



**S**ell my restaurant? Are you joking? I thought this magazine was about starting and growing a restaurant business, not cashing out. Anyway, I'm too young to think about retiring.

No one is asking you to get out of the business as soon as you get into it; however, unless you started your restaurant simply to create a job for yourself and perhaps your family, your ultimate goal is to build an asset that you can turn around for a neat profit some time down the road. Even if selling your business is something you won't even consider for years, it is never too early to prepare your business for the eventuality, at which time you get top dollar for your investment of money, sweat and time. If you are considering selling your restaurant in the short term — perhaps you want to take advantage of the market, move onto another enterprise, or maybe it's just time to smell the roses — we hope the following information hits on the key issues that will help ease you through the process without disappointment or a stomach ulcer.

Buying and selling a business is among the most complex transactions in which most of us will ever engage. You only become really savvy and confident through repetition.

The first-timer (and very likely one-timer) has to be especially careful. Consider these 10 steps a checklist to help keep you focused. As noted, you will not be alone in this process, and you should be able to bank on your team of advisers and counselors to protect your financial and legal interests.

### **Step 1: Know Why You are Selling and Be Honest With the Buyer**

Restaurant owners can save themselves a great deal of time, money and frustration by thinking about the sale of their business before deciding whether to sell. Why do you want to sell now? Know why you are selling the restaurant. What is your reason for exiting the business? Is this a planned sale of a good business and

# Selling Out

## 10 Steps to a Successful Sale of Your Restaurant Business

By Jay Goldstein

time to move on or cash out, or is this a necessary sale of a failing business and you want to stop the bleeding and salvage what you can? When considering a planned sale, your motivation may be to retire or move to another city. Maybe you are tired of the day-to-day business demands, you own the building and the real estate market has reached its peak and you want to take advantage of this, or some other personal reason. If you are selling to escape a failing business the reasons are pretty obvious. You no longer want to finance the losses and you want to preserve any value the business may hold.

Knowing clearly why you want to sell will help you with a number of decisions. It also prepares your answer for potential buyers when they ask the inevitable question, "Why are you selling the business?" They will be curious as to why you are selling and they may believe that uncovering that answer will influence the final selling price. While your reasons for selling are ultimately your own business, do not be dishonest about your intentions, such as telling a prospective buyer that you're selling so you can retire when, in reality, you need to get out because the business is hemorrhaging cash

on a weekly basis. A savvy buyer and its team will look at the numbers and know the truth, and you will have lost both leverage and credibility with nothing to show for it. The less prepared you appear, the lower the final price will be. Conversely, the more confident and well prepared you are, the higher the final price may be.

It takes time to prepare for a successful sale and now is the time to get started down that path. Doing your own due diligence before you put the restaurant on the market for sale is what any potential buyer will certainly do as they investigate the purchase of the business. You will want to have everything in order so that you can answer any question or issue on his list. This list can include things like past or ongoing lawsuits, and specifics on financial and sales performance.

### Step 2: Know What Results You Want

What are your goals for exiting the business? How much do you want, or how much do you need to get out of the business to make a sale worthwhile? What is the best way to meet those objectives? Be realistic with your expectations. Are you selling one restaurant, a local

chain, or a number of restaurants? What level of income has the business provided for you and what will it take to replace that income? These are some of the questions you need to answer to complete the picture for yourself, any partners, and your family.

Another point to consider is how much money you will actually put in your pocket at the close of the sale. You should realize that the “net proceeds” of the sale are typically much different from

the “selling price.” For example, if you are able to sell your restaurant for \$1 million you may leave the table with only \$750,000, with \$250,000 (25 percent) going to cover the expenses incurred during the due diligence process, broker’s fees, and other costs associated with the sale, such as final payroll expenses, payroll taxes due, sales taxes due, alcoholic beverage sales taxes due, final accounts payable and other vendor obligations.

It is imperative to know whether you can achieve your goal. To make this determination you will perform an analysis that calculates your expected sales price minus all anticipated associated costs, and then compare the result with your goal. It is always wise to be on the conservative side and factor in a slightly lower selling price and slightly higher associated costs to be safe at the end of the analysis.

Dallas restaurateur Jim Baron says that when considering what you want from the sale it is best to detach emotionally. Emotions can lead to nowhere but trouble for you and the sale of the restaurant. There could be a significant difference between what you think the business is worth and the fair market value. Do not confuse the two or you will set yourself up for disappointment. Look at the business from the point of view of the purchaser. How novel is the concept? Is it simple and replicable? Is there potential for growth? The true value of anything is what the market or a purchaser will pay for it. Attempt to understand the buyer’s objectives and work toward meeting both his needs and yours.

### Step 3: Get Your Business in the Best Shape Possible

You must be willing to invest in order to maximize the proceeds of a sale. It will take both time and money to properly prepare. Investing in the right things in the sale to put your “best foot forward” will ultimately produce the best result. Seek to be one step ahead with the right materials and answers throughout the due diligence process that any serious buyer will conduct. Also, understand and expect that any “skeletons in the closet” will come out during this process and be prepared to address them with clear, honest answers. You will most likely need the following documents and information at hand to be able to satisfy the questions of the buyer and his representatives:

**A simple business plan.** This outlines the purpose of the business, the position of the business, the management plan, marketing plan, financial projections, capital budget, and operating plan. This gives the buyer a basic understanding of the business and the potential for today and for the future. It also provides the buyer with a point of beginning and a roadmap to the future. Be clear and concise. Do not embellish. Rather, be realis-

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tic and honest, with a bit of optimism.

**Audited financial statements.** These verify the numbers and the operating results and eliminate any suspicion or debate. It is recommended to present at least three years of audited financials. The audit should be performed by a third party with a solid reputation in this field. By doing this you help avoid any potential misrepresentations or errors and you help build the confidence of the buyer regarding his investment. This also documents “normal” business expenses. Audited financials will disclose sales, profits, cost of goods sold, direct operating expenses, occupancy costs, and indirect costs such as any owner’s extras.

**Operating manuals.** These are well-written documented manuals that are the “how-to’s” for the operations and management of the restaurant, and should include three main categories:

- ✓ **People management.** These include staff selection guidelines, interview checklists, general employee handbooks, training schedules, department manuals, staff tests, job descriptions, evaluation process, discipline action forms, termination forms, exit interview forms and a management training program.
- ✓ **Product management.** These include a master recipe book, purchase order system, inventory system, ordering guide, station diagrams, item portion list, recipe references, product preparation list, daily production guide, and approved purveyor list.
- ✓ **Management policies and procedures.** These include management job descriptions, operating policies and procedures, rules and regulations, opening and closing checklists, daily, weekly and monthly accounting and reporting system recommendations, master labor schedules, weekly meeting agendas, management development, incentive bonus structure, and unit evaluation program.

These materials provide a solid foundation for continued operations and business practices so that the buyer can step right in and not miss a beat. It also sets up the management and staff for a smooth transition, as they will know what is expected and how to meet expectations. This should help retain management and staff, lowering costly turnover, and creating continuity for the guests. A well-trained loyal staff will

typically be a robust part of the reason for comp guest count and sales gains.

**A well-negotiated lease with options.** Before entering into negotiations with a prospective buyer, you should know the status of your lease. How much time is left in the lease term? Is there an option to renew? Does the lease allow an assignment without the landlord’s consent (or is the landlord prohibited from “unreasonably withholding” consent), a sublease, or early termination (and if so, are there penalties for so doing)? If you do not have these rights, then a prospective buyer will likely be forced to purchase the entire business entity from the owner (a “stock” or “entity” purchase) to prevent a breach of the lease. Though this is not necessarily a bad thing, as will be discussed in a later section, it is always good to have options. To try and sell a restaurant that has only a few years left on the lease is foolhardy. For example, if you sell your restaurant at three times earnings, that means that the new owner will theoretically recoup his investment in three years. If there are only four years or less on the lease he really has no chance to realize respectable gains on his investment. Let your landlord know what you are doing and your goals. Involve them in the process as a partner and you will more often than not find them willing to work with you. It is in their own best interest to ensure a seamless transition and to have a well-qualified buyer occupy the space. At the very least you should have five to seven years left on the existing lease and a five-year option. If the buyer wants something longer term than that they can negotiate with the landlord directly.

**A physical inspection and report.** This should include recommendations that will show the buyer the condition of the building and equipment, making it easier for him to evaluate the property. You can then address any issues or take these issues into consideration when pricing the sale. A “Repair and Maintenance Log” also goes a long way to convey the history of the property to the buyer. He can readily see what has been done to keep the operation in good condition. This log should include a list of approved repair services with contact information.

**A new ‘coat of paint.’** Just as you would prepare your home for sale, you want to do the same for your restaurant. Focus on the obvious things that a guest would see like landscaping,

signage, exterior lighting, condition of the parking lot, floors, walls, ceiling and lighting.

**Positive comp sales and comp guest counts.** While it may not be possible to provide these, positive trends on guest counts and sales are invaluable in driving the value of your business. It shows the strength of the concept, the growing status of the name and brand, and a continued relevance in the market.

**A guest database.** If possible, try to give the buyer the immediate ability to connect with the existing guest base and continue the “conversation” with them. If you have a “loyalty program” already established, the buyer will have another avenue to continue that “conversation” and keep the guest engaged.

## Step 4: Establish Your Selling Price

Ultimately, the selling price of the business will be based on a multiple of earnings and you will have verified those stated earnings in your audited financials. Business valuations are done based on a number of different metrics. The most common valuation method is a combination of a multiple of earnings plus the value of the assets. Assets will include all hard assets that go with the business and will include FF&E (furniture, fixtures and equipment), point-of-sale systems and computers, the phone system, any audio/video equipment, liquor licenses in certain states, counties or cities, and existing inventories. Tim Clark of Ryan’s Realtors and Business Brokers in Houston, says the range of multiples is between two times and four times earnings. Although you may find some businesses sold at higher or lower multiples, it is rare. Generally the smaller the restaurant, the lower the sales, and the more limited the growth opportunities, the lower the multiple will be. The higher multiples are paid for larger businesses with higher sales and an opportunity for significant growth.

## Step 5: Build Your Team

Who should be on your team and what should they do for you and the selling process? Support from these folks can help make the selling process more seamless.

**Landlord:** To provide a well-documented lease with good terms, assignment of the lease, approval of the purchasing

party, and any building repairs or upgrades that may be necessary.

**Broker:** To arrange for the appraiser, assist in determining the value of the business and the selling price, solicit potential buyers, initially qualify interested parties, guide you in the sales process, inform you of the sales process, assist in the negotiation process, and coordinate with other team members to ensure a smooth and successful closing process.

**Attorney:** To write the initial “letter of intent,” write required contracts to best achieve your goals and protect your interests, review the restaurant’s lease, contracts (supplies, marketing, employment) and assets (equipment, inventory, trademarks, Web sites, trade name), and advise on a number of other issues.

**CPA:** To audit the financials, prepare necessary reports, advise on tax implications and considerations, help perform the analysis for achieving your goals, advice on where to place your “net proceeds,” and at times deal with the buyer as your representative.

**Industry consultant:** To provide industry-specific knowledge as it relates to the restaurant and site, review the operating

systems and any related materials, provide a gap analysis and take appropriate action.

**Appraiser:** To provide a third-party assessment of the value of the assets and the business.

A prudent owner/seller will get his team in place as early in the process as possible. If the restaurant’s corporate records aren’t up to date, an attorney should update them before the business goes up for sale. If the restaurant does not have financial statements, or if they are incomplete, then your CPA should create them and, of course, they should conform to “generally accepted accounting principles” (GAAP). This is an absolutely critical step. We recommend that if you do not have any of these partners on your team that you conduct at least two interviews for each position and that you become very comfortable with your choices. They will become a part of your reputation so choose wisely.

## Step 6: Understand the Legal Issues

The “structure” of the sale is the most im-

portant consideration for you as the seller. While there are various transfer vehicles available, all with differing tax consequences, the most common are the “stock” sale (as noted above, this is also called an “entity” sale) and the “asset” sale. In a stock or entity sale you would transfer the restaurant entity (i.e., its corporation or LLC shares) to the buyer, while in an asset sale the seller retains ownership of the company and transfers the restaurant’s assets to the buyer.

The main distinction between the two types, and the one of utmost importance to you, is that in a stock sale the entire entity is transferred to the buyer, including its liabilities. In short, the buyer steps into the shoes of the seller as owner. In an asset sale, liabilities do not go with the assets when they, alone, are sold. As a seller, you will almost always want a stock sale. Conversely, buyers will almost always want an asset sale, as they seek to avoid taking the seller’s liabilities and want to “step up” the tax basis of the assets purchased, thereby allowing for greater depreciation/amor-

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tization and a smaller gain (or greater loss) if the assets are later sold.

Why, you may ask, would a buyer ever agree to a stock sale? Simply put, the buyer may have no choice. If, as mentioned above, the lease (or other significant contract) prohibits an assignment to another party, the buyer will have to purchase the entire restaurant entity to avoid breaching the contract.

### Step 7: Get a Handle on the Tax Issues

From a tax standpoint, if your company is an LLC or partnership there could be mixed items of ordinary income and capital gains in the sale. Moreover, certain transactions may qualify as “tax free” transactions, but those are only available to certain entities under certain circumstances. Needless to say, the structure of the deal can have ramifications far beyond the mere purchase price. Working closely with your CPA and your tax attorney you will be in a solid position to best select the most advantageous strategy for you and your interests.

### Step 8: Cover Your Assets

Early in the process of evaluating a possible sale you should determine whether you will be forced, by the terms of your lease, to remain liable on the contract in the event the lease is assigned or sublet. If this appears to be the case, you might attempt to negotiate that provision away with the landlord prior to the consummation of the sale. If this cannot be gained from the landlord, consider this suggestion from Jim Baron: “Create an escrow account to cover the lease liability you retain.” If you create an escrow account that the buyer funds to ensure payment of the lease you will be protected in the event the buyer vacates the property. If over the course of time the buyer shows a record of timely lease payments, the escrow account can be dissolved and the money goes back to the buyer. You may consider a two-year time frame sufficient for this account.

If, on the other hand, you are fortunate enough to own the real estate on which the restaurant sits, you will want to evaluate whether it is in your best interest to retain the property and lease it to the buyer, or whether you wish to sell the property outright. Either of these transactions should be negotiated and drafted by a real estate attorney, and properly integrated into the sale of the restaurant itself.

One scenario includes selling the business, leasing the property, and providing the buyer an option to purchase the property that must be exercised within a given time frame.

**Representations and warranties.** One trade-off you can make in a stock sale to keep the buyer from running away in favor of an asset sale is to provide an indemnity for any liabilities the buyer incurs due to a breach of the representations and warranties contained in the sale contract. (In fact, if the buyer’s attorney is worth his salt, he will probably demand this in the purchase agreement.)

Representations and warranties are statements about the business that are true as of the closing of the sale. An example of a representation might be, “The company is not aware of any pending or threatened lawsuit against it.” All is not lost, however, even if there is a pending or threatened suit, as you could word the representation as “The company is not aware of any pending or threatened lawsuit against it, except as disclosed on Schedule 1.” Schedule 1, of course, would disclose the existence of the threat or action against the company, and you would not have breached the representation or warranty, because it would remain true, though it might affect your sale price.

While the buyer will likely request that you agree to indemnify it for all presale liabilities, that would cause you to effectively lose the benefits of a stock sale and take the burdens of an asset sale. You should, instead, agree to the type of indemnity mentioned above, but negotiate a reasonable period of time your representations and warranties survive the closing of the sale, typically two to three years. Without such a provision you could be on the hook to the buyer indefinitely.

**Noncompete and consulting agreements.** As the parties look beyond closing, the buyer likely will attempt to bind you to a noncompete agreement. This makes sense, logically, since the buyer will not want you opening a restaurant across the street from its new acquisition (and taking your old customers with you).

There are a few important factors to remember when negotiating the terms of such an agreement. First, the noncompete should contain reasonable limitations as to time and geography. As for time, two to three years is likely a fair amount to be restrained from competition, though this is typically case-spe-

cific. As for geography, if the restaurant you are selling is in Dallas, you should not agree to a noncompete that prevents you from competing anywhere in Texas. Instead, it should be specific to the restaurant sold, i.e., within 25/50/100 miles. Of course, if the sale involves multiple units, the noncompete would be correspondingly broad. Remember, too, that you should be paid for executing such an agreement. It is, in effect, a restraint of trade.

Again, a consulting agreement often accompanies a noncompete. Such a scenario can both prevent you from competing with your former company and also provide a buyer the means by which it can use your knowledge and experience with the restaurant. Conversely, a consulting agreement can provide you with post-closing income, often for the promise to be available for a certain number of hours a month upon reasonable request by the buyer. Whatever the agreement, it should be for a definite term.

The amount you receive for either a noncompete or consulting agreement should be listed in the transaction documents, as it will almost always be treated as ordinary income to you, and you will pay income tax on it.

## Step 9: Negotiate

When approached by a prospective buyer, you should insist on a nonbinding letter of intent (LOI), which sets forth the major points of the proposed sale. Outlining basic terms can both streamline negotiations and bring the buyer psychologically closer to closing the deal. Moreover, an important part of the LOI should be a confidentiality provision aimed at preventing the prospective buyer from using your internal information against you should the sale fail to close (remember, if the buyer is not already a competitor, it will likely become one if it purchases a different restaurant nearby). Finally, the LOI is an important tool in allowing you time to conduct due diligence into the prospective buyer, a must if the buyer will be funding some, or all, of the purchase price with a promissory note. The best scenario is typically a cash sale, meaning that upon execution of the contract the buyer pays you in total at closing time. This eliminates the risk of "accounts receivable" and the problems that may accompany. If in fact you choose to finance some of the sale price you should factor in a reasonable interest rate since, in effect, you

are loaning the buyer these funds. Important: The LOI should be carefully drafted to ensure that it will not be construed as a binding agreement.

## Step 10: Communicate

It gets down to who to tell, when to tell and what to tell. It is generally agreed that the fewer people who know the better. Be sure to reinforce with your team that confidentiality is paramount (although you should not have to have this discussion with your attorney). When a potential buyer is "kicking the tires" it should be done with a high degree of discretion. You will want to instruct the buyer and his team regarding their conduct in the restaurant/s during the entire due diligence process. Imagine how disruptive it would be to have someone walk into the restaurant and "announce" that they are the new owners before a deal is ever done. If this were to happen, management and staff will almost always assume the worst and could begin leaving.

If in fact word does end up getting out, it is best to take an aggressive position and let everyone in the business know what is going on so that they don't have to assume or make up their own stories. You should let them know why you are selling, how you see it affecting them, what you are doing to actively ensure the continuity of the ongoing operations, and what you are doing to qualify the new buyer. They should feel comfortable that you have considered them and have their best interests at heart.

## It's Sold, but Have You Bought Into the Idea of Selling?

Something the business and legal textbooks fail to address is the psychological effect of selling your business. You need to consider this and prepare for the event mentally, years before it happens. It's easy to say, "once you have successfully completed the sale of your restaurant business it is time to detach and move on." In fact, this can be a difficult process since you have invested so much into building that business, but it is nonetheless important that you understand you have achieved your goal and you are finished with that chapter of your life. You have earned it and you should enjoy the next chapter. If you created a satisfying occupation and w

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