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PRICING THE STORE

A PRIMER ON HOW TO ASSESS THE VALUE OF YOUR STORE

BY ROBERT PRICE

WHAT'S YOUR STORE WORTH?

Determining your store's financial value

RETAILERS are good at pricing products. That's what they do every day. However, pricing the entire store - fixtures and all - requires a more seasoned eye.

Valuations are complex. They involve quantitative analyses of budgets, qualitative analyses of the business, and a whole lot of emotion. And because the only useful valuations are honest valuations, they often require a realistic appraisal of what the business is really worth, not what the owner feels the business is worth.

Whether you're valuating your store to prepare for a sale, to leverage a loan, to buy out a partner, or to plan an estate, this *Retailer's Guide* provides ideas concerning ways to organize yourself for a valuation.

GATHER DOCUMENTATION

The first step in putting a price on the business is hunting and gathering. Pull together every income statement, tax return, bank statement, inventory record, receivable record, vendor agreement, wholesale agreement, and leasing document for the last five years. Five years will help you get a sense of the business's history and trajectory. If you don't have five year's worth of documentation, you can probably get away with three.

These documents will provide the meat of the analysis, so if you don't have these readily available, gather them up. If you cannot easily pull together these documents, take heed: one day you will need to. Revamp how you organize and manage your store's records now for when you need them.

ISOLATE THE RETAIL ASSETS

Another task to complete before you get deep into the valuation: determine what part of the business you intend to sell. How is your business structured? Is everything in the store owned by the same company, or do you have different companies that own different parts of the business? For example, a retailer may sign the lease under one company name and operate the business under another company name. Or, to use another example, a retailer may own the building where they operate. The retail business and the real estate are valuated differently. To get the valuation right, you have to determine what you're selling and what the different parts are worth.

CALCULATE THE VALUE

As a rule of thumb, a valuation takes account of three kinds of value: cash flows, benefits from running the business, and salary.

Cash flows:

Potential buyers want to know where the store generates cash (from sales, services, investments), how much cash the store generates (in a month, in a year), and what the historical progress has been in terms of cash flow (has cash flow increased or decreased?).

"Buyers today are looking for cash flow," says M. Will Fischtein, Broker of Record at Beacon Corporation, Brokerage. "They're looking to buy themselves jobs, to buy themselves assets as opposed to shares, to buy themselves stability and growth. They're always looking for an edge."

Benefits from running the business:

Potential buyers want to itemize what benefits they will draw from running the business. Will they have access to office space, a budget for continuing education, or a company credit card? Benefits to the business—even something as commonplace as running personal expenses through the company—count as a benefit to future owners. Sellers should put a price on these benefits.

Salary:

Potential buyers want to calculate how much of an income they will draw from the retail business. A salary is one of the key benefits potential buyers will want to see—and will pay for.

Other considerations:

Goodwill: Goodwill includes the intangibles in the business, like a well-trained sales staff, a well-established business, a popular brand, and a good location. "Goodwill is anything over the assets, minus the debt," says Fischtein. Goodwill is easy to overstate—that's why Fischstein tells his clients to value the store strictly on cash flow.

Debt: The sale price is offset by debt. Debt is not necessarily bad. Buyers like businesses that have established lines of credit. Debt means banks are willing to do business with the store.

Decide on a method for valuation: Retailers interested in selling their store need to choose a methodology for calculating the value of their store. Here are three ways to value a retail business:

- *Calculate the net asset:* With this method, you will add up the value of the assets and subtract the debts. This method does not account for the future rates of return, and produces a lower valuation. But it's faster than other methods of valuation—good for when the store needs to sell fast.
- *Calculate the capitalization rate:* With this method, you will focus on cash flow rather than the assets. You want to gauge the store's current ability to generate cash and try to estimate the return the investor will get if they purchase your store. To calculate the capitalization, divide the store's anticipated annual net income by how much the buyer is willing to pay for the store. To price the store in this way, you'll need to know your store's net income, what kind of a return the buyer anticipates, and what price you're willing to sell at.
- *Calculate the store's value in the market:* With this method, you will determine the value of your store by measuring its cost against the selling price of similar stores on the market. This method demands a deep understanding of the market—difficult because so many private businesses keep their business private.

  Remember: You will need to be able to justify to buyers and the Canadian Revenue Agency why you chose one method over another.

GET PROFESSIONAL HELP

This is not a cute joke: seek professionals when you sell your business. If there's a tax loophole or a risk involved, your accountants and lawyers will identify them and counsel you on the ramifications of the decisions you make. Even better, engage the services of firms that specialize in the business sales.

That said - remember that many retailers sell on their own at favourable terms all the time.

"It's absolutely doable, just like it's possible to sell your house on your own," says Fischtein. Selling to somebody inside the company is preferable if you intend to sell the store on your own, Fischtein says, because you already have a good relationship with the buyer. Retailers interested in selling to an outside buyer may want to consider engaging a professional sales agent. Agents streamline the process by pre-screening buyers and organizing the sale.

Questions buyers want answered

- Why are you selling the store?
- Is the purchase price negotiable?
- How much working capital does the store have?
- Can you produce audited statements for the last three years that testify to the store's sales history?
- Can you produce the store's budget, business forecast, and projected sales and cash flows?
- Will the landlord allow for sub-leasing?
- What state is the inventory in?
- How old is the store equipment? Will it need repair or replacement?
- Can you offer a detailed portrait of the store's key demographic? Of the neighbourhood's demographic? What potential does the neighbourhood offer?
- Who are the main competitors?

PLAN THE SALE TO TAKE ADVANTAGE OF TAXES

Retailers often sell the store in one of two ways: by selling shares in the business or selling assets.

Both options have advantages. Selling assets offers a practical advantage. Retailers can sell assets fast, and some assets hold considerable worth. The other advantage: buyers purchase value. Hard assets have tangible value. The value of a share is less tangible.

Selling shares offers a tax advantage. Shares that sell for under a certain price are tax free. Retailers can spread the shares through the family to reduce what taxes they pay.

The CRA says that you may be able to avoid paying tax on the sale of the business on two conditions. One condition says that you're selling the business that you "established or carried on." The second condition says that "under the agreement for the sale, the purchaser acquires ownership, possession, or use of at least 90 per cent of the property that can reasonably be regarded as being necessary for the purchaser to be capable of carrying on the business as a business."

What does this mean? It means you want to talk to a lawyer and accountant because there is opportunity here.

Regardless of how the retailer sells the business, however, planning to sell the business requires lead time. One to two years in advance of the actual sale is normal, says Fischtein. Sales that involve changes to the corporate structure require, in most cases, that these changes be present in the corporation for at least 36 months before the sale.

Another thing to keep in mind: different rules apply to sole proprietorships and incorporated businesses.

9 ways to increase the value of the business

So you conduct a valuation of your business and discover that the store's not worth what you expected. In fact, when you take away the goodwill, the store is worth considerably less than you need from the sale.

If this happens to you, stay calm. An increase in revenue over a year or two will boost the sale price of the store. Increase the bottom line with nuts-and-bolts retail tactics and smart management.

1. **Grow traffic:** The more customers you get into the store, the more chances you have at making a sale. Focus on marketing strategies that will get people into the store. Reach out to existing customers with special discounts and attentive, personalized service.
2. **Increase conversion:** Convert more browsers to purchasers. Train employees on how to close the sale—refresher sales courses never hurt—and get your floor staff to engage every customer who comes through the door.
3. **Grow basket size:** If 1,000 customers make a $17 purchase each week, that's $17,000 in sales a week, or $884,000 a year. If you can grow that average basket from $17 to $18—just a dollar—that's an extra $52,000 to your bottom line each year.
4. **Enhance the customer experience:** What's going to convert browsers to customers? What's going to make a customer want to buy a little more than they planned? A great customer experience. Retail is an experience and stores that deliver a new experience get the business. Revitalize your customer experience with an eye to boosting sales, increasing the value of the store, and convincing the store's future owners to pay a little more.

5. **Examine the numbers for opportunities:** Sit down and examine the store's operating expenses and look for opportunities to trim expenses or build the business. Do your staffing levels really match the customer traffic patterns? Do your inventory counts reflect your needs, or are you discounting more than you should? Look for redundant expenses and free up trapped capital.
6. **Clean up the store:** Customers judge a retail environment quickly. If the store looks dirty or dated, they will spend less time in your store. Increase the value of the store by investing in the store's appearance. Clean the fixtures. Adjust the lighting. Revamp the merchandising. Paint the walls.
7. **Purchase new assets that increase the bottom line:** Investing in technologies that help increase sales also increase the value of the store at the time of sale. Investing in head count technologies will help you improve your conversion rate calculations. Installing an e-commerce portion to your website may also help drive sales and improve the customer experience.
8. **Negotiate a more favourable lease:** If you're able to leverage a better lease for your store, you can put the future buyer in a better position—and raise the value of the store. If you cannot modify the real estate lease, see what you can do to improve the terms of other leases.
9. **Reduce debt:** The less debt owned by the store, the greater the proportion of the sale price that you keep.

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