Seller's Market Opens Myriad Options

Now is a great time to sell some percentage of your business.

BY JEREMY HOLLAND

Franchise industry entrepreneurs and management teams may never see a better market for selling all or part of their companies. I have worked in private equity for nearly 20 years and have never seen companies valued at such high multiples of their annual earnings. Many factors are fueling this trend, including competition among interested investors and low interest rates, but one thing is certain — this great seller's market won't last forever.

So what's a business owner to do? As someone who seeks out deals for The Riverside Company, a global private-equity firm, it probably seems self-serving that I'd encourage you to sell now, but private equity offers many more options than simply selling. I've heard plenty of myths in the course of my work, and by dispelling some of them I hope to show how you might benefit from this incredibly strong market while doing exactly what you want with your business.

Some common concerns I hear from business owners and managers include:

- **"I'm not looking to retire, so I'm not ready for private equity."**

  You don't need to sell your entire stake to obtain liquidity. Most buyers prefer when management is eager to remain in place and shareholders wish to retain a meaningful ownership stake. This communicates continued confidence in the business and allows the new investor to retain talent and knowledge.

  You can gain liquidity without giving up control in a private-equity transaction. With so many private-equity firms vying to invest, there is likely one with the appetite for your preferred scenario.

- **"My partners don't want to sell."**

  Many owners of businesses think that they must act in unison with their partners when it comes to getting liquidity. A private-equity investment can be a very healthy way to provide liquidity to those that want or need it while allowing those that still have a passion for the business to remain in place. Private equity is a great way to realign the shareholder base and avoid the awkwardness of partners having to negotiate against each other. A private-equity firm (a neutral third party) can make an offer for the business that sets a value. Then each partner can choose to sell anywhere from 0 percent to 100 percent. Each party can make its own decision, thereby eliminating many potential conflicts.

  Sometimes shareholders with a severe health situation want a trust to retain a percentage of ownership, even if he or she were to pass away, as they wanted the estate to gain from the likely success in the years ahead.

- **"I'm growing so fast, that I would be crazy to sell."**

  Often the reverse is true. When business is booming, you get a much higher multiple for the rapid growth. If one plays out that rapid growth cycle until the business levels off, buyers will pay a lower multiple. So, even if you only want to sell part of the business today, it may be wise to take advantage of the premium value provided by your strong growth.

- **"I don't want my competitors to get a hold of my secrets."**

  Competitors gaining access to your information is a smaller hurdle in franchising than in other business models because considerable information is already publicly available via the franchise disclosure document. That said, private-equity firms routinely sign confidentiality agreements. Only work with ones that will sign. Also know that you can direct your advisors to only share the information with a small, select group of potential investors with strong credentials to limit the distribution of your information.

Perhaps you're now considering selling a stake in your business. As a potential seller, shop around to find the best private-equity partner for your situation. Do your due diligence on private-equity firms, just as they would on you. Ask around to learn about their reputation and track record, both in and out of franchising. Consider inviting them to a more social setting where you can really get to know them as people. Choose an activity you enjoy out of the office and see if you like who they are when they let their hair down. Here are some ways to dig deeper to gain insight into a private-equity firm:

1. Ask the management teams of their former portfolio companies about these items:

   a. Board Composition. Will it be full of the people from the private-equity firm or will there be external experts to help you take the company to the next level?
   b. Compensation for Management. What percentage of the company was made available to management in stock options? Do members of the management team feel they were fairly compensated?
   c. Was the focus on driving growth or cost-cutting?

2. Understand the capital structure. Two offers with the same headline valuations may be very different. Some offers have very simple capital structures and others are quite complex. If you don't fully understand an offer, ask your advisors to explain it again (and again and again) if necessary. As one example, a common structuring technique uses different classes of stock. Ask your advisor if the proceeds to you and management at the time of the private-equity firm's exit will differ among the offers/structures.

3. Find a private-equity firm that can add value to your business and demand specific examples. Speak to current and former management teams from their portfolio (including names beyond the few they have teed up for you). Look at their experience and think about whether they will add value to your business.

4. Seek alignment with your growth plans. If you are interested in expanding internationally, ask for specific examples of the private-equity firm investing in franchising outside of North America. Inquire about their overall international experience and presence. There is no substitute for having locals in various markets to help you navigate the waters, so dig deep and inquire how long they have been in those countries and their number of investments abroad. A single professional in London isn't really a global presence.

5. How many years has the firm been around? Experience and track records are crucial.

It may seem like a lot of work to prepare for a sale, but it will serve you well, and all of it can be done quickly and effectively with the help of great advisors. Choose top-tier and focused franchise counsel for your franchise matters and separately seek very experienced merger and acquisitions counsel to work alongside them to advise you through the private-equity process. Sticker shock is common when you ask about their hourly rates, but they can save (or even make) you a great deal of money by providing expert advice through the negotiations. The same applies for your accountants. The International Franchise Association can help you locate top quality, experienced and focused service providers through its Supplier Forum. Take advantage of that valuable resource.

Now is a great time to sell some percentage of your business. Selling a stake offers many options, and franchise owners that do great due diligence and pay up for great advice can really cash in on today's market.

Despite the extra work and analysis involved, the use of strategic alliances may be well worth the investment and offer franchisors the means of increasing their brand coverage in today's competitive environment. ■

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