Financials – November 2015

A Deeper View of Current Restaurant Conditions, from the Finance and Development Conference
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I had the opportunity to attend the 26th annual Restaurant Finance and Development Conference last week. This is an excellent conference to get beyond the headlines and spin from earnings calls. Here are a few observations of themes heard:

Restaurant market share overall stagnant for years, but: Restaurant sales are flat to up marginally but traffic is still down since the pre recession 2007 peak. The overall sales environment is not changing. There are exceptions, by concept, of course. Sales has been supported by a 3% increase average check. However, the amount of sales market share violatility is high, with new or emergent concepts rocketing up, taking away market share from others.

IPO checklist: while everyone is excited about potential surges in stock price at the point of offering, there are consequences of going public, First, as many can attest, the pressure is enormous. There is outsized attention of every metric; if the company gets to be highly priced, it is said to be priced for perfection, and one metric miss can have a disproportionate Wall Street effect. It was noted that the IPO needs to be of sufficient size—if the IPO is $75M, then there must be sufficient earnings per share to support that so the PE ratio isn't stratospheric to begin with. The prospective IPO company must be able to be seen to weather the periodic economic ups and downs, and with no structural surprises or sudden costs that materialize.

The Equity markets are interested in: (1) growth concepts, either company owned or not (2) franchising. There is recognition that the vast supply of restaurants especially in the US is a cautionary note, and that franchising limits investor upsides, since franchising is royalty based and more stable. It was said the curse of being publicly traded is that the same consumers and real estate was being chased.

Interest rates matter a lot to the lenders. While the FED is talking about a small increase in December, this is highly symbolic, the first increase in nine years. Most restaurant lending uses LIBOR or the prime rate as a base, so its not at all likely restaurant loans margins will soar. Low interest rates and cost of capital have driven the wave of restaurant IPOs, private equity transactions and franchisee consolidation that's been underway since 2010. What does this mean, practically:while a debt disaster is not pending, this is a good time to buy or sell your restaurant concept.

The deal professionals worry about global catastrophes. The deal matchmakers don't lie awake at night worrying about sales and profits, but they do think about global issues, global catastrophies, meltdowns of various sorts. All of those things are uncontrollable. Restauant sales and profit issues are considered to be workable in the long run, since the restaurant space is so versatile, and has survived waves of drama in the past. While not a worldwide issue, the tragic drama in Franchise this weekend is representative of those uncontrollable factors.

Getting your ducks in a role when selling your brand: my panel discussed the steps necessary to sell your brand, Retaining the right support professionals (investment banker, attorney, business broker), getting a realistic view of how the market mightl view your business from a EBITDA cash flow multiple standpoint (every seller wants higher, every buyer wants lower), getting numbers and doing buyer due diligence were discyssed.

The role of getting and keeping good people is getting more visibility. While we all know this business is about making money, and good people is critical. The role of people is getting more attention. Wage rates reported by brands in October-November were up app. 3%. The consensus is price alone cannot cover that amount going forward. More wage increase is coming in 2016 with the overtime wage threshold increase which will potentially effect unit management, One stock analyst recommended CEOs push to expand their people comfort zone quickly, finding more diverse board members and to take care of their people.

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