WHAT IS MY BUSINESS WORTH? Part II

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Last month, I outlined **Method I** for you explaining how to find **REPLACEMENT VALUATION.** Now it's time to consider a restaurateur's second query, "How much should a buyer pay me in **exchange for my cash flow?" Let's examine Method II called the EVALUATION BY INCOME CASH FLOW**. Using this procedure, determine the income and expenses of the operation for the last 12 months of operation.

Real estate brokers commonly price a restaurant for sale first, by learning the profits generated by the business over the last 12 months. Then, they factor it three and one half times the profit. I believe that the most reliable formulation deems Net Profit as *earnings remaining after a suitable salary for the owner operating as the manager.* After deciding the Net Profit, add back the Depreciation. This produces **INCOME CASH FLOW**. This is an acceptable means to value the business. After establishing the Income Cash Flow, adjust- ments are made for values of the location, length of the mortgage under seven years, or lease over five years. Note that real estate brokers penalize any lease that is shorter than ten years in length. All major improvements made over the past three years or less increase the valuation.

The final valuation uses **Method III** to answer the query what is the **FAIR MARKET VALUE** to both the seller and the buyer. By definition, it is the most probable price not affected by the undo stimulus which a business should bring in a competitive and open market. Here the buyer and seller, each acts prudently and knowingly. Implicit in this definition is the consummation of a sale by a specified date. Then the title would pass from seller to buyer under conditions by which: (1) buyer and seller are typically motivated; (2) both parties are well informed or well advised, and each acts in what he considers his own best interest; (3) a reasonable time is allowed for exposure in the open market; (4) payment is made in U. S. dollars or in terms of financial arrangements comparable thereto; (5) the price represents the normal consideration for the business sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.

To determine this value, I use a detailed method of analysis that I call the *Commercial Valuation*. I use it to give an integrated consideration of such factors as stabilized income, tangible assets, cost of money, future sales and costs, excess earnings and a series of risks. The methodology, derived from an article in INC, Magazine, uses a very flexible method of analysis. Using this method usually complements the two previous appraisal techniques. Comparing all three allows me to evolve a meaningful valuation that will stand up under intense scrutiny. I find this to be an excellent methodology to satisfy the three questions most sellers ask of an appraisal.

Following are factors that an astute appraiser should consider in making a valuation by any of the three previous methods.

1. Who needs a business appraisal? Most often appraisals are requested by business owners wishing to sell their business. Other purposes are to settle estates, divide assets for divorce proceedings, dissolve partnerships, settle tax cases, transfer ownership trusts to heirs, request bank loans and to insure assets.

2. The *Intrinsic Value* should consider including the value of the *servicemarks*, the *copyright* of the menu and recipes and capitalized training expenses of the operating staff. Also, consider capitalizing the terms of the lease itself, subjective valuation of the location in relationship to competition, surrounding markets, and landlords' leasehold improvements furnished in lieu of rent. Likewise, review the suitability of the restaurant being "grandfathered" for purposes of local building codes, and relative valuations of similar facilities in the area.

3. *Liquidation value:* This analysis requires a determination of the current in-place value of the Fixtures, Furnishings and Equipment where each item is prudently examined for its present *useful* or *liquidation value*, whichever is greater.

4. In determining *Fair Market Value* serious consideration should be given to the actual replacement costs for a similar restaurant at today's prices. This can be done on a per square foot cost commonly used by restaurant designers, contractors and architects to predetermine the costs of construction planning. Costs of construction can range today from $80 to $150 per square foot. The costs for professional fees, inventory, marketing and employee recruitment and training can range from $20 to $50 per square foot.

5. No restaurant can open for business without conforming to the building and health codes of the community in which it seeks to operate. The mechanical build-out is prerequisite for the later installation of the fixtures and equipment.

6. The evaluator must be cautious regarding specific data if they are not item specific. If they are generic approximations taken from similar costs incurred in the recent past by the investigator, say so.

7. The value of the FF&E as used equipment or equipment at "book value" as depreciated, is useful only if the business is not viable, or not operating at the time of the appraisal. Then follow these Steps VI and VII. *See following:*

Step VI . The used price value for the items listed is considered to be that commonly paid by used fixture and equipment dealers at auctions or by purchase by the piece at existing restaurant sites. Estimates of Fixtures, Furnishings, and Equipment (FF&E) are subject to varying degrees of uncertainty and its accuracy depends, among other things, on 1) the state of the new and used equipment market at this time, 2) the general business conditions in the industry and 3) the availability of and demand for used equipment. Enter this price under heading "USED PRICE."

Step VII. The "AMOUNT' of items is multiplied by the "USED PRICE" to get "TOTAL USED PRICE."

With a good appraisal of a restaurant and its business, both the buyer and the seller or any other interested parties can be confident that what is reported as value is what they will have as a useful and viable asset.

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