Maximizing Unit Economics
Thomas A. Romano, CFE
Moderator

- President/CEO of Biz Builders LLC
- A Franchise Consultant Company
- Over 35 years in franchising
- Former COO of KFC’s largest Master Franchise
- Former President and CEO of Greenleaf’s Grille/Everything Yogurt
- Former CEO of Saladworks
Presenters

• Rocco Fiorentino, CFE, Chairman & CEO Eagle Tax Services Group

• Harold Kestenbaum, Franchise Attorney with Ruskin, Moscou, Faltischek

• Todd Leff, President & CEO American DriveLine, Aamco, and Cottman Transmission

• Salman Siddiqui, VP Global Business Development, Baskin Robbins/Dunkin Brands
Maximizing Unit Economics - A Competitive Edge

• Why Is Understanding Unit Economics Important?

• How Do You Develop Unit Economics Benchmarks?

• Understanding and Using Unit Economics to Advance Your System.

• Issues in Sharing the Unit Economics Data.
Setting the scene

Competition and the economic climate is demanding that the franchisors become better informed, more sophisticated and more focused on the economics of the franchisee.

<table>
<thead>
<tr>
<th>Franchisor</th>
<th>Franchisee</th>
</tr>
</thead>
<tbody>
<tr>
<td>How do I attract more franchisees?</td>
<td>How knowledgeable is the Franchisor and how do I know that they are?</td>
</tr>
<tr>
<td>Why do some stores perform better than others?</td>
<td>How do I know if my store will be in the optimum location?</td>
</tr>
<tr>
<td>How do I improve the average performers?</td>
<td>How will the performance of my store compare to the average franchisee?</td>
</tr>
<tr>
<td>Who is my target customer?</td>
<td>Who is the target customer?</td>
</tr>
<tr>
<td>How do I know when their needs change?</td>
<td>How good is the franchisor at keeping up with customer needs?</td>
</tr>
<tr>
<td>Who are the direct competitors?</td>
<td>How will competition affect my store?</td>
</tr>
</tbody>
</table>
Franchisors focus on revenue, Franchisees focus on profit. Franchisors & Franchisees need to better align interests.

- **Key profit drivers**
  - Increase Revenue
  - Decrease costs
  - Reduce Capital

- **Improvement Levers**
  - Increase Sales Volume
  - Improve Price to Value Ratio
  - Leverage Productive Assets
  - Reduce Cost of Goods Sold
  - Maximize Marketing Costs
  - Reduce General & Admin. Costs
  - Rationalize Plant, Property and Equipment
  - Reduce Inventory Levels
  - Improve Receivables And Payables

Source: Alix Partners
Haagen Dazs
Cosimos Pizza
How do you know when a franchisor is truly focused on Maximizing Unit Economics?

- Franchisors can quantify what drives the variation in both revenue and profit across their retail network
- Average unit profitability is growing
- Every franchise produces a P&L
  - Franchisees might need incentives
- Franchise Advisory Boards are focused on improving profitability across the network by leveraging franchisee community shared data and knowledge.
- Franchisors embrace item 19 – full disclosure
- When you are recognized as the franchisor of choice!
Maximizing Unit Economics - A Competitive Edge

• Why Is Understanding Unit Economics Important?

• Issues in Sharing the Unit Economics Data
Rocco Fiorentino, CFE
Presenter

• Chairman/CEO Eagle Tax Services Group
• Joined United initially as a Director and Board Member in May 2002
• Assumed the positions of Chairman and CEO in February 2005.
• Franchisor of Financial Services and Tax Preparation Services, with nearly 200 offices operating nationwide.
• Serves on the Board of Directors for Swiss Farm Stores
• Serves International Franchise Association, Franchisor Forum and member of the Board of Directors for the IFA.
• Mr. Fiorentino holds a Master of Science in Management (MSM) Degree
Harold Kestenbaum
Presenter

- Franchise Attorney with Ruskin, Moscou, Faltischek
- Over 30 years with Franchise Law Experience
- Unique blend of experience in franchise law
- Serves as a Director of several National and International Franchisors
- Published many articles related to franchising
- Author of “So you want to Franchise your Business”
Maximizing Unit Economics

- Why is understanding Unit Economics Important
Determining the Health of your System

Strong Unit Economics typically can be evident through observing:

• Franchisee basic satisfaction/validation
• Multiple unit operator interest
• Referrals from existing franchisees
Presenting to Lenders

• Lenders are coming off of "loose" credit standards

• Lenders are faced with an uptick in defaults on SBA loans

• Lenders are no longer able to sell off portfolio as often, which means that their non-interest income from selling loans at a premium is no longer available.

• The result: lenders are lending "Less" money, which means they are much more conservative in who they are lending to.

• Lenders are influenced by "Data"
Presenting to Lenders

• Data that is above and beyond what is readily available within the Industry is well received.

• Managing, Controlling, and Providing Data on your "Unit Economics" will be a key factor in all future lending decisions.

• On November 13, 2008, SBA announces new ways to improve Small Business Access To Capital. SBA Administrator Sandy Baruah announced important loan program changes to help the agency’s lending partners increase access to capital for small businesses.
Types of Financing

- **Conventional Bank Financing**
  - currently not available for the most part, unless there are extraneous circumstances.

- **SBA Financing**
  - Still available, although there are far fewer lenders in the marketplace, due to the market conditions outlined in the previous slide.

- **Lease Financing**
  - Still available with tighter credit guidelines and higher interest rates.

- **Self Directed IRA**
  - Should be used whenever possible, possibly in concert with an SBA loan or lease financing.
Franchisor Issues – SBA Loans

- **SBA Registry**
  - A must for franchisors who want to use SBA as a resource. Contact FRANdata – www.frandata.com

- **FDD Issues**
  - Item 19 – Franchisors who have Item 19 disclosures are viewed favorably by lenders. In the absence of any disclosure, confidential reporting direct to lenders is a viable option.
  - Length of time franchising
  - Number of Units open
  - Training program – needs to be highlighted in FDD
    - Class training and field training
  - Exits and Transfers
    - Any anomaly should be explained
    - Avoid stores going “dark”
Franchisor Issues – SBA Loans

- **Coleman Report** – Used by lenders to see defaults and charge-off’s by franchise concept.
  - Report is incomplete, and may not reflect franchisor’s actual performance.
  - Underlying data can be requested under the Freedom of Information Act.
  - A Bank Credit Report can be obtained from FRANdata (for a fee)

- **Managing troubled locations**
  - Talk to lenders as soon as you know there are issues. They can work in concert with you and your franchisee
  - Try to have location transferred before going “dark”
  - Allocate resources in your company to manage lenders or hire a packager to manage the relationships on your behalf
Franchisee Issues

- Consistency Issues
  - Resume – Must have managerial experience
  - 1040, Credit Report, and resume need to be consistent
  - FICO score needs to be over 650, however personal income needs must be reflective of earnings from franchise

- Cash Injection
  - Was average of 20%, moving upward toward 30%+
  - Home Equity cannot be used without other income to service that debt
  - Gifts are still acceptable
  - Franchisor can participate by offering standby financing of some soft costs
  - Lenders looking for additional liquidity after the fact
Industry Issues

• Food Sector
  • Major tightening on start ups – moratorium by some lenders
• Size Matters!
  • Most lenders have minimum loan sizes of >$200k
What is your legal Obligation before Franchising

• Peaberry case does not require a display of a successful business model before franchising
• Personal experience has observed 58 out of 60 failures with a brand.
• Recommend at least 6 months of operating history & positive cash flow.
Issues in using in FDD

- Item 19 refers to Financial Performance Representation
- Whole sale sweeping changes in 2008
- However FRP not required, continues to be optional. Statistically, 30% of franchisors have a FRP in their FDD
- Benefits to FRP disclosure are:
  1. Eases the sales process
  2. Better hedge against FPR claims
- Transparency strengthens the relationship.
Maximizing Unit Economics - A Competitive Edge

• How Do You Develop Unit Economics Benchmarks?

• Understanding and Using Unit Economics to Advance Your System.
Todd Leff
Presenter
• President & CEO American DriveLine since 1998- Parent to AAMCO and Cottman Transmissions
• Prior to that served as its General Counsel.
• In 10 years he has guided the company’s extraordinary growth from 225 centers to 1,100 locations today
• Achieved system wide sales of $600 million in ‘08 and employs over 6,000 team members nationwide.
• Previous lead trial attorney with the United States Department of Justice, Antitrust Division.
• A cum laude graduate of Temple School of Law, and served as Editor of the Temple Law Review.
Salman Siddiqui
Presenter
VP Global Business Development, Baskin Robbins/Dunkin
• 19 years of industry and national QSR development experience with Exxon, Pepsi, Yum and Dunkin Brands.
• Held several positions with Exxon
• Later joined Pepsi and moved into the QSR sector with YUM where he held several positions at Taco bell, KFC, Pizza Hut, Long John Silver and A&W
• Joined Dunkin brands in 2005
• Salman has an MBA in Strategy and Marketing from Depaul and a MS degree from University of Illinois
How to Develop Unit Economics Benchmarks

- Develop a Unified Model
  - Get Everyone to Speak the Same Language
  - Internal Agreement on Model
  - FAC Agreement on Model
  - Owner’s Compensation?
  - Non-Cash Compensation?
  - Debt Service?
  - Depreciation, Amortization, Non-Cash
<table>
<thead>
<tr>
<th>Category</th>
<th>Above Average</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SAMPLE COUNT</strong></td>
<td>44%</td>
<td></td>
</tr>
<tr>
<td><strong>PERIOD</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>REVENUE</strong></td>
<td>$ 733,352</td>
<td>$ 538,221</td>
</tr>
<tr>
<td><strong>PARTS</strong></td>
<td>$ 212,705</td>
<td>$ 117,889</td>
</tr>
<tr>
<td><strong>LABOR</strong></td>
<td>$ 138,977</td>
<td>$ 134,911</td>
</tr>
<tr>
<td><strong>CSM (ALWAYS CALCULATED)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>COST OF SALES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>EMPLOYEE TAXES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>REAL ESTATE TAXES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL TAXES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LEASE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>REPAIR - MAINTENANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>SIGN LEASE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL LEASE EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TELEPHONE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>UTILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL UTILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>HEALTH INSURANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>INSURANCE OTHER</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LIABILITY INSURANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>WORKERS COMP</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL INSURANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>MEDIA ADVERTISING</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>NATIONAL CREATIVE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>YELLOW PAGES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL ADVERTISING</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>ALARM</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>BANK FEES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CAR RENTAL / MONEY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CONTRIBUTIONS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>DELIVERIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>DUES &amp; SUBSCRIPTIONS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FRANCHISE FEES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FUEL</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>INTEREST EXPENSE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LATE CHARGES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LAUNDRY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LEASE (LIFTS)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>LICENSE AND PERMIT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>MISCELLANEOUS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>OFFICE SUPPLIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PENALTY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>POSTAGE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PROFESSIONAL DEVELOPMENT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>PROFFESSIONAL FEES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>REFERRAL</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>REPAIRS - COMPUTER</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>SUPPLIES / ATF</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>SUPPLIES OTHER</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOWING</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TRAINING</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>UNIV. LIFE INSURANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>WARRANTY INSURANCE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>WASTE REMOVAL</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL OTHER EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>GRAND TOTAL EXPENSE</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>NET PROFIT - Pre Owned</strong></td>
<td>$ 145,203</td>
<td>$ 75,395</td>
</tr>
</tbody>
</table>
How to Develop Unit Economics Benchmarks

• Gathering Data
  • Electronically Through POS
    • Sales, Customers, Ticket Size, Products
• Field Staff
  • Require at least 2x breakevens per year
• Voluntary Submissions, Incentives?
Comparing and Stratifying Data

- Manager vs. Non Manager:
  - GP Higher but - 1.3%

- DMAs:
  - Top 20 vs. Non Top 20
    - +3.6%

- Ad Pool Spend:
  - ROI on ad $

- Regions:
  - Minimal Difference

- Types of Locations

Unit Data
Using and Understanding Unit Economics: Elements of a Concept Launch

... a disciplined approach
Maximizing Unit Economics

Sales: Investment Ratio Greater than 1
Maximize Value—at every stage...

**DESIGN / CONCEPT**
- Vision & Design
- Equipment
- Layout, Size
- Test, Value Engineer, Optimize
- Finalize V1 & start re-engineering!

**MARKETING**
Build Sales & Profitability
- Segment Analysis
- Competitor Differentiation
- Products
- Pricing
- Promotion
- Place~ Road Map

**CONCEPT TESTING**
- Where & Why, length & duration?
- Test Agreements
- Tracking Sales & Customer count
- Item 19
- Building a story
Portfolio Approach

Cafe 31'

Traditional Store

Express

49TH ANNUAL CONVENTION
FEBRUARY 14 – 17, 2009 • SAN DIEGO, CA

IFA
Franchising
Building local businesses, one opportunity at a time.
Maximize Value- at each stage...

**SUPPLY CHAIN**
- Product Preparation & Procurement
- Delivery Mechanics
- Bulk Purchasing
- Eliminate Waste
  ‘Zero-100’

**GROWTH ROAD MAP**
- US & International
- Prioritize Markets
- Trade Area
- Building Network
- Utilize Concept Portfolio
- Area developer
- Site Selection

**FRANCHISE DISCLOSURE**
- Item 1
- Item 5
- Item 7 & 8
- Item 11
- Item 19
- Item 22
Competitive Edge

- Attractiveness: Brand awareness, longevity, heritage: relevance
- Franchisee base & new
- Concept Simplicity - lifestyle
- Single vs. multi-unit - networks
- Capital availability banks willingness to loan
  - Concept Rating in a tiered system
  - SBA lending program
- Incentives
Using an Understanding of Unit Economics: Launching a New Product Line

Transmission Cars

<table>
<thead>
<tr>
<th>Year</th>
<th>Majors</th>
<th>Minors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>53.3%</td>
<td>46.7%</td>
</tr>
<tr>
<td>2003</td>
<td>52.9%</td>
<td>47.1%</td>
</tr>
<tr>
<td>2007</td>
<td>54.7%</td>
<td>45.3%</td>
</tr>
</tbody>
</table>

IFA 49TH ANNUAL CONVENTION
FEBRUARY 14 – 17, 2009 • SAN DIEGO, CA
Using and Understanding of Unit Economics: Launching a New Product Line

Overcoming Dealer Concerns:
• Is it Profitable?
• Can we Make the Same Money?
• Can we service the new Product Line?
• Will consumers buy the Product/Service?
• What is Capital Investment/ROI?
• Frequency – test centers
• Profitability – outside/internal study
• Consumer Adoption - zoomerang
• Ease of Implementation - internal
Do The Metrics Drive Behavior?

**General Repair Sales 2008**

- Engine Performance: 28.2%
- Brakes: 15.0%
- Cooling: 13.8%
- Steering/Suspension: 7.0%
- Oil/Lube: 5.2%
- Starting/Charging: 8.8%
- Exhaust: 7.0%
- A/C: 2.4%
Using and Understanding of Unit Economics: Cutting Costs

1. Identify the Cost Drivers
2. Compare Internal Performance
3. Compare vs. Industry Benchmarks
4. Build the New Model
5. Test and Track
6. Communicate the Result
Impacting Labor as a Key Driver

- Labor is our most valuable asset and our largest expense:
  - Labor – Techs 20.8%
  - Center Manager 7.4%
  - Employee Taxes 2.9%
  - Health Insurance 1.8%
  - Workers Comp 1.4%
  - Total Labor Costs 34.3%
  - Parts Costs 22.0%

- Every Labor hour generated resulted in $70 Gross Profit
- Dealers more concerned with unexpended inventory than unused labor
Comparing Costs to Industry and Internal Benchmarks

• Range internally was significant but not dramatic
  • Best performers to Average was a 7% difference in labor
• One of last auto service businesses to pay salary
• Industry Study showed:
  • 75% actual productivity, 90% benchmark
Comparing Costs to Industry and Internal Benchmarks

<table>
<thead>
<tr>
<th></th>
<th># of Employees</th>
<th># of Weeks</th>
<th>Billed Hours</th>
<th>Paid Hours</th>
<th>Productivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Center A</td>
<td>4</td>
<td>5</td>
<td>451</td>
<td>760</td>
<td>59.3%</td>
</tr>
<tr>
<td>Center B</td>
<td>3</td>
<td>8</td>
<td>857</td>
<td>960</td>
<td>89.2%</td>
</tr>
<tr>
<td>Center C</td>
<td>4</td>
<td>5</td>
<td>340</td>
<td>800</td>
<td>42.5%</td>
</tr>
<tr>
<td>5 Add'l Centres</td>
<td>17</td>
<td>33</td>
<td>2,439</td>
<td>4,200</td>
<td>58.0%</td>
</tr>
<tr>
<td>Average</td>
<td>3.3</td>
<td>6.4</td>
<td>511</td>
<td>840</td>
<td>60.8%</td>
</tr>
</tbody>
</table>

- Industry was 75% productive – AAMCO was 60%
- Labor must be thought of as perishable inventory
- Flat Rate Program – Pay a technician a fixed hourly rate (x) hours actually billed to customer
- Upside to technician is greater earning potential
Build the Model

Launching Flat Rate Pay

• Needed a system to track labor inventory – technician’s time (hours worked & hours billed)
• Implemented a comprehensive training plan for all staff
• Developed policy on comebacks and non-routine tasks
• Implemented a plan for charging testing and diagnostic services, including free inspections
• Developed policies to compensate technicians for other uses of time (i.e., equipment maintenance, CSM fill-in, training, etc.)
## Test and Track

<table>
<thead>
<tr>
<th>Center</th>
<th>Billed Hours</th>
<th>Worked Hours</th>
<th>Productivity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lee’s Summit, MO</td>
<td>298</td>
<td>280</td>
<td>106.5%</td>
</tr>
<tr>
<td>Bear, DE</td>
<td>160</td>
<td>160</td>
<td>100%</td>
</tr>
<tr>
<td>Turnersville, NJ</td>
<td>376</td>
<td>320</td>
<td>117.5%</td>
</tr>
<tr>
<td>Totals</td>
<td>834</td>
<td>760</td>
<td>109.8%</td>
</tr>
<tr>
<td>Industry Actual</td>
<td></td>
<td></td>
<td>75%</td>
</tr>
<tr>
<td>Industry Benchmark</td>
<td></td>
<td></td>
<td>90%</td>
</tr>
<tr>
<td>AAMCO Chain</td>
<td></td>
<td></td>
<td>60%</td>
</tr>
</tbody>
</table>

- Complete Car Care Growth (CCC) – Chain 19.0%
- Chain Average CCC - weekly $1,850
- Flat Rate Test Centers CCC Growth 79.4%
- Flat Rate Centers Average CCC $3,871
- % above Chain Average 109.2%
## Communicate Results

### Increased Annual Earnings

<table>
<thead>
<tr>
<th>Productivity Improvement</th>
<th>Increased Annual Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>3%</td>
<td>$14,000</td>
</tr>
<tr>
<td>6%</td>
<td>$28,000</td>
</tr>
<tr>
<td>9%</td>
<td><strong>$42,000</strong></td>
</tr>
<tr>
<td>12%</td>
<td>$56,000</td>
</tr>
<tr>
<td>30%</td>
<td>$140,000</td>
</tr>
<tr>
<td>50%</td>
<td>$233,000</td>
</tr>
</tbody>
</table>

- Convention Training
- Webinars
- Field Rollout

49TH ANNUAL CONVENTION
FEBRUARY 14 – 17, 2009 • SAN DIEGO, CA

INTERNATIONAL FRANCHISE ASSOCIATION
Franchising Building local businesses, one opportunity at a time.
Strategic Planning and Budgeting

Planning Sessions
- Internal Review of P&L
- Meet with FAC

Setting Objectives
- Grow Profitable CCC segments
- Implement Flat Rate Pay
- Expand Saturday Hours
- Reduce CCC Parts Costs

Execute
- Hire Product Specialists
- Field Rollout of Pay System
- Saturday Shopping Program
- Negotiate with Supplier on Promotions Calendar