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Agree on Business Points Early to Speed Deals, M&A Pros Say

By Beth Ewen

Mark Peterson started with one restaurant 32 years ago, with his sister as business partner. Now their company, Peterson Burge Enterprises in Kingman, Ariz., operates 90 Taco Bells and 60 Pizza Huts in the southwestern United States. He's become an efficient deal-maker along the way, buying units whenever the time is right. "Make decisions quickly on the business side," he advised, and enshrine the points of agreement in the letter of intent. This prevents attorneys from haggling endlessly over details—and wracking up large fees.

Peterson was one of several operators and advisers who shared tips about mergers and acquisitions, a hot topic at the Restaurant Finance & Development Conference this year. Plenty of restaurant operators are eager to do deals, with deal flow back to pre-2008 levels on the initial public offering side, according to Brad Swanson, managing director of KeyBanc Capital Markets in Atlanta. He noted 11 restaurant IPOs so far in 2014, a pace similar to the pre-2007 "feast" years.

"We had four years of famine and now we're back to the feast," he said at the conference's opening session.

In 2008, average restaurant valuations were 9x EBITDA, but that plunged to 5x in 2009. By 2013 the figure was back to 9.5x and trending higher for 2014.

"It's a good time if you're thinking about doing something with your business," Swanson said.

Morgan's Foods is a KFC franchisee that took the plunge, selling the firm, publicly traded at the time, to Apex Restaurant Group in May. Ken Hignett drove the sales process for Morgan's and remains as CFO for Apex, which is changing its name to Ampex to incorporate the 'm' in Morgan's.

On a panel, Hignett described Morgan's rationale and a process that started in 2013, with an equity infusion that spring and then a refinancing at the end of summer.

"Morgan's was a 68-unit franchisee supporting a public company infrastructure, so it was always a struggle to get to good, solid profitability and create shareholder value," he said. "So in the fall the board determined there were a number of franchisees in an acquisition mode, and it was time to test the market."

Morgan's investment banker, Brookwood Associates, assembled a pool of 70 potential buyers. After six months of interviews, during which buyers "de-selected themselves," Hignett said, in many cases because this was a stock sale instead of the more common asset sale, Apex bought the firm.

Tabbassum Mumtaz, CEO of Apex and a panelist, joked about being the last buyer standing. "A friend of mine who is in sales says there's always going to be an idiot to buy something," he said, to laughter from the crowd. Mumtaz also noted the difference in culture at the two firms. "A publicly traded company guy has sheets of notes," he said, gesturing toward Hignett, "and a private company guy just has a napkin. That's how franchisees work."

Turning serious, Mumtaz advised buyers to go line by line through financials pre-purchase, looking for ways to cut expenses or seize opportunities. "When we looked at G&A, they had 6 to 8 percent," he said, referring to general and administrative expenses at Morgan's, because of the costs of running a publicly held company. "The minute we closed the transaction we took it private. Today we are running at 4.1 to 4.2 G&A, in just four months' time."

He's not stopping after the Morgan's acquisition. "There are so many other franchisees that have interest in selling around the geography of Morgan's. This was the first step," he said, and he's planning "at least" three more acquisitions over the next year or two.

Peterson, the Taco Bell and Pizza Hut franchisee, said it pays for CEOs to get involved in due diligence,

especially hands-on site inspection. **Chris Kelleher**, of **Auspex Capital** and a panel moderator, asked whether Peterson was “a one-page guy or a 12-page guy” when it comes to letters of intent.

“I lean more toward the 12-page guy. I like to get most of the business points locked in as early as possible,” Peterson said. “Having a letter of intent done, you’ve already come to a meeting of the minds on key points.”

Kelleher said when buying units from a franchisor, most elements of the transaction are marked as non-negotiable. But Peterson said there’s a way around that rule: “I take a little bit different tone with that and see what they’re trying to accomplish,” he said, referring to the franchisor.

For example, a franchisor “will have certain standards they want the restaurants to meet, and I’ve had success getting some credits and concessions toward upgrading” when some units fall short.

Rich Malekzadeh, a Papa John’s franchisee based in Carson, Calif., and another panelist, put the same idea a different way: “You take the stance, you make a bigger pie and everybody gets to eat,” he said.

Malekzadeh operates 65 Papa John’s stores in Southern California and Cleveland. He differed with Peterson on when to discuss purchase price allocation in a deal; that is, when to decide who will pay for what for tax purposes.

Peterson said he tries to approach that subject “early on, but really we try to understand what both parties want as outcomes.” Malekzadeh, on the other hand, likes to wait before bringing up allocation questions. “My idea is the opposite,” he said. “Get the deal rolling, and then let the experts figure it out. First you need to know if you have a deal.”

—Beth Ewen