

Let's Invest in Restaurants

By Dennis Monroe

Often I'm asked why people invest in restaurants, and in my articles I've certainly offered many reasons why. This time, let's look at it differently: What if I had \$750,000, or \$250,000 or \$50,000 to invest?

Below are some general questions to ask before you write a check:

1. Am I investing in a business or a culinary concept?
2. Is the money being raised by the founder/concept owner?
3. Will there be enough money raised for a cushion in case of financial difficulty?
4. What do I want out of my investment – cash flow or growth?
5. Do I need and want a control position?
6. Is this a fun investment? Do I want to tell my friends I am an investor and get a good table?

Given the above, let's look at **two options where you might put your restaurant investment assuming it is \$750,000:**

Option #1: Investing in an owner-operated restaurant. Many restaurants, particularly chef-driven establishments, seek investments in this range. If you decide to invest \$750,000 in an owner-operated entity, you'll probably have the largest single investment. Ask yourself these questions:

1. Has the restaurant owner successfully opened and operated a restaurant before?
2. Does the restaurant have a good financial person, someone who is going to watch the dollars?
3. Make sure the chef is more than a chef. If the chef is the owner, is he/she a good operator who understands costs?
4. Do the proformas make sense? Do they show you can get your investment back in a reasonable time period?
5. If the restaurant plans to develop other restaurants, is there a plan for raising new money?

Option #2: Investing in a franchise business. Investing \$750,000 in a franchise unit is usually enough equity to secure the rest using debt. Depending on the type of restaurant, this size of equity investment may open two or three stores. That being said, you need to have an operator who will be an owner, sign the franchise agreement and be trained in the franchise concept. Here are some additional questions:

1. Can you effectively use senior debt?
2. Is there sufficient labor to run your restaurant?

3. Is the cash-on-cash return adequate (at least 30%)?

If you have \$250,000 to invest, there are a lot of different options. You could be a partial owner in the concepts we discussed in the \$750,000 example, or you could be one of three investor-owners. This is the most flexible amount of money and in many cases, the minimum private placement offering investment is \$250,000. Here are some options:

1. Find a good restaurant site, a talented chef or both, and develop a hot new neighborhood restaurant. You may need some debt, and your chef should have some skin in the game, but I see many successful neighborhood restaurants for a total cost of under \$500,000, providing investors with a reasonable return.
2. You could invest in or buy a restaurant concept (franchise or non-franchise) that has a low entry cost (e.g., sandwich concepts, pizza concepts or treat concepts). You probably should make sure you are the owner-operator, or are involved with an operator with whom you have a close relationship.
3. You could be a part of a private placement, raising money for development and the expansion of a proven concept either franchise or non-franchise. In most cases, private placements are in the \$2 million to \$5 million range, so you may play a significant role in this venture.

Here are some questions to ask yourself with this level of investment:

1. What does the offering look like? What type of rights are given to the investors? Are the investors all accredited?
2. Is the owner putting in some of his/her own money? (I believe it is key that the owner is investing in the restaurant.)
3. Will the owner provide guaranties?
4. What is the realistic cash flow and when can they start providing a return to you?
5. What are the collective control rights of the investor group and who are the other investors?
6. Do they have good reporting format? (This is key.)
7. Does the structure such provide much in the way of tax benefits?
8. Are they raising enough money to have a financial cushion if there are problems?

I call \$50,000 the fun level of investing. It's an insignificant investment for many people or an amount of money that doesn't deserve extensive planning. However, in many cases \$50,000 is an amount that may allow you to get involved with an innovative restaurant or operator who needs a little money to complete a restaurant opening

or needs working capital. Or it might just be an investment in a small, private placement (e.g., \$250,000), and you do not need to bet the farm. I can't really identify all the types of investment options in this category, but the source of this investment level is usually friends and family or friends of friends and family. Also, don't forget crowd funding investing as a possibility.

This smaller investment level has the following key questions:

1. Do I know and like the owner?
2. Is this a concept I want to go to?
3. Am I doing this investment for fun or am I doing this for pure investment?

4. Am I okay with just getting some cash flow distributions and possibly some tax benefits?

No matter which level of investment you choose, be sure all relevant questions are answered to your satisfaction before you proceed. I think it is a great thing to invest in restaurants—as long as you do your homework.

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