

OUTLOOK**The Inflation Trap**

The restaurant business is all about momentum. There was none of it in January. It was an awful month. Traffic was off due to the Omicron. Employees were hard to find. For the ones employed, many were out sick. That was evident as restaurant after restaurant reduced hours to deal with the shortage. I never thought I'd see a McDonald's closed on a Sunday night at 6:30 pm, but there it was locked up when I drove by. Save the remaining employees for peak sales.

Restaurant operating expenses have jumped significantly over the past six months. Beef especially has spiked. Sales may be up, but cash flow is down. Wages keep moving higher. Chipotle's average crew wage exceeds \$15 an hour and will go higher this year. Starbucks workers, probably the best-treated ones in the industry, are demanding higher pay, even toying with a union. So much for stock savings accounts, paid time off, parental leave and tuition reimbursement.

Restaurant headwinds are plenty on the consumer side, as well. The CPI jumped 7.5% in January; not since February 1982 has the rate of increase been higher.

Everything you buy is up: gasoline, home energy, groceries and rents. Inflation, according to Moody's Analytics, is costing the average family an additional \$250 per month compared to a year ago, not a positive attribute for increased restaurant spending. Operators face the delicate task of pricing their menus to cover rising commodity and labor costs. But not too high to snap the elastic band of affordability.

Deal flow remains steady, despite the issues. Restaurant brokers tell the Monitor that many deals were rushed into 2021 in case the capital gains rate was increased, and that meant a slow start to 2022. Plus, the Omicron virus dealt a blow to a number of restaurant chain results. One banker told us there are multiple restaurant companies ready to IPO in a more upbeat market.

Deal activity should pick up once Omicron subsides. For one, interest rates are still low, lower than they were before the great restaurant consolidation began. Many investors believe the dovish Federal Reserve will not substantially raise interest rates to tamp down inflation.

A second reason is there is still a ton of PE money to be invested. There was record venture capital creation in 2021 as investors allocated a larger percentage of their assets to private equity sponsors.

There are also lots of potential sellers. Investment banker Sima Griffith calls the small and middle-market M&A climate the "Gray Tsunami," where business owners in their '50s, '60s and '70s want to retire and cash out.

One can understand why the seniors want to cash out now, but they can't count on getting the price they would have gotten last year. According to Unbridled Capital founder Rick Ormsby, there are fewer buyers out there right now because too many are digesting the deals they bought. Ormsby says operating conditions are tougher and the threat of higher interest weighs on valuations.

How the Federal Reserve deals with inflation is the biggest worry. Most business owners weren't around in the late '70s and early '80s and never had to deal with inflation. Restaurant borrowers might like the fact they are paying back their loans with cheaper dollars. They might like the fact their leases have rent increases that are less than rate of inflation. They might also like the fact they have cover to raise menu prices believing commodity cost increases to be temporary.

However, the late economist Milton Friedman was spot-on when he called inflation a "disease" and said he knew of no example in history where inflation ended without a period of slow economic growth and higher unemployment. That's because the only cure for inflation is slowing the rate of monetary growth and raising interest rates. Just the threat of the Fed's medicine has already roiled the stock market.

For now, the government is throwing out excuses for inflation, clinging to the "transitory" thesis. The supply chain, the pandemic, low employment, even greedy restaurant CEOs are singled out as culprits for rising prices. But, what if the Federal Reserve really puts the breaks on monetary growth and causes a recession?

Your business may have been pandemic proof, but is it recession proof?

Truist Brings Investment and Corporate Banking to Restaurants

“We’ve all done this for 25 years, and we want to make an impact in our world, particularly at this stage of our careers,” said **Mike Phalen**, head of Consumer Corporate & Investment Banking with **Truist Securities**. “We want to talk about how we can align ourselves with like-minded restaurant founders and operators and serve them exceedingly well.”

Phalen joined Truist in late 2020 from the investment banking group at Wells Fargo Securities. Part of the appeal was that Truist, which is a result of the merger between SunTrust Bank and BB&T a few years ago, has a mission to be “a purpose-driven bank,” he said. “And that’s authentic—to inspire and build better lives and communities. I think that’s an apt descriptor of the restaurant industry, too, and it’s a great platform to align with our restaurant clients.”

From a business standpoint, Phalen is leading a group which includes both investment banking services as well as corporate banking. “It’s a universal banking model, which provides senior debt, equity and debt capital markets, M&A advisory, hedging solutions; anything a company may need.”

Jeff Llamas, Truist director, came on board at the same time as Phalen, and will lead restaurant investment banking efforts for the bank.

“We have worked together for over a decade, and Jeff has deep domain expertise and industry acumen,” said Phalen. “He knows the restaurant sector well and can quickly discern when a company is highly differentiated and has a compelling consumer value proposition. He can analyze a company’s qualitative and quantitative strengths.”

Mike Poole, managing director, who also worked with Phalen and Llamas at Wells Fargo, joined the bank in November 2021 and heads up corporate banking for restaurant clients.

“I worked with both Jeff and Mike at Wells,” said Poole, “and we had a great run together. The prospect of working with them was a primary motivation, as well as the CIB (corporate and investment banking) model.”

“I grew up at (investment banking firm) Alex. Brown in Baltimore,” said Phalen. “We didn’t have a balance sheet; however, here at Truist, we are applying the universal banking model against the middle market, which encompasses 99.0 percent of the restaurant industry.”

Where they play

On the investment banking side, Truist will work with restaurant companies and large franchisees that have an enterprise value of \$100 million on up to \$1 billion-plus. “We can focus on clients that are longstanding operators

in the industry, as well as up-and-coming brands that are doing well on unit economics and delivering a fantastic experience,” said Llamas.

“We talk a little bit about materiality,” said Phalen, “but there is also qualitative materiality and you know it when you see it. It’s about identifying those types of companies that are going to be the next big thing. We want to get to know them early on so we can grow with them.”

Younger-stage companies, Llamas added, can benefit from Truist’s advice early on. “We want to build those relationships and rapport.”

Poole’s efforts on the corporate banking side will focus on large and middle-market companies, both public and private. He will be banking both franchisors and operating companies, but will build out franchisee banking efforts in the future, he said. Deal size will be \$20 million and up.

“Restaurant companies are very capital intensive,” said Poole. “How do we differentiate ourselves? We are a total solution with both corporate and investment banking. And Mike (Phalen) has been a CFO of a public restaurant company. That matters.”

Phalen himself was CFO for Krispy Kreme from 2004 to 2007. “Mike knows what it’s like to sit in the CFO seat, and that gives him a unique perspective,” Poole added.

And, Phalen and Llamas advised Krispy Kreme on their sale, and Cheesecake Factory and Burger King on other transactions.

“We have \$2 billion in capital committed to the sector and growing,” said Phalen. “We definitely have a commitment to restaurants.” For more information, contact Jeff Llamas at (773) 860-0671, or at jeff.llamas@truist.com. Or contact Mike Poole at Michael.Poole@truist.com, or at (704) 301-7793.

Unbridled Sells KFC Units and More

Unbridled Capital, a boutique investment banking firm that focuses on restaurants, recently provided sell-side advisory services to **Fowler Foods** on the sale of 90 KFC and multi-branded units in eight states to **Tasty Chick’n**, a subsidiary of Tasty Brands, a large franchisee of Pizza Hut, Dunkin’ and Burger King restaurants.

Unbridled Managing Director **Rick Ormsby** told the Monitor there were some surprises at the last minute when they were trying to close the deal.

“When you have complexities, the first thing is you have to have the buyer and seller—especially a seller—play a different role,” he said. “When you have a change of the financial picture, you have a litany of negotiations, contingencies and circumstances that change and you

have to have good communication between the buyer and seller. They both have to want to do the deal, and that usually wins the day. And if they trust in the deal, it will almost always happen. We were also fortunate the seller was in business a long time and ran a great operation.”

He also thinks KFC “has elevated itself in the eyes of buyers, investors and other franchisees.” In years past, he explained, KFC operators had two choices in the sale of their locations: the neighboring franchisee or the large, KFC consolidator that has been buying up the restaurants.

“We’ve had about three, large outside buyers come into the system lately,” Ormsby reported. “That’s a big story for the brand.”

Unbridled also provided sell-side advisory services on the following transactions:

- **Schoenhofer Enterprises, LLC**, and related entities, on the sale of 13 KFC restaurants in Oklahoma and Kansas. The restaurants were sold to existing franchisee **SC Food Group, LLC**.
- To the **Hertzman family** and its related entities on the sale of 30 Rally’s restaurants in Kentucky and Indiana. The restaurants were sold to multi-brand franchisee **Falcons Burger, LLC**, led by **Shamsu Charania**. For more information, contact Rick Ormsby at (502) 338-0162, or at rick@unbridledcapital.com.

Trinity Capital Leads Sale of JIB Units

Investment banking firm **Trinity Capital**, a division of Citizens Capital Markets, recently closed on the sale of 20 Jack in the Box restaurants in the Sacramento, Calif.-area on behalf of franchisee **CalJax, Inc.**, owned by **Tony Lutfi**. The units were sold to franchisee **Anil Yadav** through his company, **Cal Valley Jack, Inc.**

“It was a fantastic outcome,” said **David Stiles**, managing director of Trinity and the lead banker on the deal. “We had multiple attractive offers and that gave the family options to choose what was really best for the organization.”

The Lutfis have been franchisees of several restaurant brands, as well as franchisees of retail centers, for years.

“This particular market for Jack in the Box had some of the highest AUVs in the system,” said Stiles, “and everyone recognized CalJax as a top-notch operator. To take over those assets and market was a unique opportunity, and there’s not many Jack in the Box opportunities that are on the larger side like this, as well.”

From his standpoint, Stiles said one reason the Lutfis’ businesses are so strong is their dedication to their employees. “They always concentrate on helping their people become successful. It’s a culture thing. Everyone is working hard in achieving the highest measures for

customer satisfaction and speed of service. And, they earned the right to become training stores for corporate and other franchisees. They take a lot of pride in that.”

Another way of saying it, he said, “is that they are very intentional about their culture and that’s something today’s labor force want to be part of.” The family decided to take advantage of the vibrant M&A market, and “simplify their lives,” said Stiles.

“A decision to sell family business is never easy,” said Lutfi, “and with all of the important considerations we needed to explore, we were able to confidently make the best decision for our family by leveraging the extensive knowledge and experience that Trinity Capital offered us.”

For more information, contact David Stiles at david.stiles@citizensbank.com, or at (310) 488-0884.

Auspex Completes, Advises on Franchisee Deals

Investment banking firm **Auspex Capital** recently completed the following transactions for clients:

Debt Placement: Franchisee **Wen JAI Restaurant Group** and **JAI Hospitality RG** (collectively, “Wen JAI”), secured \$84.0 million in new loan commitments to fund the acquisition of 71 Wendy’s in Texas, Tennessee, New Mexico, and South Carolina, provide funds for future development, remodels and working capital. Wen JAI is owned by **Jhonny Mercado**. **Fifth Third Bank** led the funding, which included participant banks **City National Bank**, **TD Bank** and **Amerant Bank**. The new loan commitments included a \$66.0 million senior secured business term loan, a \$15.0 million development line of credit and a \$3.0 million revolving line of credit.

Debt Placement: Franchisees **Rebecca and Todd Wilber**, owners of **CTI Restaurants** and **CTI Properties**, have secured \$26.0 million of new loan commitments. The financing included a \$7.0 million business term loan and \$1.0 million business development line of credit provided by **Huntington Bank**, and a \$12.0 million real estate term loan and a \$6.0 million real estate development line of credit provided by **First Horizon Bank**. The loans were used to refinance the company’s existing debt, fund a distribution to the shareholders, new unit development and remodel of existing locations. CTI owns 12 Taco Bell restaurants, and the fee properties underlying 10 of the restaurants, in and around Cincinnati.

Sell-Side M&A Advisory: Franchisee **Bhasin Arby’s Holdings**, an Orefield, Penn.-based Arby’s franchisee owned and operated by **David Bhasin**, has completed the sale of its six Arby’s restaurants and the real estate underlying two of the restaurants to existing franchisee, **AP Balt Mgmt.**

For more information, contact Managing Director **Chris Kelleher** at (562) 424-2455 or ckelleher@auspexcapital.com.

Farming, the Soviet Union, Restaurants and More: An Illustrious Career in Finance

The year was 1977 and a 29-year-old Bill Wildman was on a plane heading to the Soviet Union, in the middle of the Cold War.

“I remember when we landed at the airport, no planes could go to the terminal,” recalled Wildman, CEO of Pinnacle Commercial Capital, an investment banking firm that serves the restaurant industry. “They took our passports from us and put us on a bus with armed guards. We even had armed guards outside our hotel rooms.”

Such starts the colorful story of Wildman’s first trip out of the country as a young man. Leonid Brezhnev was Chairman of the Soviet Union and head of the Communist Party and Jimmy Carter was President. The U.S. State Department was forming an agricultural delegation to travel to the U.S.S.R to help in the ongoing efforts to “thaw relations” between the two.

“There’s wasn’t much friendship between the Soviet Union and the U.S. at that time,” Wildman said, “and the idea was maybe we could help the conversations a bit and ratchet down the rhetoric.”

The State Department contacted him through his contacts at Purdue University. Wildman owned a farm in southern Indiana—he grew up on one, after all—while at the same time worked at a small community bank that made loans to farmers. It was a three-week trip that took the group to six countries, but the U.S.S.R. was the primary focus.

Even though the Soviets’ country was vast, only 30 percent was suitable for farming crops, Wildman recalled. “Consequently, they didn’t have the production levels, and we knew that going in,” he said. “We wanted to help.”

The group asked questions, “and you could try your best to make a suggestion,” he said. But the delegation members knew that they couldn’t push “the American way” of farming, “because the Soviet people who took us around weren’t bashful about how great they thought the Communist way was.”

Part of that “way” were the cooperative farms in the Ukraine. State run, they could be up to 20,000 to 25,000 acres. At the time, Wildman said, about 11,000 of those existed in the Soviet Union. “They were like villages,” he said, “where the villagers worked on the farm. They would be given half an acre to farm for their own use.”

The problem was, Wildman pointed out, those workers didn’t have the right to make decisions. Every year, the Soviet ag department saddled each farm with quotas.

“They were assigned a job and they did it,” said Wildman. “And they weren’t given an incentive to do more.”

That was evident at one farm they visited. As the delegation

walked through a building housing pigs, they noticed one sow, about to give birth in her crate, was having trouble.

“It was shift change, so no one was bothering to help her,” he said. His farm experience kicked in and “I just jumped over the fence and helped her have her pigs. She would have died otherwise.”

It was the trip of a lifetime, he says, and part of his start in a storied career in finance, even though he has long since left his ag banking behind him.

And then came restaurants

Wildman got his start in restaurant finance back in around 1985 when a former banking colleague Mike McCoy contacted him for help. At the time, McCoy was working at a leasing company and was building a program to lease equipment to Wendy’s and other restaurant franchisees.

McCoy and his company were exhibiting at a Bonanza and Ponderosa franchisee convention and they were shorthanded. “He said, ‘Bill, I need a favor. I need you to get business cards printed, go to Orlando and set up the booth, and act like you know what you’re doing,’” Wildman recalled.

He actually did know what he was doing and loved it. Wildman and McCoy joined forces and started up Meridian Financial, a company that helped restaurant companies get financing. After a few years, McCoy moved on to new things outside the industry and the duo sold their company.

Wildman wanted to stay in the restaurant finance business, so 20 years ago he launched Pinnacle Commercial Capital.

The company sources financial solutions for tier-two and -three concepts. He knows more than a few franchisees, who today operate 50- or 300-plus units, who he financed when they were just starting out. Wildman and his team have raised over \$1.5 billion in funding for multi-unit operators since Pinnacle’s inception.

The best part of his career, he said, is the friendships he’s made with franchisees. Plus, he loves connecting the dots to get a deal done. And he’s tenacious about it: As this reporter knows, when the financial crisis hit in 2009, Wildman would work late into the night dialing for dollars to community and regional banks across the country to find financing for his clients at a time when banks were literally shutting their doors.

“Working hard goes back to my farm days,” he said. Looks like you can take the guy out of the farm, but you can’t take the farm out of the guy.

—Mary Jo Larson

Sterling's Franchise Finance Group Transitions to Webster After Merger

Webster Financial Corp. and **Sterling Bancorp** closed on the merger of the two banks on February 1. The combined company will keep the Webster name.

"I'm excited we'll be with a larger group, and we'll have a larger balance sheet, which will be beneficial for our borrowers," said **Lindy Baldwin**, managing director, franchise finance with Webster. According to Baldwin, pre-merger, Webster did not have a formed franchise finance group, but did participate in some syndications. "But they are excited about our franchise group, and want to continue it," she said.

The combined entity has about \$65 billion in assets and \$44 billion in loans. "It doubles the size of the bank and our cost of funds is cheaper," added **Tom Melchior**, head of credit risk management with Webster. "It will increase our hold limit, and we can have larger balances with customers. And our credit box may open up more."

Historically, the franchise finance group concentrated on financing tier-one franchise brands, but had decided to start funding tier two for 2022. The merger will help them penetrate these brands further.

An example is the recently closed transaction with Tropical Smoothie Café franchisee **H2 Smoothies Holdings**, which owns 21 locations in Michigan and Ohio. The financing, led by Baldwin, will provide \$9.7 million for refinancing of existing debt and as well as funds to support acquisitions.

They have worked with other brands like Jersey Mike's, MOD Pizza, Dunkin' Brands and Popeyes, and will look at brands with 700 to 800 units and a history of 10 years in business.

Also, they can do more larger deals, on up to \$50 million, including participation in syndications. And while both Webster and Sterling had strong presences in the Northeast—the combined bank now has 202 financial centers across the area—the franchise finance group continues to lend to restaurant franchisees nationwide.

And, the group will continue to grow. According to Baldwin and Melchior, the franchise team has openings for both business development officers and underwriters, and are open to filling those positions remotely across the nation. For more information, contact Lindy Baldwin at (402) 312-2542, or at LiBaldwin@websterbank.com.

Stan Johnson Closes on Sale/Leasebacks for Franchisees

"People went nuts," said **Matt Lipson**, associate director with **Stan Johnson Company**, a commercial real estate brokerage and advisory firm that focuses on investment sales. "There were 24 offers in 48 hours."

Lipson closed in November on the sale/leaseback of a Sonic franchisee's location in Willow Grove, Penn. The sale price was \$3.035 million and garnered a 5.25% cap rate on a 20-year lease. The market was white hot, he said.

"And, sales were high and strong for the incoming Sonic operator," he reported. "Today if we listed it, it would be at a 4.5% cap rate. The buyer got a really good deal."

Stan Johnson's **Milo Spector**, associate director with the company, represented the buyer on the deal. He said his client is one who is acquisitive. "We've done about 10 of them for this client. This is a good example of a company that is growing being able to use the real estate as a way to acquire operations."

Other transactions:

- Lipson closed in late December on the sale/leaseback of a Taco Bell location in Checotah, Okla. for franchisee **K-Mac Enterprises**, which operates more than 300 Taco Bell locations. "They are known as a good tenant; easy to work with. Part of my marketing was based on the fact someone would be getting K-Mac as a tenant."

The property, considered to be in a tertiary market, garnered a 5% cap rate at a \$1.9 million price. Fun fact, he said, the town is also the home of country singer Carrie Underwood. "I used that in my marketing, too," he said with a laugh.

- Lipson closed in January on the acquisition of a Starbucks in Loves Park, Ill. "It was an off-market deal, all done internally," he said. The purchase price was \$2.426 million and garnered a 5% cap rate with a 10-year lease. For more information, contact Matt Lipson at mlipson@stanjohnsonco.com, or at (503) 468-7503. Or contact Milo Spector at mspector@stanjohnsonco.com, or at (415) 293-7720.

NFS Finalizes Sales of Franchise Units

National Franchise Sales (NFS), a franchise business brokerage, recently closed on the following transactions:

- Assisted Marco's Pizza multi-unit franchisee **Maruti LLC #1, Pie, LLC**, and **The Pizza Joint** with the sales of five units in Alabama and Mississippi. NFS identified an existing Marco's franchisee as a buyer, which expedited franchisor approval. Despite bank challenges, NFS was able to facilitate the sale and negotiate four leases and one new lease in just over 100 days from contract to changeover.

- First-time franchisee **Mahant Management** purchased **The Lion Group's** Jimmy John's locations. Mahant was introduced to the Jimmy John's concept by (NFS) who guided them throughout the offer, due diligence, franchisor and landlord approvals, the escrow processes and assisted in securing financing.

For more information, contact NFS President **Jerry Thissen** at jt@nationalfranchisesales.com.

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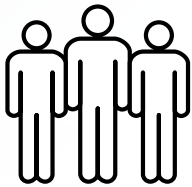
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Burger King franchisee **Chris Johnson's** acquisition of 17 restaurants in the Cleveland area from fellow franchisee **Mike Showalter**, will add to his base of 52 locations. Johnson took on a new private equity partner in 2021, Chicago-based **City Capital Ventures**, who's no stranger to the Burger King brand as it owns The Redberry Group, Canada's largest Burger King franchisee. Johnson's latest acquisition was brokered by **Tony Petrunin of Unbridled Capital**. **Carrol's Corp**, Burger King's largest franchisee, has development rights to acquire Burger King resales in Ohio, but apparently passed on the deal. Carrol's soon-to-be-retiring CEO Dan Accordino told an ICR conference audience last month that the Burger King brand has been "sideways since 2018." Johnson told the Monitor his firm recently sold their lone Popeye's restaurant and will soon announce a development deal with another chicken franchise.

Arlington Capital arranged a senior term loan in November for **Another Broken Egg** with **Comvest Credit Partners**. The funding was used to pay a dividend to Another Broken Egg's private equity owner, **The Beekman Group**, and to fund future growth in the 80-unit system. Another Broken Egg has made a number of leadership changes over the past 18 months adding CEO **Paul Macaluso** and CDO **Jeff Sturgis**. The breakfast/brunch category is hot right now given the recent **First Watch** IPO. That's resulted in growth for Another Broken Egg that will add 20 new restaurants in 2022. Comvest has been active in the restaurant credit space and recently provided a \$80 million credit facility to **P.J. Whelihan's Restaurant Group**, which was acquired by **Garnett Station Partners** late last year, a deal also brokered by Arlington.

Last summer, Bloomberg reported that **PF Chang's** executives were in discussion with investment bankers about a possible IPO filing. Its PE owners, **TriArtisan Capital Advisors** and **Paulson and Co.**, are trying to reinvent the 300-unit brand as an off-premises success story, as opposed to what it had been for many years: a low-margin casual dining business that was closing more stores than it could open. A peek inside Chang's this month, compliments of a Fitch Ratings report, shows a company slowly recovering from the pandemic, but one with high leverage and significant capex requirements as it ramps up spending on remodels and to-go locations. Industry-wide inflation, labor issues and the Omicron variant have cooled investor appetite for IPOs, and that might shelve plans for a Chang's offering. However, the IPO market changes quickly, and the good news for Chang's is that Fitch upgraded the company's default rating to 'B-' with a stable outlook as the company's leverage has improved.

Investment banking firm **Brookwood Associates** recently advised **Double P Corporation** on its acquisition by **Fresh Dining Concepts**, and thus the largest franchisee in the **Auntie Anne's** and **Cinnabon** systems was created. Before the acquisition, Double P was one of the largest franchisees of Auntie Anne's and Cinnabon with 73 stores in California, Indiana, Illinois, Kansas, Minnesota, Missouri, Nevada, Ohio and Wisconsin. The company also operated four Red Mango frozen yogurt stores co-branded with Auntie Anne's. Fresh Dining was the largest franchisee of Auntie Anne's, with baking kiosks and satellite retail units throughout the Eastern U.S. In addition, it also operates Carvel and Cinnabon stores. Today, the combined entity owns about 150 locations nationwide. **Amy Forrestal**, managing director with Brookwood told the Monitor Double P had a really nice portfolio of mall sites. "The truth of the matter is that some will say that malls are dying, but actually the good malls are doing very well, and Double P did a great job of managing their portfolio of malls (in which they operated)." And, Double P even had locations in high-traffic spots like O'Hare International Airport in Chicago, she said. This story wouldn't be complete without a mention of the pandemic. Yes, covid struck here, too: Fresh Dining agreed to a deal in early 2020 and were finalizing their due diligence when the pandemic hit in early March 2020. "Then all the stores were shut down," said Forrestal, and were not fully reopened until Spring 2021. **Fifth Third Bank** provided the senior debt for the transaction. For more information on the deal, contact Forrestal at (404) 307-2189, or at af@brookwoodassociates.com.

Tilman Fertitta's decision to pull his company out of its planned merger with the special purpose acquisition company, **Fast Acquisition** (FST), could only mean one thing: The always acquisitive Fertitta found a better deal for his conglomerate of five **Golden Nugget** casinos and a hodge-podge of tired fine-dining brands. Fertitta just completed refinancing the company's \$4.6 billion debt load which allowed for the payment of a \$250 million dividend to himself. According to S&P, the key piece of the refinancing was a \$3.3 billion, seven-year Term Loan B for Golden Nugget priced at 4.62%. Moody's Analytics calculated Fertitta Entertainment's debt to EBITDA is roughly 6.9x for the 12 months ended September 30, 2021.

Gordon Haskett analyst **Jeff Farmer** calculates that QSR marks up third-party delivery orders by 24%, with fast casual at 19% and casual dining at 9%. Farmer says the average delivery premium across the 23 concepts in his analysis is 15%, up from 13% in March 2021, and 9% in July 2020.

KeyBanc analyst **Eric Gonzales** points out in a recent research report that average hourly earnings increased 16% and 14.8% at full-service and limited-service restaurants, respectively, in November. Restaurant executives tell Gonzales that wage inflation will stay elevated given the decline in the labor pool, but it's unlikely to continue at its current rate for much longer.

Not only have **Shake Shack** shareholders taken a big hit in the past year (the stock is down from \$117 a year ago to \$75 recently—a 36% decline), the company's bondholders can't be too happy either. A year ago, Shake Shack took advantage of a frothy convertibles market and sold \$250 million of zero-coupon convertible bonds due in 2028. That's right, no coupon. Each \$1,000 bond was convertible in 5.8679 shares of Shake Shack common stock at a price of \$170.42 per share. The bonds now trade at a discount (around \$845.50 per \$1,000 bond) and if held to maturity in 2028, would yield around 3%. However, with the stock conversion price so far out of the money and with interest rates expected to rise this year, Shake Shack could be forced to refinance the debt.

TGI Friday's' presentation at the recent virtual ICR Conference sounded like a sales pitch. Turns out it might have been a warmup for the real thing. The scuttlebutt on the street has it that Friday's has a book out and is searching for a buyer. "The most recognized bar in the world," according to CEO Ray Blanchette during the same presentation, has 150 company and 154 franchised restaurants in the U.S., averaging around \$2.8 million. "The sky's the limit," said the company's COO **John Neitzel** during the presentation.

Garnett Station Partners, the \$1 billion in asset investment fund formed by **Matt Perelman** and **Alex Sloane**, has created a platform company to own the regional restaurant chains the fund has acquired, and will be acquiring, in the future. The platform company, named **Authentic Restaurant Brands** includes recent acquisitions: **P.J. Whelihan's**, **Primante Bros** and **Mambo Seafood**. Last month, Sloane told Franchise Times Senior Editor Beth Ewen he believes 2022 will bring plenty of deals. "We're busy. We feel bullish on the economy, and we feel we're well positioned to find additional opportunities, to back great founders and entrepreneurs," he said.

BDO accountant **Dana Zukofsky** was recently featured on a **Fox 5 News** report in New York City for her work distributing hand-made winter scarves to the homeless.

Hardees was well known for developing restaurants in small communities, some as small as 5,000 people. Once McDonald's moved into the smaller towns, however, Hardee's found the competition a lot tougher. Now **Chipotle** is talking up a small-town development strategy. On a recent earnings call, Chipotle's CFO **Jack Hartung** told investors of the company's "seam" strategy: In communities smaller than 40,000 residents, perhaps along an expressway, "you string a bunch of small towns together where there's one that's 50 miles away and another that's 50 miles away, you stream these along so that a field leader can, over a number of days, make sure that he gets touches with those restaurants." Sounds to us as if Chipotle is running out of good sites to build new locations.

ON THE NEXT EPISODE OF UNDERCOVER BOSS:



Frothy and Undervalued: A Possible Tale of Have and Have Nots

By Roger Lipton

The recent market volatility indicates not only inflationary trends, but the level of public confidence public and private banking officials can control. The ratio of bank assets to equity is a good indicator of risk, since the difference between the two is leverage. One institution had assets of 24x its equity base in 2007, which is high leverage by most standards, By 2011, as a result of the financial crisis, this measure had doubled to 48x. Today, the assets are 224x the capital base. Its noteworthy that if these assets, consisting of fixed-income securities, were marked to market, the capital base would be wiped out. Unfortunately, that particular institution is your friendly Federal Reserve. It would be wise to keep this in mind as Chairman Jerome Powell describes how the Fed will take all necessary measures to bring 7% inflation rate back to just over 2%. It wasn't long ago that "transitory" was a popular buzzword.

A **new stock market darling** has emerged in Black Rifle Coffee Company (BRCC). A merger took place on February 3 between Black Rifle and a SPAC which raised \$345 million about a year ago. The structure is relatively unique compared to most SPAC business combinations because, not only is Black Rifle's management remaining in place with voting control, but Engaged Capital (part of the SPAC sponsor group) invested \$100 million at \$10 per share, the original IPO unit price. Black Rifle now has about \$150 million in cash on the balance sheet, and about 183 million shares outstanding. Subsequent to the NYSE listing on February 6, the stock has run from \$10 to \$16, so the valuation, net of the cash, is \$2.8 billion or about 12x trailing revenues, with no earnings yet. "Stock market darling" is not an overstatement.

The company was founded in 2014 by an ex-Special Forces Green Beret Evan Hafer, who started the business by roasting 500 pounds of coffee in his garage with a corporate mission to benefit military veterans and their families. More than half of the 400 full-time employees are military veterans, with 10,000 expected to be employed within 10 years. Revenues were \$230 million in 2021, and are expected to double in the next two years, with positive earnings and cash flow in 2023.

Revenues are generated through a rapidly growing network of 270,000 Coffee Club subscribers and over two million cans, monthly, of ready-to-drink beverages, also sold through over 35,000 retail stores that include Walmart, CVS and 7-Eleven. The newest segment, expected to grow the fastest, are Black Rifle Outposts: 2,500-3,000-square-foot facilities that sell coffee products as well as apparel and accessories (48% of sales). There were eight company and eight

franchised Outposts operating at year end, expected to grow to 53 company and 25 franchised locations in two years. The targeted annual revenues per store are \$2.5 million with a 45% cash-on-cash-return on the \$1.4 million investment per store. Beyond the \$460 million of projected revenue in 2023, there is obviously a very large addressable market for this brand. The story is compelling with a loyal customer base reinforced by the corporate mission. The valuation of Black Rifle is more like a "cloud" or "cybersecurity" investment. However, the product is, after all, addictive and the concept has clearly touched a nerve with consumers. There are operational risks, but nothing fundamental that sheds doubt on the likelihood of success. The stock will no doubt be volatile and the valuation assumes a great deal of future progress, but the good ones are rarely cheap.

Public franchisees don't get their due. In my four decades of financial and operating involvement in the restaurant industry, franchisees hardly ever get useful valuations. This undervaluation won't allow stock ownership to incentivize employees or to raise inexpensive capital. This goes back to the 1980s, when Chi Chi's Mexican dinner-house chain had public franchisees: Kelly Johnston and Consul Corp.

Our work recently regarding 2,200-unit Arcos Dorado (ARCO), the McDonald's franchisee in South America, reinforced this observation. The other franchisees public today are Carrol's Corporation (TAST) the franchisee with over 1,000 Burger Kings and 65 Popeye's, and Meritage Hospitality Group (MHGU) a franchisee with 345 Wendy's. Carrol's trades at about 6x EBITDA, less than half of Burger King's owner, Restaurant Brands International (QSR). Meritage sells for under 8x EBITDA, about half that of Wendy's (WEN). We can't make a compelling investment case for Carrol's, because the company is heavily in debt and Burger King is something of a work in progress. Meritage barely trades, so its appeal as an investment is academic.

Conversely, Arcos, at about 7x EBITDA, sells at too large a discount relative to McDonald's at 18-22x (with or without capitalized leases). It has a strong balance sheet and plans to renovate and build, so higher earnings and cash flow are likely. Over half the stores are in Brazil, so currency risk exists but a meaningful dividend (\$0.20 annually pre-Covid) could be re-established. We think ARCO's multiple of earnings or EBITDA will approach McDonald's, but the gap—7x versus 20x-midpoint—seems too large right now.

Roger Lipton has followed the restaurant industry for four decades. Founder of money management and investment banking firm Lipton Financial Services, he publishes regularly at www.rogerlipton.com. Roger can be reached at lfsi@aol.com or 212-600-2266.

STATS AND QUOTES

THE ECONOMISTS SPEAK: INFLATION, RISING RATES AND AVOIDING RECESSION	
First Trust Chief Economist Brian Wesbury	Wesbury states in his newsletter the Federal Reserve is badly behind the inflation-fighting curve. “The CPI rose 7% in 2021, the largest increase for any calendar year since 1981. Meanwhile, commodity prices continue to rise. However, we’re still skeptical the Fed will move as aggressively as the financial markets are pricing in. If the Fed were really serious about the inflation fight, why didn’t it announce a sudden and early end to quantitative easing?”
Economist David Rosenberg	Speaking to a Financial Post reporter, Rosenberg suggested we may be headed for a recession. “Rarely have we ever gone into a tightening cycle with the yield curve this flat. If we get an increase in short-term interest rates and the bond market doesn’t move that much, they are going to invert the yield and we are going to have a recession on our hands. Sometime in the second half of the year we are not going to be talking about inflation, we are going to be talking about a recession. Those odds are rising.”
Bank of America Chief Economist Ethan Harris	Harris predicts the Federal Reserve will increase interest rates seven times in 2022 and a “few” more hikes in 2023. He told CNBC’s Tyler Matthisen the Fed is behind the curve and can’t catch up with one rate hike per quarter. “The economy has tremendous momentum. Households are loaded with wealth and liquidity. The economy will remain pretty healthy this year and then by next year we start to see more of a slowing as rate hikes start to take more of an effect.”
Hoisington Capital Management Economist Lacy Hunt	Hunt has a contrarian view on rising inflation. “With money growth likely to slow even more sharply in response to tapering by the FOMC, the velocity of money in a major downward trend, coupled with increased global over-indebtedness, poor demographics and other headwinds at work, the faster observed inflation of last year should unwind noticeably in 2022.”

To those of us in the restaurant business, it’s obvious rising food and labor costs must be offset by menu price increases, but that isn’t always clear to some politicians who characterize the price increase as “corporate greed.” Perhaps the industry could also do a better job in its messaging.

Here is Starbucks CEO Kevin Johnson providing a B-school explanation as to why the company took a price increase in October and January: “We have a very sophisticated approach to pricing that leverages analytics, artificial intelligence, and it’s overseen by a very talented team who do the modeling and look at the elasticity of demand along with the pricing actions on an ongoing basis.”

Starbucks operating income in the recent quarter was actually down 3.4% compared to 2019, but that didn’t stop Michigan Congresswoman Pramila Jayapal from criticizing the company:

“Despite soaring profits, Starbucks is raising prices AGAIN. We can’t accept this level of corporate greed as the status quo. Tax the rich and make sure every single worker in America can join a union.”

Chipotle CEO Brian Niccol was asked on CNBC’s Closing Bell about the brand’s recent 6% price increase and the ability of the company to take additional price increases this year: “I hope the inflationary environment slows down, but if we were to take no more pricing in 2022, we would have about a 6% price increase. We know if we need to take more pricing we have room to do it. To date we have seen no resistance from our customers.”

Vermont Senator Bernie Sanders tweeted a criticism of Chipotle for raising prices: “Corporate greed is Chipotle increasing its profits by 181% last year to \$764 million, giving its CEO a 137% pay raise to \$38 million in 2020 and blaming the rising cost of a burrito on a minimum wage worker who got a 50 cent pay raise. That’s not inflation. That’s price gouging.”

INTEREST RATES (%)

	2/11/22	Last Month	A Year Ago	Trend
Fed Funds Rate	.25	.25	.25	↔
30-Day SOFR*	.04833	.04967	.05567	↔
90-Day SOFR*	.04934	.04911	.07301	↔
1-Year Treasury	1.07	.46	.07	↑
5-Year Treasury	1.84	1.51	.46	↑
10-Year Treasury	1.92	1.75	1.16	↑
30-Year Treasury	2.24	2.08	1.94	↑
Prime Rate	3.25	3.25	3.25	↔

*Secured Overnight Financing Rate

A Real Estate Plan for 2022

By Dennis Monroe

Let's start with the obvious, but often overlooked: Controlling your real estate in some form of ownership, especially in today's restaurant market, is preferable to leasing. Control gives you the option of converting your investment into cash using a variety of tools, such as a sale-leaseback. More importantly, real estate can be a lucrative investment. A well-known restaurateur explained his thinking on it this way: Controlling all of your real estate allows for buildout concepts that make the investment more valuable. Since we don't yet know what the long-term effects of the pandemic will be, the more control you have over the real estate in question, then the more options (and flexibility) you'll have when that picture becomes clearer.

We also know ownership is not always possible. In some areas there is no opportunity to own the land, but you may be able to do a ground lease and own the building. If the ground lease is favorable, this may be a good option.

The second key point is that if you own, you need to determine your sales level in terms of what's an acceptable rent factor is, even if it is a related-party lease. You need to secure your debt service with a reasonable amortization. Instead of a 30-year, look for a shorter amortization on the real estate and see if reasonable rent can service a reasonable debt service.

Another consideration is whether the real estate has multi-purpose value. We are seeing many people offering development services, and even some who will do joint ventures, so the concept owner has some ownership interest. Look for creative approaches.

Finally, make sure the real estate is in a separate entity, with a market lease between the real estate and the operating entities.

If ownership is not in your pocketbook, leasing is your next best option, with the goal of attaining a reasonable rent. As discussed above, a key principle for a restaurant is to have rent as a reasonable percentage of revenue. We like to use a formula of percentages of sales for casual dining, with utilities and other occupancy expenses, not to exceed 8% to 10% occupancy cost. For fast casual it's normally a little higher; and for QSR with its bigger margins, lower labor costs and the importance of easily accessible locations, it can sometimes be as high as 10%. When you throw in additional occupancy costs such as taxes and insurance, that puts it at 12% or 13%. Always be conscious of the occupancy as a percentage of sales.

Make the most of any leasehold allowances provided by the landlord. Once you've negotiated your lowest rent, you have to deal with the cost of your leaseholds. It's always helpful if you can acquire an existing restaurant site, particularly in the casual-dining sector. In core urban areas there's a higher inventory of closed restaurants. The toughest area to find existing restaurant sites is the high-populated suburban areas or QSR sites with drive-thrus.

When you lease the property, landlords normally contemplate a leasehold allowance. Start with trying to get the lowest rent and then go back and figure out what your leasehold costs are going to be. Try to get the landlord to fund somewhere between 25% and 50% of your leaseholds (and note that equipment may not be included in this). In many cases, the landlord looks at a smaller amount, maybe 10% to 20% of your costs, and they may want to adjust the rent if your leasehold amounts are higher. Leaseholds are always problematic to finance with a lender, so push landlords.

If you have underperforming locations that you realize post-pandemic are not going to work, don't hold on to them. Don't get stuck thinking they may turn around and that the landlord will keep giving concessions. Be realistic and talk to your landlord. If you have a personal guaranty, accept that you may have to buy out the guaranty and turn the property back. If that's not the case, look at what your options are, particularly if your legal structure is such that you have that site in an entity that doesn't have other assets.

Lease-to-own situations have become more common with stand-alone restaurant sites. When negotiating a lease, always ask for right of first refusal and option to purchase. The worst that could happen is the landlord says no. Be proactive in negotiating real estate, so that you get a reasonable cost that your restaurant can afford.

And while there are other options to consider, owning provides the most flexibility. But just as important as we enter the second month in 2022, don't put off dealing with troubled real estate.

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As Starbucks Goes, So Goes the Nation?

Starbucks workers are organizing. Since December of last year, when two cafes voted to unionize, more than 60 cafes in 19 states have filed or announced their intent to file for union elections.

“We’re not unionizing because we hate our jobs,” said Tyler DaGuerre, a barista at the Coolidge Corner Starbucks in Brookline, Mass., and a leader of the union effort in Boston. “We’re unionizing because we like our jobs and want to make them better.”

His view is common among Boston baristas. They like their jobs. They like their coworkers, and in many cases, they like their managers. But they want more from their employer, and they see a union as a way to demand more from Starbucks.

Their reasons for wanting a union run the gamut from the theoretical to the practical, and many cut to the core of what it means to be a barista. The lack of seniority pay for baristas was a major concern for DaGuerre.

“I know people who have been with the company for more than 10 years who are only making \$15 or \$16,” he said.

Seniority pay is a major issue for the workers in Buffalo, New York, as well. Brian Murray, a Buffalo-area barista, said he knows baristas who have been working for five to 10 years that “only make a couple of cents more than someone who started yesterday.”

Starbucks “needs to decide if [being a barista] can be a career or if it’s just a transitional job,” Murray continued. Seniority pay — or any kind of economic return to time spent on the job — is a first step toward making a barista a sustainable career.

Pay, more broadly, is also at issue. All of the Boston-area baristas I spoke with made between \$14 and \$16 per hour. That’s more than the Massachusetts minimum wage of \$14.25, but it’s a low bar to clear. Research from the Massachusetts Institute of Technology shows the living wage for a single adult in the Boston area was \$19.17 per hour in 2020.

“An adequate living wage is the absolute bare minimum to fight for,” said DaGuerre. He estimates they’ll fight for a wage of \$19 to \$23 per hour.

Kayleigh Shuler, also a barista at the Coolidge Corner Starbucks, said she wanted the company to take COVID-19 more seriously. “They waited until two or three people got sick to close our cafe,” she said. She also noted that Starbucks doesn’t supply them with N95 masks, which was the “bare minimum” they could do.

Starbucks’ tipping rules using a credit card in the store were another common grievance. “We don’t receive tips on credit card payments,” said DaGuerre, “and credit card transactions are one of our largest, if not our largest” transaction types. He figures the company prevents tipping on credit cards in the store to keep the lines at the cash register moving. Starbucks customers can tip, however, using the mobile-app, or with cash. Absent a union, it’s tough to see how a barista would convince Starbucks to prioritize tips over throughput.

While compensation is a key consideration for any job, Murray said the campaign “has never fundamentally been about wages. Accountability from corporate is one of our fundamental demands.” That means holding Starbucks to its progressive rhetoric. He said representatives from the Elmwood, New York store, who began negotiating with management at the end of January, would demand Starbucks agree to a set of fair election principles for future union elections and commit to greater sustainability efforts.

He also said the union would negotiate for “full staffing” at all times. Under a previous system, managers earned bonuses for hitting or coming in under labor quotas. Murray said Starbucks claims to have backed off that system, but the workers want to prevent the company from introducing new structural incentives to understaff cafes.

Kylah Clay, a barista at the Commonwealth Avenue Starbucks in Boston and a leader in the unionization effort there, described the movement as a “push to empower baristas.”

“We want to protect the labor that’s contributing to Starbucks’ success,” she said. “By coming together and amplifying our voices...we can have a better say in how our store is run.”

While service-sector workers have not, historically, been unionized, the idea is gaining ground. Baristas at SPoT Coffee, a cafe chain in upstate New York, unionized in 2019. Three Boston area cafe groups, Pavement, Darwin and Diesel, Bloc and Forge, agreed to unionize in summer 2021. The IBEW and baristas at Colectivo Coffee, a Milwaukee-based chain with cafes in Wisconsin and Illinois, recently stole the show when they won their union vote in August 2021. Per Eater, a food news website published by Vox Media, the Colectivo union, which covers “about 400” workers, is the largest cafe union in the country.

—Arthur Robert

Our Backs to the Future

Restaurant owners have had their fill of a shrinking labor force, some 1 million jobs less, and 20% higher wages, than before the pandemic. If ever there was a time for restaurant chains and their suppliers to get behind technology and automation, it's right now.

There are two types of restaurants I believe will survive the after effects of the pandemic: The first is an updated limited-service, QSR model that maximizes automation and operates with just a few highly skilled employees, yet still cranks out the big volume.

The second type—the full-service restaurant model offering a variety of menu items—won't be much different than what's out there today, but they'll need a major ramp up in check average to survive.

Today's QSR is inching slowly toward the QSR model I envision. Of course, there is a drive-thru or digitally enhanced pick-up window. No inside seating anymore, as the pandemic proved it isn't essential. The biggest change is food will be prepped and cooked using robots and automated machines. Advances in 3-D printing will enable custom orders while prep decisions will be enhanced by artificial intelligence.

Only one employee will be needed to monitor the robots and automated cooking machines. Think Homer Simpson's job at the nuclear power plant. Burgers, tacos, chicken, pizzas, hot dogs, pancakes, sandwiches and french fries can all be prepped by robots and cooked automatically by the machines.

A second employee will be a technology guru named Dave, responsible for keeping the mobile ordering, drive-thru kiosk, AI, robots, and the automated cooking machines, nicknamed Hal 9000, in sync. The system will be all-knowing: "I'm sorry, Dave, I'm afraid I can't make a McRib sandwich."

A third employee will supervise inventory and packaging. They'll stock the automated cooking machines, bagging and drink-pouring equipment. A fourth employee will monitor drive-thru and pick-up windows, deal with third-party delivery drivers and handle to-go orders.

The QSR restaurants will be open for 23 hours. The store will close for one hour each night to stock the machines and air out the place. Robots will be dispatched to clean the bathroom, take out the garbage, pick up the litter in the parking lot and even give rides home to the staff.

Imagine the savings. Transactions are electronic: no cash, no robberies. Fewer employees means lower payroll taxes and workers comp. Prime costs will be 50%. The operation can be monitored by the corporate types still camped out at their lake cottages. Employees will make \$60,000 to \$75,000 per year, plus benefits and store-level bonuses, and perhaps one day they'll even receive a few stock options that haven't been snatched by the CEO. No one will accuse our industry of creating "hamburger-flipping jobs" ever again.

The future path of the successful full-service restaurant isn't as clear. Initially, I see them housed in suburban buildings now occupied by family and casual dining restaurants. The new restaurants will be high-end ones with alcohol and a \$100 check average. They'll cater to aging baby boomers afraid of venturing downtown, but still willing to pay for the Lord Grantham experience. They won't open for lunch, and most will be closed on Monday and Tuesday, and perhaps Wednesdays and Thursdays, too.

The new full-service restaurants will usher in a resurgence in hospitality, and with a \$100 check, they'll be able to afford busboys once again. Things will be sweet until the PE owners realize the savings they can realize with robots and automated cooking machines, and then the volumes will crash.

My bet is on the fully-automated QSR restaurants. Cash cows. Investors will line up to write even bigger checks than the ones they're writing now for the analog versions. You think Taco Bell multiples are high, wait 'til you see the multiples on these restaurants.

Answer Man, a former restaurant executive, once applied for a job at McDonald's when he was a teenager, but didn't get it. Something about his hair was mentioned by the hiring manager. Now he wishes he had some.

RESTAURANT FINANCE MONITOR

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