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Franchise Dining Deals Get Supersized In Development Boom

By **Natalie Rodriguez**

Law360, New York (April 21, 2014, 8:04 PM ET) -- Pent-up private equity, increasing development demands from restaurant brands and a sweet spot in the real estate cycle are all helping to fuel large-scale, multi-unit franchise development deals, experts say.

Several key market factors — including brands increasingly searching for financially sophisticated companies to partner with and a real estate boom creating new demand for restaurants — has the franchise dining sector jumping with multi-unit development deals, experts say. And operators, many with private equity cash to burn, are heeding the call.

“The sophistication of restaurant deals, it is increasing. ... I would say that a lot of franchisors are really looking for bigger franchisees that can aggregate several stores,” said Matt Sanderson, a deals attorney with Gray Reed & McGraw PC.

Over the last few months, the sector has seen many brands announce development deals for more than 10 units with one single franchisee. For example, last monthDunkin' Brands Group Inc.-owned company signed a development agreement with current franchisee Sizzling Donuts LLC to bring as many as 46 new units to California. And earlier this year, Dickey's Barbecue Restaurants Inc. inked a deal with a developer group led by former Kentucky Fried Chicken Corp. franchisees to build up to 100 new units, also in California.

The deals are in part the result of an upswing in the commercial real estate sector in general, which is creating a greater opportunity and need for restaurants in or around new office, retail or mixed-use projects, according to Rob Lauer, a partner in Haynes and Boone LLP's franchise and distribution group.

“The real estate market was really slow, almost dead, two to three years ago. The past year or so, though, it's just been doing nuts. It's really busy on the development side,” he said.

Also helping to drive the multi-unit franchise deal trend is that brands in general have gotten back their legs after the downturn and are looking to pad their development pipeline, whether it's established companies looking to protect their market share or younger concepts looking to take a piece of that pie.

And “from an administrative standpoint from the franchisor, one franchisee with 20 units is going to be a lot easier to handle,” said Andy L. Pidcock, a partner with Snell & Wilmer LP. Further, beefed up franchisee companies are more attractive because they're usually able to put in their own money, Pidcock noted.

This is becoming increasingly more important because the funds that brands were more generous about handing over to franchisees to help spur new development during the economic downturn have begun

to dry up.

“What I'm seeing on the financial side is an easing, so to speak, of capital,” Sanderson said.

Franchisees are also feeling the pressure to stay competitive by striking several-unit development deals, according to experts. With the market getting crowded by franchisees that hold dozens — if not hundreds — of restaurants in their portfolios, smaller franchise companies can easily lose their ability to keep up.

“The more stores you have, the more profits you have, and franchisors are requiring reinvestment in their stores,” Sanderson said.

There are also efficiencies for the franchisee when say, food orders can be done in bulk for several locations, according to Bruce Bronster of Windels Marx Lane & Mittendorf LLP.

Further pushing the multi-unit franchise development trend is the renewed presence of private equity in the sector. While blockbuster deals with established players, such as an Apollo Global Management LLC unit's $1.4 billion bid for Chuck E. Cheese's parent CEC Entertainment Inc., are the ones grabbing headlines, there's also been an increasing interest from private equity for some of the larger scale franchisees, according to some experts.

“There seems to be a lot of trading and more private equity activity in the franchisee space than I think we've seen historically,” said J. Riley Lagesen of Davis Wright Tremaine LLP. “The economy has picked up a little bit and some of these franchisee systems have grown to a meaningful scale, which can be very attractive to a buyer.”

There's also increasing private equity interest in fledgling restaurant brands that have the potential for significant regional or national expansion, which in turn often means new opportunities for franchisee developers and operators, according to experts. This is particularly true for relatively new concepts that speak to the healthy living trend that recently catapulted Zoe's Kitchen USA LLC to a particular warm welcome in the public markets.

“I think you're going to see a continuing increased investment in concepts that are 'better for you.' A lot of our clients that have been receiving growth financing are doing things in that segment,” Legesen said.

Some larger restaurant operators are even picking up smaller brands, often with the plan of growing the business and often with private cash — as opposed to still-hard-to-secure debt or other financing — to fuel the deal, according to experts.

Sometimes these deals are to give the operator “something new and exciting and shiny that might be to attract private equity [firms] or the public markets in the future. Some of it's just diversification,” according to Lauer.

Either way, it too is helping to fuel larger franchise development deals. And the increased private equity interest, as well as new real estate opportunities and pressures to stay competitive, are trends that experts don't see fizzling out anytime soon.

“Not only do I expect it to continue, I expect it to increase,” Bronster said.

--Editing by Jeremy Barker.

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