Re-franchising Company Operated Units–A Strategy for Growth

Gene Cerrotti

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About Gene: Gene and the management team at Praetorian Group have extensive experience structuring and negotiating business transactions, valuation of business enterprises, divestures, equity placement and commercial loan structuring. Gene manages the firm's merger & acquisition activity with additional emphasis on franchisor re-franchising programs. The firm has sold over 3,000 franchised units over the past five years. Re-franchising programs have been successfully completed for the following concepts. Checker's Drive-in Restaurants, Hardee's, Carl's Jr., Captain D's Seafood Restaurants, USA Baby and The Ground Round Grill & Bar. The firm also completed the divesture of the Taco Bueno concept for CKE, Inc. Additionally, numerous owner-to-owner transfers for many of the top franchised concepts have been completed.

Gene will serve as a facilitator for the Business Solution round Table entitled *"Re-franchising company operated units – a strategy for growth."*

Many franchisors have benefited from re-franchising programs, the sale of company operated units to franchisees. It has become a highly affective strategy for driving aggressive growth, re-imaging and revitalizing a brand.

Do you want to attract aggressive quality developers to your system?

Larger multi-unit operators are always looking to diversify through potential acquisitions. An acquisition in a new franchise concept gives them immediate cash flow to cover the organization to run a new division and gives them a base to develop additional units, usually in the same or adjacent geographic area.

A franchisor selling certain company operated units to a new franchisee will command a commitment to develop additional units, typically, two to three times as many as sold. If re-imaging is required, this will also be achieved.

As an example, if you re-franchise five packages of four units each. Each new franchisee will commit to develop eight to twelve units over the next five years. A development schedule of about two units per year is reasonable. The twenty units sold will have now been leveraged to an additional forty to sixty units over a five-year period.

What else has been accomplished?

1. Cash has been generated from the sale of the units which can be used to pay down debt, fund additional units or simply increase cash reserves.
2. A royalty stream is now being generated, not only from the units sold but also from the newly developed units as they come online.
3. Five experienced and well-funded multi-unit franchisees have been added to the system.

Do you want to attract multiple lenders to support your concept?

The top franchise lenders like to finance acquisitions. This is because they are able to see historical results, sales trends, determine real estate values and gain a good understanding of the concept's overall performance.

The sale of a multi-unit package can be an entrée to lenders for the franchisor. It can generate sufficient interest in the franchise concept to make it worthwhile for the lender to spend the time and money to approve the concept. Once approved, this will pave the way for lenders to provide financing for other new and existing franchisees.

For franchisors which have growth primarily through single unit development, SBA lenders have been the primary source of financing support. The sale of multiple unit packages to larger franchisees will attract portfolio lenders. Because of SBA loan size limits a portfolio lender is a critical addition for multiple unit development and aggressive growth. Having existing multiple unit franchisees will encourage other multiple unit operators to join your system.

If a system does not have a reasonable mix of single unit and multiple franchisees this may give prospective new multiple unit operators reason to pause. Re-franchising gets your concept past this hurdle quickly.

Bottomline, Re-franchising has proven to be a very effective means of accelerating growth for franchisors by:

- Accelerating re-imaging.
- Enhancing relationships with lenders.
- Attracting experienced and well financed multiple unit operators.

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