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Buy, buy franchisors

Roark Capital has a different spin on the traditional franchise model. Here's the sweeter side of their recent acquisition spree.

By Mike Mitchelson

If one pays even remote attention to the business section of their daily newspaper, it's hard not to notice that private-equity firms have developed a taste for franchises. None have been more aggressive during the last three years than Roark Capital, however. Since November 2001, Roark has purchased Carvel Corporation, Money Mailer, Fastsigns International, and now Cinnabon and Seattle's Best Coffee International. Roark will purchase the two brands from AFC for $30.25 million in cash, according to Neal Aronson, Roark's founder and managing partner.

Private equity's attraction to franchised companies is based on the community's predictable, steady cash flow, said Michael Shepardson, president of CNL Advisory Services. "Not only is it viable for cash flow purposes, but there's a very ready and available debt market, and also there's a way to exit the investment," he said. "Either by selling (the company) in another sale to another buyer, or to take it public."

The trend began when the damages of the dot-com and telecommunications investments began "coming home to roost," Shepardson explained. Many firms had large amounts of uninvested capital and companies in their portfolio that weren't performing. "They were basically looking for some way to invest their capital and get a reasonable return," he said. "What Roark has done, is they have made it very clear since they bought Carvel that they want to be the owner of brands—brands that are franchised, or franchisable."

Yes, franchises are precisely what Roark is interested in, said Aronson. "For us, it's really a fun business to be in where you can help an entrepreneur realize a dream of getting into his own business," he said. "In this country people love to own their own homes, and more and more people want to own their own businesses. And a franchise company makes that possible."

What makes private equity advantageous for franchise operators is cash capital and experience, Shepardson said. "A transaction can get done and there's going to be 20 to 30 percent of true cash equity in the deal—that makes the lenders very happy," he said. "Second, a private-equity firm has massive, massive experience and intellectual capital as it pertains to the finance side of a business. So it enables the operators to run the restaurant business, and if there are ways to improve the financial performance of the restaurant company through financial engineering, the private equity firms have all of that in-house talent."

Roark's challenges are those any other business would face, said Joel Holsinger, director of Navigant Consulting Inc. Particular to the dessert segment of the restaurant industry, however, is the carb-conscious craze. "But I think that the (Cinnabon) acquisition makes a lot of sense for them, because they have the existing base to work off of, they can be competitive as far as their purchase prices and still make it work within their fund."

The franchised businesses Roark has acquired are varied, but they market to a similar franchisee, Holsinger said. "The initial investment is small; they're going to be one- or two-unit franchisees. They are individuals who may have been engineers who basically decide to become entrepreneurs, and the business model works…and they can control the business."

On the hunt

Roark chooses to acquire franchise systems that have strong management teams and a product or service with strong positioning, Aronson said. Cinnabon fits those criteria, despite its recent problems caused largely by a decline in shopping mall traffic—where most Cinnabons are located. "At its core, Cinnabon is one of the world's most recognized brands, it's a great tasting and great smelling product that satisfies the big indulgence part of everybody's life," he said. "And what we plan to do is the same thing we did with Carvel."

Since they purchased Carvel, the number of units have increased from 350 to more than 500. The first step toward reviving the brand was simply to listen to what the franchisees were saying, Aronson said. Following that, they developed a new business plan and some new products, and in the second year "significantly accelerated growth," he said.

The attention paid to franchisees is a stark contrast to the prior owners, Investcorp, said Hank Koch, owner of a Carvel franchise in Fairfield, Conn. Investcorp was channeling most of its efforts into selling Carvel's product at the supermarket. "(They put) very little into franchise sales," he said.

Roark has made a point of including the

franchisees in the decision process, he added. "They've made us part of the company rather than some people who were channeling money to them," Koch said. "Right after they took over they took a survey, and six months later they took another survey of all the franchisees, and those (franchisees) that I've spoken to agreed it was a complete turnaround, from dissatisfied to very satisfied."

Sarah Cortese, a Carvel franchise owner in Peekskill, N.Y., agreed. After a brief disorganized period after the purchase, Roark is "going in the right direction," she said.

Cortese has owned her store for only a year and a half, but has worked there for 13 years—since she was 14. "(Roark is) just basically bringing back everything (founder Tom) Carvel did, which seemed to be working much better than changing everything about Carvel."

A growth plan similar to Carvel's will be implemented with Cinnabon, including developing new products and a prototype. There's also one other idea for growth that intrigues Aronson: co-branding Carvel and Cinnabon.

"There are already at least seven Carvel/Cinnabon co-brands that have been very, very successful," he said. "We also have the ability to accelerate both the Carvel growth and the Cinnabon growth even further by continuing to develop more of those products together."

> Carvel has shown the most dramatic growth since Roark purchased the brand in 2001. Money Mailer, purchased in June of 2003 is now above 250 units, and Fastsigns remains at about 485 units globally, but Roark has owned them for less than a year, Aronson noted. Cinnabon and Seattle's Best Coffee have a combined 750 units in 40 states and 12 countries.

Roark's eventual purchase of Cinnabon is welcome news to Joseph Schmidt, executive vice president of Bonaventure Group in Bloomington, Minn. Bonaventure owns six Cinnabons in the Twin Cities metro area and four Chevy's Fresh Mex.

"I just think AFC had a lot on their plate with Church's and Popeyes," he said. "As they were buying into the Cinnabon brand, they were getting rid of the Chesapeake Bagel brand." AFC, used to its freestanding stores, never really understood how to function in a mall, he added. "I think (AFC) gave it a great college try, but I don't think they have very many successes with Cinnabon, and that's why they decided to move on."

AFC was also slow to evolve the brand and introduce new product, he said. "We've always wanted to do brownies or cookies and we couldn't do any of that," he said.

Schmidt is also intrigued by the idea of co-branding Cinnabon and Carvel. "I think co-branding in the malls is key for leveraging the real estate."

From what he's seen in the industry since 2001, it's no surprise that a private equity company came in to purchase the brand. "It's always outside investment capital groups looking to get into something in their portfolio and hopefully to either take them public or leverage some cash out of it," he said.

Roark plans to stay focused in the world of franchising, however, Aronson said. "We have a very large appetite to invest in and purchase a large number of additional franchise businesses," he said. "Simply said: we're not done." FT

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