



National Franchise Conference 2013 Legal Symposium

20 October 2013

Panel session: Franchises and Insolvency

Franchising at Nab

Overview

The operating environment for franchised businesses has been impacted by the slower economy and the resulting downward trends and uncertainty that have followed since the onset of the GFC in 2008. The expected outlook for the next 5 years however is one of revenue growth, and this environment presents Nab with the opportunity for greater participation in this sector.

Lending to businesses in this industry is heavily reliant on continuing strong cash flow performance that also drives security values; accordingly the level of risk and quantum of lending losses upon business failure are high. Nab's accreditation framework, its lending covenants and security requirements are all aimed at ensuring well performing businesses are banked and that failure and loss is avoided.

Where financial distress occurs, Early Warning Systems ('EWS') and a collaborative working relationship to implement a Turnaround or Recovery strategy between the Franchisor, Franchisee, and Nab are essential to value preservation.

Accreditation

In addition to specifying Tripartite Deed terms and applicable maximum Loan to Franchise Value Ratios that are to apply, Nab's Accreditation framework is aimed at achieving a level of comfort with a Franchisor's ability to secure optimal site selection, source an appropriate level of franchisee capability, and have in place appropriate systems to monitor Franchisee performance such that any adverse trends or impending insolvency can be identified early. Time will always be critical as value can very rapidly deteriorate especially upon enforcement.

Whilst Tripartite Deeds set out the legal rights and obligations of the parties, problem identification and acceptance followed by decisive action and engagement by all stakeholders is critical. This provides the best chance for brand protection, sufficient time to consider terms of any ongoing support strategy, or to help implement a well managed and value maximising exit strategy.

Managing Distressed Businesses

- **Franchisors** – instances of formal insolvency have been limited. Where warning signs have been identified and acted upon proactively, Independent Business Reviews have assisted in identifying root causes and provided remedial action plans. Workout strategies have focussed largely on turnaround or divestment of unprofitable stores, improving working capital management, rationalising operations, and improving management, reporting and monitoring.

- **Franchisees** – this is where most distress cases and losses have occurred in the past. Key factors that have impacted Nab’s recovery outcome include:
 - Poor management and / or declining trading performance with an absence of sufficient EWS to trigger any remedial or exit strategy early enough.
 - Inability to access or control the site.
 - Absence of a tripartite arrangement and / or clear lines of communication between key stakeholders to ensure a going concern as opposed to shutdown strategy can be attempted in the first instance.
 - Automatic termination clauses in Franchise Agreements or sub-leases that have been triggered which have limited recoveries to plant and equipment sale values.

- **Strategic Business Services (‘SBS’)** - Nab’s franchise business distress cases are managed by its SBS team in collaboration with stakeholders and advisors in order to maintain momentum and deliver a solution. Every case is different and each strategy is designed to encourage sufficient change so that where possible, the business either returns to an acceptable level of risk or the risk is removed from Nab’s balance sheet.

Key Messages

- *Early warning mechanisms* play a key part in the identification of poor trading performance and impending cashflow stress. Detailed reporting systems that enable the close monitoring of franchisee KPI metrics are an essential tool for ensuring proactive action is taken to prevent formal insolvency where possible.

- Noting the high risk profiles that apply in the Franchise lending arena, and Nab’s recovery experience in distressed situations, *Tripartite Agreements* are an essential requirement in the preservation of Nab’s security value. This is especially so where the agreement provides a clear framework for sharing of information, access to business premises, records and information, management of the business, and the transfer or realisation of assets.

- Experience has shown that *collaboration and alignment* of the objectives of the respective stakeholders in any distress scenario results in better outcomes for all. The availability of a point of contact at Franchisor level when faced with a business in distress is beneficial.

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