Key Considerations for a Franchisor Exit Strategy: *The M&A Deal*

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Published on www.lorman.com - April 2019

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Posted by Ned Levitt | Nov 20, 2018

Acquisitions of other businesses, to strategically grow an existing business or as a financial investment aimed at earning a good return, have been around since the beginning of modern commerce. However, historically, franchise companies grew organically, with traditional financing, as needed. Exit strategies for the entrepreneur-franchisor were often very low on the strategic plan.

Today, with the increasing number of boomer-franchisors heading for retirement, the amazing growth of the franchise sector, the acceptance of franchising as a viable business model, a great deal of under-deployed capital waiting on the side lines for good targets and more and more examples of successful franchise system growth, it is no wonder that we are witnessing today an incredible increase in franchise mergers and acquisitions.

Adding to these factors is the growth of private equity pools of money and the realization by these funds that franchising presents an excellent investment because of predictable and steady cash flow through royalties, great leverage from deployed capital and existing assets and almost unlimited possibilities for rapid growth (domestic and internationally).

The size and sophistication of some of these franchise systems and the transactions that evolve are impressive and often rival the traditional businesses as to scope and complexity. Certainly, many of the issues, challenges and approaches are the same in franchise and non-franchise M&A transactions. However, for a variety of important reasons, franchise M&A has an additional layer of complexity and risk.

In this blog post I examine the variables and processes to consider with a franchise M&A.

Franchise Variables

Franchising might appear fairly uniform and uncomplicated in an acquisition, but in reality, franchising is multi-faceted and nuanced in the extreme. M&A in franchising can provide different opportunities and challenges based on:

- if the system is public or private;
- is a large or small business;
- provides services or products;
- the franchisees have multiple units or multiple brands;
- the franchisor has expanded through master franchising; or
- if the seller is a large master franchisee itself within a broader system.

It is rare for a franchise system to have a lot of hard assets, such as real estate or valuable equipment, even if it has a high valuation. The value of the system resides primarily in its brand, franchise agreements with franchisees and the relationship between the franchisor and the franchisees. Determining the accurate value of the system and how the acquisition is executed needs to take into account the strength, durability and transferability of these assets. This leads to a unique set of due diligence issues and choices and, while proper due diligence is important in any acquisition, it is critical in a franchise acquisition.

The Acquisition Process

If, as is often the case, a franchise acquisition commences with a letter of intent document, an interesting question arises as to whether the franchisees should be informed about the sale intention at that stage. There is no legal requirement to do so and most advisors would argue that, at the letter of intent stage, completion is too uncertain to inform the existing franchisees. However, if the franchisor does enter into such a letter of intent it is a strong possibility that this would constitute a material fact requiring disclosure to any prospective franchisees, if the prevailing franchise legislation requires such disclosure. Upon the signing of a binding acquisition agreement, the argument that disclosure is required for prospective franchisees gets more compelling, but not with respect to existing franchisees. Some franchisors opt to place a moratorium on new franchise sales during a system sale process because of this issue.

We are entering an exciting and vibrant time for mergers and acquisitions in franchising. There will be opportunities for buyers and sellers and professionals who provide the needed services. For those thinking of buying, it is a good time to increase their ability at generating deal flow and analysis and for those thinking of selling, it is a good time to improve financial performance and address valuation issues. For the professionals, it is a good time to acquire the skills needed to help their clients navigate this fascinating and challenging area.

What challenges and opportunities are you seeing in exit strategies for franchisors? I welcome your feedback and questions on this topic. Please post your comments on our LinkedIn page at: Dickinson Wright Canada, on Twitter at: @DWrightCanada or on my personal LinkedIn page at**:** linkedin.com/in/nedlevitt