# DIVERSIFYING

## Your Business and Financial Portfolio

As the Planet Fitness® brand continues to ride a wave of success, many franchisees are left wondering what's next. When the time comes to decide if you're ready to bridge the gap from gym owner to true franchisee, there are many things to consider. Diversifying your portfolio can be done in a number of ways, and each potential path comes with its own legal considerations and personal ramifications, which were covered by panelists Justin Klein, CJ Bouchard and Brian Gately during the Diversifying Your Business and Financial Portfolio session at the 2017 PFIFA Franchisee Convention.

"The returns that Planet Fitness franchisees are getting are outside the norm," said Klein, franchise and business attorney with Marks & Klein, LLP. "The reality is, now you have all of this money and institutional knowledge, and what are you going to do with it?"

While geographical diversification and entry into other asset types such as private equity are certainly options, one of the most considered alternatives is expanding into another concept or brand.

Although Klein notes that there aren't a lot of multi-brand owners currently in the Planet Fitness system, it is a trend that is on the rise.

"A concentrated position grows your wealth and gets you wealthy if you're lucky," said Gately, vice president and private wealth advisor for the Investment Management Division of Goldman Sachs. "It can also destroy your wealth if all of your eggs are in one basket, and diversification is what keeps you wealthy."

At the end of the day, it's all about putting yourself in the best economic situation, but with all of the rewards that diversifying your portfolio can provide comes great risk.

by Christina Cannon

### IS IT LEGAL?

The single most important factor to consider when trying to narrow down which brand to move forward with is how the new business will affect your relationship with the franchisor and if it will violate any contracts or provisions.

"If someone came to me and said, 'Look, I'm a successful Planet Fitness franchisee, and I'm looking to expand into a different concept,' the first thing you're going to want to do is make sure Planet Fitness is OK with that expansion and that other concept," said Klein.

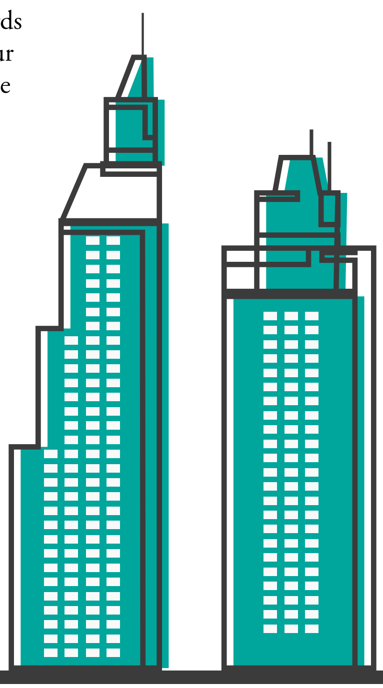
Perhaps the most obvious thing to keep top of mind is a non-compete agreement. These are often narrowly drafted but broadly interpreted, and non-compete agreements work two ways. Maybe Planet Fitness has no provisions that would prohibit you from opening up a juice bar, but the juice brand has a provision forbidding its franchisees from owning other health and wellness businesses.

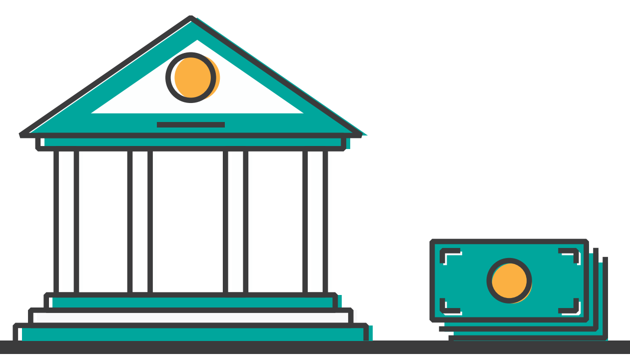
"It's not just the covenants in the Planet Fitness agreement, it's the covenants that will be in the other agreements that you're ultimately going to sign as well," said Klein.

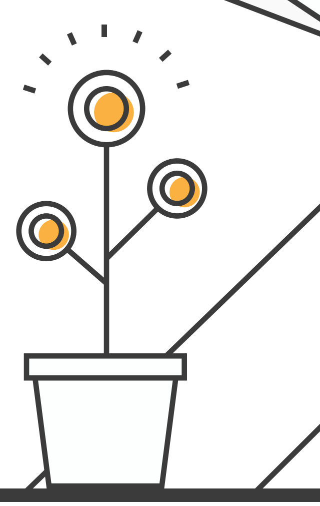
Another aspect to watch out for is guarantees.

"When you decide to diversify, you need to actually understand how your business works, where the cross guarantees are, where the personal guarantees are and how that all plays in," said Klein. "It has the potential to be a real benefit because if you have the ability to give some sort of corporate guarantee and it doesn't violate any of your other covenants, then it makes you that much more attractive to someone that has capital and may want to lend to you."

When it comes to guarantees, clauses, agreements and provisions, Klein suggests that if you are ever unsure of something,







don't be afraid to talk to your franchisor.

"Open lines of communication and understanding who the people in the deal are is critical," said Klein. "I am always intrigued by the franchisees who want to diversify and whether or not they are comfortable telling their franchisor that they want to go do something else."

Klein also notes that while communication is important, do understand that there will likely be tension when telling a franchisor you want to expand into other brands. Franchisors sometimes have a difficult time letting go of the notion that if your new business fails it won't somehow negatively impact your involvement with your core business.

"Just call the franchisor and say, 'I'm thinking of doing this. Do you have a problem with it, and if so, why?' I'd rather know that before I set up a trust, before I set up the development money, before I hire a lawyer," said Klein. "Their reaction is the important part to get back because now it's another piece of information to consider as you're moving down your investment strategy."

For some franchisees, the relationship with corporate may be a strong one. Gately notes that if the franchisor seems upset at the thought of you expanding into another brand and you are not willing to harm that relationship, there are other options.

"Talk with professionals to see how you can diversify in other ways without going into another concept," said Gately. "Planet might not be happy with something, but making sure you have the right people on your team to make sure you do it the right way can really save you a lot of heartache and headache," echoes Klein.

## IS IT SMART?

When choosing a brand to expand your portfolio with, the best guide is often where your strengths lie as a Planet Fitness franchisee.

"Your product is almost irrelevant because it's the system and the way that the product is developed," said Klein. "What you learn from Planet Fitness, which I think is one of the best assets that franchisees could have possibly gotten from a franchise, is the strength of the brand. Planet has done a really good job at protecting the brand. Not all franchises are like that."

Klein suggests to look for brands that take care of themselves and for groups that operate with a similar level of care and consideration as those in the PF® system, otherwise you're likely to be let down.

Once you have found a brand that acts with integrity and has high standards, you need to decide if it is a smart move and where the synergies lie.

Think about the companies and services that Planet Fitness is already using – management, operations, construction, delivery. Think about the skills you have learned and acquired through owning and operating a health club such as how to be a trainer or CEO or how to manage people or clean floors.

It's these aspects that you can use to boost your corporate structure and protect your assets from a financial perspective. Can you share managers, operators or accountants with the new business?

For Bouchard, franchisee with PF Eastern NC, LLC, the convergence culminated in a construction company.

"How do we use Planet as a tool to get us to diversify our portfolio? My focus has been to move toward the construction and real estate side," said Bouchard. "We have our own general contractor, and not only are we building our own Planet Fitness clubs and keeping our costs down, but we're also building other things."

In addition to the work performed for other companies, Bouchard is able to build his clubs from the ground up, which is a real advantage when it gets hard to find the right size box or good rents.

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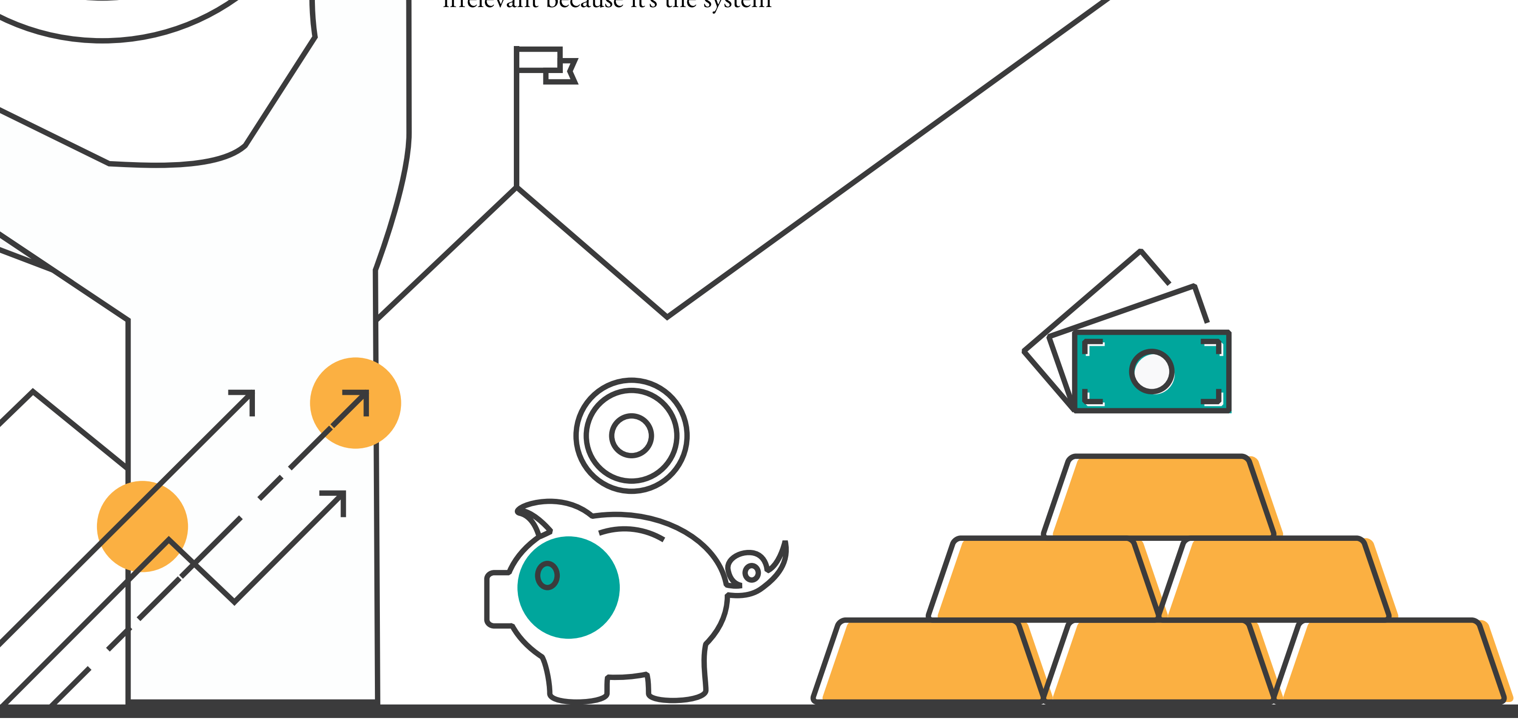

## Diversification

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"We've carved ourselves a really nice niche out because we're able to use Planet and the cash we generate on a monthly basis to look at real estate as another huge asset, and it has worked very, very well for us," added Bouchard.

But with great rewards comes great risks.

"You don't want to get into a new concept that you don't understand well and then all of a sudden it's taking a lot of your time and perhaps a lot of your capital, and then out of the blue your core business isn't running so well," said Gately.

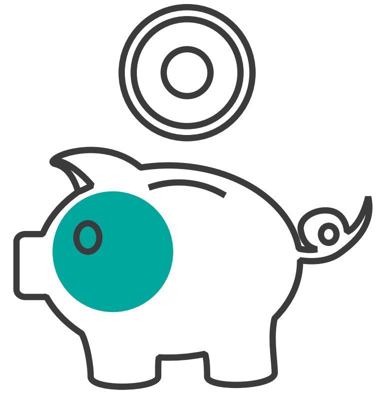
One alternative to increase wealth without expanding into another brand or concept, suggests Gately, is to combine current assets into a larger operating unit that may be able to grow faster than its smaller counterparts – something lenders currently have an appetite for.

With an increase in scale comes an increase in bargaining and buying power, as well as more capital to grow. This buying power can also be leveraged if you are moving forward with other brands or concepts. Would your lawyer give you a better rate if you bring the new business on board with his firm? Would your vendors and suppliers lower their prices if you began buying a higher quantity?

Above all, diversifying your portfolio needs to be a smart move and one that meshes with your core business.

"As you're diversifying, one of the things you really have to be careful about is in your diversification are you putting your main revenue source at risk. You've got to constantly be re-evaluating the decisions that you're making as you're going down this road," said Klein.





Gately notes that the best IRRs come from strategically diversified portfolios with the median IRR sitting at 12.8 percent. This is compared to a median rate of 8.6 percent for concentrated portfolios and 8.5 percent for broadly diversified portfolios.

"Whether it is going and buying a Dunkin' Donuts, building your own gyms and becoming the landlord or property manager, or even putting your money in Goldman Sachs, if you have a good diversified portfolio hopefully it all works together so that when something is down, something else is up," concluded Klein.

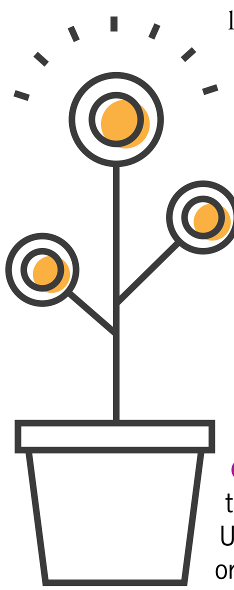
### IS IT FUN?

When diversifying your portfolio, another important aspect to reflect on is your personal and business goals.

"In franchising, sometimes you have to really re-evaluate whether the company that you are committing your time and capital to is right for you," said Klein. "If you're in the stock market or you're with a wealth manager or lawyer and the relationship goes south, you say forget it and hire a different one. In a franchise, there is a lot more that goes into that conversation, so as you diversify, you have to ask yourself 'what makes me happy, and how am I going to stay happy?'"

In addition to his construction company, Bouchard also owns and operates a Zaniac location, which provides after-school care and summer camp programs focused on the STEM industry for kids K-8.

"The reason I got into this franchise was personal. My son, who is 14, loves the computer, loves STEM, and to me, this was personal. I looked at it and said maybe my return is going to be X and maybe it won't be, but this is something that myself and a lot of other parents are absolutely interested in," said Bouchard. "Can I make a business out of it? I don't know, but I'm going to try. I want to see, and I think I can. So far it's been pretty good; just don't expect the results to be the same results we have as PF franchisees."



Bouchard notes that prospective brands are likely to be like any other brand, Planet Fitness included. Some locations will knock it out of the park and others will tank. For him, it's all about re-evaluating and being realistic about your expectations when going into a new business.

"You have to have a real appetite for risk, but you've got to have a sophisticated understanding of how your business works when you do that," said Klein. "If it all works together, it will hopefully make you personally fulfilled."

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