
Brentwood Associates: Smaller is Better

This is the first in a series of occasional articles that examine how private equity firms acquire and manage their restaurant portfolios.

"If the concept is relevant and has extraordinary unit economics, Brentwood [Associates] will look at smaller situations."—Managing Director Amy Forrestal of Brookwood Associates.

"Brentwood tends to focus on earlier stage, higher growth type companies."—Managing Director Damon Chandik of Piper Jaffray.

"Brentwood has been willing to pursue acquisitions maybe considered a little too small by other firms."—CIT Managing Director Bob Bielinski.

So how does the consumer-oriented private equity firm itself think about its four restaurant assets?

"We've been fortunate that some really interesting [concepts] have crossed our radar," declares Managing Director Rahul Aggarwal. "We try to be nimble and react to situations as they come, as opposed being didactic and saying there's only going to be x-number of retail or catalog businesses or restaurants in our portfolio."

The firm demonstrated its nimbleness last year by adding to two women's online catalogs to a portfolio of mostly mid-market consumer companies within months of each other.

Since 2011, Brentwood has acquired three restaurant brands and sold one. It added its latest restaurant company in July, acquiring a large stake in Huntington Beach, Calif.-based Lazy Dog Restaurant & Bar with its latest fund. The 12-unit full-service brand was founded in 2003. Brentwood also owns 20-unit Veggie Grill and the 90-unit Zoe's Kitchen, plus big Yum Brands franchisee K-Mac Holdings.

Brentwood sold Pacific Island Restaurants to Nimes Capital late last year, after acquiring the 80-plus unit franchise, which operates Taco Bells and Pizza Huts in Hawaii, Guam and Saipan, in 2004.

Restaurants nonetheless appear to be the safer bet today for a firm that has typically acquired small- and medium-size companies since the early 1990s. That's because, Aggarwal reasons, restaurants are not exposed to the same kind of "disruptive business models" (read: online) that continue to undermine brick-and-mortar retailers.

Restaurants, after all, provide an experience and a product that's produced on-site. To date, no Internet entrepreneur has figured out how to do that virtually and deliver it to a customer. "So there's sustainability as the result of being what they are and being safer in an economy where some businesses are being turned on their ear every day," he says.

The economy, however, is a different story – and one that doesn't look promising for foodservice operations. Same-store

sales dropped two-tenths of a percent in August, compared with a 1 percent drop in July and flat sales in June, reported Black Box Intelligence, a restaurant benchmarking company. The Bureau of Economic Analysis reported that disposable income, on which restaurants depend, had inched up just two-tenths of a percent from March to July.

Yet Aggarwal remains upbeat, arguing the risk of owning restaurants "is not quite as correlated with GDP as you might think." He cites differences in commodities, consumers, and geographies, which attenuate the impact of an up-and-down economy.

"We don't want an entire fund of restaurants by any stretch of the imagination," he declares, adding that of the firm's 11 companies in Brentwood's last fund just three were restaurants.

But the firm's partners do want to latch onto what Aggarwal describes as share-taker and new-guard brands. "We are much more focused them," he says. Enter Lazy Dog, the first full-service restaurant Brentwood has backed. But investing in a budding casual-dining chain when that segment's performance has been dismal since 2009? Aggarwal concedes that from the outside the concept could be mistaken for a mass-casual-dining eatery "with a slightly better build out."

However, he adds, inside Lazy Dog there's "a very inventive menu with a lot of interesting flavor profiles that you don't see at this price point. Its multiple dayparts work for families, foodies and people going out on a date. We are in the very early innings of how great this concept is." Aggarwal declined to share its four-wall unit economics.

Investment bankers claim the private equity firm doesn't invest in restaurants that have less than "extraordinary" growth prospects and ROI. Forrestal, who represented the sellers of Zoe's Kitchen, cites cash-and-cash returns of 50 percent or better. The Mediterranean fast-casual, for example, had 19 units when it was acquired in 2007; today it boasts 90 company-owned and franchised outposts.

Aggarwal maintains that while unit economics are certainly crucial they don't predict future performance. As important is the company's management. "Is there a team here that can open stores effectively? Because unit economics change every time you open a new store. Both concepts Veggie Grill and Lazy Dog are in Southern California, but the thesis is they will open more stores not in Southern California. So all that matters as opposed to just can we get a cash-on-cash return that makes sense. That isn't a totally sustainable strategy."

"They'll need 20-30 [Lazy Dogs] before they know anything, or get some G&A leverage," says consultant John Gordon of Pacific Management Consulting Group. "They are smart financial types yet seem to recognize they need operators on board. They are founder- friendly."

— David Farkas