Business Reference Guide Online Sample Search

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Business Reference Guide Online

A Business Valuation Resources Publication, www.BVResources.com

Restaurants—Full Service

NAICS: 722511

SIC: 5812

Rules of Thumb

EBIT	SDE includes inventory	annual sales includes inventory
2.5–3.5 x	1–3 x	20–35%

Pricing Tips

How long has the restaurant been in business? Is the trade area stable, or on an upswing or downward trend? How old is key equipment like the HVAC? How tough is the trade area labor market? Look for key employees and the importance of retaining them. What is the prime cost for the business (cost of sale plus labor)? If it's a franchise, how is the franchisor doing as a brand?

Employee history; sales fluctuation; customer base likes and dislikes; menu changes or ideas; lease issues; equipment age and durability; HVAC condition

How many hours does the owner work? How many years are left on the lease; how many options; and what are the increases? What areas of the business could use improvement?

What are the opportunities to grow the business?

Sales trends; average ticket; what is percentage of food sales versus liquor sales?

Why did you start your business? Do you feel you have exceeded your expectations; if so, how? What has been your greatest achievement with this business? Have you been disappointed; if so, how? If you were to keep the business for 10 more years, what changes would you make? Is there anything I should be concerned about in regards to your staff? Will your key people remain on board after a sale? How do you think your loyal guests will react to a new owner? Is there anything you can share with me about your vendors? Who is your greatest competitor? On a scale of 1 to 10, how would you rate your facility? How would rate your staff? How would you rate your revenue and profit performance?

Are all the sales reported? Tell me about the employees.

Any pending lawsuits or legal actions?

How would you improve the business? What are the advantages and disadvantages of the business? What mistakes have you made in the business? Opinions about staff?

Why are they selling, and what are their future plans going to be? How many hours is the seller working, and what does their typical day look like? When was their last price increase? Are all employees staying on with a sale of the business?

What are the biggest challenges to operate day-to-day?

Ask to see financials (P&L, tax returns, credit card statements, POS reports). Ask to see the lease (to review the terms and option periods). How long have the current employees been with you? How is the landlord to work with?

How long have you been in business? When it was established? Did you start it? How much is gross revenue? How much is your food cost? Any secret recipe? Any key employees and, if chef, will stay after the sell? Equipment conditions? Any code violations? Grease trap—what kind and the location?

Ask about landlord and facility issues; any deferred maintenance or repairs needed? Understand responsibilities of landlord and tenant based on the lease. Ask about key employees; health department open items; ABC restrictions; future opportunities; local competitive environment; reason for sale, of course. Understand owner's labor and also whether family members are working, on/off payroll. Are employees all paid on payroll 100 percent?

Is there any new competition coming to the area? Which employees would you suggest I keep?

Are there any sources of income that do not show on the books? If so, can it be proven?

How many hours a week have they worked in the restaurant? How difficult is it to find qualified restaurant employees, i.e., employees with restaurant experience?

How long have employees worked there? What is the food cost? Length and terms of the lease. Does the owner manage the business or perform a specific task, such as cooking?

What would you do to improve the business if you were to stay here for the next 10 years? Sellers should be prepared to answer that question in today's market.

How much is it making? Reason for selling, seasonal trends, food cost, employees' tenure, social media items, list of vendors. Do any family members work in the restaurant? Are you willing to give me all your recipes? Will you sign a noncompete? Are all licenses transferable? Are there any unresolved health department issues? Is the liquor license transferable? Is the lease transferable? Is anything leased?

If you could have done anything differently, what would it have been? What do you wish you knew when you opened? What is your relationship with your neighbors? What is the smartest thing you did as a restaurant operator?

1. Tell me about your typical bad day. 2. How much money do you set aside for your worst month? 3. Why are none of the employees here interested in buying this business? 4. What is your highest cost menu item and why do you keep it on the menu? 5. Who is your toughest competition? 6. How many customers are on your mailing list? 7. How do you determine who your vendors should be? 8. How do you determine where to spend marketing dollars?

Do your financials reflect cash and credit card sales? Is the business free and clear of any liens or encumbrances? Have you had employee relations issues?

Make sure to understand the labor picture in detail, including how people are being paid. Ask about any discounting programs that have been used (Groupon for example). These can distort both sales and expenses and have liabilities that must be considered. Gift cards and Inventory can also be sticky issues with a sale. Knowing the reason for selling and whether it makes sense is a good idea for any business. Ask if recipes and menus are documented and included.

How much time a week has the seller spent in the business? The buyer will need to know what adjustments need to be made for management if the seller has been very hands on and the buyer does not plan to be hands on.

Learn about the landlord. Understand the cost of goods. Know whether there are promos and discounts being used to generate revenue and what may be outstanding. Know who the key employees are in the kitchen and whether any are being paid outside of normal channels. Look into past health department reports and ABC conditions.

1.) Is the seller in good standing with the state Department of Revenue (DOR) and Department of Unemployment Assistance (DUA)? Failure to comply can result in delay of transfer and delay in transfer of liquor license. 2.) How old/how many tons are the heating/cooling units. I advise purchasers to inspect these, as this can be a large unforeseen cost.

How many hours have you been working? Are all sales recorded? Are there any employees being paid in cash? Do you know of any new competition coming to the area?

How old is the air conditioning unit(s)? Inspect the A/C thoroughly. This is commonly overlooked by inexperienced buyers and can be a large unforeseen expense. Read your lease thoroughly and hire an attorney to review/negotiate it. Make sure to look at the gross sales to rent ratio

How much are liabilities?

What does the future look like for the location? Zoning, competition, lease rate, etc.

Percentage of cash vs. credit. Is there reliance on a key chef?

Which equipment is leased and which is paid, and the condition of the equipment. Is there a grease trap? What kind and what size? Any key employee, especially the cook, and whether he or she wants to stay.

Will the owner offer financing, training, non-compete (for how many miles); is the lease assignable; is all equipment approved by the NSF (many states do not allow domestic appliances in a commercial location); are trade name, Website, recipes and training manuals included in the deal?

It is useful to know if the owner has experimented with different hours (breakfast, lunch, dinner, weekend brunch, late night entertainment). Of course the reason for sale is good to know. Any expected modifications from health dept. or franchisor? Any liquor license violations or restrictions?

Ask about cash payroll. Many sellers pay all or part of their payroll in cash. Check if the POS computer is connected to the corporate headquarters or franchise. How long the seller has owned the business might be a good indication that after they bought it they decided that they made a mistake and want out.

Work histories of staff? Staffing resources? What vendors should I not deal with and why? Suggestions for growth or expansion?

Expert Ratings

Historical Profit Trend
1.70
(Down=0.00 : Up=4.00)

Amount of Risk
3.20
(Low=0.00 : High=4.00)

Location and Facilities
3.30
(Low=0.00 : High=4.00)

Ease of Replication
1.70
(Easy=0.00 : Difficult=4.00)

Marketability
3.20
(Low=0.00 : High=4.00)

Industry Trend
2.80
(Declining=0.00 : Growing=4.00)

Amount of Competition
3.30
(Low=0.00 : High=4.00)

Expenses (% of Annual Sales)

- Cost of Goods: 25% to 35%
- Occupancy Costs: 06% to 12%
- Payroll/Labor Costs: 25% to 35%
- Profit (pretax): 08% to 20%

- Benchmark Data
- Statistics (Chain Restaurants)
- Number of Establishments: 120,583
- Average Profit Margin: 5.5%
- Revenue per Employee: $55,800
- Average Number of Employees: 21.6
- Average Wages per Employee: $21,038
- Products and Services Segmentation
- American: 38.2%
- Varied menus: 28.2%
- Italian/pizza: 11.8%
- Other: 8.1%
- Seafood: 7.3%
- Mexican: 6.4%
- Industry Costs
- Profit: 5.5%
- Wages: 37.5%
- Purchases: 36.3%
- Depreciation: 2.5%
- Marketing: 2.0%
- Rent & Utilities: 11.8%
- Other: 4.4%
- Market Share
- Darden Restaurants Inc.: 5.4%
- DineEquity Inc.: 5.3%
- Statistics (Single Location Full-Service Restaurants)
- Number of Establishments: 184,626
- Average Profit Margin: 5.5%
- Revenue per Employee: $102,800
- Average Number of Employees: 16.7
- Average Wages per Employee: $21,053
- Products and Services Segmentation
- Asian restaurants: 28.2%
- American restaurants: 22.1%
- European restaurants: 14.9%

- Mexican restaurants: 13.8%
- Pizza restaurants: 6.6%
- Seafood restaurants: 6.5%
- Other: 5.0%
- Steakhouses: 2.9%
- Industry Costs
- Profit: 5.5%
- Wages: 20.5%
- Purchases: 36.3%
- Depreciation: 2.1%
- Marketing: 2.0%
- Rent & Utilities: 11.8%
- Other: 21.8%
- Statistics (Premium Steak Restaurants)
- Number of Establishments: 2,536
- Average Profit Margin: 6.6%
- Revenue per Employee: $72,200
- Average Number of Employees: 45.8
- Average Wages per Employee: $21,050
- Products and Services Segmentation
- Classic steak restaurants: 35.0%
- Steak and seafood restaurants: 32.6%
- Other premium steak restaurants: 22.0%
- Premium Brazilian steak restaurants: 10.4%
- Industry Costs
- Profit: 6.6%
- Wages: 29.2%
- Purchases: 36.1%
- Depreciation: 2.2%
- Marketing: 2.7%
- Rent & Utilities: 8.3%
- Other: 14.9%
- Market Share
- Ruth's Hospitality Group, Inc.: 9.1%
- Darden Restaurants Inc.: 5.5%

- The profit margin depends on the operator. Ideally, the owner should make at least 20 percent of gross sales. Most restaurant owners are not able to achieve this percentage, but the 20 percent is a good barometer for a successful business.
- COGS is all over the board, depending on concept. Target prime costs of 60 percent or less, but hard to achieve with increasing labor costs. Occupancy costs of 6 percent have been the benchmark, but in our strong commercial real estate market, we have moved that benchmark to 8 percent for full-service restaurants.
- Big thing is rent; need to keep it below 8 percent; many restaurants are well above 10 percent, and it is very hard to be profitable at those occupancy costs.
- Food costs should be 30 percent or lower. Sales per square foot = $300+
- A restaurant operated entirely by employees will show an SDE of less than 10 percent of total sales. An owner-operated restaurant can show an SDE of up to 22 percent, with an average of 15 percent.
- Critical to success: revenues should be two times capital invested. Meaning if your capitalized build-out costs are $1 million, your restaurant needs to generate $2 million in revenue. Not the first or perhaps second year, but by year three and beyond, 2 x revenue is critical to generate favorable returns. Occupancy costs (fully loaded) need to be at 10 percent or below. Both benchmarks are critical to the long-term success of the business. Good operators can manage controllable margins; however, if you do not generate revenues two times capital investment, and your occupancy costs are above 10 percent of revenues, your profit margin will be diluted below industry average.
- Food cost should be about 33 percent, and liquor should be about 25 percent. National Restaurant Association is a big help.
- Prime costs (food plus labor) should not exceed 65 percent.
- Sales per square foot have significantly increased because restaurant owners are locating in smaller, less expensive spaces.
- In casual- and fine-dining establishments, owners are marketing more wines and specialty alcoholic beverages (house signature drinks) to increase profitability and to increase sales per square foot.
- Along with the specialty beverages, you will notice more food specials and special menus to drive sales during off hours and lower-revenue period. You will see early-week menus offering deals on food and drink. It's working!
- Food and labor combined should not exceed 65 percent. Rent expense should be under 9 percent. Higher-priced steak and seafood restaurants with higher check averages will run a higher food cost but have more dollars going to gross profit.
- Sales per square foot should be over $1,000.

- Food cost and labor cost combined are referred to as the prime cost and should run between 55 percent and 65 percent, depending upon the price point of the average entrée. Fine dining has a higher COG as a percent of revenue but a lower labor cost. The opposite is true in the fast casual segment.
- The fast casual segment is challenged by the $10 average price point for lunch and $12 for dinner. Serving finer food but still attracting customers in a fast casual setting is more common in metropolitan markets than in rural settings.
- Revenue per square foot usually breaks even around $250, if the prime cost is in line around 60 percent and the occupancy cost is between 8 percent and 12 percent. Above this threshold, operators start to generate free cash flow.
- Food cost under 35 percent; labor cost under 28 percent; rent factor under 8 percent
- Sales per square foot: full service $500; fast food $700
- Ratio of sales to the investment (what it costs to open for the build-out and equipment): sales 2.5 times to investment 1.0
- Most important factor in the restaurant business is the lease expense. Parking is very important.
- Benchmarks fluctuate per segment, such as $52,600 for chain restaurants to $100,700 per employee for a premium steakhouse. Per-square-foot and rent numbers were always 10 percent as an occupancy with a big turn in reducing that number dramatically, prior to executing a lease. Food cost percentage can fluctuate from the high twenties to the high thirties depending on menu.
- Food costs should be around 30 percent; liquor, 15 to 20 percent.
- The restaurant should try to achieve 6 percent rent, meaning if the rent is $5,000 a month, the revenues need to be $83,000 a month to earn a fair profit.
- Owner has to control the food cost and make sure the employees don't waste a lot of food.
- Food costs can only be stated as a single number but vary by cuisine and service. For example, BBQ restaurants or other high-protein concepts can be much higher in food costs, while taco shops will be much lower.
- Have over 200 comparable transactions and can correlate based on volume, SDE, EBIT, EBITDA, and other complied data.
- It is very hard to keep the food cost down;the price of goods is going up but it's tough to raise profits.
- The most important key performance indicators are rent (10 percent), food cost (33 percent), and labor cost (27 percent).
- Sales per square foot: $425.00

Data for Statistics, Products and Services Segmentation, Major Market Segmentation, Industry Costs, Market Share, and Employment Size used by permission IBISWorld https://www.ibisworld.com

Benchmark Data

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Questions

Learn the business. Make all mistakes on paper; prepare a business plan. Create something unique or do not go into the business. Copying a successful restaurant just because one feels he/she has a better recipe is a plan for disaster.

Make sure you have enough working capital; negotiate and understand the terms of your lease, and get renew options with acceptable terms. Make sure the lease/terms are assignable.

Labor and occupancy costs are putting a lot of pressure on restaurants' bottom line.

Owner-operators have a tremendous advantage; being skilled in all facets of the business is helpful to endure success.

Occupancy cost becomes increasingly important as food and labor costs rise. It is imperative to have a strong long-term lease at a reasonable rate that will not spiral out of control with escalation clauses.

High competition and high turnover. The steady and improving economy is allowing restaurant growth and new restaurants to flourish in major markets in New England.

Make sure you have a strong capital plan. Make sure you are committed to the long term. Be willing to experience a few shortfalls. Be patient, but worry and focus on the details. It's not what you pay your people—it's what they cost you if they are not performing well. Hire great people—hold them accountable to a high standard and reward them, and they will reward you.

Sellers: keep accurate accounting records, and be willing to finance a qualified buyer without the ideal down payment. Always get a third party to give an opinion of the business value. Don't hold out for the last penny; negotiate price.

Buyers: examine the accounting records carefully, and always have reserve working capital in case of an emergency or disaster. Get owner financing! Always get a noncompete clause in any sale of any business. Don't make major changes for at least a year.

Typically, and unfortunately, in today's market these businesses are sold with seller financing. Buyers are more confident buying restaurants when sellers are willing to finance the sale. There are several reasons for this. First, the buyer feels if the sellers are willing to finance, they can rely more comfortably on the information they have been provided about the profitability and revenues of the business. Second, the seller will be more willing to assist the buyer if they are financing the sale because they will want to be sure they receive all the sale proceeds. Typically, the financing is short term, two to five years, at slightly below bank rates. Owners may need to finance in order to sell their business if financial accounting has not been handled responsibly. Taxes may also influence sellers' decisions to finance, in order to delay some tax liability.

If they are buying a successful restaurant, I suggest they don't change anything for the first 90 days of ownership. After that, they should have a handle on what can be changed without hurting the business.

For sellers, keep good books and records, and make sure all your sales can be verified. This will maximize the value of the restaurant.

The marketability of any restaurant depends on location, along with the remaining terms of the lease. If the seller holds a key role in the operation of the restaurant, the buyer needs to have extensive experience in order to continue running the restaurant the same way it has been run in the past.

A good cook is not a qualification for becoming a good restaurateur. Preparing a fantastic meal for 16 friends at a dinner party is far away from serving 200 people six nights a week without getting on the production line. Treat the business as a business, not a place to make friends and have fun, and you should be fine.

The industry is undergoing a blending between the fast-food, fast casual market and the casual sector. Traditional sit-down restaurants are offering cheaper and faster options, while fast-food operators are increasing the quality and price of the offerings in response to the fast casual sector that was instigated by Quiznos and the conveyor toast production system. Casual restaurants still dominate the dinner trade but have also had to compress their margins to stay competitive.

Make sure you have a long-term commitment on the lease.

When buying, make sure they are well capitalized; expect long hours. When selling, price it right the first time.

Seller: Keep good books and records.
Buyer: Look for a business with good books and records.

Experienced food players may not look at the numbers but will look at the conditions, equipment (hood and grease trap, walk-in cooler-freezer), Internet reviews, violations, location.

Buyers—look for something reasonably priced that has some possibility for growth and improvement. If less experienced, keep it smaller or simple, or buy one with very solid and consistent cash flow and sales.

Sellers—be able to document the add-backs. The revenue is fairly easy to verify these days due to the POS and merchant services (credit/debit), although catering is often not documented and should be accounted for. Don't slack off on marketing and general maintenance during the sale process.

Have a strong cushion and do extensive due diligence before buying.

Buy on verified past performance. Good books and records are not a myth in this industry. They are real.

The large chains are hurting the small independent restaurants. They build expensive beautiful stores, offer the employees benefits, and have large advertising budgets; and the general public eats there because they are familiar with the names.

Sellers: Your CPA's valuation of the business is almost always three to four times higher than what the restaurant will sell for in the open market.
Assets are worth the revenue they generate. Do not expect to recoup opening costs in the sale of a restaurant; either stay in business long enough to depreciate the costs, or sell it for its worth.

The ideal lease will be a percentage over the gross (8% to 12%).

Restaurants are a very risky business, and lots of competition is always present. 70% to 80% of restaurants close the doors within 5 years or less.

Restaurants have high turnover rates.

In my market area, consumers continue to dine out so the customer base is strong, but expenses continue to increase so the margins are thin. There is a trend toward more limited service versus full-service, due to the cost of labor.

Restaurants have become a bit of a commodity. The plus side of this is there is a large and fluid market. The negative is that barriers to entry are low and competition high.

Be smart and keep the owner involved if you are the buyer and the seller finances the sale.

The food industry is highly competitive and easily duplicated in some cases. Real estate has become more critical in recent years.

The industry can change quickly depending on many factors. Consumer spending is the key economic factor to consider---when the economy slumps, restaurants have a tougher time. Facilities need periodic remodeling and upgrades in order to remain competitive. The minimum wage battle is of great concern to restaurants.

With liquor, hard to duplicate. Without liquor, easier to open a restaurant.

A significant portion of the restaurant/bar business is from cash sales. A buyer should verify that sales reported by the owner are accurate.

The restaurant business is a grueling one, and most sales are motivated by burnout of the owner after some period of years. Restaurants serving three meals, 7 days a week are most difficult to sell as they are burnout-prone operations. Primary traits of successful operators are drive, ability to multitask, human relations skills, ability to analyze a business and stay on top of costs. Everyone wants a restaurant because they think it is a dinner party every evening and don't realize the commitment a restaurant takes.

Make sure you have a busy location with a lease no more than 10% of the gross sales.

General Information

Know the proper percentages of gross for rent, food, liquor, bar, labor costs to know if restaurant is profitable or not.

We usually price the restaurant on three factors: one-third of sales; 1 to 3 times net earning replacement; lease and condition of fixtures and equipment. These three items should give a reasonable value of the business as a median factor.

Top line or percentage of sales is seldom used any more. For restaurants that are not cash flowing or conversions, there is value in markets that have tight real estate markets, such as ours in Denver. In our urban markets, few close, and assets are sold prior, provided a lease is in place at or below market. Additional value can be recognized for undermarket leases using the discounted earnings method.

Don't put as much weight into percentage of sales because of high occupancy costs; better to go with SDE.

Age of equipment? Leasehold postion? Is long-term lease favorable and undermarket? If so, adjustments to value can be made.

The market for restaurants is overflowing, and recent years have seen a drop in prices. Average prices I see lately are 1.5 to 2.5 times SDE, depending on other factors such as history, rent, location, ABC license, ease of operation.

Asset sales where there is no SDE will be, generally, not more than 25 percent to 35 percent of annual sales. Restaurants with good cash flow that is provable will generally appraise at approximately 2.5 times SDE, which could make the percent of average sales mentioned before go much higher now, going as high as 75 percent of sales. If there is SDE, find out if it can be preapproved for 7(a) SBA financing. We typically price at 3.0 times and expect the sale to be in the 2.5 range. Better be balance sheet knowledgeable too, as the P&L may show one thing and the balance sheet a less rosy picture. Have to know about industry P&L ratios to get at the health of the business. Use at least three years' financial info. Tax returns are more important than P&Ls.

Franchise resales can skew these metrics higher, depending on the quality of the franchise or the current hotness of the franchise concept. Rule of thumb: will list for 60 percent of gross and sell for 60 percent of list. Add the cost of the franchise fee on top of the selling price. Nontraditional sites are very lease dependent!

Including real estate, the sale price should be up to to gross sales, depending on the condition of the real estate. In leased space, up to 40 percent of gross sales.

Pricing will vary by the type restaurant. For example, casual restaurants will bring a slightly higher ratio and percentage of gross sales than fine dining establishments because of higher rent, build-out, and food costs. Fast food, sub shops, and pizza businesses will bring a much higher ratio for the opposite reasons.

The value of a license to sell alcoholic beverages would need to be added on to the value should there be a separate quota license provided.

The restaurant business is a heavy tipping business. The broker must add back the federal tip credit to the cash flow to determine the accurate cash. This is often overlooked. This is a return of the payroll taxes the owner paid on the employee tips. Look for personal items such as owner salary, owner auto, medical, travel and entertainment (the restaurant business isn't one requiring travel; owners often travel to visit other restaurants in other areas of the nation or world, but in reality it is a vacation expense and personal), and any other personal items.

Franchised businesses typically sell for an extra ½ to 1 times owner benefit due to the systems in place. Trends will shift the multiple up or down quite a bit. More important than the multiple of adjusted net is the lease term and neighborhood traffic pattern surrounding the establishment. If the area is improving or undergoing gentrification, the business will sell quicker and for a higher price, especially if the lease terms are favorable relative to the immediate market.

We calculate the selling price based on adjusted net income times 2.5, typically. We also take into consideration sales trends, location, rents, remodel needed, and owner-operated versus absentee.

39 percent of reported sales +/-
Three times cash flow, after owner salary

Good books and records will help increase the price.

SDE range, 2.0–2.5. Can be lower than 2 times if net is not at least $50K and can be maximum 3 times for the exceptional business with stable and high cash flow.
EBITDA range of 3–4 x = ROI of 33 to 25 percent. Strong national franchise brands and multiple locations can go for higher, but not the independents.

Pricing is function of sales volume, profitability, concept, duration, need for renovation, lease, liquor license, grandfathered C.O. issues, build-out, owned vs. lease assets, scalability.

For nonfranchise:
if CFO is $50–$100K, price is 1.5–2.5 x
if CFO is $100–$250K, price is 2.5–3.5 x
if CFO is $250–$500K, price is 3–4 x
if CFO is $500K–$1M, price is 3.5–4.5 x

Ranges for the sale of restaurants vary between 1.8 and 2.5 net, depending on the year. Everything depends on the type of business it is, whether full-service, franchise, fast casual; condition of books and records; location; rent; etc.

Including real estate, the sale price should go up to 1 times gross sales, but then you have to calculate debt service and make sure there is still a reasonable owner's salary available.

Pay close attention to food and payroll costs. Food cost should be between 28 and 32 percent for a well-managed restaurant. If cost controls are in place, the multiple leans toward the high end. Quality of product is important along with online reviews.

Placing a simple multiple on earnings isn't where the art is. The art resides in developing an objective way to derive the multiplier to use on the earnings. I like to break down a restaurant business into four categories, scoring each category from 1 to 6, with 6 being great and 1 being awful.

The four categories are (1) strength of revenue—is it growing, flat, or declining; (2) strength of cost management—are the cost percentages in line with industry or not; (3) lease, rent, location condition—is the lease fair and transferable; how strong is the location; how is the rent compared to market as well as revenues; (4) condition and building and FF&E—what is the condition of the facility, the parking lot, the equipment? Then I apply that average to a chart I use to determine what multiple to use.

The following factors will affect the multiple of SDE: franchise or independent; location of restaurant; parking; rent has to be in line; number of seats; any patio seating; equipment condition; any entertainment license; ABC liquor—what type; any governmental agency code or permit violations; if restaurant has a grease trap and what kind.

Usually the taxes and/or P&Ls don't show the true owner benefit. Reconstructing the financial data can be troublesome. I focus on the cost of goods to determine a likely gross sales figure. Other factors are the lease rate, and equipment and facility condition.

National franchise restaurants sell for higher prices than mom-and-pop units. Food costs and payroll costs are the two most important factors, followed closely by lease; rent should not exceed 6 percent of sales for most restaurants, 8 percent for some national franchised units.

Thirteen times the weekly gross sales

Occupancy costs/rent as percentage of volume; COGS; food to liquor volume; wages and salaries (owner vs. management)

Price will be adjusted based on the condition of the equipment and build-out.

Each deal is a stand-alone situation. Many factors determine value. Use above only as a guideline. Use more technical value appraisals to get a true value.

1. Number of years in business plays a vital part in the value of a business. A minimum of three years is essential to see what the sales pattern is for the concept.
2. The rent is a very important factor and should not exceed 8 to 10 percent of gross sales.
3. A very important factor in the valuation is how verifiable the numbers are. Gross sales must be backed up with a combination of credit card deposits along with cash deposits.
4. Have the seller finance part of the purchase as that will keep him involved in the success of the restaurant.
5. Restaurant experience is a requirement of the buyer. The failure rate for inexperienced operators is too high to take that risk.
6. Keep the operation as simple as possible. The more complicated the concept, the higher the rate of failure.
7. A good business plan is essential to keep everything on track.
8. Consistency is a key element to success.
9. Location, location, location

EBIT and EBITDA are too shallow of an estimation for restaurant valuation. For recasting, I work with the seller, using a weighted average of the last three years of income and SDE based on tax returns and income statements: 50 percent of the most current year, 33.5 percent of the previous year, and 16.5 percent of the year before that.

Discount for restaurants with rent close to, or over, 10 percent of gross sales. Discount if prime costs are more than 33 percent of gross sales

Profitable restaurants are being sold between 2 to 3 times SDE. However, distressed or closed restaurants sell as an asset sale and sometimes are a great buy. Even some landlords are asking for key money for a closed or second-generation restaurant. Removing an unprofitable seller from the lease liability may be a good deal for the seller... even if the seller does not make money.

Another pricing tip is to make sure the rent is competitive within the market place. If the rent is high on a dollar-per-square-foot basis or the annual escalations are unsustainable it will have an adverse impact on the selling price of the business.

Unlike in other industries, many buyers in this sphere care more about top line revenues and significant fixed costs like rents than they do cash flow. This is the case because most experienced operators know the expense ratios a given operation should be able to achieve.

Rent and lease terms are an important part of the equation. Lease costs need to stay under 9 percent annually. Longevity can boost value. Sales numbers need to be verified against bank deposits along with credit card statements. Cash that cannot be verified will not justify an add back for valuation purposes. A lot of times small Mom & Pop type restaurants have family members working there. If that is the case a negative add back needs to be done to show cost of replacing that person or persons. Seller financing will help increase the value of the restaurant.

Equipment age and maintenance important. Lease with market rent and good terms very important.

Most restaurants with liquor sell for a 70% multiple. Without liquor the ratio drops to 35-40% of sales. Light menu a big plus. Home cooking hard to duplicate for a buyer.

Does the owner just manage the business or is he the chef or cook? Business is more valuable if owner just manages the business.

Ease of operation—five-day operation worth more than a seven-day. Always look at food to bar sales as to what percent.

Lease should be no more than six to eight percent of sales. Food cost and payroll costs are the key items to control after lease costs.

Pricing based on cash flow can range from 2.0 to approx. 2.5 depending on several factors: lease terms, condition of FF&E, stability and years established, hours of operation, complexity of operations. Location is always a factor but is generally already reflected in the financials. Unprofitable restaurants are marketable based on location, infrastructure in place, ABC Licensing, quality of FF&E, and lease terms.

Including real estate, the price can be up to gross sales and up to 35-40% in leased space, but debt service should always be calculated to see if it makes sense for a buyer. This is going down as restaurants have become less desirable in recent years. The higher end restaurants are the toughest to sell, as the down payment needed is greater.

Proper use of the SDE formula is the most accurate way of valuing an independent restaurant with sales under $3 million per year.

The multiples increase as revenue and earnings increase due to economies of scale. Cost of goods should be at or below 30%. Must look for cash that is unaccounted for and non-operating assets and expenses.

Rent ratio over 10% lowers the SDE, EBIT, EBITDA and the percent of annual sales. The percent of annual sales is reduced point for point on every point rent ratio above 10%.

Percentage of annual gross needs to be supported by SDE, so higher prices get higher percentage of sales and lower percentages may have no SDE and may be just the sale of the tangible and intangible assets. Lots of other factors to consider including comps for like businesses.

Expert Comments

Owner financing is key. The banks do not lend for restaurants; must have adequate capital to sustain the operation until recognized. Most owners open a business without adequate cash in the bank.

We are unusual as we deal with more professional restaurant owners, not first-time novices. Over 75 percent of our deals are cash or leverage based on other assets; less than 5 percent have seller financing; and the remainder, SBA.

Seller financing with 40 percent down.

Seems like a third of our business is all cash, a third is SBA, and a third is seller financing.

Outside financing. Generally speaking, people that decide to sell and get out of this business do not want to extend the risk.

More seller financing due to banks not liking restaurants. Having said that, I closed one yesterday with bank financing in leased space, but usually finding a lender is tough.

These businesses are hard to sell without some level of seller financing. I think a seller needs to finance at least 10 percent of the price at about two points over prime over six years.

Most restaurants are either cash sales or sold with seller financing. If a seller is not willing to finance, the value of the business will drop from 10 percent to 30 percent, as there is usually no availability of any conventional financing. The exception to this is if there is real estate involved.

Seller financing is the norm. Without seller financing, the price is discounted between 15 percent and 30 percent.

60 percent cash down is normal and recommended.

Price less than $500,000: Typical financing is 1/3 cash down + 2/3 seller financing for five years.

Seller financing is common with at least 25 percent down.

We generally see seller financing for all or partial financing. Usually a 10 to 15 year payout. Recently all kinds of deals are being made such as no money down, low interest rate such as 4 percent. Sellers are doing anything to make a deal.

Seller Financing

It is hard work. Hourly turnover is high. The public can be demanding and unreasonable at times. Local and federal regulations can be challenging. Food costs can vary greatly depending on supply and demand. Food safety/recalls. Some consumers have a litigious mindset. Compared to some businesses, margins are low.

Negotiate a good overhead structure (rent and build-out costs); have a good financial management system in place to control costs to ensure profitability; manage financial results frequently. A large percentage of most food business is done on weekends and occasionally on holidays. As an entrepreneur, you will want to be there in the business when most revenues are happening, while your friends and family are off from work and having fun. The social aspect, although it's an advantage, mostly can become a disadvantage quickly and result in bad habits and results.

With social media so active today, if an owner does not deliver excellent customer service every day, then bad reviews can hurt his business immediately.

Retail with high competition

Customers can be fickle, and what was working last summer may not play well this summer. Franchisees gain the advantage of a much larger R&D facility always seeking growth, whereas independent operators must innovate every day or perish.

Long hours, relatively high risk, challenges with staff management and retention, multiple regulatory agencies to deal with on a continuous basis

Employees robbing one blind

Very long hours; difficult to find a great chef, train employees and keep them for a long time, and keep health department rating A all the time

If the owner is not a people person, is not committed to taking control, or does not have great management, things can go bad quickly.

Poor management causes huge problems, both financial and employee.

The long hours and reliance on relatively unskilled labor that turns over frequently are concerns.

New competition can enter the market easily and hurt business.

Competitiveness and, at times, liquor license availability

Hard to find quality help

Physical work and hours

Too many outside influences may hurt your business.

Very competitive, and if you are not watching the P&L and reacting to the important KPIs, the losses can be devastating.

Most major holidays are spent working. Cash flow can be mismanaged (treating retails sales tax as income...). If operators don't price dishes properly (too low), they might end up working a lot to make the deficit up in labor costs.

There is a lot of competition and the rent is the most important factor to consider.

Restaurants are not easy businesses to operate. You will need to know the proper equipment to purchase and become versed in food-handling procedures and local health codes. You may also have to conduct extensive market research before taking the plunge to see if your particular specialty, such as Italian, seafood or something more exotic, including offering Indian or Thai cuisine, will be accepted by the people in your area.

Many restaurants fail during the first year of operation, in large part due to poor planning and lack of money. Taking the time to prepare a carefully researched business plan will give you a better chance of success.

Long hours, high employee turnover, competition from major chains with lower overhead and food costs. Costs are continually changing and your supplies(food) has low shelf life. Being able to find a good model and stick with it is often key to success.

A lot of room for theft even with solid systems in place. Limited margins. Limited scalability.

Physical business.

You will require the patience of a saint. You will be open six or seven days a week. You will definitely start earlier than you thought and have later nights than you bargained for. It is relentless day in and day out with no sign of a break.

Potential threats (minimum wages, health care etc..)

New competition can enter an area and squeeze business. Food costs and payroll costs require constant supervision.

Raising labor costs, long hours, an economy that has put pressure on raising menu prices.

Tough to get employees

Attracting and keeping good people. Social media can be pretty cruel if/when an unreasonable guest lashes out.

Hard work and commitment to being successful many times takes a significant toll on family life.

Requires hands-on management, long hours, and must deal with staff turnover and training. Staff for restaurants are typically low paid and staff often does not show up or leaves with little or no notice.

Requires tight controls in order to maintain costs.

A new restaurant/bar can shut down within months after opening. High competition, high risk.

Highly competitive and a new competitor in the area can seriously affect the business. Remodeling and updating every 5 to 7 years is important.

Requires a large capital investment; there is heavy regulation by local, state and federal governments regarding many issues and in particular hiring legal employees, meeting handicapped requirements in the physical plant, enforcing regulations for serving alcohol and vulnerabilty for litigation from disgruntled employees, customers, etc.

Margins have continued to decrease. The steady decrease has forced owners to work more hours and reduce payroll expenses. Food costs have continued to increase, and transportation costs are also increasing food costs. Facility lease rates have still not significantly decreased enough to fall in line with sales.

Most concepts fail and the investors lose large amounts of money. The landlords usually want very high rents for prime locations, and the investment to build out the location can be almost as much as buying the real estate.

Disadvantages

Working with younger people helps keep you young and more relevant. Connecting with your loyal customers is very rewarding and advantageous.

It's a people business, and if you love people you will love the work. It's an exciting, dynamic business that is ever-changing, which makes it stimulating.

The advantages are also the pitfalls of being in this business! Most entrepreneurs who want to become restaurant owners feel the business is fun, easy, and very profitable. All of that looks to be correct and it can be; however, on a daily basis it is hard work and requires long hours daily and on weekends. There are many opportunities to be creative; marketing and food preparation are only a few examples, which are seen by your customers. The social aspect of the business is a double-edged sword.

The industry is fast paced and, when executed well, can be very profitable.

People often enjoy the working environment and have a passion for this business. On a larger scale and/or with multiple units, it can be very lucrative. Alcohol sales can increase profitability.

As an owner, you have the freedom to create or build a legacy. Owners have the ability to earn substantially higher profits than most businesspeople by expanding and growing to multiple locations. Many have franchised their businesses creating a lifetime of residual income.

Social interaction; great product generates great reviews.

Pride of ownership; it is possible to structure for absentee or semi-absentee if right manager is found. Easy to make people happy as long as you have good food and provide great service.

Sometimes, when an owner gets it just right, it runs itself and creates a good cash flow.

Owning your own business is still the American dream. As a broker, I love to help others achieve that.

Work for yourself; eventually try and manage so you can run it absentee and it can be a consistent cash flow.

Profitability and pride in ownership

No accounts receivable

Satisfies social and creative needs

Be your own boss. Enjoy success but be prepared for failure.

Large cash flow and the opportunity to make a lot of money. The big upside is add-on business is very profitable, as the fixed expenses typically do not change with added business and those fixed costs can be 20 to 30 percent.

Independent operators become popular community leaders almost immediately. It is a fun, lively business with a front seat to all of life's most joyful celebrations. Savvy operators can make a good living; poor operators can work themselves way too hard. Can raise a family in the business. Cash flow is not mysterious.

Owning a restaurant may seem like a glamorous business, and successful restaurateurs can achieve a measure of fame and fortune. However, success in the restaurant business does not come easily, and failure is not uncommon. Before opening your own restaurant, you should gain a basic understanding of the various pros and cons. The number of food services are growing every day. The trend was expected to continue as busy people choose to eat out as opposed to taking the time to prepare meals at home. Successful restaurateurs often become popular figures in the local community. A restaurant is a 'people' business, so if you enjoy meeting with the public you may thrive in this type of business.

High and fast turnover of accounts receivable make this a business that can be easy to expand. This is a business that is generally easy to run with some good practices and protocols in place. It is an easy-to-market business that can be accomplished by most anyone with some basic business skills.

The social aspect of owning a restaurant. To some, cooking is a passion and they can have a business that they are passionate about.

If you have the right location you can have a line outside the door the first day.

This is one of the few retail businesses that is seeing increased demand from landlords and developers. While many retailers are moving, more and more online people still want to gather together in person to eat and drink.

If you love food and drink, it makes up for the average margins, high competition and limited workforce.

Freedom & providing an experience and happiness very few other businesses can.

Restaurants can be highly profitable if run carefully.

Everyone eats, and low and moderately priced restaurants should continue to do well.

Unlimited growth opportunities, pride of ownership! You still can work around schedule for slow times.

Lots of write-offs.

Profitability tends to increase with size. At the level that management can be added, owners usually reduce hours worked.

A mid-priced-menu restaurant can perform in good and bad times. Everyone enjoys food and can relate to it.

One can actually get rich in the restaurant business. We have sold independent restaurants where the owner was netting, after all expenses, up to $400k annually with others clearing between $200-$350K.

The ability to flex creative skills

It can provide a fun working environment and social outlet for those who find this important. A person can use their creativity in numerous ways, to include designing the menu and complete dining experience (facility, ambience, guest experience). It can be very successful financially if done properly. It can be suitable for someone wanting a single location as well as those who want to create a larger business with multiple locations of the same or different concepts. It can be a great career choice for those who are hard-working and smart, but formal education may not be necessary. Many recent immigrants are attracted to the industry for this reason.

Can be very busy from the moment you open. No receivables.

Great cash flow, lots of potential, and repeat business for the right operator.

It's never been held as high, thanks to TV (food channel).

70% profit margins after overhead is covered

Easy to find a place to buy.

If you do enough advertising you will succeed. Easy to calculate the value of a business to buy or sell.

The advantage of a restaurant operation is that it is always marketable. Unless it is simply located in a bad location, a buyer can change the concept and the seller can recoup substantial value for build-out, equipment, liquor license, etc.

Advantages

With improving economy, the trends are looking good for good operators.

Full-service restaurants will have slower growth than limited-service restaurants due to consumers' changing habits.

Slight increase. Labor costs will continue to affect overall profitability making occupancy cost even more important to overall profitability.

I think local operators are doing well and will continue to do well as long as their capital plan is in place. Today's consumers are getting a little frustrated with the larger brands that do not deliver on their promise. Local consumers are passionate about local operators that have a presence in the community. This includes franchisees. Successful franchisees that connect with the community and operate strong are experiencing favorable revenues and profits. My family and I operate a franchise restaurant in Midlothian, VA. We are well connected in the community, and our revenues are 60 percent above chain average.

Good-tasting food that is, or has the perception of being, good for you is also important to today's consumers. Offering a menu that has something for everyone, and can be executed, is critical. Flavors by way of either special sauces or cooking techniques, such as a wood-burning oven, give consumers something to remember and share with others. Specialty drinks; fresh juice offerings; healthy options; gluten-free options; being allergy sensitive and able to handle special requests; speed of service. Restaurants that give consumers the chance to dine in and get out in a reasonable amount of time afford consumers the opportunity to get on with their busy lives. Technology is also a trend; that said, it is imperative to ensure a return on the investment.

More automation to counter rising labor costs. For independents, more use of locally sourced products.

Farm-to-table restaurants are opening up more, as that is what the public is asking for.

Because of high labor costs and the shrinking restaurant labor market, there will be more casual-dining restaurants opening, where you order at a counter and the food is then delivered to the table.

Lease rates are compressing profits, as the average occupancy costs are increasing as a percent of revenue (usually between 8 percent and 12 percent). New concepts are competing for space and paying higher rates per square foot than was common five years ago. Most start-ups are seeking "end cap with patio" so that they can seat without paying rent on the outside seating. As buildings usually have only two end caps, these spaces are leasing at very high rates.

The $15/hour minimum wage trend is pricing fast-food labor out of the market, as McDonald's has indicated it will do away with cashiers in favor of kiosks by 2020 in the Southeast.

Operators must also have a system in place to actively manage their social media footprint. Yelp and TripAdvisor are accelerating the free-market survival process. Negative feedback leads to a piling on of negative feedback, which can quickly spiral if not immediately managed with apologies and sincere effort to make amends.

Delivery services increase revenue but do not add to the profitability. Assuming a restaurant is not already at peak capacity, the marginal revenue is offset by the labor cost of preparation and food cost once you add the 20 percent to 30 percent delivery fee. The only cost savings come from the service (front-house) staff, which already has the lowest hourly rate, as tipped employees usually make one-third the hourly rate of the back-house employees before taking the tips into consideration.

Labor costs are getting higher; technology is eliminating some labor.

This industry has gotten tougher and likely will continue with minimum wage increases, etc.

We should see an increase in franchises due to the baby boomer cycle.

Landlords are squeezing tenants; minimum wages are squeezing them too. Price increases will happen but be rolled out slowly.

There is continued sluggish growth for the industry (+3 percent or less) with pressure on costs, but smart operators and concepts are making plenty of money.

As the economy improves, i.e., discretionary earnings improve, restaurants tend to do better.

Many more owner-operators and national companies will take over this field. Absentee owners will fade out.

Very competitive, particularly in fast casual, with overall sales volumes in decline.

Food costs will rise slightly if we see an improving economy. Beef and seafood will rise regardless because of the payroll costs at the manufacturing level and the rising cost of raw material.

Occupancy cost will also see a sharp rise because of the demand by chain owner-operators for triple-A sites. Smart business owners are looking at secondary sites and doing something unique instead of trying to do it better. If you have good food and service and a unique atmosphere or product, they will find you!

I see diminishing profits in the next five years due to governmental payroll increases and increasing food costs.

I see the trend continuing the same as it has been. Trend is to more quick-service restaurants as it is easier to run because of the lower employee count.The industry is improving; however, it is very highly competitive.

In fine dining, there is a movement away from haute cuisine toward a nutrition-based menu. Healthful food enjoys an elevated status.

Lots of new restaurants are appearing with a different kind of concept. QSR, quick service restaurants, are becoming more popular since there is no waiter service, and there is no tip, which is 15% to 20% in some restaurants.

Farm-to-table demands from consumers are high, but tourists, travelers and budget-conscious consumers like the convenience and familiarity of chain restaurants, so both will be contenders. Greatest challenge will be employee costs and retention. The large focus should be on millennials who eat out often and are a growing population.

Though a high-risk opportunity, restaurant business will continue to be a desirable form of investment.

Due to increased costs, labor in particular, I think the true mom & pops may continue to thrive if they don't require paid staff for key positions. The large multi-unit chains and franchisees may continue to grow but will operate on very thin margins. I am concerned about those who own 2–5 restaurants, especially in the full-service category. These may find it challenging, as minimum wage in our area is increasing to $15 per hour and waitstaff are paid minimum wage with no offset for tips. This also creates disparity between what the servers earn as compared to kitchen staff. I think there will always be an active market for restaurants though, because people will continue to eat out.

Increased move to automation, lower human labor, smarter equipment including iPad style ordering at the table. This can help improve business efficiency and standard daily costs.

Strong growth, higher rent and stiff competition for prime real estate.

High-end steakhouses will continue to feel the pressure as more restaurants enter the market and the restaurant industry continues to become more promotionally driven.

Expect things to remain very competitive-tough to compete against national chains, but it can be done if management is exceptional.

Restaurants and bars will continue to be a sought-after type of business. Turnovers will remain high. As rent will continue to rise, restaurant owners will be more creative in finding less popular locations and turn to social media for marketing and to promote their locations.

The demand for restaurants in general seems stable and strong, but it may become more difficult for the independently owned single operators to maintain market share when dealing with costs and regulatory environment including minimum wage increases. California is more burdensome than many other states in this regard and some franchises and chain restaurants have avoided expansion to the area. People are more health conscious and particular with their food in general and there is an opportunity to cater to this market if the restaurant can provide a good value for the product. Bars and clubs including microbreweries and craft cocktail houses are doing well.

Resources

The North Carolina Restaurant & Lodging Association (NCRLA) - https://www.ncrla.org/

We Sell Restaurants - https://www.wesellrestaurants.com

National Restaurant Association - https://www.restaurant.org

IBISWorld, August 2017 - https://www.ibisworld.com

Nation's Restaurant News - https://www.nrn.com

ServSafe - https://www.servsafe.com

Restaurant Hospitality - https://www.restaurant-hospitality.com

RestaurantOwner.com - https://www.restaurantowner.com/

Golden Gate Restaurant Association - http://ggra.org/

IBISWorld, June 2018 - https://www.ibisworld.com

Restaurant Finance Monitor - http://www.restfinance.com

Muradian Business Opportunities - http://muradianbusiness.com

Restaurant Business Magazine - http://www.restaurantbusinessonline.com/

Ohio Restaurant Association - http://www.ohiorestaurant.org

Today's Restaurant News - http://www.trnusa.com

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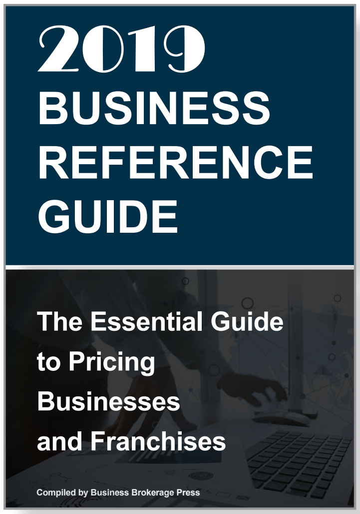

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