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THE RESTAURANT BUSINESS ADVISOR



What is the value of your restaurant?

You may not be thinking of selling your restaurant right now, but at some future time you may. Also, at some point, you may be thinking about buying a restaurant. In either case, knowing how to establish the market value of a restaurant will help you avoid over or under estimating the price. There are three industry standard approaches to determine the value of a restaurant. Keep in mind that there have been books written on this subject, so this is a general overview.

Let's begin by stating that these formulas are based on the overall condition of the restaurant being very good, especially the kitchen, and there are at least 10 years remaining on the lease.* If the restaurant is outdated or not in good condition, then the cost to refurbish or renovate should be considered. Having said this, don't overlook counterbalancing factors like, demographics, location, rent, sales and history of success.

The first approach is the **Gross Sales Approach**. This is the most common and simple formula that is based on a percentage of gross, or top line, sales. This figure is typically documented on the tax returns. (This is a very good reason to report all your sales.) The percentage can vary between 20% to 30%.

Example:

A restaurant with gross sales of \$1,000,000.00 has a value ranging from \$200,000.00 to \$300,000.00. Once again, depending on a variety of other variables, this figure can go up or down.

The second approach is the **Cost-to-Build Approach**. If the restaurant is new and there are no documented sales, or if the gross sales are low and the restaurant is in distress, this is the formula to use. Determine the actual cost to build based on a builders cost per square foot and then discount it by 40% to 60%.

Example:

A 1,500sf casual restaurant in Westchester may have a cost to build new of \$150.00 - \$250.00 per square foot. (New York City is much higher.) Let's say \$200.00sf X 1,500sf = \$300,000.00 X 50% = \$150,000.00. This can be very painful if you just spent \$1,000,000.00 to build a new restaurant and your broker tells you that he may be able to get \$500,000.00 for it. It is very important to keep this in mind when you

are building or refurbishing a restaurant that you have enough additional cash after construction to weather a slow start.

The third approach is based on **Sellers Discretionary Earnings (SDE)**. The definition according to ValuAdder is: "The pre-tax earnings of the business before non-cash expenses, one owner's compensation, interest expense or income, as well as one-time and non-business related income and expense items." Depreciation, amortization and interest paid by the business are items that are discretionary and generally "added back" to the bottom line of the business. Basically this approach is used when there is a documented (tax return) net profit. A restaurant can sell for approximately 1 to 3 times SDE. The higher the percentage the net profit is of gross sales the higher the multiple.

Example:

A restaurant with a net profit plus add-backs of \$500,000.00 can have a value of \$500,000.00 to \$1,500,000.00.

Now that you have a general idea of how restaurants are valued, keep in mind that, similar to real estate, the actual value of a restaurant is only what a qualified buyer is willing to pay for it. In other words local market conditions play a significant roll in influencing the value or price of a restaurant.

Curious about the value of your restaurant? Contact me and I will be happy to give you a **free valuation of your restaurant**. There are no strings attached and you can be completely assured that I will maintain strict confidentiality.

* If you own the real estate, then a separate value must be placed on the building in addition to the business. As a commercial real estate agent, I can guide you on this valuation as well.