

Preventing System Closings

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Objective

- **Control Process Early**
- **Establish & Monitor Early Warning Signs**
- **Triage Multiple Distressed Units**
- **Working with Units on Bubble of Profitability**

Control Process Early

- **Review License Agreement**
 - **Franchisor should retain sole right of unilateral termination**
 - **Include Right of First Refusal (RFR)**
 - **Applicable to any transfer of the license.**
 - **30 days to decide whether to exercise the RFR.**
 - **Not all franchisors specify how long the franchisor has to close the deal if the RFR is exercised**
 - **45 days is reasonable.**
 - **Include lease approval right/right to assume lease**

Control Process Early

- **Implement Policy/Process**
 - Review all closing requests.
 - Require written notification 90-120 days prior to intended closing date.
 - Franchisee should include current YTD P&L statements + 2 year historical.
 - Description of building status (owned v. lease), lease terms and complete terms of any offers for the property, building or business assets.
 - Circumstances where a closing may be necessary:
 - Eminent Domain
 - Natural Disasters
 - Trade Area Shift
 - High Crime Area
 - Lack of Profitability

Control Process Early

- **Review closing request to determine:**
 - **If RFR should be exercised.**
 - **Franchisor should assume lease or purchase land, building and approved equipment on same terms as original suitor.**
 - **If location is deemed economically viable after financial review, allow termination after a mutually acceptable settlement agreement is reached.**
 - **Example: 3-5 years future royalties calculated on NPV**
 - **If location is not economically viable, approve closure or consider workout solutions to change unit economics (e.g. royalty deferral, abatement, rent concession, loan restructure, etc.)**

Control Process Early

- **If closing approved, require:**
 - **All outstanding royalty, advertising, product and other fees must be satisfied.**
 - **Mutual Release**
 - **Return of all manuals, proprietary information.**
 - **Complete De-Identification Checklist with photo verification.**
 - **Conduct field visit to ensure proper de-identification.**

Early Warning Signs

- **Early warning signs of distressed franchisees**
 - Sales decreases
 - Delinquencies to franchisor, landlords, lenders, vendors, etc.
 - Operational issues
 - Multiple attempts to sell business
 - New units not meeting proforma expectations
 - Rumors
- **Monitor early warning signs**
 - Operations evaluations/audits
 - Review financial statements regularly
 - Conduct franchise audits of sales history/payments

Triage Multiple Distressed Units

- **Identify Distressed Units *before* Closing Request Received**
 - **Units that opened within previous 2-3 years may have unfavorable lease/real estate purchase terms.**
 - **Units in states/regions encountering severe economic pressures, including:**
 - **California, Nevada, Arizona, Florida, Michigan, Ohio**
 - **Watch list: Louisiana, Mississippi, Alabama (Oil Spill Crisis)**

Triage Multiple Distressed Units

- **Where more drastic measures are required:**
 - **Power or cluster markets where a large number of closings could lead to snowball effect.**
 - **Multi-unit operators that may be “too big to fail.”**
 - **Other unique situations that require special attention.**
 - **Example: Gulf oil disaster**

Units on Bubble of Profitability

- **Ensure license documents are in good order.**
- **Ensure your ability to terminate.**
- **Create short-term interim licenses for distressed franchisees.**
 - **Terminate early & allow continued operation for short-term**
 - **Protects franchisor if Bankruptcy is filed.**
- **Determine if you have the right operator.**
- **Consider work out solutions to keep unit open**
 - **3rd party concessions**
 - **Rent reductions**
 - **Loan restructure**
 - **Equipment refinance**
 - **Franchisor concessions**
 - **Be part of the solution, not the solution.**

Units on Bubble of Profitability

- **Franchisor solutions to keep unit open**
 - Bridge to better sales performance.
 - Apply deferred revenue or other pre-paid fees against royalties.
 - Exchange large protected territories for royalty deferment/abatement.
 - **Royalty Deferment**
 - Postpone or delay royalty payments for a limited time period.
 - Require repayments over a similar time period.
 - Example: reduce royalties by 50% for 12 months, repayment during month 13-24.
 - Outline terms in Promissory Note or Letter of Agreement.
 - Issue current license agreement in consideration of deferment.
 - **Royalty Abatement**
 - Slippery slope, only used in extreme circumstances.
 - Reduce or eliminate royalties for a limited period of time.
 - No requirement to repay.
 - Outline terms with License Agreement Amendment or Letter of Agreement.
 - Issue current license agreement in consideration of abatement.
 - Increase Royalty during later term years

Units on Bubble of Profitability

- **Royalty Deferment Repayment Options**
 - **Interest/No interest.**
 - **Equal installments over set timeline, usually 12-36 months.**
 - **Reduced initial payment with balloon at end of note period.**
 - **Interest only payments with balloon at end of note period.**

Units on Bubble of Profitability

- **Purchase unit/corporate takeover.**
- **Find other franchisees to purchase unit.**
- **Refer distressed location to a financial workout specialist.**
- **Chapter 11 reorganization.**

Improve Sales Performance

- **Improved sales performance will reduce system closing pressure.**
- **Revenue cures all business sins.**