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Why Roark's long-term strategy works

by Jonathan Maze in Reporter's Notebook

Over the past 14 years, Atlanta-based Roark Capital has made a habit of buying restaurant companies and franchises and keeping them. That's unique for a private equity group, which usually unloads its acquisitions in just a few years.

We spoke recently with Neal Aronson, Roark's founder and managing partner, for an upcoming piece in Nations Restaurant News. Aronson offered insight into Roark's strategy — namely, how the investor avoids excessive debt and benefits from an acquisition's long-term growth, rather than from its eventual sale.

Not surprisingly, Aronson said much more than we could fit into the piece, offering up insight into the risks of today's low-cost debt, high-priced merger and acquisition environment, as well as the benefits of franchising.

Good operations is good business. Private equity groups often get a bad rap because they can make money on an acquisition even if the brand does terribly, by cutting costs, ramping up leverage, and paying out exorbitant dividends. Most private equity investors exit those investments after just a few years.

Roark generally keeps its companies and has exited a remarkably small number of investments since 2001. Instead, the company reaps the benefits of improving the companies it buys. Currently, Roark owns Arby's, CKE Restaurants, Wingstop, Focus Brands, Corner Bakery and others. It owns 14 restaurant chains.

"Our strategy has been consistent — growth comes from operational excellence, not financial engineering," Aronson said. "We use a lot less debt than most people. Our philosophy is about continuous improvement."

Roark is not anti-debt. It doesn't keep leverage down as some sort of moral crusade. It's simply the way it does business, Aronson said. Keeping leverage down encourages long-term growth. "It's not moralistic," he said. "It's just a practical view. We want to make sure our brands and team members can invest in the right things to do business and not get distracted or hampered by leverage."

Long-term strategy can offset high prices. The leverage environment is nevertheless flourishing right now. Lenders are eager to make deals, and interest rates are low. This is helping to drive prices for restaurants skyward. But those high prices put pressure on new owners to increase the value of an acquisition.

Aronson noted that the high prices could make acquisitions risky for investors that want to exit in only a few years. "The high price environment, and the aggressive leverage environment, can be very treacherous to invest in restaurants if your time horizon isn't long enough," Aronson said.

Expect Roark to make more acquisitions this year. But, Aronson said, "we have to be thoughtful" about the deals and the prices to ensure that the company being acquired still has a "margin of safety."

Franchising works when everyone wins. Roark believes that the restaurant business, particularly franchising, makes for good, long-term investments.

"The restaurant industry and the franchise industry are really good for long-term opportunities," Aronson said. "But they can be pretty treacherous."

Investors love franchising. It's generally more profitable to sell the right to operate a brand than it is to sell hamburgers or burritos. And franchisors are usually insulated from rising food costs or recessionary sales troughs.

But that business works best when everybody is happy, including the franchisees. And so franchisors are better off ensuring their system is profitable for the operators.

"It's a win-win-win business model," Aronson said. "If we help our franchisees and our store managers be successful, then they'll grow. If they grow, the team members and the brands grow.

"If you have happy franchisees and team members, then shareholders will do just fine."