Getting to the Meat of Restaurant Valuations

Americans love to eat out. According to Dun & Bradstreet, the U.S. restaurant industry includes about 630,000 restaurants with combined annual revenues of about $540 billion. With U.S. consumer spending on services on the rise, average gas prices at a reasonable level, and tourism spending for food increasing, the industry has reason to be optimistic about growth.

However, even in the best of times, restaurants — both full service and quick service — face unique operating challenges. Health issues such as food contamination (like what occurred at Chipotle Mexican Grill restaurants) can cause immediate and long-term damage to a restaurant's reputation. And competitive concerns, such as growing food delivery options, can keep customers at home.

Restaurant Value Drivers

For restaurants, valuation analysts typically assess a range of value drivers, including the following:

Location: The site of the restaurant usually has a big impact on its success. Accessibility from a major thruway, for example, can make or break a quick-service restaurant. On the other hand, a more bucolic setting might add value to a "special occasion" restaurant where ambiance is prized. In all cases, the old "location, location, location" adage applies to restaurants.

Product: Organic and locally sourced ingredients seem to be a trend that's here to stay, while specific serving styles — remember the grill-your-own-steak idea? — are waning. In terms of value, a unique product offering can be a plus or a minus depending on current tastes, while reliability of food and service are evergreen in terms of adding value.

Labor: As with many industries that rely on relatively inexpensive labor, finding good staff can be a challenge for many restaurants, particularly in a fast-casual or quick-service environment. A ready labor pool is key to value.

Equipment: What's in the kitchen? Brick ovens for pizza or bread? A fire-pit rotisserie for meat? Special equipment can add value, depending on what a new owner has in mind. However, an up-to-date, clean kitchen always boosts value by reflecting a well-managed establishment and a commitment to food safety.

Technology: Restauranteurs today have access to sophisticated technology to expedite orders and keep costs in line. For example, mobile and online ordering systems are common in many urban areas. Point-of-sale systems can help manage inventory, accounting and labor costs, while beverage control systems can control liquor costs.

If a restaurant has invested in this type of technology, its owners are usually interested in maximizing profits — a value plus.

Margin: Rent is often a significant expense for restaurants, so lease terms are important in a valuation. Also, ingredient costs can vary widely and sometimes seasonally. Poor weather can affect produce — were you aware of the West Coast salad shortage of early 2017? — and supply chain problems can wreak havoc on menus.

Some restaurants can adjust prices accordingly while others have to "eat" the lost profits. The better a restaurant can control costs, the higher its value.

Cash Is King

It almost goes without saying that cash flow is extremely important for restaurants. Acquirers are looking for a restaurant with stable cash flow and above-average sales. How the restaurant performs relative to industry norms will tell a valuation analyst a lot.

Seeking a restaurant valuation? Ask our team to share their expertise.

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IVSC Issues Final Valuation Standards

The International Valuation Standards Council (IVSC) recently released the final version of its valuation standards. Known as IVS 2017, the standards went into effect in July. They are intended to serve as "the key guidance for valuation professionals globally, and will underpin consistency, transparency and confidence in valuations which are key to investment decisions as well as financial reporting," according to the IVSC.

The new standards incorporate input from more than 100 stakeholders, including valuation professional organizations, individual valuation professionals and academics. The standards include five general standards and six asset standards.

The general standards set requirements for conducting valuation assignments, including establishing the terms of a valuation engagement, bases of value, valuation approaches and methods, and reporting.

The asset standards cover specific types of assets, including background information on the characteristics of each asset type that influence value. These standards also outline additional asset-specific requirements regarding common valuation approaches and methods used.

The IVSC has also created a new Standards Review Board that will weigh in on standards going forward. The goal of this action is to continually evolve the standards as needed rather than issuing completely revised standards every few years. Two board subgroups will focus on specific valuation concerns: tangible assets (covering personal property, real estate, plants and machinery) and business valuation.

It is the IVSC's goal to foster universal use of IVS 2017 for the global economy. To that end, the IVSC has signed a memorandum of cooperation with the Singapore-based World Association of Valuation Organisations (WAVO) to promote adoption. It has also worked with the U.S.-based Appraisal Foundation to connect IVS to the Uniform Standards of Professional Appraisal Practice (USPAP).