



The next great restaurant concept

By Jaime Wall

With projected sales of about \$550 billion and more than 945,000 locations, the restaurant industry is a diverse and growing segment of the economy. As new and established chains continue to seek liquidity and capital to deleverage or capitalize on growth initiatives, opportunities exist for private equity firms to find attractive investments. However, given the impact of the challenging economic climate on discretionary consumer spending, understanding the key drivers and underlying fundamentals of a concept has never been more important to successful restaurant investing.

Over the past eight years, **Roark Capital Group** has acquired and expanded several well-known restaurant brands and now operates more than 2,500 locations in the U.S. and 32 countries under the brand names Carvel, Cinnabon, Schlotzsky's, Moe's Southwest Grill and McAlister's Deli. Additionally, while at **Bruckmann, Rosser, Sherrill & Co. LLC**, I participated in two successful restaurant transactions — McCormick & Schmick's and Il Fornaio/Corner Bakery. In each case, the firm's success with these brands stems largely from careful and thoughtful due diligence and partnering with exceptional executives.

In the exploration stage of a potential investment, five key indicators to consider include:

* **Strong unit-level economics:** How are individual stores performing? Does the underlying store-level performance generate attractive cash-on-cash returns that will support continued expansion?

For instance, one of the key investment considerations for both Schlotzsky's and Moe's was the unit economics. Schlotzsky's company-owned units generate store-level margins of nearly 20% in four distinct markets, and based on our surveys of franchisees, Moe's locations enjoy compelling cash-on-cash returns.

* **Identifiable growth:** Is there a history of consistently opening new locations, and are the new units successful? What is the long-term growth potential?

McAlister's Deli had roughly 170 restaurants in 18 states concentrated in the South at the time of Roark's acquisition in 2005. The concept had shown the ability to generate strong sales in several different markets, giving us confidence that we could both expand the store footprint within our current markets as well as bring McAlister's Deli to adjacent markets. McAlister's Deli has successfully executed on its growth potential with over 285 locations in 22 states and system-wide sale growth of 70% since 2005.

* **Predictable cash flow:** Does the restaurant company have a history of predictable, stable and growing cash flow?

With more than 50 years and 20 years of operating history, respectively, Carvel and Cinnabon have consistently demonstrated strong financial performance through a variety of economic and

product trend cycles including the low-carb craze and the popularity of frozen yogurt and slab ice cream concepts.

*** Sustainable competitive position:** Does the restaurant company have a strong market position, an identifiable niche and barriers to entry that allow a company to sustain and surpass its position in the future?

While the casual-dining segment continues to suffer in the current economic climate, the fast-casual segment has fared significantly better by offering consumers high-quality food in a convenient format at an attractive price point. In particular, Mexican is a large and expanding segment in the fast-casual industry. As one of the three largest players, Moe's Southwest Grill has established a widely recognized brand name by offering consumers fresh, healthy, made-to-order meals in a family friendly environment. Moe's Southwest Grill is well-positioned to continue to expand its share in existing as well as new markets.

*** Management team:** Is there an experienced and motivated management team with a proven track record in the restaurant industry?

Within our current portfolio, we have backed talented leaders such as Russ Umphenour, the CEO of **Focus Brands Inc.** — parent company of Carvel, Cinnabon, Moe's Southwest Grill and Schlotzsky's. With more than 40 years in the restaurant business, Umphenour was founder and CEO of Atlanta-based RTM Restaurant Group Inc. from 1973 until 2005. Russ expanded his company from 11 underperforming Arby's restaurants in Georgia and Alabama into one of the largest restaurant companies in the country with 870 locations in 22 states with several different concepts. RTM was sold in July 2005 to **Triarc Cos.** (which operates **Arby's Restaurant Group Inc.**) as the largest franchisee in its system with more than \$900 million in sales.

In addition to the points outlined above, it is important to establish a strong partnership with the seller based on mutual respect and open communication. Furthermore, owners and lenders are increasingly seeking a buyer who understands and can manage through the ups and downs of the restaurant industry. Despite the current challenges faced by many restaurant concepts, eating out is a fundamental part of consumer behavior. The key to finding the next great restaurant investment involves a focus on the concept's fundamentals and partnering with the right management team.

Jaime Wall is vice president of Roark Capital Group and focuses on investments in the restaurant and franchise industry. Prior to joining Roark, she was a principal at Bruckmann, Rosser, Sherrill & Co. LLC.