Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?



Full Episode Transcript

With Your Hosts

Patrick Totah and Andy Mirabell

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Welcome to *Restaurant Deal Making EXPOSED!*, the only show that equips you with everything you need to know about restaurant transactions. In this show, we tell you all about how to make the sale or purchase of your restaurant not just possible, but successful. Now, here are your hosts, ex-restaurateurs, and seasoned brokers, Patrick Totah and Andy Mirabell.

Patrick: Hey everybody, we're back here with *Restaurant Deal Making EXPOSED!*. Today's episode is, "I'd Buy That for a Dollar." Everybody thinks they know what a restaurant is worth until it's their own money on the line. Today, we're looking at real-world restaurant opportunities and asking one simple question: would you actually buy this restaurant?

There are a lot of factors that go into buying a restaurant, and not every buyer is looking for the same thing. Are you looking for a space to bring your own concept to life with plans to shut down, remodel, and start fresh? Or would you rather purchase an established business with revenue, employees, and customers already in place? How important is location? Are you focused on a certain level of profitability or seller discretionary earnings (SDE)? And perhaps most importantly, what does the lease look like? How much is the rent and how much time do you have left?

The reality is that what makes a restaurant a great opportunity for one buyer might make it a terrible investment for another. Before you start looking at restaurants, you need to understand what you really want and what you want to buy, what your goals are, and what matters most to you. So today, Andy and I are going to put ourselves in the buyer's shoes, break down a few different opportunities, and see whether we'd actually put our own money on the line.

Andy: Well, this is a fun one and an interesting one because I know you've come up with a couple of different scenarios of restaurants that are for sale or opportunities. And this is essentially when a buyer is out there, curiously looking for that right opportunity on one of the business brokerage listing sites on RestaurantRealty.com, whatever it may be. You see general details about each listing. You see the price. You don't always see the address until you sign an NDA, but you will eventually get there.

Patrick: Yep.

Andy: You can see revenue. You can see what the profits are, the seller discretionary earning, profits, the EBITDA profits are, however it is listed. You typically see lease rate, and you get a few other tidbits of information about the size of the restaurant or history or whatnot. So you're kind of basing your initial reaction on a few key details. So that's kind of where we're at today.

Patrick: Exactly. And I have to say, I feel like the lost art of getting in your car and going out and doing a customer visit is kind of getting lost. I don't know why. Everybody wants to look at the revenue, the profit, all the things first. I'm like, who cares? You need to go there and understand if it's even a location that you would consider. I mean, when I first was looking at restaurants, I wanted to know, you know, of course, I wanted to know what the all the things were, but is it somewhere I want to show up to work every day?

Andy: This is maybe a bad analogy, but dating online.

Patrick: Yeah.

Andy: You're looking at a picture and seeing a profile, right? You need to see that person in person and get the butterflies about it. It is no different with a restaurant. This is a hospitality-driven business. You have to have some charm and some excitement about what you're getting into. So you got to feel good about it. So you need to go there and

Patrick: Yeah, like pop in as a customer, you know?

Andy: Going and looking to buy homes one day, and I was on Realtor.com, and I looked at this house. I'm like, "Oh, it looks great. I'm going to go drive by." It was literally right across the street from a freeway. They don't show you that in the pictures, right? So you kind of have to get a feel for the neighborhood because, as we all know, every neighborhood is slightly different. So I think it's really important on top of all these other factors that you get in your car or whatever you do for transportation and you go and get in there as a customer.

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Andy: You take your drone there. Yeah, no, exactly. All right, let's get into it.

Patrick: Let's get into it. Okay, so I have this first scenario for you. We'll call it "The Money Maker." The asking price is $750,000. The revenue is $2.2 million. It's making $300,000 and rent is $13,000. It's been in business for 15 years. It's got a full liquor license, stable staff, and there's seven years remaining on the lease with an option.

Andy: Yeah. Wow. There are a lot of positives on this opportunity right out of the gates.

Patrick: What are those positives to you?

Andy: Well, the positives are that it has a long-time, stable staff showing consistency in operations. We don't like seeing a lot of turnover in management, especially. You want to know that the neighborhood keeps coming back to see the same faces. I think that, obviously, the cash flow is the number one most appealing thing right out of the gates looking at this. If you're selling $2.2 million and you're netting $300,000, it's pretty reasonable for the restaurant world at 8% revenue. I know a lot of other industries look at that and laugh, but restaurants have pretty tight margins.

Patrick: You know, when I look at it, I think, yeah, obviously the owner cash flow is decent, especially for the amount of revenue. It's at what, a two-and-a-half multiple. That seems fairly reasonable given just knowing that information. I like also what you said, the stable staff. The seven-year lease thing with an option, I would probably add like five years to that seven years and then have the option so I have a little bit more built into that lease. What do you think about the rent? I mean, I…

Andy: It's on the high end of acceptable. I'm going to say it's on the high end of acceptable. When you're in that 8% or 9% of revenue, it starts to get a little bit much to swallow. It really depends on what location you're in if it's that prime of a location. I really want to be shooting closer to that 6% of revenue for rent, but it's

a minor red flag, but it doesn't scare me away. But once I go to that business, observe it, maybe I can justify paying a little higher rent.

Patrick: What if I told you that this restaurant has an owner that's working 60 hours a week?

Andy: That changes the story. So let's talk about that. If I am 25 or 35 years old, I want to make $300,000 a year by working my butt off at my brick-and-mortar, and I like doing what I do. I have the energy for it. I understand that my quality of life will be changed some because I'm there a lot. You're kind of married to your business a little bit. If I'm that guy, sure, that's what I'm targeting. But buyer beware, because if I am looking at this more from an investment opportunity, then guess what? I need to offset that 60 hours a week by hiring a full-time manager for this place, and that is going to be a $75,000, in some communities, $100,000 salary that now eats into that $300,000 cash flow and gets you down to $200,000 or so a year. So be careful with that.

Patrick: Yeah. Yeah, or you can take on the 40 or less and hire a part-time or people to offset the extra 20, 30 hours that you don't want to work or something, and then you would do a negative adjustment to the $300,000, right?

Andy: Yeah, absolutely. You're right. There are plenty of listings and quite a handful of them that I have to put, like, big and bold, if not in the title, in the description somewhere that we are seeking owner-operator, because the numbers only make sense with an owner-operator in a lot of these opportunities.

Patrick: All right, here we go. We got, so this one's called, "The Beautiful Disaster." It's got $4.8 million of revenue. It's listed for $450,000, and it's losing $200,000 a year. The rent is $28,000, but the place is huge. It's 8,000 square feet inside and 4,000 square feet outside. Prime location, really strong revenue, has a modern build-out. And if you consider rent for 12,000 square feet, it's really not that bad. It's literally a half block off the main drag in a very prominent location.

Andy: Is this outside 4,000 square feet usable year-round or not?

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Patrick: Usable year-round. Yes, in a very warm area. It's your own little patio. It's usable unless it's raining outside.

Andy: All right, this is not in Bakersfield. We're talking more like Laguna Niguel or…?

Patrick: Let's say, yes, it's in a prime, good city location. Okay. So what do you think, Andy? Is this, do you value close to $5 million in revenue even though it's losing money?

Andy: I want to reverse calculate this a little bit. Our Restaurant One, "The Money Maker," we were justifying that it is, pretty much, we would say a realistic asking price at $750,000, okay, which is about 40% of revenue. Whereas this one, at $4.8 million and asking price of $450,000, the asking price is about 9% of revenue. So that in and of itself can be like, "Oh man, this is an opportunity here. I'm buying all this revenue." I want to say, once again, buyer beware. This is a very large space. This could be a money pit unless you are equipped or an equipped restaurant group to take this over, right away, hit the ground running with your team and streamline what probably is a restaurant that is not necessarily being run the way it should be run with managing labor and costs.

Patrick: Yeah. I guess I look at it differently. Like I'm looking at, like there's $5 million of revenue in there. As long as that's not decreasing as I'm buying it, let's say it's pretty steady. I come in there for every 1% of decrease in costs, I can save a lot of money.

Andy: Good point.

Patrick: And I see $4.8 million if I can get even 10% of that to the bottom line.

Andy: Wow.

Patrick: What, more than what Restaurant Number One had, right? I'd like to believe that, you know, my skills are pretty legit and I can get more than 10% to the bottom line, and I feel like there's a higher ceiling with this restaurant. And

there's probably some issue with labor, cost of goods, things that are just really low-hanging fruit that I bet you can fix fairly quick.

Andy: That's right. Okay. I think you have absolutely nailed that. You preached a different case, a different path, and you're right on with it. If you go in confident on this, you're right. You can hit the ground running with nearly $5 million in revenue. And if you tighten things up, your bottom line is going to look a whole heck of a lot better.

Patrick: Yeah.

Andy: The rent level doesn't scare you even with a big place?

Patrick: I mean, what does that work out to on a square foot basis?

Andy: How big is this square footage? Are you, you're counting the outside?

Patrick: Yeah, I mean, you know, like, if you're doing 28,000 divided by…

Andy: $2.8 a square foot?

Patrick: To be in a prime location like…

Andy: I think I still have PTSD and a lot of restaurateurs have PTSD from the pandemic. I really do. I think so many people's attention have gone towards smaller, more manageable places that can really pivot better, make adjustments better with a small space rather than a really massive space like this. But to your point, Patrick, the potential here for large profits is really, really, really amazing. So maybe you have a rainy-day slush fund too.

Patrick: Yeah.

Andy: From all those profits you're taking.

Patrick: I guess I would be more concerned if, like, historically speaking, the revenue was in the $2 million range, $3 million.

Andy: Good point.

Patrick: You know, it's showing that it's doing the revenue. That's not the issue. It's the operations, right? It's at a loss. And so the rent makes sense for the revenue. It's all relative, right? So, you know, there's no problem there. It's what's happening internally. I believe as that's that's what I'm seeing. Obviously, you need to dig in deeper, everybody, figure out what's really going.

Andy: Sounds like at this age and your point in your career, you have some bigger cojones than I do at this point to take these risks. I want to point out that you and I both have similar listings in the greater Sacramento area that have some similarities. And one of those similarities is the size of each of these places, the indoor/outdoor aspect, and so on. And although both of our listings, I believe, are not profitable, I think there is value in how you marketed your listing because of the revenue and, you know, of course, the leasehold improvements and so on. And I think I put more weight on the design factor, leasehold improvements, and a low lease rate on my listing. So there's pros and cons to all of these opportunities.

Patrick: Let me ask you one more question about this. Is there goodwill in an asset sale that's doing $5 million but losing money? Is there goodwill in just having that revenue walk through the door?

Andy: 100%.

Patrick: Great.

Andy: 100%. You've patted me on the back for my residual goodwill term in the past. There is a ton of residual goodwill. If you can hit the ground running, those people are still going to come to your front door, sit in a seat, and that's when you need to hook them. And that's where you build from that point on. You build on that goodwill. You didn't close down for three months, six months, a year to redesign it and so on. That goodwill goes out the window. If you can hit the ground running, that revenue is captured.

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Patrick: Great. All right, we're going to move on to the next. I've got what I'm calling the Hidden Gem.

Andy: Well, that's a little- you're alluding to this being a very positive opportunity already, Patrick.

Patrick: You know, the Hidden Gem, right? So, this business has been in operation for more than 50 years.

Andy: Okay.

Patrick: As a very loyal, regular following. The equipment is aging. The place may need a little bit of a TLC situation.

Andy: Yeah.

Patrick: The owners are retiring because they've been owning it for way too long. It's doing $2 million in revenue. It's breaking even, and the rent is at $8,000, and it's for sale for $200,000.

Andy: Got it. This is an interesting one. How much value do you allocate to goodwill on your purchase price on this one? You may be putting a lot more value on the goodwill itself because it's such a long-established business. Be cautious of an old space, old equipment. TLC is not always just TLC. When you pull back a wall or do something, you may have to pull permits to do things. You may have to go to city planning, zoning, which could close you down for a long time or cause a lot of hidden expenses. So there's some surprises potentially in this transaction. But to be honest, I think I might go for something like this. I might go for something like this. I'm not offering $200k on it.

Patrick: Okay.

Andy: I think if I got in that 150 to 170 range, I'd feel a lot better about it.

Patrick: Okay. And so you are placing some value on goodwill even though it's breaking even, but that it's been in business for 50 years.

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Andy: 50 years. You can't shake a stick at that, you know?

Patrick: Yeah. And I mean, like, what I would look at is if it's been in business for 50 years, I mean, it's gone through some significant ups and downs throughout the years, right? Like, that's like the 80s recession and the dot-com, you know, period and the 2008 period and then the pandemic. It's made it through. So there's people that have been living on this business for over 50 years.

So there's there's something in that even if it's breaking even right now. What I would suggest is reason why it's breaking even is, you know, there's retiring owners. They probably haven't kept up with pricing. They probably haven't modernized at all. There's probably kind of like a lax, like, the thing isn't broke, so like, let's not fix it.

Andy: Why fix it? There you go.

Patrick: Exactly. Yeah.

Andy: Yeah. You know, and another thing to point out with owners that have owned something for decades or this long, we talk about a break-even cash flow, but they've made it work decade after decade, year after year. And I would bet that they are running a significant amount of personal expenses to help manage their lifestyle through the business. Of course, we try to extract that and add that to seller discretionary earnings is what we would advertise. But I think there for something this longstanding, they've made it work. So I bet they've set themselves up for success financially by running certain things through the business that are not always rolled into the value.

Patrick: I agree with you. All right, so we're going to move right on here. I got a couple questions for you and you're going to let me know if it's a deal killer or negotiable. So you're looking at a business and the seller lacks clean financial records.

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Andy: You got to steer clear. Now, now, the only time I would say that those are less relevant if you are going to close down and open up your own concept and you're just in love with the location.

Patrick: Okay.

Andy: Okay? That might be a time to be like, yeah, I can look, turn the cheek from these poor records.

Patrick: If the seller lacks clean records, is there a way to try and cross-reference and confirm what the revenue is?

Andy: Yeah, 100%. If they're willing to do it, you know, we want to talk about checking their payments for on sales tax to confirm revenue. If they say, I do cash draws or occasionally I do this or that and take money out of the business, we need to see that on their bank statements to cross-reference that with tax returns and P&Ls. There's some reverse engineering on that you can do. I think that's more important if you're buying the concept, the goodwill, you're buying a going concern.

Patrick: Yeah, it's different, right? If it's an asset sale versus a going concern. All right, let's you're the seller and you're selling a business, and the landlord refuses to give you a full release of liability on the lease.

Andy: Yeah. You know, that could be a tough one. The most important part of that is who is your buyer? Is it a vetted, experienced, strong buyer? Oftentimes better, more financial strength than yourself. That would be something that I may be willing to stay on as a backup guarantor. I want to make sure that my lease liability as a backup guarantor or co-guarantor of the assigned lease, it terminates at the end of any given term. So oftentimes that can be a year, a couple years left on a given term. If it's, you know, 10 years left and you're on the hook with this tenant as a guarantor of the lease, I would probably not go for that. There has to be an end to it.

Patrick: Uh, business depends entirely on the chef.

Ep #64: I'd Buy That for a Dollar: Which Restaurant Deals Are Worth It?

Andy: Yeah, that's a no for me. That's a no. Unless I'm a star too and I have my own concept coming in and I can start from scratch, don't do it.

Patrick: All right. And then I have one last question for you. Let's say you're looking at a space and the revenue is strong, but the profitability has declined over the last three years.

Andy: That's really hard. Is that due to rising costs? Is that due to poor management, mismanagement, not keeping up with inflation on menu pricing? Those are some things that are fixable. If the reason the bottom line is declining is because of hard costs or non-controllables, it may be an opportunity that's not worth pursuing.

Patrick: All right. Great. Well, those are my questions for you.

Thank you all for listening to this week's episode of *Restaurant Deal Making EXPOSED!* If you're considering selling your business and would like a free consultation, reach out to patrickAndAndy@therestaurantsalesbroker.com or visit TheRestaurantSalesBroker.com to learn more.