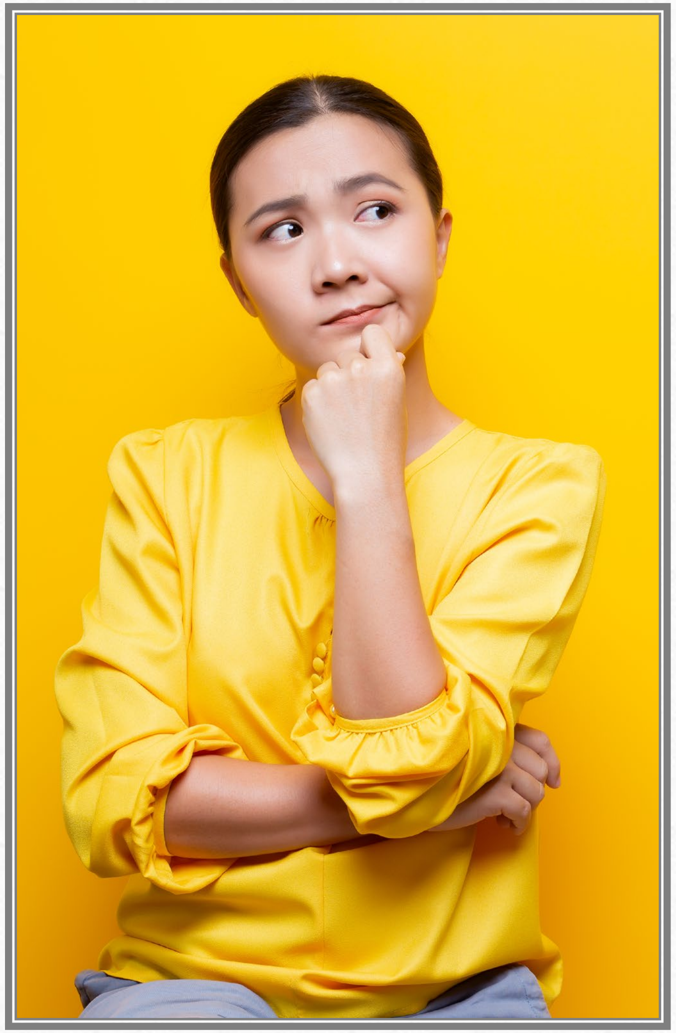
Key Factors Impacting the Value of a Hospitality Business at the Time of Sale:

Demystifying the Revenue Multiple



AGENDA

- The Basic Valuation Formula
- Key Factors of the Equation
- Role of Ownership
- Calculating Fair Market Value
- Myth Busters

The Fundamental Equation

Revenue (Factor A)

X

Multiple (Factor B)

=

Goodwill/Blue Sky Value of the Business *

*More on the definition of goodwill to follow.

How do you determine the factors?

Factor A-What is Revenue?

- A) Gross sales/topline revenue?
- B) Annual income + fair market value of equipment, inventory, and leasehold improvements?
- C) Potential future earnings of the business?
- D) Documented present day and historical profitability adjusted for discretionary & non-recurring expenses?

EBITDA-SDE-ADJUSTED CASH FLOW NET PROFITABILITY

Common Add-Backs and Adjustments to Reported Profitability:

- Compensation & benefits of ownership.
- Tangible & intangible asset write-offs. Depreciation and amortization.
- Non-recurring income & expenses. Leasehold improvements, one time legal and administrative fees, federal grants, stimulus aid, insurance proceeds, interest.
- Discretionary spending-travel, meals, entertainment.

Why is Profitability the Driving Factor for Prospective Buyers in the Marketplace?

Purchasing a Business is Fundamentally a Business Decision. A Business Must Have the Ability to:

A) **Service the debt related to the purchase (Bank.)** Ex: Business producing $500K of adjusted profitability priced at $2.5M. $500K down=$2M debt.

B) **Generate a competitive rate of return on the investment (Investment options and opportunity cost of capital.)** $500K on $2.5 investments=20%.

C) **Cover operating expenses and pay the owner a living wage (Owner operator.)**

D) **Deliver a premium beyond the labor contribution of ownership to justify the risks of business ownership.**

Disregarding basic economic principles when pricing the business eliminates approximately 90% of the buyer pool.

Structure & Replacement Cost of Ownership

- How many owners are actively involved in the business?
- How much do they work on average?
- What are their roles in the business? (special designations)
- What is the fair market labor replacement cost of ownership?

Why?? Economic & opportunity cost. Compatibility. Not all profitability is created equal.

Calculating Factor A (Revenue)
EBITDA Minus Replacement Cost of Ownership

- $575,000-$75,000=$500,000

Excess Earnings:

A) The amount of profit generated by the business beyond the labor of the principals.

B) Represents the advantage of ownership. Business vs job.

C) Receives a multiple.

D) All the above.

Factor B
The Multiple is Two-Fold

Part 1:

The Scale. 0-?????. Rate of Return.

A) 0-3 Single location retail restaurant-33%-3 Years=3X

B) 0-4 Diversified revenue stream business model-25%-4 Years=4X

C) 0-5 Multi-location chain of privately owned or franchised units-20%-5 Years=5X

D) 0-20 Commercial Real Estate-5%-20 Years=20X

High/Low ROI. What determines the expected scale/ROI for a specific business?

Second Part of the Multiple Risk

Risk Spectrum-Government bonds to Bitcoin.

The multiple range/scale is correlated to the following key risk factors:

A) Industry-Stability of the sector. Revenue profile.

B) Size of the business-1 location is riskier than 5.

C) Revenue diversification-Multiple sources of revenue.

D) Staffing & Operational Infrastructure-Support systems.

Subcategories of the Multiple

- The following additional factors are also evaluated to finetune the multiple for each individual business:
- A) Clarity of books & records-Verifiable document trail.
- B) Growth rate-Recent performance.
- C) Competitiveness-Market reputation.
- D) Desirability-Location, curb appeal, staff, role of ownership.

Putting It All Together

- **Single location retail restaurant rated on a scale of 0-3:**
- **Revenue** A.K.A. Excess Earnings-$500,000
- X
- **Multiple 2.80**
- Goodwill Value-$1,400,000+$200,000 Fair Market Value of FF&E=$**1,600,000.**
- Most of the value concentrated in goodwill.

What is Goodwill/Blue Sky?

"The concept of goodwill seems to be synonymous with profitability. Isn't there more to my business than just dollars & cents?"

Business goodwill represents:

- The vote of the paying customer.
- The strength of the value proposition.
- Market reputation of the business.
- The quality of the customer experience.

Myth Busters
Pie in the Sky Value Models

- The Bucket List Model
- The Silicon Valley Model
- The Sunk Cost Model
- The Hearsay Model
- The GOD (Good Old Days) Model

(425) 454-3052
Oliver@ibainc.com