FRANCHISE VALUE: *POST-COVID*

Steve Mize, ASA & Partner

GCF

Business Valuation

One year later . . . and the small business acquisition market has changed significantly. COVID has impacted most businesses, positively or negatively. As a valuation firm, we are constantly being asked how COVID has impacted business values. Our response is not so simple, but let me try to explain:

Basic Valuation Methodology

In basic terms, you value a company with two variables, **(1) cash flow** to the owner (dividends to the investor), and **(2) a required rate of return based on the risk of that investment.** In small businesses, it is usually the seller's discretionary earnings (SDE) multiplied by a "multiplier" (inverse of a % rate of return).

For example:
$250,000 of SDE x 3 = $750,000 in value.

Does Covid Impact this Multiplier?

In most cases, the rate of return (multiple) has not changed much post-COVID. We looked at multiples for various industries pre and post-COVID and most have only changed minimally. For instance, when we search PeerComps for ALL franchises sold in 2019 (pre-COVID) vs 2021 (post-COVID), the multiple of SDE were as follows:

2019 = 2.89x (138 comps)
2020 = 2.94 (64 comps)
2021 = 3.01 (8 comps)

We only have a few months of data for 2021, but you can see multiples of SDE have increased slightly. We can assume that required rates of return are not being significantly impacted by COVID. What HAS changed is the other variable...cash flow.

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Cash Flow and 2020

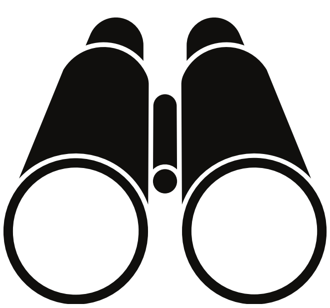
For most, values have declined post COVID primarily due to lower revenues/cash flow. In the example above, the $250,000 may have been steady for the last few years until COVID…and then maybe they have or have not recovered. If the business has not recovered, is it reasonable to still use $250,000 as the "base year" cash flow? Or would you lower it by giving some weight to 2020?

Current Value Approach

The two questions we are asking business owners:

(1) Has COVID impacted your business (positively or negatively), and if so:

(2) Have revenues/cash flow returned to normal?



LET'S TAKE A LOOK AT

2 SCENARIOS:

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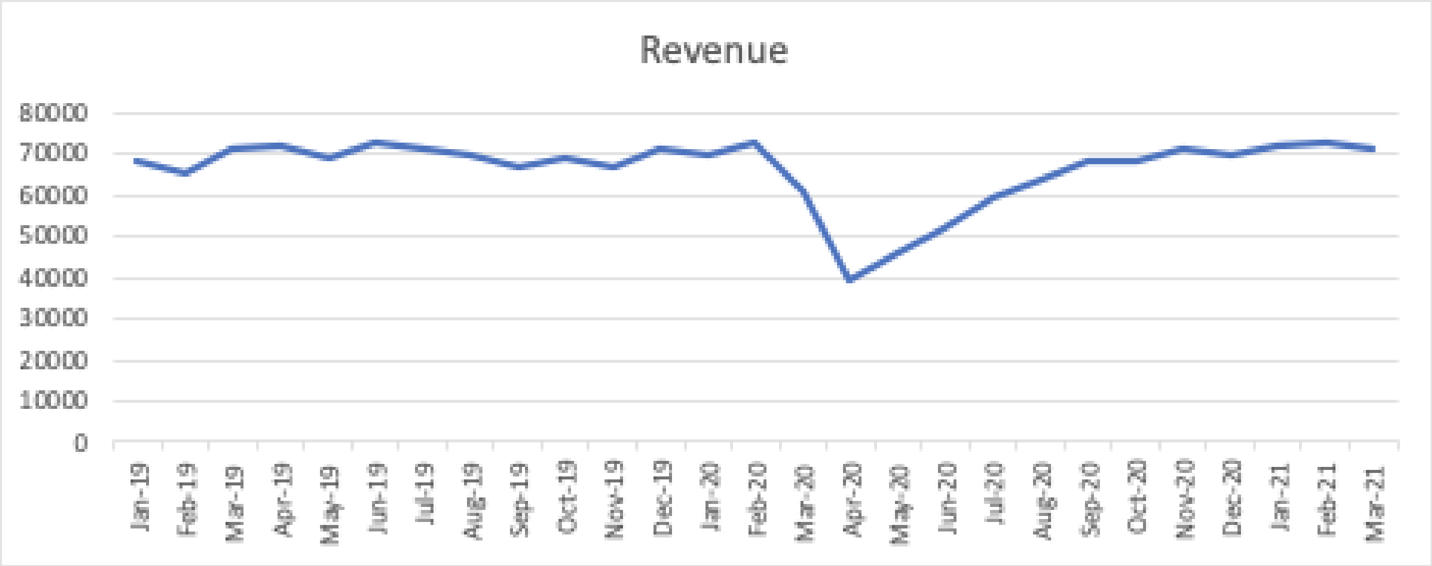
1

A franchise restaurant was impacted by COVID but has returned to normal. In this case, we would review 24-30 months of sales data to see when COVID impacted the business and what months the trend started to normalize.

See below:



As shown above, monthly revenue was clearly impacted by COVID in March, April, and May, but consistently trended upward until normalization in November of 2020. The last 6 months were equal or better than the average sales for 2019. In this case, we would simply throw out 2020 and focus on 2019 or projected 2021.

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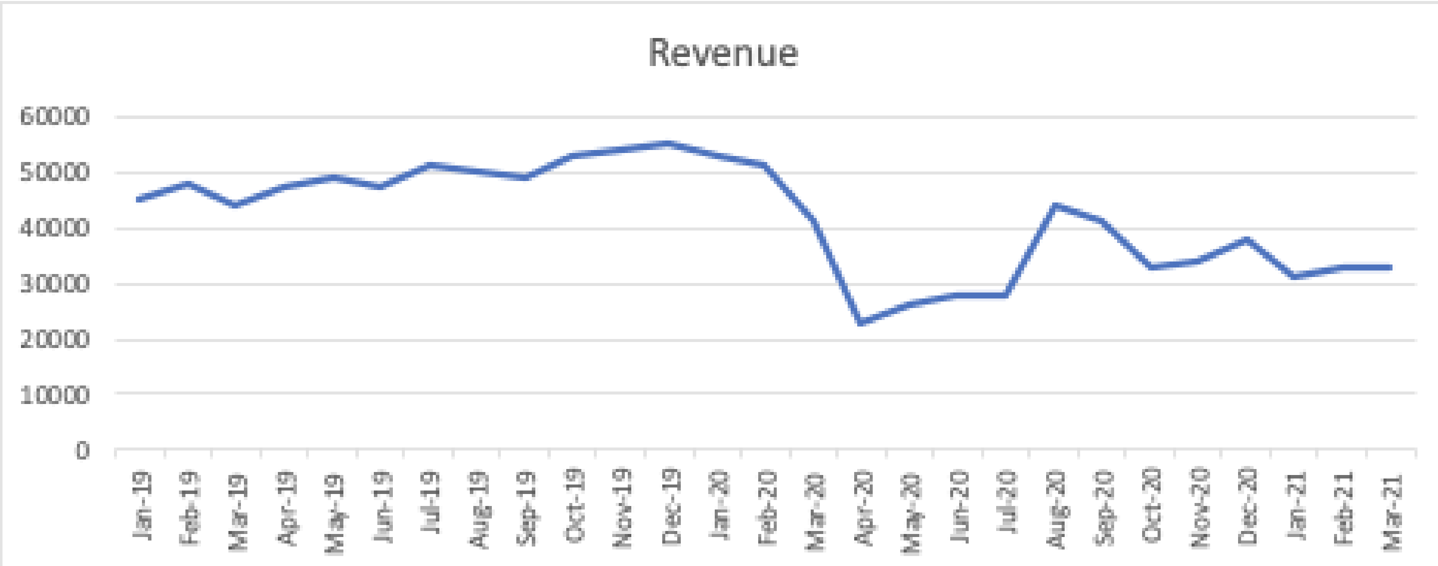
2

A franchise "Massage" unit was impacted by COVID but has NOT returned to normal. In this case, city restrictions were "on-again / off-again", which impacted sales. Monthly sales look like the following:



As shown above, monthly revenue was impacted in March with limited recovery. Monthly revenues for the last 6 months (through March 2021) have been varied but do not show any significant improvement to 2019 levels. In this case, we cannot ignore 2020 or 2021. We would most likely have to use a "forward-looking" valuation model called the Discounted Future Cash Flow Approach.

In Summary:

COVID has created some complexities in valuing small businesses. Gone are the days of weighting historical performance and using a reasonable "cap rate" or multiple. However, do not make it too complex . . . simply, ask the question, ***has COVID impacted my franchise and if so, has it normalized?***

Feel free to reach out to GCF Valuation to discuss what happens next.