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Why So Much? Three Experts Weigh in on High QSR Multiples

By Dennis Monroe

I have been very confused by the high valuations certain QSR concepts are obtaining on sale. After working in the restaurant and franchise marketplace for almost 40 years, I have seldom seen EBITDA multiples this high.

There was a significant uptick during the securitization years of the '90s, but to see the kind of multiples we're seeing today, particularly for Taco Bell, Burger King and Wendy's, has just been extraordinary. I decided that I would ask some restaurant M&A experts about the state of this market. They are David Stiles, managing director at Trinity Capital LLC; veteran restaurant banker Jeb Ball, founder of Guideboat Advisors; and Dean Zuccarello, founder and long-time industry observer from The Cypress Group.

Let's start with David Stiles. Stiles said that he's seen multiples as high as 10x to 11x EBITDA, but a normal buyer is going to probably pay more in the 8x range. He also made a point that it's not just the QSR industry seeing the high multiples, but other segments of the industry, except casual dining. Stiles emphasizes that private equity firms and family offices are experiencing "capital overhang"—that is, they've made money on their investments and have a significant amount of cash to invest. Additionally, he says that private equity and family offices "continue to be awakened to the attractive cash flow available from franchise businesses."

The real key here is buyers are willing to pay premium multiples for quality opportunities. When it comes to multiples, Stiles maintains that 8.5x can still be justified after you factor in some strategic new builds and smart remodels. Of course we can never forget leverage.

He concludes by saying that while he has seen 10x to 11x multiples, in his experience, those should be considered specific situations that are justified by such considerations as geographic protection, or leveraging overhead.

Jeb Ball, like Stiles, emphasizes that there is a lot of "dry powder" available. With that being said, he maintains that this market continues to be attractive. He cites low commodity costs which continue to benefit restaurants; financing availability remains strong; and the availability of leverage results in less cash and a higher return even at higher multiples.

Ball believes the overall economy is still perceived to be strong, and those restaurant concepts that are doing well will continue to grow. He thinks there is still a strong perception of growth opportunities in this space—I'm not sure that I agree with the perception, but I do believe the perception exists.

Finally, he said because franchisees are growing older (particularly in some of the mainline concepts), there is a willingness to sell and that there are enough buyers out there to create competition for deals. Competition seems to be a clear reason for the high multiples.

Dean Zuccarello emphasizes the overall strength of the economy and in the debt market, which creates the overall higher demand and appropriate leverage. As we noted earlier, because of the large amount of investable funds, buyers are looking for deals, and franchising seems to be very attractive.

Zuccarello adds that the QSR performance has been solid, where other segments have been showing weakness, so more funds are going to QSR deals. In addition, family offices are more willing to buy into franchise transactions. He places special emphasis on the trend toward consolidation, also noted by the other contributors. Finally, when I shared with him my puzzlement at the high Taco Bell multiples, he responded: "I can't explain Taco Bell, either. They are clearly the only ones in that field, but I still feel that there is more downside risk to those multiples in the future."

What did I take away as a summary of the comments from my three experts?

First, they all emphasize availability of capital. Two, private equity and family offices are comfortable with the cash flow model of QSR. Three, leverage continues to be available at very low rates. Four, there is a lot of competition for deals.

And, there is clearly a trend towards consolidation. As we saw in the Monitor 200 ranking of the largest franchisees, the big operators are getting bigger and consequently able to add stores even if they pay a higher multiple.

There still seems to be, as one of our famous Federal Reserve chairmen once said, "irrational exuberance." I think multiples are historically too high and that possibly right now casual dining multiples, particularly Applebee's, are too low.

Dennis Monroe is shareholder and chairman of Monroe Moxness Berg, a law firm specializing in multi-unit restaurant finance, M&A and taxation. Dennis and his partner John Berg will be conducting a pre-conference workshop for multi-unit restaurant operators at this year's Restaurant Finance & Development Conference on Monday, November 12 at 12:30 pm. The topic is Tax- Efficient Structures After the Tax Cuts and Jobs Act of 2017. In the meantime, you can reach Dennis at 952-885-5999 or by email at dmonroe@mmblaw.com.