RESTAURANT FINANCE MONITOR®

Volume 25, Number 6 • Restaurant Finance Monitor, 2808 Anthony Lane South, Minneapolis, MN 55418 • ISSN #1061-382X

June 18, 2014

How Franchisees Can Successfully Roll Up New Concepts

By Dennis L. Monroe

When reviewing this year's Monitor 200 franchisees, it is apparent the large multi-unit franchisees are getting larger and diversifying their holdings. This growth is a result of available financing, the influx of private equity, the desire to take advantage of the efficiency of size and the availability of mature franchisees transitioning out of the business.

Another phenomenon we are seeing is the growth of companies that have multiple concepts. In the 2004 Monitor 200 franchisee list, there were only two groups out of the top eight franchisees that had more than one concept. Today a good share of the large multi-unit operators have multiple concepts, and many companies have the desire to acquire their own concept.

In most cases these roll-ups of multiple concepts are acquisitions and not outright development. Mature concepts have found it difficult to spur development. A multi-unit company contemplating a successful roll-up is looking for reasonably priced acquisitions to continue to grow. What gets forgotten is there are certain key criteria a large multi-unit operator needs to become a truly successful multi-unit roll-up concept.

Here are my thoughts on successful multi-unit multi-concept companies:

1. Great Operations. The company must have a great operating team and strong back office. Franchisors require qualified operators to focus on their concept. For a successful roll-up, it is important to have specific operating teams that are trained for a specific concept and a general chief operating officer who oversees all of the chief brand officers.

2. Equity Investment. The company must have enough equity so any acquisition is not overleveraged. This gives the company time to integrate the concept. Ideally, the equity should come from patient investors. An example of the type of equity that is necessary to do an effective roll-up is the recent investment equity Flynn Restaurant Group received from Ontario Pension Teachers Fund—a potentially patient, long-term equity source.

3. Senior Financing. Senior debt is a key element in any acquisition. Senior debt at reasonable rates makes it easier for a company to make acquisitions, potentially at a slightly higher multiple because of the leverage component. In the past, senior debt was normally secured on an acquisition-by-acquisition basis for specific concepts. Customarily there was no cross-collateralization among concepts because of franchisor issues and certain credit issues. Today the trend is changing. We are now seeing overall financing across concept lines; and, in many cases, the real estate is tied in as collateral under one master facility. It is important to have financing that matches the acquisition, with sufficient resources for remodels and other capital expenditures.

4. Good Franchisors. It is key to have franchisors that understand and support companies that operate across various concept lines. Assembling such staff will inevitably raise issues of non-competition, confidentiality, intellectual property and, in general, of integrating diverse operating systems among concepts. A well-managed company and well-drafted franchise documents can alleviate many such concerns.

5. Good Accounting. The accounting needs to be done on a store level by concept and may need to be broken down by market. But in every case it must reflect the individual profitability of each concept. This means a detailed chart of accounts and also the type of accounting required by the franchisor. The accounting and chart of accounts should be as universal as possible so the company does not have to maintain different types of accounting records for different concepts.

6. Real Estate Issues. For a successful roll-up, real estate costs need to be effectively contained, and good lease provisions should be in place to allow for broad assignment and financing rights. Most roll-up companies are looking at some type of exit strategy, and minimizing landlord consents is a must. If the real estate is acquired, the best option would be to finance it separately.

7. Concept Consistency. Even though the composition of the Monitor 200 currently does not reflect it, I think it is helpful to contain multi-concept companies' acquisition activity to one sector of the restaurant space. For instance, multi-unit operators that specifically have a concentration in QSR should avoid casual dining (the QSR approach is radically different from casual dining). Concepts under ownership should have synergy, so the upper management team can use their skill sets to create real value.

8. Exit Strategies. Companies need an appropriate exit strategy by concept and by company. We are seeing an increase in initial public offerings by multi-concept companies (such as the Diversified Restaurants' IPO). There seems to be an increased opportunity for various exit strategies. This includes private equity, strategic buyers and other multi-unit operators. And franchisors are looking to acquire franchisees to boost earnings or provide refranchising opportunities.

Multi-concept franchisees are here to stay. Lenders and investors are embracing it. And large multi-unit operators contemplating new concept acquisitions are poised to do well—if they have cultivated the key characteristics necessary to become successful.

Dennis L. Monroe is a shareholder and Chairman of the law firm of Monroe Moxness Berg PA. You can reach him at (952) 885-5999, or by email at dmonroe@mmblawfirm.com.