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Ten Tips to Prepare Your Franchised Brand for Sale

We'll be attending and sponsoring the annual Franchise Capital Exchange this week in Chicago. The purpose of this conference is to put smaller or emerging franchisors in front of potentially interested private equity groups. Between franchisors adding new franchise systems to their portfolios and private equity firms acquiring franchised brands, we have seen an increase in M&A activity throughout the franchise sector. Planning for the Franchise Capital Exchange this week reminded us of the critical role that proper preparation plays in easing the burden of a sale transaction, so we're offering these tips to companies considering a transaction.

1. Maintain a database with all current and former franchise agreements. Some franchisors may have limited access to old franchise agreements due to obsolete technologies, so franchisors should attempt to track down all files, whether in hard copy or electronic form. Buyers generally also ask for up-to-date Item 20 statistics, so this will help keep Item 20 tables current.

2. Gather copies of each executed Item 23 receipt. Buyers will typically inquire about these documents immediately to help ascertain whether there is any potential liability for failures in the pre-sale disclosure obligation.

3. Make sure all of the registered trademarks, service marks, and design marks associated with the franchise (especially the principal marks), are active and do not lapse or cancel based on failure to file renewal/supplemental filings with the United States Patent and Trademark Office ("USPTO"). In addition, franchisors should confirm that all prior assignments are properly recorded with the USPTO to ensure chain of title for each registration is correct when the potential buyer begins its due diligence review.

4. Determine whether there are any existing liens on any of the franchisor's assets. If a franchisor can properly resolve any outstanding liens prior to attracting a buyer, it

may improve the purchase price. Especially in asset-based acquisitions, buyers often expend significant resources on searching for liens on the assets they are attempting to acquire.

5. Keep all franchisees current on all payment obligations. Disclosing to buyers that certain franchisees are past due on their royalty or advertising fund contributions may provide a buyer more leverage when negotiating the purchase price.

6. If the franchisor has an area development program in place, ensure all developers are current with their respective development schedules.

7. Gather all material contracts that the franchisor has entered into regarding the franchise system. For example, many franchisors execute vendor agreements with companies like Coke® or Pepsi®—buyers will ask to review these types of material agreements. If the franchisor has any outstanding debt obligations, those documents will also be critical to the buyer's due diligence review. In addition, the buyer will ask to review any applicable internal agreements, such as employment and severance agreements for the management team, retirement plans, and stock option agreements.

8. If the franchisor includes financial performance representations in Item 19 of its FDD, it should maintain all relevant backup information to support that the representations are accurate and that there is a reasonable basis for disclosing them. Depending on the nature of the FPRs made in Item 19, the backup data may include comprehensive P&Ls or basic revenue and customer statistics from each franchised location. Not only will this be important from an FDD compliance perspective, but it may also be part of the buyer's financial due diligence to help project future cash flows from franchisees.

9. Clean up any old and irrelevant content on the franchisor's website and social media accounts, as this will help attract buyers and promote a more robust brand.

10. Maintain records of any applicable advertising or marketing funds managed by the franchisor or a third party. Potential buyers typically review the amount of funds available and how the fund has been managed.

Sophisticated buyers generate complex and exhaustive due diligence requests during the acquisition process, so the better franchisors can prepare, the less of a burden the sales process will be when the time comes. These tips are only some of the things that franchisors should bear in mind when exploring a potential transaction with a private equity or other buyer group.

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