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After Rejections, Adjusting Pitch is the Key to Gaining Equity

In one room are the hopefuls, eight anxious entrepreneurs pitching their concepts to attract private equity investors at the Restaurant Finance & Development Conference.

Each has something to offer but also a flaw, in one case an awkward reference to the CEO's wife and chef/business partner as the "Bangkok Sparkplug," as one restaurant critic nicknamed her, apparently unaware some would call that a slur. "Basically I'm here to sell my wife," says the CEO to nervous laughter from the crowd. "Well, not in that way."

In two other rooms are the victors, half a dozen entrepreneurs who have raised private equity for a number of concepts in several rounds. Smooth and confident, they tell harrowing stories about the days they sought money in vain.

How to get from one group to the other? The short answer is repetition. "I think we got rejected 10 times for every person who said sure," says Mitch Roberts, CEO of PR Management Corp., a multi-unit Panera Bread franchisee in New England.

You read that right: A Panera Bread franchisee once had trouble attracting capital, when today that brand has the Midas touch. But this was in 1997 when stocks were rising 30 points a year. "I didn't blame them. If we'd had money, we would have put it in the market, too," Roberts says.

Another entrepreneur, John Pepper, couldn't convince anyone to invest in Boston-based Boloco even though his company captured second place in his college business plan competition. "They gave us the prize and then left us," says Pepper, now CEO of a hot concept with an enormous Twitter following. "You can locate investors, but you have to be able to take rejection."

The more complex answer is adaptation. CEOs who ultimately succeed begin to modify their approaches to meet investor desires. Roberts, for example, focused on debt reduction because that was important to his early backers who guaranteed loans. Pepper still finds ways to satisfy his first investor, who to this day is involved with the brand down to designing signs in the restrooms.

Adaptable founders were a key attraction for Nick Marsh, who invested and became CEO of Chop't Creative Salad in New York. Started 12 years ago, it boasts a 20 to 25 percent annual growth rate. "The guys who started Chop't—they're genius creative guys who were willing to listen. That's how we got involved," says Marsh.

"The lines were around the block" at Chop't, says Marsh, noting a theme for private equity investors. They want best in class on all the measures, major consumer demand and numbers like this, according to one player: $750 per square foot in sales; $300 a foot cost to build; 18 to 20 percent unit level cash flow; cash-on-cash return on investment "north of 40 percent."

Another investor, Jon Owsley of Catterton Partners in Greenwich, Connecticut, says his firm's criteria for investing starts with food. "How craveable is the food? How broad is the appeal? Is there a great aesthetic that fits with the offering? How replicable is it?" he says. Management teams, too, get lots of scrutiny.

Each category of investors has its own set of general expectations. First is friends and family, and until concepts get to 10 stores or so their owners would do well to stay here. "It's easy to boil down who your targets are" in this stage, Marsh says. "Anybody who has the same last name as you."

Everyone laughs, but it's a serious point. Companies that try to attract private equity too early may at best waste time. "Under 10 restaurants there is no private equity for you, no matter what anybody says," says Lou Katz, attorney at Ruberto Israel Weiner in Boston. At worst, they risk running out of funds before executing their growth plan.

Russ Stein, also at Ruberto Israel, says when clients do private equity transactions in the 10- or 12-unit stage, "it's never enough money to implement your growth strategy to get to your liquidity event," he says. "And then you have to go back to the private equity firm, because you can't sneeze without their consent."

The next stage is angel investors, those high net-worth individuals who often have a particular passion for your company. They may take an equity stake or make or guarantee loans or a combination. "Try and avoid the bells and whistles that you know are going to come from the sophisticated investments," Stein advises. "The more terms that you give in the early stages, it may get tougher for the later investors who come on."

The top tier, the holy grail for so many entrepreneurs, is private equity, for companies seeking at least $5 million and where matters of control loom large. "For sure when you get to a large check, those investors are going to want control of the business," Marsh says.

To Greg Dollarhyde, CEO of VeggieGrill, a fast-casual concept on the West Coast, the most important task is to match the stability of the capital to the risk in the concept. If funding an established, predictable brand, more debt in the deal will work well.

But with a new chain, say 10 units that you want to take to 30, "the chances to fund that with debt are zero," he says. "At VeggieGrill we're not ready to take on debt, so we have to have patient equity on the table. You can screw up a company really fast with the wrong capital structure."

The road is worth it, Dollarhyde insists, for those pursuing private equity. "I know a lot of operators who are worried about giving too much away, and they miss out on doing something very big."

— Beth Ewen