LUNCH N LEARN

IFA WEBINAR SERIES

IFA
INTERNATIONAL FRANCHISE ASSOCIATION

# First US Royalty Transaction: Franchisor Liquidity Event Without Selling Equity

December 13, 2022

SPONSORED BY: DIVERSIFIED ROYALTY CORP

# Webinar Sponsor

DIVERSIFIED ROYALTY CORP

Sean Morrison, President and CEO

sean@diversifiedroyaltycorp.com

Greg Gutmanis, CFO and VP Acquisitions

greg@diversifiedroyaltycorp.com

# Speakers

- Sean Morrison, CEO Diversified Royalty Corp ("DIV")
- Greg Gutmanis, CFO and VP Acquisitions DIV
- Afshin Cangarlu, CEO and co-owner of Stratus Building Solutions

# Options for Founders of Profitable Franchisors

- Status Quo
- Debt Recapitalization
- Private Equity / Sale
- Royalty Transaction

# Introduction

- Diversified Royalty Corp ("DIV") believes the franchisor business model is a superior business model
- Franchisors with proven store level economics, scale, profitability and with the potential to double their store count over time are cash flow machines – the operational leverage of the franchisor model, at scale, is awesome
- In the early 2000's, the management team of DIV was working with several of North America's best franchisors and invented a unique royalty transaction that generates a meaningful upfront liquidity event while selling no equity – providing the owners of these great businesses[1] a far superior alternative to selling to private equity

[1] A&W Food Services, The Keg Steakhouse and Boston Pizza

# Why a Royalty Deal?

- It takes a big effort and often a long period of time to build a Franchisor to a point where it has achieved scale and becomes highly profitable
- Many entrepreneurs (owners) want to take some money off the table when their Franchisor becomes profitable
- Once a Franchisor achieves scale, the equity risk phase (while building to scale) is over – DIV believes owners of high-quality franchisors should retain 100% equity ownership and reap the economic rewards of continuing to scale the business
- DIV's unique trademark and royalty transaction structure provides owners of high quality Franchisors with the liquidity of a private equity deal, while retaining 100% control <u>and</u> the economic upside of continued new store growth
- Furthermore, the all-important relationship between the Franchisor and franchisees is unaffected, unlike a change of control private equity deal

# Franchisor Attributes for a Royalty Transaction

Franchisor – stable annuity-like revenue streams

Robust store level economics

Strong new store growth prospects

Profitable – $4+M of EBITDA

History of positive SSSG

Amongst the market leaders in its category

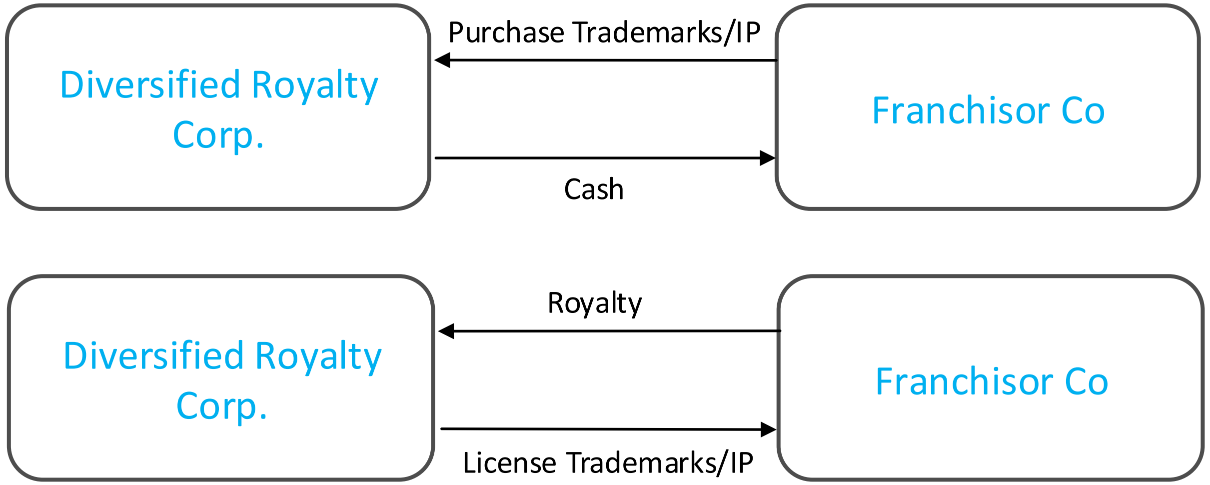
Long operating history

Experienced management team

The royalty transaction is primarily targeted at individually-owned franchisor businesses that are seeking a liquidity event and don't want to sell out to private equity

# How a Royalty Transaction Works

Step 1




DIV purchases[1] the worldwide trademarks and IP for ~9-10x TTM EBITDA

DIV licenses the North American trademarks and IP in exchange for a royalty equal to approximately TTM EBITDA – the royalty would fluctuate based on SSSG or at a fixed rate

The owners of Franchisor Co:

- realize a material liquidity event
- retain 100% equity ownership

[1] taxed as a capital gain

# How a Royalty Transaction Works

Franchisor Co

Each year, as Franchisor Co opens new stores/markets, its EBITDA should increase

Step 2

Diversified Royalty Corp.

Incremental Royalty

Cash

Franchisor Co

DIV will purchase[1] incremental EBITDA[2] generated by Franchisor Co at ~9x multiple

Since the owners of Franchisor Co own 100% of the equity, they are able to realize the benefit of monetizing increased profitability from continued new location expansion and operating leverage

[1] taxed as a capital gain [2] subject to a royalty coverage test

INTERNATIONAL FRANCHISE ASSOCIATION

# Case Study – Boston Pizza

- While the initial royalty transaction creates a meaningful liquidity event, the cumulative proceeds from the sale of incremental royalties over time should dwarf the initial liquidity event – Boston Pizza provides a perfect case study
- Casual dining restaurant chain with 150 locations and ~$10M of EBITDA
- In 2002, completed a royalty transaction and realized a $98M liquidity event
- From 2002 to 2022, Boston Pizza opened 270 additional stores and realized incremental proceeds of over $400M
- The owners of Boston Pizza have received total proceeds of over $500M and they still own 100% of the equity!!

# First US Royalty Transaction – Stratus

- Stratus Building Solutions ("Stratus") is a franchise business operating in 65 markets, generating ~$150M system sales and profitable – the outlook for Stratus is strong with continued double digit SSSG and opening up an additional 85 markets
- The Stratus owners were seeking a liquidity event, but with such strong growth prospects were reticent to sell controlling ownership to private equity – there was simply too much upside
- The Stratus owners were introduced to Diversified Royalty Corp and their unique royalty transaction at the IFA Convention in San Diego in 2022
- DIV and Stratus announced the first US franchisor royalty transaction on November 14, 2022

# First US Royalty Transaction – Stratus

- A royalty transaction met all of the Stratus owners' objectives:
  - Meaningful liquidity event
  - Maintain control of the business
  - Meaningful economic participation in the continued growth prospects of the business
  - No change in relationships with its franchisees
- The owners of Stratus believe they can replicate the success Boston Pizza had with the royalty transaction

# Founder Alternatives

**Status Quo**

Pro – retain 100% control

Con – no liquidity event

**Debt recapitalization**

Pro – retain 100% control

Con – modest liquidity – must pay back principal + interest

**Private Equity / Sale**

Pro – significant liquidity event

Con – loss of control, investors run the show

Con – might not align with the founder's goals

**Royalty Transaction**

Pro – significant liquidity event

Pro – 100% ownership retained

Pro – participate in value of new store growth

Pro – manage timing of liquidity schedule

# Diversified Royalty Corp

- DIV is acquiring a portfolio of trademarks and collecting royalties from high quality multi-location and franchisor businesses
- DIV is a ~$600M business generating ~$57M of royalty revenue from seven royalty partners

- DIV believes the royalty transaction with Stratus (the first US royalty transaction) combined with the royalty model being proven in the Canadian market over the past 20 years will be a game changer for US franchisors
- DIV is actively looking to partner with owners of great franchisor businesses

# Summary

- Owners of great franchisor businesses in the US have been programmed to think their only source of meaningful liquidity is to sell to private equity
- Private equity has earned out-sized returns over the past 20 years buying the equity of great franchisor businesses
- DIV believes the franchisor business model is superior and owners of great franchisors shouldn't have to sell their equity if they want a large liquidity event and continue running their business
- DIV's unique royalty transaction provides owners of great franchisors with the liquidity of a PE deal without selling any equity !!

Afshin Cangarlu, CEO and Co-Owner of Stratus Building Solutions

# Questions

# Thank You For Attending