



54TH ANNUAL IFA LEGAL SYMPOSIUM



IFA[®]

INTERNATIONAL FRANCHISE ASSOCIATION



Basics Track

Franchise-Related Mergers & Acquisitions

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Speakers

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What Are We Going to Cover?

- Acquisitions of Franchise Systems
- Seller and Buyer Perspectives/Goals
- Valuation Considerations
- Diligence
- Key Definitive Agreement Provisions

Overview of the Deal Process

- Assess the seller's goals
- Who is buying?
 - Financial
 - Strategic

Overview of the Deal Process

- Get ready to sell
 - Working with a M&A advisor and Assessing Valuation
 - Operational; financial; legal
 - Process
- Deal Structures
 - Asset
 - Equity (direct or merger)

Overview of the Deal Process

- NDA and Letter of Intent
 - Non-disclosure agreement
 - Sellers may limit access to information
 - Letters of Intent are typically non-binding
 - exclusivity period is binding

Overview of the Deal Process

- Due Diligence
 - Structure of deal affects liabilities assumed
 - Level of diligence (and length of time to complete)
 - Buyer and seller diligence
- Purchase Agreement
 - Sign and close; sign and then close
 - Franchise specific provisions

Overview of the Deal Process

- Closing the Deal
 - Immediate to 90 plus days
 - Pre-closing franchise sales issues
 - Buyer must be ready with post-closing FDD amendments and activities to manage franchise sales and the system

Preparing to Sell a Franchise Company

- Starts with the very first franchise sale
- Assess the franchise agreements
 - Do the agreements limit a transaction?
 - Do they have M&A friendly provisions?
 - Are there territorial issues?

Preparing to Sell a Franchise Company

- Assess the franchise agreements
 - Evaluate regulatory matters
 - Assemble and catalog versions and negotiations
- Evaluate whether changes can be made
- Weed out underperformers?

Preparing to Sell a Franchise Company

- Evaluate intellectual property
 - Registration
 - Infringers
- Resolve litigation and reduce claims
- Evaluate and update sales process
- Enhance future value enhancement opportunities

A Note on Franchise Regulatory Issues

- Franchise laws generally require an amendment when there is a material change
- Timing
- Multiple factors affect amendment or "go dark"

Assessing Valuation

- Buyers highly value franchisors for a number of reasons:
 - Stability of royalty stream
 - High margins / cash flow
 - Low cost geographic expansion
 - Scarcity value / unique brand and business

Assessing Valuation

- Royalty Stream
 - % of Revenue tied to Royalties vs. other recurring and non recurring revenues
- Same Store Sales
 - Higher is always better, but lower isn't bad. It is all about the growth story and dynamics
- Company-Owned Contribution
 - > 75% Franchised = ~15x EBITDA
 - < 25% Franchised = ~6x EBITDA

Assessing Valuation

- Profitability & Payback
- Tenure and Renewal Rates
- Franchisee Cohorts / Vintage Performance
- Franchisee Pipeline and Whitespace
 - Cost per lead and closing ratios
 - Number of available territories

Assessing Valuation

- Competitive Landscape / Positioning
- Technology Systems and Infrastructure
 - Visibility to data
 - Stability of applications, ease of use, modern architecture
- Cyclicalities
- Capital Expenditures
 - Usually a non-issue, except for software and company-owned stores

Assessing Valuation

- Franchisor vs. Franchisee Valuations
 - Franchisors generally trade at 8-10x+ whereas franchisees often trade at <8x.
 - Driven by limited territory, lack of control of brand and required investment in the business
 - Franchisees by definition are not unique
 - Franchisors ultimately have significant control over the business and brand can be deteriorated by factors outside of franchisee's control

Buyer's Due Diligence

- Getting What You Pay For
 - Identifying "Red Flags"
 - Feeding the Reps, Warrants & Indemnities
 - Can you do what you want to do post-Closing?
 - Verifying Value

The Checklist

- Key Contracts
- Franchise Regulatory Compliance
- Franchisees and Sales Issues
- Disputes, Litigation and Regulators
- Supply and Distribution

The Checklist

- Ad Fund
- Franchise System
 - Manuals
 - Training
 - QA and Audit Reports

The Checklist

- IP & IT
 - Trademarks and Service Marks
 - Software
 - Websites and Social Media
 - "Secret Sauce"

Franchise and Related Agreements

- Review all versions
- Quality of Drafting
- Special Deals?
- Assignability

Franchise Agreements

- Flexibility Going Forward
 - Scope of Grant/Reserved Rights
 - Encroachment Issues
 - System Changes Possible?
 - Ability to Re-Brand

Regulatory Compliance

- FDD Review
 - Consistent Disclosure
 - Litigation
 - FPRs

Regulatory Compliance

- Franchise Sales Compliance
 - Receipts
 - Waiting Periods
 - Other Sales Materials

Other Inquiries

- Searches
- Talking to Stakeholders
 - Franchisees
 - Landlords
 - Suppliers
 - Employees

Cross-Border Issues

- Local Counsel – “Call early; call often”
- Regulatory Differences
- Tax!

Seller's Due Diligence

- Can the Buyer Close?
- Are they a "Good Fit"?
 - Will Employees be taken care of?
 - Values and Reputation — Do they matter?
 - Will there be an ongoing relationship?

Keeping a Hand In

- Seller (Owner/Operator) may stay on with post-closing Employment/Consulting Agreement
- Often tied to performance and Purchase Price payout/earn-out
- Purchaser visibility is key

Impact on Definitive Agreement

- Reps and Warranties; Disclosure Schedules
 - Rep and Warranty Insurance
- Indemnities (Baskets/Deductibles)
- Holdbacks/Escrows
- Covenants
 - Operate "business as usual"
 - Maintain Zee/landlord/employee/supplier relations

Questions?

Thank you!