

# **Operating in Workout Mode:**

**What are Your Financial Systems and Controls Telling  
You About the Condition of Your Business?**

**Sohlen Franchise Advisors**

**Hans Sohlen**

# So, business has been good for a number of few years....

- The brand has performed decently
- Business has been good
- You have enjoyed a solid Return On Effort (ROE)
- Fair return on personal risk
  - Personally guaranteed franchise agreements
  - Personally guaranteed debt
  - Personally guaranteed leases

- In the restaurant franchise segment executive compensation (salary/distributions) in the range of 2-3% of sales typically compensate you for the guarantees (RISK) and efforts (ROE) put into running the business.
- Principal pay-down on existing debt has created additional value and future borrowing capacity.
- You have prudently structured capitalization strategies around:
  - Average remaining franchise and lease terms
  - Quality and Image/Prototype of store level assets

- Your annual value checks on business and real estate have been encouraging
  - You have mentally reminded yourself that all your franchise agreements have one less year of remaining life.
  - You have backed off some allowance for franchisor required upgrades to approve transfer of your franchise agreements/assets in a sale.
- Planned out following year comfortable that you have some net equity value (enterprise value less debt) in the business and that the upcoming year will provide further growth in net equity value of your business.

Life is Good!

# And then, things have changed....

- Sales are softer
- Cash reserves have dwindled
- Your focus on the business has changed
  - You are managing cash & not building a business
  - You are spending more time with the bean counters
  - You are reviewing covenants, ratio requirements, and lender remedy stuff in your loan documents
  - A call or two to your legal counsel to “discuss things”
  - Checking to see how other franchisees in your DMA are doing
  - Checking for local co-op delinquencies?
  - You cut checks & hold them for distribution

One day you reach a point when you are unable to stay current with your stakeholders.

- Creative cash management is not enough
- It's a paradigm shift

You are in work-out mode.

It's time to take a closer look at what your financial systems are telling you about the state of your business.

- Start by Benchmarking
  - Your brand
  - Your geography and DMA
  - Your business
  - Your financial reports to tell your story

# Financial Stakeholder Language

- Sales
- EBITDAR
- ROP
- G&A
- Debt
- Debt Service
- Leverage

- Sales

- Your sales trends for three years by store
- Provide back of the envelope sales comparison for the most recent year to:
  - Concept average (franchisor and franchisee)
  - Your DMA averages (franchisor and franchisee)

- EBITDAR (Earnings before interest, depreciation, amortization and rent)
  - Let's make that English for “store level cash flow before rent and G&A”
  - Useful concept to compare management of variable cost at store level. A cost efficiency benchmark.
  - Neutralizes for capitalization strategies and G&A.

- ROP (Restaurant Operating Profit)
  - Pre-G&A EBITDAR after third party rents
  - Store level cash flow efficiency of your store base after rent to third parties
  - Store level cash flow available to absorb G&A, debt service, privilege of ownership and maintenance capital expenditures

- G&A - General and Administrative Expense

Three key components are:

- District Management: All in usually 1.2% - 1.4% of sales.
- Administrative: All in usually 1.2% – 1.6% of sales.
- Executive/Ownership: 1% – 2% of sales.
- Above before rebates: Rebates are usually 1.2 – 1.5% of sales.

- Debt
  - Senior Secured Debt
    - Segment each loan by assets secured
    - Segment and sort by different legal entities
    - Identify cross collateral, cross defaulted and/or cross guarantee arrangements/provisions
  - Junior/subordinated debt
  - Shareholder loans
  - Good opportunity to re-visit your loans, debt structure and guarantees

- Debt Service – Principal and interest payments on your loans
- Frequently encountered debt service and leverage tests in restaurant loan agreements are:
  - Debt Service Coverage
  - Fixed Charge Coverage
  - Lease Adjusted Leverage
  - Debt / EBITDA

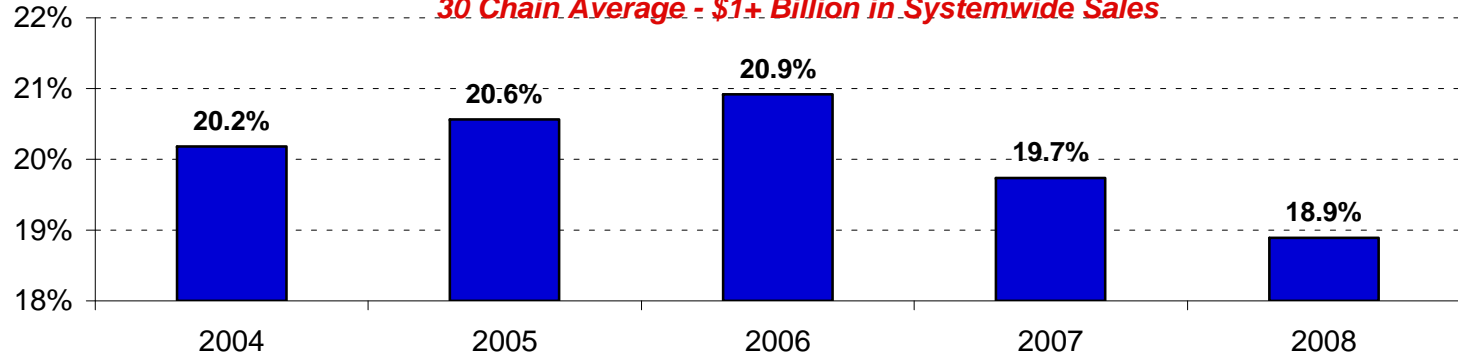
- Your job is to tell your company story in the context of these benchmarks and measures.
- How do you use your financial reports and find the public data to “spin” your situation and objectives?



|                 | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> |
|-----------------|-------------|-------------|-------------|-------------|-------------|
| Average EBITDAR | 20.2%       | 20.6%       | 20.9%       | 19.7%       | 18.9%       |

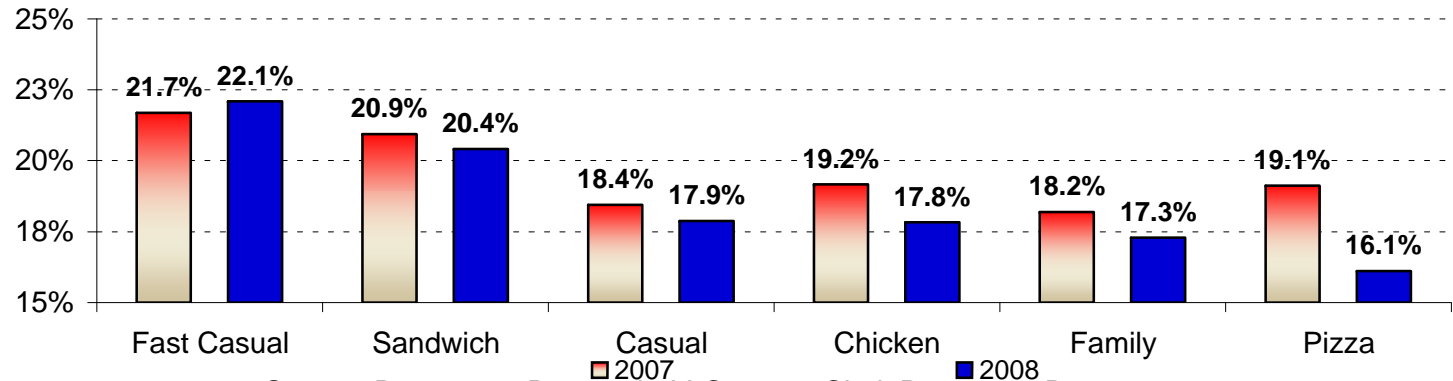
### Franchisee EBITDAR Margin Trends

30 Chain Average - \$1+ Billion in Systemwide Sales



|             | <u>2007</u> | <u>2008</u> |
|-------------|-------------|-------------|
| Fast Casual | 21.7%       | 22.1%       |
| Sandwich    | 20.9%       | 20.4%       |
| Casual      | 18.4%       | 17.9%       |
| Chicken     | 19.2%       | 17.8%       |
| Family      | 18.2%       | 17.3%       |
| Pizza       | 19.1%       | 16.1%       |

### Franchisee EBITDAR Margins by Segment



Source: Restaurant Research, LLC - www.ChainRestaurantData.com



# Financial Reports

- Store level detailed Profit & Loss Statement
- Store level Management Report
- Pre-Occupancy EBITDAR comparison
- Restaurant Operating Profit Analysis
- Consolidated Cash-Flow Analysis

# Detailed Store Level P&L

|   | 1953                     |              |
|---|--------------------------|--------------|
|   | Dec 29, '08 - Jun 28, 09 | % of Income  |
| <b>6800 - LABOR</b>                         |                          |              |
| 6820 MANAGEMENT LABOR                       | 61,436.10                | 7.8%         |
| 6850 CREW LABOR                             | 122,540.36               | 15.5%        |
| 6855 OTHER LABOR                            | 600.00                   | 0.1%         |
| <b>Total 6800 - LABOR</b>                   | <b>184,576.46</b>        | <b>23.3%</b> |
| <b>Total COGS</b>                           | <b>431,328.45</b>        | <b>54.5%</b> |
| <b>Gross Profit</b>                         | <b>359,802.13</b>        | <b>45.5%</b> |
| <b>Expense</b>                              |                          |              |
| <b>7000 - CONTROLLABLE COSTS</b>            |                          |              |
| 7010 UTILITIES                              |                          |              |
| 7010 ELECTRIC UTILITIES                     | 21,536.82                | 2.7%         |
| 7012 SEWER AND WATER                        | 1,202.41                 | 0.2%         |
| <b>Total 7010 UTILITIES</b>                 | <b>22,739.23</b>         | <b>2.9%</b>  |
| 7020 TELEPHONE                              |                          |              |
| 7022 - LAND LINES                           | 765.47                   | 0.1%         |
| <b>Total 7020 TELEPHONE</b>                 | <b>765.47</b>            | <b>0.1%</b>  |
| 7030 SUPPLIES                               |                          |              |
| 7038 ICE                                    | 0.00                     | 0.0%         |
| 7030 SUPPLIES - Other                       | 4,965.16                 | 0.6%         |
| <b>Total 7030 SUPPLIES</b>                  | <b>4,965.16</b>          | <b>0.6%</b>  |
| 7040 CLEANING SUPPLIES                      | 1,610.49                 | 0.2%         |
| 7050 CASH SHORT & (OVER -)                  |                          |              |
| 7051 - CREDIT CARDS +/-                     | -895.05                  | -0.1%        |
| 7050 CASH SHORT & (OVER -) - Other          | 1,973.64                 | 0.2%         |
| <b>Total 7050 CASH SHORT &amp; (OVER -)</b> | <b>1,078.59</b>          | <b>0.1%</b>  |
| 7800 PAYROLL EXPENSES                       | 957.02                   | 0.1%         |
| 7810 PAYROLL TAXES                          |                          |              |
| 7811 - SS-ER                                | 11,328.12                | 1.4%         |
| 7812 - MED-ER                               | 2,633.20                 | 0.3%         |
| 7813 - SUI                                  | 1,665.44                 | 0.2%         |
| 7814 - FUT1                                 | 1,102.88                 | 0.1%         |
| <b>Total 7810 PAYROLL TAXES</b>             | <b>16,729.64</b>         | <b>2.1%</b>  |
| 7910 HEALTH INSURANCE                       | 3,736.60                 | 0.5%         |
| 7911 - 401K                                 | 1,200.00                 | 0.2%         |
| 7920 WORKER'S COMP                          | 4,248.00                 | 0.5%         |
| 7900 PROPERTY INSURANCE                     | 5,376.00                 | 0.7%         |
| 8540 MAINTENANCE                            |                          |              |
| 8541 R&M BUILDING                           | 0.00                     | 0.0%         |
| 8542 R&M EQUIPM ENT                         | 6,316.56                 | 0.8%         |
| 8543 - MAINTENANCE TECHNICIANS              | 0.00                     | 0.0%         |
| 8540 MAINTENANCE - Other                    | 0.98                     | 0.0%         |
| <b>Total 8540 MAINTENANCE</b>               | <b>6,317.54</b>          | <b>0.8%</b>  |
| 8530 LAND MAINTENANCE                       | 1,445.00                 | 0.2%         |
| 8600 TRASH REMOVAL                          | 4,303.30                 | 0.5%         |

**Store Level  
Management Report  
June, 2009**

|                                   | <b>Store #1</b>   |              |                   |              |                   |                   |              |                   |              |                   |
|-----------------------------------|-------------------|--------------|-------------------|--------------|-------------------|-------------------|--------------|-------------------|--------------|-------------------|
|                                   | <u>PTD Actual</u> | <u>%</u>     | <u>PTD Budget</u> | <u>%</u>     | <u>Variance</u>   | <u>YTD Actual</u> | <u>%</u>     | <u>YTD Budget</u> | <u>%</u>     | <u>Variance</u>   |
| Gross Sales                       | \$111,025         | 100.0%       | \$127,234         | 100.0%       | (\$16,209)        | \$738,129         | 100.0%       | \$794,970         | 100.0%       | (\$56,841)        |
| less employee & manager meals     | \$585             | 0.5%         | \$998             | 0.8%         | (\$413)           | \$3,741           | 0.5%         | \$6,234           | 0.8%         | (\$2,493)         |
| Adjusted Gross Sales              | \$110,440         |              | \$126,236         |              | (\$15,796)        | \$734,388         |              | \$788,736         |              | (\$54,348)        |
| less discounts                    | \$707             | 0.6%         | \$1,486           | 1.2%         | (\$779)           | \$8,107           | 1.1%         | \$9,486           | 1.2%         | (\$1,378)         |
| <b>Net Sales</b>                  | <b>\$109,733</b>  | <b>98.8%</b> | <b>\$124,750</b>  | <b>98.0%</b> | <b>(\$15,017)</b> | <b>\$726,281</b>  | <b>98.4%</b> | <b>\$779,250</b>  | <b>98.0%</b> | <b>(\$52,970)</b> |
| Cost of Sales                     |                   |              |                   |              |                   |                   |              |                   |              |                   |
| Food                              | \$30,495          | 27.5%        | \$38,806          | 30.5%        | (\$8,311)         | \$218,290         | 29.6%        | \$242,466         | 30.5%        | (\$24,176)        |
| Crew Labor                        | \$18,581          | 16.7%        | \$18,063          | 14.2%        | \$518             | \$119,820         | 16.2%        | \$114,503         | 14.4%        | \$5,318           |
| Management Labor                  | \$5,945           | 5.4%         | \$8,387           | 6.6%         | (\$2,442)         | \$43,280          | 5.9%         | \$54,041          | 6.8%         | (\$10,762)        |
| Paper                             | \$3,888           | 3.5%         | \$4,708           | 3.7%         | (\$819)           | \$27,002          | 3.7%         | \$29,414          | 3.7%         | (\$2,412)         |
| Other Labor                       | \$100             | 0.1%         | \$100             | 0.1%         | \$0               | \$600             | 0.1%         | \$600             | 0.1%         | \$0               |
| Total Cost of Sales               | \$59,009          | 53.1%        | \$70,064          | 55.1%        | (\$11,054)        | \$408,991         | 55.4%        | \$441,024         | 55.5%        | (\$32,032)        |
| Gross Profit                      | \$51,431          | 46.3%        | \$56,173          | 44.1%        | (\$4,742)         | \$325,397         | 44.1%        | \$347,712         | 43.7%        | (\$22,315)        |
| Controllables                     |                   |              |                   |              |                   |                   |              |                   |              |                   |
| Utilities and Phone               | \$6,370           | 5.7%         | \$6,067           | 4.8%         | \$303             | \$35,555          | 4.8%         | \$37,073          | 4.7%         | (\$1,518)         |
| Employee Related                  | \$4,103           | 3.7%         | \$3,961           | 3.1%         | \$142             | \$28,144          | 3.8%         | \$25,387          | 3.2%         | \$2,757           |
| Kid's Toys                        | \$577             | 0.5%         | \$1,145           | 0.9%         | (\$568)           | \$4,405           | 0.6%         | \$7,155           | 0.9%         | (\$2,750)         |
| Supplies                          | \$1,433           | 1.3%         | \$982             | 0.8%         | \$450             | \$8,173           | 1.1%         | \$6,084           | 0.8%         | \$2,089           |
| Required Maintenance              | \$940             | 0.8%         | \$951             | 0.7%         | (\$11)            | \$6,289           | 0.9%         | \$5,706           | 0.7%         | \$583             |
| R&M                               | \$170             | 0.2%         | \$636             | 0.5%         | (\$466)           | \$4,789           | 0.6%         | \$3,975           | 0.5%         | \$814             |
| Cash/Credit Cards                 | \$0               | 0.0%         | \$0               | 0.0%         | \$0               | \$0               | 0.0%         | \$0               | 0.0%         | \$0               |
| Other Controllables               | \$1,857           | 1.7%         | \$1,452           | 1.1%         | \$406             | \$11,328          | 1.5%         | \$8,775           | 1.1%         | \$2,552           |
| Total Controllables               | \$15,450          | 13.9%        | \$15,194          | 11.9%        | \$256             | \$98,683          | 13.4%        | \$94,155          | 11.8%        | \$4,528           |
| Non Controllables                 |                   |              |                   |              |                   |                   |              |                   |              |                   |
| Royalties                         | \$4,389           | 4.0%         | \$4,990           | 3.9%         | (\$601)           | \$29,051          | 3.9%         | \$31,170          | 3.9%         | (\$2,119)         |
| National Advertising              | \$3,292           | 3.0%         | \$3,743           | 2.9%         | (\$451)           | \$21,788          | 3.0%         | \$23,378          | 2.9%         | (\$1,589)         |
| Co-Op Advertising                 | \$1,151           | 1.0%         | \$1,282           | 1.0%         | (\$131)           | \$9,370           | 1.3%         | \$7,985           | 1.0%         | \$1,385           |
| Coupons, Discounts, Gifts         | \$708             | 0.6%         | \$1,486           | 1.2%         | (\$778)           | \$8,107           | 1.1%         | \$9,486           | 1.2%         | (\$1,379)         |
| Personal Property Tax & Lic.      | \$185             | 0.2%         | \$185             | 0.1%         | \$0               | \$1,110           | 0.2%         | \$1,110           | 0.1%         | \$0               |
| Property Insurance                | \$827             | 0.7%         | \$827             | 0.7%         | (\$0)             | \$5,376           | 0.7%         | \$5,377           | 0.7%         | (\$1)             |
| Total Non Controllables           | \$10,552          | 9.5%         | \$12,512          | 9.8%         | (\$1,961)         | \$74,802          | 10.1%        | \$78,505          | 9.9%         | (\$3,703)         |
| Pre-Occupancy Cash Flow           | \$25,429          | 22.9%        | \$28,466          | 22.4%        | (\$3,037)         | \$151,911         | 20.6%        | \$175,052         | 22.0%        | (\$23,141)        |
| Occupancy Costs                   |                   |              |                   |              |                   |                   |              |                   |              |                   |
| Rent                              | \$7,489           | 6.7%         | \$8,234           | 6.5%         | (\$744)           | \$46,641          | 6.3%         | \$51,431          | 6.5%         | (\$4,789)         |
| Real Estate Tax                   | \$1,950           | 1.8%         | \$1,950           | 1.5%         | \$0               | \$11,700          | 1.6%         | \$11,700          | 1.5%         | \$0               |
| Total Occupancy Costs             | \$9,439           | 8.5%         | \$10,184          | 8.0%         | (\$744)           | \$58,341          | 7.9%         | \$63,131          | 7.9%         | (\$4,789)         |
| Restaurant Operating Profit (ROP) | \$15,989          | 14.4%        | \$18,282          | 14.4%        | (\$2,293)         | \$93,570          | 12.7%        | \$111,921         | 14.1%        | (\$18,352)        |

## Pre-Occupancy (EBITDAR) Comparison

|    | April, 2009   |               |       | May, 2009     |               |       | June, 2009    |               |       | Ranking |     |      |
|----|---------------|---------------|-------|---------------|---------------|-------|---------------|---------------|-------|---------|-----|------|
|    | 5 week period |               |       | 4 week period |               |       | 4 week period |               |       | Apr.    | May | June |
|    | Sales         | Pre-Occupancy |       | Sales         | Pre-Occupancy |       | Sales         | Pre-Occupancy |       |         |     |      |
| 1  | 168,920       | 47,942        | 28.4% | 124,588       | 31,504        | 25.3% | 136,311       | 37,644        | 27.6% | 1       | 1   | 1    |
| 2  | 159,249       | 38,620        | 24.3% | 118,000       | 22,262        | 18.9% | 122,754       | 27,151        | 22.1% | 6       | 4   | 5    |
| 3  | 151,532       | 38,355        | 25.3% | 115,565       | 28,276        | 24.5% | 122,143       | 30,911        | 25.3% | 4       | 2   | 2    |
| 4  | 142,952       | 35,013        | 24.5% | 105,521       | 19,771        | 18.7% | 111,025       | 25,429        | 22.9% | 5       | 5   | 3    |
| 5  | 146,202       | 37,289        | 25.5% | 110,457       | 25,204        | 22.8% | 116,116       | 25,693        | 22.1% | 3       | 3   | 4    |
| 6  | 141,269       | 28,318        | 20.0% | 104,887       | 17,658        | 16.8% | 113,044       | 23,953        | 21.2% | 13      | 8   | 9    |
| 7  | 130,710       | 29,027        | 22.2% | 95,935        | 15,974        | 16.7% | 100,788       | 21,687        | 21.5% | 9       | 9   | 7    |
| 8  | 124,305       | 23,230        | 18.7% | 93,179        | 10,686        | 11.5% | 94,919        | 12,157        | 12.8% | 17      | 19  | 21   |
| 9  | 128,360       | 27,038        | 21.1% | 92,749        | 15,721        | 16.9% | 104,308       | 19,235        | 18.4% | 10      | 7   | 13   |
| 10 | 116,318       | 22,950        | 19.7% | 86,993        | 11,678        | 13.4% | 91,286        | 16,501        | 18.1% | 16      | 15  | 15   |
| 11 | 119,198       | 26,588        | 22.3% | 87,623        | 15,165        | 17.3% | 95,133        | 18,233        | 19.2% | 8       | 6   | 12   |
| 12 | 118,426       | 24,177        | 20.4% | 92,039        | 15,279        | 16.6% | 95,676        | 15,817        | 16.5% | 11      | 10  | 18   |
| 13 | 109,000       | 18,105        | 16.6% | 87,309        | 11,735        | 13.4% | 93,644        | 15,847        | 16.9% | 19      | 16  | 17   |
| 14 | 118,458       | 23,843        | 20.1% | 90,750        | 13,895        | 15.3% | 97,599        | 18,975        | 19.4% | 12      | 12  | 11   |
| 15 | 101,890       | 15,621        | 15.3% | 78,410        | 7,624         | 9.7%  | 83,799        | 12,628        | 15.1% | 22      | 20  | 19   |
| 16 | 111,456       | 20,743        | 18.6% | 85,700        | 12,556        | 14.7% | 94,008        | 18,931        | 20.1% | 18      | 14  | 10   |
| 17 | 140,919       | 36,160        | 25.7% | 95,935        | 15,438        | 16.1% | 108,248       | 23,219        | 21.4% | 2       | 11  | 8    |
| 18 | 106,454       | 20,989        | 19.7% | 82,802        | 12,131        | 14.7% | 88,695        | 15,656        | 17.7% | 15      | 13  | 16   |
| 19 | 105,675       | 16,447        | 15.6% | 78,543        | 6,291         | 8.0%  | 79,483        | 9,153         | 11.5% | 21      | 21  | 23   |
| 20 | 96,447        | 12,222        | 12.7% | 68,699        | 3,312         | 4.8%  | 73,430        | 5,667         | 7.7%  | 25      | 25  | 25   |
| 21 | 91,819        | 14,763        | 16.1% | 67,868        | 5,329         | 7.9%  | 73,791        | 8,985         | 12.2% | 20      | 22  | 22   |
| 22 | 95,818        | 12,743        | 13.3% | 71,597        | 5,189         | 7.2%  | 75,446        | 10,412        | 13.8% | 24      | 23  | 20   |
| 23 | 90,772        | 11,477        | 12.6% | 70,909        | 3,806         | 5.4%  | 74,089        | 7,685         | 10.4% | 26      | 24  | 24   |
| 24 | 85,227        | 11,571        | 13.6% | 62,678        | 1,586         | 2.5%  | 64,728        | 2,683         | 4.1%  | 23      | 26  | 27   |
| 25 | 82,855        | 5,371         | 6.5%  | 62,126        | (260)         | -0.4% | 64,856        | 4,649         | 7.2%  | 27      | 27  | 26   |
| 26 | 118,198       | 26,971        | 22.8% | 76,387        | 9,249         | 12.1% | 92,465        | 19,853        | 21.5% | 7       | 18  | 6    |
| 27 | 109,177       | 21,709        | 19.9% | 76,371        | 9,699         | 12.7% | 89,340        | 16,393        | 18.3% | 14      | 17  | 14   |
|    | 3,211,606     | 647,282       | 20.2% | 2,383,620     | 346,758       | 14.5% | 2,557,124     | 465,147       | 18.2% |         |     |      |

# Restaurant Operating Profit (ROP) Analysis

|  | April, 2009      |                |              |                | May 2009         |                |              |               | June, 2009       |                |              |                |
|--|------------------|----------------|--------------|----------------|------------------|----------------|--------------|---------------|------------------|----------------|--------------|----------------|
|  | 5 week period    |                |              |                | 4 week period    |                |              |               | 4 week period    |                |              |                |
|  | Sales            | Pre-Occupancy  | ROP          |                | Sales            | Pre-Occupancy  | ROP          |               | Sales            | Pre-Occupancy  | ROP          |                |
| 1  | 168,920          | 47,942         | 28.4%        | 32,436         | 124,588          | 31,504         | 25.3%        | 15,968        | 136,311          | 37,644         | 27.6%        | 22,108         |
| 2  | 159,249          | 38,620         | 24.3%        | 20,256         | 118,000          | 22,262         | 18.9%        | 3,898         | 122,754          | 27,151         | 22.1%        | 8,787          |
| 3  | 151,532          | 38,355         | 25.3%        | 31,046         | 115,565          | 28,276         | 24.5%        | 20,967        | 122,143          | 30,911         | 25.3%        | 23,602         |
| 4  | 142,952          | 35,013         | 24.5%        | 25,131         | 105,521          | 19,771         | 18.7%        | 10,378        | 111,025          | 25,429         | 22.9%        | 15,989         |
| 5  | 146,202          | 37,289         | 25.5%        | 27,440         | 110,457          | 25,204         | 22.8%        | 15,565        | 116,116          | 25,693         | 22.1%        | 15,918         |
| 6  | 141,269          | 28,318         | 20.0%        | 17,919         | 104,887          | 17,658         | 16.8%        | 7,525         | 113,044          | 23,953         | 21.2%        | 13,494         |
| 7  | 130,710          | 29,027         | 22.2%        | 20,649         | 95,935           | 15,974         | 16.7%        | 8,008         | 100,788          | 21,687         | 21.5%        | 13,674         |
| 8  | 124,305          | 23,230         | 18.7%        | 17,006         | 93,179           | 10,686         | 11.5%        | 4,462         | 94,919           | 12,157         | 12.8%        | 10,633         |
| 9  | 128,360          | 27,038         | 21.1%        | 18,285         | 92,749           | 15,721         | 16.9%        | 7,311         | 104,308          | 19,235         | 18.4%        | 10,401         |
| 10   | 116,318          | 22,950         | 19.7%        | 14,451         | 86,993           | 11,678         | 13.4%        | 3,180         | 91,286           | 16,501         | 18.1%        | 7,822          |
| 11   | 119,198          | 26,588         | 22.3%        | 15,319         | 87,623           | 15,165         | 17.3%        | 3,896         | 95,133           | 18,233         | 19.2%        | 6,964          |
| 12   | 118,426          | 24,177         | 20.4%        | 10,209         | 92,039           | 15,279         | 16.6%        | 1,311         | 95,676           | 15,817         | 16.5%        | 1,849          |
| 13   | 109,000          | 18,105         | 16.6%        | 11,040         | 87,309           | 11,735         | 13.4%        | 4,356         | 93,644           | 15,847         | 16.9%        | 8,262          |
| 14   | 118,458          | 23,843         | 20.1%        | 11,531         | 90,750           | 13,895         | 15.3%        | 1,583         | 97,599           | 18,975         | 19.4%        | 6,663          |
| 15   | 101,890          | 15,621         | 15.3%        | 9,420          | 78,410           | 7,624          | 9.7%         | 1,400         | 83,799           | 12,628         | 15.1%        | 6,238          |
| 16   | 111,456          | 20,743         | 18.6%        | 13,356         | 85,700           | 12,556         | 14.7%        | 5,236         | 94,008           | 18,931         | 20.1%        | 11,275         |
| 17   | 140,919          | 36,160         | 25.7%        | 26,416         | 95,935           | 15,438         | 16.1%        | 6,283         | 108,248          | 23,219         | 21.4%        | 13,809         |
| 18   | 106,454          | 20,989         | 19.7%        | 6,935          | 82,802           | 12,131         | 14.7%        | (1,922)       | 88,695           | 15,656         | 17.7%        | 1,603          |
| 19   | 105,675          | 16,447         | 15.6%        | 5,494          | 78,543           | 6,291          | 8.0%         | (4,662)       | 79,483           | 9,153          | 11.5%        | (1,800)        |
| 20   | 96,447           | 12,222         | 12.7%        | 5,710          | 68,699           | 3,312          | 4.8%         | (2,770)       | 73,430           | 5,667          | 7.7%         | (540)          |
| 21   | 91,819           | 14,763         | 16.1%        | 6,248          | 67,868           | 5,329          | 7.9%         | (3,186)       | 73,791           | 8,985          | 12.2%        | 469            |
| 22   | 95,818           | 12,743         | 13.3%        | 1,261          | 71,597           | 5,189          | 7.2%         | (6,293)       | 75,446           | 10,412         | 13.8%        | (1,070)        |
| 23   | 90,772           | 11,477         | 12.6%        | (588)          | 70,909           | 3,806          | 5.4%         | (8,228)       | 74,089           | 7,685          | 10.4%        | (4,394)        |
| 24   | 85,227           | 11,571         | 13.6%        | 2,166          | 62,678           | 1,586          | 2.5%         | (7,818)       | 64,728           | 2,683          | 4.1%         | (6,722)        |
| 25   | 82,855           | 5,371          | 6.5%         | (4,147)        | 62,126           | (260)          | -0.4%        | (9,778)       | 64,856           | 4,649          | 7.2%         | (4,869)        |
| 26   | 118,198          | 26,971         | 22.8%        | 18,292         | 76,387           | 9,249          | 12.1%        | 2,320         | 92,465           | 19,853         | 21.5%        | 12,169         |
| 27   | 109,177          | 21,709         | 19.9%        | 5,924          | 76,371           | 9,699          | 12.7%        | (6,086)       | 89,340           | 16,393         | 18.3%        | 609            |
|  | <u>3,211,606</u> | <u>647,282</u> | <u>20.2%</u> | <u>369,205</u> | <u>2,383,620</u> | <u>346,758</u> | <u>14.5%</u> | <u>72,904</u> | <u>2,557,124</u> | <u>465,147</u> | <u>18.2%</u> | <u>192,943</u> |
| Company 1                                    | 1,658,395        | 329,591        | 19.9%        | 210,210        | 1,218,976        | 170,989        | 14.0%        | 55,828        | 1,320,808        | 242,277        | 18.3%        | 124,111        |
| Company 2                                    | 493,306          | 105,495        | 21.4%        | 43,324         | 369,212          | 59,371         | 16.1%        | (2,799)       | 396,465          | 75,017         | 18.9%        | 12,848         |
| Company 3                                    | <u>1,059,905</u> | <u>212,196</u> | <u>20.0%</u> | <u>115,671</u> | <u>795,432</u>   | <u>116,398</u> | <u>14.6%</u> | <u>19,875</u> | <u>839,851</u>   | <u>147,853</u> | <u>17.6%</u> | <u>55,984</u>  |
|  | 3,211,606        | 647,282        | 20.2%        | 369,205        | 2,383,620        | 346,758        | 14.5%        | 72,904        | 2,557,124        | 465,147        | 18.2%        | 192,943        |
| G&A (Plan)                                   |                  |                |              | 95,000         |                  |                |              | 95,000        |                  |                |              | 95,000         |
| Debt Service (Plan - P&I)                    |                  |                |              | <u>65,000</u>  |                  |                |              | <u>65,000</u> |                  |                |              | <u>65,000</u>  |
| EBTDA (after debt service - P&I)             |                  |                |              | 209,205        |                  |                |              | (87,096)      |                  |                |              | 32,943         |
| Rebates                                      |                  |                |              | <u>34,580</u>  |                  |                |              | <u>34,580</u> |                  |                |              | <u>34,580</u>  |
| EBTDA (after debt service - P&I and rebates) |                  |                |              | 243,785        |                  |                |              | (52,516)      |                  |                |              | 67,523         |
| Total Neg. ROP                               |                  |                |              | (4,735)        |                  |                |              | (50,743)      |                  |                |              | (19,395)       |
| # stores w. neg. ROP                         |                  |                |              | 2              |                  |                |              | 9             |                  |                |              | 5              |

# Cash Flow Year-to-Date Roadmap

| <u>Entity</u>                                   | August YTD, 2009  |                      |              |                  |             |
|---|-------------------|----------------------|--------------|------------------|-------------|
|   | <u>Sales</u>      | <u>Pre-Occupancy</u> |              | <u>ROP</u>       |             |
| Company 1                                       | 11,320,145        | 1,871,920            | 16.5%        | 933,209          | 8.2%        |
| Company 2                                       | 3,307,683         | 562,130              | 17.0%        | 71,204           | 2.2%        |
| Company 3                                       | <u>7,276,352</u>  | <u>1,264,194</u>     | <u>17.4%</u> | <u>506,852</u>   | 7.0%        |
| <b>Combined Entities</b>                        | <b>21,904,180</b> | <b>3,698,244</b>     | <b>16.9%</b> | <b>1,511,265</b> | <b>6.9%</b> |
| <b>G&amp;A</b>                                  |                   |                      |              |                  |             |
| - Company 1                                     |                   |                      |              | 494,278          | 4.4%        |
| - Company 2                                     |                   |                      |              | 97,197           | 2.9%        |
| - Company 3                                     |                   |                      |              | <u>135,212</u>   | <u>1.9%</u> |
|   |                   |                      |              | <b>726,687</b>   | <b>3.3%</b> |
| <b>EBITDA B-4 Rebates</b>                       |                   |                      |              | <b>784,578</b>   | <b>3.6%</b> |
| <b>Debt Service</b>                             |                   |                      |              |                  |             |
| - Company 1                                     |                   |                      |              | 181,880          |             |
| - Company 3                                     |                   |                      |              | <u>388,105</u>   |             |
|   |                   |                      |              | <b>569,985</b>   | <b>2.6%</b> |
| <b>Rebates/other income (full year rebates)</b> |                   |                      |              |                  |             |
| - Company 1                                     |                   |                      |              | 263,219          |             |
| - Company 2                                     |                   |                      |              | 77,988           |             |
| - Company 3                                     |                   |                      |              | <u>160,202</u>   |             |
|   |                   |                      |              | <b>501,409</b>   |             |
| <b>P&amp;L Cash +/-</b>                         |                   |                      |              | <b>716,002</b>   | <b>3.3%</b> |

# You've benchmarked your financials for stakeholder discussions

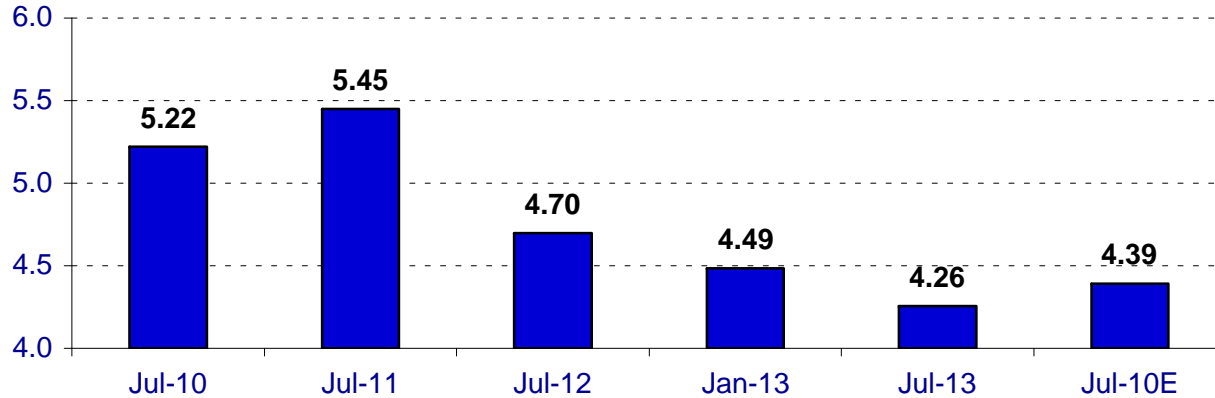
- Time out. Ask yourself if at current trends you still have a viable business with reasonable prospects to satisfy all your stakeholders (including yourself) over time.
- Do a big picture valuation & assessment
  - How is your segment of the restaurant industry?
  - How is your geography/marketplace?
  - How is your brand?
  - Does your business still have embedded net equity value?

# Do a business valuation with your latest numbers (TTM or LTM)

- Calculate store level cash flow (before rebates).
- Use a 4% G&A (1.2% for DM, 1.8% G&A, 1% for executive management)
- Use a reasonable multiple for your brand - if you're not sure, check with a Restaurant Research expert like Wally Butkus.
- Remember that EBITDA multiples vary by restaurant brand, segment, economic cycle and can range from 3.5 to 5.5 times.

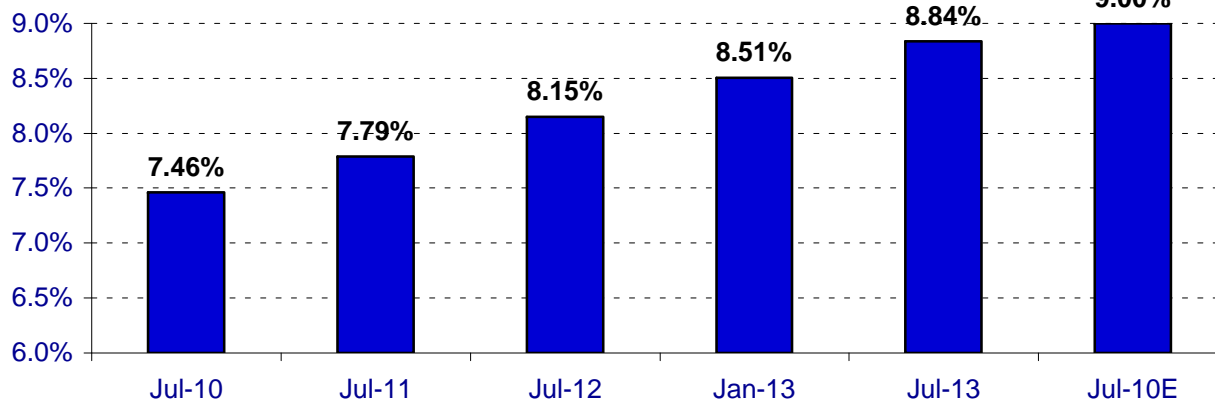
|                        |               |               |               |               |               |                |
|------------------------|---------------|---------------|---------------|---------------|---------------|----------------|
|                        | <u>Jul-10</u> | <u>Jul-11</u> | <u>Jul-12</u> | <u>Jan-13</u> | <u>Jul-13</u> | <u>Jul-10E</u> |
| <b>EBITDA Multiple</b> | 5.22          | 5.45          | 4.70          | 4.49          | 4.26          | 4.39           |

**National Restaurant Chain EBITDA Multiple Trends**



|                  |               |               |               |               |               |                |
|------------------|---------------|---------------|---------------|---------------|---------------|----------------|
|                  | <u>Jul-10</u> | <u>Jul-11</u> | <u>Jul-12</u> | <u>Jan-13</u> | <u>Jul-13</u> | <u>Jul-10E</u> |
| <b>Cap Rates</b> | 7.46%         | 7.79%         | 8.15%         | 8.51%         | 8.84%         | 9.00%          |

**National Restaurant Chain Cap Rate Trends**



Source: Restaurant Research, LLC - [www.ChainRestaurantData.com](http://www.ChainRestaurantData.com)

# Real Estate Valuation

- Use an 8.5% rental rate on fee owned properties.
- Use realistic cap rate on real estate - check with a real estate expert like Peter Nisbet of Marcus & Millichap.
- Keep in mind that there is a 35% difference in value of an \$85,000 rental stream comparing a 7 cap rate versus a 9.5 cap rate ( $\$1,215,000 - \$1,905,000 = 320,000$ ).

You are benchmarked. You have value perspectives. Before you decide to actively work-out your situation, ask yourself:

- Do you have reasonable prospects to restore a positive value framework in a time horizon that you are comfortable with?
- Do you have the intestinal fortitude to wrestle with stakeholders that may look for you to “save your way to prosperity”?
- Do you have the skill-set and team to successfully endure a work-out?



# Remember....

- No new capital. Forget new store development.
- Once you ask a stakeholder to “forebear” on a payment you will be on everyone’s radar screen for a long time.
- Like building a store, a work-out will “take longer and cost more” - emotionally, as well as financially.
- Folks want to be repaid. You will work with the collectors, not the wine and dine folks.
- It’s all about cash, cash flow, cash forecasting...



- In work-out mode you are under constant scrutiny by your stakeholders. It's a small community. Your franchisor, vendors and lenders all have a wealth of comparative data, as well as each other's telephone numbers. Welcome to the glass house.
- Effective communication sure helps.

## **Expect that you will need to “borrow” or *lean* on some of your stakeholders for liquidity support.**

- Don't wait for Thursday's payroll to make a snap decision on who not to pay. Think about your options to generate liquidity before you run out of cash.
- If you plan to borrow from the government (except for a SBA loan). Stop now. Think again.
  - Sales & Payroll Taxes are off the table
  - Income and Property Taxes - you are playing with fire.
- Vendors
  - A little stretching - pass on discounts to gain a few days
  - Do this as part of a plan, if possible
  - COD is very expensive

After stretching your vendors, it's time to chat with your franchisor, then your lenders.

- Franchisor
  - National Advertising
  - Local Co-Op
  - Royalties
- Lenders
  - Principal
  - Interest
- Landlords
  - Short term relief
  - Long term concessions

# Conclusion

1. Look at the big picture. Is the business worth fighting for?
2. Benchmark your business for your stakeholders.
3. Workouts = Pain Sharing.
4. Pencil out a plan before you start asking for concessions.
5. Don't forget that you personally should participate in pain-sharing.
6. Your franchisor controls your brand and have significant vested interest in your success.
7. Track your progress. Communicate your progress.

# Sohlen Franchise Advisors

Hans Sohlen

612-920-8888

[hsohlen@sohlen-advisors.com](mailto:hsohlen@sohlen-advisors.com)

[www.sohlenfranchise.com](http://www.sohlenfranchise.com)