NEWS | SAN DIEGO | HOSPITALITY

Food for thought: Growth strong in restaurant sector

By KATIE THISDELL, The Daily Transcript
Tuesday, June 16, 2015

Americans are dining out more than ever and their taste for what and where they're eating is changing.

The thriving restaurant sector was the topic of a breakfast panel event held Tuesday by the San Diego chapter of the Association for Corporate Growth at the Marriott Del Mar.

The share price of quick-service restaurants (think McDonald's) have outpaced the broader market, including casual dining (such as Applebee's) and the S&P 500 Index, said Joel Weinstein, director at **W Partners**, an investment banking firm in San Diego.

In March, sales at restaurants and bars overtook grocery store spending for the first time ever, according to data from the Commerce Department.

"The trend is clear that Americans spend more out," Weinstein said.

Americans aren't just going to fast-food drive-throughs. Lately, the fast-casual segment has trended as the area with the most growth.

Fast-casual places such as **Panera Bread** (Nasdaq: PNRA) offer higher-quality food at slightly higher prices than quick service, and a "fine fresh" segment, such as **Tender Greens** and **Luna Grill**, may be even one step above.

And then there's **Chipotle Mexican Grill** (NYSE: CMG), perhaps the most successful of the fast-casual emergence.

Chipotle went public in 2006, and in the past five years, the company has seen shares rise 310 percent, surpassing **Apple Inc.**'s (Nasdaq: AAPL) 250 percent rise over the same period, according to data from W Partners.

"The issue is what happens to casual does it go away? Ultimately, folks will need to reinvent their concept," Weinstein said.

For instance, just like shopping malls are becoming more experiential, Dave & Buster's has developed its restaurant concept into an entertainment experience.

Restaurants are now going public earlier. Rather than establishing a chain with hundreds of locations, some companies may have 100 restaurants or less when they make an IPO.

Panera, for example, has grown from just 81 restaurants in 2000 to 1,901 in 2015.

Wildly popular Shake Shack (NYSE: SHAK), which started as a food cart in New York City in the early 2000s, had just 63 restaurants at its Jan. 29 IPO. Its performance on the first day was 119 percent.

Over the next 12 months, **Shake Shack** could see its value rise by a factor of 47, according to the EV/EBITDA metrics provided by W Partners.

But, there are market pressures that could affect future successes.

For instance, the real estate market is at its tightest level, said Brian Kelley, managing partner and CFO of San Diego-based **Paradigm Investment Group**, which owns 130 restaurants around the country, from Hardee's to TGI Friday's to San Diego-based Donovan's Steak & Chophouse.

"Some of these IPOs are on the expectations of building out these restaurants, and the reality is there's just no real estate available for them," Kelley said.

Mike DiNorsica, managing director for **Sweet 100**, a private equity firm focused on investing in emerging restaurant brands, said there's only so much space in each market for certain styles of food.

"You can only have so many burger concepts in a particular center, you can only have one pizza concept in a particular center, so that makes it really challenging," DiNorsica said.

That's where it pays to stand out.

Dave Schroeder is CFO of Luna Grill, a San Diego-based Mediterranean restaurant group with 21 fast-casual locations in California and Texas. He said because there's limited real estate availability and many concepts going after those spaces, more noncompete and exclusivity clauses are being required.

"Fortunately for us, where we've been having a little bit of the advantage in some of these cases with us being Mediterranean is we don't run into that," Schroeder said. "A lot of times what landlords enjoy about us is if they lose a pizza or burger place, they can bring us in and they're not impacting their existing tenants."

W Partners acted as the exclusive financial adviser to Luna Grill in its debt and equity capital raise.

The restaurant industry was forced to reinvent itself during the recession as companies cut costs on the expense side of the ledger, said Tim Halverson, founder and managing partner at **Halverson & Co.**, an Encinitas-based accounting firm.

With consumer spending back up, restaurants are reaping rewards, but there are some challenges that are going to be even more difficult – notably, the increasing minimum wage in Los Angeles, and perhaps, in the rest of California.

"It's going to be a continued difficult state in which to do business," Halverson said.

Kelley said the vast majority of growth for Paradigm's restaurants is outside California.

Minimizing waste and food costs are also going to become more important, Halverson noted.

Supply-and-demand principles should also help lower the costs of healthier offerings at restaurants to reflect changing preferences.

Luna Grill has focused on healthy offerings since its inception, but 10 years ago, it was much more difficult to find a sufficient volume of organic produce at fair prices to sustain the restaurants.

With increased interest from other restaurants, producers are changing production to focus more on these items, Schroeder said.

"While it is more expensive, what we've seen as more and more concepts start moving toward that, as producers see there is a demand for it, a market for it, they're willing to produce more, which in the long run, if you get the production up, it will help bring the costs down," Schroeder said.

The distinction of healthy restaurant meals may fade as offerings blend into the rest of a menu as more diners opt for those meals, Halverson said.