The Zombie Restaurant Brand Collectors

Zombie movies and TV shows are big business around the world. The Walking Dead TV series for example is a huge success in the USA and is now into its 10th season. Most Korean readers will also remember the 2016 film, Train To Busan, when a zombie apocalypse breaks out in the country and threatens the passengers.

Some commentators also refer to "Zombie ideas" which are opinions held by politicians that continue to survive year after year even after evidence has shown that they just don't work. In other words, the ideas are virtually impossible to kill. The best example that is often cited by commentators in the USA is the Republican party view that tax cuts for the rich pay for themselves with increased revenues to the government, which apparently has never been proven to be correct.

There are also plenty of zombie restaurant chains all over the world which seem to survive year after year despite poor performance, many kept alive with debt provided by junk brand collectors and private equity funds. Let's take a look at some examples to show that this trend is still alive and well in the USA.

Recently, Fat Brands Inc., has been in the news with the acquisition of Johnny Rockets, the retro burger chain that has seen hard times. Fat Brands is a collection of very mediocre restaurant concepts supported by high debt. It is doubtful that many Americans would shed a tear if any of these concepts simply were killed off. There are simply too many similar brands that would fill the demand for burgers, wings, tacos and steaks. The group has three burger brands - Fat Burger, Johnny Rockets and Elevation Burger, all of whom have run into financial trouble over the years and none with any market leadership.

Ponderosa Steakhouse is a low price family restaurant chain founded 55 years ago and has been losing market share for over

30 years to brands like Outback Steakhouse, Texas Roadhouse and Longhorn Steakhouse to mention a few. Wingstop is the clear leader in the chicken wings category in the USA, but Fat Brands owns two wings concepts with limited scale – Hurricane Grill & Wings & Buffalo's World Famous Wings none of which are famous. So, what is the logic behind accumulating such a ragtag group of brands?

The answer is financial engineering. The company has raised money with some innovative high yield debt which pays as much as 8% to investors. In the old days these were referred to as "junk bonds." The restaurant industry is a low margin business and piling on high yield debt to a low margin business is not generally a wise idea. The company is betting that they can generate enough cash from the brand portfolio to cover the debt and benefit from a higher share price. The company which trades on the NASDAQ exchange (FAT), has a market capitalization of $74 Million, negative earnings per share (EPS) and pays no dividends. This story will probably not end well for either the share or bond holders.

Another interesting example is Brix Holdings, Inc., owner of a brand familiar to most Koreans, Red Mango. Brix is a collection of many zombie brands that have seen better days – Smoothie Factory, RedBrick Pizza, Souper Salad & Greenz. They were recently in the news for buying Friendly's family restaurant group for only $2 Million out of bankruptcy. Friendly's lenders wrote off $88 Million of debt and the brand has reduced their footprint in the USA by almost 70% to only 130 locations today. The company was founded in 1935 and has been in distress for at least the past 25 years. It is the ultimate zombie restaurant brand!

A final example is Pandya Restaurant Group, owner of Boston Market, which recently bought Corner Bakery from Roark Capital. Boston Market's previous owner, Sun Capital, a private equity fund, has been selling off its restaurant holdings recently, after doing highly leveraged buy-outs. Boston Market was a high flyer in the mid 1990's when it went public and considered an innovator in the home meal replacement business. The brand has been bought and sold several times and never recovered its early luster. Corner Bakery was another innovative concept in its time. Developed by Brinker International around the same period as Boston Market, it sold high quality sandwiches and salads but the price points were not affordable to the broad middle class, and never reached its potential. Pandya Restaurant Group's founder is Jignesh Pandya, a real estate investor and restaurant operator. Apparently, he feels he can revive both brands to a degree necessary to turn a decent profit on his investments. The jury is still out!

Why is there so much interest in old brands that have experienced uneven success during the past 5~10 years? The answer is usually money. There is plenty of it around to lend and invest. Interest rates are pretty much zero or negative in most countries. All investors are looking for yield and many are apparently willing to take the risk on restaurants because of the cash flow. Even average restaurant brands can generate reliable cash flows if they are in smaller cities with less competition. The owners rarely spend money on renovations so the facilities are usually rundown. Poor looking facilities hurt a brand's image and usually lead to negative same store sales growth.

These zombie restaurants will be around for a long time as they are continually bought and sold by investors looking for returns. As one can see, it is very hard to kill a restaurant chain no matter how hard one tries!