

# Mining Important Information from an FDD

## **How much money can I make?**

Item 19 Financial Performance Representations may provide information about unit sales, costs, margins, average ticket, or operating profit. You should also obtain as much financial information as you can from existing franchise owners. You can find their names and contact information in Item 20 or Exhibit E.

*Note: Most franchisors will help coordinate “validation” activities with franchise owners.*

## **How much will I need to invest?**

Item 7 provides a detailed table with notes of what the Franchisor estimates to be the total initial investment to get a unit up and running. The initial investment numbers have a low and high range. Obviously, the investment to get started will vary by region and investment group. For example, a retail unit opening in the San Francisco, CA area would most likely have a higher investment than Houston, TX.

*Note: As a general rule, the investor’s net worth should be more than twice the initial total investment. And, it is better if your net worth is 5 times the initial total investment.*

## **Is the Franchisor in a strong financial position to provide support for my business?**

Item 21 or Exhibit B provides Franchisor audited financial information for the last 3 years.

*Note: If a franchisor is losing money and has a poor balance sheet, then walk away.*

## **Is the franchise system growing or shrinking?**

Item 20 provides unit count by state for the last 3 years for both franchise owners and corporate-owned units.

*Note: Newer franchisors with few units, or slow/shrinking growth should be avoided.*

## **What type of territory protections do I get? Will I be the only franchise operating in the area?**

Item 12 describes the “territory” provisions in the franchise agreement related to competition from the franchisor or another franchise owner.

*Note: Franchisors rarely provide “total exclusivity”, however, there should be significant protection provided for your territory, area of operation.*

## **Does the franchisor have a troubled legal history? Are there any pending lawsuits against franchisor?**

Items 3 and 4 tell you whether the franchisor or management have been involved in material litigation or bankruptcy proceedings.

*Note: If a franchisor has been around a while and has 100 plus franchise owners, then we would expect to see some litigation reported. The US is a very litigious business environment. If it seems significant, then get clarification from the franchisor.*

## **Getting a Legal Review**

You do not need to engage a franchise attorney for a legal review until you have decided that you are fairly sure you want to invest in the franchise. When you get a legal review, make sure you use an experienced franchise attorney, not an attorney friend of the family. Here are some quick tips:

- Make sure you are using an attorney who is familiar with franchise agreements. You wouldn't use a foot doctor for brain surgery. Keep in mind that lawyers specialize as well. You want a franchise attorney that commonly reviews franchise agreements for potential franchisees (contract and transactional franchise law). It typically will cost around \$2,000 for them to review a number of items for you. Make sure you agree on a fixed rate and what it covers.
- Most franchisor's do not make changes to the franchise agreement. Do not pay to have an attorney rewrite chunks of the franchise agreement.
- Get a legal review just before Discovery Day. Timing is important. You do not want the review too early, and you do not want it too late. It typically takes 7-10 days to complete a review specific to your situation.

***Other Resources: Franchise Disclosure Documents recorded webinar (referenced in Stage 4)***