

FINANCE FOCUS

fundraiser extraordinaire

Bucking conventional wisdom pays off for dealmaker

By Mary Jo Larson

When the winning World Series pitcher trots off the field and the infamous “What are you going to do now?” is thrown his way, you know his answer before he says it.



Neal Aronson, USFS

But after carefully constructing the major league deal that would sell hotel concern U.S. Franchise Systems (USFS), financier Neal Aronson is not going to Disney World, but rather, he's staying on the playing field: in franchising.

After 14 years in the finance game, five of which were with USFS, Aronson has started his own private equity firm, Roark Capital. And although it's not the only game in town, Aronson's career path makes it a sure bet to make its mark on history.

Getting to the big leagues

Before he was in charge of executing the deals that made U.S. Franchise Systems a hotel company to be reckoned with, Aronson warmed up in the finance department of Drexel, Burnham, Lambert, Incorporated. There he participated in raising more than \$4 billion of equity and debt capital and various merger and acquisition advisory assignments. Aronson then joined the lineup at



completed six transactions worth \$650 million. Add to his resume the title of principal of Odyssey Partners, L.P., founded by Jack Nash and Leon Levy, a former private investment partnership with equity capital exceeding \$2 billion, and you have someone who knows his way around an acquisition.

In fact, it was at Odyssey that fellow principal Jaimee Halper saw Aronson beginning to work on franchise transactions.

“Even then he had big ideas,” said Halper. “I recall that he had full financed offers for a number of deals, including Thrifty Drug. At that time he was beginning to focus on companies that were franchises, or companies that could be franchised. Neal wasn't the first to recognize it (franchising), but he was very forward thinking in applying it to different businesses. He looked at it (franchising) as another way to add value to companies.”

Hitting homers at USFS

Since this is a franchise magazine, Aronson's story gets even more interesting when we get to U.S. Franchise Systems (USFS). If you are on the lookout for familiar faces in franchising, Mike Leven, CEO of USFS, is one of them. Leven's hotel career has spanned 40 years, with impressive credentials such as president and COO of Holiday Inn and president of Days Inn.

Aronson approached Leven, who is also Aronson's uncle,

Acadia Partners, L.P., a \$1.7 billion investment partnership whose founding partners included the Robert M. Bass Group, the American Express Companies and the Equitable Life Assurance Society. Those who know him say being a rookie certainly didn't stand in his way. Instead, he became the firm's youngest principal and general partner.

“Neal came in as a youngster,”

said Ron Beck, then senior partner for Acadia and now senior partner and co-head of Oaktree Capital Partners, a diversified money management firm with \$18 billion under management. “He started off really learning the business, but then got to the point where he was conceiving, executing and completing transactions from start to finish on his own at a very young age.” At Acadia, Aronson

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around 1991, about putting together an operating company in franchising. Leven said he was still busy at Holiday Inn, but later the two decided to go for the deal, and tried to buy the Red Roof chain, but “missed it,” said Leven.

But the two believed in franchising. “It is a high profitability model,” said Leven. “The elements of the business, the nature of the business model, were appealing to both of us.”

The duo co-founded USFS with the purchase of the Microtel chain with 27 locations. Leven and Aronson’s goal was to build USFS into a multi-brand company. Their lineup included a sales force of 50—“the second largest franchise sales force in the entire industry,” said Aronson—which got in front of “a lot of owner operators.” That, combined with Aronson’s financial and Leven’s operational expertise, helped the company grow at a steady pace. USFS is now the 10th largest hotel chain with over 500 locations operating.

But let’s talk about the deals. As co-founder, director, CFO and executive vice president, Aronson was the deal maven behind many a USFS transaction.

“In our first acquisition, we bought a small brand from a small public company, and I had 30 days

to raise the investment capital to get the deal done,” said Aronson. “Three weeks later we had over \$30 million in commitments.” And that was just the start.

Aronson raised \$94 million of equity securities in three tranches—a private placement, an IPO and a secondary public offering. To add to their Microtel lineup, he completed a master license agreement and acquisitions of two hotel concepts, Hawthorne Suites and Best Inn & Suites, selling 17 hotels in the Best transaction for \$84 million to a private investment partnership to help finance the acquisition. Aronson created an off-balance sheet finance vehicle with \$50 million of equity commitments and a \$60 million revolving credit facility to build and own USFS-branded hotels in high-barrier to entry markets without impacting the company’s status as a pure fee-based company.

“Neal is a brilliant deal man,” said Leven.

Beck agrees. “Throughout Neal’s tenure at USFS,” said Beck, who also was a private equity investor in the company, “he continued to be one of the most creative financial entrepreneurs in terms of deal structuring and financing. He raised an amazing amount of equity for a

company that would have otherwise been undercapitalized, with numerous follow-on debt offerings.”

But for Aronson and the USFS team, the World Series of deals was yet to come.

Nine months out of a life

“About two years ago, I saw the hotel franchise industry consolidating very quickly,” Aronson recalled. “I decided we needed to be much bigger, or we should sell. So I went out and raised \$1.1 billion, and made a fully financed offer to buy 100 percent of the shares of Red Roof Inn.” At that time, Red Roof was the largest publicly traded hotel chain in the economy-lodging segment. (It’s a little more complicated than Aronson makes it sound at first blush.)

“In order to maintain USFS’s status as a pure fee-based company, I developed a structure that would have allowed Red Roof’s real estate to be owned by a newly formed private entity that would be majority owned by investors unrelated to USFS,” Aronson explained. After the transaction closed, USFS would have Red Roof’s trademarks, its 350 franchise agreements and approximately 300 management contracts on the hotels owned by the private real estate company.

Banc of America Securities committed \$800 million of its own capital—\$125 million to USFS and nearly \$700 million to the real estate company. Aronson’s capital-raising abilities had outside investors committed to provide the additional \$300 million.

Sam Wilkins, who at the time was a senior managing director and head of Lodging Investment Banking for Banc of America Securities, saw firsthand Aronson’s capabilities. Wilkins not only worked on the Red Roof deal, but also lead multiple debt

and equity offerings for USFS and worked with Aronson on a great number of deals, both reviewed and completed.

“It takes a lot of tenacity to take a \$300 million or \$400 million company and acquire a \$1 billion company,” said Wilkins. “It took a certain amount of vision and determination to go after Red Roof.” Wilkins described Aronson as the “driving force” behind the deal.

“Whenever we would run up against an issue, he was the problem solver,” Wilkins said. “He would find some type of structural modification that would solve the problem at hand—but he would not let the problem screw up the deal for him.”

And when Aronson would get in the thick of negotiations, he knew “where the line was on what would still make the deal work for him. He always had in the front of his mind what he would get out of the deal,” said Wilkins. Some people “negotiate just to negotiate. They will negotiate on who will pay for coffee this morning—not Neal. He negotiates where it matters. He focuses on the objective.”

With what Wilkins describes as a transaction with “a ton of moving pieces,” the deal was ready. It worked. It was fully financed.

The nature of the beast

What happened next is the stuff of which novels are made. At the eleventh hour, Accor, a multi-billion French conglomerate which also owns the Motel 6 chain, came in and topped USFS’s bid. Aronson couldn’t compete. After nine months of mental gymnastics, meetings, phone calls and constructing and reconstructing a very complicated financial transaction, some would be bitter losing, but not Aronson.

“Although it was a disappointing result,” Aronson said, “I

took great pride knowing that our small-cap company nearly swallowed a competitor whose cash flow exceeded ours by more than 30 times. It was a great lesson. But it’s also the nature of the deal business. You have to be ready to deal with disappointments.”

When the deal fell through, he still had a commitment to shareholders: Grow or sell. In September 2000, USFS was sold to a subsidiary of Pritzker family of Chicago for \$5 a share or approximately \$100 million, reported Leven. So committed to the end result, Aronson delayed honeymoon plans for four months until the deal closed.

“USFS was one of the best investments I ever made,” said Beck. “It was extremely well capitalized. Neal structured it in such a way where the investors got the bulk of their investment out very quickly. I made six or seven times my money in three or four years.”

Halper, who also invested in USFS, agreed. “It was a smashing success for me as an investor. I made six times my money.”

No bench warming allowed

When Aronson got together with Leven, he made a five-year commitment to USFS. And when the company was finally sold, it was almost five years to the day that the duo had co-founded the company. It was time for Aronson to move on. “Mike is doing what he loves,” said Aronson of the

partnership. “I’m moving to the next investment opportunity with my background, which is private equity.”

Roark Capital is Aronson’s new field of dreams, and the game is still franchising. The private-equity investment firm is targeting brands they can franchise. “A typical sweet spot for us would be a 75- to 500-unit chain with terrific store-level economics—one where the franchisee is winning, there is brand recognition and consumer acceptance. We would look to buy that business and grow the brand dramatically through franchising—that’s what we did at USFS,” he said. Typically, they would look for middle-market transactions with enterprise values between \$40 million and \$175 million, resulting in equity commitments of \$20 million to \$75 million.

Aronson has called on his contacts of the last 10 years for these investments—a combination of institutions and wealthy families, some of whom invested in USFS. For his potential acquisitions, he brings this capital to the table along with “an understanding of the franchise business. We hope to combine both the financier and operator portions, an advantage that will allow us to analyze an opportunity quickly and provide the capital necessary to get a company purchased and to get it additional capital to achieve its growth potential.” Roark would support the management

team, bringing in the financial and sometimes strategic expertise.

One year from now, Aronson predicts Roark Capital will have at least one or two companies in its portfolio. Five years from now, “we’ll have a portfolio of five or six multi-unit businesses,” he stated.

For Aronson, this is exactly where he wants to be. “I think franchising is a great way to grow a business. There are many people that have been frustrated with dealing with franchisees—I enjoyed it. For those who work

hard to understand the franchisee’s position and put themselves in the franchisee’s shoes, there is an opportunity for the franchisor to grow faster, for the brand to grow faster and the franchisee to be successful.”

Said Beck, “My firm and I would love to invest with Neal and Roark Capital. I think he is one of the most creative investors I’ve worked with. Unfortunately for me, there’s a lot of guys like me that would like to invest with him.”

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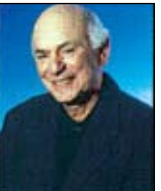
Shaking more hands

When the publicly held hotel franchisor USFS was sold last fall, CEO Mike Leven exchanged one rigorous job description for another. Now a private company, USFS still has Leven as busy as ever. “There’s not much leisure in either one,” said the hotel guru of the public versus private company chairmanship—but there is a difference.

“When you are a public company, CEOs are out promoting the stock,” said Leven. In a big company like IBM, he said, that may be OK. But for the CEO of a smaller concern, it takes a lot of the CEO’s time away from running the business, or as Leven put it, “The CEO still has to do his work.” He estimated that approximately 40 percent of his time was devoted to pro-

moting the stock and the general concerns of running a public company.

OK, now that he has 40 percent of his time back, is Leven out on the links, taking it easy? For a guy with 40 years in the hotel biz—with some of that time as head honcho over at Days Inn and Holiday Inn—we thought, hmmm...probably not. “Now I can spend more of that time out in the field, working with the franchisees,” he said. “Now I’m marketing the brand, shaking hands, trying to get the guys to do their deals. When you’re private, you can spend all your time on the business.”



Mike Leven

Why the name Roark Capital?

To answer that question look to founder Neal Aronson’s favorite author, Ayn Rand, whose hero in the novel “The Fountainhead” was architect Howard Roark. “For much of the book, Howard’s style of architecture and his unwavering discipline put him at odds with the people in power and thus the people who influenced public opinion,” said Aronson. “Howard’s work and his dedication to its purity caused him many hardships throughout the book, however, he refused to succumb to conventional wisdom. He comes to receive all of the accolades and wealth that comes with success...while the former architectural elite come to be discovered as the frauds that they really are.”

Aronson said he bases his life on these types of values, both in his business and personal life. He avoided the “dot-com” craze, missing out on the riches of that phase, he admits, but also missing out on the losses. “The key is avoiding the ‘flavor of the month’ and sticking to what you know and believe in,” he said.