THE EVOLVING LANDSCAPE OF PRIVATE EQUITY INVESTMENTS IN FRANCHISING

GREENWICH CAPITAL GROUP

Franchising has long been a staple in the consumer and retail sectors, offering a proven business model for rapid expansion and stable revenue generation. Historically, private equity ("PE") firms have gravitated towards franchisors, drawn by their scalable business models, predictable cash flows, and strong brand equity. However, a noticeable shift has been underway, with franchisees increasingly becoming targets for PE investments. This article explores this evolving interest, spotlighting specific funds and transactions that underscore this trend, attributes making franchisees attractive to PE firms, and the inherent risks and challenges.

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The Shift Towards Franchisee Investments

Traditionally, PE interest was predominantly in franchisors, attracted by the allure of a high-margin, asset-light model that promises significant returns on investment. Franchisors offer a unique blend of brand strength and operational efficiency, making them highly attractive investment targets. Recent years, however, have seen a pivot, with PE firms now also setting their sights on franchisees.

There has been a significant increase in private equity investments in franchisees over the last decade. This shift is driven by the scalability, predictable revenue streams, and growth potential of franchisee operations. For example, multi-unit franchisees have become particularly attractive to PE firms due to their ability to expand quickly and efficiently, often leading to higher returns on investment compared to franchisors alone. This strategic shift is evident through recent acquisitions made by prominent consumer-focused investment firms.

Case Studies and Transactions

Franchise Equity Partners Takes Stake in Fresh Dining Concepts:

FEP FRANCHISE EQUITY PARTNERS

takes stake in

FDC FRESH DINING CONCEPTS

In 2022, Franchise Equity Partners (FEP) injected $44 million in equity funding into Fresh Dining Concepts, a major player within the Focus Brands ecosystem that includes Auntie Anne's, Cinnabon, Jamba, and Carvel.

Orangewood Partners Acquires Pacific Bells:

ORANGEWOOD

acquires

PACIFIC BELLS
A FRANCHISEE OF TACO BELL

In 2021, the investment firm Orangewood Partners successfully acquired Pacific Bells, LLC, a leading Taco Bell franchisee operating more than 270 restaurants spanning across 9 states. Taco Bell's robust profitability and strong brand recognition render it a notably secure investment option.

Brentwood Associates Acquires Afterburn Holdings:

In 2019, Brentwood Associates acquired Afterburn Holdings, a leading Orangetheory Fitness franchisee. Orangetheory makes an appealing investment primarily due to the robust support system that the franchisor provides its franchisees, including extensive trailning, assistance with real estate, operations, and marketing. Additionally, Orangetheory locations require a small footprint, leading to reduced initial investments, lower operating costs, and an opportunity to consider prime real estate options with higher foot traffic. Brentwood has since expanded its investment by partnering with Garnett Station partners, another prominent consumer investor, to acquire additional studios. Brentwood has grown Afterburn's studio footprint by over four times since its initial investment in 2019.

Trivest Partners Acquires PCRK Group:

Trivest capitalized on growing consumer demands for personal wellness and therapeutic services by investing in PCRK Group, the largest Massage Envy franchisee, with 95 locations across 11 states. Massage Envy's monthly subscription model makes it an attractive investment due to its customer loyalty, recurring revenue, and scalability. Massage Envy has grown to more than 1,000 franchised locations in the U.S.

Attributes of Attractive Franchise Investments

Private equity investors are increasingly attracted to franchisee investments. As factors can vary given the industry or franchise, some compelling attributes that attract PE interest for franchisee groups include:

Strong Unit Economics: Operations that demonstrate profitability at the unit level, with efficient cost management and high revenue per unit. Investors also value a franchise group's history, including its age, profitability, and positive company culture within its business models.

Geographic Diversification: Groups that operate in multiple locations reduce market-specific risks, particularly in terms of economic downturns or regional fluctuations.

Quality Management: Experienced leadership teams with a track record of success in scaling operations.

Brand Strength: Association with well-known brands that have a loyal customer base, strong market positioning, and a proven business model.

Secured Territory Rights: Protection against area encroachment and competition, ensuring a stable market presence and reduced risk of internal brand competition.

Relationship with Franchisor: Established relationships with the franchisor and favorable royalty agreements can optimize ongoing costs, boosting profitability potential.

Proven Scalability: Demonstrating ability to grow and scale effectively provides confidence that the business model can be replicated across new markets or regions.

Leveraging Private Equity for Accelerated Growth: Benefits for Multi-Site Franchise Owners

For multi-site owners of franchise systems looking to accelerate their growth, partnering with PE firms offers compelling advantages. PE firms can expedite growth by infusing additional resources and capital, enabling rapid expansion and operational enhancements that might otherwise be unattainable. This partnership allows owners to take some chips off the table, providing immediate financial security while still retaining a substantial upside as the business continues to grow. Additionally, PE firms bring strategic guidance and industry insights that can refine business strategies and drive efficiency. Importantly, franchise owners can leverage these benefits while remaining in the driver's seat, ensuring that their vision and operational control continue to shape the franchise's future.

Recent Examples of Multi-Site Franchise Owners Partnering with PE:

TSG Consumer Partners and Planet Fitness Franchisees:

In 2021, TSG Consumer Partners, a leading private equity firm, made a significant investment in a Planet Fitness franchise group. The deal involved one of the largest Planet Fitness franchisees, operating over 100 locations. This partnership provided the franchisee with the capital needed to expand its footprint rapidly and upgrade existing facilities, while the franchisee's leadership team retained operational control and benefited from TSG's strategic expertise.

Levine Leichtman Capital Partners and Hand & Stone Massage and Facial Spa:

In 2020, Levine Leichtman Capital Partners (LLCP) invested in Hand & Stone Massage and Facial Spa, a rapidly growing franchise with over 400 locations. LLCP's investment aimed to support the franchise's expansion plans and enhance its operational capabilities. The partnership allowed Hand & Stone's multi-site owners to accelerate growth, improve service offerings, and take advantage of LLCP's extensive industry experience.

Roark Capital and Jim 'N Nick's Bar-B-Q:

In 2019, Roark Capital, a private equity firm with a focus on multi-unit franchise brands, acquired a majority stake in Jim 'N Nick's Bar-B-Q, a popular barbecue chain with over 40 locations. The deal provided the franchisee with the necessary resources to expand into new markets and optimize operations. Roark Capital's investment also allowed the franchisee to benefit from the firm's strategic guidance while maintaining day-to-day control of the business.

Sentinel Capital Partners and Massage Envy:

In 2020, Sentinel Capital Partners invested in Massage Envy, a leading provider of therapeutic massage and skincare services with over 1,150 franchise locations. The partnership enabled Massage Envy's multi-site owners to leverage Sentinel's capital and expertise to fuel growth and innovation. The deal also provided financial liquidity to existing franchisees while positioning the brand for long-term success.

Alliance Consumer Growth and Shake Shack Franchisees:

In 2022, Alliance Consumer Growth (ACG) invested in a prominent Shake Shack franchisee group operating multiple locations across the United States. The investment aimed to support the franchisee's aggressive expansion strategy and enhance operational efficiencies. ACG's involvement brought additional capital and strategic insights, allowing the franchisee to scale rapidly while maintaining high-quality service and brand standards.

Risks and Challenges

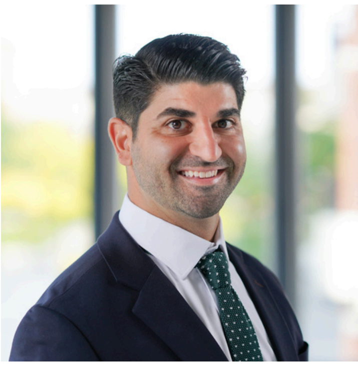
Investing in franchising is not without its challenges. PE firms face risks such as market saturation, where too many franchise units dilute the brand and cannibalize sales. A notable example in recent years is the powerhouse brand Starbucks, which faced a slowdown in growth due to this issue. Due to concerns of sales cannibalization, Starbucks undertook rounds of store closures targeting underperforming stores. This move was largely driven by the proximity of new stores, which were diverting a significant number of transactions away from existing stores. Conversely, Subway is a brand that has successfully pivoted from these challenges. Historically, Subway's aggressive expansion strategy allowed for easy and low-cost opening of new locations, which led to market saturation. Recently, Subway launched a brand revitalization strategy led by menu innovation, modernization of restaurants, and improvements to guest experience. Subway has reported high levels of same-store sales growth since implementing this strategy, reviving its brand, and boosting profitability for its franchisees.

Similarly, franchising is a highly regulated field that is subject to stringent regulatory oversight, introducing unpredictability and additional expenses which can impact the overall business model. Moreover, the success of investments in franchisees often hinges on the continued relevance of the consumer brand and its adaptability to changing consumer preferences.

IN CONCLUSION

The growing appeal of franchising to private equity investors reflects a broader recognition of the strategic value inherent in both franchisors and franchisees. With the retail landscape continuously evolving, franchising offers a flexible and scalable model that can adapt to changing market dynamics. As PE firms become more nuanced in their investment strategies, their interest in franchising is set to grow. This trend is underpinned by an understanding of the sector's potential for lucrative returns, while remaining strategic in maneuvering around its inherent risks. PE firms are well positioned to capitalize on the opportunities within franchising, leveraging its adaptability and growth potential.

GCG has experience working with both franchisees and franchisors. For more information, please reach out to GCG's Consumer co-lead, Andrew Dickow:



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ABOUT US

GREENWICH CAPITAL GROUP

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GCG was founded by entrepreneurially minded investment banking professionals focused on building an organization centered around advising clients. We strive to build relationships by representing our clients' long-term interests and earning their trust. In contrast to the practice of pushing transaction responsibilities to junior resources, our philosophy is to deliver personalized, senior-level attention and experience to every GCG engagement. We are proud to offer references that will speak to a differentiated level of service and results.