

Anatomy of a Deal for 2022

By Dennis Monroe

Two words come to mind for the anatomy of a deal the last few years: flexibility and creativity. Those two words were the hallmark of deals completed during the height of the pandemic and are still appropriate for 2022 deals. Let's look at some basic controlling factors affecting deal pricing.

First, since deals are normally based on a pricing model of a multiple of EBITDA, the question for the last two years, and carrying over into 2022, will be what the appropriate multiple and level of EBITDA should be. Companies that did well during the pandemic expect their sale price to be at a higher multiple and a higher level of EBITDA. However, it's far too early to determine what the trajectory of any company's earnings will be post-pandemic.

The successful businesses want to believe their trajectory will continue at a high-performing level, and of course, restaurant owners who had problems during the pandemic believe they can revert back to 2019 levels. The first challenge, then, will be assessing truly sustainable EBITDA levels, as well as what constitutes appropriate projected growth.

The second factor affecting price will be the availability of financing. In recent discussions, lenders across the board have not been willing to chase the higher multiples or the so-called pandemic higher-earning levels with higher advance rates or EBITDA-to-debt levels. Lenders are being fairly conservative and keeping consistent with pre-pandemic lending structures.

Real estate prices, which are at historic highs (lower actual CAP rates), are the third factor affecting pricing. Additionally, new construction costs and the rental rates being sought by landlords are also at high points. All that being said, real estate is a huge opportunity for the restaurant owner.

If you are doing an acquisition with real estate, you will be able to use the higher prices for real estate as a financing source to bridge the purchase price for the business side of the transaction through financing, or even better, sale/leasebacks.

The last major point for 2022 is the uncertainty of the new tax law. This uncertainty created a flurry of year-end activities with the thinking that closing in 2021 could beat the rise in capital gains rates, or tax rate increases in general.

We had a number of transactions close on an installment basis because they couldn't get all the financing pieces put together, and the seller was willing to take an installment note that most likely will come due some time in 2022.

Our best advice is to proceed under current tax law and take advantage of favorable depreciation, business deductions and current tax rates.

Here are six important points to consider for the New Year:

1. Whether you are a buyer or a seller, recognize the difficulty in determining price because of pandemic swings that most likely will continue into 2022.
2. Keep the due diligence process as short as possible. We have seen a huge increase in deal fatigue. People are trying to create certainty in an uncertain world, and as a result, due diligence sometimes has become almost overkill.
3. If there is real estate involved (either on the seller or buyer side), capitalize on the availability of the robust real estate market and take advantage of sale/leasebacks.
4. Understand as a buyer that if you are using traditional financing, and are paying a higher price than normal because of market valuations, you are not going to be able to leverage to the extent you could pre-pandemic.

5. Things are backed up, such as title appraisals, environmental and closing financing, so be patient and flexible.

6. Find creative solutions – ideas like joint ventures, installment sales, lease-to-buy and options to buy or sell.

And one more point that can't be stressed enough: Make sure you understand employee issues and are current on market wage and benefit requirements. Do everything you can to retain employees.

The anatomy of a deal in 2022 is all about being flexible, patient and creative. This might be a good time to sign up for a yoga class. Happy deals in 2022.

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