

# Takeouts

*Restaurants serve up enticing properties for private equity firms and eager lenders*

by Kelly Holman

New York private equity firm Trimaran Capital Partners LLC last fall had been eyeing Charlie Brown's Inc., a family-oriented steakhouse chain owned by Castle Harlan Inc., another New York private equity firm. Trimaran's timing turned out perfectly: Castle Harlan was preparing to sell the Mountainside, N.J.-based company through Wachovia Securities. And Trimaran's \$140 million takeout offer for the chain—at 7 times Ebitda—was like a medallion of filet mignon laid on a meat lover's plate.

The juicy offer was hard to resist. Castle Harlan realized a return of 4 times its \$12 million investment in Charlie Brown's, which runs 54 restaurants, including Charlie Brown's Steakhouse, The Office Beer Bar and the Jolly Trolley Bar & Grill.

Buyout activity is heating up in the restaurant industry. With an improved economic climate, consumers tend to dine out more often, which translates into better cash flows and bigger profits for restaurants. The increased availability of senior, mezzanine and high yield debt from independent finance shops and investment banks enables private equity firms to leverage up purchases of quality eateries. Having plenty of capital to deploy also helps.

"The demographics are very supportive of the long-term prospects for restaurants," says Christopher Reilly, formerly a partner at Saunders Karp & Megrue and now a partner at Apax Partners Inc. (the two firms recently announced they would merge). Restaurants with a consistent financial performance, a well-established brand name and concept that resonated with consumers have made prime acquisition candidates.

Not surprisingly, multiples for restaurants have also risen over the past two years by two additional turns of leverage to 6 times or in some cases 10 times Ebitda, according to investment bankers. "Quality properties are going for the best multiples we've seen in the past five years," says David Jacquin, a partner at San Francisco-based North Point Advisors, which advised on more than \$1.6 billion worth of restaurant M&A transac-

tions in the last seven months.

Investors have feasted on a smorgasbord of restaurant properties, buying or selling everything from family dining places to casual service or fast-food chains. Last year, private equity firms exited six restaurant properties, totaling more than \$100 million in transaction value, according to North Point.

The majority of acquisitions were by seasoned investors in the sector. "The equity funds that were acquisitive over the past year are those that have been interested in restaurant chains for some time," says David Epstein, a principal at J.H. Chapman Group LLC, a Rosemont, Ill.-based investment bank.

Trimaran, for instance, was previously a co-investor in Bain Capital LLC's \$1 bil-

though the firm ultimately forked over a rich price for Charlie Brown's, the chain's long-term growth prospects outweighed the cost, says Andrew Heyer, a managing partner at Trimaran Partners.

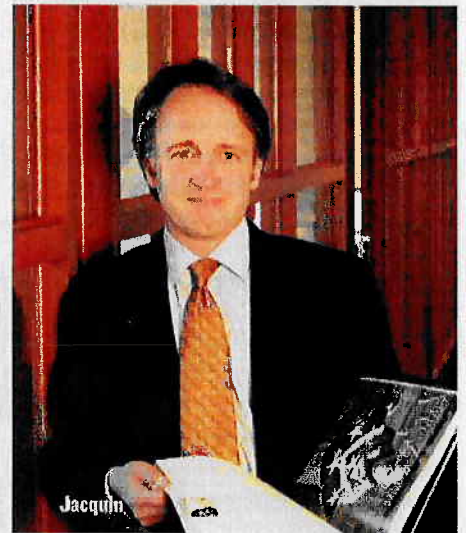
"They paid a fair price for a company that was a successful investment," says Justin Wender, chief investment officer and a senior managing director at Castle Harlan. After seven and a half years, he adds, "it was time to move on."

In fact Castle Harlan had moved on. Just a few months earlier, it acquired Burger

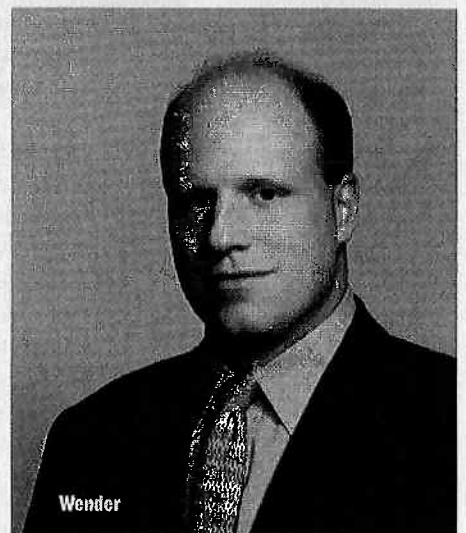


Heyer

lion 1998 recapitalization of Ann Arbor, Mich.-based Domino's Pizza Inc. The buyout shop had wanted to buy a restaurant group for the past five years, but hadn't found the right business for the right price, until Charlie Brown's came along. Trimaran saw the opportunity to acquire a well-established steakhouse with a lot of room for growth. The private equity firm aims to roll out 12 Charlie Brown's restaurants in new geographic territories under an aggressive expansion plan over the next 12 months. Al-



Jacquin



Wender

# SPECIAL REPORT

## MIDDLE MARKET

King Corp.'s San Juan, Puerto Rico-based fast-food restaurant chain, Caribbean Restaurants LLC, from New York's Oak Hill Capital Partners LP and American Securities Capital Partners LLC. The firm paid \$340 million for the asset, which it had sought unsuccessfully to buy since 1996 when it was owned by Charlottesville, Va.-based Quad-C Management Inc.

Oak Hill, the majority shareholder in Caribbean Restaurants since 1999, had wanted to exit the company. Earlier in the year it planned to carry out a dividend-paying leveraged recapitalization of Caribbean Restaurants that would have leveraged the company at 5 times Ebitda. However, Castle Harlan preempted the recap, offering a deal valued at between 6 times to 8 times Ebitda in an auction run by Credit Suisse First Boston and Wachovia Securities. (Castle Harlan has not released the exact multiple it paid for the company).

According to Wender, Caribbean Restaurants is the dominant fast-food hamburger player in Puerto Rico. The company claims a strategic advantage over its principal competitor on the island, McDonald's Corp., since it operates 165 Burger King locations whereas McDonald's runs 118. Given its strong market position, Castle Harlan was able to secure \$255 million of debt to support the purchase, according to Wender. The financial advisers provided \$180 million of senior debt and \$75 million of mezzanine debt.

For Oak Hill and American Securities, the buyout generated a 2.5 times return on their investment (American Securities made 4 times its investment when it sold 73% of Caribbean Restaurants to Oak Hill in 1999 for an undisclosed sum).

As with other sectors, however, the industry has its own mix of issues, which set the bar for investors without a history in restaurants. Besides operating in a

highly competitive environment and being subject to macroeconomic whims, earnings at restaurants are subject to fluctuations in same-store sales. Moreover, restaurants face constant personnel issues. Locations typically turn over their entire staff within a year. Thus, new employees constantly need to be trained.

"You've got a high degree of operating leverage so your profits are very sensitive to changes in sales, and you're talking about multilocation businesses, so you have to be concerned about delivering quality across multiple locations," says Samuel Bartlett, a vice president at Boston's Charlesbank Capital Partners LLC.

Restaurant deals are consummated largely through investment banking-managed auctions, although some of these comprise just a handful of bidders. Because of aggressive financing, financial sponsors can remain competitive with strategic bidders.

"Restaurant properties were generally hotly contested because in the last 12 to 18 months the market has gotten better," says North Point's Jacquin. For instance, North Point, along with Piper Jaffray & Co., ran a full auction for Captain D's Inc., a Nashville-based quick service seafood chain. They sent deal books outlining the company's finan-

cial performance to more than 50 bidders.

On the other hand, there were cases like Mimi's Cafe, for which Piper Jaffray and North Point conducted a limited, dual-track process, whereby an auction is conducted in tandem with a possible initial public offering. The ploy comes in handy sometimes. "The filing helped put a greater sense of urgency on the sale, which is an effective tool," explains North Point's Jacquin who advised the Tustin, Calif.-based chain, which runs 81 restaurants in 10 Western states. Jacquin worked alongside Murray Huneke, a managing director at Piper Jaffray.

While the upscale New Orleans-inspired, family-oriented chain was pitched to about 10 bidding groups—equally weighted between private equity and strategic bidders—Piper Jaffray was preparing to hold an \$85 million IPO for the eatery. Bob Evans Farms Inc., a Columbus, Ohio-based operator of 589 Bob Evans and Owens Restaurants in 21 states, began serious talks with Mimi's owners in February 2004. By July, it had the winning bid—\$182 million in cash and assumed debt—or a lofty 9.6 times Ebitda multiple. Despite paying on the top end of prevailing market multiples at the time, the acquisition was equitable, says Bob Evans chairman and CEO Stewart Owens.

"I wouldn't consider it a bargain, but you don't buy companies of that caliber at a bargain." Mimi's has posted strong historic revenue and cash flow growth at 20% per annum. Evans was convinced the purchase was worth every penny. For Stamford, Conn.-based Saunders Karp & Megrue, which owned a 60% stake in Mimi's, the sale netted a return of at least 3 times its roughly \$20 million investment.

In 2004, buyers could afford to pay higher multiples because leverage was readily available. Banks had largely



### Eat your hearts out

Private equity restaurant acquisitions (includes undisclosed deals)

ANNOUNCED 2004	TARGET	ACQUIRER	DEAL VALUE (\$mill.)
12/29	Church's Chicken	Arcapita	\$390.0
5/3	Caribbean Restaurants	Castle Harlan Inc.	340.0
11/28	Captain D's Inc.	Charlesbank Capital Partners, Grotech Capital Group	150.0*
3/11	Garden Fresh Restaurant Corp.	Centre Partners, Fairmont Capital Management	134.2
10/21	Bruckmann Rosser Sherrill & Co.	Chevy's Mexican Restaurant	100.0
10/1	Sydrian Group	Cerberus Capital Management	50.0+
11/1	Cinnabon	Roark Capital Group	30.2
8/20	Oceanaire Seafood Room	Clarion Capital Partners LLC	20.0
8/20	Bear Rock Café	United Enterprise Fund	NA
4/22	Brigham's Inc.	New England Capital Partners	NA
8/2	IHOP franchisee	Argonne Capital Group	NA
12/29	K-Mac Enterprises Inc.	Olympus Partners	NA
8/20	Lenny's Sub Shop	George Alvord investor group	NA
12/9	Mr. Gatti's Inc.	Blue Sage Capital	NA
10/12	Not Your Average Joes	Grace Restaurant Partners	NA
8/16	Papa John's	Blue and Silver Ventures	NA
6/1	Papa Murphy's	Charlesbank Capital Partners	NA
8/23	Una Mas	Heritage Ventures	NA

\*estimate

Source: J.H. Chapman Group LLC, North Point Advisors, The Deal

