

## Restaurant Research Think Piece – August 2009

### Unprecedented Unit Level M&A and Credit 1H09 Trends

Our discussions with the 7 largest players in franchise finance restaurant appraisals reveals dire M&A and credit conditions for industry operators during 1H09. Please learn more about our recently issued report on Unit Level Valuations @ <http://www.chainrestaurantdata.com/industry-data-reports/>.

Advanced Restaurant Sales, LLC	The Cypress Group	Hopkins Appraisal Services, Inc.	National Franchise Sales	Praetorian Group	Sohlen Franchise Advisors, LLC	Valuation Associates
Rob Hunziker	Dean Zuccarello	Brock Rule	Alan Gallup	Gene Cerrotti	Hans Sohlen	Ed Karabedian

*Please note answers below do not follow alpha order of above survey participants.*

#### 1. Your estimate of the y/y percentage change in industry wide acquisition transactions for the first 6 months of 2009?

Down at least -50%.	There has been a 30%+ decline in the number of transactions in the first half of 2009 as the difficulty in finding debt financing has protracted deal time. However, as buyers and sellers become more astute as to adaptive strategies for acquisitions and divestitures, more deals are in the works for the second half. Perhaps not at the level of activity we saw in 2007, and certainly not at the multiples we saw then, but generally more than we saw in late 2008.	Down -30%.	On the real estate side we have seen drops of at least -50% 2008 to 2009	Down -70%.	Down by over -70% percent.	Down by -25%.
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#### 2. Your estimate of the y/y percentage change in industry wide refinance transactions for the first 6 months of 2009?

Down at least -50%. Does a workout count? If so, volume is down less.	The re-financing element is nearly all confined to restructuring of established lender clients, with either significant embedded equity, or distressed ownership. Overall, the refinancing is off by 30% or more.	Down -50%.	More than half the refi transactions we analyzed during the prior six months were not completed.	Down -60%.	N/A	Unchanged.
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#### 3. How have equity requirements changed over the last 6 months?

LTV is now 65% to 70%. Was 75% to 80%.	Equity is playing a greater role than it has in over a decade. If deals in the 2003 to 2007 era could be characterized as 20% equity, the '09 environment is going to be in the 25% to 35% range, not counting the cross-collateralization into embedded equity. Interestingly, it is now not only buyers that have increased equity requirements, but often sellers require sufficient equity in order to carry a portion of the buyers debt after meeting selling costs and lender payoffs.	Doubled to tripled (now 25% to 40%).	We have seen lender requirements go from 10-20% to as high as 35% through a combination of declining values and higher ratios.	Equity for new unit development has increased dramatically. The norm seems to have moved from 20-30% to 30-40%. Equity for transactions has not necessarily been dictated by an absolute, targeted percentage. It is more controlled by purchase price and leverage. There are some deals that can get done with little equity in connection with a forced sale. We are also seeing buyers use 100% equity just to get a deal done quickly given the opportunities in the market. However, on a grand scale, we are seeing equity as a percentage of the total capital structure increase. I would estimate an average to be 25% to 40% equity / capitalization.	Gone from 20 percent to 25-40%.	Dropped slightly to 25%.
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**4. Please provide any color you can on changes to capital access and loan terms.**

<p>Interest rates are now 7% to 8.5% and amortization terms are shorter. The big banks (WF and B of A) are starting to do deals--but they are cherry picking and doing fewer deals with lesser dollars. Small banks have now pulled back--they became active 6 months ago.</p>	<p>Access to debt capital is largely being limited to established lender clients with impeccable compliance, strong ratios, and significant embedded equity. Interestingly, we are seeing larger operators divest unproductive assets in order to access the associated unproductive equity, and to parlay that equity into more synergistic enterprises, geographically, or by brand associations. Buyers are also seeing this near bottom valuation, and poor returns on liquid capital, as an opportunity to capture strategic acquisitions at good prices. As such, we are seeing nearly one in three deals as no debt acquisitions. Finally, sellers are also seeing an opportunity to improve their returns and balance sheets by selling, and using their equity as the buyer's bank. In many instances, due to poor operations, bloated G&amp;A, or poor synergy, the returns are greater than the business ownership provided. Further, it may bring existing core business debt back into compliance, thus freeing the former owner of loan penalties.</p>	<p>The number of traditional national lenders have shrunk drastically. Some regional banks are showing up selectively but at 2-2.75X EBITDA - not what this marketplace has been used to working with. Real estate assumptions are taking a similarly cautious turn. Cost of money is very competitive when compared to the last five years. Structure (amortizations) are much less cash flow friendly compared to the last five years. Leverage tolerances reduced by 25-40%. Not a very pretty picture. New unit growth will slow even further from current trickle. Further franchisee consolidation likely. Most deals must factor in capital upgrades (remodeling) that franchisors will require to approve transfers among franchisees.</p>	<p>Capital access is limited to the best borrowers and/or investors, that have existing bank relationships. Investor equity capital is severely limited and will remain so near term.</p>	<p>Access to debt capital has been reduced significantly (~60%) given a confluence of factors brought on in the current recession. All economic and other terms, not just loan terms, have become more conservative as lenders critique restaurant credits in ways not done over the last several years. Overall, the large household names have slowed their origination dramatically, but some smaller players are taking up some of this opportunity. We do expect capital access to improve over the next 6 months and particularly over the next 12 months.</p>	<p>No new portfolio loans available. The only portfolio loans being done are with each company's existing clients. Also, there are cash plus mezzanine deals being done. Minimal amount of SBA loans available.</p>	<p>GE and other major lenders are tightening on terms. This has opened up new avenues for innovative capital sources that may or may not work out.</p>
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For more information please contact us at (203) 405-1901 or [info@ChainRestaurantData.com](mailto:info@ChainRestaurantData.com) with questions related to this report.

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