BY DEAN ZUCCARELLO

Casual Dining's Upside

Opportunities abound as valuations fall

I frequently receive questions from clients and prospective buyers asking, "What's the hottest new opportunity in the marketplace?" While it's true that discovering the new McDonald's or sexiest "brand du jour" seems most exciting, often the greatest opportunities are far less glamorous. Do new and flashy concepts seem instinctively more appealing? Perhaps, but glamour is inherently fleeting. And since we operate in the multi-unit franchise industry and not the fashion industry, this subjective allure will forever be eclipsed by stability and the potential for operational upside.

This might come as a shock to some, but I believe that casual dining might just be that opportunity in 2017. So what about the widely publicized reports that the casual dining subdivision has suffered greatly over the past few years? It turns out that the explanations for this are legitimate. But they also are manageable, and by no means are going to cause the downfall of the entire segment. For example, some of the primary reasons for casual dining's downtrend include more competition, consumers' shifting preference toward take-out and delivery, changing tastes, and the demand for high-quality offerings and speedy service.

Considering these factors, it's not far-fetched to view casual dining as behind the times. However, it is also important to note that all of the aforementioned elements affecting this segment are not solely problems for casual dining, or even restaurant concepts at large, but instead are factors that affect all businesses operating in the market today.

Despite these issues, casual dining concepts will almost certainly bounce back in the future. There is one particular phenomenon I have witnessed time and again during my 35+ years working in the restaurant industry that is particularly relevant in this case: brands don't die. Some brands will inevitably dissolve, but most find a way to survive and even thrive. Some relevant examples of this happening can be found by examining the Burger King, Arby's, and Denny's systems. All of these brands found a way to weather some serious hardships and are now arguably operating better than ever before. Thus, it is reasonable to expect that casual dining can and will experience a similar rebound.

Furthermore, the casual dining segment is certainly not sitting idly by, waiting for the market to bring about this rebound. The big, savvy brands are making some

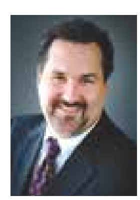
crucial adjustments to address the issues they are facing. Because of their established nature, these systems have the ability to leverage their large-scale infrastructure to put the necessary resources behind initiatives to win back their customer base. With a renewed focus on providing higher food quality, improving their menus, and refining their mobile apps and online ordering, these restaurants are ready to fight for the consumer's attention. Casual dining is also in a unique position, as it is perfectly situated to capitalize on the growing take-out and delivery trends that are making a huge impact on the restaurant industry today.

Lower multiples, greater opportunity

Interestingly enough, it is this current conflict in the casual dining segment that presents prospective buyers with the most substantial opportunity. The underperformance of the segment as a whole has significantly brought valuations down to the lowest multiples seen in years. On the flip side, valuation multiples for the top-performing QSR brands, such as Taco Bell, have reached record highs, making the casual dining financials look far more attractive to a prospective purchaser.

We must also consider the fact that it wasn't so long ago that the QSR segment was experiencing a nearly identical struggle, further demonstrating the ebb and flow of concept and segment success that is fundamental to the industry. Granted, casual dining restaurants will experience their own distinct complications, such as more limited financing options and a larger capital requirement. Nonetheless, these strong, broadly recognized concepts possess the brand equity to maintain consumer interest and adapt to better address the demands of the marketplace.

Everyone who is active in the field plays with their own strategy, and there is no basis on which any one specific approach can be touted as best. But before determining which method suits you best, ask yourself this: "As a buyer, what do I find more compelling right now: a hot QSR brand at 8.0x EBITDA or a national casual dining brand sitting at 5.0x EBITDA?" We think some buyers will make the move toward casual dining and ultimately be happy that they did. MUF



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