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OUTLOOK

Multi-Concept Independents Grab Market Share and Attract Private Equity

Despite a still-wobbly economy, multi-concept operators remain cautiously bullish regarding growth prospects for the rest of this year. They're relying on a diverse stable of concepts and an ability to exploit opportunities, particularly real estate, to spur growth.

"It doesn't feel like a recession. Maybe slow growth is the new normal," posits Lettuce Entertain You Enterprises President and CEO Kevin Brown. Nonetheless, he adds, overall sales are ahead of last year, helped by the group's variety of concepts.

Diners appear to have reined in restaurant spending in 2016. Several publicly traded casual-dining chains, for example, reported sinking comp sales and traffic Q1. Some observers believe a portion of casual-dining's dwindling market share has shifted to smaller, regional players, with nifty restaurants chiefly in urban areas.

Former TGI Fridays CEO Wally Doolin, who now heads market research firm TDn2K, is among them. He believes tables are being turned on the chains, contending that urban consumers (especially Millennials) avoid legacy chains, preferring trendier decors and fresh, artisanal foods that are the standard fare of small restaurant groups.

"From a consumer standpoint, they are looking for new and fresh, and a lot of that is coming from local and regional operators," Doolin says. "There's a concern about how much growth is left for big legacy brands, at least in full service."

Labor pains

That might otherwise be good news for multi-concept operators if the labor pool weren't so shallow and costly. Apart from bracing for a near-future $10.10 minimum wage, operators struggle to find competent staff. "The challenge has been personnel," concedes Jack Sosnowski, owner of Noble Chef Hospitality, which operates five concepts in Madison, Wis., and is about to debut its first restaurant outside its home-base, in Milwaukee.

Students in the sprawling college town (and state capital) no longer want to work at entry-level, front- or back-of-the-house positions — typically summers to pay for books and tuition. Today, he says, students travel to Europe or take internships at businesses in big cities: "They're unpaid internships, but they're great for the résumé."

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To Infinity and Beyond.... And Then Some
Restaurant Finance & Development Conference
November 14-16, 2016 at Bellagio, Las Vegas

The **Restaurant Finance & Development Conference** is all about the business side of the restaurant business.

The conference is the place to network with the lenders, banks, finance companies, real estate companies, private equity, and the investment bankers who each year make this a not-to-miss event on their calendar—its the best and most efficient conference in the restaurant sector for dealmaking.

Plus, we assemble an excellent financial educational program covering all facets of the restaurant capital markets, including restaurant financing, mergers and acquisitions, valuation, accounting and tax and strategy. Our workshops on financial and operational efficiencies are led by real experts. No commercials.

Last month in this space we announced our keynote speaker, **Captain Scott Kelly**, an astronaut who spent 520 days in orbit last year. By the time you attend the Restaurant Finance & Development Conference in November, the election will be over and we'll be calling our new leader—him or her—President. We'll need **Hugh Hewitt** and **Juan Williams** to help us sort it all out.

Hewitt is an American radio talk show host with the Salem Radio Network, a CNN commentator, lawyer, academic, and author.

Also enter our left-leaning pundit Williams, who is a journalist and political commentator for Fox News, and frequent contributor to The Washington Post and The Wall Street Journal, and to magazines such as The Atlantic Monthly. During a lively give and take, they'll provide us with insight on how the new adminstration will affect economic policy, labor issues and the like.

More details about the conference program in next month's Monitor. Nevertheless, register early is our advice. The event has sold out the past four years.

Registration is available online now at www.restfinance.com.

Duff & Phelps Continues to Grow Relationships with Restaurants, Lending Community

"Literally, we value thousands of properties a year," said **Michael Gibbs**, managing director with **Duff & Phelps** in Atlanta, where he leads the valuation group that covers restaurants.

"Where we specialize and add value is the ability to execute large portfolios over compressed time frames," he said. Gibbs, in fact, talked about a large casual dining assignment where they valued 300 assets, cutting across various geographies, in a two- to three-week period. "We have an incredible amount of resources and can execute rapidly."

They've made inroads into that private equity world, valuing portfolios for them, and REITs, too. But they also value a lot of 10-plus unit portfolios. Corporate or franchise owned, "it's the bread and butter of what we do," he said.

One thing that sets them apart, Gibbs says, is "our people are paid a salary plus a bonus. When you take the commission out, you get people delivering great service. We're incentivized to work together." There's no fee split, he added, and they aren't motivated by how much they are going to make on the appraisal. "It's about the clients needs—answering questions and helping get that loan closed."

Gibbs himself has had 20 years in real estate, joining Duff & Phelps in 2004 and building the focus on the restaurant industry. "We're not big into advertising what we do—we're appraisers." But their growth in the industry was born out of early relationships with names like GE Capital and later STORE Capital, and Spirit Realty Capital.

They concentrate on speed to market with their work—the faster they get their work done, the faster the client closes on the loan and they get their restaurant open. Gibbs sees the lending community as a growth opportunity for Duff & Phelps.

"We've been cautious for who we've worked with—the relationships and the clientele," he says. "It's about finding the right people and getting on their list." For more information on Duff & Phelps, contact Michael Gibbs at (678) 916-2513, or by email at Michael.Gibbs@duffandphelps.com.

Finance Execs Cantieri, Cortell Join Wintrust

Wintrust Franchise Services, headquartered in Rosemont, Ill., continues to build out it's franchise finance platform most recently adding **Paul Cantieri** and **Todd Cortell** as managing directors. Cantieri and Cortell each have over 25 years of franchise and commercial lending experience, most recently with GE Capital Franchise Finance.

The latest hires are part of Wintrust's efforts to expand the number and size of the restaurant deals they execute each year, according to **Sandy McCraren**, senior managing director. Deals sizes have been smaller to mid-range, and they targeted operators with three to about 25 stores. Those deals have been quietly adding up. As a senior lender, they have a sizeable franchise portfolio, which has grown "organically," she said.

Adding Cantieri and Cortell, who both have experience structuring larger deals in the space, will give Wintrust additional "depth and expertise" to target that larger activity, she reported. "They add a different and wider contact base." Wintrust will have further reach, covering a broad range of franchise deal opportunities in terms of size and geography.

"We are very nimble," she added. "We have the capability of doing smaller deals through the SBA with three- or four-store operators, as well as much larger transactions. With the expanded talent we will also focus on the 100+ store operator." Wintrust will hold and service the loans.

While they have participated in syndications before with what is considered the "tail" or a small fill in for a deal, Wintrust will accept larger holds in a participation, and they'll be able to lead syndications, as well, she reported.

McCraren herself has been in franchise lending for about 27 years, with the last 14 at Wintrust. "No two years have been the same here; we can tweak things and adjust to the market. And, if we want to tweak things here as a team, we can, and that's pretty cool."

"Wintrust is engaged in several niche businesses, and there is no reason the franchise business niche can't get bigger and better," she said. Senior management is behind them, and "the team has direct input on what we're doing here. We don't have a lot of layers," she said. For more information, contact Sandra McCraren at smccraren@wintrust.com; Paul Cantieri at pcantieri@wintrust.com; Todd Cortell at tcordell@wintrust.com; Lori Christensen at lchristensen@wintrust.com or Sean Willison at swillison@wintrust.com.

Cushman & Wakefield Amps Up Restaurant Real Estate Services

Greg Schuster, senior managing director, and **Rick Bagy**, vice president, are wielding the full force of **Cushman & Wakefield**, an international real estate brokerage and services company, for their restaurant clients.

Prior, the two were executives were with Cassidy Turley, a U.S.-only company. Last year PE firm Texas Pacific Capital group acquired Cassidy Turley, along with DTZ, which had only a nominal presence in the US. The Cassidy Turley name was gone and the company went forward as DTZ. But soon after, Texas Pacific picked up Cushman & Wakefield, too, merging it with DTZ—with the latter's moniker the go-forward brand name.

Whether or not you can keep any of that straight really doesn't matter. What does is that the new Cushman & Wakefield is a company with $5 billion in revenue, and Schuster and Bagy use that power to bring a new offering to their clients: the Portfolio Services Center.

With 350 people on that team they can offer and integrate design and construction management for new brands or rebranding projects; site selection management; lease administration and facilities management.

"If I list out those four services, other firms do one or two of those," said Schuster. Their portfolio services center allows them to integrate all four into one. "It's aligning your real estate strategy with your business strategy."

"It's everything in the real estate process but stocking the merchandise," said Bagy.

And while it all sounds sophisticated, Bagy says "real estate is still a very local market business." Cushman & Wakefield has "more specialists and more retail brokers in local markets—boots on the ground." His point is "connectivity is key" in markets, where you have issues that run from market analytics to planning, zoning and construction management.

Each client has a specific account executive assigned to them, as well as a client team dedicated to the brand. "The value is that we have a centralized team—the knowledge—that owns the relationship with the client, but then parlays it into our on-the-ground resources." And the addition of advanced technology has helped them with seamless franchise rollouts. All together, their Portfolio Services Center drives efficiencies, which saves money and time, said Schuster. For more information on Cushman & Wakefield, contact Rick Bagy, 314-925-2904 or by email at rick.bagy@cushwake.com.

Calkain Companies Partner Launches Public REIT

It isn't everyone who runs two businesses at one time, but then **David Sobelman** says, "I've not been one to sleep much anyway."

He's joking of course, but the managing partner of Calkain Companies, a national real estate brokerage firm, probably doesn't have as many hours in the day to sleep. He just launched **Generation Income Properties**, a publicly traded REIT for single-net leased properties, including restaurants.

Sobelman is not a stranger to real estate investing. He's had his own private fund since 2012, and he's the managing member, with outside investors. It's been successful, and his investors wanted to know when he would launch the next one.

"They liked their returns, and they liked me running it," he said. "I thought we needed to do it bigger the next time around." He talked to his investors about a publicly traded REIT, and they were in.

"They would have their own shares, trade them when they wanted to, and have some sense of liquidity, as opposed to a fund, which is more arduous to exit," Sobelman said. "They loved it." Sobelman himself liked the transparency of public traded REIT, where investors and others could go online and look at filings, and that it would be "extremely scalable."

The first raise would be $20 million. "Look, $20 million is a lot of money," but not so much in the publicly traded REIT world, he says. That's okay with Sobelman. "I wanted to purposely do that so I am not out there just to raise as much money as possible." He has lined up a board, including Jamie Graff, managing director and co-head of real estate for Raymond James, an advisor to the REIT ever since it started.

He's taking it slow, but says the next round could be $300 million to $500 million. By 2020, the goal is to be a billion dollar REIT.

He's also got a different investment strategy: Sobelman is focusing on investments in the 20 largest cities nationwide, ranked by population density. A recent study by Case-Shiller "put out a report that quantifies real estate by population density. Of course those cities have the potential for real estate appreciation, but the report quantified it; they proved it," he said. "We want the value of the real estate to increase tremendously."

He's looking for investment-grade tenants; if they aren't then they need strong balance sheets with long-term leases. They were just approved in March, and are open to investments. He hopes to close the fund in the next 30 days or so.

"This won't affect what I do at Calkain," he said. "Part of the transparency is full disclosure. I am still working with clients, buying and selling different properties."

For more information on Generation Income Properties or Calkain Companies, contact David Sobelman at dsobelman@calkain.com, or by phone at (813) 282-6000.

Acquisitions, Debt Placements, M&A Advisories...

Boutique investmant banking firm **Auspex Capital** recently advised **MUY Hamburger Partners** in its acquisition of 82 Wendy's restaurants in the Cleveland, Rochester, and Buffalo DMAs from the franchisor. MUY now owns and operates 257 Wendy's restaurants in Texas, Ohio and New York. The assignment also involved securing acquisition financing, including a $77.375 million senior secured term loan and a $10 million revolving line of credit to fund remodels and new store development. The acquisition financing was provided by a six-bank syndicate comprised of **City National Bank**, **Huntington National Bank**, **Fifth Third Bank**, **BMO Harris Bank**, **Cadence Bank** and **Manufacturers Bank**.

Sage Family Investments, a newly formed Kingman, Ariz.-based real estate holding company owned by Yum! Brands franchisees **Mark Peterson** and **Krystal Burge**, has secured a $10.644 million senior secured term loan and development line of credit from Cadence Bank to refinance its existing debt and to provide for the acquisition and development of additional restaurant real estate. Auspex was the structural agent and provided debt placement advisory for the transaction.

In addition, they represented Wendy's franchisee **CapWen** in the purchase of five restaurants from franchisee Wendonie. City National provided the $4.5 million of financing in the deal. For more information on Auspex Capital, contact **Chris Kelleher** at 562-424-2455 or by email at ckelleher@auspexcapital.com.

Joyal Capital Management subsidiaries **JCM Franchise Development** and **JCM Finance** provided both M&A advisory and debt placement services for **Broward Donuts**, which recently closed on the purchase of a network of Dunkin' Donuts locations, a development territory and real estate in Florida, for $54 million. Financing was provided by **Northern Bank & Trust Company**.

JCM Advisory Services and JCM Franchise Development, provided advisory and M&A consulting services for **Quality Brand Capital**, which closed on its sale of a 35-store Dunkin' Donuts network, a development territory, and a commercial kitchen in Washington, DC, totaling $31 million. For more information on Joyal Capital Management, contact **Daniel Connelly**, managing director, at dconnelly@joycapmgt.com.

FINANCE INSIDER

A thoroughly remodeled **Sizzler** restaurant in Carson, California with a renewed emphasis on food quality chainwide has Sizzler CEO **Kerry Kramp** and Chief Strategic Officer **Dennis Scott** excited about the direction of the brand. With 121 franchised and 17 company stores, look for the chain to ramp up development in 2017.

Madison Jobe has joined **Watermill Express** as its new COO. The company is the largest drive-up provider of pure drinking water with more than 1,300 locations. Jobe was previously chief development officer for **Pizza Inn Holdings** and was instrumental in the creation and expansion of the **Pie Five Pizza** concept.

RBC Capital Markets restaurant analyst **David Palmer** hosted a webinar last week to discuss RBC's proprietary survey which measures customer intent within the QSR segment. According to Palmer, "The scary reality for traditional fast food sandwich and burger chains is that the consumer has become more discerning regarding quality ingredients, and the scores for the overall fast food segment have been declining." Palmer says the gap in quality perception has widened versus fast casual. **Chick-fil-A**, **In-N-Out Burger** and **Culver's** lead the survey results in quality.

According to commodity analyst **David Maloney**, "the grain and oilseed markets have found support despite the USDA signaling the largest total corn and soybean acreage on record for 2016." Maloney says the commodity markets firmed in the last month due in large part to the declining value of the U.S. dollar.

Chipotle offered up on May 3 a buy-one-get-one promotion for educators for National Teacher Appreciation Day. Teachers just had to show their ID to get the deal. The company is now moving to half-price burritos instead of just giving them away. In the first quarter, comp sales were down 29.7%, comp transactions down 21.1%, restaurant-level operating margin down to 6.8% versus 27.5% a year ago. The company reported a loss of $26.4 million, its first quarterly loss as a public company.

Mega sale-leaseback. **Bob Evans** sold 119 restaurant properties to **National Retail Properties** for $160.8 million and 26 properties for $36.4 million to **Mesirow Realty**. The company entered into a master lease agreement on both transactions for an initial term of 20 years, with five, five year renewal options. The initial cap rate was 6.65% of the purchase price for the first year. The National lease includes a CPI escalator with a maximum 1.5% annual increase, while the Mesirow lease includes a 1.5% annual rent escalator. **Franchise Capital Advisors** (**Steve Schwanz**, **Ryan Kress** and **Jeffery Cohen**) arranged the transaction.

Long-time **DineEquity** shareholder MSD Capital (the investment arm of Dell Computer's **Michael Dell**) sold a million shares of the **Applebee's** and **IHOP** operator in late February for close to $91 a share. Dell acquired the majority of his stake in 2003 when the company was still known as IHOP. As of the latest SEC filing, MSD still holds approximately 727,000 shares, worth almost $60 million. Dell's basis we calculate is roughly $20-$25 per share.

BMO Capital Markets restaurant analyst **Andrew Strelzik** estimates the casual dining segment is oversupplied by 3,000 to 4,500 units, which represents 4% to 5.5% of total casual dining units. Strelzik says casual dining's share declined to an 8% share of overall restaurant transactions in 2015 from more than 10% share in 2007.

Ignite Restaurant Group (**Brick Oven Tavern** and **Joe's Crab Shack**) tested a no-tipping policy in 18 restaurants last quarter but is now reducing the test to just four restaurants. CEO **Bob Merritt** told a first quarter earnings conference call audience that based on their research, almost 60% of the customers disliked it and that some restaurants in the test lost customers as a result.

Retiring **YUM Brands** CEO **David Novak** pitching China on CNBC's Squawk Box last week: "This economy and this consumer class is continuing to grow and I think it's been the big reason why YUM has been such a great stock in the last 10 years, and as we go forward thinking about how we restructure our company it's the reason why we think YUM will be an even better investment in the next 10 years." Novak wasn't specific in his remarks about plans to spin off the China division (**KFC** represents 75% of the operating profit in China) by the end of the year, nor did he discuss the major debt crisis unfolding in that country. Could that be the reason YUM wants to reduce its capital commitment to China going forward?

In its third acquisition since early 2015, **KBP Foods** acquired 91 KFC and Taco Bell locations in several states and entering New York and New Jersey markets for the first time. KBP CEO **Michael Kulp** said they had looked at the acquisition several times in the past three years, and finally pulled the trigger. The restaurants come from **Star Partner Enterprises Two LLC,** which picked up the restaurants out of bankruptcy. The restaurants were performing about 15% ahead of the system average, but need a lot of work. "We made a commitment to remodel 89 of the 91 restaurants by end of year 2017," said Kulp. "So we're going to be piling a boat load of money into this business."

Blaze Pizza's 47 franchised and three company stores that were open for one full year averaged $1,335,162 in 2015.

The Adventures of Restaurant Deal Guy...

The Next Formula for Restaurant Pricing and Profits

If you want to enjoy the South American Tour menu at Next, Chicago's trendy restaurant on Fulton Street, you'll have to act quickly, because the 62-seat eatery has only one date available between now and mid-June. That Thursday night you can dine on a fixed-price menu that includes Ceviche, Tiradito and Dulces at 9:00 pm for $105 per person; at 9:15 pm for $95 or at 9:30 for $85. Reservations, which rise to $115 per person on weekends, are otherwise sold out.

Co-owner Nick Kokonas developed Next's ticketing and pricing formula when he saw that Alinea, the three-star restaurant he opened in 2006 with chef-partner Grant Achatz, was spending $140,000 a year on its telephone reservations staff and still losing $260,000 to no-shows. When they opened Next in 2011, all reservations were online and prepaid (including taxes and tip), like tickets to a Cubs game. Just as fans pay less for nosebleed seats, Next customers pay lower prices on weekdays and 'shoulder,' or non-premium times.

No-shows dropped to under 1% and revenue increased by over 20% when Kokonas switched Alinea (now closed for renovations) to the Next system. While walk-ins are still welcome at the partners' high-end cocktail lounge, Aviary, customers guarantee themselves a seat by making a $20 online deposit or pay upfront for tasting menus of cocktails and food.

Can Next's formula work for other restaurant owners who must boost their margins to cover higher wages and increased health care costs?

Kokonas, a former derivatives trader, is betting it can. He raised millions from investors that include Thomas Keller and the Lettuce Entertainment Group, hired top software developers and rolled out the online reservation platform Tock (tocktix.com) last summer. So far, over 100 restaurants in eight countries are paying $695 a month to collect everything from nominal deposits on a la carte menus to $398 a person for elegant prix fixe meals. In a Tock Overview, posted online, Kokonas says TockTix works best for restaurants where customers spend at least $25 per person. Variable pricing is easiest to manage at establishments that offer fixed-price meals.

But restaurants that do not fit those parameters can still benefit from Kokonas' innovations or other strategies to increase revenues without overall price increases. Restaurants that have high demand on weekends, for example, can discourage no-shows by offering tables on a pre-paid deposit basis on Fridays and Saturdays. TockTix targets smaller restaurants and pop-ups by offering to take such reservations for $1.50 each instead of a monthly fee.

Or you can simply charge a fee for the reservation itself. In a paper published this April in the Cornell Hospitality Report called "Revenue Management in Restaurants: Unbundling Pricing for Reservations from the Core Service," professors Sheryl Kimes and Jochen Wirtz report three ways besides ticketing to fill restaurant seats. They say companies like Shout, FoodForAll, and Disney Dining Buddy are controversial and not very helpful because they make reservations under fictitious names, sell them to diners and keep the money themselves. Reserve, Table8 and Resy also use fake names to snare reservations but claim to share the proceeds and essential customer information with the restaurants they trick. But the easiest solution, the professors say, is for restaurants to charge for high-demand time reservations themselves, a practice many customers might see as unfair.

Adopting some form of Next's variable, or dynamic, pricing at QSRs could definitely make some customers really mad. Bonnie Riggs, restaurant industry analyst for The NPD Group, Inc. in Rosemont, Ill., says, "Lowering the prices of popular menu items during slower times might make customers feel good, but if you increase prices during busy times, you risk ticking off consumers, especially your heavy users. Competition is so fierce in today's marketplace, you have to be very careful."

Riggs says QSR operators who follow another money-saving strategy—removing difficult-to-prepare menu items from their drive-through digital menu boards during busy times could also lose more revenue than they save in labor costs. QSR operators, she says, are safer offering discounts or pick-and-choose combo meals.

Variable pricing at full- service restaurants has been discussed before. During the economic boom times of the mid-2000's, Cornell's Dr. Kimes and other academics conducted research into whether customers of full-service restaurants would accept variable pricing to smooth out RevPASH, revenue per available seat hour. When they surveyed consumers, most thought the idea slightly unfair.

"If you ask customers what they're willing to do," says Mark Kuperman, president of North American operations for restaurant data firm Revenue Management Solutions, in Tampa, "you create a huge amount of bias. We measure how customers are voting with their dollars. A restaurant operator should be looking how menu changes impact customer behavior."

If you raise the price of a Porterhouse steak on weekends, for example, you might lose a lot of demand, he says. Or customers might still order the steak, but share appetizers and order less wine. As for lowering prices during slack times, "customers never give you credit for that," he says. "They think about the value of their entire experience."

Better strategies for restaurants with a la carte menus, Kuperman says, include offering discounts at stated times, like 20% off regular prices on Tuesday nights; lower-priced food items during happy hours and after 10 pm; half- sized portions at lunchtime and 'early bird specials.' "Instead of asking customers to pay more for a product they know," he suggests, "why not entice them into paying more for something new?" Selling a new item at 'market price' provides an easy vehicle for restaurant operators to vary pricing based on demand, he says.

Restaurant consultant Fred LeFranc, president of Results Through Strategy in Charlotte, NC, says, "I can definitely see the appeal of TockTix for high-end restaurants. But things change so quickly in our industry. What happens when a hot restaurant is no longer the new kid on the block? Do prices return to normal?"

—Julie Bennett

Continued from page 1

Cleveland chef Zach Bruell, who operates 10 concepts and an event business, recalls when he became a chef-owner in the 1980s he opened restaurants solely to keep assistant managers and sous chefs from being poached by rivals. "I'd trained them and didn't want to lose them. But if you didn't give them a vehicle to grow, they'd leave," he says.

Today, Bruell gripes about the dearth of restaurant workers, due mainly to the steady growth of restaurants in the rust-belt city, now undergoing redevelopment of its downtown. (The city hosts the Republican Convention in July.) In March, for instance, the YTD percentage of"leisure and hospitality" employees in Cleveland crept up to 5.9% from 5.5%, according to the Bureau of Labor Statistics.

"It becomes difficult when the labor market gets stretched, and the labor market here is stretched," complains Bruell, who with investors opened three new concepts within the space of three months last summer. He now employs 470 people.

Interest from PE firms

Speaking of investors, private equity firms are looking closely at multi-concept operators. Their interest centers mainly on whether a group is capable of incubating concepts that can be scaled. "So how expensive is it to open that store, what kind of numbers do you generate, and how quickly can I get my money back?" says Aurify Brands' CEO Andy Stern, parroting the questions investors ask.

Aurify Brands apparently answered them sufficiently enough to receive a $22.5 million Series B investment last fall from Topeka, Kan.-based Security Benefit Corp. The capital has allowed Stern and partner John Rigos to hire "a team that can handle another 20 to 30 stores."

The group, a 13-unit Five Guys franchise in Manhattan, began developing fast-casual concepts a few years ago, including The Little Beet and Melt Shop. It has also partnered with Fields Good Chicken founder Field Failing, who opens his second outpost next month in Manhattan.

D Cubed Group's Managing Director Glenn Kaufman, describing such investments as once a "small off-center notion," concedes staking restaurant groups is becoming more mainstream. Reason: They're an innovative source for scalable (and salable) concepts. "They're interesting in the broad nature of the concepts they create, and also because they often become incubators," he says.

Kaufmann cites Sam Fox Restaurants: The Phoenix-based group steadily nurtured 12-unit True Food Kitchen until slowly ceding ownership to P.F. Changs, whose former COO is currently president. The small chain serves healthful meals in a trendy, full-service environment.

Yet groups with concepts that could be scaled and eventually sold may be more trouble than they're worth, warns Brentwood Associates Managing Partner Rahul Aggarwal. Founders may not have built an infrastructure or may not want to — a serious issue if the founder is integral to operations.

Even when concepts are turnkey-ready, private equity firms may discover the founder has signed personal guarantees and/or involved a variety of investors in each restaurant deal. "We've been though that. It's untying a lot of knots," Aggarwal says.

Kaufman's investment criteria depends on the mix of restaurants within the group, which could include one-of-a-kinds and multiples of the same concept. But most important is the scale of the operation and management's sophistication. For example, hearing about a restauranteur who operates a random collection of concepts in a market has little appeal.

"But if you heard about a strategically designed restaurant group taking advantage of local market knowledge over which they are applying their restaurant capability, that sounds interesting," he says.

Yet both executives agree there's opportunity if for no other reason there are so many multi-concept operators. "They're everywhere," Kaufman declares.

But just try to count them. The National Restaurant Association doesn't keep track of their numbers, says a spokeswoman. Every year the trade publication Restaurant Hospitality bestows an award on the country's 25 "coolest" multi-concept companies., though editor Michael Sanson can't tell me how many there are in the U.S. "I don't know, because their numbers keep growing by the day," he said in an email.

Real estate plays

It's probably true. Low interest rates, landlords eager to attract cool restaurants to development projects and a low barrier to entry is sparking growth in second- and third-tier cities like Cleveland. Many founders no doubt are taking their cues from innovative groups in Chicago, New York and Los Angeles, which have thrived for years given the density and wealth surrounding their restaurants.

The advantages of multiple restaurants within smaller cities (without density and wealth) include almost immediate loyalty from customers and media. Bruell, for example, who has never won a James Beard Award (though he was nominated this year) is as popular in Cleveland as local chefs Michael Symon and Jonathon Sawyer, who have. Sosnowski's eateries win plaudits from the local newspaper, Open Table and Yelp reviewers.

And both owners continue to grow their companies, though Bruell is "taking a breather" after last year's openings. He wants to make sure the new concepts — an oyster bar, burger joint and museum cafe — work.

Sosnowski, meanwhile, will soon open a Rare Steakhouse in a Milwaukee office building to discover whether the high-end concept has legs. He's already been to Louisville, Ky., to scout for third site. He may be onto something if judged by the praise for his hometown steakhouse on Open Table. Wrote one customer: "Great ambiance, great food, steak was delicious. Service was fabulous and free desert for our birthday guest."

—David Farkas

Early Stage Restaurant Investing

A good friend of mine invests in early stage restaurant companies and new concepts. The first thing he asks is, "What are my dining privileges?" and "How many gift cards do I get?" It's interesting how people get emotional about owning restaurants—they can have fun dining at what they believe is their own restaurant and keep an eye on it. If the investment doesn't go well, you at least get some free meals.

While restaurants are exciting and fun, there is substantial risk. Here are some keys to investing in early stage restaurants, particularly those that are chef driven or helmed by a first-time owner:

1. The Operator: Are you investing in someone who's successfully developed a start-up restaurant and made the concept successful, even if's not a home run? You are investing in the founder/operator, so be sure to ask these questions:

- Did investors in the founder's previous restaurants get their money back?
- Has the founder been successful in a restaurant that is somewhat related to the one you are investing in?
- Has the founder proven to be financially responsible?
- How will the founder focus on this restaurant? Does he or she have multiple restaurants that may be a diversion?

2. The Concept: The restaurant concept should be in a category that's relevant, one that will have or has consumer acceptance, and considered by consumers to be a hot concept category. Unique concepts are few and far between and are restaurants that will take a lot longer to get a return than a solid and well-run restaurant in a good demographic area.

3. **Good Business Plan:** Make sure the business plan you are presented with is solid, has consistent assumptions, considers all of the appropriate food, labor, rent and management costs and provides adequate funding for start-up costs. If your concept founder does not have a solid business plan that takes into account all of the various aspects of a truly strong restaurant unit, then it's probably not a good investment.

4. Skin in the Game: Make sure the concept founder has significant skin in the game, so you know he or she is not just using other peoples' money. Is the concept founder willing to guaranty the debt or asking the investors to guaranty the debt? Check the founder's credit. Has the founder personally made money in other restaurant ventures? Does the founder have good relationships with banks and the investment community?

5. Investment Itself: I like to see a reasonable split of distributions, where the investors get 70% of the distributions and the founder gets 30%. The investors will get 70% until they've received their money back and, at times, a preferential return. Once the investor money is returned, then it flips to 70/30 in favor of the founder. Additionally, the founder would share pro-rata with the investors as it relates to their actual cash investment and sometimes gets possibly two times the amount invested. For example, if an investor puts up $100,000 for a 10% interest in the preferred class, the founder (if he or she put in the same $100,000) would get a 20% interest. This rewards skin in the game.

A few other questions: Who are the other investors and are they knowledgeable and sophisticated? Why are they investing? Are they protected if there's no return on investment? Do they get a right to replace management? Do they have the right of first sale if the founder is not maximizing the investment? What are the expectations for distributions?

6. Realistic Proformas: A key element is understanding the unit economics. Sales projections must be reasonable vis a vis other restaurants in the vicinity given the size of the restaurant, number of seats and check averages. The investor needs to understand there is a ramp-up period. With hot restaurants, there may be a first year that is really superior and then tapers off the second year. Expenses must be aligned. We like to see restaurants' overall profitability in the 15% to 20% range for store operating profit. We like to see 2-3x sales to investment.

7. Rent: Except for food and labor, the third largest expense of a restaurant is normally the rent. We have certain guidelines for rent. Make sure the rent terms are market or better than market and there are market-rate leasehold allowances. I like to see a period of free rent, particularly during the pre-opening and start-up phases. In most cases, the total rent should be between 6% and 8% of sales. Higher rent could be problematic. There are exceptions, particularly in large, expensive metropolitan areas.

8. Lease: A reasonable lease term should be a 10-year lease with some renewals (normally, two to three five-year renewals). Sometimes the lease can be four, five-year renewals. You may also want to negotiate a kick out clause if the restaurant is not performing, so you can buy out the lease.

9. Management Team: The first question you should ask before investing is: Has the management team been hired (or at least recruited) and made commitments to join the restaurant once it opens? Are they experienced? Have they worked with the concept founder in other ventures? What is the management team's success record, particularly the general manager? Make sure the management team has been provided with appropriate incentives, has a real desire to be at the restaurant and has a proven history of being able to hire restaurant-level talent.

10. Overhead: Overhead items are important (this includes accounting, marketing, human resources, and management of the physical assets). Many of these items may be outsourced. Review these to make sure they are reasonable.

11. Competition: Look at the competition around the restaurant. Are there enough potential diners? Will the restaurant have national appeal where you have to look at getting potential diners? Will the diners have easy access to the restaurant?

Restaurant ownership can be fun. I am one of the biggest romanticizers of restaurants of any investor around. However, an investor needs to be logical about the investment. I hope my points above will be helpful in your future restaurant investing and result in making you a very happy investor.

–Dennis Monroe

STAS AND QUOTES

Share Buybacks Look Better In A Bull Market

Public company CEOs get pressure from activist investors, hedge funds and other financial types demanding funds be returned to them via share buybacks and dividends. The more assets or debt capacity, the more pressure to shell out cash.

Wall Street's penchant for monetizing assets has made restaurant chains a fertile target. Mega sale-leasebacks of restaurant real estate, company store refranchising and whole company securitizations are music to the ears of a financial engineer. Everyone should be leveraged, right?

There are many examples of activist love in the restaurant business: Witness the 2014 takeover of Darden's board by Jeff Smith of Starboard Value or the hedge fund assaults on Famous Dave's and Bob Evans. Activists target other industries for immediate cash, too. According to the research firm FactSet, there were 70 activist campaigns in 2015 in which a dissident objective was to return cash via dividends and/or buybacks, the highest total since 2005.

It isn't just the companies targeted by activists that are buying their shares at a torrid pace. Public companies purchased $570 billion of their shares in 2015 says FactSet. Reuters reports that since 2010, 60% of the 3,297 publicly traded non-financial U.S. companies bought back shares. Restaurant chains were no exception.

In the restaurant industry, 37 of the 57 public companies, including most of the big chains—McDonald's, YUM, Starbucks, Brinker, Domino's, Panera, Jack in the Box, Chipotle and Dunkin'—bought back $26.4 billion of their shares over the past three years.

McDonald's was the big dollar behemoth purchasing $11.2 billion of their shares and reducing their outstanding share count by 10%. Where did the money come from? McDonald's doubled its debt from $13.6 billion outstanding in 2012 to $24.1 billion in 2015 and slashed capex spending. Wendy's was the more aggressive acquirer of its common stock over the period spending $1.5 billion to reduce its share base by almost a third. It ramped up debt by almost a billion dollars.

Low borrowing costs and accommodating credit markets are evident, as 22 of the 37 companies that bought back stock during the three-year period also added debt.

Typically, share buybacks are deemed positive when a company's share price trades below its intrinsic value. However, intrinsic value—the present value of the future cash flow of a business at a discount rate—is difficult to quantify. It also takes discipline to know when to buy.

CEOs and boards often make mistakes in the timing of their share purchases. Bravo Brio thought they were getting a bargain when they bought back $75 million of their shares at $14. The stock is now $7. Some companies want to send a signal to the market their shares are undervalued. Chipotle, stung by last year's foodborne illness scandal, purchased $486 million of its shares in 2015 at $579 and another $584 million in the first quarter of 2016 at $470. The stock currently quotes at around $450.

Buying back shares improves the earnings-per-share calculation (fewer shares outstanding in the denominator) provided profits don't fall, but it doesn't mean the business is any better off for the effort. A recent McKinsey & Company report found that any correlation between EPS growth and total return to shareholders is more about revenue and earnings growth in the business, rather than the intensity of share repurchases.

For instance, Bob Evans bought back $400 million of its shares (29% share count reduction) and paid $90 million in dividends, just as the restaurant and sausage businesses slowed. A combination of lower capex spending, sale-leasebacks and $300 million of incremental debt paid for the buybacks. The market capitalization, not surprisingly, declined.

Capital allocation in the restaurant business is difficult given the maturity of some segments and competitiveness of others. Whether companies should invest in new units and remodels, or spend their cash on buybacks and dividends, is not an easy question. Of the 37 restaurant companies that bought back stock in our study, only 12 companies spent more on property and equipment over the three years than what they spent on their own shares. Is this a sign the economic model of the restaurant business might be broken?

"It depends," says investment banker Adam Birnbaum. Birnbaum believes a more mature restaurant system may have less opportunity for its capital and therefore a buyback or dividend could make more sense. Alternatively, "a younger company with a lot of the country to still fill out is making a bearish statement when it is buying back its stock versus expanding market share," said Birnbaum. (Note: Potbelly and Noodles, two recent IPOs, bought back shares.)

How does one gauge whether the share buybacks of the 37 restaurant companies paid off for shareholders? (See my calculations on page 9.) One way is to identify those companies that purchased shares at a discount to their current stock price and call out the others who paid a premium. Under those ground rules, McDonald's bought back 10% of their share base at a price of $2.1 billion less than if they bought the shares on December 31. (An even bigger discount today as the stock is up $15.) Chipotle, Bravo Brio and Noodles all lost money dabbling in their shares.

Which restaurant company provided the greatest return to shareholders from 2013 to 2015? To get at this number, I took the difference in market capitalization from the beginning of 2013 to the end of 2015 and added in the dividends. I took that number and subtracted the incremental debt added to the balance sheet over the same period. Then I divided that total by the market capitalization at the beginning of 2013 to get a total return.

By my calculations, Texas Roadhouse, Sonic, Domino's and Popeyes provided the greatest return to shareholders over the three-year period. Above-average returns are a combination of share buybacks, dividends and good operations. And of course, the bull market helped.

—John Hamburger

SELECTED RESTAURANT COMPANY SHARE BUYBACK SCHEMES—2013, 2014 & 2015									
Company	**Total Size of Buyback**	**Buyback Avg Price Per Share**	**Share Price 12-31-15**	**Buyback Discount (Premium)**	**Share Count Decrease**	**Debt Increase (Decrease)**	**Three-Year Market Cap Increase**	**Total * Return to Shareholders**	**% Total Shareholder Return ****
McDonalds (MCD)	$11.2 B	$98	$117	$2.1 B	-10%	$10.5 B	$17.9 B	$20.7 B	19%
Yum Brands (YUM)	$2.8 B	$73	$72	($26) M	-7%	$1.0 B	$532 M	$4.8 B	5%
Starbucks (SBUX)	$2.6 B	$60	$60	$5 M	-1%	$1.8 B	$8.5 B	$5.1 B	11%
Wendy's (WEN)	$1.5 B	$9	$11	$189 M	-31%	$969 M	$1.1 B	$1.7 B	17%
Panera (PNRA)	$900 M	$173	$195	$116 M	-17%	$406 M	$67 M	$904 M	-8%
Brinker (EAT)	$881 M	$47	$48	$7 M	-19%	$448 M	$548 M	$1.1 B	13%
Jack in the Box (JACK)	$850 M	$62	$76	$193 M	-20%	$390 M	$1.4 B	$914 M	87%
Domino's (DPZ)	$848 M	$94	$111	$155 M	-11%	$680 M	$3.1 B	$1.0 B	105%
Dunkin Brands (DNKN)	$740 M	$45	$42	($45) M	-13%	$596 M	$399 M	$1.0 B	2%
Chipotle (CMG)	$720 M	$520	$480	($55) M	-2%	$0	$5.4 B	$720 M	59%
Darden (DRI)	$485 M	$48	$63	$149 M	-1%	($1.7) B	$2.3 B	$1.3 B	82%
Cheesecake (CAKE)	$431 M	$45	$46	$12 M	-8%	$0	$504 M	$525 M	35%
Bob Evans (BOBE)	$408 M	$48	$39	($78) M	-29%	$306 M	($358) M	$498 M	-51%
Papa Johns (PZZA)	$356 M	$45	$56	$84 M	-14%	$168 M	($305) M	$422 M	-17%
Sonic Corp. (SONC)	$276 M	$23	$32	$106 M	-12%	$303 M	$1.0 B	$300 M	124%
BJ's Rest (BJRI)	$196 M	$40	$43	$18 M	-12%	$101 M	$149 M	$196 M	5%
Bloomin Brands (BLMN)	$171 M	$22	$17	($42) M	-2%	($178 M)	$110 M	$205 M	17%
Denny's (DENN)	$153 M	$8	$10	$25 M	-17%	$25 M	$305 M	$153 M	62%
DineEquity (DIN)	$142 M	$87	$84	($4) M	-3%	$70 M	$268 M	$308 M	28%
Popeyes (PLKI)	$122 M	$49	$59	$23 M	-6%	$40 M	$689 M	$122 M	104%
Krispy Kreme (KKD)	$112 M	$18	$15	($19) M	-3%	($26) M	$337 M	$112 M	59%
Bravo Brio (BBRG)	$75 M	$14	$9	($26) M	-25%	$23 M	($130) M	$74 M	-58%
Red Robin (RRGB)	$72 M	$66	$62	($5) M	-3%	$78 M	$347 M	$72 M	55%
Texas Rdhouse (TXRH)	$67 M	$27	$36	$21 M	+2%	$26 M	$1.3 B	$191 M	124%
Potbelly (PBPB)	$50 M	$12	$12	($3) M	***	($15) M	***	$100 M	***
Noodles & Co (NDLS)	$42 M	$16	$10	($17) M	***	($27) M	***	$42 M	***

Footnotes: ** Share buybacks and dividends for 2013, 2014 and 2015* **** Not meaning ful as Potbelly and Noodles went public during the three year period* *M: Millions*
*** Change in market capitalization plus dividends less incremental debt divided by beginning market capitalization* *B: Billions*

Krispy Kreme Doughnut Corporation

NYSE-KKD

To be acquired by JAB Beech Inc.

Date Announced: May 9, 2016
Price Per Share: $21.00
Transaction Size: $1.35 billion
Financial Advisor: Wells Fargo Securities

Financial Statements

INCOME STATEMENT
Year ended Janauary 31, 2015

Revenue	$518,714,000
Net Income	$32,398,000
Net Income Per Share	$.50

BALANCE SHEET
As of Janauary 31, 2015

Cash	$50,785,000
Shareholder's Equity	$256,140,000

SUMMARY:
Krispy Kreme operates 1,121 stores in 25 countries and had systemwide sales in Fiscal 2016 of $1.2 billion dollars. 824 of the Krispy Kreme stores are located internationally.

JAB Beech Inc. USA is a subsidiary of JAB Holding Company, an investment firm based in Luxembourg. JAB Beech owns Peet's Coffee & Tea, Caribou Coffee Company and Einstein Noah Restaurant Group. The holding company's largest investment is in Reckitt Benckiser Group Plc. with a share of approximately 10.5%. Reckitt Benckiser is a UK consumer goods company which includes brands such as French's Mustard, Air Wick, Calgon, Clearasil, Lysol, Jimmy Choo and the cosmetics maker Coty.

BDT Capital Partners, a private equity firm based in Chicago, will purchase a minority stake in the company.

Stephens analyst Will Slabaugh estimates the valuation of the deal to be approximately 16x 2016 EBITDA.

Checkers Drive-In Restaurants

Franchise Disclosure Document
Financial Update

Date Filed: April 1, 2016
Company Description: As of December 31, 2015 there were 829 Checkers and Rally's restaurants in operation across 29 states that included 324 company-operated and 505 franchised restaurants. Of the 829 restaurants, there were 292 Rally's restaurants and 537 Checkers restaurants.

Financial Statements

INCOME STATEMENT
Year ended December 28, 2015

Revenues	$348,713,000
Net Income	$2,580,000

BALANCE SHEET
As of December 28, 2015

Cash	$3,425,000
Long Term Debt	$159,918,000
Shareholder's Deficit	($72,867,000)

SUMMARY: Checkers has been owned since March 2014 by an investment fund sponsored by Sentinel Capital Partners. Sentinal is active in the restaurant industry and also owns Newk's Eatery, Huddle House, TGI Friday's and Fazoli's.

Checkers has a credit agreement with Antares Capital consisting of a $176.5 million term loan and a $25 million revolving credit facility.

The average Checkers restaurant (463 restaurants in the comp base) generated $994,896 in annual sales in 2015. The average Rally's restaurant (283 restaurants in the comp base) generated $994,896 in annual sales in 2015.

A franchisee of Checkers pays a $30,000 franchise fee and a royalty of 4% of net sales.

Perkins & Marie Callender's

Franchise Disclosure Document
Financial Update

Date Filed: April 4, 2016
Company Description: Perkins owns and operates 132 restaurants, and licensed another 272 restaurants in 33 states and five Canadian provinces.

Financial Statements

INCOME STATEMENT
Year ended December 27, 2015

Revenue	$394,553,000
Net Income	$9,855,000
EBITDA	$25,282,000

BALANCE SHEET
As of December 27, 2015

Cash	$7,713,000
Long Term Debt	$104,768,000
Shareholder's Deficit	($3,622,000)

SUMMARY:
Perkins completed its financial restructuring and emerged from bankruptcy in 2012. 2015 showed evidence of a successful turnaround as the company reported a $9.8 million profit versus a $2.8 million loss in 2014 and a $21.9 million loss in 2013. The company reported a 4.5% increase in same store sales and a 3% increase in guest counts. Franchise locations posted same store sales gains of 2.3%. 2015 was the second consecutive year of positive same store sales and guest counts for the chain. A total of 69 company and 40 franchised locations have been remodeled. An additional 20 corporate and 70 franchised locations are slated for remodeling in 2016. The company anticipates a 2018 completion date for the initiative, at which time all restaurants in the Perkins system will have the new look.

Perkins entered into a new Senior Secured Credit Facility in 2015 in the amount of $111.5 million with multiple lenders, including Bank of America Merrill Lynch as the administrative agent. The credit facility consists of a $100 million term loan and $25 million revolving credit facility.

ANALYST REPORTS

Fiesta Restaurant Group
FRGI-NASDAQ
(Downgrade to Neutral)
Recent Price: $25.17

The Wall Street analyst community is split on **Fiesta Restaurant Group** after a disappointing first quarter earnings report. One thing they can all agree on is taking a step back and seeing what happens next.

Revenues were up 7.8% to $176.7 million, short of consensus by about $13 million. Comps were flat at Pollo Tropical lapping a 6.4% bump in Q1 2015, traffic inched up .1% but average check sank .1% for an even 0. Taco Cabana fared slightly better with a 1.7% sales gain, but still missed estimates of 3%.

Analyst **Lynne Collier** at **Stern Agee CRT** says margins slipped to "22.2%, down 1.4% year-over-year falling 1.3% short of our estimate. This was primarily driven by higher COGS, labor and other operating expense."

Weakness in new, major Texas markets were a function of "cannibalization, oversupply and the downturn in energy," said Collier. "We are moving to the sidelines until clarity improves around the ROI profile and performance of the Pollo Tropical brand outside of Florida."

Collier downgraded shares from Buy to Neutral with a price target of $45.

Wendy's
WEN-NASDAQ
(Outperform)
Recent Price: $10.46

Wendy's ongoing refranchising slashed company revenue by 16.2% with 375 fewer restaurants, but fundamentals still look great and are only getting better.

Wendy's has no problem taking market share from better-burger players with the "4 for $4" value deal. It's also incrementally upgrading core offerings with a new "bakery style" bun and new burger cooking techniques to compete with upscale burgers in the long run.

David Palmer, an analyst at **RBC Capital Markets**, said new tweaks have "helped Wendy's start to pull away from the pack in quality perception." Q1 comps of 3.6% beat consensus at 3.3% and revenue came in at $378.8 million, ahead of a $352.1 million consensus. But the revenue drop due to fewer corporate restaurants caused some investors to jump ship, sending the stock down more than 7% after earnings were released. The company is "targeting 1,000 new units and $2 million in AUV by 2020" with 66% of restuurants renovated (22% currently).

Palmer has a price target of $12 and guides toward an EPS estimate of $.36 in 2016.

Noodles & Company
NDLS-NASDAQ
(Buy)
Recent Price: $10.11

Noodles & Company stock is still down more than $5 and 34% from May 2015, but there are still plenty of bullish investors holding on for a turnaround.

Q1 revenue hit $114 million and comps were flat at company-owned stores and down .5% at franchised stores, putting system wide comps at negative .1%.

Restaurant analyst **Gregory Badishkanian** at **Citi** said Q2 isn't off to a great start either, but it's not all operations. Comps are down .2% through May 2 as a good Easter timing and 1.5% price bump "have been muted by late season snow storms in the Colorado market, a volatile industry environment, and tougher YoY compares due to LTO timing."

Noodles plans for 50 new units in 2015 and will build on mostly successful media spending and try to push more off-premise sales which now account for 43% of all sales (6% online).

"We believe the valuation for NDLS does not fully reflect the growth potential of the company," said Badishkanian, who has a $15 price target with an EPS of $.05.

OUTLOOK

Answer Man Sours Somewhat On the Oracle

You missed the Berkshire Hathaway meeting this year for the first time in years. Have you given up on Warren Buffett?

No. He is still one of the greatest investors. The 40,000 people that flock to Omaha each spring come away with one or two grand nuggets of investment delight from the Oracle and his sidekick Charlie Munger. That's all it takes to keep the flame alive and make some money too.

Why didn't you go to Omaha?

To be honest, I'm frustrated with Buffett and his frequent call for higher personal income taxes. He's the second or third richest guy in the world calling for higher taxes that wouldn't even apply to him. I think it's hypocritical. Plus, this was the first year you could follow the annual meeting online so I decided to save on the travel expenses.

What do you mean hypocritical?

Warren Buffett takes a salary of $100,000 from Berkshire Hathaway as its CEO. He owns roughly 19% of a $380 billion market cap conglomerate. Berkshire pays no dividends by his own directive. In 2015, Berkshire's increase in book value versus the prior year was $15.4 billion. Warren's share of that gain was almost $3 billion. No tax is paid on the gain because it wasn't realized. I get that. But, by taking an extremely low salary and having no dividend income to report, Warren is the one beating the taxman, not the big shots he complains about. When he talks up higher taxes the media comes a running and says "see!" Buffett's higher tax spiel is just a clever ploy to keep the anti-business crowd in Congress off his back. It's brilliant, but nonetheless it bugs me when he gets on his high horse.

You are still impressed with his investment acumen?

Of course. Buffett is best in his shareholder letters. His writing style is folksy and he explains the nuances of finance in simple terms. Buffett's comments about buying a business at a bargain purchase price—a "cigar butt" company as he calls them—is classic. He says that a business available at a deep discount is that way because they're difficult to operate. "No sooner than one problem is solved than another surfaces—never is there just one cockroach in the kitchen." Buffett says the price advantage of buying a "cigar butt" company is generally eroded over a long period of time by low returns. Buffett said he had to learn a lesson the hard way. His initial bargain purchase of Berkshire Hathaway, a New England textile mill, came at a time when the textile industry was beginning to languish.

What does he recommend instead?

Buffett wrote in his 2014 shareholder letter that marginal businesses purchased at cheap prices might be attractive as a short-term investment, but not the foundation to build an "enduring enterprise." It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price," wrote Buffett.

Has Buffett written anything applicable to restaurants?

Not specifically. His only restaurant holding is Dairy Queen. He hits close to home with his criticisms of EBITDA (earnings before taxes depreciation and amortization). Buffett is not a fan of EBITDA as a proxy for earnings. He says that using it implies that depreciation is not an expense, given that it is a "non-cash" charge. "In truth," Buffett says, "depreciation is a particularly unattractive expense because the cash outlay it represents is paid up front, before the asset acquired has delivered any benefits to the business." If you read a restaurant annual report, listen to a conference call, or talk with a restaurant franchisee, you'd think depreciation expense doesn't apply to the restaurant business. I'm glad to see most lenders are aware of this parlor game and will normalize the P & L, or at the very least look closer at the deferred maintenance in the business. Buyers should too.

What will be Buffett's legacy?

I think Buffett's emphasis on long-term investing versus trading and market timing is what he'll best be remembered for. Whenever I hear seductive ads for day trading, timing the market or some new investment scheme, I think of Buffett sticking with the same companies he's owned for years and adding to his positions. He warns investors against the payment of high fees to managers and financial advisors. He's publicly criticized hedge fund investments and bet that a stock index fund would outperform them over a ten-year period. Eight years running, the index fund is way out in front. I think the entire investment industry is under suspicion for overcharging and underperforming. The hedge fund business is reeling. Buffett has had a lot to with that.

Answer Man is willing to impart his extensive restaurant knowledge to any member of Augusta National Golf Club, in exchange for a round of golf and an overnight stay in one of the Butler cabins. Warren, are you reading this?

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