2022FLDC

FRANCHISE LEADERSHIP & DEVELOPMENT CONFERENCE

2023: It’s Complicated

Trends Universally Impacting Business

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FRANCHISING IN 2023

Macroeconomic Outlook

The key economic drivers for 2023 and beyond?

Capital Access

How lender credit boxes will change from 2020/ 2021

State of Franchising

How will both of these affect franchising in 2023?

World Economy: Overview

Inflation driving downturn around world

UNITED STATES

- Inflation
- Slow growth in economy
- Supply chain constraints
- Labor issues

EUROPE

- “Deep recession”
- Energy conflict with Russia
- Devaluing currency
- Out of control inflation – 9.9%
- Public sector job cuts
- Russia Ukraine War

RUSSIA

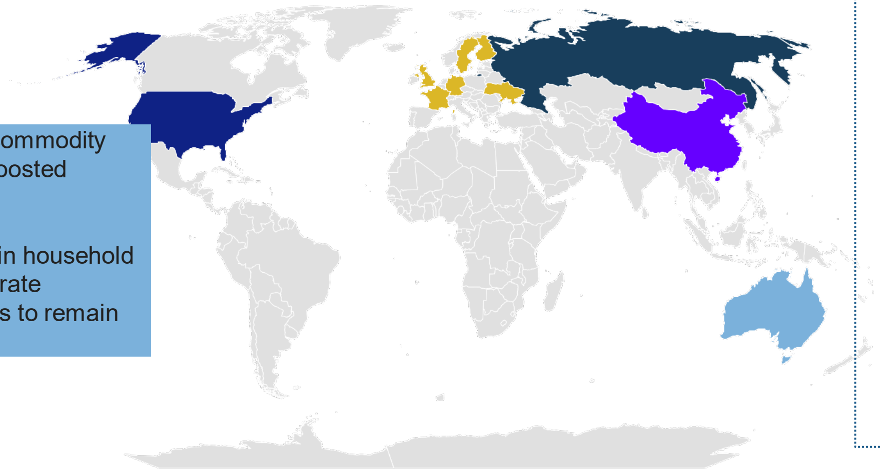
- Trade war and sanctions
- Ongoing war with Ukraine
- Rising cost of imports

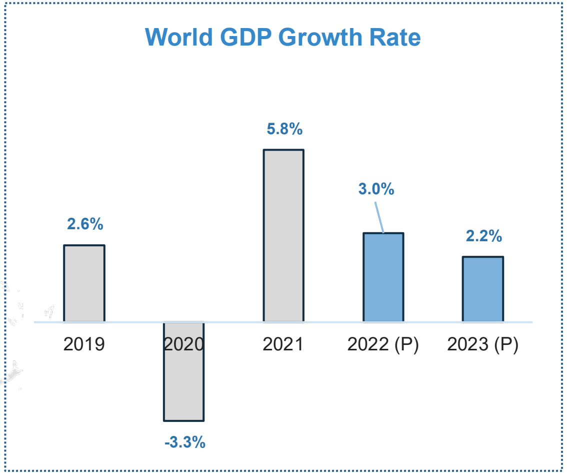
CHINA

- COVID-19
- Slow GDP growth
- Collapse of housing market
- Trade sanctions
- China-Taiwan war?

AUSTRALIA

- Higher commodity prices boosted exports.
- Inflation
- Decline in household savings rate
- Oil prices to remain high





Source: FRANdata Research, OECD Interim Economic Outlook September 2022

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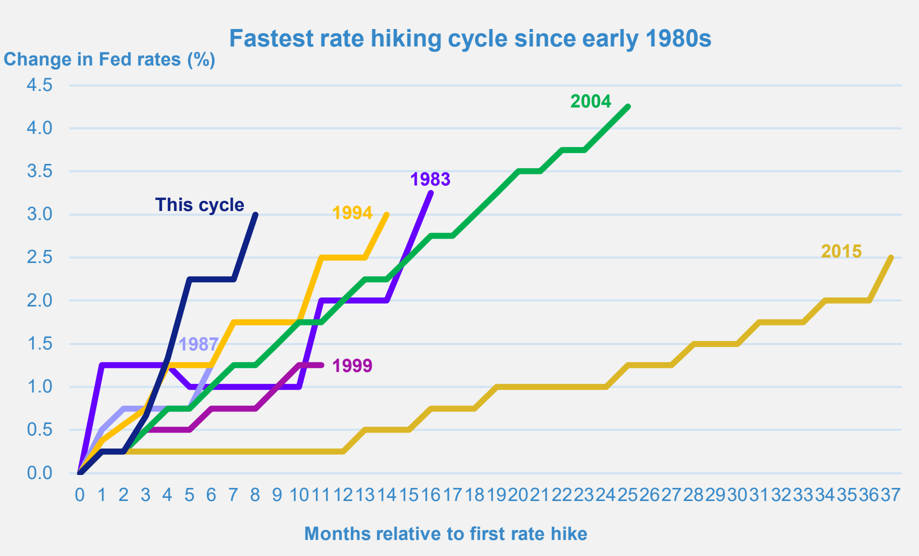
FED won’t back down from fighting inflation

Three letters will determine ‘23 domestic economy – “FED”



Current SBA Rate – 20 Yr

Period of high interest rate can extend 2-3 years

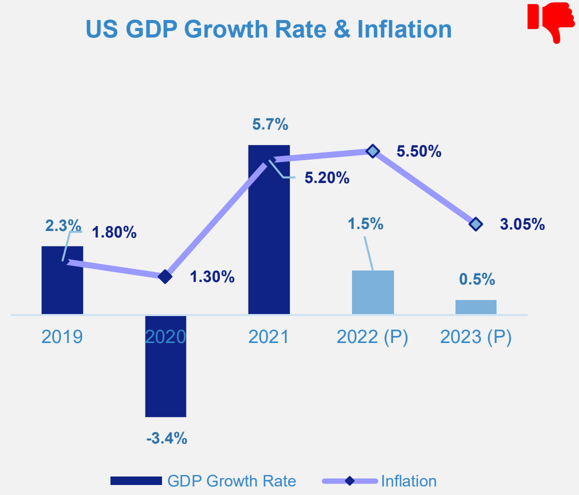
Forecasted GDP growth rate in 2023

Source: FRANdata Research, Charles Schwab

Rising rates dampen domestic spending

Cost of fighting inflation: GDP growth and negative sentiment

- Projected GDP growth rate 0.5%
- Inflation will slightly improve in '23 but still high
- High interest rate to keep inflation in check
- Financial institutions are healthy



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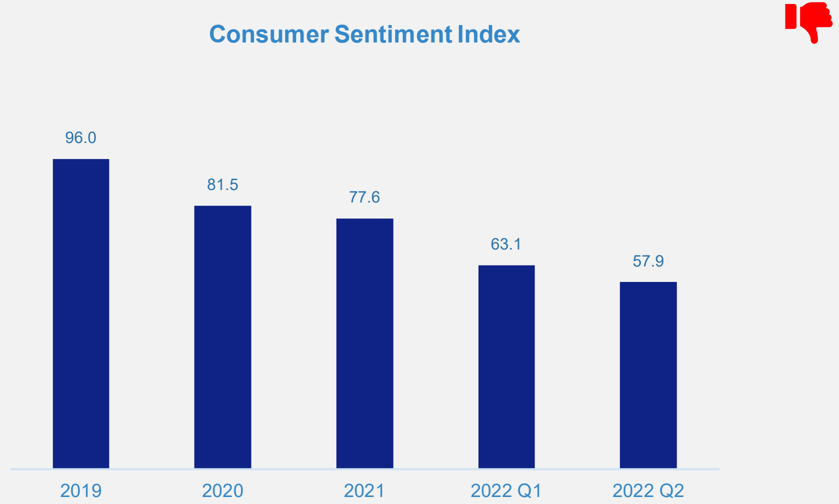
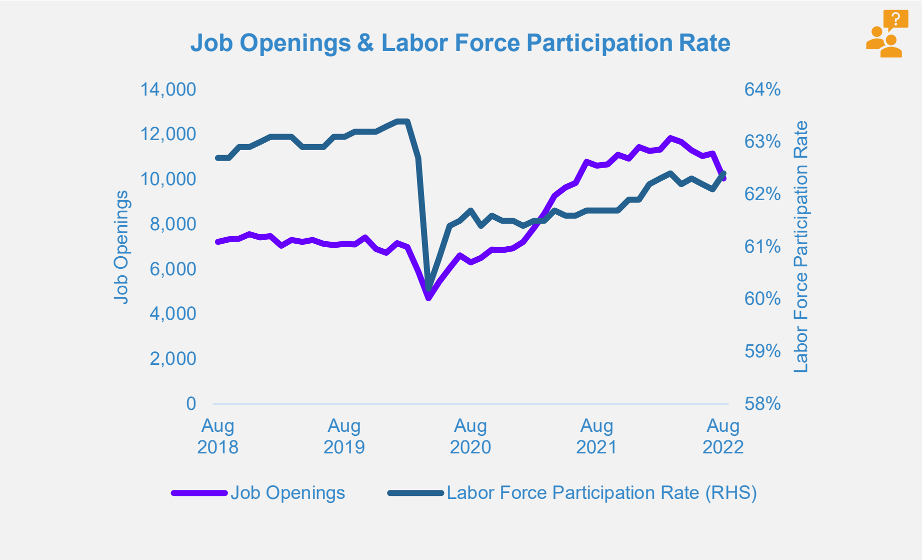


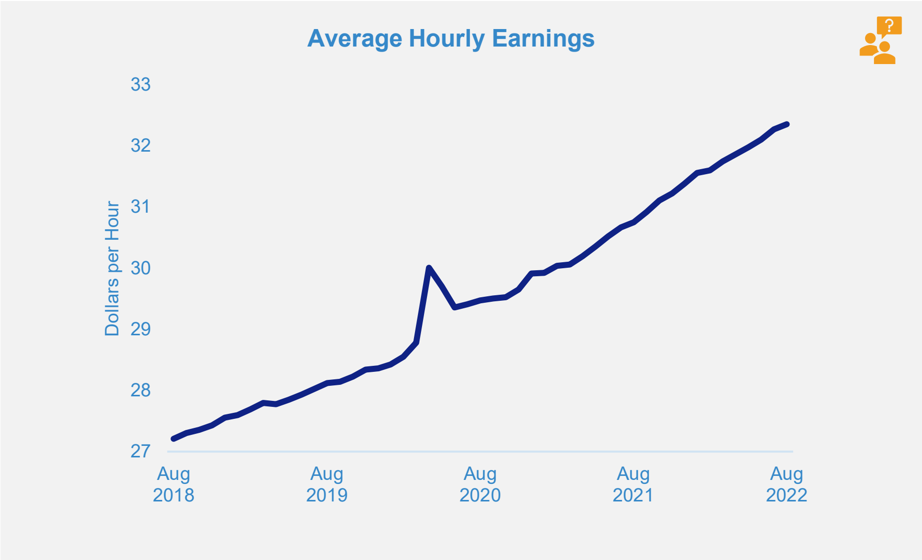
Source: University of Michigan

Labor Market

Labor supply and cost of labor will continue to be a challenge



Source: Bureau of Labor



Source: Bureau of Labor

Workforce shortage and wage inflation are top challenges for small businesses in 2022/2023 – 88% franchisees are unable to find employees; Wages increased by 4% in 2022

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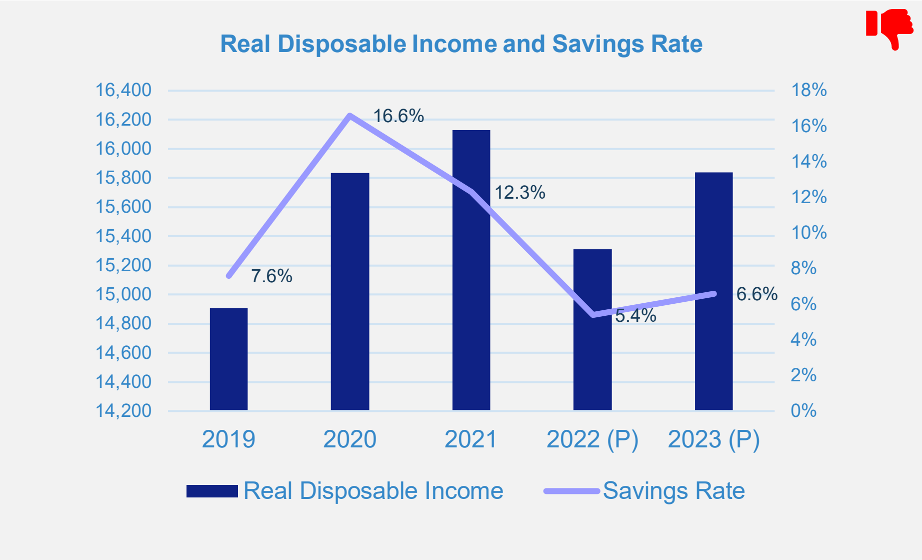
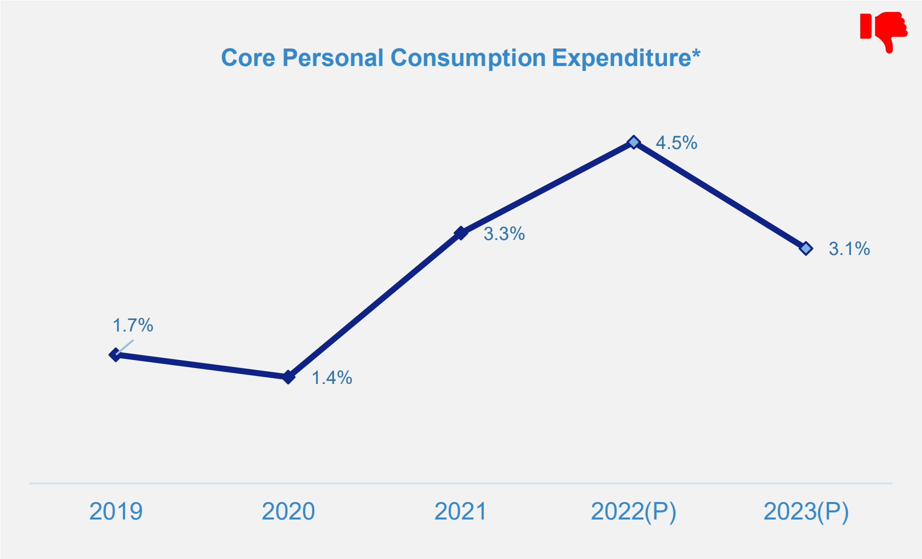
Household Income

Declining ability and willingness to grow spending



Source: U.S Bureau of Economic Analysis, April 2022

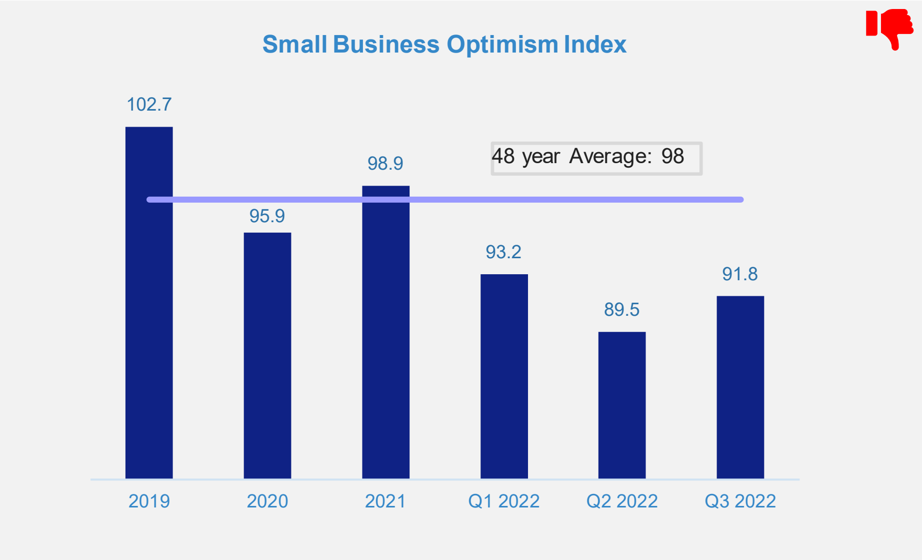


Source: U.S Bureau of Economic Analysis, April 2022

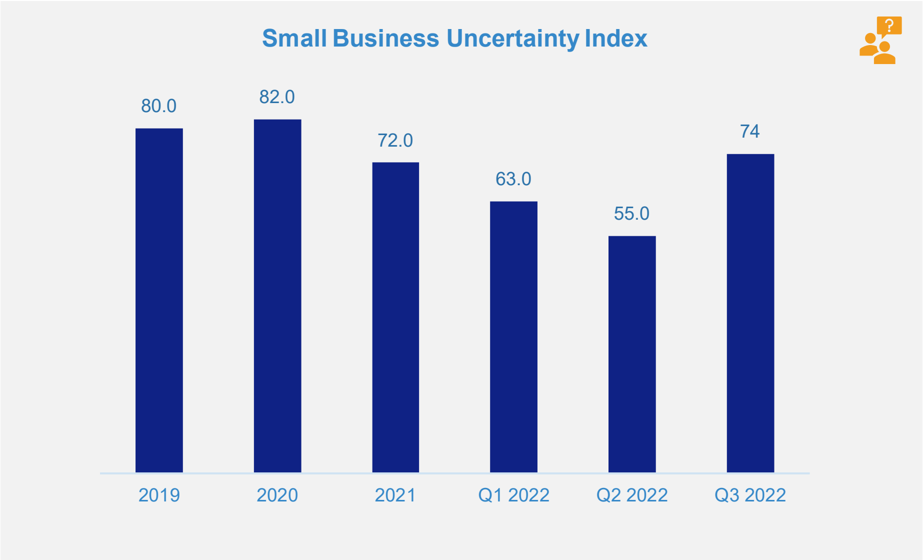
We're looking at negative discretionary cash flow for the first time since the 2008-09 financial crisis

Small Business Impact

Small businesses are more uncertain and risk averse



Source: NFIB, FRANdata Research

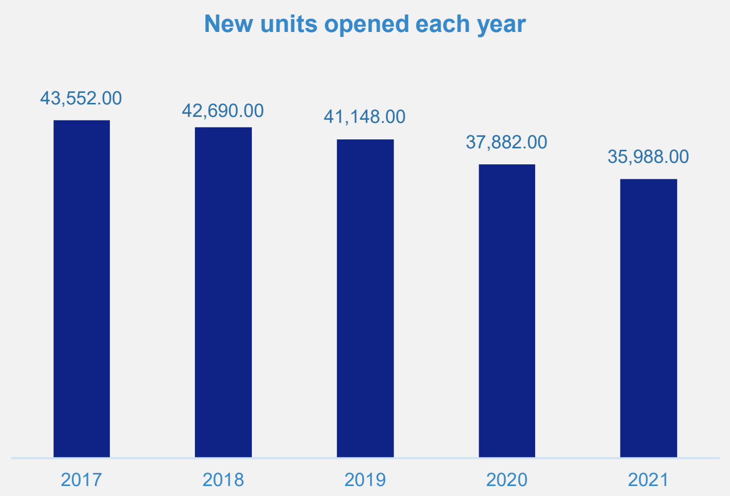


Source: NFIB, FRANdata Research

As optimism for small businesses declines and uncertainty about future increases, small businesses will reassess their growth and expansion plans for 2023

History Shows Switching Jobs/Careers Drops

Prospect franchisees will be more risk averse



Source: FRANdata Research

New unit development is below pre pandemic period

Negative sentiment and high uncertainty will impact new development

Cost of development has increased due to inflation & high interest rate

Economic concerns, inflation driving initial investment up, and increased cost of capital will make prospects hesitant

No rockets on horizon to propel recovery

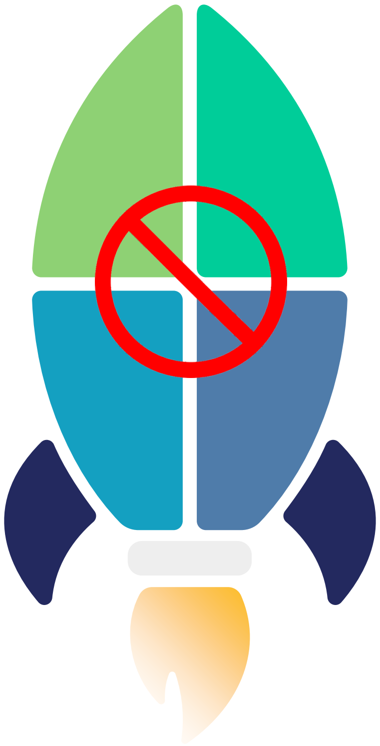
The recovery from “*pasta bowl recession*” will be slow

What we know

- Slow economic growth
- High interest rates to continue
- No government bailouts to propel growth

What we don’t know

- Will slowdown qualify to be called a “recession”
- When exactly supply chain disruption ease out



What matters

- Fed focus on inflation is likely to onset recession
- Certain price increase (such as labor) is permanent

How does it impact

- Businesses will continue to face inflation challenge
- Many will experience margin erosion as prices increase
- Businesses will face negative sentiments from all stakeholders

What does it mean for business?

As market rationalizes, businesses deals with dual challenges of inflation and slowing economy

1. Consumption spending will substantially decrease for expendables in 2023

2. Brands should bolster trust for their products: safe products, value for money, etc.

3. Some should use this opportunity to reposition their brand

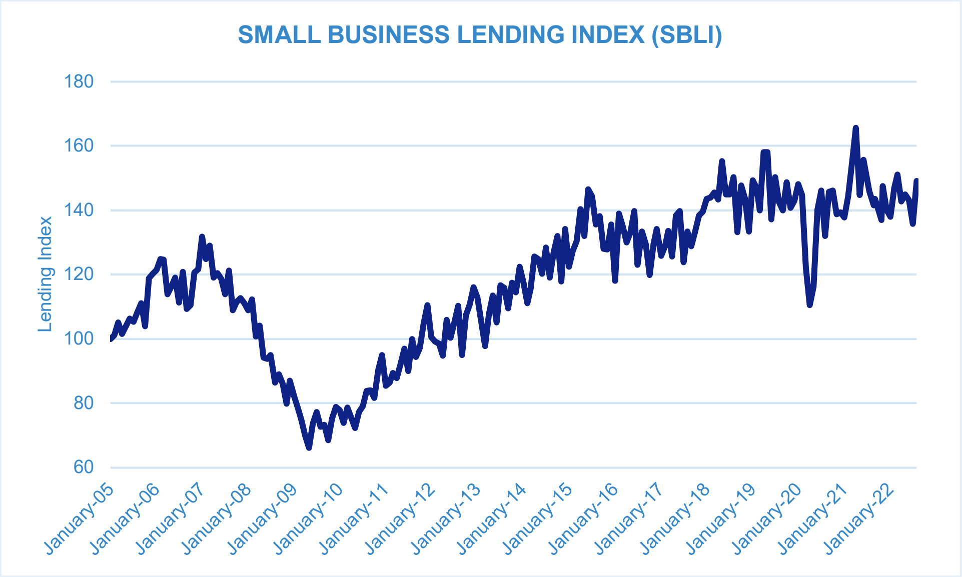
4. Brands should not get tempted to move down-market to cover larger customer base. This will alienate and confuse loyal customers

5. Streamline product portfolio. Most important seize the opportunity rather than making changes when forced to do

6. Be prepared for long term shift in consumers' values and attitudes

Small Business Lending Index

Banks will be more selective and offer tougher terms



Source: Equifax, FRANdata Research

Availability of capital

≠

Accessibility of capital

How lenders are thinking?

Lenders will have low risk tolerance

	Pre 2020	2020-2021	2022-2023
Past Performance History	●	●	◔
Cash in Balance Sheet	●	●	◔
Loan repayment history	●	●	◔
Viability of business model	◑	◔	●
Revenues & Margin	◕	◔	●
Impact on cost when delay in opening new units	◔	◔	●
Change in Buildout and Opening Cost	◔	◔	●
Consolidation through M&A	◔	◔	●

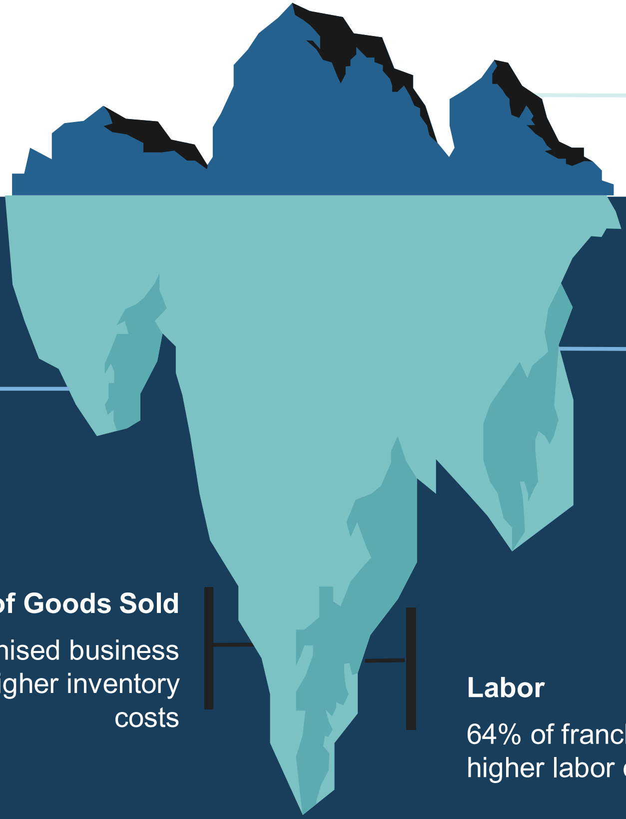
● Very Important

◑ Somewhat Important

◔ Not Important

Lenders and franchise businesses

Banks are assessing impact of inflation on unit margins, placing more value to profit margins after royalties, etc.



Profit Margin

Along with impact of inflation in other business areas, cost of financing has significantly increased for most businesses

Initial Investment Cost

With inflation, the initial investment cost for most brands have increased. Add to it increased cost of capital. There will be delay in opening new units.

Franchise related cost

Royalties, marketing fund spends, & other franchise related cost typically reach 10% of revenues. Lenders are more cautious and are looking at business models that “worked”

Cost of Goods Sold

87% of franchised business experienced higher inventory costs

Labor

64% of franchisees witnessed higher labor cost

What lenders & prospects want to know

Lenders & prospects will be risk averse; will seek higher value

?

How is the brand dealing with inflationary pressure?

?

How is the brand helping franchisees deal with macroeconomic challenges?

?

What is the impact of increased cost of capital on bottom line?

?

What will the demand of brand's services/goods look like in 2023+?

?

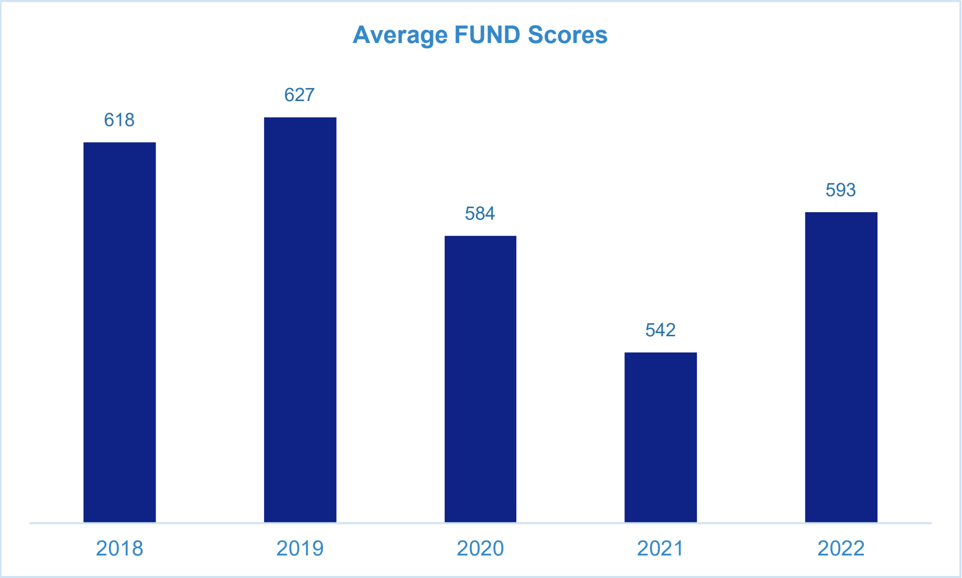
Is brand prepared to survive economic downturn?

?

Is the business model recession resistant?

FUNDScores

Franchised system are better prepared to handle economic downturn



Source: FRANdata Research

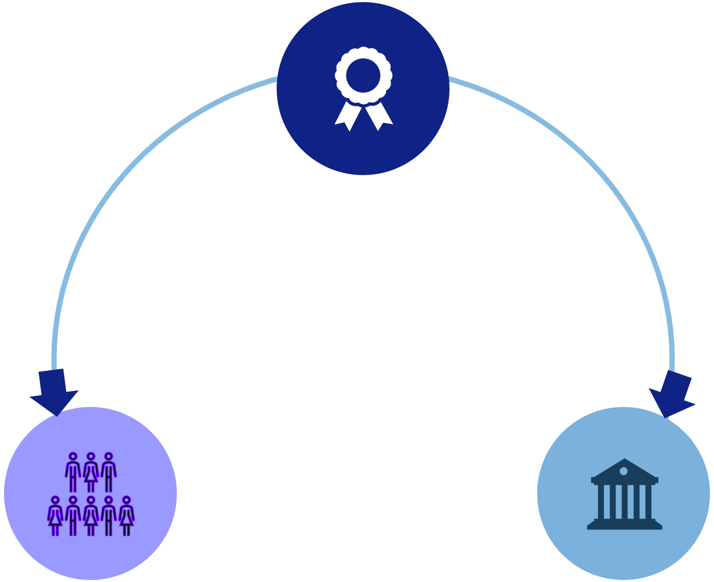
What worked in past will not work anymore.

Post pandemic FUND scores signify that certain brands that received funding in 2020 & 2021 may not necessarily get funding in 2023

Accessing the right resources

Transparency will play a key role in ensuring brands attract right franchisees and receive capital

Brands will play a major role making sure right information is shared with prospects and banks



Any brand proposition for **franchisees** must justify higher capital cost

Banks have strength to lend but will avoid underwriting risky loans

What does it mean for business?

There is a journey from being eligible for loan to receiving loan

1. Despite being risk averse, banks will continue to evaluate new investment opportunities

2. Brands should use this opportunity to “look good” when lenders evaluate them

3. Interest rates are expected to remain high for 2023; franchisees will need help in financing

4. New loans underwriting expected to slowdown; Brands must seize current opportunity

5. Building relationships with multiple lenders; your favorite lender of today may not be your favorite lender of tomorrow

6. As lenders become risk averse, significance of FUND scores will amplify

Outlook 2023

2021 was pandemic driven; 2022 has been inflation driven; 2023 will be worrying about severity of downturn

Offering models and changing operations

- Consumer preference shifts and input cost pressures changing offering models and support structures

Consumers more price sensitive

- Price increases to protect margins getting more difficult

New pool of franchisees

- Layoffs will lead to more prospects but when?

Tougher lending standards

- Eroding margins, higher cost of capital

Legal impediments

- New regulations such as AB 257 will continue to challenge brands in unique way

Stretched working capital

- Remodels and new capx requirements get delayed as working capital declines

How brands will deal with these challenges

The focus will be on preserving margins and not on driving growth

Technology Innovation

Brands must weigh the cost of technology vs. benefit in economic downturn

Consolidation

Strong franchisees consolidating with low performing units will increase.

International Expansion

With global economy in turmoil, international expansion will be tougher

Marketing

Brands must do efficient and tailored marketing. Keeping in mind short-term sales vs. long term brand

Cross-selling

Cross-selling across portfolio companies' brands will increase but the challenge will be to keep brand value intact

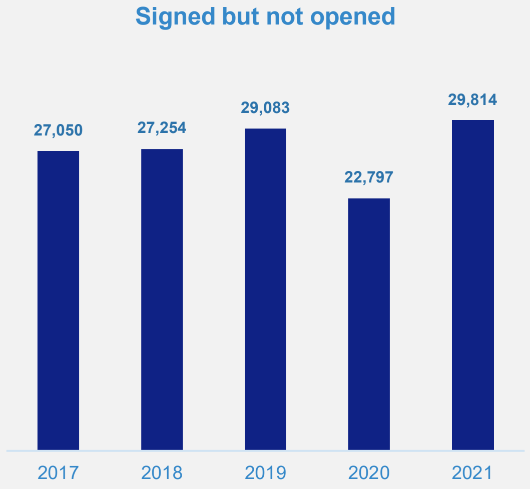
More time to open

Increased initial investment cost with higher cost of capital will increase time to open

How franchised units have performed?

Expect more closures, transfers, & delay in opening new units

- Delay in opening new units will add to cost of capital
- Signed but not opened will add strain to development resources, create further delays.
- Backlog of new unit openings indicates operational inefficiency



Source: FRANdata Research

- Lower transfer rate in 2020 was supported by government aid and fiscal support
- Absence of fiscal support and tougher business environment will question whether stronger franchisees will be willing to acquire weaker units.

Source: FRANdata Research

As government aid withdraws from system there will be more unit closures, & transfers. Opening of new units will be challenging with backlog units, higher investment value, & economic uncertainty.

What does it mean for the business?

Brands must have stronger proposition for consumers, prospects, and lenders

1. In absence of government aid, will stronger franchisees be able to acquire low performing units?

2. With no fiscal support, there will be more closures

3. Increasing signed but not opened units indicate that there is a challenge in opening new units

4. Add to it higher investment cost and capital cost, opening of new units will be get tougher

5. Brands will have to support new unit development by offering real estate support, financing support, and in some cases recruitment support

6. Brands must also find innovative ways to reduce time to open such as reducing training period, etc.

Key Takeaways

How should you plan for year 2023?

Key Takeaways

Q

How deep is the downturn you believe your sector will have?

Interest rate will continue to remain high for 2023. Decline in growth rate will impact everyone

A

Key Takeaways

Q

What will be the key drivers for your sector to climb out of the downturn?

Strong brand value, being ahead of curve, access to capital, easy journey of prospects to franchisees

A

Key Takeaways

Q

How much stress will your franchisees have?

Strong brand support will help franchisees navigate economic uncertainty

A

Key Takeaways

Q

How do you account for slower openings?

Slower openings will increase cost of finance.

A

Key Takeaways

Q

How appealing is your brand to lenders?

FUND scores will have more importance in 2023

A

Thanks

Did this change the way you think about franchising in 2023?

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