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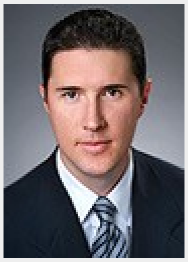
Acquiring Restaurants in Turbulent Times



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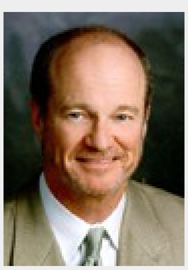

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Our attorneys have worked with over 80 nationally recognized restaurant companies. Based on those experiences we offer these helpful tips.

Investors with liquid financial resources are finding seemingly endless opportunities to acquire businesses and assets at significant discounts to prices seen in recent years. One industry of note that has more than its share of businesses available for sale is the restaurant industry. Whether it is one restaurant or a chain, there are numerous restaurants available for sale across the United States. However, acquisitions can be a trap for the unwary.

In every restaurant acquisition there are a number of due diligence items that must be carefully investigated by the acquirer. Some of these items require even greater scrutiny in a down-cycling economy such as the current economy:

Location, Location, Location: As with real estate, the location of a restaurant will largely dictate its success or failure. This is even more the case in a bad economy. A thorough review of the surrounding location and the clientele during all hours of service should be conducted. The make-up of the surrounding businesses, including expected growth or retraction and proximity of competing restaurants should be taken into account.

Financial Due Diligence: Financial statements and tax returns should be reviewed by an accountant or consultant with experience in the restaurant industry. While current financials will likely show declining operating results, it is important to evaluate whether other non-market related factors are contributing to the decline. There may be opportunities to, for example, eliminate or curb expenses that can provide an immediate boost to the operating results post-acquisition. More importantly, there may be evidence of a declining customer base or brand loyalty that will be more difficult to overcome.

Vendors: A thorough analysis of the restaurant's vendor contracts and relationships should be conducted. It is very likely that invoices owed to existing vendors are long overdue and as a result the relationship has soured. The acquirer may want to specify in the purchase agreement that a portion of the purchase price will be used to pay-off some of these payables. If the purchase price for the restaurant will be insufficient to satisfy the payables, the acquirer will need to consider whether it will be able to mend the relationship sufficiently to ensure adequate coverage of the restaurant's needs post-closing.

Employees: A buyer should also analyze employee and employee benefit costs. A restaurant with high employee turnover, union involvement, wage and hour compliance issues and significant workers compensation insurance and health insurance costs can wreak havoc on the overall profitability of the restaurant.

Liens: A careful search of personal property and real property records should be conducted to determine what liens have been recorded against the property. The acquirer will want these liens removed prior to closing the acquisition.

Ownership of Intellectual Property: Ownership of intellectual property, including brand tradenames, trademarks and recipes is particularly important when buying restaurants from an established chain. The acquirer needs to be sure that it will have continued and uninterrupted use of the intellectual property going forward and will be able to transfer ownership of the intellectual property upon sale to another party. This can often be accomplished by negotiating a franchise agreement or license.

Lease: Assuming the lease is assignable, the acquirer will have the most leverage at the time of acquisition to negotiate an extension or modified terms to the existing lease for the restaurant location with the landlord.

Permits: Permits and licenses, including liquor licenses will need to be transferred or acquired prior to closing.

Inventory: Inventory, particularly liquor and wine inventory, should be carefully counted at the time of entering into the purchase agreement and provision made for required levels to exist at the time of closing the acquisition. Gift certificate programs and other potential "hidden" costs should also be reviewed.

Non-Compete: A determination as to whether immediate competition by the former owners would adversely affect the business should be made. If competition is an issue, a carefully drafted non-competition agreement should be entered into.

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About Allen Matkins

Allen Matkins Leck Gamble Mallory & Natsis LLP is a California law firm with more than 230 attorneys practicing out of seven offices in Los Angeles, Century City, Orange County, Del Mar Heights, San Diego, San Francisco and Walnut Creek. The firm's broad based areas of focus include corporate, real estate, construction, real estate finance, business litigation, employment and labor law, taxation, land use, bankruptcy and creditors' rights, intellectual property and environmental. more...

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