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NICK CROUCH (left) and GLEN JOHNSON

Preparing for a Sale

How to maximize returns in a liquidity event

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Before embarking down any path of selling all or part of your business, it is important to spend time preparing. First, owners and key stakeholders should decide and align on a business strategy. Next, owners must make sure they are prepared for a sale and the rigors that ensue. Finally, no matter how well-planned any exit strategy may be, it all comes down to execution.

BUSINESS STRATEGY

When it comes to business strategy, owners must first understand the goals of the key stakeholders. Start with those end goals in mind and work backward. Depending on the capital structure, there are many different variables that will determine the steps needed to maximize returns. Among the critically important subjects to address are:

- Will the sale be a full or a partial liquidity event?
- Is the buyer a related party or will it be a sale to an outside, third-party group?
- Is the operator selling, retiring, and moving on or do they have flexibility or a desire to stay with the business in some capacity?
- Which is more advantageous, an asset sale or a stock sale?
- Understand what is being sold and set expectations. Is the sale opportunity for a limited number of units in a small market, or is it an emerging brand with potential and upside?
- Is the owner seeking a partial liquidity event that likely includes new lending partners and/or outside investors?
- If there is owned real estate, should it be included as part of a sale? Are there opportunities to create value by exercising purchase options on leased sites? Should this be completed before the process starts?

Before approaching the market, every franchise business should be asking these questions, having internal discussions, and aligning on strategy.

PREPARATION PHASE

The first step in preparing for a sale is to sort out the financials and real estate.

Financial reporting and contracts. Running a franchise business is an all-encompassing venture. Owners spend so much time ensuring outstanding customer service and guest satisfaction that some of the legal, accounting, and tax issues can be overlooked. When considering a sale, it is important for the owner to understand and be prepared for the rigor that outside parties (buyers, franchisor, investors, lenders) will put into examining your business.

Integrity in financial reporting is paramount. The most serious mistake an owner can make is having inaccurate financials. Before providing financial records to outside parties, review them for accuracy and completeness. In addition, contracts, credit agreements, and leases also should be reviewed before the process starts. One-time, non-recurring adjustments should be detailed, along with proper supporting documentation. Buyers, investors, and lenders often will also require a detailed quality of earnings report (these are like mini audits and are becoming more standard in franchise transactions). Tax planning is also important, and sellers should be aware of the tax implications of any sale transaction.

Real estate. In some cases, a significant portion of an owner's equity is in the real estate. If you own property, what do you do with it? It is important to carefully consider all options, including the sale-leaseback market. Many buyers prefer to own both the business and underlying real estate and will often pay a premium to control both. However, if you plan to keep your real estate holdings, it is important to engage a competent real estate attorney to draft a marketable lease that provides the owner with flexibility to sell some or all of the properties at a later date.

EXECUTION STRATEGY

The next step for owners is to consider how to execute the strategy they've developed.

- **Franchised businesses.** Sales of franchised businesses are almost always subject to franchisor review and approval. While the owner can select a buyer or partner, franchisor approval is necessary to consummate the transaction. Before moving forward with any buyer, franchisees must understand and manage the franchisor's approval process and financial and operational requirements. In more and more cases, as a condition of approval, franchisors are requiring reinvestment commitments to effectuate a transfer. It is important to understand these requirements and articulate them to potential buyers or partners. Exactly when to engage the franchisor can be complicated and will depend on the seller, buyer, and franchisor.
- **Transfers to the next generation or existing management team.** If the sale is part of a transition to the next generation or existing management team and does not involve changes to the capital structure, managing the relationship with your existing lenders is critical. Financial institutions do not like surprises, so it is important to communicate early and often. In most cases, lenders will be supportive if they understand and have been part of the transition process. If the value of the assets being sold is questioned, obtain reasonable consensus with lenders to avoid any delays. Decide early who within the organization should be party to the transaction and make sure any key personnel are not surprised by the transition. To ensure a successful completion, it can sometimes be helpful to incentivize key team members.

FINAL POINTS

There is no one-size-fits-all strategy to maximize return in a liquidity event. However, understanding your alternatives, the transaction process, and adequately preparing are all critical to achieving your goals and ensuring a successful outcome. ■

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