

# Due Diligence... Done Right

## A Step-by-Step Look at Purchasing an Existing Laundromat



When you build and open a brand new vended laundry, you take the calculated risk of throwing a party and potentially having nobody show up.

However, when you buy an established laundry business and you believe everything the current owner tells you, you certainly don't expect your "party" to be a dud. In fact, you're expecting a decent cash flow, because that's what you thought you bought. Then, a month and a half later, you may start to get that sinking feeling in your stomach, as you realize you just bought yourself a party that nobody cares to attend.

### Beware of Red Flags

We all feel compelled to ask the owner why he or she is selling the business. Over the years, I've heard reasons like failing health, retirement and leaving the business to pursue other interests. One guy in New York actually told me he was making too much money and he had to get out. Talk about over-hype.

At the end of the day, it doesn't matter what the owner tells me. I'm going to uncover the real reason at some point. My first concern is that the area's

demographics are changing, and all the low-rent apartment units and trailer parks just a half-mile from the laundromat are being converted into higher-income condos, with washers and dryers in each unit.

Perhaps the neighborhood is changing, with crime on the increase and families (your customers) leaving in droves. Or, maybe the store is currently doing well, but after checking with the building department, you're told there is a new 5,000-square-foot laundry about to be built in the shopping center across the street.

I met a couple of new owners who had recently bought an existing laundry only to discover that a new median was being constructed in the middle of their street – which would effectively cut off customer access to their shopping center. Clearly, since these are some of the issues that must be investigated before moving forward with your purchase, a trip to the town's building official is essential.

Another legitimate reason to pass on a "good store" is the fact that the lease may have only a couple of years left and the landlord is refusing to extend it before you buy. The seller may try to convince you that the

landlord is “a great guy” and will be easy to work with at renewal time two years down the road.

However, if he’s such a great guy, why isn’t he willing to work with you right now? What’s more, this landlord may not even be there in two years; thus, you could be dealing with a completely new entity – with no guarantee of an extension. It’s frustrating when you finally find a winning location with strong numbers and then something beyond your control gets in the way, but don’t let your emotions lure you into making a bad business decision.

### Buying a Poor Performer

On the flip side, if a laundry is being sold because it’s not doing well, you still may want to buy it – after determining that the neighborhood is perfect for a laundromat but the current owner simply hasn’t been a good manager, the machines are always broken, and he or she has “chased away” most of the customers. You know you can do a better job.

Another good reason to buy a poorly performing store with strong potential is that it may be located in a county with huge sewer impact fees or other restrictions on new laundromats. For the most part, I would consider this to be “protected territory.”

After evaluating the competition in your chosen area and getting past any initial concerns, let’s say that you’re now satisfied that the marketplace is stable or even improving from a vended laundry perspective. Now, you can make an offer and begin your due diligence.

### Making an Offer

Over the years, my strategy has been to offer to buy the business for exactly what the seller is asking, with some typical provisos such as attorney and account review. I also throw in other conditions – from obtaining a satisfactory lease, as well as several utility and maintenance bills, right up to and including the kitchen sink.

Some buyers will sit in the laundry counting customers and coins every day for weeks. I’ve never been able to do that. Who has the time? Besides, it’s only a snapshot of a store’s business for that specific window of time. What about the rest of the year? Also, this approach can’t tell you if self-service revenue has been on the decline up to this point.

Several years ago, a young investor was making an offer to buy one of my laundromats. At some point, he put his laundry consultant on the phone, who insisted we count quarters together for a month. I said, “OK, but what happens if the count

that month comes up short of my stated coin revenue?” His reply was that he would advise his client to either back out of the deal or lower the offer.

When I asked if he would advise his client to increase his offer if the coin count comes out higher, he replied, “It doesn’t work that way.” My response: “In my world, it does work that way. And, if you insist on doing a snapshot count of any business, you have to live with the results.” At that point, I ended the negotiation and walked away.

In different regions of the country, there are formulas to guide owners in determining what their asking price should be. I’ve seen 40 times monthly net, two times yearly net, one and a half times gross, and so on.

### The Investigation Begins

Now, let’s assume that you’ve made your offer to buy, and the seller has accepted. A short time later, you’re given all of the documents you requested and now the work begins. One by one, item by item, all of the pieces to the puzzle are coming together, and it’s starting to look more and more like you’re going to be buying a laundromat.

If the seller is reluctant to disclose any information or documents you feel are pertinent to your purchase, or if his business broker insists you not speak directly with the seller, you have every right to become more than a little uneasy about the deal at this point. I’ve had brokers tell me, “The seller doesn’t want to be bothered. That’s what he’s paying me for.”

I really don’t care. As far as I’m concerned, there cannot be any obstacles or hindrances placed in your path by anyone during your investigation stage. You are a serious buyer and should be treated as such.

When researching a vended laundry, buyers typically have the most difficulty in determining how much money is being generated in the area of self-service washers and dryers. I refer to this area as the “coin portion” of total revenue.

That’s probably why most financial workups I’ve ever looked at show “gross sales” on the top sheet. More often than not, there is no attempt to separate the business’ various profit centers, which leaves you to do it yourself.

One quick test I’ve used is where total monthly utility expenses are customarily projected at between 20 percent and 30 percent of gross coin revenue, for purposes of establishing a cash flow pro forma for a new laundromat business. This is a “first blush” observation and is conservatively high. It’s not entirely reliable

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when evaluating an existing business, as there are too many variables to consider.

A more accurate test I use is matching the coin volume the seller is stating with water and natural gas consumption, based on the store's utility bills and machine use over a specific time period.

When referring to machine revenue, some operators will use the term "turns per day." Others, including myself, prefer to use "percent of maximum potential." Both are methods of measuring how often the washers and dryers are being used or "vended" each day by your self-service laundry customers. Water and gas consumption formulas are used to measure their volume the same way, so you will be able to match them up with the self-service revenue after you "net out" the utilities used for any wash-dry-fold business.

Be cautious here. Some laundry owners have been known to "run off" water over several billing periods in anticipation of selling their stores. High water bills typically mean high coin revenue – except when the gas consumption to make hot water and to dry clothes is not in line with the volume of water being used to wash clothes. At that point, you may want to ask the owner if most of his or her customers are using only cold water to wash and taking their clothes home to dry them.

If the utility calculations come up short of expectations but you still insist on buying the store at the seller's asking price, add a new equipment note, a possible increase in rent and several other additional expenses. And, if your projected increase in business going forward is slow to arrive, you could be in serious trouble very quickly.

At this stage, it's important to meticulously comb through the books, ledgers, daily tickets, invoices and supporting documents related to other sources of revenue – especially wash-dry-fold and drop-off drycleaning services – so that you can isolate the coin portion of the business' revenue from over-the-counter income. If you find that documentation related to these services isn't clear or doesn't exist, then (as far as I'm concerned) the money probably doesn't exist either.

Laundries that take in drop-off drycleaning will probably show gross sales on the top sheet. Be mindful of the fact that there will be a cost paid to the drycleaner of as much as 60 percent. Simply put, if the owner is claiming \$1,000 in drycleaning sales, your take actually could be \$400.

Whenever I work with an owner, I always underscore the importance of meticulous recordkeeping and of running the business like a business. First of all, if the IRS decides it's your lucky day, you had better be prepared to answer all of their questions. Secondly, if you've worked hard over the years and built up a good business with lousy records, the value of your store no doubt will be impacted. Typically, a serious buyer will buy only what he or she can see in a business-like form.

I'm not suggesting you spend a lot of money on professional accounting and bookkeeping services, which can eat into your profits. However, I am strongly recommending you pay some personal attention to simple recordkeeping and documentation, which will prove the value of your business years from now.

I've worked with several potential investors over the years who have been extremely motivated and eager to buy. Most are tired of working for someone else and have saved money all of their working lives just for this moment. Unfortunately, they quite often overlook or ignore questionable issues or red flags in order to own their own business. Their dreams become blinders, which often pull them through the process much faster than they should go.

I've been contacted by people who had mortgaged their homes or borrowed money from relatives to raise the down payment for a laundry. And they lost a lot more than just the business when it ultimately failed. Sadly, and sometimes tragically, strong emotions and motivation to buy can work against you.

Use this guide to keep your feet firmly on the ground and your emotions in check. Remember, the numbers won't fail you. If they don't add up, no amount of massaging will change the facts.

I always tell clients to believe nothing they are told and only half of the documents they are given to study. If you ever feel

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you're being rushed because "another buyer wants to make an offer," it may be wise to slow down the pace at that point.

You've already decided that the laundromat may be in need of extensive refurbishing, including adding new equipment. You know you'll be following your initial payment for the business with a substantial injection of new money to get the store looking the way you want it.

Typically, when purchasing a laundry business, the lease is the lease and you live with it. However, since you will be investing a boatload of cash into the space, you must meet with the landlord or leasing agent to rework the lease as though you're building a brand new laundromat. It's crucial to establish your own business relationship with them before finalizing the deal. This will be one of the most important provisions in your offer to purchase.

### Closing Time

When you've finally concluded the investigative stage – and if you end up buying the store – be advised that you will need a chunk of cash before and at the closing, in addition to the amount of money to actually buy the business.

Utility companies usually ask for deposits equal to one or two months' billing, and the landlord will want you to put up one to three months' rent as a security deposit.

In the past, since that money belonged to me, I've asked that it be held in an interest-bearing account for me. This condition has never been agreed to and occasionally I've been laughed at for requesting it – but it never hurts to ask.

You also will need extra cash at the closing for legal and other fees. It's customary that you and the seller split

the cost of the closing attorney. Since all of the negotiations are over and the deal is done, the attorney's job is to simply represent the closing, not either of the parties. The attorney also will have established there are no outstanding liens on the business or the equipment.

Be aware that you will be buying, at an agreed upon price, all of the unpaid, finished or pending wash-dry-fold orders left in the store. You'll need to purchase the coins in the machines, as well as the unopened boxes of vended laundry products, bags, hangers, sodas, snacks, etc. You and the seller can work that out the night before the closing, while you're testing all of the equipment.

An important condition of buying the business is that all of the machines and equipment are in working order at closing and when you take possession of the store – or will be brought up to running condition within a short, specified period.

Your attorney should advise you to set aside funds to be held for a period of time after closing, just in case an unpaid bill pops up that the seller "forgot" to mention, or if several of the out-of-service machines aren't repaired promptly.

I recommend not paying for any clothes left with tickets dated past 60 days. Also, look for phone numbers on the tickets so that you can call customers

whose clothes have been at the store for a while.

If the closing takes place in the middle of the month, you will need money to pay a prorated amount for rent, utilities, taxes, etc. In addition, be sure to have some reserve cash on hand for operating expenses.

After leaving the attorney's office, you and the former owner should go directly to your new vended laundry to change the alarm code and the locks on the doors, as well as to organize the keys to all of the machines. Try your best to have one full set of keys that you can keep at home.

As should be specified in your buy/sell agreement, the former owner should spend at least 14 days following the closing showing you the entire operation of your new business and introducing you to the customers.

Also, now that you've taken over an established laundry business, be sure to let everyone in the neighborhood know that the laundromat is "under new management." Do so through social media, signage, banners, flyers and perhaps a few ads in the local newspaper.

The final order of business – only after you've made all of the necessary improvements to the store – is to host a "Grand Re-Opening" event. If you've done everything correctly up to this point, there should be no need to worry about any no-shows at this party.



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