Selling a Franchise Location:

A Step by Step Process

Financing for restaurant franchise owners

a complimentary whitepaper for franchise professionals

You're giving thought to selling a franchise location that you own. While you've had plenty of experience at operating it, and had purchased it once upon a time, you may not have any experience with selling a business. Don't worry -- the process doesn't have to be complicated. While no two franchise sales are identical, we've include general information that will help you better understand the steps that may be involved.

Many reasons to sell

Franchise locations are bought and sold all the time, and there are a variety of reasons existing owners choose to put their locations on the market. Some owners are ready to retire, and want to turn the value they've built into a source of retirement income. Multi-unit owners may want to downsize their operations or divest a location that just doesn't perform as well as their others. Some franchisees may want to invest in another business, industry, diversify concepts or need to free up capital.

No matter what your reason may be, the goal of selling is the same: you want to get the greatest value possible for your business. You may also want to ensure you're leaving your employees and customers in good hands.

Give yourself plenty of time

If you hope to sell your franchise location in the next 12 months and are just getting started, you're already behind schedule. For optimum results, preparing any business for sale should begin at least two to three years before you put it on the market. During this time, you need to devote special attention to these potential selling advantages:

- Continuing or developing upward sales and profit trends
- Keeping clean, accurate financial records
- Maintaining organized files and corporate governance
- Minimizing major changes
- Making sure your location and its assets are free of liens or other encumbrances

This is also the time to begin assembling a support team of advisors with experience in mergers and acquisitions, such as a business attorney, tax consultant, and CPA, who can guide you in developing your sale strategy and advise you throughout the process. In addition, your franchisor may have several interested buyers or pre-qualified candidates.

Some prospective sellers include a business broker on their team. An experienced broker specializing in franchise sales can save time and hassle during the selling process, but it pays to do your homework before signing up with someone. To find a professional who provides quality service, you might consider seeking referrals from colleagues who have used brokers in buying or selling a location. Be sure you choose a broker accustomed to working in the franchise industry and with businesses of a similar size, or you may receive limited attention.

Estimate your location's fair market value

Before you take your franchise location to market, you'll want to know what kind of price it's likely to command.

One of the most common valuation models uses multiples of a statistic known as EBITDA, which stands for earnings before interest, taxes, depreciation, and amortization.

One of the most common valuation models uses multiples of a statistic known as EBITDA, which stands for earnings before interest, taxes, depreciation, and amortization. To calculate this value, add together net profit, interest on debt, income tax paid, depreciation and amortization, and your salary and benefits, and then adjust for projected expenses such as rent, if applicable, employee compensation, franchisor royalties (when selling a franchised location, royalties should be in the numbers unless they are anticipated to change with the change of ownership) and the cost of replacing you. According to franchise expert Daniel Slone, franchises often sell at multiples of three or four times the location's EBITDA.[1]

Attorney Dennis Monroe says the EBITDA-based valuation should also take into account the strength and scope of the franchisor's concept. What he calls Tier One franchisees, which are developing concepts that account for the middle 40 to 50 percent of all franchisees, are typically valued in the 3.5 to 4.5 times EBITDA range. Larger, "mega" franchisees that are part of stable national concepts, tend to be valued just under 5 times EBITDA. And concepts that are emerging and already strong fall into the 4.5 to 6 times EBITDA range. [2]

Slone cautions that the valuation also needs to address the value of the furniture, fixtures, and equipment, with an eye toward depreciation. While buyers will want to see your profit and loss statement, he advises buyers to use the statement of cash flow as a valuation tool, noting that "multiples of three to four times cash flow are a reasonable basis for valuation." [3]

Finding a buyer

As mentioned above, a qualified business broker can generate interest for you, pursue leads and help negotiate the best deal. However, if you're working on your own, First Franchise Capital's™ Franchise Exchange is a free resource you should consider. This online marketplace allows you to list your franchise location for sale and potentially allows you to connect with thousands of motivated buyers. It's a quick, easy, and free way to get your listing out to potential buyers. First Franchise Capital Corporation's marketing and exposure of Franchise Exchange provide benefit by increasing the number of buyers who might see your listing.

Determine the best sale structure

Once you negotiate a price, you'll want to consult your attorney, CPA, business broker and/or tax advisor to determine which of these structures would be the best fit for your objectives and tax situation:

- In a leveraged buyout, a buyer finances most of the purchase price with a loan. The assets of your location are used as collateral for the loan (sometimes along with assets of the buyer).
- In an earn-out, a buyer typically pays 60 to 80 percent of the purchase price upfront, with the remaining 20 to 40 percent paid out over time as the location achieves certain levels of revenue or profitability. This method is often used to bridge a gap between the seller's and buyer's assessments of a firm's value.
- In a seller-assisted sale, the buyer makes a sizable initial payment and gives you a note to cover the rest. You can choose to receive the buyer's regular payments on the note, or resell it to a company that specializes in note purchases.

Performing due diligence

When a franchise sale falls apart, it's often because one or both parties don't do enough (or the right kind of) due diligence. Once you identify a buyer who meets your criteria, these tasks should be part of your homework:

- Determine the buyer's financial stability. Ask for full disclosure of financials, how the money will be raised (including the lending source) and how the transaction will be closed. Be sure there's proof of funds to support the buyer's ability to pay. Make sure to request a copy of a commitment letter from a reputable lender.
- Clarify management structure. You need to be comfortable with the buyer's way of running the location. This is important for you, especially in an earn-out structure, and for the employees who have worked alongside you for years.

Don't hesitate to call off discussions early if things don't feel right.

Helping your buyer find financing

If discussions between you and a prospective buyer are promising, the next big hurdle may be finding a source of financing for the purchase. The obvious place to turn for a commercial loan is a bank, but the vast majority of banks don't always understand how to value a franchise location's true worth. Some buyers think about turning to Small Business Administration loans, but those typically involve extensive paperwork, complex rules, and unfriendly lending limits.

So if a traditional commercial loan or SBA financing isn't the right choice, what's a franchise business to do? There are specialty lenders who are accustomed to working with franchise owners. They understand how a business like yours operates, so they can approach the underwriting with realistic expectations and an appreciation for inherent risks.

When a franchise sale falls apart, it's often because one or both parties don't do enough (or the right kind of) due diligence.

About First Franchise Capital Corporation

Looking for a lender that understands and focuses exclusively on serving franchise operators? First Franchise Capital Corporation (FFCC) provides cash flow and asset-based loans to franchise owners throughout the United States. We believe strong relationships with our clients lead to personalized service and customized finance solutions to finance equipment, real estate, and business acquisitions. Our team of specialists deliver a personalized client approach to ensure your satisfaction and success.

FFCC can customize a loan for your needs and situation, from $200,000 to $20 million. The goal is to help you finance growth with minimal out-of-pocket cost by leveraging the power of your assets and cash flow. Learn more by contacting us at 844-395-8249 or www.firstfranchisecapital.com.

FOOTNOTES

1 Daniel Slone, "How to Value a Franchise Business," FranchiseChatter.com, March 24, 2014

2 Dennis Monroe, "What's my Franchise Worth?" mmblawfirm.com blog, September 1, 2008

3 Slone, op. cit.