The Art of the (Tax) Deal

There are many reasons to feel optimistic about 2018 if you are a restaurant owner or investor. President’s Trump’s tax reform package and battle against Washington’s regulatory apparatchiks provide a bag of New Year’s goodies that should take the edge off of 2017, a year many would agree was particularly foul-smelling in restaurant land.

The much-maligned tax reform package reduces business income taxes and marginally increases the amount of personal disposable income available to average restaurant goers, especially in those states with lower tax rates. Hopefully, the additional pocket change will nudge the negative traffic of 2017 into positive territory for 2018.

The C-corp rate, reduced from 35% to 21%, was long overdue and is a windfall for American-based businesses. Subchapter S corporations, which pass their earnings on to shareholders and make up the bulk of independent restaurant businesses, including franchisees, also receive a break—a deduction equal to 20% of their business income. And, the Work Opportunity Tax Credit and FICA Tip Credit were thankfully retained.

The new tax law provides incentives to make capital expenditures to build new restaurants and remodel old ones. First-year bonus depreciation—100% expensing of furniture, fixtures and equipment is in place until 2022, while the Section 179 deduction was doubled to $1 million and now includes such real estate-related expenditures as roofs and HVAC equipment.

BDO’s tax expert Adam Berebitsky told me growing restaurant chains shouldn’t pay much tax. And, speaking at the recent ICR Conference in Orlando, Dunkin’ Brand’s CEO Nigel Travis said, “tax reform and store development will be a powerful combination in the next few years.”

On the regulatory side, the National Labor Relations Board finally stuck a dagger in the misguided joint employer rule that threatened to upend franchisor/franchisee relationships. While the likelihood of a mass unionization of restaurant businesses was unlikely, the ruling eliminates unnecessary legal expense to rewrite franchise contracts and dance around the relationship. Another pending Trump administration

continued on the back page
FINANCE SOURCES

Mega YUM! Franchisee Builds Business with Acquisition/Financing Transaction

Dallas, Texas-based franchisee Ampex Brands, and its collective companies, has obtained a total of $60.5 million of financing including $51.5 million of business value secured term loans, $4 million of real estate secured term loans and a $5 million development line of credit. The loans were used to refinance the company’s existing debt, finance the acquisition of 76 Pizza Hut stores, including four fee properties, and provide capital for remodels and development of new restaurants. The transaction was financed by a three-bank syndicate, led by Cadence Bank with participations from Regions Bank and First Fidelity Bank. Investment banking firm Auspex Capital provided debt-placement advisory for the transaction.

Owned and operated by long-time franchisee Tabbassum Mumtaz, Ampex Brands now owns and operates 111 Pizza Hut restaurants, including the real estate underlying six of those restaurants, which are located in Texas, West Virginia, Kentucky, Ohio and Virginia. Ampex owns an additional 358 restaurants under the brands KFC, Tim Hortons, Long John Silvers and Taco Bell.

Mumtaz has been on a bit of an acquisition tear in the last few months, as this was his third package of YUM locations acquired since October. “What I see for my business is growth,” he said. “And I don’t see it stopping, based on the team I have.” Team members often joke: “Let’s retire together.” Translation, they are having fun and want to keep growing, too. There’s no reason he and the team can’t take the company past 1,000 restaurants, he says. And, he’s looking at investments in smaller franchisor companies, as well.

Part of that growth for him means incentivizing people by giving them ownership in locations, whether they are employees in the stores themselves, or in Ampex’s corporate headquarters. Employees can invest more in the locations, or exit at a certain time. They can even buy out Ampex altogether.

“I imagine a restaurant manager’s dream is to own their own restaurant,” said Mumtaz. “If I can help them with that dream, why not?” It’s his mission to reward them and show them a future, he says.

Mumtaz’s loyalty to his team of people is just one of many reasons the business is high on Cadence’s list. Cadence’s relationship with Ampex spans a couple of years, says Dan Holland, executive vice president and head of the restaurant group at the bank. “Tabbassum is very detailed oriented and looks at a number of transactions each year,” he said. “And he’s also willing to walk away from a deal if it doesn’t make sense for his business or his team.”

Cadence likes to take an advisory role with their clients, as well, where “we can have open dialogue. We’ve looked at several deals with Tabbassum and he’s willing to listen to all viewpoints,” said Holland. “When it comes to how he looks at the business and how we look at the business, we find a common ground on a deal that works for both of us.”

Shriram Chokshi, managing director with Auspex, said the Pizza Huts sites acquired in the deal were top in the nation for AUVs and “ops metrics.”

“Tabbassum won the bid largely due to his credibility to deliver and close on a timely basis,” said Chokshi. “This was a strategic acquisition in a strategic market and in an iconic brand...it puts him on the forefront of being a preferred buyer of restaurants for Pizza Hut and several other major QSR brands. I expect to see more acquisitions and further growth for Ampex in the near future.”

Both Cadence and Auspex help to set up Mumtaz’s business for growth. “Cadence has told me they will be there for me, and they have never backed off that commitment,” he said. “They are the type of people I like to do business with.” Auspex’s ability to bring things to light “I don’t even think of sometimes” like certain covenant details, has helped save him money—more than their fee, he said.

For more information on Auspex Capital, contact Chris Kelleher, managing director, at (562) 424-2455, ckelleher@auspexcapital.com. For more information on Cadence Bank, contact Dan Holland at (770) 274-6877 or at daniel.holland@cadencebank.com.

TD Bank Funds $26.5 Million for Wendy’s Franchisee

TD Bank’s Restaurant Franchise Finance Group provided $26.5 million in financing for Gold Coast Holdings Restaurants to support the acquisition of 15 Wendy’s locations in Florida. Eric Pashley, senior relationship manager in TD’s franchise finance group, closed the transaction.

The funds were used to acquire 15 Wendy’s franchise units in Volusia, Lake, Marion, Putnam and St. John’s counties, and to purchase the real estate grounds of 12 of those units. A line of credit will be used to renovate and reimage the acquired stores as well as support future purchases. Gold Coast owns and operates a total of 91 Wendy’s and TGI Fridays locations on the East Coast.

“This group is a top-notch franchisee with tremendous experience in the space,” said Mark Wasilefsky, who heads up the restaurant franchise group for TD Bank. It was also an important transaction for the bank, as they are trying to increase their exposure in the Wendy’s brand, as well as expanding their presence in the Florida market, he reported.

Wasilefsky says the restaurant M&A market continues to be hot, due to two things, as he sees them: the tremendous amount of capital continuing to come into the market, as well as franchisors’ desire for franchisee consolidation to continue. And while the underwriting metrics aren’t crazy yet, says Wasilefsky, “the deals are being stretched as far as they can safely go.”
TD Bank’s Restaurant Franchise Finance Group provides financing to owners of major franchisees and large independent concepts throughout the bank’s Maine-to-Florida footprint. For more information, contact Mark Wasilefsky at (860) 652-6550, or at mark.wasilefsky@td.com.

Trinity Closes International/Domestic Transactions

Investment banking firm Trinity Capital LLC served as the exclusive financial advisor for the following deals:

**Sell-Side Advisory: Homestyle Dining LLC.** Homestyle is parent company to its international, legacy, family-style, full-service and buffet chains, Ponderosa Steakhouse and Bonanza Steakhouse, operating under franchise and sub-franchise agreements in 19 states in the United States, Canada, Puerto Rico, the United Arab Emirates, Egypt, Qatar, and Taiwan.

**Sell-side Advisory: First Picks Holdings LLC.** A Panera franchisee in California, divested its assets in a sale to PBS Foods, LLC.

In both sell-side assignments, an auction produced interest from institutional investors and franchisees and provided a premium valuation to the seller.

**Buy-Side and Debt Placement Advisory: G.F. Enterprise LLC.** A Taco Bell franchisee with 30 restaurants in three states, acquired 19 restaurants in the Nashville market from Taco Bell corporate. Trinity also served as the executive financial advisor in securing the debt financing for the acquisition, negotiating and securing a $51 million senior term loan and a $14.5 million development line of credit with BMO Harris Bank. For more information on Trinity Capital, contact Kevin Burke, managing director, at (310) 231-3100, or by email at kburke@tcib.com.

NFS Brokers Restaurant Divestitures

National Franchise Sales (NFS), a franchise business brokerage, recently announced the following transactions where they provided sell-side advisory:

- **2 for 5, LLC** sold 12 Five Guys units in South Carolina, which included their development commitment and refresher requirements, to Quintet Acquisitions, LLC.
- **Denny’s franchisee Social Den, LLC** sold their restaurant in Southern California to franchisee JD Hawthorne, Inc.
- **Mich-Can Inc.** sold six KFC restaurants in Michigan and the accompanying real estate as they exited the brand. NFS partnered with SRS Real Estate and completed the sale of the package to KBP Foods, Inc., the largest KFC franchisee in the system with over 500 units.
- **In an exit of the brand, Karsan Enterprises** sold multiple Togo’s restaurants in central California to Neel Foods Enterprises, Inc.
- **Multiple Subway franchise units in New Hampshire markets with small town geography were sold by the entities RAE Sandwich Shop, Inc. & RGW, Inc. to Greenbelly.**
- **Wingstop franchisee Russell of Wings, LP** sold one location in Texas. The buyer, Khana Khazana, LLC is a first-time franchisee of the brand. For more information, contact Michael Ingram, senior VP at NFS, at 949-428-0482, or at mi@nationalfranchisesales.com.

Peak Franchise Capital Closes Deals At Year End

Boutique advisory firm Peak Franchise Capital advised Church’s Chicken on the sale of 70 company-owned restaurants in Texas and New Mexico to a new franchise operator, Ampler Chicken LLC, led by restaurant industry veterans Steve Wiborg, former Burger King Corp. chairman, and Mike Collins, a former Burger King franchisee of the year. Ampler Chicken will be the third-largest multi-unit Church’s franchisee in the country, and the fourth-largest in the world.

Peak also recently advised Sonic franchisee, Wilkinson Management, in the sale of certain of Wilkinson Real Estate, LLC-owned Sonic Drive-In properties to Realty Income Corporation in a sale-leaseback transaction. For more information on Peak Franchise Capital, contact Mike Elliott at 972-719-5690 or at mike.elliott@peakfranchisecapital.com or Alex Blanton at 972-719-5692 or alex.blanton@peakfranchisecapital.com.

Ascentium Exceeds $1 Billion in Funded Volume

Ascentium Capital announced it surpassed $1 billion in annual funded volume for the first time in its history. Ascentium is a direct lender that specializes in providing a broad range of financing, leasing and small business loans to businesses nationwide, including multi-unit restaurants.

The company manages $1.9 billion in assets and funded $3.7 billion since 2011. Ascentium Capital has over 300 employees, including a national salesforce of 125 finance professionals. The company will expand the size of the sales team in 2018. For more information on Ascentium Capital, contact Len Baccaro, senior vice president, at (281) 902-1931, or by email at lenbaccaro@ascentiumcapital.com.

Upland Arranges Sale of Top Minnesota Restaurant

Upland Real Estate Group arranged the sale of 700 Hennepin Avenue located in the heart of the vibrant downtown Minneapolis sports and entertainment district. The 30,977 square-foot building sold for $7.5 million to an individual New Jersey investor. One tenant is top local restaurant Seven Steakhouse Sushi & Rooftop. Both tenants occupying the site have over nine years remaining on their lease term and annual rent increases.

Keith Sturm, Deb Vannelli, and Amanda Leathers of Upland exclusively represented the seller. For more information, contact Deb Vannelli at (612) 376-4475, or by email at deb@upland.com.
Selling Your Royalty Stream as an Alternative to Issuing Debt or Selling Equity

In last month’s Monitor we highlighted the move by large franchise companies to issue securitized debt backed by rights to receive future royalties. We reported that large franchisors like securitization financing because their funding is at lower rates, better covenants and less principal amortization than they would obtain in a traditional term loan.

Diversified Royalty Corp. has a different solution for using royalties as a financing tool, especially for smaller franchisors that would never qualify to issue securitized debt. Instead of issuing debt and using the right to receive future royalties as collateral, the Canadian public company is looking to buy royalties outright from U.S. franchisors. It has completed three royalty transactions in Canada, where it’s purchased royalties from multi-location and franchise businesses in order to pay dividends to its shareholders.

Why would a franchisor sell their royalty stream? Sean Morrison, president and CEO of Diversified Royalty Corp, says the answer is simple: “A company doesn’t need to sell equity or issue debt to get liquidity. A franchisor could sell some, or all of its current royalty stream to us at a high multiple for cash.”

Here’s an example of how Diversified Royalty’s program works: A franchisor has a company with 150 locations, $150 million in system sales, and $10 million in EBITDA. Doing the math, 90% of the EBITDA, or $9 million, converts to a 6% of sales royalty rate. At a multiple of 10x, Diversified would pay the franchisor $90 million in cash for the right to receive future royalties on the stores that were sold. The franchisor would be obligated to remit 6% of its sales each month to Diversified. After the initial royalty sale transaction, the franchisor would continue to open stores in the brand and would have the right, but not obligation, to sell the royalty rights on those new stores to Diversified at a premium multiple.

Morrison says a business “can monetize virtually all of their current EBITDA at a premium multiple.”

“Franchisors are a good business for this,” he said. “They have a proven business model with multiple locations. This is an opportunity for those franchisors with 150 units or more who are growing, and want to take some money off the table. It is a type of financing that has been used in Canada for 20 years, and Morrison and his team would like to bring the process to franchisors in the U.S.”

DIV is working on deploying $87 million of cash on hand to fund new royalty purchases. They are targeting franchisors that “have businesses where the franchisee is getting a good return on equity and assets, is profitable and wants to grow.”

For more information, contact Sean Morrison at (604) 235-3146, or at sean@diversifiedroyaltycorp.com.

Auspex Capital Closes Pizza Hut Deals

Investment banking firm Auspex Capital has been active within the Pizza Hut system as of late, closing the following transactions:

Sell-Side M&A Advisory: Norman, Ok.-based franchisee Floyd Bergen has sold 25 restaurants in two transactions. His company Bergen SE, sold 18 Pizza Hut restaurants in North Carolina and South Carolina, including the underlying real estate at nine locations, to SDS Restaurant Group, LLC, a Greenville, NC-based Pizza Hut franchisee. His company Bergen AZ sold seven restaurants in Arizona to Hot Pizzas, LLC, a Kingman, Ariz.-based Pizza Hut franchisee, owned and operated by Mark Peterson and Krystal Burge.

Bergen’s other company, RGV Pizza Hut, LLC, which he owns with Jerry Greenfield and Chris Wicker, sold 45 restaurants located in southern Texas, including the underlying real estate at one restaurant, to MUY Pizza-Tejas, LLC. MUY is a San Antonio, Texas-based Pizza Hut franchisee owned and operated by James Bodenstedt and members of his senior management team. For more information call Chris Kelleher, Auspex managing director, at (562) 424-2455 or at ckelleher@auspexcapital.com.

Unbridled Capital Closes 17 Pizza Huts in Alabama

Unbridled Capital, a franchise advisory firm focused primarily on the restaurant industry, closed the following transaction in December:

Cecil Eiserer and SEC Restaurants sold their 17 Pizza Hut restaurants, including the underlying real estate, to existing Pizza Hut franchisee Legacy Pizza. These restaurants are located throughout Alabama. Unbridled provided sell-side M&A advisory to SEC Restaurants.

“The buyer in this transaction represents a progressive trend in the business, which is an influx of 30- to 40-year-old operators who are backed by investors and family offices. And we’re seeing this within the legacy brands,” said Rick Ormsby, managing director of Unbridled Capital.

“Private equity is more an option for companies with $8 million to $10 million in EBITDA or more. For companies with $2 million to $5 million in EBITDA, private equity just isn’t interested, but it is a good play for a smaller family office. And, they don’t have the timeline that PE usually does, which is an exit anywhere from five to seven years.”

Unbridled Capital decided to focus on family offices as a source of M&A and equity financing for their multi-unit restaurant clients—those deals that represent 20 to 70 units. “While we will do larger deals and have established relationships with private equity, that segment is underserved,” said Ormsby.

For more information on Unbridled Capital, Rick Ormsby, at 502-252-6422, or Rick@unbridledcapital.com.
THE MONITOR STOCK INDEX

Keeping Tabs on the Industry with the Restaurant Finance Monitor Stock Index

The true health of the restaurant industry is a constant debate. While there is data, it's hard to know exactly what makes up that data. Anyone looking just at legacy casual dining is going to think the industry is falling to pieces. Anyone just looking at asset-light QSR stocks may be wearing rose-colored glasses.

To get a true sense of industry performance, we’re launching the Restaurant Finance Monitor Stock INDXX (RFMSI).

This stock market tool will help answer questions about the industry and bridge gaps of understanding between “main street, Wall Street and the restaurateur,” said Dan Weiskopf, the founder of Access ETF Solutions LLC. Access developed the index and is behind the research.

Weiskopf said there are a few things that make the index different from other measures of the industry and other indices in the industry. One key is how the index is weighted.

“Most indexes are defined with traditional recipes. They are market cap weighted or perhaps even equally weighted. The problem with those two strategies in the restaurant industry is that they are not research driven,” said Weiskopf.

“A market cap weighting in the restaurant industry skews way too much to the large brands like McDonald’s and as such the top six to 10 companies drive the performance. The problem is that six companies don’t make a trend and certainly shouldn’t define an industry.”

Instead, the RFMSI recipe weights each public company to look more like the actual industry. The QSR and fast-casual category makes up 70% of the index, while full service makes up the balance. There’s also a minimum market cap that narrows the scope down to about 40 public companies. Then research determines who is really performing with it’s public peers.

“The index is rebalanced quarterly at which time it sidelines about six companies that are showing relative underperformance versus the index,” said Weiskopf. “Specifically, the top five companies are about 5% each, thereafter the next 20 are within a range of 3-4% and the last of the group are between 2-3%. In total the index holds today 29 names, but historically has held a range of 23-34 names.”

So who should care about the Restaurant Finance Monitor Stock INDXX? Just about any restaurant watcher out there.

“Private equity, activist and institutional investors should pay attention to the index because it offers a transparent independent 10-year backtested benchmark to measure the industry stock performance,” said Weiskopf.

“Similarly, restaurant owners will find value in monitoring the index because the methodology is transparent and should help highlight from a competitive front what public companies appear to have momentum and those who are falling on harder times.”

Monitoring the index, he said, allows any industry watcher to see the macroeconomic story in full. Everything from demographic and consumer trends as well as commodity costs and regulation will reflect how the index performs, and thus how the industry is really doing.

Weiskopf said the index offers some clear insights for 2017 and should be useful in identifying how technology might be driving the success of the industry.

“We do not believe the recent past performance of the index is an indication of a restaurant recession or an overall recession. The index was up about 7.03% in 2017, underperforming the 21.5% returns for both the Small Cap Growth index and the S&P500 index. Arguably this disappointing performance was more about the disruption occurring in the industry than any lack of expansion,” said Weiskopf.

Since the index was first formed in December of 2006, it has shown a return of 13.19% compared with the S&P500 index return of 8.21% and the Russell 200 Growth index of 8.99%. For further details and disclosures we encourage readers to review the Monitor index at www.restfinance.com. Dan Weiskopf can be reached at 212-628-4882.
Former Einstein Bagel CFO Rick Dutkiewicz has a full plate. In addition to his role as CFO of Igloo Products Corp. (yes, the cooler company), Dutkiewicz is an independent director at Oaktree Specialty Lending, a unit of Oaktree Capital and lender of first- and second-lien, unsecured and mezzanine loans. Dutkiewicz also is acting CFO for Tocabe, a three-unit restaurant chain.

NRD Capital’s acquisition of Ruby Tuesday closed last month, and the Atlanta-based PE fund obtained a $115 million term loan from Goldman Sachs Specialty Lending. The loan bears interest at the rate of LIBOR plus 8%. A $242 million sale-leaseback with four net-lease funds made up the balance of NRD’s financing package. John Goldasich of Arlington Capital served as investment banker to NRD.

VGM Group’s Jeff Knipe, playing with former Notre Dame football coach Lou Holtz last month at Lake Nona Golf Club in Orlando, shot a four-under par 68, with seven birdies.

The asset-light model isn’t always peaches and cream. Franchise expert Joe Matthews recently analyzed the franchise leads that resulted in 6,000 closed franchise sales transactions and found that of every 100 people inquiring about a franchise, only one moves forward to buy. Also, according to Franchise Grade, only one out of five start-up franchise systems, or 20%, reached 100+ locations and that was after their eighth year of franchising.

Brother and sister Tiffany Oder and Chad Burge are following in the foodservice footsteps of their mother and uncle, Taco Bell and Pizza Hut franchisees, Krystal Burge and Mark Peterson. The pair recently opened their second Dickey’s Barbecue Pit restaurant in suburban Phoenix.

Luby’s insiders, primarily brothers Chris and Harris Pappas, bought 681,000 shares of the restaurant and contract feeder in 2017.

Is it a sign of market exhuberance when investors take a second look at B-quality assets? Online real estate publication National Real Estate Investor says some newly formed family offices are embracing Class-B office properties, while in the retail space, net lease buyers are looking closer at franchise properties as they “tend to have leases that feature 10% rent escalations every five years or 2% rent escalations annually.”

Dave & Buster’s CFO Brian Jenkins exercised an option on January 4 and sold the 9,400 shares at $57.32 per share the same day, just four days before the company surprised investors with downbeat fourth quarter profit and sales outlook after announcing that same store sales were down 5.1% in the current quarter. Shares closed at $43.79 the day of the announcement, down 22.3%. Jenkins’ sale was part of a Rule 10b5-1 trading plan, which sets in advance agreed-upon selling dates for company insiders. Still, the optics are poor. The company spent $110 million during the first three quarters of 2017 buying back 1,778,484 shares equal to an average price of $61.84.

More activist fights: Marathon Partners Equity Management, owner of 6.3% of J. Alexander’s (JAX-NYSE), is opposing the company’s proposed acquisition of 99 Restaurants from Fidelity National Financial for approximately 16.3 million Class B shares. The acquisition would create a new controlling shareholder in Fidelity, which would then own roughly 53% of J. Alexander’s. Marathon believes the company is essentially giving up control to Fidelity and wants the Board to consider strategic alternatives, including a sale of the company, which they believe would result in a higher valuation.

We regret the error in last month’s Monitor where we wrote that GPS Hospitality CFO Scott Jasinski’s son Pat Jasinski is the starting middle linebacker for the undefeated University of South Florida football team. Ooops! We meant the University of Central Florida. UCF edged USF 49-42 during the regular season.

It was odd that Domino’s Pizza CFO Jeff Lawrence made absolutely no mention of the fact that its celebrated CEO Patrick Doyle was leaving the company, despite speaking to an ICR Conference audience less than an hour before the Doyle announcement was released over the wire. That set off a flurry of speculation at the conference as to why Doyle was leaving and why it wasn’t announced earlier. Was Doyle going to Chipotle? Was he replacing Papa John? Or, did he just make so much coin he decided to get out of the rat race?

Fat Brands CEO Andrew Weiderhorn told a breakout session at the recent ICR Conference that he’s projecting $17 million of EBITDA, free cash flow of $11 million, and a dividend payout of approximately $4.8 million in 2018. The company, which includes the franchise operations of Fatburger, Buffalo Cafe, Ponderosa, Bonanza and soon-to-be-acquired Hurricane Grill and Wings went public on October 19, 2017 issuing 2 million shares of common stock at $12.00 per share.

That was legendary short-seller Jim Chanos sitting through the Wingstop investment presentation at the recent ICR Conference in Orlando. At $44 per share, the company’s trailing 12-month price earnings ratio is a healthy 62x. Chanos told CNBC in December he is short a number of fast food operators, and specifically mentioned that some franchisors embracing the asset-light model have poor unit-level economics. Nevertheless, Wingstop reported 135 net, new openings in 2017 and its 14th straight year of same store sales growth and will begin advertising nationally this year, according to CEO Charlie Morrison. The brand will push digital expansion, delivery and international development. Morrison said they would also start rolling out delivery late in 2018 after updating their french fry technique to retain a crisp texture during travel.

Former Jack in the Box franchisee Abe Alizadeh pleaded guilty to wire fraud, bank fraud and making false statements to a federally insured financial institution, according to the U.S. Attorney’s Office for the Eastern District of California. The criminal case stems from over-inflating the value of
actual purchase agreements in order to obtain more funding than the banks would be willing to fund given the appraisal values. The indictment alleged Alizadeh's actions resulted in a loss to various financial institutions of over $22 million. He will be sentenced on March 30.

Be happy if you don’t operate restaurants in Ontario. On January 1, Ontario raised its minimum wage from $11.60 to $14 per hour. That will especially impact Tim Horton’s franchisees, of which there are 1,847 stores located in Ontario. The Great White North Franchisee Association, which represents the franchisees, says the increased minimum wage will cost the average Tim franchisee $243,889 (CAN). Some franchisees announced labor changes, such as eliminating paid breaks and a reduction in health care benefits, which then sparked consumer protests against the brand across the province.

California-based Black Bear Diner opened a company store in Oklahoma City and is looking to build restaurants in Oklahoma, Arkansas, Kansas and Texas. The company is looking to franchise in the no tip-credit states of Oregon, Washington, and California. A recent 19-unit franchise deal was just inked with existing franchisees Karan Gogri and Sanjiv Patel for San Diego and Marin County, Calif.

Mobile-ordering pioneer Olo now has over 200 customers and 40,000 restaurant locations. And, to keep up with all the growth, CEO Noah Glass told ICR Conference attendees that he has over 60 engineers working to scale the operation.

Bravo Brio Restaurant Group CEO Brian McNally confessed third-quarter numbers “were tough” on the Italian polished casual chain. Declining traffic (down 7.7% at Brio alone) and comp sales (overall negative 5.7%) took their toll. BBRG shares have tumbled nearly 40% year to date. Yet management, he promised during a presentation at the ICR Conference, was up to the task of resurrecting both. To reignite traffic, the chain is pushing third-party delivery (about 6% of sales) and enhancing its banquet and bar businesses. As for lifting sales, McNally announced the restaurants now market to an older crowd instead of millennials. “That 55-to-60-year old wants to eat little bit healthier and local,” said McNally, who closed five restaurants in 2017, “and to see the atmosphere matches the menu.”

We found it curious given news regarding the buzz around immigration reform that the topic didn’t come up during Fogo de Chao’s “fireside chat” at this year’s ICR Conference. In fact, officials boasted the Brazilian employees throughout churrascaria’s 29 domestic units are a distinct point of differentiation. What gives? It turns out many of Fogo’s longtime workers have been naturalized while others enter the country on J-1 (Temporary Exchange Visitor) and L-1 (Intra-Company/Transfer Work) visas. Neither one has come under the same threat of extinction by the White House as the better known H-1B (Speciality Work) visa. CEO Larry Johnson indicated to us that he wasn’t worried about supply because so many U.S. businesses (like his) depend on people obtaining these visas to operate their companies.

Following on the heels of Famous Dave’s November private placement where it sold 418,169 shares of common stock to the hedge fund PW Partners for $3.50 per share, the 144-unit barbecue chain has offered subscription rights to its existing shareholders to purchase up to 1,581,831 shares of common stock at $3.50 per share. PW Partners agreed to buy shares that aren’t purchased by shareholders. Speaking of Famous Dave’s, since 2013, when hedge funds led by PW Partners became involved in the business, the number of restaurants and systemwide sales have declined steeply. In 2013, Store locations peaked at 194 units and annual systemwide sales reached $500 million. Sales have declined almost 20% since then. Jeffrey Crivello, former CFO of PW Partners, was named Dave’s CEO in November. No wonder the results are poor—Crivello is the fifth Dave’s CEO since 2013. CapitalSpring picked up the 12-unit chain, Buddy’s Pizza, out of its fifth fund, which received $725 million in capital commitments late last year. Buddy’s is known for creating “Detroit-style” square pizza with a thick and crispy crust. CapitalSpring which took a majority stake in the brand, will provide foundational updates, including both technology and operational best practices.

MOD Pizza raised $33 million in equity and added a $40 million credit facility in a round led by PWP Growth Equity and Fidelity Management.

Pam Sherman is starring in a one-woman play about the late humorist and newspaper columnist, Erma Bombeck. The play—At Wit’s End—is at the Geva Theater in Rochester, New York through February 18. Sherman writes a nationally syndicated column, The Suburban Outlaw, which can be read in Gannett publications, and is the wife of TAGeX Brands CEO Neal Sherman.
### 2017 MARKET REVIEW

**RESTAURANT STOCKS THAT ACHIEVED SUPER RETURNS IN 2017**

<table>
<thead>
<tr>
<th>Company/Stock Symbol</th>
<th>12/31/17 Price</th>
<th>2017 Change</th>
<th>Market Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Meritage Hospitality</td>
<td>$20.00</td>
<td>+79.4%</td>
<td>The 300+ unit Wendy’s franchisee has compounded net income at 25% over the past five years.</td>
</tr>
<tr>
<td>McDonald’s (MCD)</td>
<td>$172.12</td>
<td>+41.4%</td>
<td>MCD’s value play in 2018 ($1, $2 and $3 meals) will put the hurt on competitors, especially Subway.</td>
</tr>
<tr>
<td>Famous Dave’s (DAVE)</td>
<td>$6.55</td>
<td>+32.3%</td>
<td>Sales and units are declining, but the hedge funds and speculators think they can squeeze blood out of a turnip.</td>
</tr>
<tr>
<td>Darden Restaurants (DRI)</td>
<td>$96.02</td>
<td>+32.0%</td>
<td>A 12x EBITDA multiple for new DRI shareholders is akin to OG customers swallowing their buttered breadsticks whole.</td>
</tr>
<tr>
<td>Wingstop (WING)</td>
<td>$38.98</td>
<td>+31.7%</td>
<td>Goldman Sachs analyst Karen Holthouse calls Wingstop “one of the strongest growth stories in restaurants.”</td>
</tr>
<tr>
<td>Restaurant Brands Intl (QSR)</td>
<td>$61.48</td>
<td>+29.0%</td>
<td>Stephens analyst Will Slabaugh calls this QSR his number one pick and cites the “impactful promotions” driving BK sales.</td>
</tr>
<tr>
<td>YUM Brands (YUM)</td>
<td>$81.61</td>
<td>+28.9%</td>
<td>YUM says thank God for Taco Bell and KFC China, as Pizza Hut must now navigate the pizza discounting wars.</td>
</tr>
<tr>
<td>Noodles &amp; Company (NDLS)</td>
<td>$5.25</td>
<td>+28.0%</td>
<td>For a company that calls itself a “World Kitchen,” the No. 1 selling item after 22 years remains Wisconsin Mac and Cheese.</td>
</tr>
<tr>
<td>Papa Murphy’s (FRSH)</td>
<td>$5.38</td>
<td>+27.5%</td>
<td>Weldon Spangler spent his early days as CEO on a franchisee listening tour. What he heard was “they’re a little ticked off.”</td>
</tr>
<tr>
<td>Dunkin’ Donuts (DNKN)</td>
<td>$64.47</td>
<td>+22.9%</td>
<td>The asset-light evangelists are all pumped up because of the lower tax rate.</td>
</tr>
</tbody>
</table>

**RESTAURANT STOCKS THAT WERE TO BE AVOIDED IN 2017**

<table>
<thead>
<tr>
<th>Company/Stock Symbol</th>
<th>12/31/17 Price</th>
<th>2017 Change</th>
<th>Market Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kona Grill (KONA)</td>
<td>$1.75</td>
<td>-86.1%</td>
<td>Sushi now represents over 25% of our total sales, but five suffering locations and $38 million in debt cloud the outlook.</td>
</tr>
<tr>
<td>The Habit Burger Grill (HABT)</td>
<td>$9.55</td>
<td>-44.6%</td>
<td>More drive-thru windows are needed to offset the rising labor costs in West Coast locations.</td>
</tr>
<tr>
<td>Luby’s, Inc. (LUB)</td>
<td>$2.64</td>
<td>-38.3%</td>
<td>Despite Hurricane Harvey, the average Luby’s still did $2.6 million in sales and $400,000 of store-level profit in 2017.</td>
</tr>
<tr>
<td>Bojangles, Inc. (BOJA)</td>
<td>$11.80</td>
<td>-36.7%</td>
<td>Bojangle’s biscuits finished next to last in a Washington Post taste test with McDonald’s numero uno. Fake news!</td>
</tr>
<tr>
<td>Fiesta Restaurant Group (FRGI)</td>
<td>$19.00</td>
<td>-36.3%</td>
<td>What happens when you shut down marketing? Look at Pollo Tropical’s third-quarter, 13-point drop in traffic, that’s what.</td>
</tr>
<tr>
<td>Papa John’s (PZZA)</td>
<td>$56.11</td>
<td>-34.4%</td>
<td>With Papa John Schnatter banned from the house, the company can focus on pizza, instead of the NFL and politics.</td>
</tr>
<tr>
<td>Bravo Brio Restaurant Grp (BBRG)</td>
<td>$2.50</td>
<td>-34.2%</td>
<td>With no buyer in sight, shareholders hope the company can muster enough fingers to plug the leaking dike.</td>
</tr>
<tr>
<td>DineEquity (DIN)</td>
<td>$50.73</td>
<td>-34.1%</td>
<td>$1.00 Margaritas and Long Island Ice Teas provide late-inning relief for Applebee’s during a disastrous year.</td>
</tr>
<tr>
<td>Zoe’s Kitchen (ZOES)</td>
<td>$16.72</td>
<td>-30.3%</td>
<td>Catering is 16% of sales, primarily week-day business catering, which helps to leverage rising labor costs.</td>
</tr>
<tr>
<td>Chipotle Mexican Grill (CMG)</td>
<td>$289.03</td>
<td>-23.4%</td>
<td>Shareholders anxiously await a new CEO, while the board awards two executives a million apiece to stick around.</td>
</tr>
</tbody>
</table>
STATS AND QUOTES

<table>
<thead>
<tr>
<th>WALL STREET ANALYSTS OFFER UP OUTLOOK FOR 2018</th>
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<tbody>
<tr>
<td>Analyst</td>
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<tr>
<td>--------------------------</td>
</tr>
<tr>
<td>Andy Barish Jefferies</td>
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<tr>
<td>Andrew Charles Cowen</td>
</tr>
<tr>
<td>Lynne Collier Canaccord Genuity</td>
</tr>
<tr>
<td>Chris O’Cull Stifel</td>
</tr>
<tr>
<td>David Palmer RBC Capital Markets</td>
</tr>
<tr>
<td>Nicole Regan Piper Jaffray</td>
</tr>
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<td>Brian Vaccaro Raymond James</td>
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<tr>
<th>INTEREST RATES</th>
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<td></td>
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<tr>
<td>Fed Funds Rate</td>
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<tr>
<td>1-Month Libor</td>
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<tr>
<td>3-Month Libor</td>
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<tr>
<td>1-Year Treasury</td>
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<tr>
<td>5-Year Treasury</td>
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<tr>
<td>10-Year Treasury</td>
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<tr>
<td>30-Year Treasury</td>
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<tr>
<td>Prime Rate</td>
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Blackstone Vice Chairman Byron Wien annually offers up his “Ten Surprises” for the coming new year: “Inflation becomes an issue of concern. Continued world GDP growth puts pressure on commodity prices. Tight labor markets in the industrialized countries create wage increases. In the United States, average hourly earnings gains approach 4% and the Consumer Price Index pushes above 3%.” *In a recent conference call with investors, Darden CEO Gene Lee described the company’s four competitive advantages: “1) Leveraging our significant scale to create a cost advantage; 2) using extensive data insights to improve operating fundamentals and to better understand our guests and communicate with them more effectively; 3) ensuring our brands systematically go through our rigorous strategic planning process; and 4) cultivating our results oriented people culture to enable growth.”*

From Thomas Sowell, Senior Fellow at the Hoover Institution at Stanford University: We’re raising whole generations who regard facts as optional. We have kids in elementary school who are being urged to take stands on political issues, to write letters to congressmen and presidents about nuclear energy. They are not a decade old and they are being thrown these kind of questions that could absorb the lifetime of a very brilliant and learned man. They are being taught that it’s important to have views, and they are not being taught that it’s important to know what you are talking about. It’s important to hear the opposite viewpoint and more important to learn how to distinguish why viewpoint A or B are different and which one has the most evidence, or logic behind it. They disregard that. They hear something, they get some rhetoric and they run with it.

Shortseller Jim Chanos discussing the restaurant industry on a CNBC show: Everybody gives a higher multiple to the asset-light companies. The problem at the end of the day, the box has to work.
FINANCING

The Right Way To Do Refranchising

By Dennis Monroe

Over the years, our firm has been involved in many refranchising programs and seen both good and bad approaches. One of the most problematic programs was the Applebee’s refranchising, which was initiated to pay off excessive debt and left the brand with few corporate stores and no effective way to test and improve the concept before rolling out to franchisees. Buffalo Wild Wings might have taken a similar path if the activists had gotten their way. Thankfully, it turned out differently. Yum and Hardee’s have refranchised over the years and have done a relatively good job in their sale of corporate stores. Red Robin seems to be taking a very thoughtful approach to refranchising and so is Big Boy. So what does it take to do it right? Here are the five keys to executing a good refranchising program.

Refranchise for the Right Reasons

You don’t want to refranchise just to come up with a financial solution. You want to achieve the right mix of franchise and corporate stores. I always become concerned when the percentage of corporate stores drops below 10%, because this can really create problems when it comes to alignment with the franchisees, the ability to test new products, prototypes, and technology. Also, it is clear that one of the primary purposes of refranchising should be to bring new blood into the system and also to reward existing franchisees. These concepts are the foundation for a successful refranchising program. Never look at the short term.

Make Sure You Provide Development Rights

Refranchising shouldn’t be used just to get rid of stores, it should be used so the corporate stores can seed development in specific areas. You should seldom refranchise without corresponding development rights. While sometimes it makes sense to refranchise an isolated store because it fits with an existing franchisee’s development plans, in most cases I like to see refranchising programs coupled with reasonable development obligations. The beauty of this approach is you give existing or new franchisees immediate cash flow, which provides an economic benefit as they grow the development area. One item to always keep in mind is that development rights should never be too aggressive, particularly when you are trying to integrate existing, purchased corporate stores.

Find the Right Partners

The sale of corporate stores needs to be strategic, and getting the right franchisee under all circumstances is the best strategy. Go for the potential franchisee who makes the most sense for your system and can grow and develop the stores as well as increase the revenue in the existing stores they are buying. The ideal partner should: 1) Fit the culture; 2) Have the financial resources to acquire the stores; 3) Have “dry powder” to develop the stores around the refranchised stores; and 4) Have strong operations that can be verified through a proven track record of their performance in your system or in other systems.

Price It Right

Make sure the existing stores are not overpriced. Sometimes we’ve seen inflated prices that create unreasonable entry costs into the system. I would prefer to see refranchising programs with market prices or even slightly below-market. The idea is to sell to the best and most appropriate potential franchisee or existing franchisee, keeping in mind they will generate significant royalties in the long run. Therefore, short-term pricing is not as important as long-term success and a sustainable royalty stream. The other problem with pricing either too high or too low is you then create concern in the existing franchisee community as to value, which may affect exit strategies and refinancing. It’s always good to consult with existing franchisees prior to the commencement of a new franchising program.

Make Sure the Franchising Program is Appropriate for Refranchising

You need to review your franchise agreement and development agreements. Specifically, you need to make sure that the provisions in all of these documents meet the needs of the potential refranchising buyers. If you’re looking at private equity or family offices, you need to have provisions that fit the situation. Also, if you are looking at selling underperforming stores that need to be turned around, you need to make sure there is some latitude in the royalty arrangement to take into account these stores. In many cases, the agreements need to provide flexibility to fit the kind of situation necessary for the stores being sold and the development rights being granted.

Refranchising is a major decision that needs to be carefully thought out. It should never be a knee-jerk reaction, and certainly activist shareholders and financiers should not be the primary movers in this process. The best approaches always take into account what is best for the overall franchise system and the long-term economic health of the franchise, and making sure that the refranchised stores and the development rights create a successful and economically viable business.

Next time, a quick primer on the new tax law and how it affects you as a restaurant owner.

Dennis L. Monroe is a shareholder and chairman of Monroe Moxness Berg PA, a law firm specializing in multi-unit franchise finance, mergers, and acquisitions and taxations in the restaurant industry. You can contact him at 952-885-5999 or dmonroe@mmblawfirm.com.
Blasts from the Past, Satisfying Weed-Hunger

The big news in the NFL last month was Carolina Panthers’ owner Jerry Richardson announcing he was selling the team. Word came after a Sports Illustrated article revealed the team had paid settlements to at least four female employees who had accused Richardson of sexual harassment. Another employee had accused him of directing a racial slur at him. It wasn’t, however, the team owner’s first brush with settlements.

You may recall Richardson earned the money it takes to buy a major league football team by first operating a Hardee’s franchise in 1961. He and a partner named their company Spartan Food systems, which eventually grew to include El Pollo Loco, Quincy’s Steakhouse and Denny’s after SFS was acquired by TW Services in 1979. Richardson established a reputation as a turnaround specialist during a seven-month stint as president of Denny’s.

“I think the fact that he is now leaving Denny’s reflects the confidence of the parent company,” the late Joe Buckley, then of Bear Sterns, told me at the time. Richardson became chairman of Flagstar Corp. (successor of TW Services).

When I interviewed Richardson in 1988, he claimed his success was due to an ability to connect with workers: “It’s just a human relationship-type of situation. I don’t know how to tell you how to do it, other than to say we apparently do it well.” Meanwhile, Denny’s trimmed some 200 employees from headquarter’s payroll.

Trouble started a few years later, after Denny’s was accused of racial discrimination by African-American Secret Service agents and students, in two separate incidents. The company paid $46 million to settle the claims.

Richardson abruptly quit Flagstar a year after the payout, declaring he was buying an NFL expansion franchise based in Charlotte, N.C. The Panthers have played in two Superbowls since then, losing both. Hip-hop mogul P. Diddy has announced he wants to buy the team, which has been valued at $3.7 billion in 2018 alone, while rising to $5.1 billion in 2019. Weed went legal in the Golden State on January 1. To date, eight states and the District of Columbia have legalized small amounts of marijuana for adult recreational use.

As of yet, however, no national restaurant brand has publicly promoted using marijuana alongside its menu items. The reason seems obvious: a public backlash.

Still, it is well-known, after all, that one after-effect of smoking weed is hunger pangs. Chipotle, you might recall, came close with an ad featuring an image of its burrito with the line: “Usually when you roll something this good, it’s illegal.”

To be sure, San Diego-based Jack in the Box didn’t directly suggest lighting up; it partnered instead with Merry Jane, a pro-marijuana website, to promote JIB’s existing, late-night Munchie Meals menu. The craveable items, which cost about $10, consist mainly of big, messy sandwiches (fried chicken sandwich topped with bacon, hash browns and melted cheese with ranch dressing, for example, with two tacos and a small drink thrown in).

The short-lived promotion included just three Long Beach units. Why there? One reason may be that the city is dope-friendly. Webehigh.org rates its “smoking tolerance level” a 4.2 (5 is “virtually legal”).

No word on whether late-night sales spiked during the week. But given that 64% of Americans support legalizing marijuana, according to Gallup, and the dizzying sales estimates, why ignore an opportunity to further ingratiate your brand with existing customers?

—David Farkas
action to allow tip pooling should help back of the house employees receive a more equitable share of gratuities, although this will be fought tooth and nail by the “wage theft” activists.

All of this contains positive news for an industry that often bore the brunt of the Obama administration's tax and regulatory zeal. However, don’t go out and spend the savings right now. Too much of the tax relief proffered by Trump is pro-development, which may be of no economic value if the demand side of the dining equation doesn’t improve soon.

Promoters look back at the 1981 Economic Recovery Tax Act signed into law by Ronald Reagan, which also reduced tax rates for individuals and businesses and provided for generous accelerated depreciation of business assets. GDP growth in the three-year period following the Reagan tax cuts averaged almost 6%. As expected, those years were marked by rapid restaurant expansion brought on by relaxed lending standards and a vibrant IPO market.

The Reagan tax cuts, however, came at a time when the economy was in recession, inflation was high, the unemployment rate was in double digits and the prime interest rate had peaked at 21.5%.

The Trump tax cuts come late in the business cycle, what with stock and real estate markets at peak valuation and most investors already pushed way out on the risk curve.

We’ve already experienced rapid restaurant expansion, with restaurant capital—loans and private equity—never more plentiful in history. Where was this stimulant back in 2009 and 2010, when there was little business activity and even less capital. But, what now?

Development incentives offered up by Trump and the GOP may not be significant enough to overcome expensive construction costs, high rents, a shortage of employees to staff the restaurants, and a competitive environment where restaurant execs are out-value menuing each other.

Our advice: Things may heat up, but make sure any restaurant development or remodel program you’re planning makes real economic sense—not just for tax benefits.

The Tightest Labor Market Ever Ushers in Change

Walmart’s decision to raise their minimum wage to $11 per hour will do more to upend restaurant budgets than anything a state or local municipality could ever dream of imposing. Sourcing people to staff the restaurants at an economic level is the core mission of any restaurant owner or manager today, especially when an hourly employee can flip over to Walmart or Target and get 11 bucks an hour.

Rising wages means different things to different restaurant companies. For Del Taco, it plans to implement a 3% price increase throughout 2018 to counter a $.50 hour minimum wage increase in California and a Los Angeles increase of $1.25 an hour on July 1.

Another, Red Robin, is committed to its value platform, so it’s looking for productivity enhancers. The 570-unit restaurant chain eliminated its restaurant expediter role last quarter in company stores and is now eliminating the busser position.

No more busboys?

“How will the tables get cleaned?” I asked senior executives Denny Marie Post, Caryn Stutz and Guy Constant at the recent ICR Conference in Orlando. The answer from CFO Constant was the servers will now clean the tables. “The servers are on board because now they won’t have to tip out the bussers,” said Constant.

Wait a minute, This doesn’t pass the smell test. No server wants to clean booths and tables after the guest has departed and the tip is already pocketed—even if it means saving a few bucks that might go to a busser.

Either the economic model is so poor at Red Robin that they must slash labor hours immediately, or this is a shot across the bow of servers, especially in the no tip-credit states, of which Red Robin has almost 25% of their stores. I get the logic of the latter.

With servers making more than any of the other hourly workers at Red Robin, they better clean the tables or what? Or, go across the street and work at Walmart for less.

—John Hamburger

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Subscription Rate: $395.00 per year. $650.00 for two years

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