

Chain Leader

INSIGHT FOR RESTAURANT EXECUTIVES

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ON THE MONEY

Franchise Player

Here's a private-equity firm that likes the franchise business.

BY DAVID FARKAS

With almost \$41 million invested exclusively in franchisors and franchisees, New York-based United Enterprise Fund controls nearly 1,700 restaurants; many of them are minority-owned and in urban markets. UEF's current roster includes Bear Rock Cafe, Le Petit Bistro, Maui Tacos, Popeyes Chicken & Biscuits and Church's Chicken. Managing Partner Dan Dean, a former PepsiCo foodservice executive, recently shed light on the firm's investment strategy.

What are success drivers in a franchise-oriented company?

There are many, but one of the most significant is whether the franchisor is focused on franchisee profitability or just perceived brand-building.

The difference being?

Some franchisors have marketing departments run by sophisticated people who want to do a lot of promotions for the purpose of brand-building without assuring that branding-building also builds sales in the short term. That forces franchisees to commit resources to advertising and promotional initiatives that may have no tangible ROI for them.

Are there inherent risks to investing in urban-centered franchises?

Urban markets have higher sales and more transactions. On the negative side, they have higher security, lighting and labor costs, indirectly in the form of turnover. Urban markets aren't as saturated because there's less available, viable real estate.

Your firm wants its portfolio companies to use profit-based incentives. Why?

It's important both at the store level and corporate level because it gives everyone a sense of ownership. A lot of companies

offer bonuses based on cash-flow targets. They might say that stock doesn't mean anything to store-level managers. We disagree. Giving people a sense of ownership impacts productivity and profits.

What concerns do you have about the balance sheets of emerging chains?

If your approach is "if we build it, they will come," you will be faced with liquidity issues. But if you have done your job properly, you will emerge from that issue like Bear Rock Cafe and Le Petit Bistro.

The other issue is lack of debt financing. Lenders want to see longevity, a certain number of restaurant units and consistent sales performance around the mean. These can be challenging for emerging chains.

Finally, because most young chains don't have robust balance sheets, even if you are a great concept, it's tough to compete for a great site. Developers may think you're the best but often go with a national brand with a great balance sheet because they care about certainty of payment.

What's your view of current restaurant valuations?

Our view of franchise packages is 4.0 times to 6.25 times [EBITDA] depending if real estate and deferred capital-expenditure requirements are part of the deal. Yet it is really hard to judge valuations because each deal takes into account factors like unit portability, brand extendability, pipeline and real estate.

Finally, is it possible to balance your role on various boards as both investor and management adviser?

Board membership is complicated for an investor because it can put the investor in a position where he or she has a contractual relationship and a fiduciary responsibility at the same time. Balancing those two can be a delicate process. **A**

