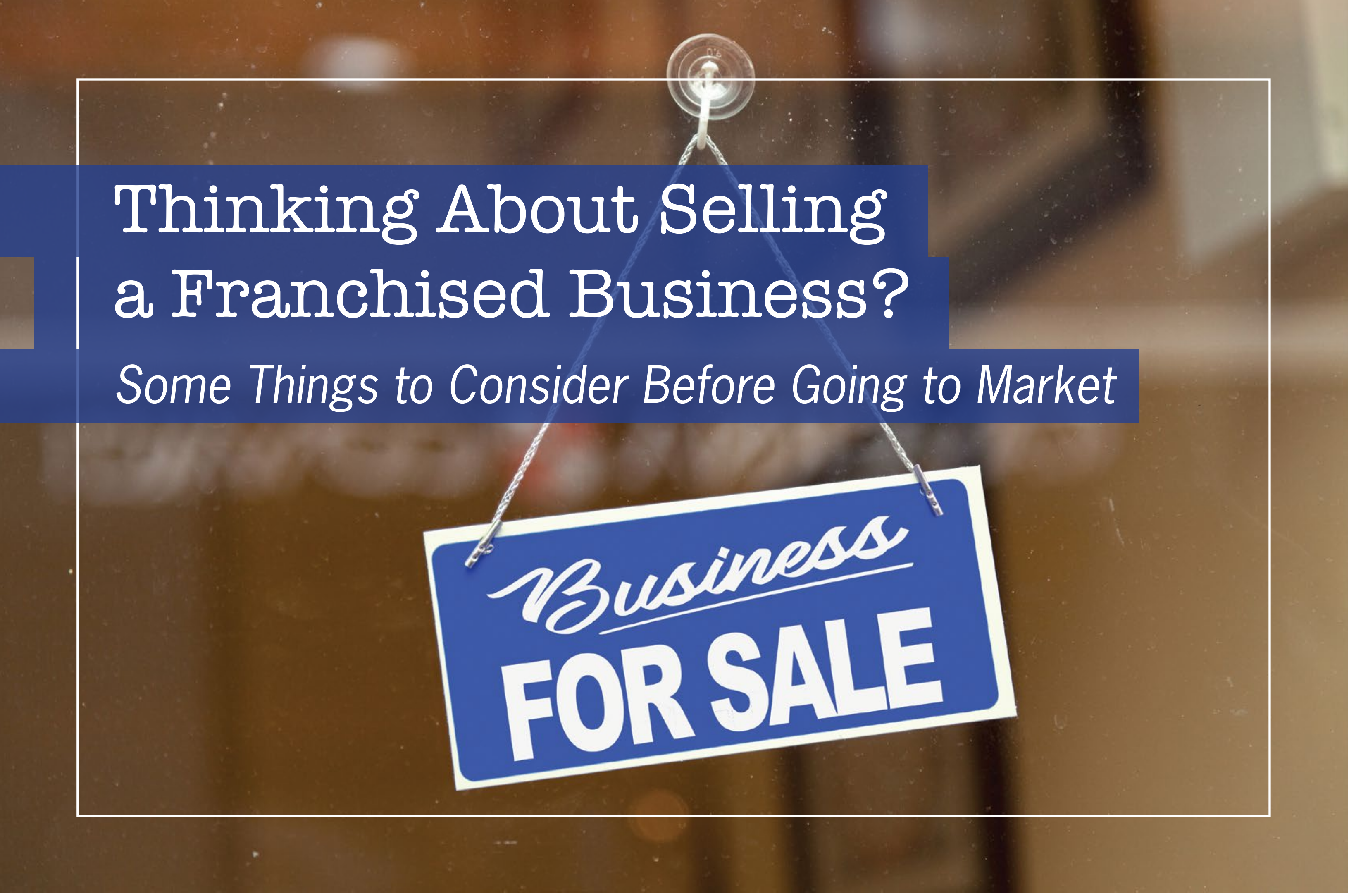
Thinking About Selling a Franchised Business?

Some Things to Consider Before Going to Market



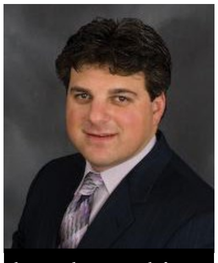
Franchisees frequently make the mistake of seeking to sell their business before properly positioning it for sale. In so doing, sellers are often unable to command top dollar for their business in a sale transaction. To maximize value, a prudent seller should consider several issues before going to market. This article provides a summary overview of some of these important considerations.

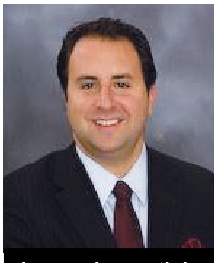
LEASE TERM

Initially, if a seller does not own the property on which the business is located, it is critical that the seller fully understand the lease for the premises, including the significance of the provisions relating to the lease term and available option periods. A seller who is nearing the end of the lease term without option periods will not be able to demand as significant a value for the business if the buyer is in jeopardy of being unable to renew the lease for the premises. A seller should seek to obtain option periods or otherwise extend the term of the lease before marketing the business for sale.

LEASE ASSIGNMENT

Likewise, a seller should be aware of whether the lease contains problematic assignment or change of control provisions that might interfere with the sale. Despite a tenant's best efforts, in the excitement and eagerness of trying to get a deal done, landlords sometimes successfully incorporate detrimental terms into assignment clauses such as recapture rights, rent increases and provisions that permit the landlord to share in some of the sale proceeds, all of which may serve to inhibit a sale. To the extent such provisions are incorporated into the lease, a seller should try to amend or modify the lease to remove such adverse terms before attempting to sell the business.


by Andrew P. Bleiman


by Justin M. Klein

LEASE GUARANTY

Furthermore, the seller should assess the nature of any personal (or corporate) guaranties that might have been signed in connection with the execution of the lease. Because landlords will frequently require the seller to continue to personally guaranty the lease after an assignment, sellers should seek to terminate, modify or limit any existing guaranties before the sale process begins. Where the landlord's initial investment in the premises (e.g., any tenant improvement allowance) has been recouped, the termination, modification or limitation of a personal guaranty can sometimes be effectuated. This is particularly true where the tenant (seller) is executing an extension of the lease, increasing the security deposit or making capital improvements to the premises in connection with a reimaging or remodeling of the premises. Obviously, limiting or eliminating a personal guaranty prior to selling the business substantially reduces the seller's risk in connection with any transaction.

THEN-CURRENT FRANCHISE AGREEMENT

In connection with the transfer of a franchise business, franchisors typically require the buyer to sign the most recent form of franchise agreement. To that end, certain changes to the terms and provisions of newer forms of the franchise agreement may impact valuation and the ability of a franchisee to sell. For example, as franchise systems evolve over time, the form of their franchise agreements also change, and newer forms of franchise agreements sometimes contain higher royalty fees, additional fees or increased marketing contributions.

Likewise, newer franchise agreements might require additional mandatory local marketing dollars be spent or contain other more restrictive non-monetary obligations (e.g., enhanced in term and post-term covenants). Modifications to the newer forms of franchise agreements may significantly impact unit performance. A seller must understand how the current form of franchise agreement affects valuation and marketability before marketing the business for sale.

CAPITAL IMPROVEMENTS

Mandatory reimaging or remodeling requirements imposed by the franchisor may also substantially impact the value of the business. Any buyer who is required to make a capital investment associated with remodeling or reimaging after the acquisition of the outlet will look to offset the purchase price by the cost of the anticipated project (or will seek a lower valuation to account for such anticipated costs). A seller should take steps to market the business once compliant with applicable brand standards and imaging requirements. Alternatively, the seller should be prepared to provide a credit toward the purchase price to incentivize a buyer to move forward with a transaction in the face of any franchisor-required capital investments.

QUALITY OF EARNINGS ANALYSIS

Finally, to maximize value, many prudent franchisees are now performing a quality of earnings analysis prior to marketing the business for sale. A quality of earnings analysis is an independent analysis of a company's financial information, a type of financial report that has become increasingly popular in recent years. An independent quality of earnings analysis helps identify issues prior to engaging in the sale process, facilitates the process once the business is being marketed and allows a seller to preserve value in connection with a transaction. A quality of earnings analysis can help a seller best prepare the company for a transaction and maximize the value of the business to be sold.

Overall, a franchisee seller is best advised to perform its own due diligence and prepare for a sale process before going to market. A franchisee seller who fails to properly position itself for a sale risks losing considerable value in connection with a transaction. Understanding the issues that drive value and proactively positioning oneself prior to going to market will help to maximize value in a sale.

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