25	8.25	4.75	↑

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

Restaurant industry veteran Greg Dollarhyde writing about the recent Cava IPO on Linked In: "What I love was Brett (Schulman) and Ron (Shaich) were smart enough to buy Zoe's for $1 million per store and sell it to the public for $7 million per store. It's a great country!"

Hedge fund manager Doug Kass explaining on his Twitter feed the impact of higher interest rates on equity returns: "The world is not done with raising interest rates. And the broad range of adverse effects are expanding. Higher interest rates adversely impact all discounted cash flow models, a market-unfriendly development. Higher fixed-income returns provide a non-volatile and attractive low-risk competition to stocks. The equity risk premium currently suggests that credit is more attractive than equities."

What makes a wonderful business, according to John Train, author of the classic investment book The Money Masters:

1. They have a good return on capital without accounting gimmicks or lots of leverage.
2. They are understandable.
3. They see their profits in cash.
4. They have strong franchises and thus freedom to price.
5. They don't take a genius to run.
6. Their earnings are predictable.
7. They are not natural targets of regulation.
8. They have low inventories and high turnover of assets.
9. The management is owner oriented.
10. There is a high rate of return on the total of inventories and plant.
11. The best business is a royalty on the growth of others.

A Macro and Micro Economics Lesson

Somebody should inform our political leaders one does not get out of a hole by continuing to dig. Donald Trump's campaign routine ignores the fact the U.S. cumulative debt went from $19.6 trillion to $27.7 trillion under his watch (with $4.2 trillion in his last year, ending in September, 2020 inflated by Covid). In fairness, the debt was only going up an average of about $1 trillion annually prior to Covid. President Biden brags how he has produced the largest annual deficit reduction in U.S. history (from $3.1 trillion in 2020 to $1.4 trillion in 2022), only increasing the debt by $1.9 trillion in fiscal 2021, versus Trump's Covid-driven $4.2 trillion in 2020. Currently, though, the debt is now escalating at close to a $2 trillion annual pace.

The federal budget deficit, amounting to $240 billion in May, was up a cool 263% from $66 billion in 2022, increasing to a cumulative $1.16 trillion for the first eight months of the fiscal year ending in September, up 191% from $426 billion a year earlier. The Treasury has attributed the increased deficit primarily to rising interest costs, rising rates of Medicare and Medicaid, and "federal depositor insurance costs related to the failure of a small number of regional banks." This is important because currently more normalized interest rates will drive annual interest expense to a trillion dollars within three to four years, inhibiting the government from directing their entrenched deficit spending toward more productive pursuits. This is why stagflation becomes our best hope, as the Federal Reserve returns to accommodation of a stagnating economy.

A stabilizing stock market, as investors look across the tight money "valley" has allowed a couple of new issues, CAVA Group (CAVA) and Gen Restaurants (GENK), to come public successfully, and others such as Panera and/or Fogo de Chao likely to get through the IPO window. Both CAVA and GENK have a long runway for growth, but the valuations seem to ignore some obvious potential pitfalls while assuming consistent success. Each will be growing organically faster than ever before. GENK is opening eight to nine units annually, versus three to four previously, and CAVA will be developing new sites rather than converting Zoe's locations. G&A, including pre-opening expense, will appropriately run higher than will be desirable in the long run. I will be doing more work relative to GENK, but have yet to be convinced how mainstream, and sustainable, Korean BBQ will become.

On the subject of G&A support for an aggressive expansion program, Kura Sushi (KRUS), also with attractive unit-level economics, focused on reducing the obviously high G&A at about 15% of revenues, is now selling for about 70x trailing 12-month adjusted EBITDA. My view of the prices of CAVA, GENK and KRUS, I turn to the legendary country singer, George Strait: "Now I've found a game I cannot play, this is where the cowboy rides away."

"Refranchising" is a popular strategic approach for companies with a large number of company locations. PE investors are attracted to the asset-light direction, getting out from under capital needs and always present margin risk within a less-than-robust economy. Why bother with operations, if you are only making 8-10% EBITDA or less at the store level, when you can almost match that in royalties and fees, and also free up capital?

In recent years we watched as Buffalo Wild Wings, Jack in the Box, Red Robin and others pursued this route to varying degrees. Not adequately considered, perhaps, is the fact that store-level economics have to be adjusted by royalties and other service fees which will be expenses the company was not incurring but have to be absorbed before the franchisee can generate a return on capital. This is why the franchising company often gets next to nothing for the store, perhaps some future payout in the form of debt, which is the "sale price" as far as Wall Street is concerned.

Right now Noodles (NDLS) and Potbelly (PBPB), both with a predominance of company-operated locations, are trying to accelerate their franchising activity. This exercise often involves using a handful of company-operated locations to provide a franchisee a foothold in a particular market. Noodles has done this in California and Potbelly in Manhattan. It helps a lot that both Noodles and Potbelly have made some serious strides in terms of improving AUVs and store-level economics.

Realistically, though, the mid-teens for store-level EBITDA at company locations is not yet compelling. Starting at 15% EBITDA at the company-run location, after a royalty of 5% (more or less), a couple of percent of required local advertising or contribution to a national fund, a point for "other fees" (some of which used to be gratis, but not lately), and at least a couple of points of local G&A, there is not much left. Keep in mind, also, that a 2-4% depreciation capex "reserve" cannot be ignored. A company-operated location really requires something like 20% store-level EBITDA margin, or higher, before franchisees will beat a path to your door. Just sayin.'

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Cava Group, Inc.

CAVA-NYSE

Initial public offering

Date: June 20, 2023

Offering: CAVA sold 16,611,110 shares of common stock at a price of $22 per share.

Use of Proceeds: The net proceeds of $340 million will be used to fund new restaurant development.

Underwriters: J.P. Morgan Securities and Jefferies were joint lead book-running managers of the offering.

INCOME STATEMENT
16 weeks ended April 16, 2023

Revenues	$196,761,000
Net Loss	($2,141,000)
Adjusted EBITDA	$16,746,000

BALANCE SHEET
As of April 16, 2023

Cash	$22,716,000
Preferred Stock	$662,308,000
Shareholders' Equity	($451,041,000)

Summary: Cava is a Mediterranean fast-casual restaurant brand which some have likened to the "next Chipotle." Its stores average $2.3 million with 20% store-level margins. Cava CEO Brett Schulman told CNBC shortly after the IPO that Cava was doing well in all regions of the country.

There are 265 CAVA restaurants in 22 states and Washington, D.C. Cava acquired the 261-unit Zoe's chain in 2018 for $300 million and has converted 145 of those locations.

In the first quarter ended April 16, 2023, Cava reported restaurant-level profit margin of 25.4% versus 17.5% a year ago. The company says it will open 34 to 44 net new restaurants during the remainder of 2023 and says it has 100 new sites in the pipeline where letters of intent were signed as of April 16, 2023.

Former Panera Bread CEO Ron Shaich is chair of the board of directors of Cava and owns 10.3% of the outstanding shares.

GEN Restaurant Group

GENK-NASDAQ

Initial public offering

Date: June 30, 2023

Offering: GEN sold 4,140,000 shares of its Class A common stock at a price of $12 per share. It closed the first day at $15.34 per share, up 27.8% for the day.

Use of Proceeds: The net proceeds of $46.2 million will be used to fund new restaurant development.

Underwriters: Roth Capital Partners was sole book-running manager. Craig-Hallum and The Benchmark Company acted as co-managers.

INCOME STATEMENT
Year ended December 31, 2022

Revenues	$140,561,000
Inc from Operations	$16,685,000

BALANCE SHEET
As of March 31, 2023

Cash	$9,775,000
Shareholders' Equity	($5,289,000)

Summary: GEN was founded in 2011 by two Korean immigrants—Jae Chang and David Kim — in Tustin, Calif. The company is a consolidation of 19 restaurants owned by Kim and 12 owned by Chang. There are now 34 restaurants. Kim was previously a franchisee of Denny's, Carl's, Golden Corral and Pick-Up Stix and led a group that bought Baja Fresh from Wendy's and La Salsa from CKE.

The GEN restaurants are located in California, Arizona, Nevada, Hawaii, Texas, New York and Florida, and serve Korean food where guests prepare their own meals on embedded grills on each table. The format allows the restaurants to operate without chefs and fewer kitchen personnel. Guests order unlimited quantities of food at a fixed price, ranging from $17.95 to $24.99 for lunch and $25.95 to $29.95 for dinner. AUV's are approximately $5.96 million per store and in the first quarter its restaurant-level margin decreased to 19.2% from 21.2% in 2022.

Pinstripes, Inc.

BYN-NYSE

Intends to merge with SPAC

Date Announced: June 22, 2023

Merger Transaction: Pinstripes intends to merge with Banyan Acquisition Corp, a special purpose acquisition company that raised $253 million in January 2022 with the sale of shares and warrants at $10. However in April 2023, Banyan shareholders exercised their right to redeem their shares at a price of $10.42 per share, and agreed to extend the time to complete a business combination from April 24, 2023 to December 24, 2023. That left $40 million in trust funds with which Banyan could use for a merger partner. The intended merger values Pinstripes at approximately $521 million, which represents approximately 17x the estimated 2024 EBITDA of $30 to $34 million. The transaction must close by December 23, 2023.

Private Placement: Chicago-based real estate investor, Middleton Partners, intends to invest $20 million in the company, while Banyan intends to raise an additional $15 million in a private placement funds which in total would give Pinstripes $75 million of growth capital.

Summary: Pinstripes is a large-format entertainment concept that combines the games of bowling and bocce ball with Italian food and a banquet and event center. The locations, mainly suburban, range from 25,000 to 38,000 square feet of interior space, with additional outdoor patios.

There are currently 13 locations open (six under construction) with AUV's of approximately $8 million. The company reports revenue and adjusted EBITDA of $104 million and $13 million respectively in fiscal 2023. Pinstripes founder and CEO Dale Schwartz said the Pinstripes concept has potential for 150 locations.

Franchisee/Franchisor Litigation—What Are We Going To Do About It?

By Dennis Monroe

As reflected in a recent Franchise Times article, there is no shortage of litigation between franchisors and franchisees. Our firm recently looked at the specific types of litigation that are the most common. These aren't necessarily reflective of overall disputes, but rather cases that have gone to court and are publicly recorded. Much of the litigation centers around the breakdown in the franchisee relationship, which often results in non-payment of royalties. Other disputes concerned capital investments, particularly when the franchisor mandates investments for remodels or technology. The other major area of litigation centers around development rights, as well as post-termination non-competes and continued use of intellectual property.

I believe the majority of the disputes could have been avoided if there had been open communication between the franchisor and franchisees, using a partnership approach rather than fostering the idea that the franchisor is there to protect its brand and see its royalties grow.

For his take, I talked to an expert in these dispute areas, Ron Gardner of Dady & Gardner, P.A., in Minneapolis. His expertise is franchisee advisory councils (FAC), from existing ones with disputes to ones just being formed. I also looked at FACs as a litmus test as to how a franchise works in terms of cooperation. Gardner said a good FAC has a safe environment for the franchisor and the franchisees to discuss tough issues and air out perceived differences. The expectation is that once FACs are in that space, they can come to a resolution and present a united approach to the franchisee community.

With that as background, let's look at disputes and how they could be handled. First, many evolve when a franchise system has a weak performance and the franchisor's solution is to come up with new products and revenue sources that, in many cases, require capital improvements and new technology, all necessitating additional funding out of the franchisees' own pocket or from their lenders and investors.

Before any capital investments are mandated, franchisees need to be convinced the capital investment is appropriate and there is a clear understanding of return on investment and revenue potential. If the changes involve an increase in labor costs, which is a big deal in the franchise community, they need to know this upfront. The franchisor should test capital investment in their company-owned stores, then select franchisees to test it, Gardner advised. Once it's determined there is a return on investment and available financing, then it can be rolled out.

Another type of dispute is when a franchisee is financially distressed and stops paying royalties. Franchisors tend to overreact to nonpayment and send a default notice, escalating into an adversarial situation. The driver of these disputes are when franchisees are disappointed in unit performance. Expectations exceed reality, which in turn, leads to conflict. A solution is for franchisors to provide a clear understanding of the unit economics, but also for franchisees to approach the franchisor early on with any financial problems. When I have represented a franchisee, I've heard numerous times from the franchisor that my client is a bad operator or has a bad manager. How much more productive would it be for them to recognize that there is financial distress and help find a solution rather than blame the franchisee?

Another point of contention is the initial franchise negotiation. Gardner suggests when franchisees initially negotiate their franchise documents, franchisors should provide more information and flexibility in the franchise documents, rather than insist they cannot change anything. He points out that every year when the franchisor does their annual filing, they are likely to make changes in the agreements and certainly the FDD. There needs to be a reasonable approach to reasonable changes in the initial franchise documents.

Development rights can be another major source of disputes. Too often development agreements provide for an overly aggressive development schedule and severe penalties for not meeting the schedule. Flexibility in timing is a must and solutions that keep the franchisee as part of the system at a reduced number of stores, if the development schedule cannot be met.

Finally, there are times that it is best to part ways in a civilized manner with an underperforming franchisee. The franchisee can hopefully resell their identified site with a reasonable and not overly restrictive post-termination non-compete, so some value can be recovered.

In summary, the key to a healthy relationship is to not think of it as a zero sum game, where there has to be a winner and a loser. The key is to create a franchise culture of partnership and mutually agreed to solutions for difficult situations.

Dennis Monroe is chair of Monroe Moxness Berg, a law firm which focuses on M&A, taxation and other business matters for multi-unit restaurant business. You can reach him at dmonroe@mmblawfirm.com, or at 952-885-5962.

Two Successful Restaurant IPOs Have Just Been Completed; Consistent with an Improving Overall IPO Market

CAVA Group, Inc. (NYSE: CAVA) and GEN Restaurant Group, Inc. (NASDAQ: GENK) priced extremely successful initial public offerings (IPOs) in June. Indeed, the stocks are up 80% and 33%, respectively, over their IPO prices.

Furthermore, several other restaurant groups seem poised to make their first public stock offerings to investors over the next few months. With that as a backdrop, here we explore the current status of IPOs in the U.S., as well as provide some historical context to the strength of the IPO market.

A common refrain in the financial media has been the IPO market only recently reopened after a prolonged slumber. This generalization is partly correct; indeed, no notable venture capital-backed technology stock has IPO'ed in the U.S. since software vendor HashiCorp, Inc. (NASDAQ: HCP) debuted on the NASDAQ in December 2021. The first 12 months of this drought were understandable given the collapse in risky stocks in 2022 (the NASDAQ plummeted 33% last year), but the lack of tech IPOs in the first half of 2023 is difficult to reconcile with the NASDAQ's 32% jump in 1H 2023, its biggest percentage increase in more than 40 years.

On the other hand, the level of IPO activity in the first half of 2023, as measured by the number of deals (79), was close to historic averages, though far below the extraordinary year in 2021. (Indeed, the year 2021 dwarfed any other in IPO history; more than 2,000 companies raised about US$600 billion globally via IPOs, according to SoFi.) The sizes of the 1H 2023 deals were fairly small; only ten companies raised $100 million or more in 1H 2023. In 2021, there were 517 IPO transactions of that size. Notably, the pace of IPO activity in 1H 2023 did pick up from the second half of 2022. According to stockanalysis.com, only 56 IPO's were priced in 2H 2022.

Counterintuitively, the spring 2023 failures of the large regional banks Signature Bank, and especially Silicon Valley Bank, may have contributed to the improvement in IPO conditions in 2023. The regional banking failures led to tighter credit conditions. This, coupled with a private equity industry reticent to invest after a very difficult 2022, may have forced some companies to tap the IPO market, perhaps at an earlier stage than conventional wisdom suggests (see just below) to bring in necessary funds to grow their businesses.

Indeed, companies generally file to sell shares to the public for the first time when markets are stable and the economy robust. This latter characteristic was certainly not in place in the spring of 2023.

Achieving $100 million in annual revenue has been the traditional benchmark a company must attain before it contemplates an IPO. However, investment bankers seem to have shifted that milepost in recent years. Current potential investors seem to prioritize identifiable growth potential over a company's size. Glenn Solomon of the venture capital firm GGV Capital frames the trade-off succinctly: "The time to go public could be at $50 million or $250 million. No matter how big you are today, the question is: Do you see a clear path to being three or four times the size you are today in two to three years?"

A company which cannot answer this question in the affirmative will have difficulty completing an IPO, regardless of its size. Another potential "go or no go" factor is whether a company is inordinately dependent on a single customer or a single supplier. The downside if such a relationship were to sour can be a disqualifying factor for investors.

Why some IPOs are successes—spectacular successes in some instances—whereas other IPOs fail, seems to be related to how well a company's results align with the expectations it sets when it markets its initial offering. This uncertainty, as well as many others, such as a company's potentially short track record prior to the IPO and generally less experienced management teams, make investing in IPOs a daunting challenge. Indeed, a SoFi study shows the majority of IPOs produce negative returns over the long-term and that two-thirds of IPOs underperform the stock market within three years of their IPO date.

Three factors, sometimes working in conjunction, seem to represent the most common reasons for IPO failures: 1) the offering was priced too high to garner sufficient investor interest; 2) the IPO took place at the wrong time (perhaps when the market was less than sturdy or when the economy was shaky); and 3) a problem with the company's fundamentals became apparent at a later date.

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

OUTLOOK

Continued from page one

The fast casual formula—find a strip center, build a Subway-style assembly line and introduce a few healthy menu items has been the magic ticket for raising equity capital. "Hey, Mr. Investor we're the next Chipotle."

When I looked at the number of "next Chipotle" references over the years, I was amazed at how many concepts had been mentioned:

In 2011, Lisa Jennings, then at Nation's Restaurant News, identified Piada Italian Street Food, Cava Mezze Grill (the original version of Cava) and Hello Pasta as candidates. She was early on Cava, but I can't say I've heard of Hello Pasta.

Also in 2011, a food newsletter picked Lyfe Kitchen (now defunct), Veggie Grill, Piada again, and Modmarket, as the next Chipotle.

CNBC ran a segment in 2014 where it picked new concepts that could be the next Chipotle. They mentioned Burger Lounge, Cine Bistro, Tender Greens, Bruxie, Nick's Restaurants, Pieology, Pizza Rev, Mendocino Farms, Hopdoddy and Project Pie. A few nice concepts, but no Chipotles.

Sweetgreen, which opened around the time Chipotle went public in 2006 was dubbed the next Chipotle by CNN in 2015. Sweetgreen, unfortunately can't make money so they're out.

The quick pizza segment was all the rage a few years ago, what with Blaze Pizza, Mod Pizza, Pie Five and Pizza Rev—all mentioned at one time or another as the next Chipotle. The pandemic set them back.

In 2016, Business Insider identified the Mexican fast casual restaurants that could become the next Chipotle. Moe's Southwest Grill, Tijuana Flats, Freebirds, Baja Fresh, Pancheros, Taco Cabana, Del Taco, Qdoba, Taco Bueno, Dos Toros and El Pollo Loco all have had varying degrees of success, but will never live up to being the "next Chipotle." Business Insider forgot to mention Rubio's, which they had already named a "next Chipotle" back in 2007.

In 2016, the Motley Fool highlighted Zoe's as a potential "next Chipotle." Then, 261 Zoe's were sold to Cava in 2018 and roughly 155 of them were, or will be converted. The rest were closed.

Even Chipotle tried to create its own "next Chipotle" when founder Steve Ells became enamored with a Asian fast casual concept called ShopHouse. The first Shophouse opened in D.C. in 2011 and roughly 20 were built before they were all shuttered in 2017.

Is Cava the next Chipotle?

The fast-casual brand has awfully big shoes to fill. It had 263 stores when it went public last month compared to Chipotle's 489 stores when it went public.

Cava's initial public offering at $22 per share was quite the hit amongst investors. It closed that day at $42, which valued the company at roughly $4.8 billion. That compares to Chipotle, whose shares were offered by McDonald's in January 2006 at the same $22 per share and closed at the same $42. However, Chipotle's market cap was a paltry $1.4 billion, as it had less than a third of the shares outstanding as Cava. Could it be inflation, massive amounts of Fed money printing, or do investors really think Cava is the next Chipotle?

Cava's prospectus reads a lot like Chipotle's prospectus 17 years ago, except for the fact that one serves Mediterranean cuisine and the other serves Mexican. Both emphasized their food quality, consumer trends breaking their way, their sustainable sourcing and the customer opportunity to customize their meals.

Cava has impressive numbers. Its average unit volume in 2022 was $2.4 million, versus Chipotle's $1.6 million in 2006, although keep in mind, Cava has more sales channels than Chipotle had. Chipotle's AUV is now pushing $3 million. Cava's restaurant profit margin is roughly the same as Chipotle's in 2006, at 20%, and its recent first quarter store margin hit 25.4%. Chipotle's recent store margin was 25.6%.

Good luck to Cava. Things are on the right track, so I hereby officially name them as the "next Chipotle." No more nominations are necessary.......ever again. Those who agree, please send a nickel to me.

—John Hamburger

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