

## Can You Really Determine What Your Business is Worth?

By Dennis Monroe

In the almost-50 years I've been involved as a lawyer in the restaurant world, I've never seen a period where there's been so much uncertainty regarding valuations. The current marketplace is unpredictable and concepts we've seen for years just don't have a reasonable resale market, particularly in franchise systems. Given all the uncertainty, here is a way to look at the restaurant market divided into six different categories with corresponding multiples of unit cash flow (EBITDA).

### 1. AAA Concepts:

These are franchise concepts that survived *and* thrived during and after Covid with favorable economics and that consumers see as special, like Taco Bell and Chick-fil-A. The multiples we've seen over the years are not relevant anymore. Because the other concepts in this group command the highest prices, we'll call these multiples of 8x to 11x.

### 2. AA Concepts

These have fairly sturdy performance without a lot of ups and downs, such as McDonald's, Dunkin', Wingstop and 7 Brew, which have a following, strong systems and carry values with a multiple of 6x to 8x.

### 3. A Concepts

These are struggling national concepts, like Wendy's, Five Guys and Pizza Hut. These brands have been historically good performers, but, for multiple reasons, have lost their historic appeal to the consumer. There is a wide range of franchisee pricing, but a multiple of 3x to 5x seems to fit.

### 4. Small Chains

This is a diverse group of primarily 10-to-20-unit, mostly local, non-franchised chains that have strong profitability. These brands are the hardest to value. The multiples usually are in a range of 4x to 6x, and possibly higher if they've proven the ability to diversify demographically and have some franchise opportunities. It's been my experience that owners tend to be disappointed with their valuation, because they believe they have substantially higher value than the market is willing to recognize.

### 5. Emerging Concepts

These brands haven't proven themselves, nor have their

franchisees. They are still trying to find their way and don't have a significant number of corporate stores. They perform well in their original location, but not always in broader-based areas. Values and multiples can be all over the board and are dependent on the prospective buyer's perception of the growth opportunities.

### 6. Vintage Concepts

These concepts are strong locally and have good cash flow, but don't have a lot of growth potential.—the right kind of buyer is needed. These companies may have some critical mass, such as 3-plus restaurants of compatible concepts or are multi-concept. Many are polished casual, which while a good sector to be in, it's still hard to find buyers. I've seen local concepts that generate good cash flow, but if you use any kind of multiple, say 3x to 5x, your price is so high no one is willing to pay it.

So, you want to look at how you move up into those different classes to capture market value. I asked two veterans of the restaurant M&A world for their thoughts on the state of the market.

Jeb Ball, managing director of Guideboat Advisors, said the idea of 8x to 11x multiples for the AAA group was probably right on point; AA concepts are probably more like 5x to 7x, but the A concepts are tough ones. He agreed the market is volatile, particularly when you look at consumer behavior. He thought Wendy's being in the A group is really a question of volatility. If you look at the A group on the lender-preferred concepts list which was printed last month in the Monitor, some on the AAA list are lower on the lender list, which also makes valuations tricky. Covid pumped a lot of sales in the QSR sector and some brands were able to sustain those sales. Today, their valuations are high.

The best example is Taco Bell. The others that weren't able to sustain high sales numbers and multiples have dropped, especially if they haven't repositioned themselves like Burger King has been trying to do.

David Stiles, managing director with Citizen's Capital Markets & Advisory, said valuation is on a case-by-case basis. You have to look at every circumstance behind a

seller's business and both the buyer and seller expectations. A circumstantial approach is the starting point of a multiple-unit transaction. He didn't think my division of groups and the price were necessarily the best way to segregate concepts. He did agree the AAA group had about a dozen or so concepts that are driven by a strong consumer relevance and growth territories. He said the other groups (emerging and vintage), are basically one big group which are determined not necessarily by concept but by numerous factors, such as leases term and deferred maintenance, labor, food costs and competition. Stiles maintained that price is influenced by all these factors.

I like the idea of having a range of pricing for each group as a good starting point. Then, we can arrive at a reasonable expectation that can be adjusted up or down based on economic conditions, leases, development ability, franchisors and other factors. It would be nice to have certainty and hard and fast rules, but that's seldom been the case in the restaurant business, especially in the current environment.

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