VALUATION OF A PERSONAL SERVICE FRANCHISE IN TODAY'S MARKET

Steve Mize, ASA & Partner

GCF Business Valuation

Last year we wrote an article on how to value a "personal service" franchise. In the original article we discussed some of the concerns being a continued decline in revenue trends for this industry due to competition and overall saturation in the market, but more importantly the reliance on "cash flow".

Fast forward 12 months...

COVID has put an absolute halt on business acquisitions in this segment of the industry. GCF Valued 7 Massage Envy / Hand & Stone / European Wax franchises in 2019 and zero in 2020 or 2021 (for acquisitions). The only valuation that was performed for one of these franchises was for a divorce. Most of these businesses were significantly impacted by COVID with many not return to "normalization" as of the first quarter of 2021.

Tale of Two Years

For the valuation we did on a recent "massage franchise", we actually did the valuation for acquisition in 2019. I've outlined below the "market" approach that was used:

December:	Tax Return 2016	Tax Return 2018	Tax Return 2019	Projected 2020
Seller's Discretionary Earnings	$330,378	$252,311	$266,669	$276,369
Less Replacement Salary	($36,000)	($42,000)	($38,000)	($51,000)
EBITDA	$294,378	$210,311	$228,669	$225,369
as % of Sales	21.06%	14.69%	17.23%	17.40%
Cash Flow Weight	10%	40%	40%	10%
Weighted Revenue	$1,372,753	*100.00%*		100%
Weighted SDE	$268,267	*19.54%*		
Weighted EBITDA	$227,567	*16.58%*		
SDE % By Year	23.6%	17.6%	20.1%	21.3%

Weighted SDE	$268,267
Market Multiple (7 comps)	3.3
Estimated Value	$885,280

Steve Mize, ASA & Partner

The above is an actual calculation of one of the methods used in the valuation. **The value as of January 15, 2020 was $885,000.**

We were asked to "re-value" the business as of February 10, 2021. Due to COVID, 2020 revenue was down to $860,000 (down from $1.3mm in 2019) and unprofitable. Month to month sales is shown below:

Jan-20	$107,678
Feb-20	$109,823
Mar-20	$72,121
Apr-20	$65,456
May-20	$32,980
Jun-20	$39,894
Jul-20	$49,091
Aug-20	$50,235
Sep-20	$62,123
Oct-20	$59,009
Nov-20	$69,998
Dec-20	$71,232
Jan-21	$68,870

As shown above, sales declined significantly in March through July and never really recovered as this region has strict COVID rules and were "on / off" again throughout most of 2020.

So what's the best approach?

The ONLY approach is to project out sales and cash flow until normalization and discount back to the present value. A summarized calculation is shown below:

Year	Forecasted Cash Flow		Present Value Factor (Discount Rate 22.00%)		Present Value of Future Cash Flows
1st Year	($35,479)	x	0.81967	=	($29,081)
2nd Year	$98,902	x	0.67186	=	$66,449
3rd Year	$163,215	x	0.55071	=	$89,884
4th Year	$168,928	x	0.45140	=	$76,254
5th Year	$174,840	x	0.37000	=	$64,691
Terminal Value (a)	$978,159	x	0.37000	=	$361,918
Indicated Value - Public / As If Freely Traded, Controlling Basis					$630,113

(a) Terminal Value = 5th year cash flow x sustainable growth ÷ by cap rate.

In the above example, given restrictions in the area, the first 12 months is projected to be negative "free" cash flow (after officer salary, taxes, etc). We estimated the subject business does not return to "normalcy" until year 3 (2023) with steady growth thereafter. With an after-tax discount rate of 22% and a cap rate of 18.5%, the value calculates to $630,000 - a COVID impairment of $255,000.

In Summary:

The above example would work in the opposite scenario…if a company had a "spike" in revenue/cash flow due to COVID. Historical years may not be the best representation of future performance IF the business has not shown a recovery back to normal cash flows.

To find out more how to value a franchise in today's market, please contact Steve Mize at smize@gvalue.com