

## The Mystery of the Multiplier!

**No, this month's RAAS Report is not a cheap detective thriller! But delving into the mysteries of the "multiplier" would sometimes tax the forensic skills of Sherlock Holmes!**

Our **RAAS RIGHTS** consultants talk to dozens of Rights owners each week, and invariably the conversation will come round to the question of multipliers.

"What do you think multipliers are doing?"

"What multiplier did xyz complex sell for?"

"We would want a multiplier of 5.5 because we heard Fred got 5.1 and ours is much better than his!"

"You're joking; I'd only get a multiplier of 4.2 to 4.5?"

Sound familiar?

As we all know Management Rights businesses are valued by applying a multiplication factor to the **provable** Nett Profit of the business. If a verified Nett Profit is \$100,000 and the multiplier 4.85, the selling price of the business would be \$485,000. Of course, to reach the total selling price you must add the value of the manager's unit.

The strange thing is, that the basis for the mysterious multiplier --- that little number that sets the big price --- is largely unknown, and greatly misunderstood! We all understand that it will be quoted at over 5 by the seller and considered as closer to 4 by the buyer, but - hey - that is capitalism! Where does the truth lay?

My co-director of **RAAS RIGHTS**, Geoff Glanville, is a qualified valuer of many years standing; here is his take on the matter:

*"The value of your Management Rights business is determined by capitalizing the income stream of the business. If a buyer had an expectation of a 20% return on the business invest-*

*ment they would need to multiply the proven net profit per annum by 100 and divide by 20. So a business netting \$100,000 per annum, would price up at \$500,000. (A multiplier of 5 was used). This only leads us to the next question, "where did the 20% come from?" Well the amount someone will pay for your business is determined by the amount that other people are paying for similar businesses at any point of time. "Sales evidence, in valuation parlance." This historical evidence is all based on the market's assessment of the risk involved in each business."*

So how did all these other people arrive at the price they were willing to pay? Same way you will! It's all about reward and risk. Let's say the business you are looking at has a new 25 year agreement, is positioned in the middle of the tourist strip, has a solid rental pool with no evidence of leakage, is comprised of small but comfortable 2 bedroom units, the manager's unit is a fair size but reasonably priced so as not to distort the overall return, and the Nett Profit is \$140,000.

As there is little risk in purchasing an operation like that, the buyer will receive a lower return which equals a higher multiplier which in turn equals a bigger price for the lessened risk.

What about a small resort complex at the edge of the tourist strip with 15 large three bedroom units, an expensive manager's unit, and eight years left on Standard Module agreement? YOU would rightly assess this as a riskier proposition and accordingly you would expect a higher return to cover the risk. A higher return equals a lower multiplier, which equals a lower price for the increased risk.

It is not sensible to believe that the two examples above should both sell for the same

multiplier and time will show that they won't.

It is also not sensible to think that the value of your business will increase automatically because the mysterious multiplier will keep floating upwards as if filled with helium!

Over the last few years when real estate was really booming, many in the industry could look forward to easy capital gains because the multiplier was rising every quarter, as was the manager's unit. Those days are over for the moment, but the days of growing businesses need not be. It is sound business and marketing practices that grow businesses, not an unsustainable market bubble. **Forget the multiplier**, you can't ever control that. Instead **Grow the Nett profit!** That is something you really do control. Maybe some ideas on growing your Nett profit could be the subject of a future **RAAS Report**. I'll put on my thinking cap in the interim.

### RAAS RIGHTS GOLF DAY

Thanks to our generous co-sponsors, the amazingly successful **RAAS RIGHTS** Golf Day is on again. Thousands of dollars worth of top quality prizes will be on offer (forget that monogrammed golf ball as the runners-up prize at this gig!) No, we won't have four green jackets for the winners, but we guarantee you will go away happy. **Tuesday 12th July** at Oxley Golf Club, 290 Boundary Road Oxley (off Blunder Road). Full details over page.

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**If you would like to comment on anything you have read in the RAAS Report, please send an email to [mike@raas.com.au](mailto:mike@raas.com.au) or write to The RAAS Report, 13/17 Victor St., Runcorn Q 4113.**



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