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OUTLOOK

The Economic Voice Within Says...

Wayne Pankratz's 15 minutes of fame came unexpectedly last month when the operations director for Apple Central, a 50-unit Applebee's franchisee in Missouri, channelled his inner Milton Friedman in a rambling memo to store managers. His treatise, "Gas Increase is Good for Hiring," rankled a few managers while one posted it to an online forum dedicated to "those who want to end work and get the most out of a work-free life." Not surprisingly, the post bought Pankratz a trip to the social media woodshed.

Pankratz's memo, a "heads up" to keep managers focused on hiring, went off the rails when his "inner voice" spouted a number of dubious economic theories. You know the inner voice, the unhelpful and negative one that lurks in the back of your mind, the one your spouse orders you to "keep to yourself."

Pankratz started innocently enough with these themes: High gas prices will result in more employee applications while existing employees will ask for more hours. Phasing out the stimulus and supplemental unemployment checks will increase the labor pool.

"The labor market is about to turn in our favor," was his prediction.

Then the inner voice took control. Pankratz said employees will need more hours because they "live paycheck to paycheck." He told his managers to hire new employees "at a lower wage to decrease our labor (when able)." His comments became a flashpoint and were elevated to the national stage.

Yes, there are many restaurant employees that do live paycheck to paycheck, but for an employer to be seen taking advantage of that, well, that was too much. As for hiring employees at lower wages, Pankratz was off the mark. Labor is often mischaracterized as a commodity, akin to shopping for strawberries. Strawberry prices go up and down, but individual wages when they move, generally go in one direction, and that's up.

If the labor market is turning in favor of employers, it's a secret to most franchise executives. In a recent survey conducted by the International Franchise Association and FranData, 88% of the respondents reported they are still having trouble finding workers. Sixty-four percent said they experienced an increase in store-level wages over the past six months, with an additional 18% experiencing significant increases. Respondents totaling 66% said they anticipate additional increases in average employee wages in the next six months.

Why is that?

Two Harvard researchers found there were 1.7 job openings per job seeker in December, the highest level since 1960. They calculated the real unemployment rate to be between 1.2% and 1.7%, some two points lower than the official published rate.

A study published in February by the Economic Research Department of the Federal Reserve Bank of Chicago suggests competition for employees will remain elevated for the foreseeable future, coupled with more wage inflation.

Two factors, a combination of the low unemployment rate and a high quit rate (4.4 million last month) means there are fewer unemployed individuals willing to take a job at any price—aka the Pankratz doctrine. Confident employees take advantage of the competition for their services and sell to the highest bidder.

With so many jobs available and so many potential free agents, poaching employees is expensive for employers, according to the Chicago Fed study:

"The firm that intends to poach the worker from their current employer has to offer a sufficiently large wage to make the offer attractive. And if a worker is particularly valued by their own employer, they may be offered a pay raise that is necessary to retain them. If employed workers search more, wage competition among employers increases, leading to an increase in inflationary pressures."

What might put the kabosh on staffing shortages and wage pressures? My inner voice says recession. My wife says, "shut up."

—John Hamburger

Oliver to Leverage Education, Experience to Lead CrossFirst Bank's Restaurant Finance Group

Growing up, **Bobby Oliver** knew the importance of getting an education. He holds a Bachelor's degree in Business Administration in Finance, a Master of Business Administration, and a Juris Doctor from Georgia State University. He is also a member of the State Bar of Georgia.

"I never intended to practice law," said Oliver. "What I learned from law school was how to be a better communicator, a better writer and a better listener. When I got into banking, my education helped me approach issues and analyze them differently."

Two decades later, he still brings that approach to his new position as Executive Director, Restaurant Finance Group with **CrossFirst Bank**, headquartered in Leawood, Kan. Oliver has had a long career in restaurant finance, with more than 20 years at Bank of America and Cadence Bank combined.

"I enjoy working in the restaurant industry and have formed the most meaningful relationships," said Oliver. "It's why I'm excited to join CrossFirst to help them expand their presence in the restaurant finance vertical."

CrossFirst Bank was founded in 2007 and had $5.6 billion in assets at December 31, 2021 with nine full-service banks across Kansas, Missouri, Oklahoma, Texas and Arizona. The bank isn't a stranger to the restaurant business—Sonic and Pizza Hut are in their backyard, after all, and they have some restaurants in their portfolio.

"When I met CrossFirst Bank's President and CEO Mike Maddox, Mike said, 'I want someone who wakes up and thinks about the restaurant industry every day,'" Oliver recalled.

CrossFirst's model isn't the traditional bank model, he noted. It doesn't have a branch on every corner. Instead, they focus on hiring experienced bankers who are committed to building trusted relationships with businesses and professionals, said Oliver.

The bank offers a full suite of financial products, including business, treasury, personal, and international services. The Restaurant Finance Group looks to connect with restaurant companies across the U.S. who have credit and depository needs. For larger restaurant operators, CrossFirst can leverage their syndication group to assist them in partnering with other banks, said Oliver.

"We look forward to working with mature national brands as well as those that are growing—those types of brands are growing their footprint and franchisee base," he said.

To help Oliver in his efforts, he's hired an established restaurant banker, **Josh Taylor**, to serve as Director, Restaurant Finance Group. Taylor has over 16 years in the banking industry. Taylor will oversee the bank's restaurant finance portfolio and manage client relationships.

"Josh and I are extremely excited to leverage our experience to build out the restaurant finance portfolio at CrossFirst Bank," he said. "What we do every day is impactful to the bank, and that is meaningful to us."

For more information, contact him at Bobby.Oliver@CrossFirstbank.com, or 770-540-9733.

Zukofsky Brings Holistic Avenue to Aprio Clients

"It's the team approach," said **Dana Zukofsky** on why she is so excited about her new role as Director and Practice Leader, Retail, Franchise & Hospitality for **Aprio**, a business advisory firm. And that practice, of course, includes restaurants, an area Zukofksy has served for over 20 years, most recently with BDO.

At Aprio, "We bring the team to it, regardless of the service we were hired for," she said. "We are client focused, not service-line focused."

Her role is to help the firm take that "360 approach" with all their verticals: tax, audit and advisory. "I make sure the verticals are working together as a cohesive team and that we're going to market that way," she stated.

Initially Zukofsky is meeting with the firm's existing restaurant tax clients, and learning their "go-forward plans. Once I see where they want to go, we can be part of that team to help with a life cycle of the entire company."

She gave a couple of examples: "In a certain situation, I may suggest an Aprio service, or maybe what you need instead is a strategic CFO. We have external resources to help you with that."

Or is it analyzing the next move with technology? "There so much noise out there right now," Zukofsky said. "We can be an unbiased resource to help you spend your money the right way."

She'll also be bringing on new clients—restaurant companies that are in the middle to upper-middle market. They will work with startups, multi-unit independents, franchisors and multi-unit franchisees.

"Helping companies become a franchisor will live in my world, as well," Zukofsky reported. "And, we'll make an investment in smaller assignments, too—a lot of larger firms can't do that. We will make that investment because we want to be with you throughout your growth."

And, that includes the sale of a business, too: doing the due diligence needed for the transaction, sorting out tax implications and other issues involved with a sale.

"And afterward, we can help with the integration of the two brands, bringing them under the same umbrella," including everything to helping to integrate data to the culture of the company.

When Zukofsky is asked what her advice is to restaurant companies right now, her answer is two-fold.

"First, there is so much federal money out there for restaurant companies, from PPP to ERTC, and it's free money if you qualify," she said. "It's mind blowing how many people haven't taken their money."

Also, with so many private equity firms coming into the industry, restaurant companies need to "make sure you know what you are doing. Make sure the decisions you are making are the most advantageous for you; that you are getting the best price."

Part of the reason Zukofsky has stayed in the restaurant industry so long is she loves the people. When she worked in another industry before restaurants, she recalled showing up at various companies to do their audit. Often, the reaction was, "Geez, the auditor is here.' When I showed up at restaurant companies, everyone was just welcoming and nice."

Plus, she loves their entrepreneurial spirit, too, and that's one of the reasons she joined Aprio.

"They encourage us to have ideas and be forward thinking," said Zukofsky. "I want to work with that type of client, and that's the type of people I want to work with at my firm."

For more information, contact her at Dana.Zukofsky@aprio.com or at (770) 353-3190.

First Midwest, Old National Merge: Restaurant Group to Operate with Bigger Balance Sheet

When you talk to **Adnan Assad**, his excitement is palatable. "The fact that we are bigger and stronger means we can do larger deals. We can compete on rate."

The "bigger" and "stronger" monikers come from the merger of equals that closed in February: First Midwest Bank is now a division of **Old National Bank**, with First Midwest taking on the Old National name in July.

According to Assad, the combined organization makes it the sixth largest bank headquartered in the Midwest: $45 billion in assets and $34 billion in deposits.

"With both a larger balance sheet and footprint," he said, "we have the increased capability to service both existing and new clients and compete with larger banks. For restaurant borrowers, it means they have a stronger bank to support their growth, and we have the ability to go where the growth takes them."

The restaurant group at First Midwest, which Assad heads up as senior vice president, has been funding restaurant operators for the last four years. He said they have now grown their restaurant portfolio to about $300 million, but will start to grow faster under new marching orders.

"The bank loves the restaurant space," he enthused, "and they love what we're doing. They have a larger deal appetite; they have a lot of cash and need us to deploy it."

Historically, First Midwest has financed tier-one concepts like McDonald's, Taco Bell, Dunkin', Popeye's and Wendy's, Assad said. "But that's not to say we won't finance other tier-one concepts, and other brands beyond that."

They target franchisees who own eight stores or more, and will transact deals as small as $5 million on up to $50 million.

A recent Dunkin' deal for a 30-unit operator is a good illustration of where they want to play: They closed on $11 million in refinancing and a $23 million development line of credit for the restaurant company.

"We want to be part of their team to help them grow," he said. They will do syndications with other lenders, as well.

"We are approaching our first syndication that we will be leading," Assad reported.

Kara Symeonides, senior vice president, has worked with Assad since the group's inception. "She was my first hire for the group," he said, "and has done a great job growing the portfolio. Her clients trust her and she understands the business well."

Chad Lyons, vice president, had a number of clients in the space, so Assad brought him onto the team, too. "He's a seasoned relationship banker," he said, "with a lot of contacts."

First Midwest Vice President **Eddy Nufio** has gained his restaurant experience by managing the group's portfolio, and now Assad has moved him into originations.

"All of us have built great relationships with the operators out there," he said, "but we realize we need to grow the team so we can continue to expand."

And that's exactly what Old National wants them to do. "Luckily for us, we have had a great bank to support us over the last four years, and we've been able to deliver and help these operators grow. Now Old National is asking us to scale it up."

For more information, contact Adnan Assad at (847) 361-7568, or at adnan.assad@firstmidwest.com.

C Squared Closes Large Dunkin' Acquistion and Recap; Other Transactions

"We were able to get it approved much more quickly than normal," said **Dan Connelly,** partner with investment banking firm **C Squared Advisors**. "We found the right buyer—the Costas are great operators—and the units had above-average AUVs. The deal jumped off the page to lenders."

Connelly is referring to the $73 million acquisition, recapitalization and capital raise for Dunkin' franchisee **DMPC Group,** which is owned by brothers **Danny and Mike Costa** and **Dina Pereira**. DMPC purchased eight locations from **FMP Donuts**, owned by **Frank Minigell** and **Bob Seavey**, who retired after the sale. **Bank Rhode Island** financed the operating company, while **Enterprise Bank** financed the real estate. The stores have an AUV of about $1.6 million, which is about $500,000 above the AUV nationwide.

Connelly represented the seller, and his colleague and C Squared Partner **Pete DiFilippo** represented the buyer. While it is rare for C Squared to represent both buyer and seller on the same transaction, Connelly and DiFilippo had previously represented their clients in other deals. When Connelly was engaged by FMP to sell the business, DiFilippo knew DMPC might want to look at the locations, as they were in generally the same geographic footprint.

"The Costas are extremely well connected and active in the Dunkin' system, and well respected by other franchisees and the franchisor," said DiFilippo.

"It was the right buyer at the right time," said Connelly. "My client was happy the buyer was working with Pete and that there would be certainty of funding at closing."

C Squared Advisors also announced the completion of a $10.3 million recapitalization and capital raise for Dunkin' franchisee **SAWS, LLC**. Proceeds of the loan were used to recapitalize existing debt and fund future development of restaurants in Southern California. **Huntington Bank** provided the financing for the transaction.

SAWS has nine locations and "significant expansion plans," DiFilippo reported.

C Squared also provided advisory on a $5 million recapitalization and capital raise for another Dunkin' franchise, whose company name was not released. Proceeds of the loan were used to recapitalize existing debt and fund future development of restaurants in the Southeast.

Other C Squared closings include:

• Ownership buyout and capital raise for a New Jersey Dominos franchisee totaling $9.1 million. Proceeds were used to buy out the majority owner and capital raised will fund future development in the area. The company has seven locations.

The franchisee, **Bill Dunn**, was originally a minority partner "and we had lenders jumping to do this Domino's deal," said DiFilippo, who advised on the transaction. "We delivered the most appropriate results for our client and exceeded the client's expectations for the deal." The deal included using embedded equity to leverage the transaction, he added. Bank Rhode Island provided the financing.

• A $22 million recapitalization and capital raise for **PSP Holdings**, which owns 15 Popeye's and 10 Five Guys locations. Proceeds of the loan were used to recapitalize existing debt and fund future development of restaurants in the Southeast. **Wells Fargo Restaurant Finance** provided the financing for the transaction, with Wells Fargo's Managing Director **Veda Cloud** leading the deal for the bank.

• Completion of a $14.5 million recapitalization and capital raise for a 20-plus unit Burger King franchisee, **Big Brands** and **Golden B Enterprises**, in the Carolina region. **Wintrust Franchise Finance** provided the financing.

"Strong communication and a partnership with Wintrust helped us execute the deal," said DiFillippo. C Squared Principal **Brent Elsass** was lead advisor on transaction.

All of the deals signify that "there is a flight to quality right now," said Connelly. Brands that had to change course during covid and speed up their "race to technology" are winning, and buyers and lenders want to see that.

And while deal activity is still robust, DiFilippo agreed some buyers are being more selective in what they are paying now for certain brands. "With rising interest rates, labor shortages coupled with inflation and commodity uncertainty, there is a lot of noise in the numbers," he said. Despite this, "there are some very good buying opportunities out there."

Plus, some franchisors have stepped on the gas when it comes to mandating capex requirements, many of which were put on hold during covid. "We're seeing a lot of franchisors really enforce mandates to keep their business relevant to the consumer," said Connelly. "So, the buyer has to consider that and put capex requirements into the purchase price."

For more information, contact Pete DiFilippo at (401) 525-6771, or at pete@c2advisorygroup.com; or contact Dan Connelly at dan@c2advisorygroup.com, or at (617) 784-7866.

Cypress Sells Business for Legacy Pizza Hut Franchisee

Franchise investment banking firm **The Cypress Group** acted as sell-side exclusive advisor to **Hallrich, Inc.**, one of the longest-standing Pizza Hut franchisees in the system, in connection with the sale of its business and real estate operations. Hallrich owned approximately 125 locations in Central Ohio. The restaurants were acquired by affiliates of **Manna, Inc**. The exact purchase price was not released—only that it ranged from $100 million to $200 million, Cypress reported.

Hallrich, founded by the late **Scott Ritchie** and **Tony Szambecki** some 53 years ago, was one of the original Pizza Hut franchisees, said **Bill Pabst**, principal with Cypress and the lead banker on the transaction.

"They developed the market organically," he said. "They had a very specific DNA to their business: It was the same ownership throughout all those years, and they had a consistent way of operating that allowed the business to thrive through five decades."

Part of that, he said, was Hallrich did well through all three channels of service: dine-in, delivery and carryout. While some QSR operators have struggled with dine-in as of late, Hallrich "maintained their facilities and the customer service was always good. If you live in an area where the local Pizza Hut has always been nice and clean, and the service was great, why wouldn't you go there to eat?"

As far as the transaction itself, Pabst said it was complicated, but not unusual for the size of the deal. "There's a lot that goes on during it, when you have that much real estate and that many of units."

He gives a lot of credit to Hallrich CEO and President **Scott Arbuthnot** for helping the process move along quickly. "He was masterful in all phases," said Pabst. "The sheer amount of data that he put forth was amazing. He's a top five percent person."

For him it was fun working with the company, "because these were people who absolutely were concerned about all of the stakeholders, including Hallrich employees—and they wanted a great fit for Pizza Hut corporate to complete their legacy. These are people who are honest, decisive and not trying to shade the truth. They are just great people to work with."

Pabst said the Cypress team has been busy, and believes that will continue to be the case over the next year. In fact, Cypress is approaching $1 billion in Pizza Hut M&A value in the past 12 months and have other deals on the horizon.

He says they have seen that most QSR brands have done well coming out of Covid. "What the market doesn't necessarily see is that the amount of competition has shrunk," he said. "Some of this is because of closures—the strong are getting stronger. These brands will continue to emerge healthier as the consumer dollar continues to get pushed there."

For more information on The Cypress Group, contact Bill Pabst at (303) 680-4141 x 104, or at wpabst@cypressgroup.biz.

Auspex Capital Active in the Taco Bell Space

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

Buy-side M&A Advisory: Great Lakes Tacos (GLT), a Grand Blanc, Mich.-based company owned by long-time industry veteran **Louis C. Dortch Jr.**, acquired three Taco Bell restaurants in central Michigan from a retiring franchisee. GLT now owns and operates 28 Taco Bell restaurants in western and central Michigan.

Buy-Side M&A Advisory/Debt Placement: Franchisee J&S Food Sales, owned and operated by long-time Taco Bell system veteran **Steve Stoico**, has acquired four Taco Bell restaurants located in southern California from Danbarb, Inc. As part of this transaction, J&S has secured a new $5.3 million business term loan from **Manufacturers Bank**, which was used to refinance J&S's existing debt and finance the acquisition of the Taco Bell restaurants. J&S is an Orange, Calif.-based Taco Bell franchisee that now owns and operates nine Taco Bell restaurants throughout southern California.

Sell-Side M&A Advisory: Aarsand Holdings and its affiliates, a Hunt Valley, Md.-based Taco Bell franchisee has completed the sale of its 56 restaurants and the real estate underlying 19 of the locations to affiliates of Conshohocken, Penn.-based **Summerwood Group**. The restaurants are located in Maryland, West Virginia, Pennsylvania and Delaware. Financial terms of the transaction were not disclosed.

Debt Placement: Franchisee **SERJ Taco California** and **Dreamland Real Estate Holdings** (collectively, SERJ), owned and operated by long-time quick-service restaurant industry veteran, **Jasmin Patel**, has secured a total of $15.4 million of new loan commitments. The financing included a $11.9 million term loan and a $4.5 million development line of credit from **Lake Forest Bank & Trust Company** (Wintrust). The loans were used to refinance the company's existing debt and finance the acquisition of two real estate properties for the development of future Taco Bell restaurants. SERJ is an Orange, Calif.-based restaurant operating company that currently owns and operates five Taco Bell restaurants in San Bernardino, Calif.

For additional information about Auspex Capital, contact managing director **Chris Kelleher** at (562) 424-2455 or ckelleher@auspexcapital.com.

CapitalSpring's $950 million capital raise for its sixth restaurant credit fund, **CapitalSpring Investment Partners VI, L.P.** was oversubscribed by $200 million. One investor, the Iowa Public Employees Retirement System, cited CapitalSpring's "extensive, relevant industry experience, including operating insight, unusual for a credit strategy." Prior to the current fund, CapitalSpring had raised a total of six funds, investing about $1.7 billion of capital through 190 transactions in more than 60 brands. Other investors in the current fund include Ohio Police & Fire, Teacher's Retirement of Illinois and the Texas County and District Retirement System. CapitalSpring provides structured loans and makes equity investments to restaurants in the $10 million to $150 million range.

Restaurant lenders tell the Monitor they are fretting the upcoming reporting season when a higher number of franchisees than normal are expected to trip their bank covenants. For many brands, sales were choppy in the first quarter while food and labor cost spikes have disrupted restaurant operating profits. M&A advisors say this has put a damper on transactions in the first quarter.

TGI Friday's CFO **Giovanna Koning** passed away on March 25 after an unexpected illness. She had been with Friday's since 2017. Prior to that, she was CFO of Falcon Holdings, a large multi-unit franchisee of Church's. A CPA with 10 years plus in public accounting, she had over 20 years in restaurant finance experience. Koning was a frequent attendee and speaker at the annual Restaurant Finance & Development Conference. Two days before she passed away, Koning participated in an online Oracle finance seminar where she provided career advice to listeners. Friday's CEO **Ray Blanchette** called her a "force of nature, generous with her time and kind with her demeanor."

Shauna Smith of the **Savory Restaurant Fund** was named "2022 CEO of the Year" by Utah Business magazine.

Rumors continue to swirl about the financial problems at **Red Lobster** following the sudden departure of CEO **Kelli Valade** after only eight months on the job. Majority owner **Thai Union**, a Thailand-based global seafood supplier and owner of the Chicken of the Sea brand, reported a challenging start to 2022 due to declining guest counts "as well as negative effects of higher COGS, labor costs and shortages." Thai Union said its 2022 initiatives for Red Lobster were to drive up the guest count and implement cash preservation measures." Private equity fund **Golden Gate Capital** acquired Red Lobster from Darden in a $2.1 billion, leveraged buyout deal in 2014 and sold its interest to Thai Union in 2019. Covid has been especially hard on sit-down restaurants such as Red Lobster.

The store-level average unit volume for the Wisconsin-based QSR restaurant chain, **Culver's**, cracked the $3 million mark in 2021. Sales for restaurants open at least one year were $3,064,848 in 2021 versus $2,615,278 in 2020, an increase of 17.1%. Culver's operating income was also up 50% in 2021 compared to 2020.

Former Montgomery Securities banker **Al Baldocchi** has been on the board of **Chipotle** for 25 years. Former **Darden** CEO **Clarence Otis** serves on the boards of Verizon, The Travelers Companies, VF Corporation and MFS Mutual Funds. Former **TGI Friday's** CEO **Nick Shepherd** serves on the board of Spirit Realty and Fiesta Restaurant Group. Retiring Darden CEO **Gene Lee** is on the board of Advanced Auto Parts.

McDonald's board members receive an annual retainer of $115,000 plus a prepaid gift card for their food and beverage expenses at McDonald's restaurants.

The **Relief for Restaurant Franchisees and other Hard Hit Small Businesses Act of 2022** was passed on April 7 by the House of Representatives in a 223-203 vote. Only six Republican House members voted in favor of the bill that would provide $42 billion to the **Restaurant Revitalization Fund**, which ran out of money last year after disbursing $28.6 billion. Under this bill, a restaurant applicant must be operating or intend to reopen within six months after the application. Private equity backed and public restaurant companies are not eligible. Eligible applicants are businesses that have less than 200 employees and had a pandemic-relate revenue loss in 2020 versus 2019 of 40 percent or greater. The bill now goes to the US Senate where its passage prospects are dim.

Welcome back Howard!

EVERYONE BUT THE FED THINKS RATES SHOULD BE HIGHER	
William Dudley Former New York Federal Reserve President	"This would mean hiking the fed funds rate considerably higher than currently anticipated. One way or another, to get inflation under control, the Fed will need to push bond yields high and stock prices lower."
Jan Hatzius Goldman Sachs Chief Economist	"If the economy does not slow and if we, in particular, don't get a pretty substantial slowdown in employment growth, then you'd be looking at something that could go significantly higher, to the 4%-plus range."
John Cochrane "The Grumpy Economist"	"The Taylor rule says the interest rate should be 2% (inflation target), plus 1.5 times how much inflation exceeds 2%, plus the long-run real rate. That means an interest rate of at least 2+1.5x(8-2) = 11%. Yet the Fed sits, and contemplates at most a percent or two over the summer."
Paul Kasriel Former Northern Trust Economist	"Let's assume that the annualized inflation rate will soon slow down to 4% because supply-chain issues miraculously disappear, the Russians remove all their troops from Ukraine, thus allowing her to sell petroleum products, fertilizer, nickel and aluminum to any and all buyers. The 1.21 percentage point [historical average] spread [of federal funds rate minus CPI] would then imply 5.21% federal funds rate. The upshot of all this is that the federal funds rate is going to a go a lot higher than the current level."
Ray Dalio Founder/Investor Bridgewater Associates	"Oh, I'm like an eight, an eight to 10 or something like that," regarding his inflation concerns on a scale of one to 10.
Jeffrey Gundlach CEO, Doubleline Hedge Fund	Gundlach is worried not just about inflation, but a slowing economy. On March 8, he said, "I think we need to start admitting that we're running into a stagflation situation. The Fed is in really a difficult position, because these price spikes are really going to need the Fed to be aggressive if they're serious at all about fighting inflation."

INTEREST RATES (%)				
	4/15/22	**Last Month**	**A Year Ago**	**Trend**
Fed Funds Rate	.50	.25	.25	↑
30-Day SOFR*	.29	.05	.01	↑
90-Day SOFR*	.29	.05	.02	↑
1-Year Treasury	1.75	1.17	.06	↑
5-Year Treasury	2.79	1.95	.82	↑
10-Year Treasury	2.83	1.99	1.58	↑
30-Year Treasury	2.92	2.35	2.28	↑
Prime Rate	3.50	3.25	3.25	↑

Former McDonald's CEO Ed Rensi on what's ailing the restaurant business: "Portion sizes are shrinking. Prices are going up. It's insane what's happening in the restaurant industry. The biggest single problem we've got is the...truckers shortage and a disruption of imports coming into this country. This truckers' situation is enormous and is having a big impact."

Jessica Parrish, Treasurer and Controller of Domino's Pizza, talked inflation on a recent conference call: "The store food basket within our U.S. system will be up 8% to 10% as compared to 2021 levels." That inflation level, according to former CEO Ritch Allison, is three to four times the inflation the company faces in a typical year.

In his prepared remarks on Brinker International's second quarter (period ended December 31, 2021) conference call on February 1, CFO Joe Taylor said this: "A large majority of our contracts [being] locked for the next six months," although the company expects "high single-digit inflation for the third and fourth quarter."

In an April 8 television interview on CNBC, Alan Rosen, owner of Junior's Restaurant (famous especially in the New York metro area for its cheesecakes) remarked: "That over just the last three months the restaurant has experienced 4% to 100% wholesale price inflation on the ingredients it uses.

On its first quarter (period ended December 31, 2021) conference call, Jack in the Box management said that commodity costs increased by about 11% in the quarter, due principally to price increases in beef, pork, sauces and oil.

In his final conference call as CEO of Darden Restaurants, Gene Lee used a quote from restaurant industry consultant Malcolm Knapp: "Malcolm Knapp said it best. The restaurant business is simple, but simple is hard. To be successful in the restaurant industry, you must have great people who consistently serve outstanding food and an engaging atmosphere."

Multi-unit independent Cameron Mitchell told CNBC Squawkbox host Becky Quick that sales have been "robust" but his cost of goods were up 18.6%, labor is up 15% and construction is up 37.5%: "A lot of storm clouds are on the horizon."

The Rubber Meets the Road at the Federal Reserve

By Roger Lipton

In addition to raising rates steadily over the next 12 to 18 months, the latest indication from the Fed is they will shrink their balance sheet from its current, all-time high of $9 trillion. Recall that this number was approximately $1 trillion in 2007. That means a cool $8 trillion in money has been printed out of thin air and used to purchase fixed income securities of all stripes, but mainly government securities. That's financed something like half of the government's operating deficit over these years and kept interest rates from rising in the process.

Recall that in May 2013, with the Fed balance sheet at "only" $3.4 trillion, up $500 billion in the prior six months, Fed chair Ben Bernanke announced a plan to start tapering these asset purchases. In short order, a "taper tantrum" in the bond market took the yield on the 10-year treasury from around 2% in May to around 3% in December, and then the Fed suddenly backed off. Also recall that in mid-2018, when the Fed assets were "only" around $4.4 trillion, newly installed chair Jerome Powell established an "automatic" reduction of $50 billion per month. This lasted about eight months, reducing assets modestly before the stock market sank by about 18% and the politicians screamed "do something."

Having capped off the largest financial experiment in the history of the planet, the Federal Reserve is planning an immediate $50 billion per month reduction of their balance sheet, at the same time that interest rates are allowed to "normalize." It seems relevant that until two weeks ago they were still printing $40 billion per month, with a slight increase even last week. One might ask why, if the plan was to start reducing within a matter of months, they would continue to print right up to the inflection point. In any event, we'll see how long this reversal, along with already rising interest rates, is tolerated by the capital markets. I suspect Powell will be strongly encouraged to back off. There's plenty of time after the November 8 election, and no chairman since Paul Volcker has been willing to take away the "punch bowl."

Analysts should refresh their cash-on-cash (much more cash) return analysis. Store-level performance is often measured by various calculations of store-level cash-on-cash returns. Broader parameters, such as ROE and ROI, are not only dependent on volumes and store-level margins, but corporate G&A. The denominator, the cash investment per operating location, is a predictable focus when the company raises capital, public or private, but tends to get overlooked later on as the analysts seem to avoid getting "granular."

Since most of us realize that construction costs are rising materially, and because I don't mind digging a bit, I compared disclosures in 2021 10-Ks to those in 2019 to see what construction costs are doing. Space does not allow a complete listing, but McDonald's spent $4.4 million in 2021 per store versus $4 million in 2019. Chuy's spent an average of $3.5 million versus $3.0 million. Cracker Barrel spent $4.9 million versus $4.7 million. Cheesecake Factory targets $1,000 per square foot in construction costs in 2021 versus an average of $950 per square foot in 2019. Texas Roadhouse spent $5.7 million per store in 2021 versus $5.5 million. You get the picture.

I suggested here last month that BJ's and Shake Shack, based on their fourth quarter numbers versus 2019 were a "work in progress." Exacerbating the situation, BJ's "currently targets" a cost of $6 million per store on average, versus $5 million in 2019, up 20%. Shake Shack averaged a per-store cost of $2 million (net of tenant allowances) in 2021 versus $1.9 million in 2019. Here's the bottom line: It's not a good situation for investors when AUVs are challenged, traffic is down, store operating costs are up and the cost of the facility is rising materially. It does not promise to get any easier in 2022.

Black Rifle Coffee Company is priced for perfection. After running from $12 to $26 since February 9, Black Rifle (BRCC) is valued at over $6 billion, which is over 400x adjusted EBITDA. Two months ago, I said Black Rifle at $12 per share was "not cheap, but the good ones rarely are."

The company's investor presentation that accompanied their merger with a SPAC in February compared the multiple of the last 12 month's sales to that of eight high-growth companies, Beyond Meat, Dutch Bros, Oatly, etc., and five direct-to-consumer lifestyle brands, including Lululemon and Warby Parker. Black Rifle's valuation at $12 was generally inline. However, in the last 60 days, the comparable stock prices are down 22.2% and 10.1% respectively, while BRCC is up about 150%. Part of the price rise is likely due to the somewhat limited share float, with perhaps 70% held by the sponsors, institutions and the earnout by the founders. A recent S-1 registration filing in conjunction with the exercise of all the warrants will roughly double the float when it is effective, so there will need to be a great deal of demand to absorb $1.5 billion to $2.0 billion of potential share supply. Black Rifle is a good company, but now ridiculously priced!

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 646-270-3127.

Build Higher Energy Costs into Your Budget

By Jim McFadden

A rule of thumb in the restaurant industry is that about 5% of an individual restaurant's operating costs are spent on energy. It seems likely that given recent sharp increases in the costs of energy commodities, the current range may be adjusted even higher.

These costs can vary widely based on the location of the food service establishment. Generally speaking, restaurants located in eastern coastal states and California face significantly higher electricity and natural gas costs than eateries in other locations. (These broad conclusions do not factor in the very high utility costs in Hawaii and Alaska, which are due to their isolated locations.) Of these two utility costs, the power bill generally has the largest bottom-line impact. Another related factor: Patrons of restaurants in these areas pay noticeably higher gasoline prices than in other regions of the U.S., potentially impacting the frequency of dining out. This problem has grown much more acute over the last few months.

Electricity Costs

According to Friendly Power, a restaurant uses an average of 81 kilowatt-hours (kWh) of electricity and 174 cubic feet (0.174 thousand cubic feet, or 0.174 Mcf) of natural gas annually per square foot. Since a typical restaurant ranges in size from 1,000 to 6,000 square feet, a foodservice establishment consumes 81,000 to 486,000 kWh (284,000 kWh at the midpoint), and 174 to 1,044 Mcf of gas (609 Mcf at the midpoint).

EXHIBIT A—STATES WITH HIGHEST AVERAGE COMMERCIAL ELECTRICTY RATE

State	Commercial Rate	Industrial Rate
California	17.10	14.28
Vermont	16.47	10.93
Massachusetts	15.99	14.40
Rhode Island	15.87	15.06
New Hampshire	15.81	12.89
Connecticut	15.53	13.20
New York	13.43	5.42
Maine	12.69	10.12
New Jersey	11.78	9.69
Michigan	11.44	7.36

Source: ElectricRate.com

Restaurants are generally charged the commercial rate for electricity by electric utility companies. The highest commercial electricity rates in the continental U.S. are concentrated in the Northeast—for example in Exhibit A, eight of the top 10 highest-cost states are in the Northeast.

Connecticut, at approximately 15.53 cents per kWh, would mean an average-sized establishment in that state might incur annual power bills of about $44,000, while a restaurant of comparable size in a state with low commercial electric rates like Arkansas (8.59 cents per kWh) bears a yearly electric bill of only $24,400. This nearly $20,000 annual differential could play a major role in the long-term viability of the establishment.

EXHIBIT B—STATES WITH LOWEST AVERAGE COMMERCIAL ELECTRICTY RATE

State	Commercial Rate	Industrial Rate
Oklahoma	$7.48	$4.54
Nevada	7.82	5.04
Utah	7.86	5.58
Missouri	8.09	6.06
Texas	8.19	5.63
Virginia	8.20	6.87
Arkansas	8.59	5.73
North Dakota	8.65	8.53
Nebraska	8.76	7.12
Washington	8.75	4.87

Source: ElectricRate.com

Electric rates vary from state to state for a variety of reasons: fuel mix, differences in regional construction and payroll costs, the need to place underground electricity distribution lines, and magnitude of state and local taxes added to customers' monthly bills. The biggest differentiator is usually whether a local utility decided to build nuclear generating plants to fill part of its electricity needs. Those plants have generally proven to have higher costs than coal- or gas-fired generating plants. All of these elements are considered cost-of-service items, including property and income taxes, and are passed on to its customers.

Natural Gas

The rate restaurants pay for natural gas approximates residential natural gas rates, and the difference between the most- and least-expensive state rates is significant. The highest rates are generally concentrated on the east coast and California; whereas, the rates in the Midwest are more reasonable. The reason: Transporting gas to areas further away from the main-producing gas basins in the middle of the country is expensive, and those extra charges are charged to customers.

An average-sized restaurant in Connecticut may incur an annual natural gas bill of about $9,300 (609 Mcf consumed times $15.21/Mcf rate). At the other end of the spectrum, the same entity in Colorado would be billed only around $6,000 per year.

MOST EXPENSIVE STATES FOR NATURAL GAS		LEAST EXPENSIVE STATES FOR NATURAL GAS	
State	**$/Mcf**	**State**	**$/Mcf**
Florida	22.61	Idaho	$6.77
California	19.97	Michigan	8.67
New Hampshire	18.54	North Dakota	8.71
Massachusetts	18.25	Ohio	8.95
Maine	17.82	Montana	9.21
Rhode Island	16.48	Indiana	9.26
Connecticut	15.21	Wisconsin	9.68
Alabama	15.06	Colorado	9.70
Arizona	15.04	Utah	9.82
Georgia	14.33	Nevada	9.87

Source: Choose Energy

Electricity and natural gas prices have increased markedly over the last few years, and the jumps so far in 2022 have been even sharper!

Across all regions of the country, and particularly in the West, utility rates for both electricity and natural gas have moved markedly higher over the last few years. More specifically, between year-end 2019 and 2021, these increases averaged about 12% and 27%, respectively. Natural gas rates in the West jumped more than 30% over this period.

The even-worse news is utility rates are now substantially higher than year-end 2021 levels. Energy commodity prices have exploded this year: The prices of both natural gas and thermal coal are both up 60+% since just December 31, 2021. Both commodities are used extensively in electric power generation. Since almost all electric and gas utilities have fuel-adjustment clauses embedded in their rate structures and commodity costs comprise the lion's share of the overall rates, these increases will eventually be reflected in much higher electric and natural tariffs charged to all customers, including restaurants.

Gasoline

Nationwide gasoline prices follow a fairly similar pattern as power and natural gas prices. The gasoline costs incurred by a restaurant's customers are generally higher on the two coasts and lower in the middle of the country. However, gasoline prices are much higher in the West than in the East. Western gasoline prices are linked very closely to prices in California which run higher based on three main factors. First, California imposes high state gasoline taxes. Second, both the summer and winter blends of gasoline used in the state contain extra additives to reduce air pollution and are more expensive to produce than gasoline used in any other state. Finally, California does not receive gasoline through interstate pipelines; the fuel is either refined in-state or transported there by ship or truck. These costs translate into higher prices at the pump.

Clearly, energy costs are in most cases not the primary reason a restaurant flourishes in its present location. Quality of food, the general affluence of the area and the location of the establishment relative to vehicle and foot traffic are more important factors. However, energy costs are creeping up in importance, particularly if the increases in oil and natural gas prices over the last few months do not reverse.

Jim McFadden is a former utilities analyst on Wall Street —Bear Stearns and Goldman Sachs—with more than 25 years experience.

Things to Remember That Get Lost in the Day to Day

By Dennis Monroe

I really don't want to write another article about what we learned from the pandemic, you probably don't want to read one. But, I would be remiss if I didn't point out a few things that are important in terms of your business's economic value and soundness going forward.

These are six key things I think you should concentrate on:

1) Landlords: I have seen landlords use an extreme amount of pressure and action to recoup what they believe is back rent. This applies to abated or deferred rent, with landlords trying to make up for lost time. Don't be lulled into thinking things are going to go back to the way they were. We're in a new era. I've worked with a number of clients whose landlords have said they either want to restart the old lease and amortize a repayment of deferred rent, or attempt to rewind the lease to the terms prior to the pandemic.

The key for many restaurant operators still struggling is to negotiate a new shorter-length of lease because we really don't know what is going to happen. Limit your exposure and figure out ways you can get out if needed. Maybe it's a dollar buyout or maybe it's paying some back rent, but at least have a safety valve in your leases so that if things don't work out, you have a walk-away.

2) Concept: We've all thought about what a post-pandemic concept looks like. The most common view is it should include take-out and another other profit center, such as a to-go marketplace. These changes were important prior to the pandemic, but the ones to focus on now include take-out and delivery, some sort of market with grab-and-go items, as well as staples and special events like pop-ups and private room dining. Your products and menu offerings have to take these new profit centers into account.

3) Service charges: I'm now convinced the service charge/gratuity approach in lieu of tipping, except in some unique cases, is not the best one. I still think that unless you're doing fast-casual or some other kind of grab-and-go, you should try to do a traditional approach to service. If your model includes servers with tips, you should continue. You may be able to still incorporate a 3% to 5% service charge into the check, since diners seem willing to accept some level of that. Make sure you are right-sizing your compensation for servers, and particularly do so for the back-of-the-house. Going forward, it's going to cost you more for good service. Also, consumers don't like high gratuities—they want to control their tips. The only exception is in the case of private parties.

4) Special customer service: In so much of the service world that I've witnessed post-pandemic, there seems to be an anger component. Whether it is bad behavior on airplanes or taking it out on restaurant workers, people are irritated on both sides. That's why it's more important than ever to insist on a strong service style, especially since, due to labor shortages, you may be providing slower service and there are empty tables on view while patrons wait. Coach your staff to make guests feel welcome and to let them know you'll seat them as soon as a table in a server's section opens up, or why their entrée may be delivered to the table slower than usual. Bar seating seems to be more popular than ever because people want that direct interaction with a bartender or server. Make sure your service style, and how you treat your customers, duplicates that bar experience.

5) Capital improvements: Your restaurant needs something new and exciting to win back customers. Even a true institutional restaurant needs to improve its décor, be more modern looking and exhibit an element of fun. Fun is key to the restaurant industry now in all segments. New, but comfortable, is something we are craving after the pandemic.

6) Employee involvement: A key to success in today's restaurant business is to have total employee involvement. Make pre-shift meetings beneficial and team-building. Hold employee meetings with full disclosure and use each meeting as a teaching component. Get people involved on a daily basis and make it safe for them to contribute their ideas, get involved with social media, new service styles, and then provide rewards for their participation. Think of this as a time to build a whole new culture.

Going back to basics—those tried-and-true solutions we all know but sometimes forget—is what is going to make your restaurant culture stronger. It's too bad that sometimes it takes a disaster to make us stronger and smarter.

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Inside Greg Flynn's 'Thrilling' Deal, Plus Two More Stars

Greg Flynn, founder of Flynn Restaurant Group, knew it would be tough to purchase 1,031 Pizza Hut and Wendy's restaurants from the bankrupt NPC International last year. In fact, one of the deal's attractions "was how difficult it was going to be, because that's a barrier of entry. I don't think there were many other potential buyers that could get through the process. I have a high tolerance for pain," he said this March, upon the first anniversary of the deal's closing.

"In bankruptcy, you really need to have ready money. We put up an $80 million non-refundable deposit early in the process. Then you have to have the sophistication and advisers to get through a bankruptcy."

What kind of pain? "You just can't believe how many lawyers are involved, and how much money—I won't say it's wasted, but you sit there on calls and there are 30 lawyers on the call. My god," he said. "Then the hardest part is, you have to be approved by the franchisors. It made this a thrilling and challenging deal."

Yum Brands owns Taco Bell and Pizza Hut, so gaining their approval was relatively easy because of Flynn's successful Taco Bell operation. By contrast, "we had never been in business with Wendy's before. We tried to educate them as best we could on our track record, but like many things in life, they will judge us over time by what we do, not what we say," Flynn said.

"They brought a healthy level of skepticism to the conversation, in part because of the context. The last guys, NPC, made a lot of promises, too. We both tried to find a solution that made everyone happy."

This year, the mandate is operating. "What we always focus on is just running our restaurants well. That's the absolute key to the business," Flynn said. "We also have made serious commitments around the assets we acquired, and we will make sure we fulfill those commitments." The firm is spending "tens of millions" of dollars on remodeling, relocating and building.

Flynn is not done yet. "We're open for business, so listen, if you're out there and you want to sell, here we are. Let us know."

When private equity came calling for Nothing Bundt Cakes in 2016, co-founder Dena Tripp did not exit stage left with a pile of cash as many do, including her fellow founder and friend Debra Shwetz. Instead, she told Levine Leichtman Capital Partners she wanted to plow her share of the proceeds back into the business and even increase her equity percentage because there was so much growth ahead.

"Dena said, 'You guys are nuts. I think we're in the second or third inning.' Not only did this founder invest 100 percent of the value into her business, she even wrote a check on top of that," recalled Matthew Frankel, managing partner at LLCP.

The private equity firm and CEO Kyle Smith got busy. "The AUVs and the margins of the units were incredible," with average unit volumes last year pushing "north of a million" and unit-level margins "north of 20 percent." There were 179 bakeries at the time; "we saw an opportunity for that number to quadruple." Technology systems needed, and received, a big upgrade. And the executive team needed more executives. "We upgraded a CDO, we upgraded a CFO, we upgraded a chief marketing officer," Frankel said.

By the time Nothing Bundt Cakes was sold last year, to Roark Capital after a stiff bidding war, the store base had doubled. The revenue grew almost four-fold. The EBITDA grew five- to six-fold. And the kicker: "We were able to sell the business for over seven times what we bought it for," Frankel said. This time, Tripp exited.

The stage was set in 2017 for Al Bhakta, CEO of CMG Cos., to begin a roll-up in the Sonic system when he received approval from the franchisor to start buying. But not much happened until late 2020.

Then the team went gangbusters. In just 15 months through the end of 2021, the subsidiary SOAR Restaurant Group acquired 96 Sonic units in 18 separate deals in 13 states, and then added eight more in two deals in the first part of this year. The smallest deal was for one store; the largest was for 20. All were family owned businesses with the usual assortment of funky accounting and not necessarily airtight P&Ls.

"So they're paying family members who aren't working in the restaurants anymore. The spouse's car is getting paid out of it. College education gets written off, things like that," said Bhakta with an affectionate laugh. "Again, family run businesses are unique and beautiful at the same time."

Bhakta and his five partners have been down this path before and it shows—he calls it "muscle memory." His group uses a form letter of intent, pays all cash when needed for speed and then adds debt later. They offer to value the business for the owners even if they don't ultimately do a deal. "You'll have a valuation and you didn't have to pay for it," is the pitch. "Then our reputation is good, so that starts building some momentum."

They'll even buy not-so-great restaurants because it plays well with the franchisor. "Sometimes those aren't the best opportunities to buy but it's the right thing to do for the brand."

—Beth Ewen

Revenue and Earnings Blow-Out for Chick-fil-A in 2021

If Chick-fil-A were a public company instead of a family run enterprise, its stores would be open seven days a week instead of six, and the magic and mystique would be something entirely different. It would probably generate half the revenue it does now. Instead, Chick-fil-A remains in the family and recorded blowout revenue and earnings in 2021, during a year in which CEO Dan Cathy passed the reins on to his son Andrew, just like his father, Truett Cathy, did for him 20 years ago.

Chick-fil-A, building on the substantive gains the 2,700-unit quick-serve operator made during the Covid-19 pandemic, generated almost $17 billion in systemwide sales in 2021, up 22% over 2020. More impressively, its sales average reached $8.1 million per year per store, an additional million dollars plus compared to 2020. The company reported double-digit gains in all revenue categories including royalties and rents paid by franchisees, rental income and company store sales.

Revenue reached $5.8 billion in 2021 compared to $4.3 billion in 2020, an increase of 33.3%. Comprehensive earnings were $1.2 billion in 2021 compared to $715.9 million in 2020, an increase of 67.3%.

Average unit volumes reached a record $8.1 million per store in 2021, an increase of 14.7% over 2020. And, system-wide sales generated from franchised and company-operated restaurants were $16.7 billion in 2021 compared to $13.7 billion in 2020, an increase of 22%.

Of the approximately 1,836 domestic free-standing locations not inside mall locations that were open for at least one full calendar year, the average annual sales volume in 2021 was $8,142,257. That compares to 1,735 domestic franchised restaurants not located in malls that were open for at least one full calendar year in 2020 with a per store average of $7,096,393, an increase of 14.7%.

Of the approximately 187 domestic franchised restaurants located in malls that were open for at least one full calendar year in 2021, the average annual sales volume was $3,224,721.

Of the 369 domestic licensed locations open for at least one full calendar year, 289 of them were located on college or university campuses and had average annual sales of $859,740 in 2021. Eighty of the 369 licensed locations were located at hospitals, businesses, industries or airports and the average annual sales volume in 2021 was $1,863,550.

As of December 31, 2021, the Company operated 2,235 franchised, 76 company-operated and 393 licensed Chick-fil-A restaurants for a total of 2,704 locations, an increase of 106 locations over 2020.

Chick-fil-A is primarily a franchise model whereby single-unit franchisees are charged an operating service fee equal to 15% of restaurant sales, less amounts charged to franchisees for equipment rentals and business services fees.

The company also receives from franchisees an additional operating service fee equal to 50% of the net profit of franchised restaurants, as defined by the franchise agreement. The base operating service fee and additional operating service fees are charged to franchisees monthly and are recognized as revenue in the period earned.

The company charges rent to its franchisees for the land and retail space that it leases from third-party developers under month-to-month lease arrangements with rent subject to a cap of 6% of restaurant sales.

Note: The Monitor obtained the financial statements and store operating highlights for 2021 from Chick-fil-A's annual Franchise Disclosure Document which was filed by the company on April 7.

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