

FOR THE EXCLUSIVE USE OF KKEZAR@BIZJOURNALS.COM

From the Dallas Business Journal:

<http://www.bizjournals.com/dallas/news/2016/10/13/why-private-equity-firms-are-eating-up-north-texas.html>

Why private equity firms are eating up North Texas restaurants

SUBSCRIBER CONTENT:

Oct 13, 2016, 1:24pm CDT

While restaurants across the country are being gobbled up by private equity firms, investors are also tackling North Texas companies like medium-done filet mignon.

The proof is in the deal volume. In the past year, North Texas-based restaurants or firms have been involved in at least eight private equity deals.

In comparison, over the past 12 months, the U.S. as a whole has logged just 18 private equity deals in the restaurant space, according to Elizabeth Lim, a research editor for Mergermarket.

None of Texas' major cities have logged deals in the past year.

For private equity firms, bankrolling restaurants is simple: Invest, fuel growth and exit with more money than invested.

For restaurant companies, it's about tapping into the funding needed to become bigger brands.

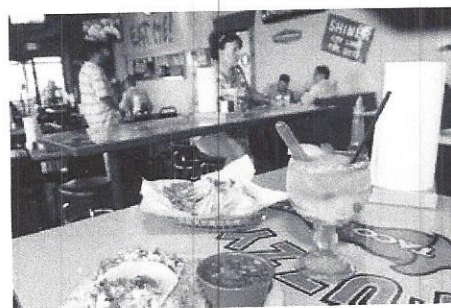
And when those motivations mesh, it can mean big benefits for both parties.

ON WFAA: Tune in to Channel 8 for Jason Wheeler's report about what this could mean for North Texas consumers. FRIDAY, 10 p.m.

Dallas-based Wingstop (Nasdaq: WING) is just one local success story. Atlanta private equity firm Roark Capital purchased the chicken chain in 2010 for roughly \$95 million, and last year, took it public in a \$750 million deal.

In return, Wingstop nearly doubled in size, growing from a 440-location brand to 712 domestic and international units at the time of its initial public offering.

"The beauty of the restaurant business is, if (deals are) done properly, they can generate a lot of cash, and (restaurants) can continue to grow through economic cycles, depending on the positioning of the



JAKE DEAN

NRD Capital bought a 70 percent stake in Fort Worth-based Fuzzy's Taco Shop.

concept," said Craig Weichmann, founder of Fort Worth-based Weichmann & Associates, an investment banking consultancy specializing in restaurants.

But unlike Wingstop, fewer restaurants are looking to hit the stock market. Of 11 restaurant initial public offerings to begin trading since fall 2013, only five are trading above their offering price.

So with investors not biting into restaurant stocks, eateries are looking to private equity to fuel growth instead.

And firms are hungry to bankroll the food industry. The return on investments in restaurants is in the top quartile versus returns in other industries.

"Restaurants are fairly quick return businesses, and those who treat capital well will get capital," said Ray Hemmig, general partner with Plano private equity firm Retail and Restaurant Growth Capital. "In my experience, the restaurant business has treated capital pretty well."

What's driving investments?

North Texas is drawing attention from investors thanks to the sheer number of restaurants in the region. According to a study by Self Storage using data from the U.S. Bureau of Labor Statistics, Dallas-Fort Worth ranked fourth among the country's 100 largest regions for restaurant, hotel and bar growth between 2005 and 2013. DFW grew its number of venues by 12.3 percent to two per 1,000 residents.

The area also ranked fourth among the top regions for restaurant growth between 2014 and 2015, according to NPD Group. The firm reported DFW saw a 2 percent growth over the year, logging 13,763 eateries last year.

"Dallas has always been a strong restaurant market," said Fouad Bashour, a partner with private equity firm CIC Partners. Dallas-based CIC's portfolio includes five food and restaurant concepts, including Willie's Grill and Ice House, a Houston fast casual concept it acquired in September 2015.

"The restaurant talent in this area has led to a proliferation of strong concepts that are based here, so it's no surprise that Dallas companies are strong targets for investment," Bashour added.

Population growth is a main driver behind the expanding local restaurant scene. Not only is the region adding roughly 1,000 residents per day, its demographics are starting to skew younger, toward consumers ages 35 and under.

And as restaurant concepts look to serve that customer base, they are creating new and innovative concepts ripe for investment.

"(There) is consumer distrust of corporate restaurants, especially with people 35 and younger," said George Young, CEO of consulting firm Kalypso. "Those folks don't look to go out to brands that have stood the test of time. That means there are opportunities for new restaurant concepts... (and) you see private equity coming in and buying new ideas."

But while the local population is expanding and restaurants are growing or moving into the North Texas market, many eateries are suffering from shrinking same-store sales. According to research by Dallas restaurant industry analysis firm TDn2K, in August, same-store traffic was down 2.7 percent industry-wide. In July, it declined 3.9 percent.

With fewer customers, revenue is declining. TDn2K reported average guest checks increased by 2.3 percent in August, but that was a 0.5 percent decrease from July.

Those dips in customers and sales also lead to private equity deals, making more restaurants open to funding that will help them improve operational systems and lure in diners.

"It makes sense for some owners that now is the time to sell," Bashour said. "They're fearful that trend might continue to get worse before it gets better."

Who's investing?

Smaller firms are leading the way in North Texas restaurant investments. Private equity titans such as Roark and TPG are eating up larger chains like Jimmy Johns and McDonald's Chinese restaurants. But smaller firms, family offices and venture capital companies are looking to invest in startups or less-established businesses and make them major brands.

"Typically, if a chain has decent restaurant economics, high enough sales levels and is operating in more than two major markets, then that is some evidence to an early stage private equity investor that this concept may have legs and be able to stand on its own," said John Gordon, principal and founder of restaurant consulting firm Pacific Management Consulting Group.

Aziz Hashim, founder and managing partner of NRD Capital, said his company bought a 70 percent stake in Fort Worth-based Fuzzy's Taco Shop because it has "superior unit economics." NRD has just one other investment, a \$175 million buyout of Cincinnati-based Frisch's Big Boy Restaurants.

Atlanta-based NRD plans to expand Fuzzy's 100-store footprint nationally, adding roughly two dozen units per year.

"Our goal is to grow aggressively but responsibly," Hashim said. "We have to make sure we strengthen the economics for the franchisees, and we have to make sure we're adding infrastructure to support the growth of the brand."

Most of the money being bankrolled into North Texas restaurants is being used for growth. Coppell-based Cicis, which has nearly 450 restaurants in 33 states, plans to add 70 new franchised locations through the end of 2017, with funding help from the Arlon Group, based in New York.

After that, Cicis CEO Darin Harris said the company next will tack on 20 to 30 corporate and franchised units per year.

But some of Arlon's funding is also being used to overhaul Cicis' brand image. In November, the pizza chain announced it was slicing "pizza" from its name and the apostrophe from Cicis. It also debuted a contemporary look it plans to roll out to all of its restaurants over the next few years.

"Our objective with the investment from Arlon is to put in place the right human resources and invest in infrastructure for growth," Harris said. "And then lastly, invest capital for growth in new restaurants and reimagining our restaurants."

The hottest targets

Cicis fits into the restaurant segment attracting the most investor interest. Fast casual restaurants, where customers place orders at counters or kiosks and have their food delivered to their table, have seen a spike

in deals.

That may be due to what Gordon calls "the Chipotle effect." The Mexican fast casual showed investors that restaurants can generate high sales out of spaces as small as 2,500 square feet, requiring lower real estate costs than fine dining concepts, which need larger footprints.

And like North Texas is seeing a proliferation of restaurants, the food industry is seeing a boom in fast casuals, from Plano-based Zoes Kitchen (NYSE: ZOES) to Your Pie, an Athens, Georgia-based pizza concept that just debuted in Frisco.

"I think you see an uptick (in deals) across the board with fast casual concepts ... because of the simplicity," said Andy Ritter, executive director of the Greater Dallas Restaurant Association. "When you're buying a restaurant brand, you're not just buying the brand, but the operations, and that will be important to someone looking to make a sound investment."

With the proliferation of restaurant concepts, paired with plenty of available capital, analysts believe private equity investments will continue to be restaurants' choice for funding growth.

IPOs are expected to remain an unpopular choice due to low stock prices for publicly traded restaurant companies.

"In general, the private equity industry has an abundance of capital to deploy," Bashour said. "With interest rates continuing to stay low and the availability to debt capital being strong, there's no reason to think acquisition activity will slow."

PRIVATE EQUITY FOOD INDUSTRY INVESTMENT

RESTAURANT	DEAL DATE	INVESTOR	SELLER	STAKE PURCHASED
 WILLIE'S GRILL & ICEHOUSE	Sept. 16, 2015	CIC Partners*	N/A	100%
 TACO BUENO RESTAURANTS*	Dec. 2, 2015	TPG Growth*	Palladium Equity Partners	100%
 FUZZY'S TACO SHOP*	Feb. 26, 2016	NRD Capital Management	N/A	70%
 CICIS*	Aug. 29, 2016	Arlon Capital Partners	ONCAP Management Partners	100%
 WETZEL'S PRETZELS	Sept. 2, 2016	CenterOak Partners*	Levine Leichtman Capital	Undisclosed
 VELVET TACO*	Sept. 6, 2016	L Catterton	N/A	Undisclosed
 PHILZ COFFEE	Sept. 12, 2016	TPG Growth*	N/A	Undisclosed
 LAST CALL GUARANTOR*	Sept. 28, 2016	Fun Eats and Drinks/ Kelly Investment Group	Cerberus Capital Management	100%

* North Texas-based company Sources: Pitchbook and Mergermarket

Korri Kezar
Staff Writer
Dallas Business Journal

