Investor Seeking a Value Meal in the QSR Space

UPDATED: CKE Restaurants Inc. Receives Alternative Takeover Bid

Transaction Update

On April 7, 2010, CKE Restaurants, Inc. (NYSE: CKR) announced that it had received an alternative takeover proposal to acquire all outstanding shares of CKE from an unnamed buyer. This offer, purportedly from private equity group Apollo Management, comes on the heels of a previous offer from private equity firm Thomas H. Lee Partners (THL) to acquire CKE for $610 million in cash plus the assumption of $309 million in debt, or an estimated 6.0x LTM EBITDA.

CKE first came into play on February 26, 2010, when the company announced that it had signed a definitive agreement to be acquired by THL for $11.05 per share, or a 24% premium to CKE's undisturbed stock price prior to the THL deal announcement. The THL offer included a 40 day "go shop" provision, which allowed CKE to actively seek out superior offers from interested parties. At the "go shop" period expiration, CKE announced it had surfaced a superior offer and qualified the potential buyer as an "Excluded Party", allowing CKE to engage in further negotiations and discussions with the new potential buyer until April 27, 2010.

As mentioned in TM Capital's previous deal spotlight on the CKE – THL transaction, we felt that THL's valuation of CKE was modest when considering where QSR comparables were trading, recent M&A transactions and CKE's historical share price performance, leaving room for a superior competing offer. Although CKE's share price traded at a premium to THL's $11.05 offer during much of the "go shop" period, indicating that the market initially foresaw a new buyer emerging, CKE's stock price subsequently settled back around the $11.05 mark where it stood near the end of the 40 day period.

It is our belief that the case for increased restaurant company valuations, and specifically a higher value for CKE, has only strengthened since the THL definitive agreement was signed. With the S&P 500 up 8.3% and the Consumer Discretionary Index up 10.5% during the same time period, it is evident that investor confidence in the US retail sector continues to rise.

TM Capital Commentary

Industry Observations

The restaurant industry has seen a dramatic increase in M&A activity since THL's February 2010 offer for CKE. Lee Equity Partners' pending acquisition of the Papa Murphy's take and bake pizza chain appears to have attracted a healthy valuation due to the significant growth potential of the brand and a hotly contested auction process. Similarly, Brinker International's (NYSE: EAT) decision to sell its On The Border Cafe concept to Golden Gate Capital at a gain in order to focus on its core Chili's operations also appears to have carried a healthy multiple. Additionally, Wingstop Restaurants announced this week that it has been acquired by Roark Capital Group for an undisclosed amount. Reports have also recently emerged that several other casual dining concepts are pursuing strategic alternatives, including rumors that California Pizza Kitchen (Nasdaq: CPKI) and Hooters of America, Inc. have been exploring potential sale transactions.

In addition, we've seen two existing restaurant takeover offers raised as a result of rising industry valuations and investor optimism. On March 30, 2010, PE firm RDG Capital reportedly raised its buyout offer for Japanese steakhouse chain Benihana (Nasdaq: BNHN.A) from $7.00 to $8.00 per share (valued at 6.1x LTM EBITDA). Additionally, Levine Leichtman Capital Partners had previously extended its October 2009 unsolicited bid for fast casual chain Rubio's (Nasdaq: RUBO) through the end of March 2010 and raised its offer from $8.00 to $8.50 per share (valued at 6.4x LTM EBITDA).

Future Implications

We believe that the first quarter of 2010 provided many potential restaurant investors with the reassurance of a stabilizing retail sector and the potential for significant upside in terms of consumer spending intentions. As evidenced by THL and Apollo's interest in CKE as well as Roark's acquisition of Wingstop, QSRs remain an attractive investment in a challenging top line environment given the sector's strong, stable cash flows and favorable risk / reward scenarios. Moreover, CKE has recently traded at a discount to its QSR peers due in part to the brand's relatively premium positioning and store concentration in the Southern California region that has been affected disproportionately by the recession. We believe THL's initial offer and Apollo's overbid also signal a bet on macroeconomic recovery and increased investor interest in geographies that were hardest hit by the recession.

Many sources of private equity we talk to are increasingly interested in taking advantage of tremendous opportunities in the commercial real estate market to expand healthy fast casual and casual dining concepts that have weathered the recession. It is our belief that such fast casual and casual dining restaurants are often the first to achieve material sales gains coming out of recessionary environments. By capitalizing on favorable lease rates, growing, healthy brands such as Papa Murphy's and Wingstop should be able to effectively expand into attractive locations in new markets and generate a significant return on invested capital, validating a premium purchase multiple.

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