

FRANdata

Enhanced SBA Loan Loss Analysis

for the years 2000-2011
on the Tropical Smoothie Franchise Brand

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Source Material

All information in this report was compiled from company information, SBA loan data, publicly available information deemed to be reliable, and FDDs registered with state franchise examiners.

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TABLE OF CONTENTS

IMPORTANT – MUST READ	5
UPDATED SBA LOAN DATA FOR TROPICAL SMOOTHIE.....	5
ANALYSIS	6
Loans Over Time	6
Unit Growth Correlation.....	6
Franchisee Selection Criteria	7
Franchisee/Borrower Profile.....	7
Location and Macroeconomic Factors.....	8
Demographics.....	8
Peer Group Comparison	9
MITIGATING FACTORS	10
Improved Franchisee Selection Process	10
Use of MUOs in Territory Development.....	10
Improved Site Selection and Cost Allocation for Rent	10

IMPORTANT – MUST READ

The annual data provided by the U.S. Small Business Administration (SBA) on franchise loans are inaccurate. The SBA puts a disclaimer on every FOIA request containing franchise failure/loss data stating that the reader should not rely on this information. Nevertheless, the lending community does rely on this information to a considerable extent, sometimes deciding whether to lend at all to a brand and at other times incorporating it into loan policy decisions about specific brand and industry concentrations.

Broadly speaking SBA franchise data are inaccurate in four major ways: 1) loans that should have been attributed to franchise brands have not been; 2) loans that have been attributed to franchise brands but should not have been; 3) loans that have been attributed to the wrong franchise brands; and 4) most loans that fail are properly identified with the correct brand during the guarantee process so the greatest errors are under-reporting of performing loans.

Some examples:

- A recent FRANdata examination of SBA data discovered more than 400 loans made to franchisees of a major sub shop brand which were not labeled as franchise loans and were not grouped under the SBA Code for that brand.
- Our review of the list of brands that the SBA identifies as franchises found more than 500 which we have not been able to verify as franchises, even considering the SBA's broad definition of what constitutes a franchise that expands beyond business format franchises.
- In working with separate brands with similar names we found numerous loans attributed to the wrong brand.

The SBA is addressing the problem and has asked FRANdata to do two things:

1. To provide a constantly updated and accurate master list of franchise brands so that lenders may identify loans as having been disbursed to franchises and associate them with the proper brand. Each brand will be given a new coding value called a FRUNS number which will uniquely and permanently identify each franchise brand (similar to the DUNS number issued by D&B for all business entities in the United States).
2. To review and restate historical SBA performance data for franchises, addressing the problems identified above.

UPDATED SBA LOAN DATA FOR TROPICAL SMOOTHIE

According to the report released by the U.S. Small Business Administration on September 30, 2011, the SBA loan-loss data for the Tropical Smoothie franchise brand is:

Brand	Num of Loans	Total \$ Distributed	\$ Distributed per Loan	Charge-Off Rate	Failure Rate
Tropical Smoothie	123	\$24,192,000	\$196,683	13.84%	23.58%

After reviewing and correcting the SBA transactional data, the re-stated loan-loss data for Tropical Smoothie (FRUNS# 14030) up to December 2011 is

Brand	Num of Loans	Total \$ Distributed	\$ Distributed per Loan	Failure Rate
Tropical Smoothie	193	\$33,245,676	\$172,257	15.54%

The rest of this report analyzes the adjusted and re-stated performance data.

ANALYSIS

Loans Over Time

Between 2000 and 2011, there was a significant increase of 600% in Tropical Smoothie's SBA loan disbursements, from 3 to 193. The total disbursed was \$33.2 million or an average disbursed amount per loan of \$172,257.

Out of the 193 loans approved between July 2000 and November 2011.

- 57 were paid in full
- 23 were fully cancelled
- 6 loans were undisbursed
- 1 loan was closed
- 68 are open and under regular service
- 8 loans are open and under liquidation
- 30 loans failed

Year	Loans (cum)	Total \$ Distributed (cum)	Failure Rate (cum)	Failed Loans (year)
2011	193	\$33,245,676	15.54%	0
2010	186	\$31,727,176	16.13%	0
2009	178	\$30,106,576	16.85%	0
2008	169	\$28,001,876	17.75%	1
2007	147	\$22,366,194	19.73%	8
2006	114	\$16,384,694	18.42%	7
2005	89	\$12,256,910	15.73%	3
2004	66	\$8,313,722	16.67%	5
2003	41	\$3,914,266	14.63%	3
2002	23	\$2,266,709	13.04%	3
2001	9	\$981,900	0.00%	0
2000	3	\$259,900	0.00%	0

During these 11 years, 30 of the 193 loans (15.5%) failed; 68 or 35% are open and performing normally; 8 are open and being resolved. The rest were either paid in full or cancelled before any money was disbursed.

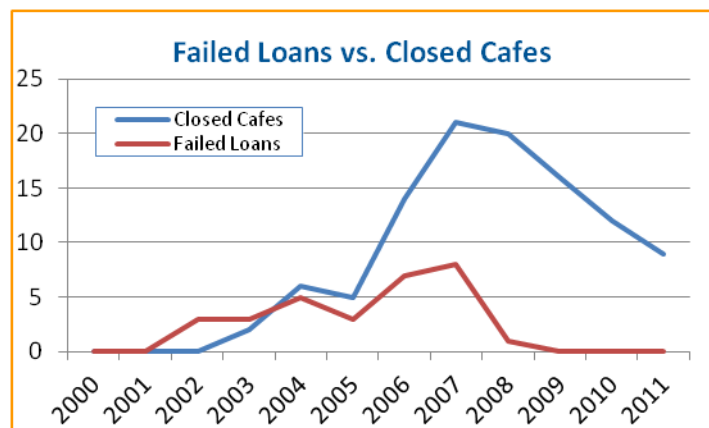
While Tropical Smoothie's failure rate increased each year until 2007, it has since then declined every year, from 19.73% to 15.54% as of 2011. The rate declined as new loans were disbursed but no more loans failed since 2008.

Unit Growth Correlation

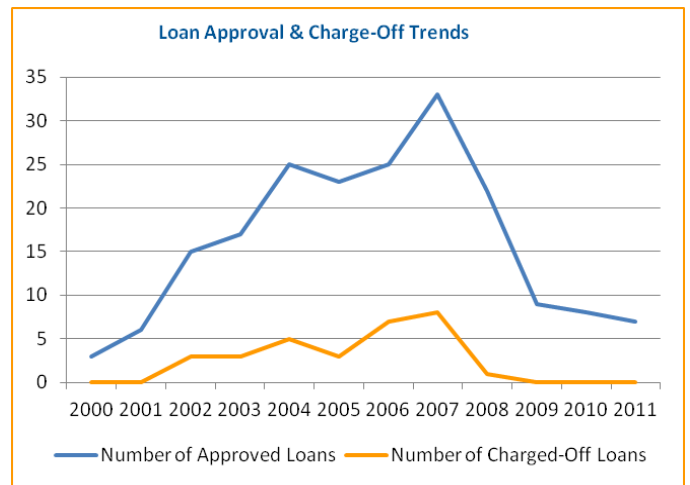
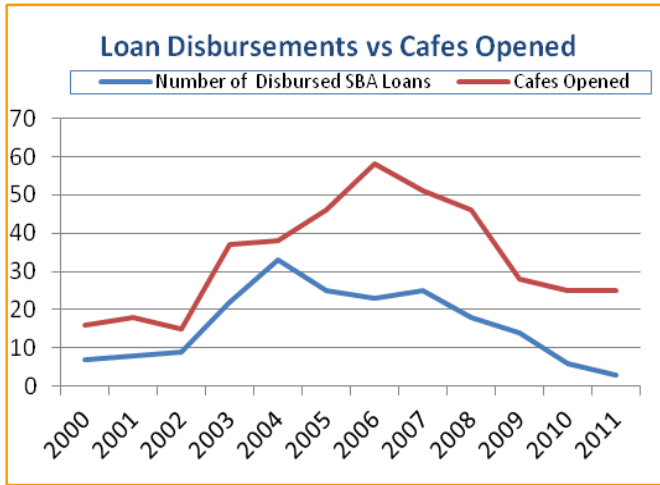
Between 2000 and 2011, the franchise grew from a start-up to a successful system with a total of 378 franchised cafes. Tropical Smoothie increased the number of its franchised locations at a CAGR of 19% over the period adding 201 cafes.

Tropical Smoothie's growth trend mirrors that of many start-up franchise systems: After a few years of little growth while developing recruitment programs, Tropical Smoothie experienced a growth spurt after 2002. In 2003 the franchise system added 37 franchised cafes, more than double the number of new stores that opened in the previous year.

Also similar to many new franchises, Tropical Smoothie's growth outpaced its support operations. As a consequence, the brand began to see failures of its initial cafés. The real business failures for Tropical Smoothie peaked in 2007. Between 2004 and 2007, a total 105 cafes went out of business. Before closure, they had been in operation for an average of nearly 33 months, ranging from eight months to six years.



The SBA loan failures followed this pattern of café closures with a peak in 2007. After 2008, no more loans failed.



Franchisee Selection Criteria

Prior to 2008, Tropical Smoothie required prospective franchisees to have a minimum cash liquidity of \$50,000. The franchisor increased this requirement in 2009 to range between \$100,000 and \$150,000. Prior to 2008, many new franchisees were undercapitalized.

This is proven by the fact that Tropical Smoothie's number of real business failures steadily increased after 2000 peaking in 2007. The real business failures started declining from 2008 onwards. Tropical Smoothie's franchised café real business failure rate peaked at 8% in 2007 and declined to 4% in 2010. Based on management provided information, between 2000 and 2011, a total of 105 cafés left the system. The closures peaked at 21 in 2007 and then declined to nine in 2011.

Similarly, the number of failed SBA loans also peaked in 2007, after which no more loans failed. Undercapitalization of franchisees for the period between 2000 and 2007 could be one of the reasons for such high loan failure rate. Management realized issues with franchisee performance and took counter measures.

CONCLUSIONS:

1. Undercapitalization of franchisees led to high business failures for Tropical Smoothie franchisees, which in turn was one of the reasons for failure of SBA loans distributed to such franchisees.
2. As the brand gained experience and improved recruitment policies and support operations, lending risk is decreasing

Franchisee/Borrower Profile

Twenty-three percent of all Tropical Smoothie franchisees are multi-unit operators (franchisees who own more than one café); these MUOs control 43% of all franchised locations. The typical MUO operates between two to three cafes. By comparison, nearly 70% of the failed SBA loans were for single-unit operators.

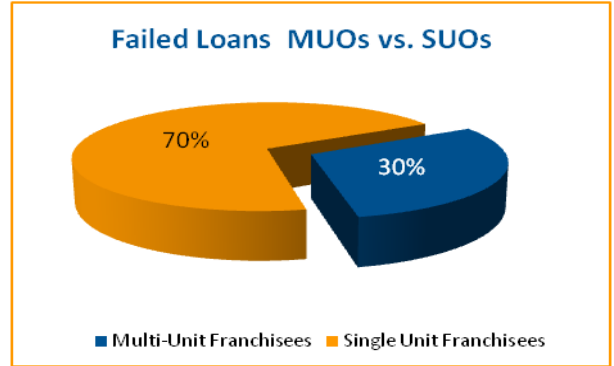
Between 2000 and 2011, out of the total 193 loans disbursed by the SBA to Tropical Smoothie franchisees, FRANData could match 118 Tropical Smoothie franchisees. Out of these 118 loans, 60%, or 71 loans, were provided to single-unit operators, while 40%, or 47 loans, were made to MUOs.

Matching up the 30 failed loans with the 118 total loans identified with a corresponding café location, FRANdata found that 24%, or 17 loans, given to single-unit operators failed. On the other hand, 19%, or nine loans, given to MUOs failed between 2000 and 2011.

Of the 17 failed loans disbursed to single-unit franchisees, 12 can be associated with an actual closure. Of the nine failed loans made out to multi-unit franchisees, only two can be associated with a closure.

CONCLUSION:

Multi-unit operators have a better SBA loan performance than single-unit operators, as MUOs have a lower number of failed loans than single-unit operators.



Location and Macroeconomic Factors

Tropical Smoothie is a regional brand with a large presence in the south eastern part of the country. Certain markets were more significantly hurt than others by the recession of 2008 and the housing crisis.

With 105 and 76 cafes, respectively, Florida and Virginia have the highest concentration of Tropical Smoothie cafes as of 2011. SBA loan activity was similar in both places – 24% of all approvals were disbursed to franchisees in Florida and 21% of all approvals were disbursed to all franchisees in Virginia. However, while franchisees in Virginia had a relatively low failure rate of 8%, franchisees in Florida had a much higher 23% SBA loan failure rate.

CONCLUSION:

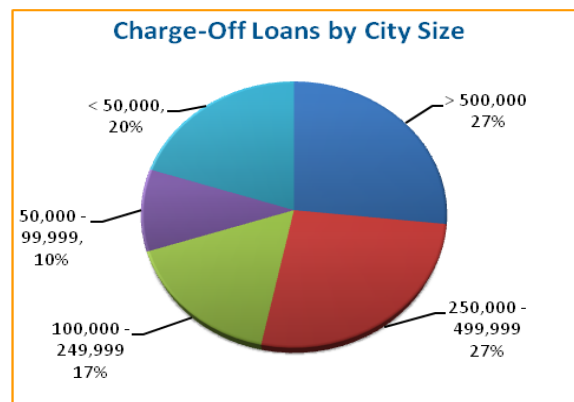
Macro-economic factors such as the recession and the housing market crisis had a noticeable impact on the performance of Tropical Smoothie franchisees in Florida and consequently influenced the failure rate of their SBA loans.

Demographics

Between 2000 and 2010, 44% of cafes were opened in cities with a population of less than 50,000, followed by 31% of openings in cities with a population of more than 250,000. Over the same period, 54% of failed SBA loans were from cafes in large cities and 20% occurred in cities with less 50,000.

CONCLUSION:

Most loan failures occurred to franchisees with cafes in cities with a population of more than 250,000.



Peer Group Comparison

Between 2000 and 2011, brands which sell smoothies had a total of 685 SBA-guaranteed loans with an average of \$168,218 disbursed per loan. Their average SBA loan failure rate was 19.27%. This means that the comparable brands, in total, had 131 failed loans between 2000 and 2011.

Among the smoothie brands for which SBA data was available, Tropical Smoothie had the highest number of loans distributed, i.e. 193 SBA-guaranteed loans between 2000 and 2011. By comparison, comparable smoothie brands had an average 62 SBA-guaranteed loans distributed in the same period. Despite having more loans distributed, Tropical Smoothie's SBA loan failure rate was among the lowest in the group.

FRUNS	Brand	# of Loans	\$ Distributed Per Loan	Total \$ Distributed	Failure Rate
14030	Tropical Smoothie	193	\$172,257.39	\$33,245,676	15.54%
N/A	Comparable Brands	685	\$168,218.64	\$115,229,771	19.27%

Conclusion:

Tropical Smoothie's SBA loan failure rate of 15.54% was below the average of other comparable brands.

MITIGATING FACTORS

According to Tropical Smoothie management, as a consequence of their higher than desired café closure (and corresponding loan failure), they have implemented many changes that have improved their recruiting and support operations.

Improved Franchisee Selection Process

Starting in 2009, Tropical Smoothie increased its minimum cash liquidity requirement to range between \$100,000 and \$150,000, up from \$50,000. The concept also reduced its investment requirement by 11% to an average of \$281,250 between 2009 and 2011. As a result, franchisees financed their investment either with cash or loans from private sources. Consequently, new franchisees have become less dependent on financing, thus having a lower or no debt burden.

Subsequent to these changes, the concept's real business failure rate declined and its franchised café continuity rate increased. In addition, the number of approved SBA loans decreased since 2009. The franchisor has not any charged-off loans since 2008 due to access to private lending sources and/or self-funded franchised cafes.

Since 2008, the brands' area developers in Florida improved their franchisee selection techniques in order to induct more stable franchisees into the system. Management also believes that the real estate market crash and other macro-economic effects of the recession could also have affected the market in Florida much more than in Virginia.

Use of MUOs in Territory Development

To improve the chances of success for new cafes, Tropical Smoothie in recent times has adopted a concentric model for market entry. Based on this strategy, several single-outlet franchisees set up operations in a new market simultaneously. Previously, just one or two single-café operators used to enter new territories with little or no prior Tropical Smoothie presence. This caused challenges. According to management, this new market entry model will reduce business failure rates significantly.

Improved Site Selection and Cost Allocation for Rent

Management believes that the rent component in a bigger city put franchisees in a difficult and less profitable situation. The franchisor has improved its site selection and focuses on lower rent cost. It is recommended that franchisees maintain an average 8% of gross sales as rent component to ensure profitability. Management estimates that if the rent expense is greater than 10% of gross sale, the business is too rent heavy.

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