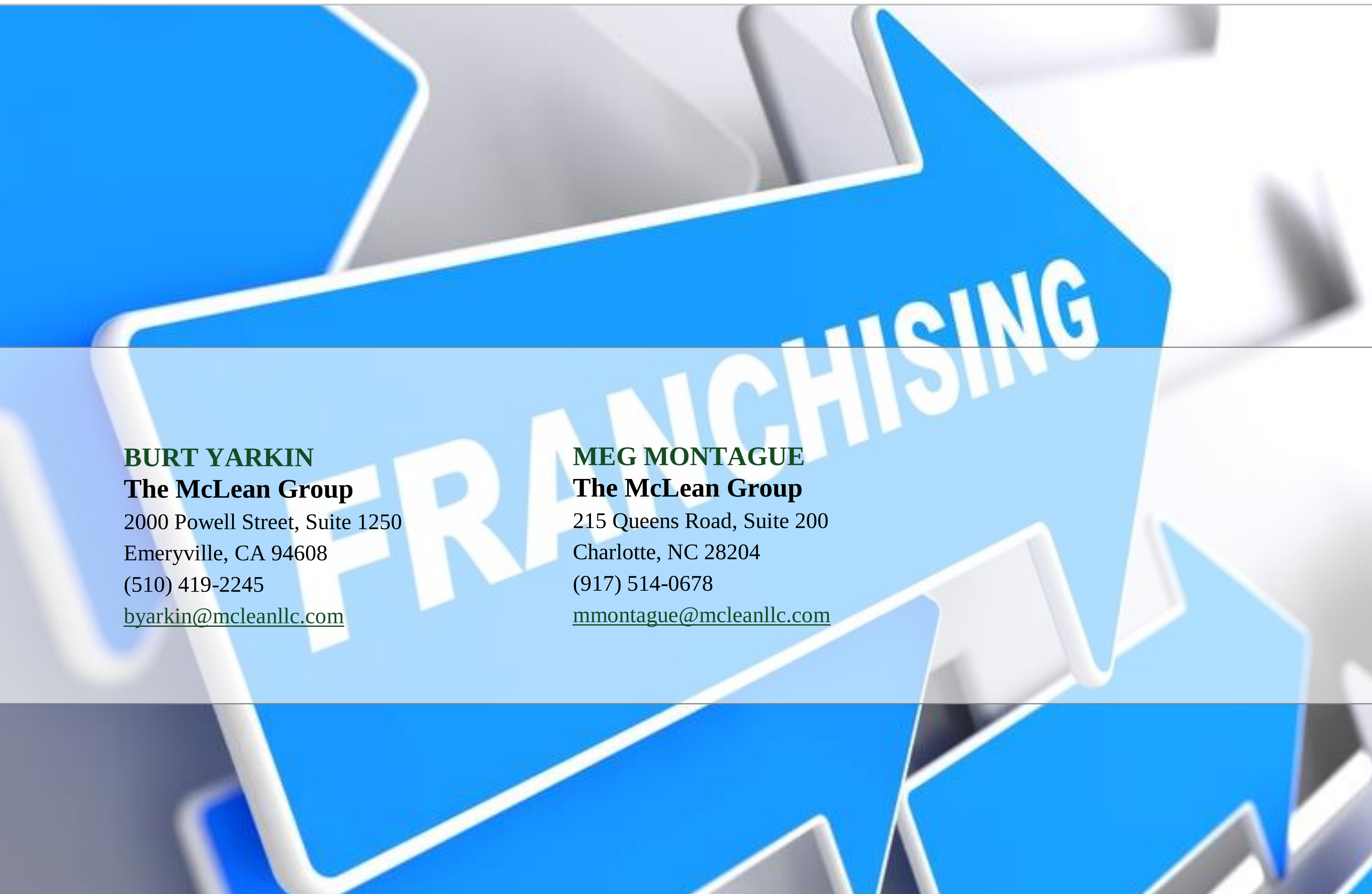
Mergers & Acquisitions in Franchising

2014 Year End Overview



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Record Valuations

YEAR END REVIEW

Franchise valuations currently mark historically high levels. While valuations for franchisors and large multi-unit franchisees were negatively impacted during the recession, since then, the industry has experienced another year of strong transactions in 2014. The M&A market for franchisors and large multi-unit franchisees is as strong as it has ever been. Now is an ideal time to be a franchise brand owner looking to exit or seek growth capital.

Capital Markets and Franchising

During 2014, the M&A market was robust and included some very prominent transactions. Key 2014 acquisitions included Massage Envy, a franchisor of massage and facial spas, trading from Sentinel Capital to Roark Capital. In the fall, TZP Group sold Dwyer Group, a multi-branded home services franchisor, back to Riverside Capital, which had owned the brand previously. Earlier in the year, TZP acquired Snap Fitness from Summit Partners. Fastsigns, a franchisor specialized in digital and graphic signs, was acquired by Levine Leichtman Capital Partners from Roark Capital; and Apollo Management acquired CEC Entertainment, which operates Chuck E. Cheese's restaurants. In addition, Sentinel Capital acquired Newk's Eatery in the first quarter.

During the same time, we have seen significant capital injections in franchise systems. Since 2012, there have been more than 100 private placements involving franchise companies, including: European Wax Center's $24M financing from Princeton Ventures and Brazos Private Equity in March 2013; and Smashburger's $48M financing in September 2014.

Additionally, investors in capital markets have benefited from the successful IPOs of franchise systems. The IPOs of El Pollo Loco, ServiceMaster, Papa Murphy's, and LaQuinta have brought strong returns to investors and entrepreneurs alike. The impressive gains reaped from M&A, Private Placements and Capital Markets over the past two years have cemented investor interest in the franchising industry. Going forward, the promising investment landscape offers entrepreneurs a wide range of opportunities. The M&A market will continue to be robust for franchisors and multi-unit franchisees selling their companies as the combination of low interest rates and strong, growing franchise brands supports higher valuation multiples.

What is driving these record values?

Several key factors are driving strong valuations today. We previously reported Prequin's estimates that private equity firms have approximately $1.2 trillion in cash to invest and strategic buyers have more than $2.0 trillion to invest. While only a portion of these funds will be invested in franchising, this $3.2 trillion in "dry powder" creates pent-up demand – thereby driving up prices – because private equity firms and strategic buyers are under pressure to invest their cash.

Strong debt markets support higher valuations. Most significant franchisors today have access to inexpensive debt capital, especially if they have private equity sponsors and strong cash flows. The availability of relatively inexpensive bank financing for acquisitions provides private equity firms the ability to increase the purchase price they may be willing to pay in competitive situations for attractive companies.

The competition between private equity firms for good franchisors and large multi-unit franchisees is intense. We have tracked more than 300 private equity firms that have invested in franchising and are active in the market. Almost all of these firms are looking for additional brands in which to invest.

Finding brands of scale that need capital or have owners who are willing to exit and sell is the challenge for most private equity and strategic investors in franchising. A lack of franchisors of scale in the marketplace has resulted in more private equity investment in high quality multi-unit franchisees. The combination of affordable debt and steady cash flow of multi-unit operators make them ideal leverage buyout targets.

Franchise Industry in 2015 and Beyond

Since the recession, the franchise industry has experienced substantial growth based on the number of newly opened franchised units. According to the International Franchise Association, in 2015, the number of franchised establishments is estimated to increase 1.6% to more than 780,000, while the total economic output from franchises is estimated to grow 5.4% to $889 billion. Gross domestic product from the franchise sector is expected to increase 5.1% in 2015 as compared to total estimated GDP growth of 4.9%. Based on these anticipated favorable franchise growth trends, combined with the attractive cash flow dynamics generally inherent in most franchise models, private equity interest in franchisors is expected to be robust in coming years.

In 2014, at least 20 deals were completed in the franchise industry by private equity firms. Valuations for these franchisors generally have been considered to be at a "premium" – or at least at levels considered above average M&A deal valuations in the middle market (i.e., many franchisor transactions are completed at high single-digit, if not double-digit EBITDA multiples). These above market valuations can partially be attributed to (i) a general scarcity of franchisors of scale (i.e., greater than $5 million of EBITDA), (ii) the attractive cash flow dynamics of many franchisors, which can increase the leverage available to consummate a transaction, (iii) potential untapped growth available to the company acquired, and (iv) overall attractiveness of the acquired brand and value proposition within its marketplace.

Growth of the Multi-Brand Franchisor Platform

While there are certainly single brand franchisors of scale, there is an inherent opportunity to create scale through creating a multi-brand franchisor platform. There are several successful examples that exist, but they represent a relative minority compared to the estimated 770,000 US franchise establishments (according to the International Franchise Association). A few successful examples of multi-brand platforms include the following:

Home Services

The Dwyer Group	ServiceMaster Family of Brands	Service Brands International	Outdoor Living Brands
The Riverside Company	Public	Private Ownership	Private Ownership

Restaurant and Food Services

Focus Brands	Yum!	Global Franchise Group
Roark Capital	Public Company	Levine Leichtman Capital Partners

Health and Wellness

Lift Brands – Elevated Wellness Companies
TZP Group

Children and Family Entertainment

Fun Brands
Tregaron Capital

Consumer and Retail

Driven Brands	Winmark – Create-Support-Finance Business	Annex Brands
Harvest Partners	Nine Ten Capital Management	Private Ownership

Given the relative dearth of franchisors of considerable scale, investors interested in participating in the franchise sector should consider the benefits of creating a consolidation platform stemming from one strong brand. While some franchisors may have tremendous brands and growth potential, they lack the infrastructure and perhaps team depth to support a diversified brand platform. In other cases, the brand has so much growth potential on its own, the team may prefer to avoid diluting its efforts with other brand add-ons. In the case of a franchise concept that has a strong, complete management team across critical functional areas, combined with a solid, expandable IT infrastructure, creating a multi-brand platform could offer an attractive investment opportunity for private equity firms seeking scale within the franchise industry.

To determine if a multi-brand franchise platform could yield positive investment returns, potential considerations may include:

Potential Upside:

- **Valuable Team Resources**: Consolidation offers the potential to leverage or rationalize teams in finance/accounting, legal and information technology. There may be an opportunity to realize cost savings or bolster leadership where duplicate teams exist or functions are outsourced, or functional leadership gaps need to be filled.

- **Sharing of Operational Best Practices**: Either at the corporate level or franchisee level, having multiple brands that interact can facilitate the adoption of best business practices across the network. Many existing multi-brand concepts have summits or conferences periodically where all brand teams and franchisees can interact and present ideas, ask questions, discuss challenges and develop solutions to common problems.

- **Ability to Provide High Performing Franchisees with Growth Opportunities**: Having multiple brands within one platform may enable a franchisor to offer existing high performing franchisees an opportunity to expand within their territories through opening new franchises of other platform brands. This opportunity provides the franchisor the ability to efficiently grow brands within territories where it did not currently have a presence by leveraging its existing franchisee system.

- **Cross-marketing Opportunities**: Assuming the brands are complementary, cross-marketing to the combined customer base could be advantageous; however, it requires tremendous coordination across the platform. Franchisees need to have access to a user-friendly CRM system to manage relationships. This CRM system, in whatever form makes sense for the business model, would likely need to be owned and controlled at the franchisor level, and appropriate customer protections would need to be put in place. The franchisees across the brands would need to be willing to share data to benefit the entire system.

<u>Potential Considerations</u>:

- **Disgruntled Franchisee System**: How competitive are the franchise brands? If they are too competitive, the acquiring franchisor may have considerable issues across the franchisee network, especially if brands compete for similar customers within the same geography and/or the franchisor plans to consolidate two brands into one brand. While this strategy may selectively be successful, some franchisors that have attempted to consolidate competing brands either as one brand or as two brands on one platform, have ended up with franchisee "revolts" or lawsuits.

- **Need for Distinct Teams in Certain Core Functions**: Even if the brands are complementary and not directly competitive, certain franchisor functional areas potentially should be kept specific to each brand. Teams that likely would benefit from being dedicated to certain brands include franchise development, marketing and branding, and franchisee support. At the franchisor level, incentives in these functional areas can be better aligned to brand goals if they are kept dedicated to one brand. Additionally, franchisees may appreciate having franchisor support in certain areas that are fully focused on one brand versus potentially facing conflicts of interest or more focus and resources being provided to one brand at the expense of another.

Select Transaction Activity in 2014

Franchisors and large multi-unit franchisees continue to attract significant capital from private equity and strategic investors. In addition, multi-brand franchisor groups, such as Dwyer Group, are receiving growth capital to acquire complimentary brands and expand its market footprint. Last month, Roark Capital Group closed its fourth fund with committed funds of $2.5 billion. Since inception, Roark has acquired 34 franchise/multi-unit brands, including Anytime Fitness, Arby’s, Wingstop, Massage Envy and others. Going forward, investors will continue to sponsor franchisors, multi-unit franchisees, and multi-brand franchisor groups to accelerate growth through the acquisition of new brands and aggressive expansion of existing brands.

The Dwyer Group Acquired by The Riverside Company
The Dwyer Group, based in Waco, TX, has become a leading operator of multiple service-based, franchise concepts. Brands include Aire Serv, Glass Doctor, Mr. Appliance, Mr. Electric, Mr. Rooter, Rainbow International, and The Grounds Guys. In August 2014, The Riverside Company acquired majority ownership of The Dwyer Group with reinvestment from the executive team. Riverside Company initially acquired The Dwyer Group in 2003 and sold it to TZP Group in 2010. Since the recent Riverside acquisition, The Dwyer Group has added Five Star Painting to its portfolio of service-based brands. Five Star Painting operates in seven countries, including the US, with an expansive network of more than 1,600 franchisees.

The Huntington Company and CRDN Expands Franchise Network

In the fourth quarter of 2014, The Huntington Company acquired One Hour Martinizing. The Huntington Company is the largest provider of dry cleaning services in the US. Management expects substantial synergies through the alignment of services with existing brands, such as Bizzie and 1-800-DryClean. Launched in 2013, Bizzie utilizes revolutionary mobile technology to provide drop-off and delivery dry-cleaning services. The 1-800-DryClean franchise serves residential communities and office buildings with convenient door-to-door pick-up and delivery. Martinizing is a portfolio add-on to The Huntington Company's platform, which includes its largest brand, CRDN, a textile restoration company serving the insurance industry.

Sentinel Capital Acquires Newk's Eatery

In March 2014, Sentinel Capital acquired the 67-unit franchise, Newk's Eatery, which is an attractive addition to its portfolio of restaurant and franchise brands. The past two years, Sentinel has been extremely active having sold Massage Envy, acquired Huddle House, sold a large Pizza Hut franchisee, and acquired Checker's. Newk's Eatery has doubled its store count to more than 70 units in two years. Newk's Eatery plans to open more than 25 units in 2015 and a total of 200 units by 2019. The restaurant concept is known for hand-tossed salads, oven-baked sandwiches and California-style pizzas.

Announced Date	Target/Issuer	Buyers/Investors	Implied EV
12/23/2014	PODS Enterprises	Ontario Teachers' Pension Plan	-
11/11/2014	Martinizing	The Huntington Company	-
10/16/2014	Peter Piper Pizza	CEC Entertainment, Inc.	-
10/07/2014	Pressed 4 Time	The Huntington Company	-
9/29/2014	Einstein Noah Restaurant Group	JAB Holding Company	-
9/17/2014	The Cleaning Authority	PNCRiverarch Capital	-
9/4/2014	Lube Stop	Argonne Capital	-
8/21/2014	Hot Dog on a Stick	Levine Leichtman Capital Partners	-
8/18/2014	Dwyer Group	The Riverside Company	-
7/28/2014	Mister Car Wash	Leonard Green Partners	$380
7/17/2014	Fastsigns	Levine Leichtman Capital Partners	-
5/28/2014	Flynn Restaurant Group	Teachers' Private Capital	-
5/20/2014	TGI Fridays	Sentinel Capital Partners	-
5/15/2014	Red Lobster	Golden Gate Capital	$2,113
5/5/2014	Learning Care Group Inc.	American Securities	-
4/24/2014	On The Border	Fortress Investment Group / Argonne Capital Group	-
3/25/2014	Newk's Franchise	Sentinel Capital Partners	-
2/27/2014	Anytime Fitness	Roark Capital Group	-
1/31/2014	Don Pablo's	Food Management Partners	-
1/24/2014	Checkers	Sentinel Capital Partners	-
1/16/2014	CEC Entertainment	Apollo Management	$1,309
1/9/2014	Snap Fitness	TZP Group	-
1/9/2014	PJ United (Papa John's Franchise)	TPG Growth	-

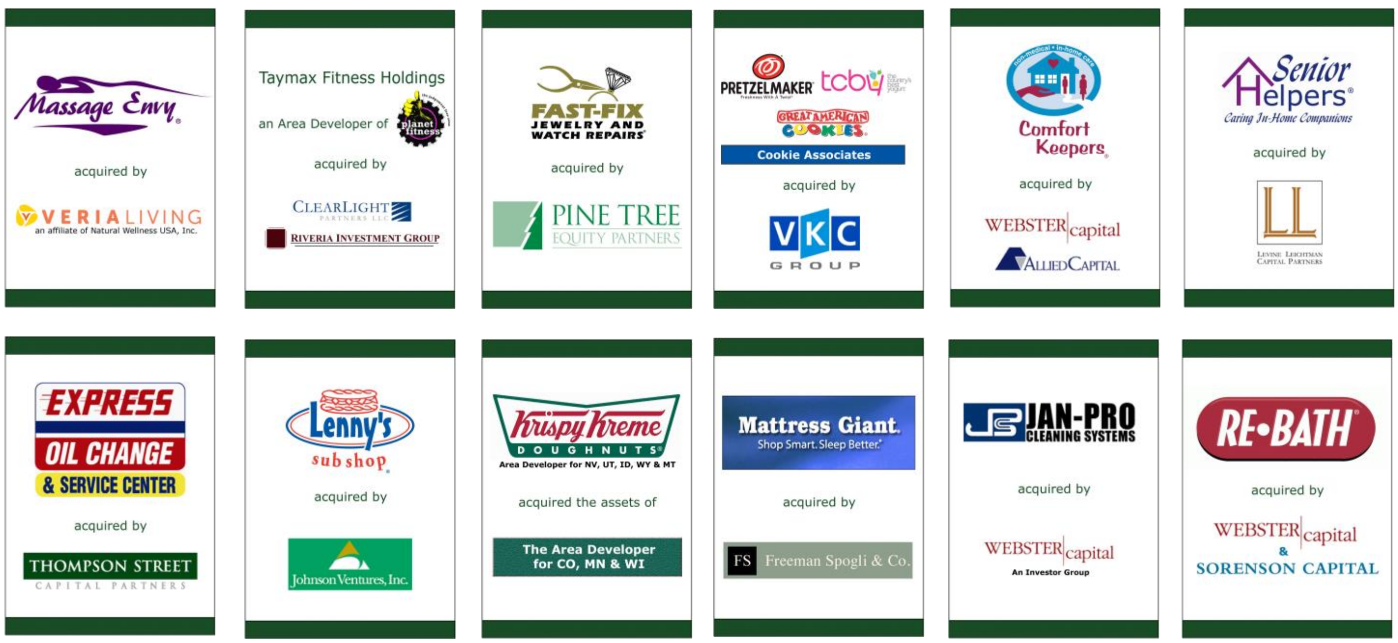
Source: CapitalIQ

THE MCLEAN GROUP FRANCHISING PRACTICE

The McLean Group is a leading independent investment bank that provides mergers and acquisitions (M&A), business valuation and strategic consulting services to middle market businesses. The McLean Group's Franchising practice is one of the most active M&A practices in the industry. Our franchising practice has a regular presence at conferences across the country and our bankers have strong connections to active buyers and investors.

Additionally, our M&A advisory and valuation services reflect our comprehensive industry knowledge, extensive transactional successes, commitment to provide senior-level attention to every client engagement, and real-time understanding of industry-specific valuation drivers. Through our commitment to partnering with clients and providing strategic advice throughout every phase of a company's development, The McLean Group is uniquely positioned to build lasting relationships and contribute measurable value to each client's long-term success.

Select Franchising Engagements



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