HOPCAT - Privately held "Up & Comer'

Date : May 30, 2017

(Roger Lipton has recently been appointed to the Board of Barfly Ventures, LLC.)

HOPCAT

Barfly Ventures LLC was founded in 2008 by Mark Sellers (48), an experienced financial professional and at that point an aspiring restauranteur, in Grand Rapids, Michigan when he opened the now critically acclaimed ***Hopcat***. Over the next 4-5 years, while “fine tuning” Hopcat, Mr. Sellers opened three “one-off” casual dining (and drinking) establishments, namely Stella’s Lounge, Grand Rapids Brewing Company, and The Waldron Public House, then decided that Hopcat should be the expansion vehicle. Starting in 2013, the Hopcat brand has now been expanded to 11 (soon to be 12) locations in eight states. The brand recognition and approval has grown steadily. Serving 100-130 craft beers on tap, Hopcat has been judged the “3rd Best Beer Bar on Planet Earth” by Beer Advocate Magazine (multiple times), “Best Brewpub in America” by RateBeer.com, and has appeared on DRAFT Magazine’s list of Top 50 Beer Bars in America six years in a row. When a new store opens there are typically 400-1000 people standing in line waiting to experience the new location.

The concept (about 50-50 food/alcoholic beverage split) and, MOST IMPORTANTLY, the attendant corporate “culture” are particularly appealing to millennials and include an appealing burger/pub menu, their “world famous ‘Crack’-Fries”, and 100-130 beer taps. Only “craft” beers are sold: no Bud, Miller, or Coors. Each Hopcat has a unique interior design, ***portions of which can be viewed at www.hopcat.com.***

Relative to “The Culture”: Employees (and in turn the customers) are proud that 90% of all waste produced is composted or recycled, making Hopcat the largest restaurant chain in North America with that distinction. Employees are not required to wear uniforms, encouraged to be themselves, as one manager put it “to display our inner freak”. Employee turnover is well below industry norms, obviously a substantial asset in terms of maintaining customer loyalty. The customized musical playlist has been assembled by founder, Mark Sellers. My personal visits to several locations, and conversations with employees, as a “secret shopper”, have confirmed to me that this organization truly “walks the talk”. A burger is a burger, and lots of restaurants can serve craft beer, but I believe the organizational culture here may provide the greatest long term opportunity to differentiate the Hopcat “experience” from the increasingly commoditized world of casual dining.

Aside from the three “one off” locations that are still within Barfly Ventures, there are currently 13 locations, including the highly successful opening in February ’17 in Kansas City, and the even more impressive opening in Royal Oak, Michigan in May ‘17. The other 11 units are located in

Grand Rapids, East Lansing, Detroit, Ann Arbor, and Kalamazoo, Michigan. Outside of Michigan, they are in Indianapolis, Madison WI, Lexington and Louisville KY, Chicago IL, and Lincoln NE. Two additional locations will open in '17: Minneapolis in mid-year, St. Louis later in the year, with Port St. Lucie, FL being the 16th location very early in '18.

The store level and corporate economics are as follows:

At the store level: The first 14-15 Hopcat locations, including several that are under current development, will have averaged about 8,000-8,500 square feet, costing about $2.0 million in leasehold improvements plus $500,000 in pre-opening expenses (training is intensive). The average run rate volume of the 13 locations currently open is above $4,000,000, with a store level EBITDA of about 20%. Cost of Goods runs about 26%, fully loaded labor about 31%. The cash on cash return currently being generated is therefore at about $800,000 (20% of $4M) on an average total investment of $2.5M or 32% (40% excluding pre-opening, as most restaurant chains prefer to report it). Furthermore, the potential for returns is materially higher than that. Management feels strongly that the stores can be 10-15% smaller and generate the same sales levels, and pre-opening expenses can be reduced as well. The total investment is anticipated to be closer to $200 per square foot, than the $250-300 historical level. It is also noteworthy that the returns within Michigan are notably higher, on average sales of $4.8M with 23-24% EBITDA, than outside of Michigan with 15-16% EBITDA on $3.3M average. The two most recent openings, in Kansas City (KS) and Royal Oak (MI) will likely increase the average sales levels as well as store level returns. As an objective, management believes the store level EBITDA within (and close to) Michigan can exceed 25% of sales, with EBITDA further afield above 20%. The worst of the thirteen current locations is in Chicago, an obviously large market to impact with only one location, but even that location is expected to be cash flow positive in 2017. Aside from modestly reducing the store size and pre-opening expense, management feels that a backfill expansion strategy in adequately large markets, as well as moving concentrically away from the Michigan center will maximize operational efficiency and reach receptive customers who are already aware of the brand. Relative to same store sales trends: of the five stores that were in the comp base for all of '16, three were ahead in sales and EBITDA, while two were down slightly. Indianapolis (opened in late '14) had sales down (against the honeymoon period) but EBITDA was up, and downtown Detroit, opened in Dec'14, fell off from huge opening volumes in '15, but still had very high volume, with EBITDA over 20% in '16.

Overall Company Economics

All stores, including the three "one off" locations generated about $9.2 million of EBITDA at the store level in calendar 2016, which was 19.8% of $46.5M in sales. Store level EBITDA is expected to grow to $12.5 million or more in 2017 on a sales increase of close to 40%. Below the store level EBITDA line, depreciation runs about 5.0%, interest (on $21M @12%, which can be renegotiated after 8/17) runs about 2.5M, and corporate G&A was about 10.3% of sales in '16, budgeted at 8.7% of sales in '17, and projected to decline steadily as a percentage of sales. Internal cash flow, along with several million remaining on the current credit line, should allow for the scheduled openings in '17, 3-4 openings in calendar 2018, and steady growth from there.

Management

Mark Sellers, 48, is Founder and 40% owner of Barfly Ventures. He has a BA in accounting from Michigan State, and an MBA in finance from Northwestern University's Kellogg School of Management. Prior to founding Barfly, in 2007, in his hometown, Grand Rapids, Michigan, he had a successful career in finance at GE Capital and formed and was General Partner at hedge fund, Sellers Capital. He estimates he has been to 1500 bars, breweries, and restaurants in all 50 US States and 40 countries.

Mark Gray, 41, is CEO of Barfly Ventures. He has worked in the restaurant industry for 21 years. He started his career at On The Border as an executive kitchen manager for three years. He was then with Chili's for three years as a GM and Managing Partner for four years. He was then with the Yard House for nine years, working his way up from General Manager to Regional Manager and ultimately Director of Operations – Southeast Region. He joined Barfly as COO in January, 2014, and was promoted to CEO in late 2016. Married for 17 years, he has three children. He grew up in south Florida, spends the majority of his time at Grand Rapids, MI headquarters and traveling between locations, while still maintaining a residence in south Florida.

Lisa Miller, 48, CFO, has been with Barfly since 2010. A graduate of Miami University in Oxford, Ohio, she earned her CPA certificate in 1995. Prior to joining Barfly, she was in public accounting for 8 years, as well as property management for six years.

The Capitalization & Shareholders

In broad terms: The balance sheet reflects a current equity base of about $8.4 million, and $21 million of short to intermediate term debt. The equity base is (roughly) spread between founder, Mark Sellers (40%), a broad group of private investors (with about 38%), an institution affiliated with the primary lender (15%, including warrants) and the management team aside from Mark Sellers (7%).

Roger Lipton, author of the above article, has recently been appointed a member of Barfly's Board of Advisors.