Nation's Restaurant News

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Fast-casual pizza concepts raising dough

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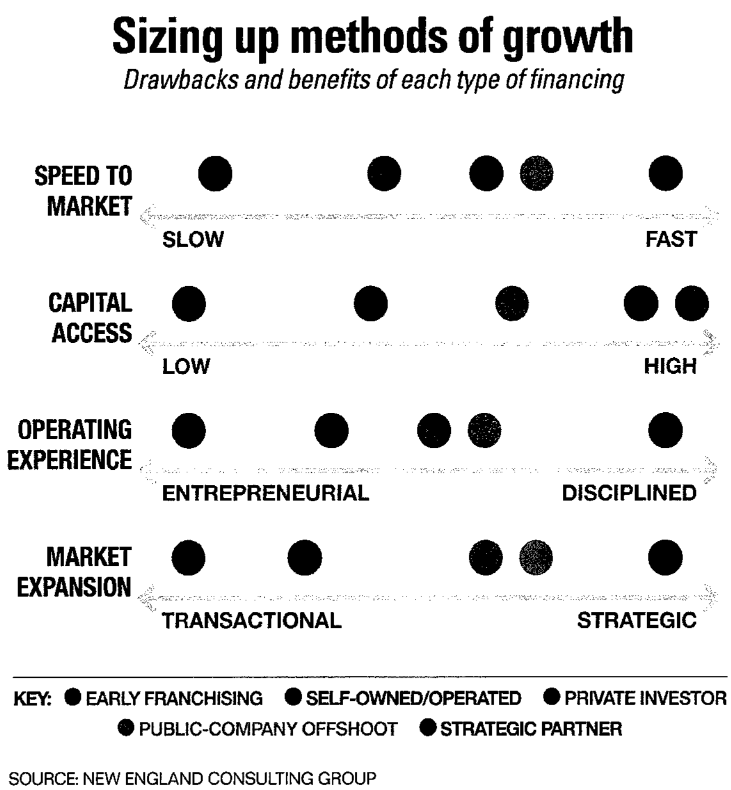
Up-and-coming segment players are financing growth through a number of methods

Over the past few years a hotter-than-hot niche has emerged within the $40 billion pizza space that many are watching with keen interest.

Dubbed fast-casual pizza, roughly two-dozen concepts already have surfaced with plans to take their build-your-own, single-serving pies to new markets nationwide.



But while their central offerings — customized, quick-to-cook pizzas — are similar, their plans for funding growth are not. Looking to jump-start development and snatch up real estate, some brands are launching early and aggressive franchising programs. Others are offering joint-venture deals, or taking on strategic partners or silent angel investors.

And even those that initially sought organic growth are revising their game plans to accelerate openings as the competition heats up.

"It's a land grab," said Rick Wetzel, co-founder of two-unit Blaze Pizza. "The stakes are huge. Who gets to own fast-casual pizza?"

Here's a look at how some contenders are fueling their efforts:

Early franchising

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Chipotle Mexican Grill, the 1,410-unit chain whose success many fast-casual concepts aspire to emulate, tried franchising in its early days and later scrapped the idea. But that's not keeping some fast-casual pizza players, whose service is modeled after Chipotle's, from trying it.

Rather than taking a more traditional route and opening corporate locations in several markets to prove the concept's viability before launching a franchising program, Blaze jumped right into it, signing its first franchise agreement just months after its two company-owned units were open.

The first Blaze opened in Irvine, Calif., in August 2012, and a second debuted in October in Pasadena, Calif., where the company is based.

"I'm a franchise guy," said Wetzel, who is building Blaze with his wife, Elise Wetzel. Wetzel also co-founded the 250-plus-unit Wetzel's Pretzels franchise chain, also headquartered in Pasadena. "This is familiar, comfortable territory for us."

With the pretzel concept, Wetzel followed a more traditional route. The first five locations were company owned.

"But they chewed up cash like crazy, and we saw we could build faster with someone else's money," he said.

The two company-owned Blaze locations "went into the black instantly," Wetzel said, and have weekly sales of roughly $35,000. He noted that he could not elaborate on sales results because of the franchise plan.

The plan is to grow through franchising alone, Wetzel said, noting that 56 Blaze locations are in development and that fast-casual pizza pioneers, such as the 5-year-old MOD Pizza concept based in Seattle, have already proven that the business model works.

Blaze also has some big-name investors, including California's former first lady Maria Shriver, Boston Red Sox owner Tom Werner and professional basketball player LeBron James. Their support has helped the Wetzels build a franchise development team with deep experience and attract some heavy-hitting franchisees, Wetzel said. Among them are Levy Restaurants founder Larry Levy, who has signed on to open Blaze units in Chicago and Miami, and Lessing's Hospitality Group, which is developing 10 units in New York and Connecticut.

John Walch of Walch Hospitality Group, based in Milwaukee, built and sold 25 Panera Bread locations before signing on to open six Blaze units in Milwaukee and Madison, Wis.

Walch said he was attracted to Blaze because of the integrity of the product and process, as well as the quality of the franchise team.

"I think the segment is proven," said Walch. "I could have waited three years for them to show it works, but by then there might have been that many more competitors out there."

Still, franchise consultant Michael Seid, managing director of MSA Worldwide in West Hartford, Conn., warned that franchising too soon can be risky, no matter how experienced the operators.

Issues such as seasonality, marketing, supply flow and "whether or not a piece of equipment would work better if moved from left to right" take time to work out in a way that can be sustainably replicated, he said.

"When the franchisor doesn't know except theoretically what their brand concept is, then it comes down to pure luck," he said. "The franchisee is not the lab rat. Knowing franchising and knowing your brand are two different things."

Joint ventures

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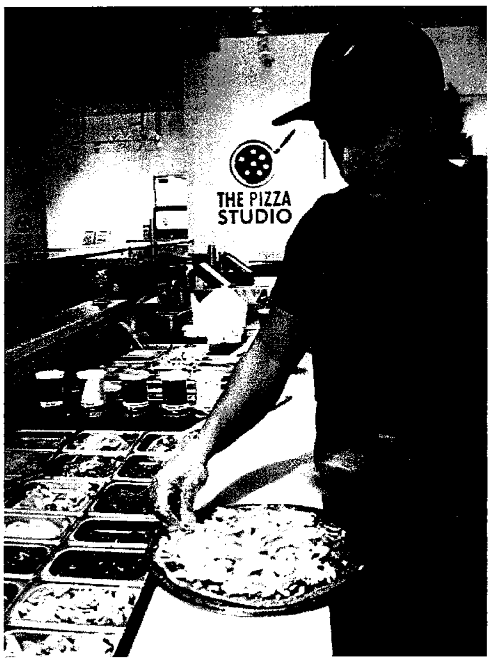
The Pizza Studio, which launched earlier this year and has only one unit in Los Angeles, also is rushing to franchise — but through joint-venture partnerships.

The concept, developed by former venture capital fund manager Samit Varma and former Wolfgang Puck Express Licensing executive Ron Biskin, has signed with Lloyd Sugarman, one of Johnny Rockets' largest franchise operators, in a deal that would bring 12 Pizza Studio units to Massachusetts, Rhode Island and Connecticut over the next three years.



Pizza Studio also has funding from Austin, Texas-based venture capital firm Mastodon Ventures Inc. and Anthem Venture Partners of Santa Monica, Calif.

Two more corporate Pizza Studio locations are scheduled to open in the Los Angeles area this year, with a fourth planned for early 2014.

"We'll continue to do corporate stores; we'll do a mix," Biskin said. "You want to secure the best real estate opportunities out there before someone else does."

Seid of MSA Worldwide said he sees joint ventures, where the franchisor invests capital along with the franchisee, as a viable option for securing top-notch operators who may not have the money to get restaurants open.

But he warned that the agreement should be well-structured to protect both parties.

Franchisors could be at risk because of bad decisions by the franchisee, he said. And franchisees could end up operating more like employees of the franchisor, which is not the intent.

"The beauty of franchising is that you're leveraging the local knowledge and entrepreneurial drive of the franchisee," he said. "But the problem with a joint venture is that they can be difficult to get out of because they're a partnership."

Strategic partners

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Three-unit PizzaRev is not only following Chipotle's service model, but its early growth model, too.

Based in Los Angeles, PizzaRev was founded in April 2012 by former Clear Channel Communications executives Irv Zuckerman and Rodney Eckerman, along with their respective sons. In March Buffalo Wild Wings Inc. announced that it had acquired a minority stake in PizzaRev, stating the concept had big potential for growth.

The investment is reminiscent of Chipotle's early days, when McDonald's in 1998 invested in the then-5-

year-old, 16-unit chain. With the strength of the QSR giant behind it, Chipotle grew to more than 500 units before McDonald's divested it in 2006.

Wall Street analysts said the PizzaRev investment is a smart strategic move that could leverage Buffalo Wild Wings' existing infrastructure of distribution, real estate and even franchisees.

"One might argue that the fast-casual 'better-pizza' space is getting crowded with similar operators," wrote analyst Conrad Lyon of B. Riley & Co. in a recent report, "but we have yet to see any operator scale its brand and garner any critical [market] share as of yet."

And that's where PizzaRev may have an advantage, Lyon continued.

"Conceivably, PizzaRev has the ability to scale fast and first [in order] to attain a dominant position and brand awareness with the support of [Buffalo Wild Wings]," he wrote. "And this support should aid in reducing operational errors."

It's too early to get excited, he added, but the investment positions PizzaRev for growth and gives Buffalo Wild Wings a stake in a chain that will likely be popular with Millennials.

Zuckerman said, however, that the deal with Buffalo Wild Wings was not undertaken to rush growth. The chain has two more restaurants under construction, with "several more" in stages of development for 2013, he said.

"At PizzaRev we are not in a hurry on any level," he said. "Our goal is to create the most complete model in this space and improve on it each and every day."

When PizzaRev launched last year, Zuckerman said franchising was not likely. Now, however, the company is actively developing a franchise program, he said.

Wetzel of Blaze said he sees PizzaRev as "a fine contender, but they've sealed their fate that they'll have to go the way Buffalo Wild Wings wants them to go. As an entrepreneur it's very early to throw that card."

Others said the success of such partnerships depends entirely on the partners involved.

"The divorce rate can be high," said Gary Stibel, founder and chief executive of Norwalk, Conn.-based New England Consulting Group. "Just as Chipotle got stronger under McDonald's, Boston Market got weaker under McDonald's."

Cash flow, with help

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MOD Pizza was one of the first fast-casual pizza concepts with the walk-the-line — or as they call it, Made on Demand — model when its first location opened in Seattle in 2008.

The eight-unit chain this year will open its first restaurant outside Washington near Portland, Ore., and will also move into the Los Angeles market.

Then the pace will pick up significantly, with MOD doubling its unit count to 16 before the end of 2013 and doubling again in 2014, mostly with corporate-owned locations.

Scott Svenson, MOD's founder and CEO, said the company's growth has been somewhat slow because "we wanted to develop out the concept to make sure we had something we could scale."

Now the company has a solid foundation of knowledge on how to execute, he said. The restaurants have average unit volumes of about $1 million per year.

Though the primary focus will be growing company-owned locations, MOD is exploring the idea of franchising.

"We wouldn't do it broadly, but we're thinking of trying to identify a small number — maybe a dozen — of established, sophisticated operators to partner with in new markets," Svenson said.

"We're operating in a niche that has a lot of activity and, if we are going to build the brand, we're going to have to do it more quickly," he added. "There will be some markets where a local partner might be able to do it better than we could."

So far, MOD has grown organically with funding from Svenson and his wife, Ally, who also built the Seattle Coffee Company in the United Kingdom before selling it to Starbucks in the late 1990s. MOD Pizza has no debt, he said.

Though franchising may be a "more capital-light approach to growth," brands that franchise too early are likely to meet with added challenges, Svenson said.

Public parent

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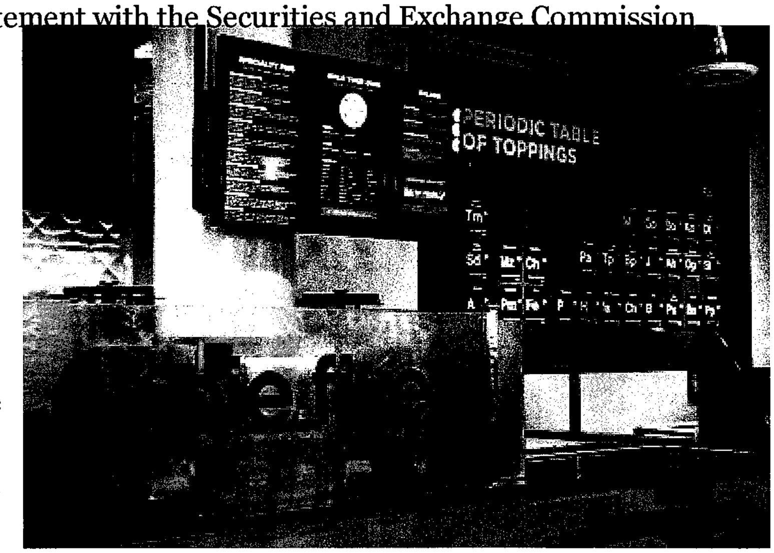
Pie Five Pizza Co. is one fast-casual player that was born into a pizza family.

The brand is being developed by Pizza Inn Holdings Inc., a publicly traded operator of the buffet concept Pizza Inn, based in The Colony, Texas. Pizza Inn, with more than 300 units, has been in the business since 1958.

First launched in 2011, the nine-unit Pie Five is growing both through company-owned locations and franchising. The first franchise location opened in April in Salt Lake City, and the company said 38 units are in development in Utah; Florida; Charlotte, N.C.; and Kansas City, Mo.

Earlier this year, former Applebee's president and CEO Dave Goebel and his sons signed on as franchisees of Pie Five with plans to develop 10 units in the Kansas City area.

In May the company filed a shelf registration statement with the Securities and Exchange Commission seeking approval to sell up to $3 million in common stock to continue developing company-owned Pie Five units in the Dallas-Fort Worth area and other markets.



Jerome Trojan III, Pizza Inn Holdings' chief financial officer, said activity in the space has heated up significantly over the past six months.

"We always expected competition to emerge," he said. "I wouldn't call it a land grab, but we do want to move forward as quickly as possible with both company and franchise locations."

Lyon, the analyst with B. Riley, said tapping the public equity market is a nice option to have, but it could indicate a relative weakness of cash flow.

Most companies would secure credit lines or facilities to develop company-owned locations, which generally have a lower cost and fewer control issues, and come with a tax benefit — without diluting stock for existing shareholders, he said.

For Pizza Inn Holdings, the filing "is a reflection of the relative weakness of cash flows versus larger, more established growth companies, and that raising debt-financed capital would likely be expensive," he said.

"If not for the strength and potential of the Pie Five concept, I'm not so sure the company would be able to pull off the equity raise," he continued. "In fact, it's likely it's the potential of Pie Five that elevated shares to frothy levels and contributed to the decision to sell shares while it's hot."

Individual investors

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Some other fast-casual pizza concepts have attracted deep-pocketed investors, such as 800 Degrees in Los Angeles, which opened in January 2012 and is one of the few players that is not planning to franchise at this point.

The concept was developed by Umami Burger founder Adam Fleischman along with former fine-dining chef Anthony Carron and restaurateur Allen Ravert.

Last month, the group received an injection of $7 million in minority equity financing from a fan who asked not to be named.

The funding will be used to accelerate growth throughout the Los Angeles market, with the goal of opening 10 units by the end of 2014.

Also backed by an individual investor is the two-unit Project Pie. The concept — which was developed by James Markham, who also worked on MOD Pizza and two-unit Pieology, based in Fullerton, Calif. — has plans this year to open seven locations that will be a mix of company and franchised units.

Project Pie, like other fast-casual pizza brands, also is casting its sights overseas. It has an agreement for 50 locations in the Philippines.

And 10-unit Top That! Pizza, based in Tulsa, Okla., has a franchise deal to open units in the Middle East.

Meanwhile, Consumer Capital Partners, the private equity fund behind the Denver-based Smashburger burger chain, was expected to unveil a fast-casual pizza concept called Live Basil in Denver in late May.

But even as the race intensifies, there's room for all, said Blaze's Wetzel.

"We'll all coexist just fine," he said.

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