

## OUTLOOK

**You Don't Need a Weatherman.....**

That restaurant CEOs took a victory lap because of positive same store sales in the first quarter is more likely a case of Omicron amnesia than a sign that everything is peachy in the foodservice business. The compounding effect of multiple menu price increases over the past two years is what's keeping restaurants purring, not because of any measurable increase in traffic.

Restaurant operators can't be blamed for repricing menus in an inflationary environment. An ability to raise prices is the beauty of this business, especially given the rapid rise in prime costs lately. However, with commodity costs falling now and operators reporting lower food costs as a percentage of sales, tight-fisted consumers are reassessing their personal value proposition. I get it. My craving for an excellent Portillo's chopped salad that has risen 26% in price in two years is waning.

"Not sure that charging fewer customers more money is sustainable in the long run," is how a QSR franchisee explained his micro-economic concern to me recently.

This post-Covid inflation isn't the first time restaurant operators have faced a teetering supply and demand curve. Fifty years ago this December, the 12-month increase in the Consumer Price Index was a Jerome Powell-like 20.3%, the highest one-year level in recorded U.S. history. Food prices increased a total of 31% in 1973 and 1974. By comparison, the increase in food prices in 2021 and 2022 seems measly at 18%.

Inflation shocked Americans in the '70s. High grain prices drove meat prices higher, so people reduced their consumption. Shoppers organized protests at grocery stores. President Nixon imposed wage and price controls to get inflation under control, but each time he relaxed the controls, producers raised prices. And restaurants, then just 25% of the food budget, scrambled to survive.

Henry Bolling, a National Restaurant Association board member and operator of seven restaurants in downtown Chicago, described the restaurant industry's inflation quagmire in a 1973 speech to the Institute of Food Management:

*Continued on page 10*

**Mark Your Calendars for RFDC!  
Restaurant Finance & Development Conference  
November 13-15, 2023 • Bellagio Las Vegas**

Decision-making during times of uncertainty is difficult and there is no better place to find that timely financial advice than at the **Restaurant Finance & Development Conference**, which will be held November 13-15 at the Bellagio Hotel in Las Vegas.

Last month we announced **Restaurant Brands International** Executive Chairman **Patrick Doyle** will join us for this year's conference and speak during our opening general session. Doyle was CEO of Domino's Pizza from 2010 to 2018 and led the transformation of that pizza brand into a digital powerhouse. We're excited to hear Patrick's views about where his company is headed and also his thoughts on the industry.

RFDC attendees will also hear from Stanford University economist **Nicholas Bloom**, the co-director of the Productivity, Innovation and Entrepreneurship program at the National Bureau of Economic Research and an expert on remote work. Bloom has researched working from home for almost 20 years and has consulted with hundreds of CEOs and managers. His presentation, "The Future of Remote Work and What it Means for Restaurants," will be during our general session.

**Danielle DiMartino Booth**, a former Dallas Federal Reserve advisor and current CEO of Q1 Research, will participate in a wide-ranging discussion about the economy, inflation, interest rates, Fed policy and what restaurant operators might expect in 2024. Booth is a global thought leader in monetary policy, economics, and finance and is frequently featured on CNBC, Bloomberg, Fox Business News, Yahoo Finance and other major media outlets.

RFDC is taking shape quickly and we hope you attend the conference this year! **Registration for the conference begins on June 1st at [www.restfinance.com](http://www.restfinance.com).**

### Assad Joins Byline Bank as Franchise Finance Group Grows

“One of the reasons I like Byline is that they are already in the franchise space,” said **Adnan Assad**, a new SVP and Commercial Banking Division Head for **Byline Bank**. “They want to continue that growth.”

Assad most recently headed up Old National Bank’s franchise finance group before joining Byline. He had worked with some of the principals of the Bank before at other organizations, including **Brogan Ptacin**, Byline’s executive vice president-head of commercial lending. There was also a comfort level knowing he enjoyed working with those folks before.

“Another lender on Brogan’s team, **Praveen Chathappuram**, really started the franchise initiative,” said Assad. “He had strong ties with the franchise community here locally in Chicago, and then began to expand to financing franchisees nationally. I want to help Praveen and the team take it to the next level.”

Assad intends to leverage his name and connections with other lenders and brokers to raise Byline’s profile in the franchising, “and start doing larger deals,” he said.

Indeed, Assad has a rich history in franchise finance, including leading the effort for First Midwest Bank, which was acquired by Old National Bank last year, and Popular Community Bank before that. He’s worked with owners of concepts like Dunkin’, Taco Bell, McDonald’s, Popeye’s, Culver’s and Wendys, to name a few.

Byline Bank has \$7.5 billion in assets, and has acquired banks along the way to grow their footprint. The bank announced in November they will acquire Inland Bank, a Chicago-based bank with \$1.2 billion in assets.

Byline’s franchise finance group targets franchisees with at least eight stores, five years of experience and those who work within their business. Their transaction size is around \$25 million, but will grow with the franchisee. Byline will finance recapitalizations, development lines of credit, acquisitions, remodels, equipment and upgrades. The Bank will also participate in syndications.

“We are not going to be transactional,” Assad said. “We are a relationship bank. We want to manage treasury and deposits for our customers, as well as offer other services.” The Bank has been in the top 10 of SBA national lenders for over nine years.

Byline is supporting their franchise efforts with a strong credit team, too, which helps turn around deals faster. “I report to Brogan, and he reports to the president. I can walk down the hall and talk to the president or the chief credit officer and prescreen something pretty quickly,” he said.

And because of his experience in the space, they trust him to make decisions about transactions on a national

basis. “We know what we can do and can deliver on those promises,” he said.

For Assad, he’s also excited to work with a bank that has “deep roots in the community. I tell the story of the Bank to the potential customer before I even talk about a transaction. In 2022, the Bank did \$60.4 million in community development projects. That’s music to my ears.”

For more information, contact Adnan Assad at [aassad@bylinebank.com](mailto:aassad@bylinebank.com), or at (847) 805-9546.

### SREG Offers Real Estate Development to Restaurants

In 1998, when he worked for The Shopping Center Group in Atlanta, **Andy Salomon** started the company’s landlord division, where he built many relationships with tenants.

“I saw a niche they weren’t focused on,” he said. In 2003, he decided to go out on his own and partnered with a developer to start their own development company. They each came to the table with complimentary skills and experience.

“I understood the tenant side; he understood development,” Salomon said. They grew the company to 12 people, but by 2010, the bottom had fallen out of the commercial market. (Remember the housing crisis starting in 2008?)

“We had about 25 strip center assets in hand, and the value of the properties decreased by 40%,” he recalled. “We were merchant developers and could not sell the assets. Most of our projects were on construction loans and the loans came due. The only way the banks would extend the loans was if we substantially paid them down. That meant we had to go back to our investors, which we didn’t do. In good conscience, we couldn’t ask our investors to put good money after bad.” Salomon and his partner were paying the debt, but the banks took the properties back.

“We lost everything,” he said, frankly. “I try not to define myself by my work, but I do to a point. It was very difficult. I thought I was doing the right things, but I learned there are factors out of your control. I realized that was the risk, and figured out there are other ways to be in business with less risk.”

He said he started back from nothing with the help of friends and developers “who had faith in me and we worked together on some deals. I worked some deals to a point where I was able to build up enough to start doing it on my own.”

Salomon said it’s his nature to be transparent about his past challenges, “and I guess it all helped me be who I

am today. It happened, and I know it happened to a lot of other people. I was one of the lucky ones who had friends in the business who helped me stay in business and get to a good place.”

He formed Salomon Real Estate Group, now known as **SREG**, in 2011, with the capital from two family offices. Today, he has a staff of six, and the team is focused on retail and restaurant development, both freestanding and multi-tenant properties from Florida up the coast to Virginia.

They are the preferred developer for Starbucks in Virginia, and have developed properties for Popeyes, Five Guys, Taco Bell, Chicken Salad Chick and Burger King, to name a few.

Today they are “very focused on developing outparcels or parcels right on the road,” he said. Their development deals are usually between \$2 million and \$5 million, and Salomon added he’s finding it harder to find one-acre sites for individual tenants and make it work.

“We’re purchasing larger properties, maybe for two tenants, as an example, and that helps bring the cost down for the tenant,” he said. And, they are working on even larger deals where there are up to 10 outparcels.

“We can break that into pieces and have an Aspen Dental, let’s say, and then add a Popeye’s, a car wash and a Starbucks.”

Salomon said their calling card is creativity. “We always seem to figure out how to buy the property or how to get the deal done for the tenant.”

Another is their profit-sharing program, and that means transparency is a must. “We are open book and show them our numbers,” he said. “When we sell, if we hit a certain basis point spread, we share the profit above that spread with the tenant, or if possible reduce the rent by the equivalent amount. It’s a creative way to show our tenants we are on the same team.”

For more information, contact him at [andys@sregretail.com](mailto:andys@sregretail.com), or at 404-276-8444.

### WSFS Bank Funds Scooters Franchisees

**WSFS Bank** recently provided SBA 7(a) guaranteed funding to two Scooter’s Coffee franchisees.

- \$950,000 to a first-time franchisee in Lubbock, TX for a build out of a new unit.
- \$600,000 to an existing Scooter’s franchisee in Peoria, OK, to refinance an existing location and help with cash flow long term.

When looking to finance a start-up franchisee, WSFS Vice President, SBA Relationship Manager **Carl Buchholz** says among other things, the bank looks at the strength of the business plan.

“The borrower was very organized, and had put together a detailed business plan,” he says, “some 20 to 30 pages. It is an indication they will be able to execute on it.”

In the case of the existing franchisee with one location, “he’s been in business two years and has strong financials,” Buchholz reports. “And he’s looking at opening more.”

WSFS targets established brands with four to five years of operating history, with a significant number of units, he says. In the case of Scooter’s, their units have strong historical financials systemwide.

“Post-covid they have created a concept in the coffee industry that’s very successful,” Buchholz says. Scooter’s has a double-drive through, coffee kiosk building, and “that’s a business model and concept that pushes through a large number of customers each day.”

“Maybe,” he says, “the days of sitting around a coffee shop are behind us.”

For more information, contact him at [CBuchholz@wsfsbank.com](mailto:CBuchholz@wsfsbank.com), or at 484-880-0447.

### Auspex Completes M&A Transactions for Yum! and Wendy’s Franchisees

Boutique financial advisory firm **Auspex Capital** recently closed on the following transactions for clients:

**Sell-Side M&A Advisory:** YUM! Brands franchisee **PRB Management**, based in Fairfield, CA., and owned and operated by QSR veterans **Rita and Pavan Basra**, has completed the sale of its 32 Taco Bell restaurants, including two Taco Bell-KFC co-branded restaurants, to **Kumar Management Corp. II, Inc.** (KMC). The restaurants are located in and around the northern California cities of Sacramento, Stockton and Richmond. PRB retained the real estate underlying 23 of the restaurants and leased the properties to KMC under individual, long-term absolute triple-net leases.

**Buy-Side M&A Advisory:** Wendy’s franchisee **WenJohn, LLC**, an affiliate of CKA Management has acquired two high-volume Wendy’s restaurants in Watertown and Evans Mills, New York, from a franchisee who is exiting that market. Owned by long-time QSR operators **Joe Cugine, Keith Kas** and **John Antonaccio**, CKA is a Lyndhurst, NJ-based restaurant operating company which, through various affiliates, now owns and operates 76 Wendy’s restaurants in New York, New Jersey, Connecticut and Pennsylvania.

For more information, contact Managing Director **Chris Kelleher** at (562) 424-2455 or email at [ckelleher@auspexcapital.com](mailto:ckelleher@auspexcapital.com).

### JAG Finds Underutilized Real Estate for Growth Brands

When he founded **JAG Retail Properties** in 2016, his goal was to find underutilized retail and land sites, and upgrade them with a national tenant.

“An example would be a site we redeveloped in the greater Seattle market. At the time it was a local restaurant that wanted to close,” **Joshua Guthartz** recalled. “We purchased the real estate, added a drive through, and leased it to a national coffee chain. We are constantly on the lookout to place growth tenants in their target markets.”

With the ability to work in all major metros nationwide, JAG focuses on purchasing corners for retail and restaurant investments, and that includes QSR, fast casual and full-service brands.

Guthartz himself has worked in commercial real estate for 18 years, including tenure with a REIT, leasing portfolios of shopping centers on both the east and west coast. He joined a family office in 2012, and there he worked on ground up tenant development in southern California.

“I realized there was a lot of money chasing value-add opportunities, and I was good at putting projects together,” he said. “That’s why I created JAG. I love being on the open road and learning about new markets, and turning over rocks that other people don’t see.”

The company targets brands in a growth mode, both nationally and regionally. “Our clients are typically growing companies with strong credit and strong sales, and once we find a site and the project is complete, the new tenant/project will be a positive add to the community. We want to create a development that the community can be proud of.”

Since JAG is not a large company, they are nimble. “It makes us entrepreneurial, as we’re not doing hundreds of projects at a time. We have the ability to be an extension of a restaurant company’s real estate department.”

They focus on assignments that are typically under \$10 million per project, and can work with tenants on building out a market, if that’s the client’s goal.

Guthartz said they differentiate themselves by “our strong relationships with our tenants, the capital partners and development partners. We have done a lot of great projects and we go above and beyond to get things done.”

He’s an “opportunities deal junkie,” and relishes in the hunt for a deal. He loves finding those diamonds in the rough, he said, to help his clients get into a market. “I just really like the people in the industry,” Guthartz said. “I love when all sides of a transaction win.”

For more information, contact him at [josh@jagretail.com](mailto:josh@jagretail.com) or at 424-259-2510.

### Martin Joins Ascentium Capital to Lead Business Development Efforts

**Jeremy Martin** joined **Ascentium Capital** in March to help take the franchise lending efforts there to the next level.

Named Vice President of Franchise Business Development, his job is to build relationships with franchisors and franchisees, and create more brand recognition within the space.

“There’s so much growth in the space, Ryan wanted to hire someone just for business development,” he said, referring to Ryan Driscoll, vice president, professional development at Ascentium. “I will be working on the brand image, and helping the department as a whole be more streamlined.”

Martin has over 20 years of experience in sales and business development, and started out his career in finance. For the last 16 years, he’s been in strategic development for a medical supply company, calling on their largest accounts.

“I think I have gotten really good at building relationships and friendships with any position I have had,” he said. “I follow through on the promises I make and I work to exceed expectations.”

Perhaps it had something to do with his upbringing. “We lived in 10 different states as I was growing up, and we moved around a lot,” Martin said. “I was forced to get good at making new friends. And really, people want to do business with people they like.”

One of his first goals at Ascentium is to help franchisors and franchisees understand that “using us is a very simple process. Sometimes we can even offer financing with a one-page application.” Under that program, they offer full funding for build outs and leasehold improvements, with a term of up to 72 months.

For mid-ticket lending, they offer funding up to \$2 million, with a term for up to 84 months. “And, we do a lot more than equipment financing. We can lend to new store builds, partner buyouts, remodels and reimagining,” he said. “Plus, we have an SBA offering, too, where the franchisee can borrow up to \$5 million for their project.”

As a small-ticket lender, they can lend up to \$2 million. But, as a division of Regions Bank, as well, “we can leverage our partnership with them, to help our customers get the lending they need, even if it is larger than \$2 million. Regions can do larger-scale transactions, and that includes funding for new builds, real estate or land.”

Martin is excited to lead the business development efforts “and make it my own. I have an entrepreneurial spirit, and I am excited to take the vision to the next level.”

For more information, contact him at [JeremyMartin@AscentiumCapital.com](mailto:JeremyMartin@AscentiumCapital.com), or at 281-921-3868.

### Tauro Capital Advisors Puts Real Estate Strategies to Work for Restaurant Companies

**Tony Festa** enjoys seeing how the pieces of a real estate transaction come together. “Every single opportunity has its own nuances; each location has its own story. Understanding the people and their backgrounds and how they are best suited for their role in the transaction—that’s the most enjoyable part for me.”

As senior director for **Tauro Capital Advisors**, a commercial real estate advisory company, Festa has the opportunity to see the real estate process for restaurant companies from beginning to end. Tauro provides solutions for commercial real estate financing, equity requirements, and advisory services related to acquisitions, recapitalizations, dispositions, asset management, portfolio and capital structuring, due diligence/analysis manpower, and down-market situation strategies. “We have capital sources that can get into the hundreds of millions for the right opportunity,” Festa explained. “We regularly work in the \$2 million to \$120 million space.”

Specifically, “our expertise in construction financing differentiates us from others like us in the space,” he said. “We work with clients to understand their business plan and find the best capital plan to support that. For merchant developers, we can bring in a capital provider to provide 100% of the capital.”

For multi-unit operators, this means “getting more locations online sooner,” Festa said, whose own expertise is in single-net lease properties.

Burgeoning construction costs and decreases in sale prices have “constrained developers,” he added. “Understanding the operations side of the business, there are certain levers that can be pulled.” Franchisees want to keep their rent-to-sales ratio at a certain figure, but might not be able to make a desired location work—they would be paying a higher rent because of the increased costs.

“There are certain ways to work with operators and developers where, maybe for a lower rent, the tenant comes in with some capital on their end and vice versa,” said Festa. “It’s our job to understand from the end-use perspective what the constraints are on an operator and the developer, and their viewpoints and priorities.”

In addition, an area of growth for Tauro now is their analytics and research services. “That team sees all types of commercial real estate transactions, and we’re going to see a lot more traction with straight real estate advisory in the restaurant space,” he reported. “This is especially timely given all of the financial and banking news recently.”

Part of that will be analyzing the portfolio for the client, “and finding the best path forward for them,” he said. “It’s a really diverse skill set for us to have—to understand and

dissect the hurdles, and advise on the best path forward.”

For more information, contact Tony Festa at [tfesta@taurocapitaladvisors.com](mailto:tfesta@taurocapitaladvisors.com), or at 310-903-2806.

### NFS Opens MN Office; Guyre to Lead Effort There

**National Franchise Sales** (NFS), a franchise brokerage firm, recently established a satellite office in Minnesota spearheaded by industry professional **Brian Guyre**.

Guyre’s work with franchisees across their ownership cycle includes previous experience in finance and franchise development for Regis Corporation, the largest franchisor of hair salons in North America, and in a consultant capacity for Marco’s Pizza. Guyre will participate in the resale of the firm’s existing cadre of restaurant brands in addition to establishing relationships with new concepts.

“Marco’s executive team brought me in to help with their development process,” Guyre said. “The process was taking longer than they wanted it to. They had the process in place, but they needed more communication with new franchisees—getting them in to the real estate process and keep them moving forward.”

During his time at Regis, he and his team worked on getting 4,000 franchisee new units open and resales transferred, “and there was a similar issue there. A franchisee would sign an agreement, but they would sit idle. I had a team responsible for supporting our franchisees. We owned the resale process (on the franchisor side).” He and his colleagues would pull together presentations and help the franchisee price their locations and work with landlords. If they sold it to someone outside the system, he would be part of approving the new franchisee for the brand.

“What qualifies me to be an advisor at NFS is that I essentially did everything that needs to get done when reselling or opening new units,” Guyre said. Plus, working with Marcos, “I spent a lot of time understanding the economics of the restaurant business.”

He started at Regis by supporting the corporate hair salons in operations and P&L management. “I have that financial piece, too. I guess you would say financial statements are my friend.”

Guyre is ready to work with both the franchisees who are selling, as well as the restaurant brands themselves. “I enjoy working with the people who have worked in their business, who are passionate about it,” he said. “Also, a big piece of what I do is developing the relationship with the brands. A new franchisee has to go through their approval process, and we don’t want to bring candidates to the franchisor who won’t be approved. I want to be an advisor and resource to both franchisees and franchisors.” You can reach him at [bg@nationalfranchisesales.com](mailto:bg@nationalfranchisesales.com), or at 949-374-5293.

Much has been written about actor **Ryan Reynolds** ownership of the Welsh team Wrexham that was recently promoted from the fifth-tier National League of professional English football to the 4th division. However, former **Dunkin'** CEO **Nigel Travis** has a much more compelling ownership story in English football. In 2017, Travis led a group that bought a financially struggling Leyton Orient football club. After being relegated to the National League, the lowest of the five nationwide professional divisions in England, Travis' East London club is now just two divisions below the prized English Premier League.

**Tilman Fertitta's** planned 43-story, 2,400-room hotel casino on six acres on the Las Vegas strip is on hold. "It's very expensive to build right now in an inflationary environment," Fertitta's CFO **Steven Scheinthal** told the Las Vegas Review Journal last month. Fertitta also recently acquired the Hard Rock Hotel & Casino in Lake Tahoe, which he intends to convert to a Golden Nugget. In addition to the Golden Nugget, Fertitta owns the NBA team the Houston Rockets and a smattering of mature restaurant brands such as Del Friscos, Morton's, McCormick & Schmick's, Rainforest Cafe and Saltgrass Steakhouse. Fertitta Entertainment's \$1.25 billion, 6.75% senior unsecured notes traded recently at \$80.45 to yield almost 11%.

Speaking of Fertitta, **Ruth's Chris** would have been a likely pickup for the master consolidator of mature full-service brands, except **Darden** is splurging and has agreed to pay 9.4x this year's EBITDA, a total of \$715 million for the 60-year-old brand. Fertitta's modis operandi on the other hand, was to pay a much lower multiple, generally in the 3x-to-4x EBITDA range.

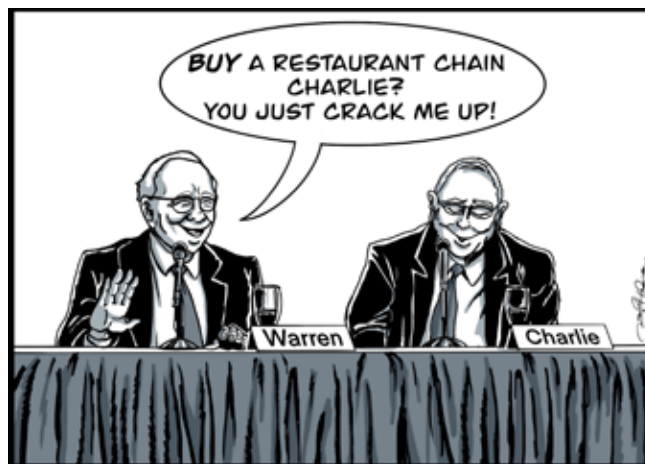
Tax, accounting and consulting firm **GBQ** sees Employee Stock Ownership Plans (ESOPs) gaining ground in the restaurant business, especially in light of a slow M&A market. ESOPs can provide a significant tax benefit to those company-owned chains or independent sellers that have a concentrated share ownership and minimal debt levels. **Brian Bornino**, Director of GBQ Capital Advisors, sees an opportunity for restaurant businesses valued in the range of \$5 million to \$100 million in value, especially ones with a single or family owner that might want to gradually phase out of their business. The key parameter in any ESOP is the new employee ownership be broad. To "make the math work," Bornino says the company must pass an anti-abuse test and would need approximately 20-plus core employees who would be expected to be longer-term team members. Sellers can delay or even eliminate capital gains taxes by selling their stock to an ESOP. And, the new employee owners may be able to avoid paying federal and even state income tax on the portion of the business owned by the ESOP. For more

information on ESOPs and restaurants, contact **Kaz Unalan**, Director, Tax & Business Advisory Services at [kunalan@gbq.com](mailto:kunalan@gbq.com).

**Brinker's** latest earnings report reveals a rough traffic environment for **Chili's**. Restaurant operating margin was flat versus a year ago at 13.2% even with menu prices up almost 10%. Traffic took a big hit, down 5.8%. Evercore ISI restaurant analyst **David Palmer** is forecasting Chili's traffic declines to likely continue, predicting in the near-term it could fall approximately 9% versus a year ago. That, despite Chili's launching an advertising campaign on national television in late February. The company attributes the traffic declines to a de-emphasis of its virtual brands and according to CEO **Kevin Hochman**, a fall-off of the "low-end customer."

A former Wall Street analyst showed the Monitor a recent earnings press release from **Dine Brands Global** whereby they reaffirmed domestic development activity for **Applebee's** in 2023 of "between 10 and 20 net fewer restaurants." The analyst said Applebee's will be closing restaurants for some time, primarily because of lease expirations. Many Applebee's restaurants were built in the '90s: Those restaurants had run out of term and now are running out of renewal options.

Workout specialist **Dan Dooley**, fresh off Burger King franchisee **Tom's King's** restructuring assignment, is advising **Summit Restaurant Holdings**, a 108-unit **Hardees** franchisee. Summit formerly operated over 145 Hardee's restaurants, but recently closed 39 of them. Summit is part of a larger group of affiliated companies (the Capstone Group) which had as many as 226 restaurants in 16 states through a variety of brands, including Hardee's and Carl's Jr. Dewey Brown and Todd Pahl are the principals. As for the bankruptcy filing, Summit owed Cadence Bank approximately \$22 million plus unpaid interest and fees totaling \$6 million. **Brookwood Associates** has been appointed the investment banker to market the business in a sale.



## STATS AND QUOTES

### WHAT THE EXPERTS SAY ABOUT COMMERCIAL REAL ESTATE

Wells Fargo CFO, Mike Santomassimo	The office market is showing “signs of weakness due to lower demand, higher financing costs and challenging capital markets conditions. While we haven’t seen this translate to meaningful loss content yet, we expect to see more stress over time.”
JP Morgan Private Bank Economist, Joe Seydl	“Compared to big banks, small banks hold 4.4x more exposure to U.S. CRE loans than their larger peers. Within small banks, CRE loans make up 28.7% of assets, compared with 6.5% at big banks. More worrying, a significant percentage of those loans will require refinancing in the coming years, exacerbating difficulties for borrowers in a rising rate environment.”
Federal Reserve Board’s Financial Stability Report, Published May 1	“The shift toward telework in many industries has dramatically reduced demand for office space, which could lead to a correction in the values of office buildings and downtown retail properties that largely depend on office workers. Moreover, the rise in interest rates over the past year increases the risk that CRE mortgage borrowers will not be able to refinance their loans when the loans reach the end of their term.”
JP Morgan CFO, Jeremy Barnum	“Given the recent focus on commercial real estate, let me remind you that our office sector exposure is less than 10% of our portfolio and is focused in urban dense markets, and nearly two-thirds of our loans are multifamily, primarily in supply-constrained markets.”
From Data and Analytics Firm Cred iQ	“Of the 50 largest MSAs, the overwhelming majority exhibited month-over-month increases in the percentage of distressed CRE loans. There were 42 markets with increases in CRE distress. The average increase in distress was approximately 80 basis points. Notable markets with the largest increases in distress this month included Minneapolis (+2.5%), Jacksonville (+2.0%), and San Antonio (2.0%).”

### INTEREST RATES (%)

	05/12/23	Last Month	A Year Ago	Trend
Fed Funds Rate	5.25	5.00	1.00	↑
30-Day BSBY 1M*	5.11	4.90	0.83	↑
90-Day BSBY 3M*	5.29	5.18	1.10	↑
30-Day SOFR**	5.05	4.80	0.80	↑
90-Day SOFR**	5.05	4.80	0.80	↑
1-Year Treasury	4.79	4.69	1.96	↑
5-Year Treasury	3.45	3.51	2.87	↔
10-Year Treasury	3.46	3.45	2.93	↑
30-Year Treasury	3.78	3.69	3.09	↑
Prime Rate	8.25	8.00	4.00	↑

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

**Berkshire Hathaway Co-Chairman Charlie Munger in a recent interview with the Financial Times:** “We’ve had some disappointment in banks, too. It’s not that damned easy to run a bank intelligently, there are a lot of temptations to do the wrong thing.”

**JP Morgan CEO Jamie Dimon asked by Bloomberg reporter Francine Lacqua about the prospects for a recession:** “Consumers are spending. Unemployment is at 3.5%. Home prices have gone up for 10 to 15 years. Stock prices have gone up for 10 to 15 years. They have a trillion more dollars in their checking accounts. They are spending that money. You see it in travel. You see it in restaurants. You see it in hotels. That’s all good, but the excess money is being spent down. So the bite of that is going to happen later this year or early next year. And the bite of QT hasn’t happened yet. I would take a mild recession happily right now.”

**Jason Thomas, The Carlyle Group’s head of global research and investment strategy discusses the severity of a credit pullback:** “A credit crunch may be difficult to avoid precisely because if you manage a bank today when you think about extending new credit you have to be looking at your liabilities. How fast are deposits declining? To what extent are your depositors leaving to go to money market mutual funds? To what extent are your depositors worried about fair value losses on your long-duration securities? Maybe some of the mortgages that you have extended that are whole loans on your balance sheet. It makes things much more complicated than just assessing the merits of the new loan.”

**Economist David Rosenberg when asked by CNBC anchor Sara Eisen ‘where is the recession?’:** “This is a credit-driven economy. We just came off the most pernicious tightening schedule since 1981. 1981 if you remember, was followed by 1982, another recession people didn’t see. Recessions are like like this odorless gas, they catch up on you.”

### Straight Answers are Hard to Come By

One of the most successful macro-driven investors in the world is Stanley Druckenmiller, a multi-billionaire who “made his bones” helping George Soros “break the Bank of England” in 1992. They shorted the British pound, after interest rates in the UK had been kept abnormally low and inflation accelerated. Sound familiar? The short trade made billions for Soros and Druckenmiller.

Druckenmiller’s forecasts are therefore closely studied, to the point that he is invariably modulated, intentionally careful not to create panic. An interview last week was telling. He talked about the debt, the deficits, interest rate suppression and the misallocation of resources and distortions of the last 20 years. He made reference to Paul Volcker, hired as Fed Chairman by Jimmy Carter in 1979, supported by Ronald Reagan in 1981, and fought the 13% inflation by raising the Fed Funds rate to 18%. Druckenmiller recalled how this tightening process caused a painful recession until 1983. He was not sure that politicians and central bankers would have the will to impose similar hardships today. His (modulated) conclusion is he is hoping for a “soft landing” as the Fed corrects past excesses, but investors should recognize the possibility (not a probability) of a much worse scenario.

Now comes the interesting part, well known but unstated by Druckenmiller. The total US debt in 1980 was \$1 trillion versus \$30 trillion today. The annual US deficit was about \$100 billion then versus about \$2 trillion today. The long-term unfunded entitlements of Social Security, Medicare, and Medicaid were insignificant compared to the tens of trillions today. Today’s economy is about six times the size of 1980, but the problems, inflation adjusted, are many times as large. Judge for yourself whether Jerome Powell will channel Paul Volcker, likely imposing a recession many times as serious as the hard times of the early 1980s. Our bet is the Fed folds, rebuilds the money supply again while reducing interest rates, essentially kicking, once again, the can down the road. Don’t be surprised if we read five years from now about Stanley Druckenmiller making another fortune by shorting the US Dollar.

**For the restaurant industry, the glass is more than half full.** In short, the problems are well documented and largely discounted by the marketplace. Almost all the publicly held companies have protected their balance sheets during these challenging times and are in a position to freshen existing units. Those brands with attractive unit-level economics will expand.

The 20 to 30 analysts who spend full time analyzing quarterly results and trying to predict short-term

changes in same store sales may have lost the forest for the trees. The restaurant industry provides an affordable luxury to families that need a break from their workaday routines. Over half of all meals continue to be prepared away from home.

It is more expensive than ever to eat out but it’s the same story at the supermarket. While the industry is far more competitive than a decade or two ago, many independent operators have closed during the three years, including Covid, providing greener pastures for survivors. This is not your parent’s restaurant industry, with technology playing a major role, providing convenience and labor savings. Smaller stores are becoming a pattern because permitting and construction are more time consuming and expensive than ever, as “capacity” is used mostly on weekends. A growing percentage of meals prepared away from home are delivered or picked up.

I have come to these views after listening and reading the first quarter results from over 30 companies. Space here does not allow for details, which I provide on my website, but the consensus is that (1) Commodity inflation is abating. Most companies reporting are showing lower cost of goods. (2) Labor inflation is also moderating, with most reporting a modestly lower labor expense. (3) Menu prices, mostly chasing the cost spiral over the last few years, have pretty much caught up. Modest increases from here should protect current margins. (4) The current macro environment is far from robust but fairly stable. Brands that can provide an experience as well as consistent food and service are in a relatively good position. (5) Companies with a strong digital presence continue to outperform the industry. (6) Many companies are building units again. (7) Though the first quarter, sales comparisons are relatively easy against the Omicron variant from a year ago and traffic gains are still hard to come by. Very few publicly held companies are undershooting previous cash flow and earnings guidance. (8) Some publicly held franchised restaurant stocks are more interesting than others, but very few are grossly overpriced.

If you are a restaurant operator or an investor in the space, there are worse places to be in an economic environment that reflects either Stanley Druckenmiller’s probabilities or possibilities. Count your blessings and get to work!

*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](http://www.rogerlipton.com). He can be reached at [lfsi@aol.com](mailto:lfsi@aol.com) or (646) 270-3127.*

## MARKET SURVEILLANCE

YOU LEARN THE DARNDDEST THINGS ON A QUARTERLY EARNINGS CALL			
Company/Symbol	Price 5/12/23	% Chg YTD	Commentary
Bloomin' Brands (BLMN)	\$23.25	+15.5%	CEO David Deno said he hopes to take as little pricing as possible in 2023 and if the consumer balks, they "may not take it."
Brinker Intl. (EAT)	\$36.99	+15.9%	CEO Kevin Hochman said the lower-income consumer fell off the map a year ago when gas prices went up, and they haven't come back.
Dutch Bros. (BROS)	\$26.02	-7.7%	In just two years, the cost of a free-standing location has gone from \$1.5 million with pre-opening, to around \$1.8 million to \$1.9 million.
Carrol's Restaurant Group (TAST)	\$5.05	+271.3%	Higher prices and fewer discounts have been carrying the load, but TAST expects traffic to improve when the "Reclaim the Flame" marketing kicks in.
Cheesecake Factory (CAKE)	\$31.18	-1.7%	Costs have been favorable so far this year, according to CFO Matthew Clark. The goal this year is to offset the current year's inflation with price increases.
Chipotle (CMG)	\$2,045.63	+47.4%	Restaurant margin increased to 25.6% in the quarter and CEO Brian Niccol says they are in a strong position to raise prices if they have to.
Denny's (DENN)	\$10.66	+15.7%	The ground work for Keke's corporate development outside of Florida is underway. New franchisees may come on board in 2024.
Dine Brands Global (DIN)	\$64.50	-0.1%	Applebee's President Tony Moralejo acknowledged most of their guests are lower income, but they're starting to see more higher-income guests.
Domino's Pizza (DPZ)	\$307.58	-11.2%	U.S. franchisees made \$139,000 per store in 2022. Based on current construction costs, franchisees can expect a three-year payback.
El Pollo Loco (LOCO)	\$9.42	-5.4%	Noticing a decline in the number of low-income consumers, the company introduced three different bowls for \$5.
First Watch (FWRG)	\$17.09	+26.3%	2023 is 53-week fiscal year. The fourth quarter is a 14-week quarter, and that additional week alone is roughly \$10.5 million in sales.
Krispy Kreme (DNUT)	\$15.09	+46.2%	Krispy Kreme doughnuts are being delivered to over 160 McDonald's restaurants in Kentucky, with no apparent impact to local-store volumes.
McDonald's (MCD)	+296.14	+12.3%	About 80% of McDonald's customers in China order food digitally. Only 40% in the U.S. do.
Noodles & Co. (NDLS)	\$3.90	-28.9%	Margins are up, but soft traffic meant a quick pivot to more value offerings, including a \$7 pasta special.
Papa Johns (PZZA)	\$76.67	-6.8%	More carryout results in a lower check, because there's no delivery fee with the sale. How you make that up is the key for 2023.
Portillo's (PTLO)	\$20.36	+23.2%	The first quarter was a story of positive traffic and improving margins, despite a 7% higher check.
Restaurant Brands Intl. (QSR)	\$72.88	+12.7%	BK's franchisee plan calls for franchisee portfolios to be fewer than 50 units in contiguous geographies, and with local ownership.
Texas Roadhouse (TXRH)	\$105.54	+16.0%	With AUVs of \$145,000 per week per store, a 15.9% store-level margin is pretty disappointing.
The Wendy's Company (WEN)	\$23.44	+3.5%	CFO Gunther Plosch sees disposable income rising as inflation comes down in grocery, while wage inflation remains high.
Wingstop (WING)	\$207.41	+50.7%	WING is experiencing the opposite of most restaurant chains—commodity deflation and positive traffic!

*Outlook continued from page one*

“The thing that happens is that we lose a certain amount of customer count for a while, but that gradually comes back as people realize the increase was necessary. The trouble is our costs are increasing so fast that about the time they’re coming back we’re ready to raise prices again.”

Bolling suggested restaurant owners examine their food costs as a percentage of sales to see if they’re still providing value. He said his food cost percentage increased from 34% to 37% so he felt he was providing customers plenty of value and still had pricing power.

Using Bolling’s food cost percentage test, are you still providing value to your customer?

### **Everything is undergoing a reassessment**

It’s common practice for economists and financial analysts to compare a current economic situation with a similar time in history—an opportunity to glean some information about how it was previously handled. For instance, the current regional banking crisis has been explained in terms of the 2008 financial crisis when banks were bailed out by the government. That’s not really accurate. This crisis didn’t emanate from credit problems; it’s due to the rapid rise in interest rates, mistakes banks made by buying long-dated treasuries and uninsured deposits on the move.

The problems in commercial real estate, especially in the office sector, have also been compared to the period of the late ‘80s when the government created the Resolution Trust Corporation to unload commercial real estate held by defunct savings and loan institutions. Again, not entirely comparable. Back then, the real estate problems impacted every property segment. This time it seems concentrated in the urban office market.

What’s happening now is the market is reassessing every asset—homes, cars, stocks, bonds, banks, commercial real estate and even restaurant businesses—given the higher hurdle rates. When the cost of capital was zero, it was easy to green-light a deal. The clamoring for the Federal Reserve to lower interest rates now is a response to the fear investors have experienced during this repricing of risk. Capital is constrained because of that fear. That employment remains strong given the rapid rise in borrowing costs suggests higher interest rates will be around for quite a while longer.

### **What does all of this mean for restaurants?**

Let’s review my 2023 predictions from the January issue of the Monitor and see how they’ve held up. They’re the ones in bold in the next column. I’m no Nostradamus, but am a fan of Dylan’s lyrics that “you don’t need a weatherman to know which way the wind blows.”

### **An update on the Monitor’s top ten predictions**

**1. Margins slowly improve as menu prices generally hold; operating costs stabilize and labor shortages continue to ease.** This is absolutely the main story for 2023. Hold on to your customers and watch margins climb.

**2. High menu markups and delivery fees stall third-party delivery orders requiring more operators to subsidize customer fees in 2023.** Delivery is still growing, just not as fast as dine in and takeout.

**3. The M&A market accelerates in the second half as buyers and sellers gain confidence in a stable EBITDA and interest rates peak.** There is still a lot of liquidity out there and the banks in this sector have not closed their shops. Interest rate direction is key to a successful second half.

**4. The long-awaited U.S. recession finally arrives this summer. As expected, a weaker economy hammers second- and third-tier brands.** You already see the traffic softness in these companies.

**5. Franchisors experience more royalty workouts as high store-level operating costs impact a franchisee’s ability to pay.** Higher margins will ease some of last year’s pain.

**6. Patrick Doyle will take over as CEO of Restaurant Brands International, replacing José Cill.** José who?

**7. Chipotle’s billion-dollar cash hoard spurs calls for a large special dividend or massive share buyback.** It’s only May.

**8. A number of PE-backed restaurant chains file bankruptcy in 2023 after they fail to refinance outstanding debt.** The three big franchisee bankruptcies so far in 2023 all had some connection to private equity or family offices, and yes, they had too much debt.

**9. The venture capital drought results in a spate of restaurant tech mergers. Operators need to know if their tech provider will survive.** Tech investor Jimmy Frischling of Branded Hospitality Ventures told a Food on Demand Conference audience that any tech company more than one capital raise away from breaking even is in trouble. Do your due diligence.

**10. The 20% to 25% increased cost of construction will force Wall Street to question the expansion plans of some public brands.** The unit economics of many restaurant brands have changed dramatically since Covid. Just ask the bankers and franchise salespeople who deal with this on a day-to-day basis.

—John Hamburger

### Direct Lenders Provide Increasing Amounts of (Expensive) Loan Financing to Small- and Medium-Sized Businesses as Banks Become More Reluctant to Lend

By Jim McFadden

As bank lending officers are employing stricter standards in deciding whether to grant loans to small- and medium-sized businesses, many such businesses are turning to direct lenders, also called non-bank lenders, and business development companies (BDCs) for capital. BDCs, which are generally part of large-asset management companies, are closed-end investment organizations that provide debt and equity to small- and medium-sized companies as well as distressed companies. Of course, another factor which may limit a bank's ability to lend (and was never really contemplated prior to the repercussions from the recent Silicon Valley Bank, Signature Bank and First Republic Bank failures) may be weaknesses in other parts of a bank's balance sheet, such as its commercial real estate portfolio.

The presence of direct lenders (including BDCs; a group which in aggregate we will call simply direct lenders) has increased dramatically over the last eight years. Indeed, according to Refinitiv, a leading provider of financial market data, direct lenders comprised 80% of all U.S. middle market LBO loan issuances in 2022, up from 40% in 2014. Total loans provided to businesses by direct lenders totaled roughly \$800 billion, per Preqin, another investment data company. A shift in banking practices after the 2008-2009 Financial Crisis, including the effects of the Dodd-Frank legislation and giant inflows into private equity funds, are key reasons for direct lenders' rapid market-share gains.

For a business, the advantages of direct loans include more efficiency, near certainty of execution and flexibility. Importantly, loans can be funded in just days versus weeks or even months at commercial banks. Furthermore, since direct lenders do not face the constraints of regulation that commercial banks do, they can take on higher risks. A direct illustration of this: Direct lenders' willingness to lend up to higher multiples of EBITDA (say, 4.5x to 5.0x versus 4.0x for a term loan from a bank). Of course, the cost to a borrower of such looser lending policies is a higher interest rate, sometimes much higher.

Many financially healthy businesses choose to obtain credit from direct lenders for the expediency reasons outlined just above. In addition, businesses with less than exemplary credit or profitability histories rely even more heavily on direct lenders for capital, as those businesses have limited other borrowing options. Such higher-risk companies are more focused on the certainty of capital rather than its cost.

Direct lenders raise funds from Limited Partners (LPs) like pensions, endowments, insurance companies and sovereign wealth funds. Indeed, Preqin data shows about 3% of all U.S. pension fund assets are allocated to the broad category of private debt. Like hedge funds, direct lenders generally charge the LPs both management and performance, or incentive, fees. A direct loan is not publicly traded and is generally held by the issuer until maturity. Consequently, the market value of a direct loan is difficult to determine. Other direct lenders securitize their loans by selling them to institutional investors.

As an example of a direct lender, last month the Monitor wrote about Comvest Credit Partners, a direct lender that provides senior and second-lien financing to middle-market companies. Comvest lends to middle-market companies and provides senior secured, unitranche, and second lien capital as well as equity co-investments. Loans range from \$25 million to \$250 million-plus per transaction and they look for companies with EBITDA in excess of \$7.5 million. Comvest has provided the debt capital to private equity firm Garnett Station's acquisitions, including Fat Tuesday, Ojos Locos and PJ Welihans. Last month it provided the debt financing on Garnett's acquisition of Firebirds.

#### Direct loans can be expensive sources of capital

Interest rates on direct loans can vary widely between loan providers, with the prime lending rate—8.25% after the Fed's decision to raise short-term rates for the 10th time this cycle on May 3—being the low end of the available rates and the high end touching a very expensive 30% or more. Key determinants of the rate these unregulated financial companies will offer a business include the length of time the business has been operating and, of course, its revenue and profitability history. The maturity for a long-term business loan to a good customer is generally three to 10 years.

The dollar amount that an individual direct lender may offer to a business borrower obviously is tied to the size and profitability of the borrower. Origination fees, or the upfront charges direct lenders assess to review an approved business loan application, are expensive. They can range from 3% to 5% of the total amount. Such fees for traditional bank loans seem to be about 100 basis points cheaper.

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

### Creating Franchise Concepts That Work for the Franchisee

By Dennis Monroe

Over the years a steady stream of people who are in the early stages of developing a restaurant concept have come to see me to ask about franchising. In most cases, the business owner has received numerous inquiries from customers or employees eager to become their first franchisee. So, it's easy for them to believe they have something franchisable.

It's one thing to run one or two successful locations, but quite another to have something that satisfies the demands of a franchisee. In some cases, I try to talk them out of it. For others, I discuss the metrics necessary to have a great franchise and the key unit economics that will make the venture successful for a franchisee. It's not always an easy concept to grasp, because while they may be making money for themselves, it doesn't automatically mean the concept will make money when a franchisee takes over.

Aziz Hashim of NRD Capital in Atlanta has been on both sides of the table, as franchisor and franchisee. His unique experience and skill set has given him the knowledge base of what it takes to run a successful franchise business—and not just one concept at a time. Hashim, through his NRD's Experiential Brands platform is developing franchisable concepts that have consumer demand and can generate sustainable revenues.

I asked Hashim to outline his thought process while working through two concepts that are in the development prototype stage. One is a chicken concept—The Original Hot Chicken—and the other is Inked Taco—both are in hot categories right now.

Hashim first looked at these concepts by defining the important metrics. The first is craveable food that can be made efficiently and cost effectively without sacrificing quality. The profitability should be at a pre-franchise level or what we call “the four-wall level”—at least 20%. Being mindful of the matrix, Hashim is developing concepts that have a limited menu and that emphasize efficiency, which then lowers the labor and training costs.

Additionally, Hashim's concepts are almost exclusively intended for existing restaurant spaces so the occupancy cost is lower than average by using the existing infrastructure.

The next matrix is sales-to-investment. His two concepts go into existing restaurant sites only, which lowers costs, and helps to achieve the goal of sales-to-investment in the range of at least 4 to 1.

The third key matrix is the overall technology, particularly on the marketing side. Successful concepts need to have the latest technology and real-time reporting in order to track consumer usage and communicate with them to keep them coming back. This means utilizing all types of communication methods and loyalty programs, especially for delivery and take-out. Hashim's concepts are built around technology and locally focused marketing, thus lowering the need for the franchisee to pay high fees for a national advertising fund.

Implementing these three standards can help create a much more effective restaurant industry and help deal with some of our systemic issues such as labor and cost of development.

Industry veteran, Dan Rowe, founder of Fransmart, agrees with Hashim's use of existing restaurant sites. He compares it to “playing with house money.”

Building an evolved franchise system not only benefits the franchisor, but it also puts the franchisee onto a clear path to success. The hard part is not being tempted to start franchising too soon before you've proven your system and before you have the keys to success.

*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@mmlawfirm.com](mailto:dmonroe@mmlawfirm.com), or at 952-885-5962.*

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2808 Anthony Lane South, Minneapolis, Minnesota 55418

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

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