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FRANCHISE INVESTMENT BANKING

Title: Welcome to The Restaurant Boiler Room Episode 3. I'm your host, Rick Ormsby, Managing Director at Unbridled Capital.

Today, in the the Boiler Room:

1. Applebee's sales resurgence could mean an imminent M&A uptick in likely
2. Taco Bell sales and valuations are still dominating the industry
3. Bojangles and Taco Bueno Acquisitions Announced
4. Question of the Week: Which brands attract the highest valuations?

Tag Line: The Restaurant Boiler Room is a one-stop-shop for multi-million dollar merger and acquisition activity and financial complexities affecting the franchise restaurant industry. We talk money, deals, valuations and risk – delivered to the front door of franchisees, private equity firms, family offices, large investors and franchisors on an every-other-week basis. Feel free to find our content at Unbridled Capital's website at www.unbridledcapital.com

Now, let's enter the Boiler Room:

A. Applebee's sales resurgence could mean an imminent M&A uptick in likely
    a. *Background*: After difficult years in 2016 and 2017, resulting in a collective sales drop of around 13%, the Applebee's brand has experienced 43 consecutive weeks of same store sales growth, most recently with an eye-popping +7.7% comp sales increase on higher traffic. Kuddos to President John Cywinski and his team. I remember John from his days as President of KFC several years ago.
    b. *Why it is important*: The brand is revitalizing sales on the heels of the $1 drink menu, an increase in off-premise sales by 37% and an overall low hurdle from a sales-lapping perspective. This is great news in the battered casual dining segment, and we certainly hope to see the trend continue to be strong. In 2016, Applebee's made a strategic investment in the Wood Fired Grill platform to serve hand-cut steaks, which didn't drive sales and resulted in huge capital investment. RMH Franchise, Applebee's 2nd largest franchisee with 163 units at time of filing, filed for Chapter 11 bankruptcy protection in May 2018. Several other Applebee's franchisees have been in financial difficulty, and lenders are quietly working-out loans on their Applebee's clients.
    c. *How it will affect M&A*: Store count at Applebee's has been predictably dropping as franchisees have been shedding unprofitable locations. Much like KFC, however, this store closure strategy can result in a much healthier store portfolio and stronger valuations for a franchisee's business. There are only a few brands that offer large platform investments in the restaurant industry, and Applebee's is one of them with the average franchisee owning over 50 units. I'd expect Applebee's to follow Pizza Hut's example, which has a similar average unit count per franchisee. At Pizza Hut, a rush of new private equity and family office buyers have entered the brand, resulting in higher valuations over time. If the positive sales trends continue, we could see a meaningful EBITDA multiple accretion as well for Applebee's valuations over the next 12-18 months.

d. *Personal experience*: Coming off the heels of a very difficult timeframe, it is likely that many franchisees will explore selling their Applebee's businesses once they get another year or so of strong sales, especially if EBITDA margins start trending higher. Many Applebee's franchisees are older, and most are worried about the high labor model of the dine-in business, especially when off-premise sales are growing so much. Also, it is unlikely that many existing Applebee's franchisees will be aggressive acquirers given the past headwinds in the business. We will likely see a wave of new Applebee's franchisees soon.

B. Taco Bell sales and valuations are still dominating the industry

a. *Background*: Taco Bell is at it again – with a surprising Q3 comp sales of +5%, several points higher than what many analysts predicted for the quarter.

b. *Why it is important*: Unbridled is currently selling 7 Taco Bell companies for franchisees, and valuations are still trending at 8X EBITDA, even in the face of increased interest rates. Big sales increases are driving incredibly-strong EBITDA growth as our deals enter due diligence, and for those who know M&A, strong sales trends make deals much easier to close with lower risk of re-trading.

c. *How it will affect M&A*: There are some interesting new products about to launch at Taco Bell – variations on nacho fries, for example. Most franchisees I know expect the strong performance to continue until at least Q1 2019 or later. A friend and Taco Bell franchisee recently told me he has never seen such a prolonged upcycle at Taco Bell in his 40-year association with the brand.

d. *Personal experience*: The best brands typically perform even better when things get tough too. Right now, things aren't really tough, but they are getting tougher as traffic is still negative across the industry and margins are pressured by increased wage rates. The Taco Bell system has undergone a big refranchising effort, and the success of the brand has brought high valuations and bunches of leverage into the system. If the brand continues to outpace its peers, Taco Bell should continue to be superior, even with high leverage and aggressive new unit development obligations.

C. Bojangles and Taco Bueno Acquisitions Announced

a. *Background*: Reports just surfaced that Durational Capital Management and The Jordan Company have announced an all-cash offer for Bojangles at $16.10 per share. Additionally, Taco Bueno just announced that Sun Holdings will help restructure the brand through the Chapter 11 reorganization process. Sun's investment will include a $10 million in debtor-in-possession financing and would become the owner of Taco Bueno through a debt-for-equity swap.

b. *Why it is important*: Bojangles is a go-private transaction, and the brand has been struggling with sales, especially with newly-developed units resulting from a heavy corporate development push in recent years. For Taco Bueno, it struck my attention that a franchisee made this investment and will own the company.

c. *How it will affect M&A*: Bojangles is about 50% corporate-owned. Any take-private transaction would likely include some consideration for future refranchising as well as significant G&A reduction and a high desire to sell more franchises since the brand is mostly a regional concept. For Taco Bueno, the future is a bit more unclear, but since it will be acquired by a franchisee, an operational turnaround may be a larger part of the strategy to increase profits and augment company performance.

   d. *Personal Experience*: I have always liked the Bojangles brand. They came and went in my hometown of Louisville, but they are extremely strong in North Carolina, Georgia, South Carolina and Virginia. A friend of mine is a franchisee, and I have seen several P&Ls in this brand. When the AUVs are strong, the financial performance is great if lease costs are not too high. Acquisition multiples for Bojangles are typically in the mid-range, which would appeal to would-be buyers if the brand ever decides to refranchise. For Taco Bueno, they also came to the Louisville market several years ago and didn't make it. Their focus on plated-meals made a difficult drive-thru concept, in my opinion. The franchise system is small with a heavy penetration in Texas and a bevy of smaller, undercapitalized franchisees.

D. Question of the Week: Which brands attract the highest valuations?
   a. *Background*: Collective restaurant valuations remain at the 15-year high water mark, but there is a clear dichotomy between the best performing brands and the rest of the pack. Brands with great positioning, innovative products, good value, great customer experience, good operations and nice assets are really doing well.
   b. *Why it is important*: The dichotomy is being exacerbated by heavy requirements from franchisors for new unit growth, significant discounting (especially in the burger and pizza spaces) and margin pressures regionally as minimum wage rises. So, profitability is really starting to vary between brands, and it is getting more and more pronounced.
   c. *How it will affect M&A*: Just like stocks, investors in franchised restaurants invest based on their particular strategies – for example, growth, value, large-cap, mid-cap, small-cap, dividends, time horizon, risk, etc.….And while there isn't a specific way to measure and bucket all of these metrics like a stock investment, we see different brands succeeding and struggling within these various buckets. We also see distinct buyers for the various brands that fit their investment strategies.
   d. *Personal Experience*: We are currently seeing more appreciation in EBITDA multiples in the value-priced brands due to shyness from the historic run-up in valuations at brands such as Taco Bell, McDonald's, Panera Bread and Dunkin'. Many investors are looking for more value now that interest rates have increased, lowering return on investment. Mid-priced brands include Buffalo Wild Wings, Wendy's, KFC, Pizza Hut and Popeye's. Lesser, but still mid-priced brands are Burger King, Arby's, Jack-in-the-Box, Hardee's, Carl's and Zaxby's, for example. Value price brands are most of the sandwich brands, many of the pizza brands and franchise brands with smaller unit counts.

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