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Stacks of Conditions Burden Some M&A Deals, Panelists Say

Franchisors are putting “a lot” more conditions on franchisees these days before they will approve buy-or-sell transactions, some of them burdensome, according to a panel on mergers and acquisitions at the Restaurant Finance & Development Conference on November 12.

“I think we’ve seen a lot more conditions from the franchisor as a condition to approve transactions,” said Carty Davis of C-Squared Advisors. “It’s capital structure; remodeling guidelines; new development as a condition to approve a franchisee-to-franchisee sale, which is something we’ve never seen until two or three years ago.

“We think franchisors will continue to put conditions on ‘zee to ‘zee transactions. There are some problems out there, and some franchisors have allowed franchisees to get a little too big and haven’t examined the capital structure,” Davis said.

Said Stuart Adair, City National Bank: The mega-development agreement seen in recent years “is one of the scariest things. The size of them has gone up significantly over the last couple of years, so the capital requirements to stay in compliance with the franchisor has gone up in the last 10 or 15 years.”

Added Chad Spaulding of CapitalSpring: “Franchisors want good operators, and sometimes if you buy 10 stores and have to build five more, you’re not an operator any more, you’re a developer.” So when franchisees are “wringing their hands on the use of capital...it detracts from the core of what they’re supposed to be doing, which is putting smiles on their customers’ faces.

“You think of some of the largest brands, who have to get a return for their shareholders. You have to get unit growth, so you have to” enter new markets “because there’s nowhere else to go,” Spaulding said. “It becomes a really hard thing for operators, now developers, to make good decisions around that. And the real problem with that is it’s just eating away at unit economics.”

The Outlook for M&A panel was one of many lively sessions at the Restaurant Finance & Development Conference in November. Next year's conference is Nov. 9-11 at the Wynn Hotel in Las Vegas.