

FRANCHISING OUTLOOK POSITIVE, BUT REDUCED. FUNDING STILL AVAILABLE FOR SOLID FRANCHISEE PROPOSITIONS

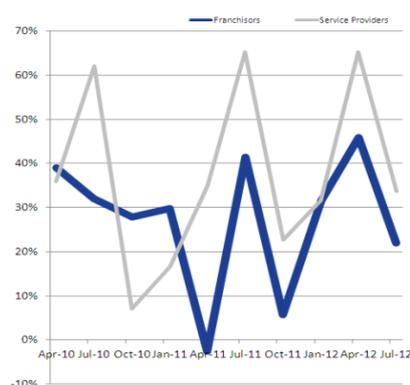
Franchise Consultants' July 2012 *Franchising Confidence Index* demonstrates mixed results across confidence measures. Sentiment reductions were recorded for general business conditions, access to both financing and suitable franchisees, and, franchisee sales and profitability levels. By contrast, sentiment improved for availability of suitable locations and staff, franchisee operating costs, and franchisor growth prospects.

This edition also featured a special focus on bank funding for franchisees. Responding franchisors generally agreed solid franchisee propositions could still be funded.

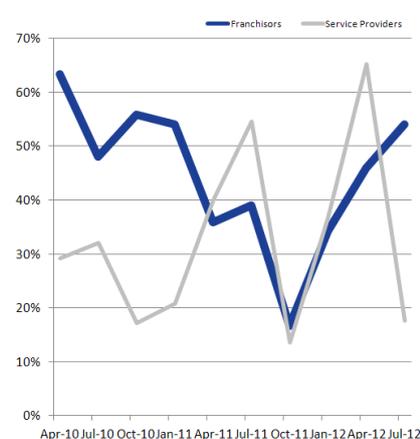
After record net results in the April survey (net 46%), confidence in general business conditions decreased with franchisors less optimistic (net 22%) about the next 12 months. Service providers echoed this reduction for franchisors generally, but were more optimistic (net 34%). While reduced, franchisor sentiment towards general business conditions was more optimistic than that indicated by general business in the July NZIER (-1%) and BNZ (9%), and, June National Bank (12.6%) surveys.

Franchisor sentiment toward their own growth prospects consolidated to a net 54% level. Meanwhile, service provider sentiment toward the same featured a violent drop to a net 18%, from 65% in April.

GENERAL BUSINESS CONDITIONS



FRANCHISOR GROWTH PROSPECTS

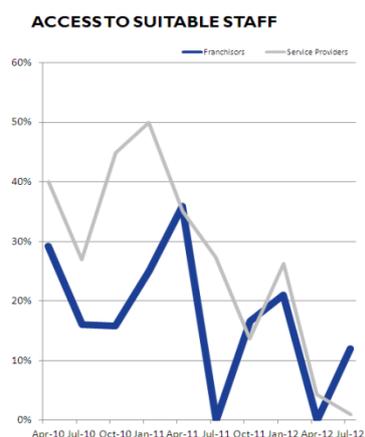
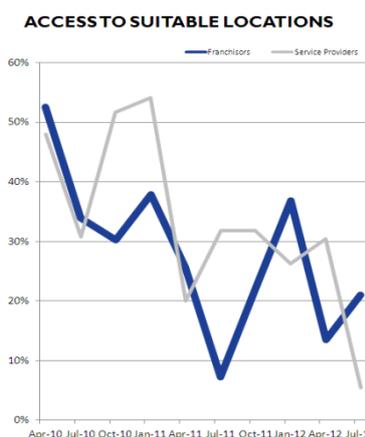
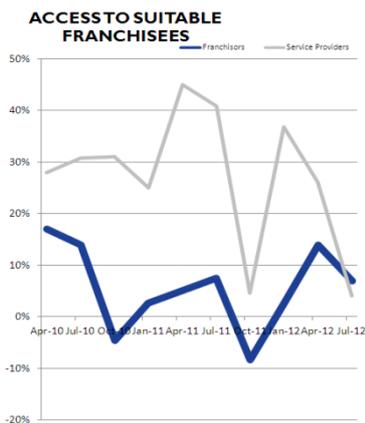


RESULTS SUMMARY TABLE *

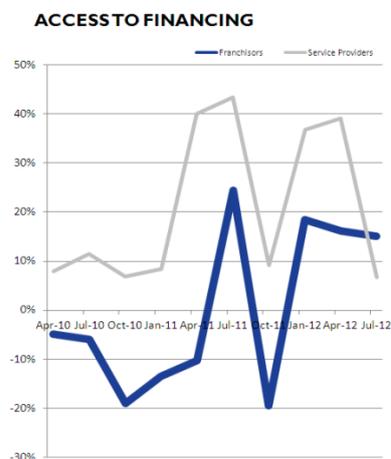
	Franchisors										Service Providers									
	Apr-10	Jul-10	Oct-10	Jan-11	Apr-11	Jul-11	Oct-11	Jan-12	Apr-12	Jul-12	Apr-10	Jul-10	Oct-10	Jan-11	Apr-11	Jul-11	Oct-11	Jan-12	Apr-12	Jul-12
General business conditions	39%	32%	28%	30%	-3%	41%	6%	32%	46%	22%	36%	62%	7%	17%	35%	65%	23%	32%	65%	34%
Access to financing	-5%	-6%	-19%	-14%	-10%	24%	-19%	18%	16%	15%	8%	12%	7%	8%	40%	43%	9%	37%	39%	7%
Access to suitable franchisees	17%	14%	-5%	3%	5%	8%	-8%	3%	14%	7%	28%	31%	31%	25%	45%	41%	5%	37%	26%	4%
Availability of suitable staff	29%	16%	16%	25%	36%	0%	17%	21%	0%	12%	40%	27%	45%	50%	35%	27%	14%	26%	4%	1%
Availability of suitable locations	53%	34%	30%	38%	26%	7%	22%	37%	14%	21%	48%	31%	52%	54%	20%	32%	32%	26%	30%	6%
Sales levels per franchisee	59%	36%	48%	33%	33%	44%	22%	29%	51%	34%	28%	27%	-7%	4%	15%	50%	14%	11%	52%	39%
Operating costs per franchisee	-2%	-29%	51%	-22%	-38%	-32%	-31%	-26%	-24%	-12%	-52%	-46%	-41%	-33%	-30%	-27%	-27%	-11%	-43%	-17%
Franchisee profitability levels	41%	16%	16%	5%	-3%	22%	3%	-8%	30%	5%	-12%	-15%	-24%	0%	0%	14%	-23%	-5%	14%	20%
Franchisor growth prospects	63%	48%	56%	54%	36%	39%	17%	34%	46%	54%	29%	32%	17%	21%	40%	55%	14%	37%	65%	18%

*The figures indicate 'net' confidence. Net' confidence is the difference between those reporting 'better' and 'worse'

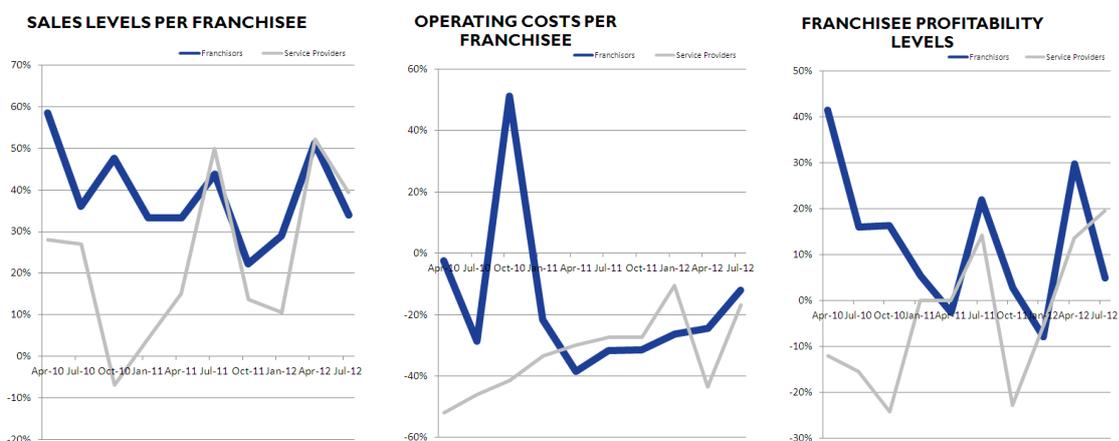
Franchisor sentiment toward access to suitable franchisees reduced to a net 7% from 14% in April. Meanwhile sentiment toward accessing both suitable locations and suitable staff both improved to a net 21% and 12%, respectively. Service provider sentiment dropped markedly towards franchisor access to suitable franchisees and locations.



Results relating to access to financing were especially relevant for this issue of the Franchising Confidence Index, with its specific focus on funding. Disappointingly, there was a slight decrease in confidence from franchisor respondents (from net 16% to 15%) in relation to ease of access. Service providers were more pessimistic moving from 39% (in April) to 7%.



The following tables explore further monetary aspects from a franchisee perspective. Here franchisor sentiment toward sales fell from a net 51% (April) to 34%. Meanwhile, the outlook for operating costs improved slightly (from -24% to -12%). Overall franchisor sentiment toward future franchisee profitability levels remain positive, albeit declining from 30% (April) to 5%. A declining outlook for franchisee profitability is always a concerning sign. Service provider sentiment toward sales levels per franchisee and operating costs per franchisee mirrored franchisor expectations, generally. By contrast, however, service providers were more optimistic in their outlook for future franchisee profitability levels.



Franchisors were asked how things were looking in their sector. An analysis of 27 written responses revealed contrasting views ranging from “horrible” to “very good...but don’t tell anyone!”

Most responses contained an element of positivity, but generally expressed a high level of challenge overall. The following responses were indicative:

- *“Very tight market with signs of improvement as customer review cost of service to their business. Market wanting points of differences mainly in control of quality and anything added value aspects”*
- *“Still saturated and competitive. The value proposition and execution will see franchisees proposer”*
- *“Generally static but excellent practice = improvements”*

The main themes related to high levels of competitive intensity, customer focus on price, and the importance of good franchisee business model execution. A number of comments also referred to the growth opportunity Christchurch, while also indicating different growth rates in different regions.

Service providers were asked how they thought things were looking for franchisors and franchisees. Their responses were mixed from those expecting improvement to those foreseeing more of the same. Examples of more positive responses include:

- *“Improving growth and profitability for both”*
- *“Good systems will continue to prosper”*
- *“Low interest rates & inflation continue to assist profitability. Countered by continued subdued confidence. Business failures, redundancies should open up opportunities to gain franchisees and new locations. Lots of opportunities in ChCh”*

Examples of less optimistic responses include:

- *“I think everyone has adjusted to the fact that it won't be easy but that is no reason for not getting on with life”*
- *“These are uncertain times with no clear passage out of the recession. This leads to more of the same uncertain business direction”*
- *“Trading conditions remain challenging and franchisors need to be more proactive in working with franchisees who often have good technical skills but poor business skills”*

Overall, on balance, the general outlook from both service providers and franchisors was that even though things are still challenging, they are slowly improving.

Special Focus: Access to Franchisee Bank Funding

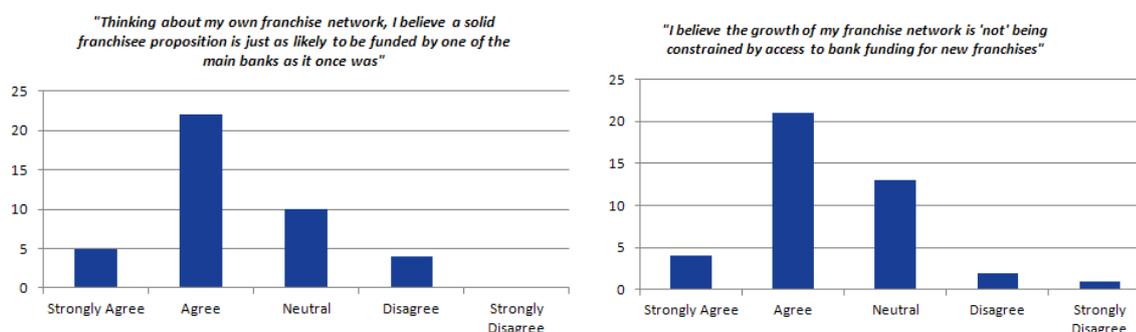
This edition of the Franchising Confidence Index featured a special focus on bank funding for franchisees – an often discussed and debated topic in franchising circles.

In particular, franchisors were asked to rate their level of agreement with four statements.

1. Thinking about my own franchise network, I believe a solid franchisee proposition is just as likely to be funded by one of the main banks as it once was
2. I believe the growth of my franchise network is 'not' being constrained by access to bank funding for new franchisees
3. I believe that there may be more that my franchise network can do to make my system more fundable
4. I am interested in learning more about how my franchise system could become more fundable

Note, service providers were also asked for their views on the first three statements from a broader franchise sector viewpoint. It should also be noted that the service provider population includes specialist franchise banking representatives.

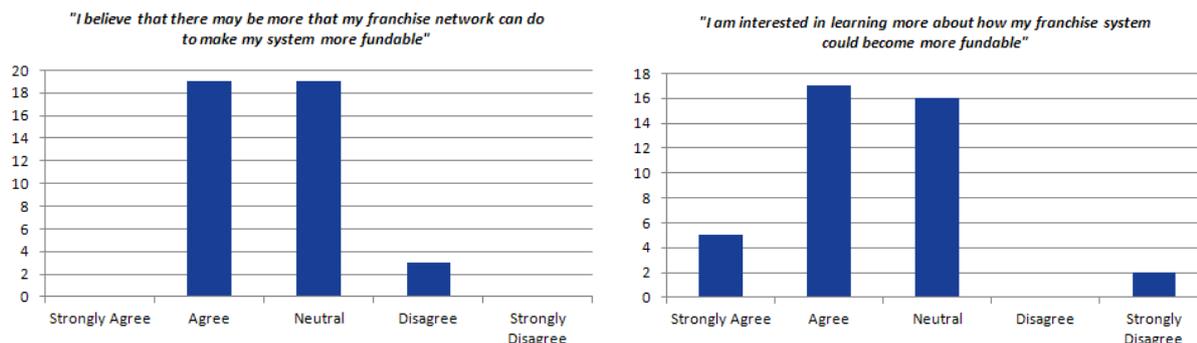
The first two statements relate to the availability of bank funding for franchisees and the degree to which it is believed to constrain franchise system growth.



Surprisingly, franchisor respondents mostly agreed that funding has not changed due to the tough economic climate, with 27/41 (66%) indicating either Strongly Agree or Agree. This sentiment was largely mirrored by service providers, with 13/19 (69%) indicating Strongly Agree or Agree to the aligned statement 'I believe a solid franchisee proposition is just as likely to be funded by one of the main banks as it once was.'

Franchisor respondents similarly mostly agreed that their respective franchise network's growth was not being constrained by access to bank funding for new franchises. A solid 61% reported either Strongly Agree or Agree with this statement. This sentiment was to a lesser extent supported by service providers, with 10/19 (53%) noting Strongly Agree or Agree to the statement 'I do not believe the growth of New Zealand franchising is being constrained by access to bank funding for new franchisees.' However, it is important to note that six service provider respondents did report Disagree (5) or Strongly Disagree (1) with this statement.

Franchisor respondents were also asked a) if that felt there may be more that their franchise network could do to make their systems more fundable, and b) about their interest in learning more about making their franchise system more fundable.



Eighteen (41%) of franchisors responded both Agree and Neutral (separately) to the statement I believe there may be more that my franchise network can do to make my system more fundable. Only three reported Disagree. Interestingly, 15/19 (79%) service providers indicated Strongly Agree (7) or Agree (8) to the same statement. Just over half (54%) or 23 franchisor respondents agreed that they were interested in learning more about how their franchise system could become more attractive and their fundable by banks.

Both franchisors and service providers were asked if they would like to add any comments relating to funding for franchisees – whether bank-related or otherwise. Surprisingly few franchisors (7 or 17%) chose to comment. Those that did represented a wide range of views. But notably the majority were more positive than expected. Representative examples include the following:

- *“We have built very strong relationships with main trading banks and they now look very favourably at our franchise business when new franchisees require finance or existing franchisees who are wanting to have multi sites”*
- *“All franchise interested banks have made clear they will fund suitable franchisees”*
- *“Note funding is not what our franchise is after to grow at the moment as it just adds to more financial pressure during uncertain economic times”*
- *“Any recent undertakings the banks give re funding proven cash flow businesses with good trading histories are worthless. They still only led on brick-and-mortar security”*

Service provider comments were more focused on what franchisors could do to improve their attractiveness to banks. Examples included:

- *“Franchisors need to have good quality benchmarking and franchisee results in order to assist in getting banks to fund growth”*
- *“Funding depends on franchisees having equity - as it always did - and on franchisors having workable business models - as it always did. For many franchisees, their equity has reduced,*

resulting in less borrowing power. Some franchisors have found their model is not sufficiently robust to be profitable in the hard times. Why blame the banks for that?"

- *"I consider that any tightening of funding has been more to do with the lack of or reduction in information provided by franchisors. Banks are very aware of the GFC and are not surprised to see financial accounts reflecting this. Consider they are more interested in the now and what is being done to counter the GFC impacts, than they are the past. Franchisors/franchisees should be sharing their business plans to give the funders the confidence that the strategies are/will be in place to see the system through this period"*

Concluding Comment

The responses in this quarter's Franchising Confidence Index were mixed – indicating economic climate remains uncertain. Sentiment reductions were recorded in many areas, including general business conditions, access to both financing and suitable franchisees, and, franchisee sales and profitability levels. In contrast, sentiment levels improved for some factors, including availability of suitable locations and staff, franchisee operating costs, and franchisor growth prospects.

This edition also featured a special focus on bank funding for franchisees. Responding franchisors generally agreed solid franchisee propositions could still be funded and that access to bank funding was not a constraint to franchise system growth. This sentiment is contrary to the views held by some in the franchise community.

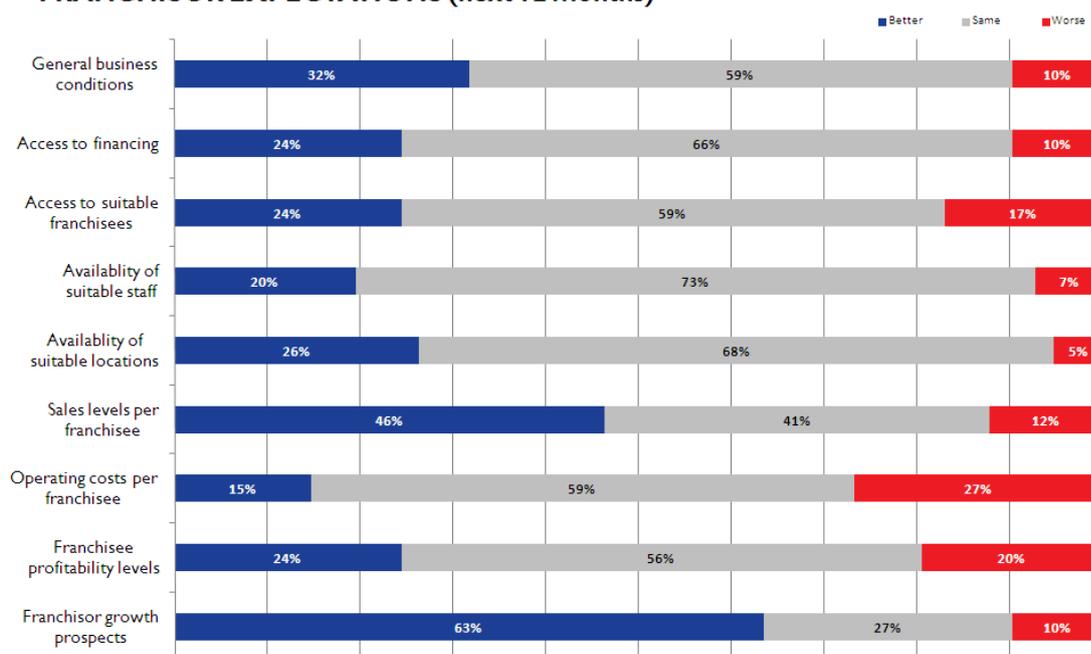
Despite some of the positivity in response and comments it is clear that substantial challenges to profitability remain, as indeed they do for other forms of organisation. Many are experiencing pricing pressure, many sectors remain competitive, and many input costs continue to rise. Combined, these and other factors pressure profitability at all levels.

Overall it is great to see responding franchisors largely in agreement that a solid franchisee proposition is still as fundable by banks as it once was. Clearly, the focus needs to be on creating more similarly solid bank-fundable propositions.

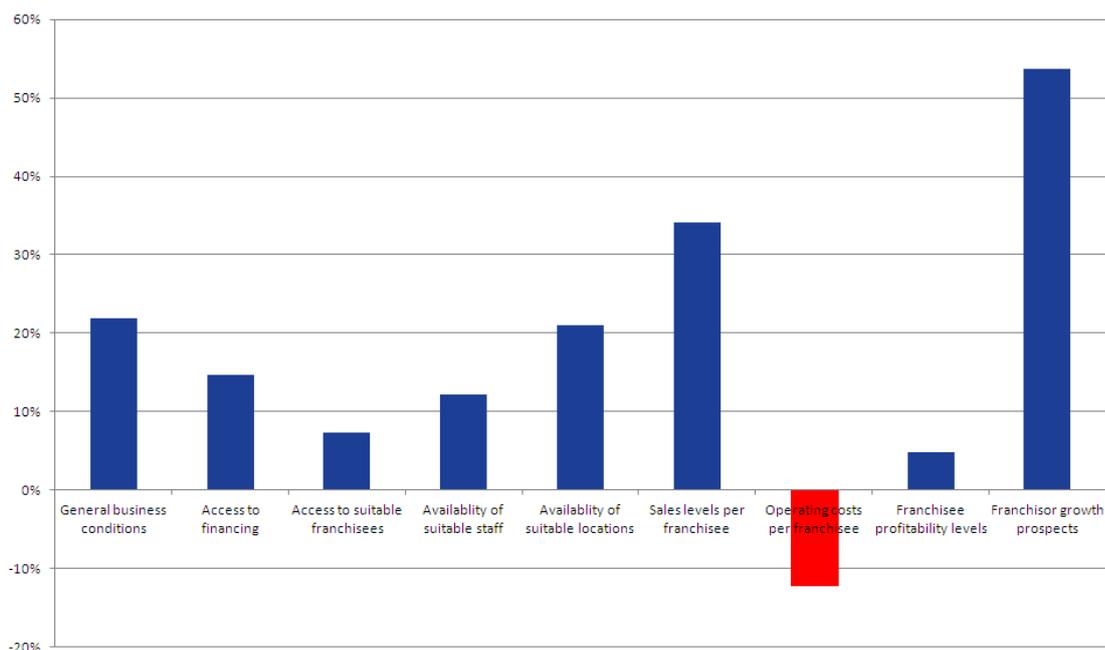
FRANCHISING CONFIDENCE CHARTS

The following four illustrations present individual and net franchisor and service provider expectations (separate charts) for the following year across all questions, including general business conditions and franchisor growth prospects (covered above).

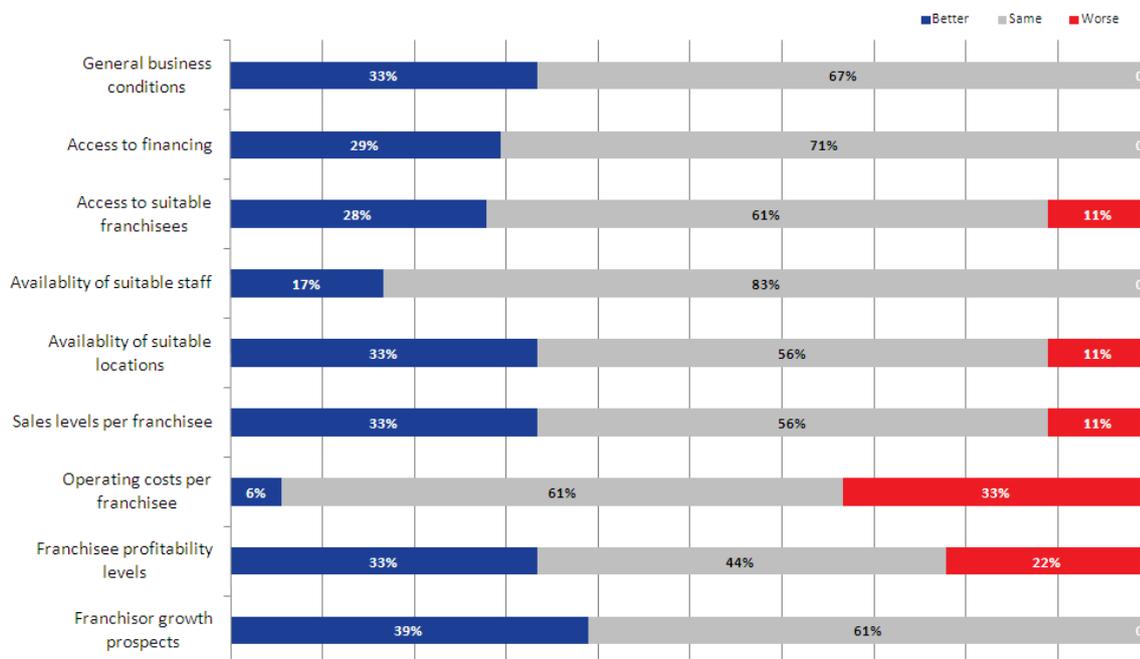
FRANCHISOR EXPECTATIONS (next 12 months)



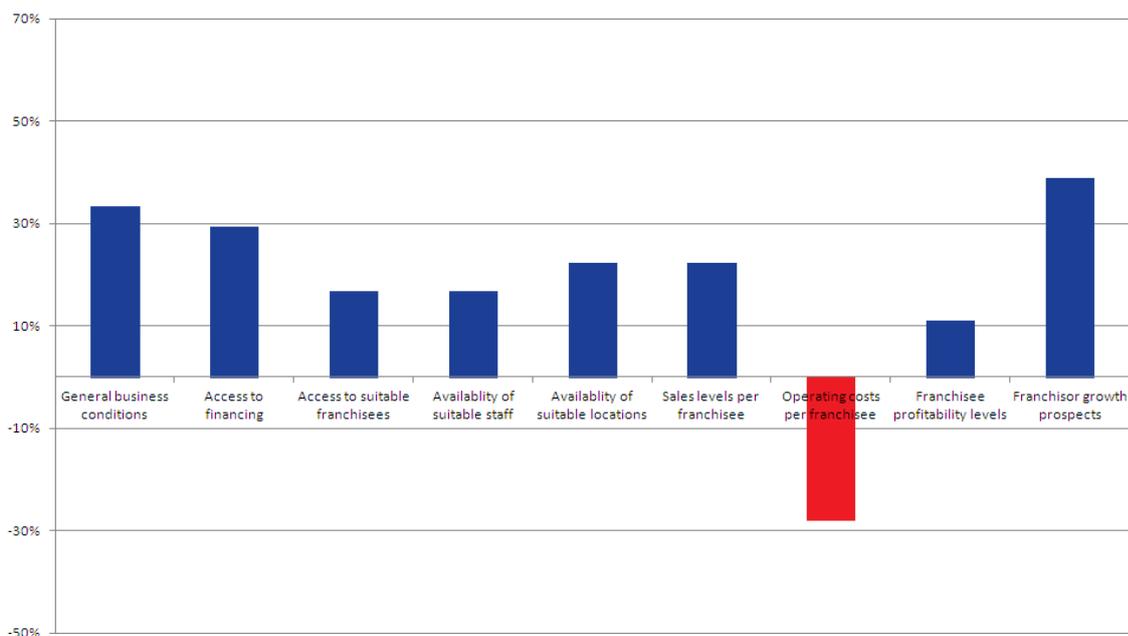
NET FRANCHISOR EXPECTATIONS



SERVICE PROVIDER EXPECTATIONS (next 12 months)



NET SERVICE PROVIDER EXPECTATIONS



Franchising Confidence Index

The Franchising Confidence Index represents the views and expectations of franchising, an important domain of business within the New Zealand economy.

Franchising is a substantial and growing domain of business making up an important part of the New Zealand economy. The *Franchising New Zealand 2010* survey, conducted by Massey University in collaboration with Griffith Business School, indicates New Zealand has 423 individual franchise systems comprising some 23,600 units (owned mostly by franchisees). The survey also suggests local franchise systems employ some 80,400 people, including 57,700 permanent full-time employees. Finally, local expert estimates of total franchise system turnover range from \$15 to \$25 billion – suggesting franchising is a strong contributor to New Zealand GDP – as it is around the world. Companies involved in franchising are as diverse as Foodstuffs (New World, PAK'nSAVE, Four Square), NZ Post, Fisher & Paykel, Contact Energy, McDonald's, Columbus Coffee, Fastway Couriers, Harcourts and Fletcher Building.

The Franchising Confidence Index represents confidence in key measures critical to the success of franchising in this country by reporting attitudes toward general business conditions, as well as key franchising growth determinants including access to capital, suitable potential franchisees, staff and locations. The Franchising Confidence Index also covers franchising health attributes and outcomes by exploring franchisee sales, operating costs and profitability, and franchise system growth prospects.

The data and analysis presented represents the views of 41 franchisors and 19 service providers collected between Monday 23 and Friday 27 July 2012. Findings from both groups are reported separately.

Respondents are asked whether they expect conditions to be 'better,' 'same' or 'worse.' 'Net' confidence is the difference between those reporting 'better' and 'worse.'

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