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Sourcing Deals

An Increase in M&A activity could bode well for the future

By Dennis L. Monroe

While the economics (particularly in the franchise world) have not substantially improved, there recently has been an increase in mergers and acquisitions (M&A) activity. In large part, this is due to the fact that there has been little activity for so long that the pent up demand is beginning to be reflected in increased transactions.

The private equity folks seem to be stepping back into the marketplace. Multiples used for determining valuations for various franchise businesses seem to have bottomed out; thus, returns have increased.

Additionally, the high yield debt market has started to provide available financing (although high priced), and, in part, has filled the shortage of senior debt. With lower multiples, high yield debt has become a viable financing source.

Further, positive same store sales for many franchise businesses has resulted in optimism and encouraged buyers who are looking for growth.

All said, it is still incumbent upon a potential buyer to figure out where the deals are and what deals make the most sense. This can be a difficult process because many businesses have come off rather poor performances; and even though current performances may be improving, it is still a matter of sorting out sustainable growth trends.

Here are my recommendations for sourcing deals and how to navigate this difficult landscape:

Look for Compatible Businesses

Rather than looking at any deal that comes across your desk, choose an industry sector you feel is compatible with your business experience and existing business(es). I have not seen many franchise companies that can cross over to substantially different sectors. Companies in the QSR restaurant world should stay in the fast food world. Companies in casual dining should stay in casual dining. Companies in the auto aftermarket industry should stay in the auto aftermarket industry.

Understand Your Financial Strengths

Ask yourself the following questions before you begin looking at deals: Are you a turnaround specialist or a growth specialist? Are you a consolidator? Management teams who turn businesses around have a different mentality than management teams who chose emerging concepts and want growth. Management teams who look to consolidate and leverage general administrative costs have a different approach than the emerging or turnaround companies.

Ability to Finance

Recently many businesses have asked me about doing deals but they have no clue as to how they will finance the deals. Consider these approaches:

- Are you looking at deals and then trying to find financing?
- Are you trying to find financing first and then looking for deals? or
- Are you looking for deals where you know the seller, in large part, needs to provide the financing?

These are key questions that will dictate the deals a buyer pursues.

Where Do I Find Deals?

Once you have determined answers to the above questions, where do you go to find deals?

Franchisor: If you are a franchisee, the first source to contact is your franchisor. The franchisor always knows businesses that are for sale. Another source for deals is your franchisee association or your network of franchisee friends.

Brokers: The franchise world is full of good investment bankers and brokers. It is important for you to find investment bankers and brokers who specialize in the type of business and concept you are suited for. Hiring a broker to do a search for you may be helpful and money well spent. The broker can contact other brokers as well as cold call businesses that have the criteria you are targeting.

Lawyers and Accountants: Lawyers and accountants who specialize in the industry you are considering may be a good source for deals as they may have clients who are interested in selling their businesses. You can certainly expedite the process and save costs by using these individuals or firms.

Trade Shows: There are many trade shows in the franchise world; and going to select shows gives you a sense of what may or may not be for sale. In many cases, this is not just looking to buy a new franchise but looking to acquire some existing franchise businesses.

Networking: It is important to let people know (whether they are in your franchise system, your legal or financial advisors or even brokers) that you are looking for a certain type of investment or a merger/acquisition target. It is amazing in today's market to see how quickly letting people know can generate leads.

Internet activity: It is essential to understand who the potential targets may be. The internet and access to various lists, FDDs and other analytical information are all helpful in the process.

Once you have decided on your deal profile and sources, you need to have some basic tools at your disposal:

Confidentiality Agreement: You need to develop a good confidentiality agreement that is not over the top yet provides the potential seller a comfort level as to the information they will provide to you. You also want a confidentiality agreement that protects you in the use of the information, particularly if you are providing information to your professional advisors.

Letter of Intent: Develop a standard letter of intent that is also not over the top so that when you come across a deal, you can immediately look at providing a preliminary offer that gives you appropriate time to determine the viability of the deal.. Make sure you have a clear understanding of what your criteria is for pricing, financing, due diligence and closing. Setting parameters for all of these items makes the process a lot easier.

Finally, have a good middle of the road purchase agreement that does not require a lot of needless negotiation.

Planning, being strategic and taking away uncertainty are the keys to successful merger and acquisition activity. While uncertainty and volatility will remain the state of the market, the above items will help sort through this confusion. FT

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