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When to Sell Your Concept

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A question I am often asked is "when is the best time to sell my restaurant concept/business?" In approaching this question, it is important to separate concept value from franchise value (though in many cases a company that franchises has both franchise stores and corporate stores). In this article, I will address concept values. Next month, I will discuss franchise company values.

In the life of a growing company, there are, what I like to call, inflection points for maximizing value. These inflection points occur at several stages:

1. The first inflection point is the initial store, which, if it's a homerun, can have some value over and above an EBITDA multiple (but not very likely).

2. The next inflection point arrives once the company has opened three or four units and proved out the basic unit economics and some uniqueness of the concept.

3. Inflection point number three is when there are 10 to 15 locations, and the company has nurtured a formidable concept, able to achieve some geographic diversification and to attract different types of customers.

4. Finally, the fourth inflection point is what I would like to call a proven restaurant company that has 30, 40 or even more stores, and the concept has shown sustainability as well as the ability to grow in various locations and geographies.

How do we figure out pricing at these different inflection points?

1. With one store, it's very difficult to sell for a growth value. Normally, it's just a multiple of cash flow with maybe a premium.
2. When you have three or four stores, in many cases you can attract private equity—which nowadays is looking at earlier-stage companies—and get a growth multiple over and above a normal cash flow multiple. This would sometimes be in the seven or eight times EBITDA level.

3. With 10 or 15 stores, you may have several potential buyers. There's a strategic buyer, a financial buyer, and at times maybe even a public company that's looking for a growth concept. This can give you a very strong multiple or even a multiple and pro forma EBITDA.

4. When you have 30- or 40-plus units, you're likely to seek for the company a multiple similar to a public multiple.

I had the opportunity to discuss this subject with two experts. The first was Dean Zuccarello, the CEO of The Cypress Group. He said that years ago the smaller concepts probably wouldn't even get a review by the private equity folks or some of the other financial buyers. Now with growing interest in hot concepts, the smaller concepts are getting more attention, and it is important for those concept owners to think about sale when they may be at four or five units. Sometimes the decision to sell is made because the company has just run out of the ability to grow. They either need people or financial resources.

Zuccarello stressed the importance of "an honest assessment of the company's ability to grow and to continue to survive and thrive." He said sometimes you'll have an uncut diamond and it may be a good time to sell, but someone else needs to basically do the cutting. Then there might be a stage where a company has built all the infrastructure and is all poised to grow; and yet it may be one of the best times to sell because you can see that "it's a diamond—it just needs some polishing."

I also spoke with Rick Ormsby, managing director of Unbridled Capital. He emphasized two inflection points where a sale opportunity arises. The first is when the company is still small and has proved the concept out but really haven't proved much diversification. The second occurs when the company has seven to 15 stores and has proved the concept in at least two different markets.

Ormsby said one of the most important things when you're getting ready to sell at early stage is to try to have as few issues as possible. That means you not allow the company to reach a stage where it has three or four great stores, a couple of OK stores and a couple bad stores. It's a mistake, he said, to leave the bad stores open and think that somehow you're going to explain them away. The key point is always principals in the company. They are the ones that drive growth and the ones that are going to be most likely to be able to attract buyers and get the highest value.

You can see that the three of us agree that the early stage companies are now more attractive than ever. We think it's best to have strong principals who have the ability to grow the company to proof of concept in several markets. And we urge all potential sellers to be realistic about what the company resources are and not get over their skis.

Finally, when you're ready to sell, make sure you hire an expert to help.

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