



Private Equity and the U.S. Restaurant Industry

Bob Bielinski, Head of the Restaurant Industry Practice within Corporate Finance at CIT

Elliot Forrest: Welcome to **5 Minute Capital (www.5minutecapital.com)**, CIT's executive insight series, which takes on financial issues in about five minutes.

Today we're discussing Private Equity and the United States Restaurant Industry with **Bob Bielinski**, head of the Restaurant Industry Practice within **Corporate Finance** at CIT. Good to see you again.

Bob Bielinski: Thanks. Great to be here.

Forrest: How active is the private equity sector in the restaurant industry today?

Bielinski: 2010 was an extremely strong year for Mergers & Acquisitions (M&A) in the restaurant sector, and the private equity firms really dominated the action. With the exception of Landry's, there really wasn't much strategic interest in these transactions. Optimism around the economic recovery and an improved debt market really fueled the transaction market and there were a number of headline grabbing deals like CKE and Burger King, who both went private. There were also some high-growth chains that sold at very strong multiples, and there were also a number of distressed deals and turnarounds that took place.

Forrest: Which concepts are receiving the most interest from the private equity community?

Bielinski: There are really two themes that stand out for private equity firms. The first is growth. So you had businesses like Papa Murphy's and Wingstop—they were very well received by the market and their sellers were very pleased with the prices that they received.

On the other hand, you had operational improvement deals and that's a very common theme for private equity investors. They look at businesses that they think they can manage better. So you had balance sheet restructurings where firms had too much debt initially.

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In other cases, buyers just thought that companies were undermanaged and they thought that they could do a better job. For public companies, it's a lot easier to restructure as a private company outside the spotlight of quarterly reporting and investor attention.

- Forrest:** So, if I have it right, it sounds like the private equity community is interested both in the restaurants and what they serve and also how they're managed.
- Bielinski:** No question. I would say the brands are very important and the private equity sector gets very excited about potential growth brands. You always have someone looking at management and saying, "I could do a better job." In those examples, private equity firms may get involved.
- Forrest:** In our other podcast we talked about casual dining. Are upscale or fine dining concepts getting more interest in light of the economic recovery?
- Bielinski:** The upscale chains were just crushed during the recession. High-end chains saw four or five quarters in a row where their same-store sales were down, in some quarters as much as 26%. So 2010 was a much better year for high-end chains and all the chains bounced back. They reported some of the strongest comps of any of the companies, but off a much smaller sales base. Even with the stock prices down there really hasn't been a lot of M&A activity around the high-end chains.
- Forrest:** When we talk about restaurants, we are really talking about consumer behavior, so if people have a few extra dollars in their pocket, you're saying they will go to the casual and they have left the high-end behind in the last 6, 8, 9 months.
- Bielinski:** You've seen the trade down reverse. Trade down happens in a number of different places. You had the casual dining customer go to the quick serve restaurant and you had the fine dining customer take a step back as well. In fine dining, there is a lot of business entertaining that goes on and business entertaining completely dried up during the Great Recession. Business travel has picked up; you are starting to see better bookings at airlines, at hotels, and chains like Morton's are enjoying a recovery as well. On the casual dining side, you saw sales pick-up in the third quarter of last year as people have said, "We can take the family to Applebee's."
- Forrest:** What lessons did private equity investors in the restaurant industry learn from the Great Recession?
- Bielinski:** I think the first one is be careful with leverage. At the peak, restaurant companies were being offered more debt than they probably should have taken. When you run a business that is fundamentally a fixed-cost business and sales drop, then profits are going to drop faster. So a business that is highly leveraged can become over-leveraged awfully fast and that's trouble because then you start making decisions that aren't good for the business, like deferring maintenance Cap Ex, or cutting expenses that the consumer can actually see.

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Another lesson private equity firms learned was that franchising is not a guarantee of growth. Private equity firms love franchisors because franchisees fund the growth. But, if you were a chain that was reliant solely on franchisees to fund your growth, development may have come to a complete halt during the recession because there was a credit crunch and these franchisees had a tough time finding the capital they needed to grow their stores.

Forrest: What other trends are driving private equity behavior?

Bielinski: 2011 started off a little bit slow, but there’s a significant amount of money sitting on the sidelines right now and I would expect 2011 to be a good year for M&A. Strong businesses are going to attract a lot of attention from these private equity firms. Right now private equity firms are also taking advantage of the strong debt markets. People are refinancing debt, they are doing recapitalizations where they take a little bit of money off the table and actually they are just going out and re-pricing debt and saying to their lenders, “We think we deserve a lower rate,” and they are being successful at it.

Forrest: Bob Bielinski from CIT. Nice to talk to you

Bielinski: Good to see you again, Elliott.

Forrest: And thanks for listening. Please visit cit.com/restaurants for more information. I’m Elliott Forrest. This has been a production of CIT.



Robert (Bob) Bielinski is a Managing Director who leads the restaurant industry practice within **Corporate Finance** at CIT. He has more than 20 years of restaurant and retail financial management, investment banking, and transaction experience.

To learn more about CIT restaurant industry practice, visit www.cit.com/restaurants. Members of the press who have an interest in speaking with Mr. Bielinski can contact Curt Ritter at Curt.Ritter@cit.com. Additional CIT executive podcasts can be found at: www.5minutecapital.com