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OUTLOOK

Corner Bakery: Always the Bridesmaid, Never the Bride

Corner Bakery Cafe was a treat to visit back in the day when Chicago's downtown seemed safer and office workers actually went to the office. The novel bakery cafe concept, founded by Richard Melman in November 1991 at Grand & Clark, was "fast-casual" before the now ubiquitous term was invented.

The first Corner Bakery was just 2,200 square feet, but baked 10 to 15 types of artisan breads and breakfast foccacia each day. It was adjacent to Maggiano's Little Italy, Melman's family Italian version of Carmine's. As for expansion, Melman told a columnist with the Chicago Tribune that Corner Bakery "has potential and I'm massaging it." The next year he opened one in the Union Depot and another in suburban Oak Brook.

Melman was the creator of many classic restaurants and was on trend with Corner Bakery. The bakery cafe business in the early '90s was evolving from its baked goods emphasis—selling croissants, baguettes and pastries at retail—to breakfast and lunch spots that sold coffee, bagels, bread and sandwiches. The cafes were typically centered in urban areas, with a high concentration of office workers and residences.

Au Bon Pain was the segment leader at the time, with roughly 200 stores when it acquired St. Louis Bread in 1993 for $23 million. St. Louis Bread, now known of course as Panera Bread, was noted for its high-quality food served in a cafe atmosphere. CEO Ron Shaich was in the process of transitioning Au Bon Pain's "croissant and bread shop" positioning by adding higher-quality breakfast and lunch items. St Louis Bread, Shaich told a Washington University audience last year, was a place where he could apply the principles of higher-quality food and engagement with the customer.

Melman explored an IPO for the then five-unit Corner Bakery and three-unit Maggiano's in 1995. In fact, the top restaurant investment bankers of the day, Alex. Brown & Sons and Montgomery Securities, were on board. Melman instead got an offer from Brinker International and decided to flip the two brands for four million shares of Brinker's common stock, a $73.5 million valuation.

Fast forward to 2023. In the midst of foreclosure proceedings, Corner Bakery's owner, Jay Pandya, files a Chapter 11 on February 28, roughly 30 years after Melman sold the brand to Brinker. Pandya blames it on Covid. What's interesting is that after Melman, four different owners couldn't get Corner Bakery to reach its potential. And, three of the owners were big guns—Brinker, and the PE funds Bruckman Rosser and Roark Capital.

What happened to Corner Bakery?

In the early '90s, Brinker's bread was buttered principally by the Chili's brand, 400-plus units strong, on its way to over 1,500 locations. Its CEO Ron McDougal, the successor to the restaurant industry demigod, Norman Brinker, wanted an expansion vehicle, one with high volumes and an innovative menu.

Chili's was in the midst of a seven-quarter comparable sales decline and toying with a calvacade of concepts—Grady's, Kona Ranch, Spageddies, On the Border, Macaroni Grill and Cozymel—when the call went out to Melman. Melman's concepts and operating team would revitalize Brinker's operation, McDougal reasoned.

Also, Ron Shaich's St. Louis Bread/Panera operation had just 42 locations, averaging roughly $1.5 million per location. Shaich told me during a recent phone call he'd been impressed with Corner Bakery and felt Melman created a "real food environment where people cared." When Shaich read the Nation's Restaurant News fax service that Brinker was to acquire Corner Bakery, he said, "I felt I was kicked in the stomach."

"Brinker's people were good and I immediately thought they would go right past us in a no-nonsense kind of way," Shaich said.

Brinker's strategy was to favor brands with the highest return on invested capital. McDougal told a Wall Street Journal reporter that he envisoned Corner Bakery with $2 million AUVs and 1,000 locations. In order to hit those numbers, Brinker would need to establish a repeatable system, one that would run Corner Bakery like they did with Chili's.

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M&T Leads $55 Million Credit Facility on El Pollo Loco Deal; New Hires Join Franchise Team

M&T Bank recently closed on their first lead deal in the restaurant space since the bank merged with **People's United Bank** last year.

According to **John Dysart**, Executive Vice President, Head of Franchise Finance with M&T, the bank closed on a $55 million refinance of an existing credit facility with Roland Spongberg's **WKS Restaurant Corporation**, the largest El Pollo Loco franchisee. The company also is a large operator of Wendy's, Krispy Kreme and Blaze Pizza. **Pinnacle Financial Partners** was joint lead arranger in the transaction, and **Manufacturers Bank** also participated. WKS will use the proceeds to build new stores and reimage existing locations.

"What brings this full circle for us is it was a relationship deal," Dysart reports. M&T had participated in other financings for WKS, "and that's the approach we've taken to the business. We are willing to come in and do smaller plays with bigger borrowers, so later we can step up and be a bigger resource."

One notable lead-agent, syndicated deal M&T successfully completed included one for a large 200-plus unit Papa John's franchisee securing $60 million in credit facilities, bringing in two other industry banks prior to closing. In another, M&T fully underwrote and committed to $70 million in credit facilities for a 100-plus unit Dunkin' franchisee, ultimately syndicating with three other industry banks. M&T also acted as joint lead arranger for a large 150-plus unit Taco Bell/YUM! franchisee group in securing large OpCo and PropCo credit facilities.

Dysart was leading the restaurant group at People's United when it merged with M&T. "One of the great benefits to the merger of the People's United team into the M&T world is having access to larger, more sophisticated capital markets capabilities and other large commercial bank resources," he says.

Dysart says the above deals, and many others, show M&T's Capital Markets team's experience in both being a lead agent and joint lead arranger on larger syndications.

Pre-merger, M&T had a $700 million portfolio of restaurant loans. At the time, Kent McClintock, M&T SVP, started "to gravitate to doing large franchise deals," Dysart says. "M&T had developed an industry knowledge, growing with franchisees in their footprint. But they didn't go national with it."

When they merged, McClintock was brought on the franchise lending team, which Dysart sees as a big win for his group. "He has a huge amount of industry knowledge," he says, and McClintock is well known in the franchise community. Being part of the current franchise team will allow him to concentrate on building his book of business nationally, as well.

Other M&T Franchise Group News

Juan Cobrda recently joined Dysart's team as Franchise Group Commercial Credit Senior Underwriter. Cobrda has over 20 years of experience in restaurant underwriting, with tenure at names such as GE Capital, Bridge Funding and Fifth Third Bank.

Mayank Prasad also has joined as Franchise Group Commercial Credit Senior Underwriter. He has restaurant underwriting experience with Independent Financial and Woodforest National Bank.

Alex Chiang, who was with Dysart at People's United as an underwriter before the merger, recently was promoted to Senior Vice President, Franchise Group Commercial Credit Team Lead – Franchise Finance.

"We're executing on our plan to grow this industry vertical," says Dysart, "and continuing to add people with experience is a main focus of ours. We have the balance sheet to grow from here."

And, with the bank also owning Leaf Commercial Finance, which focuses on equipment financing, and Wilmington Trust, a wealth management firm, "Borrowers should feel comfortable they have options for their businesses with one group," he says. For more information, contact him at (774) 722-5261, or at Jdysart@mtb.com.

First Franchise Promotes McClure; Raises Lending Amount for QSR Franchisees

Finance executive **Jon McClure** was recently promoted to Director of Franchise Lending for QSR lender **First Franchise Capital**, a First Financial Bank company.

McClure joined First Franchise Capital in 2015 and has worked in the QSR lending industry since 1992, instrumental in the growth and development of the organization's portfolio, the company reports in a release. In his new role, he will be responsible for expanding the QSR franchise relationship team while continuing to focus on growth and excellent customer service.

"Jon's deep industry knowledge, commitment to the industry and charismatic personality make him ideal for this position," says **Rick Dennen**, CEO of First Franchise Capital.

"If you really want to know what gets me up in the morning," McClure tells the Monitor, "I love helping these folks achieve their dreams. Entrepreneurs march to the beat of their own drummer—they are so optimistic. And I get to work with all walks of life, from the three-unit Jimmy John's operator to the 300-unit Wendy's operator."

Indeed, that's one of the changes McClure wants to communicate to the restaurant industry: More recently, First Franchise has been expanding the deal amount they will lend to operators.

"We were perceived as a smaller-ticket lender, and we were. We were predominately focused on smaller operators," he reports. "But we've changed." And they have the backing of First Financial Bank, which has $17 billion in assets, to do so.

McClure cites their deal size: $4 million to $12 million, "and we are actively seeking participations and syndications; we can hold up to $30 million."

Changing their philosophy and focus that meets the needs of the 15- to 300-unit operator, they can go lower than that $4 million, "but we really are looking to do larger transactions," he says.

First Franchise differentiates itself by McClure and his team having access to the decision makers on credit, which speeds up the approval process. And they aren't "rigid" on their structures, "customizing a financing solution for the operator," he says.

McClure has a 30-year history in franchise finance, recalling for the Monitor an internship with AT&T Capital where he called on Hardee's franchisees for equipment leasing, which launched his franchise finance experience. His tenure includes franchise finance executive positions with companies such as Atherton Franchise Capital, Textron Franchise Capital, NFA Restaurant Finance and others.

At First Franchise, "they created this position for me to build a team," he says. "We are actively hiring folks who have my experience and skill set. There aren't a lot of people who have been doing this as long as I have. And, we are looking for some junior people who have a passion for the industry."

McClure's passion is the relationships. "I feel like treating franchisees with respect and recognizing their journey has helped in my success over the years," he says, adding that he's been invited to customers' houses for Thanksgiving and been invited to their childrens' weddings.

"I'm a company person, but I'm a big client advocate, too. I like to work with the bank and the franchisee to tailor something to their needs." For more information, contact him at 317-428-3835, or at jon.mcclure@firstfcc.com.

Regions Provides SBA Lending to Restaurants

"I've got franchise in my blood," says **Peter Salas**, with a laugh. "I've been doing this for 20 years."

Salas joined **Regions Bank** in 2021 as Senior Vice President, Head of Franchise Lending, which focuses on bringing SBA-guaranteed 7(a) lending to franchisees in all sectors, including restaurants. His experience also includes holding leadership positions with Bank of America and at JPMorgan Chase, where, prior to joining Regions, he served as SBA Southeast Division Manager for Business Banking.

"I joined the bank to develop this specialty and centralize the franchise efforts," he reports, throughout Regions' footprint in high-growth markets across the Southeast, Texas and the Midwest.

They focus on providing financing from $500,000 on up to $5 million to operators in proven brands with one to 10 units looking to grow. They can go higher than that, leveraging their conventional lending capabilities. If needs are smaller than $500,000, they can work with Ascentium Capital, an equipment lender Regions acquired in 2020.

"Many banks and lenders love those large, multi-unit franchisees," Salas says. "But when you get down to smaller operators, it's a fragmented industry. We have developed a vertical to arm our bankers so they can bring those specialty capabilities to the client and add value. We give customers access to other resources, too," such as educational webinars around employee retention, financial literacy, cash flow management and other business topics.

Salas cites a franchisee who told him he picked Regions from a group of three banks. "When I asked why he chose us, he told me, 'You brought subject matter expertise, treasury solutions. You know about our concept and how to underwrite the deal. The other banks just brought a loan proposal,'" he recounts.

Salas and his team want to build relationships, and Salas himself loves the space. "Franchising provides to people who want to work hard a proven concept, and if they follow it they will be successful," he says. "It helps create generational wealth." For more information, contact him Peter.Salas@regions.com.

Auspex Secures Financing for Wendy's Franchisee

Tri-Cities Restaurant Group, a Tennessee-based Wendy's franchisee owned and operated by QSR operator **Jamey Horton**, has obtained $14.45 million in new loan commitments, including a delayed-draw term loan and a development line of credit. The loans were used to refinance existing debt, buy back warrants from an exiting private equity firm, provide capital for remodels of existing restaurants and the development of new restaurants. Tri-Cities owns and operates 17 Wendy's restaurants in Tennessee and Virginia. Investment banking firm **Auspex Capital** acted as the financial advisor and debt placement agent. The financing was completed in partnership with **CrossFirst Bank**.

For more information, contact **Chris Kelleher** at 562-424-2455 or email at ckelleher@auspexcapital.com.

ConnectOne Formalizes Franchise Division

Justin Anderson was brought on to lead the **ConnectOne** franchised lending efforts in 2021.

"ConnectOne had been originating franchise loans for numerous years; it began as ancilliary business to support our relationship clients," he reports. "As the bank grew, we saw an opportunity to formalize the division and built out a team to support the franchise space."

As Franchise Lending Team Leader, Anderson has been building the team, expanding on existing client relationships and went "full bore into origination last year," he says. "I'll say this: I've been around for a while, and we had a fantastic year. We hit the ground running."

His first restaurant lending experience came working with two large multi-unit restaurant franchisees while he was at JP Morgan Chase about 14 years ago. In 2016, he joined Sterling Bank (now Webster), as the lead credit officer for their franchise group. The managing director then left, and Anderson was charged with running the entire group. Under his management, they originated close to half a billion in franchise loans.

In 2021, he joined ConnectOne, and "we've crystalized the group—the team has blossomed, and our underwriting team and lenders are actively pursuing deals."

ConnectOne provides a wide range of senior debt for acquisitions, refinancing, development lines of credit, commercial real estate, construction loans and more, for restaurant franchisees nationwide. And, they also work in tandem with their SBA department, which is a preferred lender.

Separately, the bank purchased in 2019 online lending marketplace BoeFly, which operates as a separate entity under the leadership of CEO Mike Rozman. BoeFly helps verify potential franchisees as viable candidates for franchisors, and connects franchisee loan requests with banks that target the franchise space. While BoeFly counts numerous franchisors and banks as clients, Anderson says the bVerify service—where BoeFly verifies the credit worthiness of a franchisee—as well as BoeFly's market intel, has helped to expedite the loan process.

And, he says that is the bank's calling card: being responsive.

"At the end of the day, we've got a client-focused, sense-of-urgency culture," he reports. "We have easy access to all of our products, and we have a flat organizational structure here. I can get on the phone with the CEO or head of the commercial bank and pick their brain on a deal. Our clients appreciate that. For instance, our development lines of credit: We can draw requests incredibly quickly —normally same day—and a customer can have the money right away for vendor and construction payments."

Part of that is even accommodating the atypical deal structure. "It is meeting the direct needs of the client," Anderson says. "We focus on the strength of the borrower, the story of that operator and building a relationship with the client, despite the phase of business they're in."

The common denominator regarding all customers for Anderson is getting to know them and their stories, and seeing their impact on their communities. "It might be about hearing how they started as an employee who was mopping up the back of the Dunkin' Donuts, and now today, they have 50 units," he says. "They have a commitment to their employees, too: They are creating jobs and making their community a better place."

For more information, contact him at janderson@cnob.com, or at 845-367-4987.

Unbridled Closes on Taco Bell Units for Franchisee

Investment banking firm **Unbridled Capital** recently closed on the sale of two Taco Bell locations in Washington state for the seller, **Apex Restaurants**, owned by **Earl and Donna Bell**, who are retiring. The buyer was **Northwest Restaurants**, owned by the **Sibert family**. Northwest is a large YUM! Brands operator with almost 200 restaurants.

"This is continuing the trend we're seeing of first-generation franchisees who are reaching retirement and are recognizing the value of the business they created," said **Rick Ormsby**, Unbridled Managing Director.

For a lot of brands, he says, it's a tough time to sell because of commodity costs, lower customer traffic and labor pressures.

"Valuations have come under pressure over the last year," Ormsby says, "But Taco Bell continues to outperform most of its peers, and is bucking the trend with strong valuations." In fact, he is working on a deal right now—a large market—that has garnered more than 10 offers.

"The valuations there, in my opinion, are some of the highest I have ever seen in that brand," he reports.

And while all brands are not created equal, still, most "healthy businesses are still attractive (to buyers) despite the headlines, because of the supply/demand situation that still favors sellers," Ormsby reports. And, franchisees have an immense amount of capital sitting on their balance sheets, a lot of it from ERTC Credits.

Case in point: "We have a Burger King deal right now that attracted nine offers at strong and unexpected prices," Ormsby says.

And a Wingstop deal currently on his desk "has garnered twice the interest I thought it would." But, he warns, if the business is marginal, "don't expect any interest." For more information, contact him at rick@unbridledcapital.com, or at 502-338-0162.

Oak Cap Scaling Up to Buy Restaurant Real Estate

"By the end of the year, we'll be out there competing and buying restaurant and convenience store real estate," says **Glenn Kindred**, the recently appointed Partner and Managing Director with **Oak Cap Ventures**, a real estate investment and development company.

"Oak Cap has a solid history of investing in restaurant real estate, but it was not at the scale we intend to do now," he reports. Enter Kindred, whose 20-year restaurant real estate résumé includes executive roles in restaurant-focused REITs, such as VEREIT, CNL and Trustreet, and leading the restaurant real estate efforts for GE Capital.

The firm raises institutional capital to invest in real estate, either through sale/leaseback financing for restaurant operators or portfolio acquisitions.

Oak Cap is also an affiliate of **Guernsey Holdings**, an investment firm that acquires and operates Sonic restaurants and other franchise restaurants throughout the U.S. "They know how to run restaurants," says Kindred, "and they have a great head for real estate."

Oak Cap Ventures will look to invest 5 million to $50 million-plus in franchisee real estate with "proven quality operations," he says. "Yes, we look at the brand and tenant credit, but well-run, unit-level operations is what makes a store survive in hard times. We do that unit-level and real estate analysis."

Plus, they can fund and support the development process for franchisees. "Because Oak Cap is an active developer, we can bring those skills to the table to support our clients," he says. "We can come alongside them with capital to meet their new store obligations."

Kindred attests for some REITs, it can be all about the financial returns. But as he sees it, it is the individual unit and skill of the operator that pays the rent.

"As long as the franchisee can have a long-term, friendly landlord who understands their business—not just real estate, but operations, too—they should like working with us," he says. "We're in partnership with the operators."

That's all part of being a smaller organization that Kindred is helping build. Because they have institutional capital, "We can compete with the big boys, even though we're not one of them. We can compete, but we still want the relationship. We don't want to compete if we don't get a relationship with it."

Understanding the operator's business is part of that, as well as helping them with their real estate issues, and helping them to grow.

"I love the acquisitions, the asset management, getting to know the franchisees and the brands. I get to be involved in all parts of those processes," he said. "I spent 20 years in restaurant real estate and it's good to be back. We are off and running." For more information, contact him at (321) 663-1925, or at glenn@oakcapventures.com.

Eatz Provides Sellers with Restaurant Brokers Expertise

"We have nine brokers across the nation," says **Tami Hillier**, a broker with **Eatz & Associates**, "and everyone comes from a restaurant ownership background or franchise restaurant sales."

Owner **Tom Traina** launched the brokerage firm in 2003 when he was selling his own multi-unit Subway business, as well as an independent restaurant. "When he was selling, he didn't have a good experience, and he saw a niche that needed to be filled," Hillier explains.

She joined Eatz in 2008 from Kahala Company, where she was Vice President of Sales for Cold Stone Creamery. "Business brokers vary quite a bit in how good they are, and he was just the strongest broker I worked with" when she was selling Cold Stone locations.

Today, Eatz primarily works with sellers, and will take on listings of all sizes. "I have a listing for 50 corporate Friday's locations right now, but we'll do listings for one or two restaurants."

Since launching, Eatz has sold about 2,500 restaurants, and in 2022 alone, they sold 126 locations with $35 million in listing value. The company assists sellers in all stages of the sale process, from listing and buyer screening to LOIs and closing and all that goes on in between.

Hillier says franchisors have a unique opportunity to help educate their franchisees on exit strategies before the operators decide to sell. But most, she said, have not stressed that.

Operators can become tired, "and they can be checked out and operations are suffering. There is a life to a restaurant owner's career. But you want to figure out when you want to get out in order to go out on top, when things are looking good," she says. "That education is just shockingly lacking in the franchise world."

But that's also part of her challenge, and she loves it. "Everything changes and that's fun. I'm looking for the deal, and both sides have to be happy. That's a great role to play: making sure both sides win. The biggest compliment I get is when my buyers come back later become my sellers." For more information, contact her at 503-319-4626, or at tami@eatz-associates.com.

Since Covid it's become the regular practice for restaurant company CEOs to tout their high levels of liquidity during shareholder conference calls. However, they define liquidity as the cash on their balance sheet, plus the unused portion of their revolving lines of credit. Ha! In this shaky banking environment, no one should assume a revolving line of credit is rock solid, nor their cash. Both **Silicon Valley Bank** and **Signature Bank** were touting their balance sheets, too, and now both are out of business. Imagine if you were a borrower at Silicon and needed to draw on your line of credit? Who makes that decision? The FDIC? Corporate treasurers now have the responsibility to make sure their cash is safe too. For now the feds are backstopping all deposits, but that could change if there is another bank failure. Let's hear some discussion on the next conference call about the safety of your cash and where you stand with the covenants in your credit agreement.

Speaking of **Signature Bank**, New York State banking regulators shut down Signature on Sunday, March 12 as customer demand for withdrawals overwhelmed the bank. CNBC reported that Signature customers withdrew $10 billion in deposits on Friday, March 10. Signature was active in restaurant and franchise lending through its specialty finance subsidiary and provided financing for acquisitions, new construction, remodeling, equipment and real estate to a variety of approved national and regional restaurant concepts and chains. We reached out to Signature for comment but were unable to reach anyone. Currently, the FDIC has taken over the day-to-day operations of Signature and all of the deposits and substantially all of the assets of the bank were transferred to Signature Bridge Bank, an entity operated by the FDIC.

If **Subway** were a 1,000 unit chain and had the lowest AUVs in the sub-sandwich space and poor franchisee profitability (Hint: Jersey Mike's, Jimmy John's and Firehouse Subs have really put the hurt on Subway), a buyer might look at a potential acquisition as an opportunity to turn it around and ramp up growth. Instead, Subway is a giant behemoth—21,000 U.S. and 16,000 global stores. Reigniting meaningful growth is going to be a challenge. Since 2011, Subway's domestic unit count has declined by more than 3,500 stores in the U.S. The opportunity with Subway lies in substantially growing AUVs, which given how low they are currently, is going to be a challenge. It's not insurmountable, though. A buyer is going to have to write a big equity check.

Without a fast and reliable delivery system, **Domino's Pizza** is just another pizza brand. Pizzas are meant to be delivered. By offering a $3.00 coupon on the next pizza pick up order, it muddles their decades old convenience message. Customers don't buy Domino's Pizza because it's great pizza, they buy it because it's conveniently delivered. Domino's is struggling to generate same-store sales growth after years of outperformance. **Gordon Haskett** analyst **Jeff Farmer** sees average franchisee EBITDA falling to $143,000 in 2022 versus $174,000+ in 2020 and 2021. That, he believes, diminishes the economic incentive to build more stores. On March 3, Farmer downgraded Domino's shares to a hold from buy.

Update on **Del Taco** refranchising: Parent **Jack in the Box** refranchised 16 Del Taco corporate stores to franchisee **David Beshay**, and obtained a development commitment for 16 additional units in California. Del Taco's current plans are to refranchise 120 units over a three-year period. Jack in the Box CEO Darin Harris told a recent conference call audience the company expects any franchisee that buys a Del Taco corporate store to agree to develop at least one additional store. The Cypress Group is handling the refranchising.

Former **Panera** CEO **Ron Shaich** has written a book that will be published this spring by Harvard Business Review Press. The book is entitled, *Know What Matters: Lessons in Building Transformative Companies and Creating a Life You Can Respect.*

Casual dining franchisees say they are having trouble finding banks willing to finance them. Pehaps this is the reason. Despite posting eight consecutive quarters of positive comparable sames store sales, **Applebee's** has closed 116 franchised restaurants in the U.S. since 2020. Parent company Dine Brands Global estimates a net decline of 10 to 20 more Applebee's restaurants in 2023.

Wall Street restaurant analysts are finding greener pastures in CFO roles at growing restaurant chains. **Goldman Sachs** analyst **Jared Garber** is leaving to become CFO of **Just Salad**. His predecessor, **Katie Fogerty,** joined **Shake Shack** in June 2021 as CFO. Piper Sandler analyst **Nicole Miller Regan** is **7 Brew Coffee's CFO** as of late last year.

Interested in executing a sale-leaseback this year and wondering how long it might take to sell your properties? If you are using a broker to sell property into the commercial real estate market, the time it takes depends on a number of factors, including the deal size, cap rate, lease term and region of the country where the property is located. According to data provided to the Monitor by **Matt Lipson** of **Northmarq**, the lower the cap rate, the quicker the sale. Cap rates north of 7% are taking the longest to close, according to Lipson's data. Properties with lease terms under five years also take longer. The difference between a lease with under five years left and one that is 15-plus years is 60 more days on the market.

FINANCE INSIDER

Meridian Restaurants Unlimited (and related entities), the 118-unit **Burger King** franchisee that filed Chapter 11 on March 2, owes approximately $46.4 million to **City National Bank,** according to the court filing. There is approximately $14 million of unsecured claims, the majority of which are owed to Burger King Corporation for royalties, advertising and rent. The filing also indicates that Meridian is asserting City National's outstanding debt is unsecured, the result of its perfected security interest lapsing prior to the bankruptcy filing date. **Polar Star Capital**, a Utah-based private equity investor owns 60% of the equity. **Peak Franchise Capital** has been appointed by the court to be a financial advisor. Meridian cites increased wages and food inflation as the prime reasons for the bankruptcy filing. James Winder, chairman of Meridian and Polar Star's principal, told Laura Michaels of Franchise Times in an email that he supports Burger King's "Reclaim the Flame" program and that BKC leadership is "taking an effective step to move the brand forward and drive future sales."

A&G Real Estate's **Joe McKesska**, MorrisAnderson CEO **Dan Dooley** and Punch Bowl Social CEO **Robert Cornog, Jr.**, were John Hamburger's guest on a recent webinar discussing workouts and underperforming restaurant operations. McKesska advised operators to be more aggressive in trimming bad stores. He said to focus not only on restaurant level cash flow and the rents relative to the market, but take into account future capital investment requirements of the location. "Operators hate to close restaurant locations, but I think if you hold on to locations for too long, it will really come back to bite you." Dooley, who is currently serving as Burger King franchisee **Tom's King's** restructuring officer, said franchisors hate it when franchisees close stores because many of them have securitized their royalty streams and have other restrictions within their financing. Dooley said you usually have to resort to "self-help" which means shutting stores over a franchisor objection. Dooley said he once told a franchisor who was telling him he couldn't close locations this: "I can either run out of cash, or shut the stores and have you mad at me. I am going to chose to not run out of cash and make payroll next week." The Monitor webinar is available for viewing at www.restfinance.com.

Interesting stats from **UBS** restaurant analyst **Dennis Geiger**: Quantitative analysts at UBS have developed a crowding score, which in its most simplest term, represents the most crowded long or short positions in the stocks of certain companies. According to UBS data, the most crowded longs in the restaurant sector are McDonald's (MCD), Starbucks (SBUX) and YUM! Brands (YUM). The most crowded shorts are Cheesecake Factory (CAKE), Kura Sushi (KRUS), Brinker International (EAT) and Dutch Bros (BROS).

Wall Street analyst **Mark Kalinowski** reports that **Starbucks** (SBUX) now has approximately $1.7 billion in unredeemed gift cards.

Strategy and innovation consultant **Lisa Miller** has published a new book, *The Business of Joy*. Her book contains lessons learned from the pandemic based on over 55,000 consumer interviews and many hours she spent interviewing business leaders and frontline employees. It is available on Amazon. Lisa's recent surveys of 1,000 consumers still show that 32% of survey respondents are extremely concerned about Covid, with GenZ overindexed in that survey.

Former founders, **Famous Dave's Dave Anderson and Rainforest Cafe's Steve Schussler** have teamed up and will open a new pizza concept called Big Dreams Pizza, which they said they intend to franchise. It opens in Minneapolis later this year.

YOU KNOW YOU'VE GOT IT GOOD WHEN....
SWEETIE, THE STEAKS FROM MORTONS ARE HERE!
DOOR DASH
MAKE SURE THEY REMEMBERED THE CHEESECAKE!

Sticky Inflation, Share Buybacks and More

By Roger Lipton

Inflation will linger well above 2%—In the nine months from June of 2022 to February 2023, the year-to-year consumer price index (CPI) in the U.S. has come down from 9.06% to 6.41%. The current year-over-year number is in the high 4% range. Many financial pundits say the Federal Reserve has already broken the back of inflation. However, the U.S. ran a trade deficit of $948 billion in calendar 2022, which means we are importing almost a trillion dollars more than we are exporting. The cost of goods purchased abroad is therefore critical to containing the CPI. During the same nine months referenced above, Germany's CPI went from 8.25% to 9.17%. Italy from 8.46% to 10.67%. Great Britain from 9.08% to 10.05%. Japan from 2.41% to 4.39%. Modestly down were Mexico, from 7.99% to 7.91%, India from 7.01% to 6.52% and China from 2.5% to 2.1%. The only material decline among our trading partners is Russia (with an economy one eighth our size), falling from 15.02% to 11.7%. Suffice to say that inflation is far from beaten down abroad, so a further material decline in the U.S. is problematic.

Returning cash to shareholders is often a misnomer. Papa John's (PZZA) announced recently the repurchase of 2,176,928 shares at $82.52 per share from Starboard Value, an activist that took a position in the company in 2019. The company pointed out they will have spent more than $410 million, buying back more than 10% of its shares since 2020. Though Papa John's did not say they were returning cash to shareholders as others often do, the clear implication is they have done shareholders a favor by shrinking their share base.

If share buybacks are done at an attractive price and a low multiple of cash flow and earnings, and the shares outstanding number shrinks, the share repurchase can be purposeful in terms of improving the value per share for the remaining investors. However, the Papa John's bullet point of "buying back more than 10% of our shares" is misleading to me, because the common shares outstanding are similar to what was outstanding at the end of 2020, as well as before Starboard came on the scene. The common shares outstanding increased by about two million from 2020 through 2022. In essence, $420 million has been spent, most of it to redeem the Starboard preferred stock, but it has not helped shareholders in terms of shrinking the capitalization.

Relative to the value repurchased, Starboard made a good investment back in 2019. However, Papa John's had no obligation to provide them liquidity. I suggest that Papa John's common stock, the last tranche purchased at $82.42, was no great bargain. Its enterprise value is about 20x trailing, 12-month EBITDA. On my website, I follow all publicly held restaurant companies and I would say an enterprise value to trailing EBITDA in the high teens is more or less "fair value." Papa John's, in essence, completed a trade, selling stock at about $50 per share and buying it back at $82. A special dividend of about $5.00 per share (on 35 million shares) could have been paid, representing about a 6% yield.

Other pure franchisors such as Wingstop and Domino's have periodically paid special dividends, and their shareholders seem to appreciate it. I hasten to point out that Papa John's is far from the only company that has bought back stock at fully valued prices, with the primary benefit to management who are issued stock or options that offset the stock re-purchased.

With most of the publicly held 2022 reports in: The post-Covid reality is clearer. Commodity cost increases, costing 100-300 points of store margin in 2022, were not fully offset by higher menu prices and are now catching up with further price increases of 3-5%. Wage increases in 2022 were better controlled than cost of goods, by way of better labor management, sometimes enforced by lack of labor availability. Job applications are coming in, but a mid-single-digit increase in wages is expected and staffing will be more complete so operating leverage here is doubtful unless sales accelerate. From the customer's standpoint, service should be improved. Digital ordering is broadly increasing, and off-premise activity is up 10 to 15 points from before Covid. Transactions/traffic is mostly down from 2022, even from 2019, especially considering dine-in activity. With building costs up about 15-25% per square foot, and dining rooms underutilized four days per week, it should be no surprise chains are choosing to shrink the footprint of their new stores and are including more drive-thru lanes. While there is a modest increase in unit growth, the step up in openings is mostly coming from the franchisee communities.

Shake Shack is growing their domestic company stores at "only 15%, their slowest rate of growth since going public, which should work to their benefit in terms of controlling costs. The stocks have bounced substantially off their lows of last fall and are now more appropriately priced. With consumer credit card debt at a new high, with applicable interest rates as high as 20%, it seems overly optimistic to count on a resilient consumer.

Roger Lipton has followed the restaurant industry for four decades. Founder of money management and investment banking firm Lipton Financial Services, Inc., he publishes regularly at www.rogerlipton.com. He can be reached at lfsi@ aol.com or 646-270-3127.

STATS AND QUOTES

INTERESTING TIDBITS HEARD ON RECENT CONFERENCE CALLS	
Gunther Plosch, CFO, The Wendy's Company	"From a competitive point of view, I would say the QSR category is definitely competitive. We are seeing of late trading down from mid-scale casual into QSR that helps. I would also say, whilst I'm saying it's competitive, we don't expect the value wars of 2018."
Mel Hope, CFO, First Watch Restaurant Group	"2023 is a 53-week fiscal year for us. Our fourth quarter will be a 14-week quarter and we expect the impact of that extra holiday week to be roughly $10.5 million in sales and $2.5 million in adjusted EBITDA."
Darin Harris, CEO, Jack in the Box	"I think as a whole we're seeing some trade down from casual dining and fast casual into QSR. We're also seeing across the industry what I think a lot of us over the last two years thought that maybe we'd flatten out on a digital and delivery standpoint. Our business continues to accelerate in the digital and delivery space."
Craig Pommels, CFO, Cracker Barrel	"Relative to pre-COVID, we're still down, but we've seen tremendous gains in off-premise, or individual to-go third party, and catering has been a particularly strong bright spot that we have made a focus area that's also driving our off-premise business."
Michael Osanloo, CEO, Portillo's	"There are certain elements that make it easier to work in Texas, but our first restaurant there is in a relatively high-priced location. We're paying really well. We're paying for great labor. We're expecting greatness out of our team. So I would tell you that I don't think of it as coming out of the gate with Chicago-like margins."
Cheryl Henry, CEO, Ruth's Chris	"The reality of the situation with beef is the herd size is down and until we can bring that back up, which will take some time, we are going to see some challenges on beef."

INTEREST RATES (%)

	03/13/23	Last Month	A Year Ago	Trend
Fed Funds Rate	4.75	4.75	0.25	↑
30-Day BSBY 1M*	4.74	4.57	0.30	↑
90-Day BSBY 3M*	5.05	4.77	0.75	↑
30-Day SOFR**	4.56	4.55	0.12	↑
90-Day SOFR**	4.40	4.55	0.13	↔
1-Year Treasury	4.29	4.99	1.30	↔
5-Year Treasury	3.68	4.00	2.20	↔
10-Year Treasury	3.55	3.76	2.19	↔
30-Year Treasury	3.69	3.80	2.46	↔
Prime Rate	7.75	7.75	3.25	↑

*Bloomberg Short Term Bank Yield Index **Secured Overnight Financing Rate

Michael Kantro, Chief Investment Strategist at Piper Sandler, tweeting about the relationship between interest rate hikes and a possible recession: "The stomach ache doesn't hit immediately when you eat a big meal. It hits you an hour later. This is why we overeat, or in this context, the Fed 'over tightens.'"

Former Federal Reserve governor Judy Shelton discussing Fed interest rate policy on a March 8th episode of CNBC Squawk Box: "Their formula is really collapsing into an axiom of the higher the interest rate, the lower the inflation. That could be exactly wrong because I think they are affecting supply more than demand so it could prove damaging rather than helpful to resolving inflation. The downside of continuing to hike rates is that you are adding to the costs of doing business. The cost of capital for small businesses and corporations is extremely important. If you are causing businesses to increase their cost of capital, that's going to go to the bottom line."

First Trust Chief Economist Brian Wesbury discussing the impact of the Federal Reserve raising interest rates: "The bottom line is that in spite of investors and markets obsessing about rate hikes, they need to focus on the money supply. The supply of money exploded in 2020-21 but peaked in early 2022 and has since declined at the fastest pace since the 1930s. It's the growth in the money supply, or continued lack thereof, that will determine what happens to economic growth and inflation in the next couple of years. Obsessing about the short-term interest rates targeted by the Fed, when there is no real market for federal funds traded among banks anymore, is barking up the wrong monetary tree."

Why Loan to Our Industry?

By Dennis Monroe

Fortunately for all of us, there tends to always be a supply of new lenders and finance sources exploring and/or entering the restaurant, and particularly the restaurant franchise, finance sector. When the Monitor started 35 years ago, there were only a small number of lenders and finance resources. But now in addition to the longtime banks and finance companies, there is an ever-growing group of banks that have gotten into the franchise lending space. I interviewed some key new players, but I'll also give my thoughts on why this industry seems so desirable for lenders.

1. The demand is there: There certainly has never been a shortage of demand for funding in the restaurant industry; and on the flipside, there is always a shortage of lenders to provide this funding.

2. It's a cash flow business: And it's pretty easy to define cash flow, particularly in the restaurant franchise world. This predictable cash flow is key in the loan underwriting process.

3. Franchisor assistance: Franchisors don't like franchisee defaults or closures, so they usually are willing to actively assist with bank or credit issues to maintain value in the borrower/franchisee business.

4. Other programs: There is the availability of additional lending programs, such as those offered by the Small Business Administration (SBA) which gives banks the overarching safety net.

5. Short amortization: Because most restaurant loans have shorter amortization periods, the risk decreases.

6. Low sensitivity to interest rates: Finally, most restaurant owners are not rate sensitive. They are more concerned about the supply of funding and typically don't demand lower rates. The exception may be the large operators.

Here's what lenders I talked to have to say:

Luke Rhyner, director of franchise finance at Heartland Bank (HTLF), has recently gotten involved in this space. HTLF is a national player with a number of different banks operating under different names. This is a progressive group pioneering some new thought processes. They have structured a vertical lending approach (industry-specific) and one of the vertical's franchise finance groups focuses primarily in the restaurant space. Rhyner heads up this group, along with veteran players, and they've already had some significant traction, particularly participating in larger loans and leading syndicates in major restaurant franchise areas. Rhyner said they saw this as an opportunity to provide their banks with enough supply and demand to make it a powerful lending vertical. HTLF looks at not just the loan volume, but also the broader banking relationships.

While Rhyner agreed there was less rate sensitivity in restaurant franchise lending, his key incentive is developing relationships to do full-service bank services for the franchise industry.

The second person I talked to was Craig Caldwell, executive vice president and director of specialty finance at Encore Bank. Encore was started as a small community bank with a business proposition to fund new markets with local investors from 100 to 150 people. That, in effect, provides the capital for expansion, and serves as both a customer base and referral source to grow the marketplace. This strategy has allowed them to grow to $3.8 billion with continued growth.

Encore considers itself a concierge bank, which means they strive to take exceptional care of their customers. One of their major specialty lending areas, headed by Caldwell, along with his veteran team, is the franchise industry. To date, their lending activities have been with the key large concepts, but they have also done a good job in the lower to middle markets for restaurant franchise systems.

The reason they're involved in this space, he said, is to meet a significant need of their customers in specific markets. They also have a strong SBA presence which has led them to fulfill some other needs in this industry.

"The one thing about franchise lending is that it is so relationship driven," Caldwell said. He understands what's important in the development of a franchise-lending program (including the six points above), and they are key to their culture. He stressed they are committed to this sector and will continue to develop relationships that will tie the investor approach to their bank and future expansion.

These two examples, as well as others profiled in the Monitor every month, point to the lender groups coming into the space hiring industry experts. Even with these well-known professionals, each bank/lender has some unique approaches to our industry—and as the way we do business continues to evolve creative approaches are always welcome.

Dennis Monroe is chair of Monroe Moxness Berg, a law firm which focuses on M&A, taxation and other business matters for multi-unit restaurant business. You can reach him at dmonroe@mmblawfirm.com, or at 952-885-5962.

Banks Plan to Write Fewer Loans to Business Customers, Which in Turn are Less Interested in Taking on Additional Debt; Higher Funding Costs Pressuring Banks

By Jim McFaddin

Commercial and industrial (C&I) loans made by the 15 largest publicly traded U.S. banks increased to around $1.5 trillion in 4Q 2022, up 2.8% from 3Q 2022, according to S&P Global Market Intelligence. The 4Q 2022 data marked the fourth successive quarter where banks' C&I loan portfolios grew. Such a jump in this cyclical category of loans seems quite robust, but that seasonally boosted 4Q 2022 rate of increase seems likely to reverse in 2023. Indeed, more than 43% of banks reported tightened lending standards for companies of all sizes in the fourth quarter, per the January 2023 Fed's Senior Loan Officer Opinion Survey on Bank Lending Practices. That percentage was much higher than the 31.8% to 39.1% range reported in the previous quarterly survey.

This reversal in tone and direction to significantly tougher lending has occurred over a remarkably condensed time frame. According to the Fed, the large U.S. aggregate C&I loan balance as of September 30, 2022, was up 18% from September 30, 2021.

Even more concerning, C&I loan demand has dropped even faster than supply is tightening. The percentage of banks acknowledging weaker demand in the last quarter of 2022 increased sequentially by more than 20 percentage points to a range of 31.3% to 42.2%. Chris Duncan, a senior loan officer at LaSalle Street Bank in Illinois seems to sum up borrowers' cautious attitudes: "There's not much in the pipeline. Things have really kind of dried up here in the middle of January. And I think that is a result of the interest rate increases, inflation, just general uncertainty in the market on the part of businesses and consumers."

The reason for this fall-off is obvious: With the Prime Rate at 7.75%, many small businesses including restaurants which take out loans to establish or grow their business, must pay more than 10% interest for those funds. Small Business Administration (SBA) lenders are limited to a 3% maximum spread over the Prime Rate.

Both psychologically and from a bottom-line perspective, a double-digit interest rate is expensive money. Unfortunately, interest rates seem likely to increase over the course of 2023. Several brokerage firms expect the Federal Reserve to raise rates by an additional 75 basis points before year end. Not surprisingly, 62% of small business owners said they were not interested in a loan, per a January 2023 survey published by the nonpartisan National Federation of Independent Business (NFIB).

Overall, the Fed report paints a discouraging backdrop for banks' willingness to lend to businesses, and the volume of such lending. A single statement from the Fed's loan officer survey is a good summary: The banks "reported tighter standards and weaker demand for commercial and industrial loans to large, middle-market, and small firms over the fourth quarter."

Banks' funding costs rose significantly in the second half of 2022 as the Fed continued its historic pace of overnight rate increases. Deposit costs have risen about 100 basis points since the first quarter of 2022 (The low point in cost of funds in this cycle was just 0.15% in 4Q 2021) as banks have been forced to pay much higher rates on savings and especially on expensive certificates of deposit. You saw this play out in the recent bank failures. Indeed, many banks have made a concerted effort to raise interest rates on customer deposits quite aggressively to keep the funds. Nevertheless, total U.S. banking deposits declined more $166 billion in 4Q 2022 from 3Q 2022, according to S&P Global Market Intelligence.

Moreover, funding costs are likely to move still higher over the coming months. As referenced above, the Fed funds futures market is projecting around 75 basis points of additional tightening over the next handful of months. Curinos, a consulting and data firm, reports 23% of money market deposits held by middle-market customers have yields below 75 basis points. Many of those customers will likely demand higher compensation from banks or move funds to outside managers over the next few months.

Separately, the U.S. Treasury yield curve reached its most inverted level in more than 40 years on March 7 when the yield spread between the U.S. two-year Treasury note, 4.87%, and the U.S. 10-year government bond, 3.94%, reached a remarkable negative 93 basis points. The spread turned negative in mid-2022 and has trended steadily to more negative levels over the last eight months. An inverted yield curve is considered a reliable early warning sign of an economic slowdown.

In simple terms, investors are lending their money out for the long term at rates well below short-term rates. Rates have dropped slightly since the recent bank failures and when we went to press the difference between the two-year and ten-year had declined to a still-inverted 56 basis points.

Jim McFadden is a CFA and has 25 years of experience as a Wall Street analyst and portfolio manager.

Corner Bakery continued from page one

Brinker owned Corner Bakery for 10 years and had roughly 90 locations when it sold it to Hal Rosser's 20-plus unit fine-dining chain, Il Fornaio, in 2006. By comparison, Panera had 877 locations, 566 of those franchised—nine times the size of Corner Bakery.

Believing Brinker's corporate store bias was impinging its growth potential, Il Fornaio's CEO Mike Hislop saw an opportunity to franchise, especially to multi-unit franchisees. Hislop discovered, however, that ramping up a franchise program takes time and requires an experienced team in place. Five years into it, with the franchise momentum well underway, Bruckmann Rosser decided to exit and it merged the operation into an entity affiliated with Roark Capital. Roark founder Neil Aronson told a restaurant magazine Corner Bakery was a "terrific opportunity on the franchise side, and we would expect to accelerate the growth in franchising."

Roark knew franchising and by the end of 2015, the number of franchised locations had increased by roughly 50 stores. Hislop, who stayed on as president, set out to add more franchise partners, hoping to double the number of locations in two years. But there were problems. Corner Bakery was the second or third brand for most of its multi-unit franchisees. For franchisees, bridesmaid brands often get more scrutiny and must fight for expansion capital with their main brand. And, the fact is, franchisors and lenders aren't as favorable to second brands, especially when franchisees seek to collateralize both operations into one loan.

Corner Bakery's move to ramp up franchising also strained the company's ability to service the franchisees. A five-unit operator in California sued the chain in 2015, alleging false representations regarding the financial performance and lack of support. Twelve franchise restaurants closed in 2016 and 2017.

In 2020, with franchise sales waning, a pandemic to deal with and little desire to build company stores, Roark unloaded Corner Bakery. Two years later, Pandya would default on the approximate $33.8 million debt he owed on the deal.

Sunil Dharod's SSCP Restaurant Investors bought Corner Bakery's outstanding debt last month at a steep discount. Dharod declined to comment, but a source told the Monitor it was being shopped around for a number of months to investors by Goldman Sachs for roughly $12 million. Dharod likes old brands and may do something with Corner Bakery once he gets it back. He's currently a large Applebee's and Sonic franchisee and in 2015 purchased the casual diner Roy's from Bloomin' Brands. Recently he and Anand Gala acquired Cici's Pizza in a bankruptcy sale and are making progress stabilizing that brand. Gala did not participate in the Corner Bakery transaction.

What are my three Corner Bakery takeaways?

1. Second concepts never get the same attention (or capital) as the primary brand. That's true for brands and franchisees. Brinker said it would only expand brands with the best returns. Corner Bakery never lived up to Chili's.

2. Corner Bakery had too many owners. It changed hands four times and each time a new strategy was born. Three of the owners got their hat handed to them by Panera, a brand that was run by one man, Ron Shaich, for 25 years. Constant tweaks to the Corner Bakery concept from revolving-door management teams brings to mind the infamous Chinese torture, "death by a thousand cuts."

3. If at first you don't succeed, franchise. Multi-unit franchisees should be suspicious when after 15 years, a brand decides to franchise. The store numbers at Corner Bakery during the later Brinker years weren't that attractive, or they would have hung on to it. Il Fornaio and Roark brought early energy to the brand by attracting multi-unit operators to develop stores. However, sustainable growth is always predicated on franchisees achieving good store numbers. And, those weren't good enough.

—John Hamburger

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John M. Hamburger (jhamburger@restfinance.com) • Mary Jo Larson (mlarson@franchisetimes.com)
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