

FranCompare's

20-Page Survey of Item 19 Submissions for 2018

A Comprehensive Analysis of 2,277 US Franchise Systems That Submitted a Financial
Performance Representation / Item 19 in 2018

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Introduction

This is our third annual survey of Item 19 submissions (the first two were submitted through the World Franchising Network).

FranCompare.comTM is a new website. Its sole mission is to determine which franchise systems are the “best” in their category. It is built upon over 30 years of experience with managing our related websites - www.WorldFranchising.com, www.FranchiseDisclosures.com, www.FranchisorDatabase.com, www.Item19s.com, as well as having published ~50 books and directories on franchising. Given that experience, we have come to appreciate how the rational, unemotional and increasingly sophisticated prospective franchisee should approach the investment decision.

In determining the “best” franchise systems from over 3,700 active North American franchise systems out there, FranCompareTM only uses data from each company’s 2018 Franchise Disclosure Document (FDD). We extract over 50 datapoints from these FDDs and compare them on a side-by-side basis against the 4 largest (generally) franchises in that category who provide an Item 19. Companies that might otherwise be included, but which do not provide an Item 19, are at a significant disadvantage. www.FranchiseDisclosures.com includes over 2,300 2018 FDDs that we used as the basis for this White Paper.

An Item 19 is one of 23 Items covered in the initial section of the FDD. Although we refer to it as an Item 19 throughout this White Paper, it is also known as the Financial Performance Representations. The terms are interchangeable.

FranCompareTM places a strong emphasis on the quality of the Item 19. We use published Average Gross Sales to determine a basic Return on Investment (Average Gross Sales /

Average Total Investment). We calculate the Average Gross Sales over a 10-year period (compounding at 5% per year) against the Average Total Investment. We also calculate the total royalties paid out over the same 10-year period as a function of the Average Total Investment. Lastly, we reward franchisors that provide financial details below the Average Gross Sales line and especially those with additional detail down to an EBITDA level. When we determine the “best” franchisors, the Item 19 accounts for up to 35% of the total score assigned to each company. It is important to point out that this White Paper makes no attempt to evaluate the underlying quality of the Item 19 presented – only that one has been submitted. A subsequent report will investigate how a franchisor might skew annual sales data in its favor or make the Item 19 so difficult to decipher as to make it of only limited value.

Since FranCompare™ works with Item 19s on a daily basis, we thought we would provide you with the results of our research. This White Paper is intended to disaggregate which firms do and do not provide an Item 19. Sorts are provided on the basis of several variables (total unit size of the company, average total investment, primary industry group, IFA membership, etc.). It makes no attempt to quantify the value of the Item 19 itself, only whether or not one is provided. A total of 2,277 2018 Item 19s are discussed below. We are hopeful that you will find value in the analysis. A tangential hope is that franchisors who do not currently provide an Item 19 will be persuaded to do so. In our work with franchisors and other industry experts, we find an increasing number of industry professionals who say that they would not recommend that a family member invest in a franchise system that did not provide an Item 19.

Without a doubt, the single most important factor in buying a franchise - or any business for that matter - is determining a realistic and supportable projection of sales, expenses, and profits. Specifically, how much you can expect to earn after working 65 hours a week for 52

weeks a year? Before an individual can confidently invest time and resources in any business venture, he or she must fully understand the financial history and projected financial future of the venture, and must be well aware of the extent of the personal financial losses or gains that could be expected should the venture fail or succeed. It is incumbent upon the individual to perform extensive due diligence and to gather as much specific financial information as possible about a company before partnering with them. However, the typical prospective franchisee does not have the experience to accurately project what their sales and profits will be over the next five years in a particular business. The only source that is able to supply accurate information about a franchise opportunity is the franchisor itself. This is why detailed Item 19 documents are so critical.

About Item 19s

In 1979, the Federal Trade Commission (FTC) adopted what is known as the “FTC Rule.” Titled “Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunities Ventures,” the rule requires all franchisors to prepare and distribute a disclosure document or Offering Circular according to a format prescribed by the FTC. The document must be delivered to any prospective franchise buyer prior to the signing of any contract.

Financial Performance Representations (FPRs) are covered under Item 19 of the FTC’s and the state’s Franchise Disclosure Document (FDD) requirements, which is why they are typically referred to as “Item 19s.” In their broadest sense, Item 19s are defined as estimates or historical figures detailing the level of sales, expenses, and/or income a prospective franchisee might realize as the owner of a particular franchise. However, the Item 19 is voluntarily completed and is unverified, with the format and level of detail left up completely to each company’s discretion. Neither the FTC nor the state regulatory agencies checks the document

for accuracy or completeness. The only requirement for any Item 19 is that the franchisor has a “reasonable basis” for the representation at the time the statement is prepared. Few specifics and even less guidance are provided to prospective franchisees, who are largely left to their own devices.

As such, concrete, accurate financial information can be difficult to access in the franchising industry. Still, you can learn a great deal by reviewing companies’ Item 19s. Most importantly, identifying the sales and costs that would be relevant to your own business, as well as to your skills and your experience, is invaluable. Do not be swayed by the profit margin alone, as you should also consider the cost side of the equation, such as the cost of sales, payroll costs, operating expenses, and rent and occupancy costs. Furthermore, you should also note that the historical data used as the basis for the representations do not apply to every geographic region, individual location or individual franchisee, since experience and business acumen may vary significantly from your own.

Because publication of a Financial Performance Representation is at the sole discretion of the franchisors themselves, only about 57% currently provide this information. In many cases, a franchisor will simply acknowledge that they do not provide an Item 19. It is our feeling that the inclusion of financial performance data in the Item 19 segment of a company’s FDD demonstrates that a company is honest and transparent, proud of its growth and performance, and eager to assist potential franchisees in the making of a potentially life-altering investment. We have noticed that the inclusion of Item 19s has been on a modest rise in recent years - a trend that we view as a very positive one.

The Analysis

Item 19 Submission Statistics

In an effort to have a better basic understanding of the role that Item 19s play in the franchising industry at large, we surveyed 2,277 2018 FDDs. According to our extensive database of active North American franchisors (www.FranchisorDatabase.com), there are currently 3,581 active US-headquartered franchisors. Since Canada-based franchisors do not publish an equivalent Item 19, they are not included in this survey. So, this report covers 63.6% of all active US-headquartered franchisors, and includes the vast majority of franchisors who offer franchises in more than one state.

The next step is to break down the 2,277 FDDs to determine what percentage of franchisors actually provide information of value to prospective franchisees. We have disaggregated the submissions into meaningful sub-categories. Because the Franchisor Database (www.FranchisorDatabase.com) is broken down into over 50 fields, we can evaluate Item 19 submissions by: 1) Whether or not they are an IFA member; 2) Primary industry groups (food-service, lodging, retail and service-based franchisors); 3) Total operating units; 4) Average total investment; and 5) Combinations of these variables. If you want to find which companies were included in this survey, please go to www.FranchiseDisclosures.com. Under 2018 FDDs, there are 2,277 FDDs that were evaluated, and these are broken down into 28 primary categories and over 150 secondary categories. Our only sources of data for this study were the 2018 FDDs themselves.

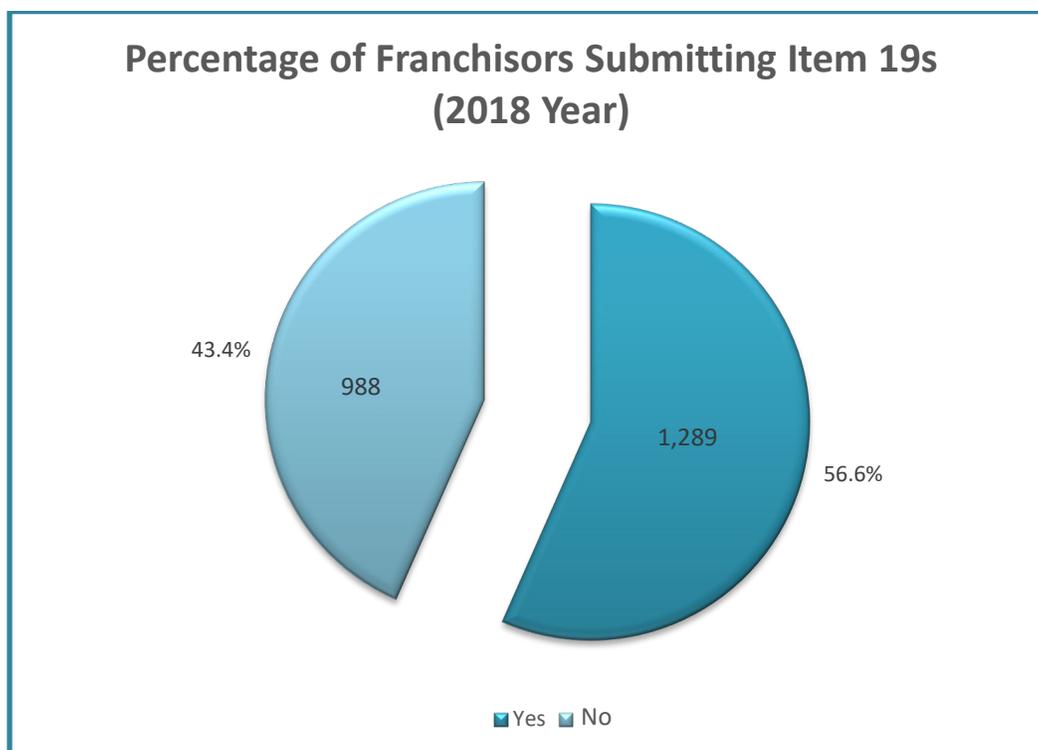
Whereas all FDDs include a section entitled Item 19 in their FDD, this study refers only to those franchisors who provide some usable and generally helpful information in the Item 19

section. Those franchisors who do not submit meaningful information simply say that they do not provide an Item 19. Typical language might be “We do not make any representations about a franchisee’s future financial performance or the past financial performance of company-owned or franchised outlets.”

Item 19 Submissions Throughout The Franchising Industry

We first determined how many of these 2,277 surveyed brands published a meaningful Item 19 or Financial Performance Representations in their 2018 FDD. Here are our findings:

- **Yes** – 1,289 franchisors out of 2,277 companies surveyed (**56.6%**) *did* publish Item 19s
- **No** – 988 franchisors out of 2,277 companies surveyed (**43.4%**) *did not* publish Item 19s



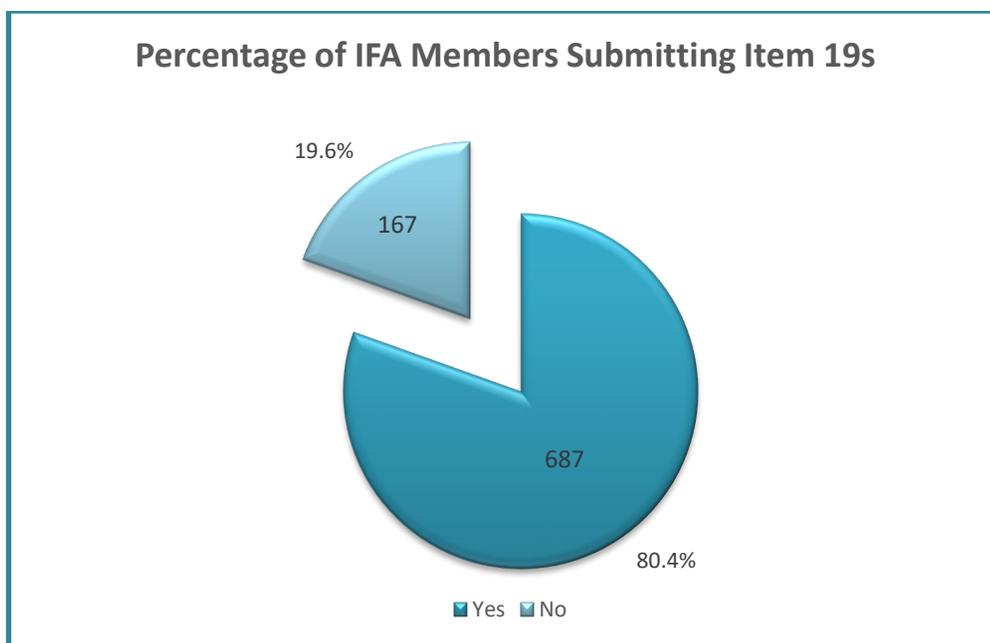
As we expected, the majority of US-Headquartered franchisors surveyed (56.6%) did make an effort to publish an Item 19. While this is already an encouraging fact, we hope that the percentage of all franchisors submitting Item 19s will continue to rise in years to come. Surely the increased transparency and sharing of knowledge can only be beneficial for all parties involved, as it helps prospective franchisees to make more informed financial projections and decisions and sets franchisors who do provide an Item 19 against those that do not.

Item 19 Submissions Sorted by IFA Membership

Given the International Franchise Association's (IFA's) exceptional leadership role within the franchising industry, we felt confident that there would be a high percentage of IFA members who submitted an Item 19. Membership in the IFA, which is not inexpensive, automatically connotes a certain degree of financial wherewithal, in-depth franchising experience and dedication to the industry. It also serves as an excellent indicator that a franchisor is well-established and deserving of consideration as an investment vehicle.

Among the 2,277 franchisors surveyed in the study, 854 are IFA members (this represents over 70% of the 1,215 members noted in the IFA's Fall 2018 *Franchise Opportunities Guide*). Of the 854 FDDs evaluated, 687 submitted an Item 19 and 167 did not. Thus, from a total pool of 854 IFA members:

- **Yes** – 687 IFA Members out of 854 IFA Members surveyed (**80.4%**) submitted an Item 19
- **No** – 167 IFA Members out of 854 IFA Members surveyed (**19.6%**) did not submit an Item 19



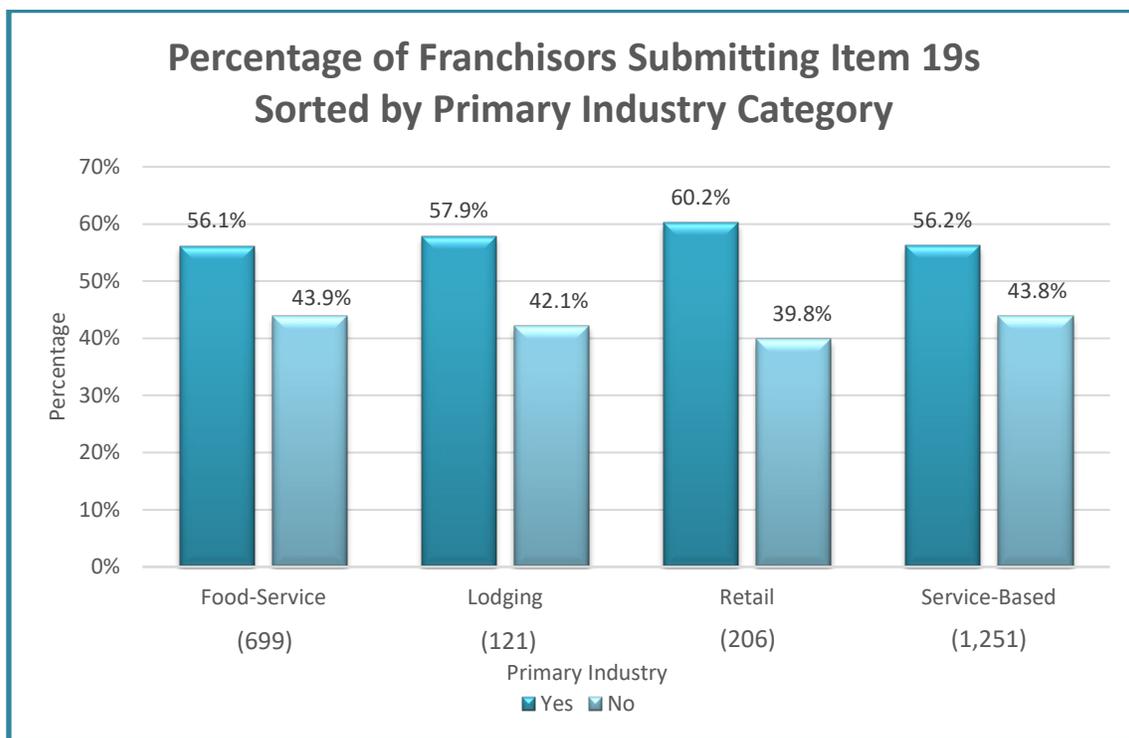
It is meaningful that only 56.6% of all of the 2,277 brands that we surveyed submitted an Item 19 compared against an impressive 80.4% for IFA members. It is not surprising that those franchisors that prioritize Item 19 submission are the same franchisors who also stay active and relevant in the industry by joining the IFA. Given the prestige connoted by IFA membership within the greater franchise community, it is our feeling that every franchisor seeking additional growth, influence, or connection could benefit greatly from membership with an association that regulates, governs, and supports their industry.

Item 19 Submissions Sorted by Primary Industry Category

Taking another swipe of the industry, we conducted a breakdown of the companies by separating them out by their primary industry category. The four primary industry categories, which we use to classify the roughly 3,581 franchisors in our database of franchise brands, are: Food-Service, Lodging, Retail, and Service-Based franchisors. We consistently found that,

within each of the four categories, the majority of franchisors surveyed did in fact publish a 2018 Item 19. The breakdown, by primary industry, of those companies that did publish an Item 19 is noted below.

- **Food-Service** – **56.1% Yes** (392 brands / 699 total), **43.9% No** (307 brands / 699 total)
- **Lodging** – **57.9% Yes** (70 brands / 121 total), **42.1% No** (51 brands / 121 total)
- **Retail** – **60.2% Yes** (124 brands / 206 total), **39.8% No** (82 brands / 206 total)
- **Service-Based** – **56.2% Yes** (703 brands / 1,251 total), **43.8% No** (548 brands / 1,251 total)



While the Retail industry demonstrates the largest percentage (60.2%) of Item 19 inclusion amongst the four distinct categories, it is worth noting that Item 19 inclusion is more common than not across all four industry categories. Indeed, about 56% of franchisors surveyed

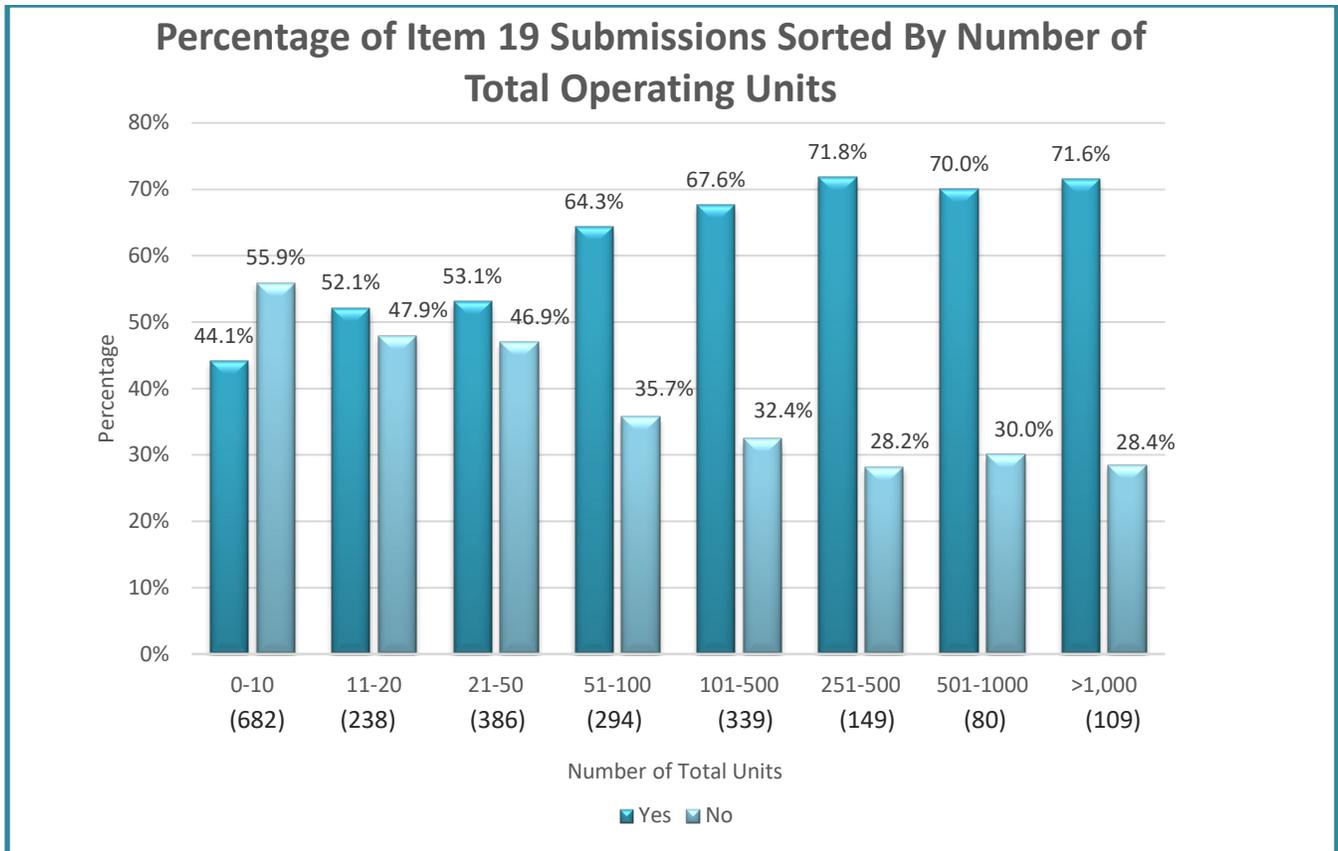
in each of the other three categories (Food-Service, Lodging, and Service-Based) published an Item 19 this past year, as can be seen in the graph above.

Item 19 Submissions Sorted by Number of Total Operating Units

After determining that Item 19s were submitted by over half of the companies surveyed in each of the four major industry categories, the next logical factor to consider was the size of these brands. How does the size of a franchisor (as indicated by its total unit count - combined Franchised Units and Company-Owned Units) affect whether or not the franchisor will publish an Item 19 disclosure? Are larger or smaller franchisors more likely to disclose their financial data for the benefit of prospective franchisees?

Perhaps unsurprisingly, we found that Item 19 submission was significantly more common amongst larger franchisors than amongst the smaller brands we surveyed. We separated the companies in our study into eight distinct categories based on total unit count, and then calculated the percentage of Item 19 submission for each category. Here is what we found:

- **0-10 units: 44.1% Yes** (301 brands / 682 total), **55.9% No** (381 brands / 682 total)
- **11-20 units: 52.1% Yes** (124 brands / 238 total), **47.9% No** (114 brands / 238 total)
- **21-50 units: 53.1% Yes** (205 brands/ 386 total), **46.9% No** (181 brands / 386 total)
- **51-100 units: 64.3% Yes** (189 brands/ 294 total), **35.7% No** (105 brands / 294 total)
- **101-250 units: 67.6% Yes** (229 brands/ 339 total), **32.4% No** (110 brands / 339 total)
- **251-500 units: 71.8% Yes** (107 brands/ 149 total), **28.2% No** (42 brands / 149 total)
- **501-1,000 units: 70.0% Yes** (56 brands/ 80 total), **30.0% No** (24 brands / 80 total)
- **> 1,000 units: 71.6% Yes** (78 brands/ 109 total), **28.4% No** (31 brands / 109 total)



The fact that the larger franchisors in our study were more likely to submit Item 19s may perhaps be explained by the fact that larger companies have most likely been in business for much longer than smaller companies, and thus have much more - and perhaps much more encouraging - financial data to publish. Smaller brands that have just begun franchising may still be in the process of getting off the ground financially, and therefore may be hesitant to make their financial details available to the public. Smaller franchisors may feel that less-than-stellar historical financial data could deter potential franchisees from investing in a brand that has perhaps yet to prosper, but that may have significant future potential.

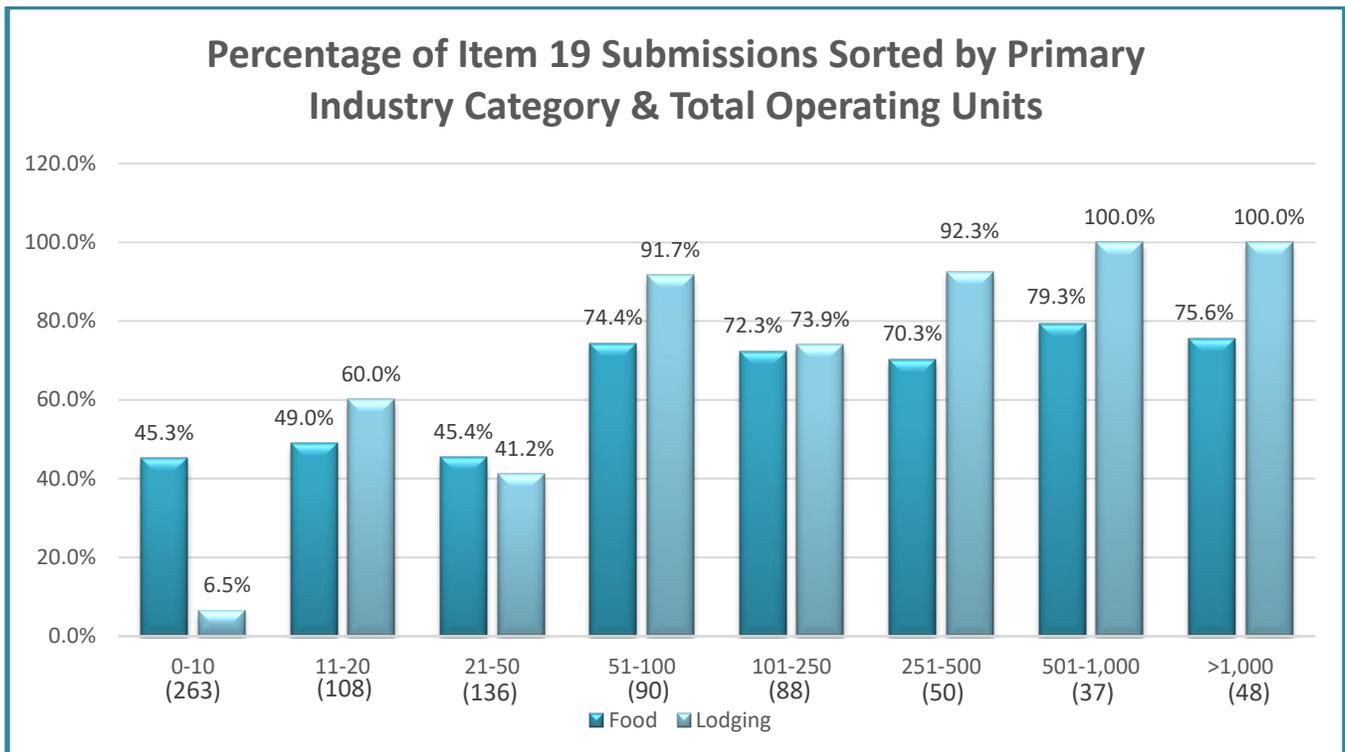
Item 19 Submissions Sorted by Primary Industry Category and Number of Total Operating Units

We then elected to examine Item 19 submission as a function of two variables at once: both primary industry category and number of total units. For this particular analysis, we looked only at those companies that *did* submit an Item 19 in 2018, sorting them first into the four major industry categories (Food-Service, Lodging, Retail, and Service-Based) and then dividing them into the same eight categories used in the previous chart. In so doing, we were able to provide answers to many different queries: for example, among smaller franchisors, which types of companies are most likely to submit Item 19s? And, is there any given industry sector in which franchisors consistently submit Item 19s, regardless of franchisor size?

- Among **Food-Service** franchises:
 - **45.3%** of those with **0-10 units** submitted an Item 19 (105 brands / 232 total)
 - **49.0%** of those with **11-20 units** submitted an Item 19 (48 brands / 98 total)
 - **45.4%** of those with **21-50 units** submitted an Item 19 (54 brands / 119 total)
 - **74.4%** of those with **51-100 units** submitted an Item 19 (58 brands / 78 total)
 - **72.3%** of those with **101-250 units** submitted an Item 19 (47 brands / 65 total)
 - **70.3%** of those with **251-500 units** submitted an Item 19 (26 brands / 37 total)
 - **79.3%** of those with **501-1,000 units** submitted an Item 19 (23 brands / 29 total)
 - **75.6%** of those with **> 1,000 units** submitted an Item 19 (31 brands / 41 total)

- Among **Lodging** franchises:
 - **6.5%** of those with **0-10 units** submitted an Item 19 (2 brands / 31 total)
 - **60.0%** of those with **11-20 units** submitted an Item 19 (6 brands / 10 total)

- **41.2%** of those with **21-50 units** submitted an Item 19 (7 brands / 17 total)
- **91.7%** of those with **51-100 units** submitted an Item 19 (11 brands / 12 total)
- **73.9%** of those with **101-250 units** submitted an Item 19 (17 brands / 23 total)
- **92.3%** of those with **251-500 units** submitted an Item 19 (12 brands / 13 total)
- **100.0%** of those with **501-1,000 units** submitted an Item 19 (8 brands / 8 total)
- **100.0%** of those with **> 1,000 units** submitted an Item 19 (7 brands / 7 total)

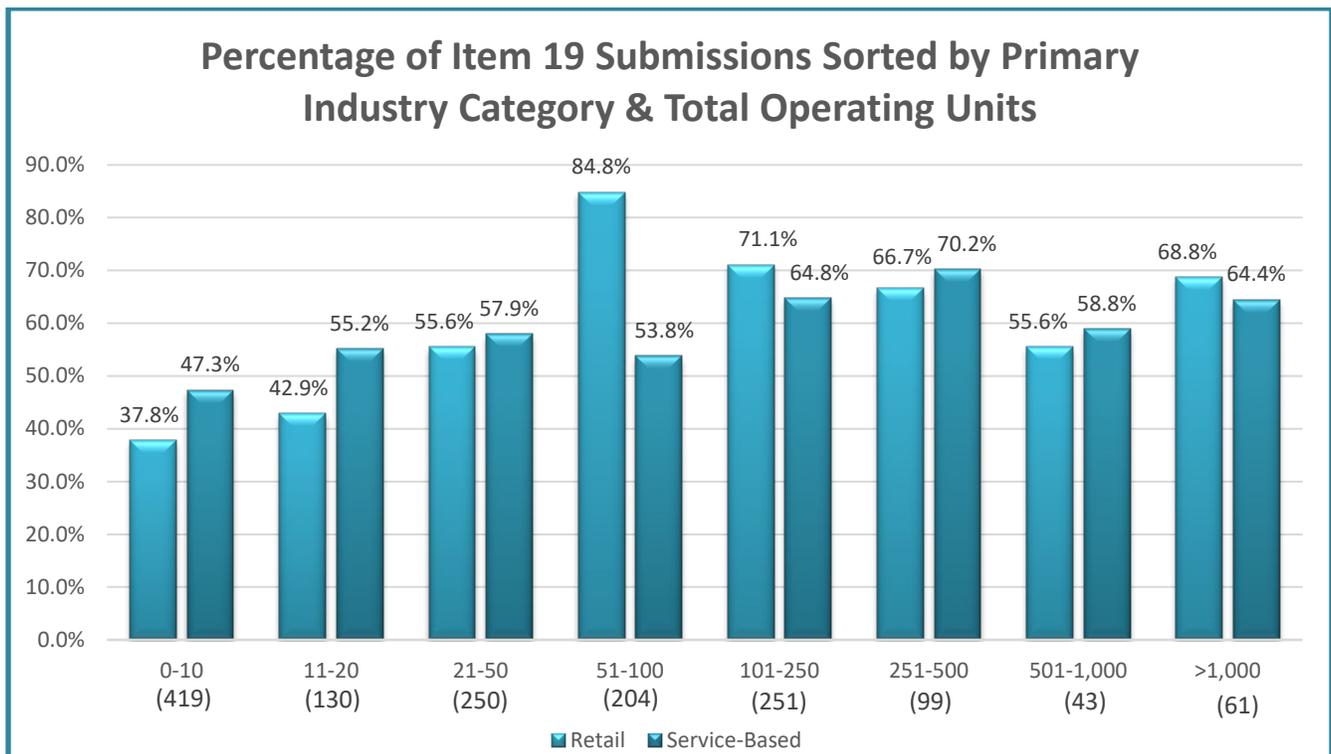


- Among **Retail** franchises:

- **37.8%** of those with **0-10 units** submitted an Item 19 (17 brands / 45 total)
- **42.9%** of those with **11-20 units** submitted an Item 19 (6 brands / 14 total)
- **55.6%** of those with **21-50 units** submitted an Item 19 (20 brands / 36 total)
- **84.8%** of those with **51-100 units** submitted an Item 19 (28 brands / 33 total)
- **71.1%** of those with **101-250 units** submitted an Item 19 (27 brands / 38 total)

- **66.7%** of those with **251-500 units** submitted an Item 19 (10 brands / 15 total)
- **55.6%** of those with **501-1,000 units** submitted an Item 19 (5 brands / 9 total)
- **68.8%** of those with **> 1,000 units** submitted an Item 19 (11 brands / 16 total)

- Among **Service-Based** franchises:
 - **47.3%** of those with **0-10 units** submitted an Item 19 (177 brands / 374 total)
 - **55.2%** of those with **11-20 units** submitted an Item 19 (64 brands / 116 total)
 - **57.9%** of those with **21-50 units** submitted an Item 19 (124 brands / 214 total)
 - **53.8%** of those with **51-100 units** submitted an Item 19 (92 brands / 171 total)
 - **64.8%** of those with **101-250 units** submitted an Item 19 (138 brands / 213 total)
 - **70.2%** of those with **101-500 units** submitted an Item 19 (59 brands / 84 total)
 - **58.8%** of those with **501-1,000 units** submitted an Item 19 (20 brands / 34 total)
 - **64.4%** of those with **> 1,000 units** submitted an Item 19 (29 brands / 45 total)



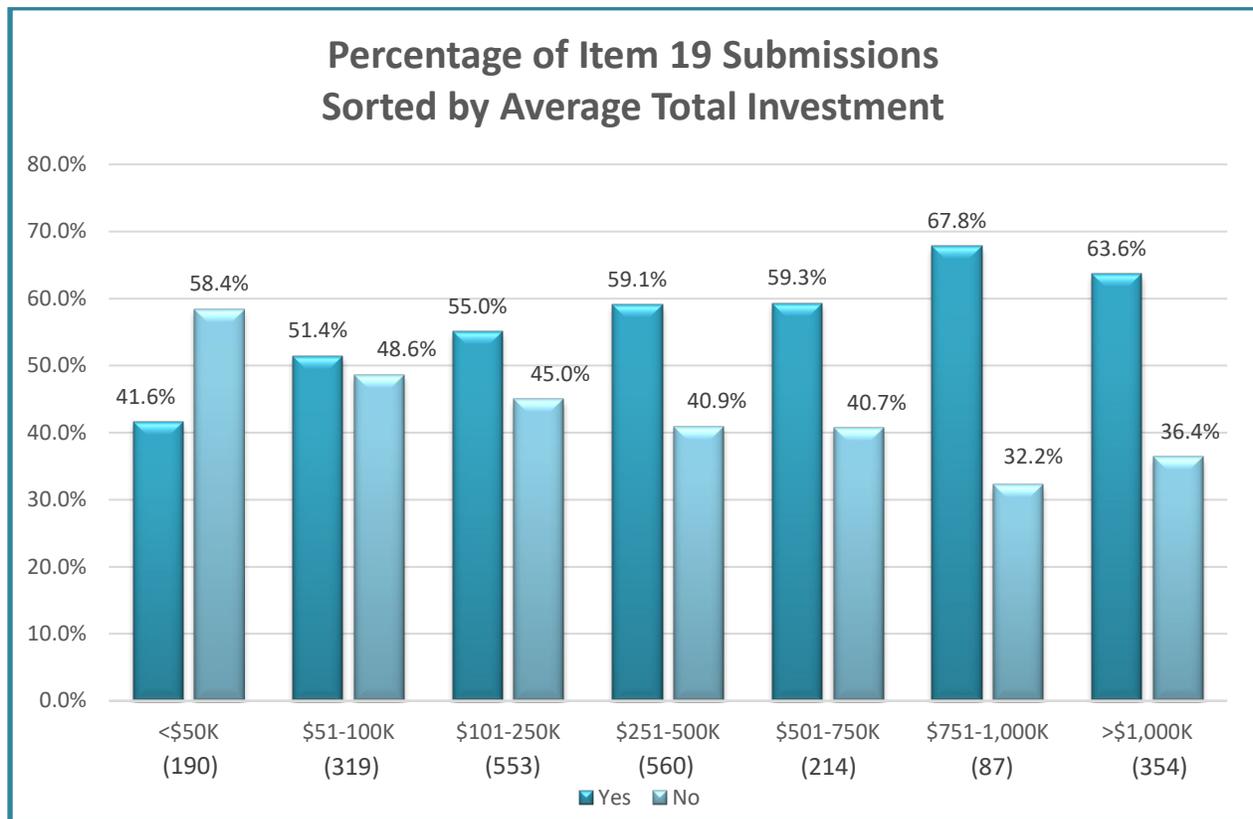
In the above graphs, we can clearly see that, across all four industry categories, Item 19 submission tends to become increasingly prevalent as the size of the franchisor increases. We even observe that, within each of the four industry categories, more than half of all surveyed franchisors with greater than 50 total operating units published an Item 19 in 2018. Once a franchisor hits the 50-unit mark, then, it becomes more likely than not that a franchisor will publish an Item 19, regardless of what industry category the franchisor falls into.

The Service-Based sector of the franchising industry, on the other hand, demonstrates much more modest levels of Item 19 submission: amongst all the various unit categories, the highest percentage reached by the Service industry was 70.2% (for franchisors with 251-500 units). Compare this with the highest percentages in each of the other three categories (79.3% for Food-Service, 100.0% for Lodging, and 84.8% for Retail), and the Service-Based category seems to be trailing rather significantly behind. This may be due at least in part to the fact that the Service-Based sector of the franchising industry is the single largest sector, encompassing such a wide range of brands and concepts - with everything from fitness centers to maid services to daycare centers to handyman services to tanning salons - and may therefore have a wider range of acceptable standards and common practices.

Item 19 Submissions Sorted by Average Total Investment

- **Investment Level Less Than \$50,000 – 41.6%% Yes** (79 brands / 699 total), **58.4% No** (111 brands / 699 total)
- **Investment Level \$51 - \$100K– 51.4% Yes** (164 brands / 319 total), **48.6% No** (155 brands / 319 total)
- **Investment Level \$101 - \$250K – 55.0% Yes** (304 brands / 553 total), **45.0% No** (249 brands / 553 total)

- **Investment Level \$251 - \$500K** – **59.1% Yes** (331 brands / 560 total), **40.9% No** (229 brands / 560 total)
- **Investment Level \$501 - 750K** – **59.3% Yes** (127 brands / 214 total), **40.7% No** (87 brands / 214 total)
- **Investment Level \$751 - \$1,000K** – **67.8% Yes** (59 brands / 87 total), **32.2% No** (28 brands / 87 total)
- **Investment Level Greater Than \$1,000K** – **63.6% Yes** (225 brands / 354 total), **36.4% No** (129 brands / 354 total)



Summary

We at FranCompare have been encouraged over the past several years to see that the submission of a meaningful Item 19 disclosure is becoming much more common practice for franchisors across all industry categories.

In summary, of the 2,277 2018 FDDs surveyed:

56.6% of all franchisors submitted an Item 19.

80.4% of IFA members submitted an Item 19.

Among the primary industry groups, the majority submitted an Item 19:

Food-Service.....56.1%

Lodging57.9%

Retail.....60.2%

Service-Based.....56.2%

In terms of Total Operating Units (Franchised and Company-Owned), the majority of all but the smaller franchise systems (10 or fewer operating units) submitted an Item 19.

In terms of the Average Total Investment Required:

○ Less Than \$50K.....41.6%

○ \$51 - \$100K.....51.4%

○ \$101 - \$250K.....55.0%

○ \$251 - \$500K.....59.1%

○ \$501 - 750K.....59.3%

○ \$751 - \$1,000K.....67.8%

○ Greater Than \$1,001K63.6%

Currently 56.6% of the franchisors surveyed submit an Item 19. As franchisees become increasingly sophisticated, they are demanding more insights into how existing franchisees are faring with their system. While an Item 19 submission tends to connote more than just a sense of diligence and pride on the part of the franchisor, more importantly, it demonstrates a commitment to transparency and a willingness to work with prospective franchisees potentially investing in their systems. There are few legitimate reasons why historical information should not be made available to potential investors.



To do our part in encouraging transparency and support within the franchising industry, FranCompare manages the following websites: 1) www.FranCompare.com (a new website that rigorously compares and scores over 40 datapoints extracted from each company's 2018 FDD in order to determine the "best" franchise in over 50 primary industry categories; 2) www.FranchiseDisclosures.com, a library of over 30,000 current and archived FDDs/UFOCs that are priced as \$100 or less and are emailed within a few hours of a request; and 3) www.FranchisorDatabase.com, an extensive database that includes ~50 datapoints on over 3,700 active North American franchisors and the names and titles of over 27,000 key executives. If you would like to order any of these documents or would like to learn more about what we do, please visit any of our websites or give us a call at (888) 612-9908.

We would greatly appreciate any thoughts you might have about this White Paper or Item 19s in general.