What Is Your Dance Studio Really Worth?

Suzanne Gerety: Hello, everyone, this is Suzanne Blake Gerety from DanceStudioOwner.com. I'm really excited about our guest today. Sean is going to say a little about his background. Sean came to me via our connection with Jackrabbit software. I was thrilled to hear that he not only understands the tax, payroll, bookkeeping, all of the high level business aspects of the dance studio business.

But he also works closely with our industry. Studio owners have enough on their plate so he really gets the industry. He understands that dance studio owners did not go into business to be bookkeepers. Sean, I'm really glad you're here today. Thanks for being here.

Sean Dever, CPA: Thanks so much.

Suzanne: Tell us a little about your background and we'll get started on the topic that we promised everyone of what your dance studio is really worth. People like to know a little about you and how you came to be the great studio person in terms of your financial background.

Sean: Sure, sure. My background actually started heavily in the sport of gymnastics. I went to college on gymnastic scholarship. At college, I pursued an accounting degree. Post college, I went off to become a CPA in Boston, worked with one of the largest accounting firms in the world.

At the same time, I had owned and was invested in a number of small gymnastic studios. Over the course of the years, I go to a bunch of seminars, similar to Dance Summit Seminar, and give a lot of training and education on gymnastics, running the business side of it, from bookkeeping, like you said, tax loopholes, and so forth.

Over the years, I've opened my own firm that focuses on bookkeeping, tax preparation and planning, and payroll with a primary focus on gymnastic schools. In the last several years, I've picked up a number of dance studios, swim schools, karate studios. That's the basis of my clientele.

Suzanne: Awesome. When we originally talked, you're one of the good guys, meaning you want to help dance studio owners do their books properly but also making sure they're taking advantage of the tax advantages. I always like if we can do something less hard, the better, making sure that they're aware of it.

I think that's what brought me to the topic, and it's one that we get asked a lot, which is studio owners are either in one of three places. They're either new studio owners looking to

buy an existing studio. They are current owners who have absolutely no idea what their business is really worth.

All this sweat equity, all the time and money, and at the end of the month, is it really worth it? What is it worth? Lastly, the group that I would almost put my mom in, which is transferring the business, getting a retirement out of it. Could you sell this? Could you be somewhere where you could retire and have your business still run, making money?

I'm excited about this topic today. While we might not be able to answer every question, if you want to help us start down the path of how do you know what your dance studio is worth.

Sean: Great point. To touch upon a little information you had brought up, I do consider myself as you referred to it, one of the "good guys." It's very difficult in defense of the accountants out there, for them to have a full understanding of every type of business.

If you look at our traditional portfolio of clients, we have painters, landscapers, restaurants, dance studios, and so forth. It's difficult for them to grasp the most important aspects of the tax code for every type of business.

My clientele is all the same. They are gymnastic schools, dance school, karate schools. My focus and my intent everyday when I come to the office is to try to find a loophole or way to plan to save a dance school or gym school money but those are the only clients I have.

When I find a loophole, I can blow it out amongst all of my clients because they're all the same. In terms of valuation, very similar. I'll start off by cautioning these businesses are very different than a traditional Laundromat or a pizza shop.

If you are to get your business valuated or you want to sell it, many times, it's important to call in a specialist, someone who really fully understands the business, how you teach, how you collect your fees, how you charge tuition.

One of the biggest problems I see when I look at dance studios especially is how they handle their competition fees, their uniform fees, collecting money in advance for their year-end shows. There are a lot of tax implications around things like that.

Perhaps we can talk about ways to save tax dollars in another teleseminar in the future but in terms of the valuation concept – is that where you want me to go now?

Suzanne: Absolutely. It goes back to this is the hard part. Dance studio owners went into this business, most of them, I will say, not to be bookkeepers. We went into this because we have a passion for teaching dance or we are committed to the art.

When I look at a spreadsheet, my eyes gloss over. I'm dangerous enough to understand a basic profit and loss statement, but really, my area of expertise is not in understanding it.

If someone said, "What's your studio worth?" I'd be like, "It's worth millions because look at all the time and energy I've put into it." But that doesn't really add up on paper. I'll let you go with that.

Sean: Exactly. I think that's important. In most small businesses, we find the owners have a really strong skill, whether it be painting, plumbing, or teaching kids lessons. That's what they pursue as an interest and a career. Like you said, understanding the finance piece of it, when we actually get under the hood and look at the finances, it in many times is a disaster.

It shouldn't be. My focus and my goal is to take that headache away from you so that you can focus on your art and skill of teaching as opposed to crunching numbers.

When that equates over to the value of the business, there are a couple of things I'll talk about high level. The one and biggest problem we have – let me start off by saying most people don't come to a seminar like this or they're not interested in it because they're not at the point in their life where they're selling a business.

I want to say that 90% of all small businesses sell when least expected. They're generally sold or valued due to divorce, job relocation for a spouse, a medical issue, and so forth. Many people don't attend a seminar or be interested in a seminar like this because they say, "I'm only five years into my career. I'm not going to sell for 20 more years."

Lo and behold, they bump into something that's gone wrong, and now they quickly need to sell so now they really need to get prepared to sell their business, and they might not have been thinking about that. It takes a number of years to prepare.

We call it dressing up a pig. It takes a number of years to get this thing ready to be sold. Before that, whether you're buying a business or considering selling, or actually in the sell process, I think a lot of this information will be valuable.

One of the biggest issues we have when it comes to valuing a business, and this will be helpful for a lot of the buyers is that you really need to disseminate the fact, are you actually selling or buying a job or are you buying a business? There are two very important things to consider there.

If you're going to buy or start a dance school, it's important that you earn a salary that's commiserate with your expertise. If I could earn $50 or $30 an hour at a dance studio down the street teaching, and I'm only going to earn $20 an hour being the owner, hopefully it makes sense that you should teach and not own.

A lot of times, gymnastic school owners, I sit with them. It's depressing when I say, "You've been working ten years and averaging $20,000 a year in profit as an owner. Do you realize, had you worked at McDonalds, you would have been financially much better off?"

Suzanne: That's a good point. I'm so glad you've mentioned that because we often find, and this is a good cornerstone to stop for a second for me to share some insights that we've had over the years too. Sometimes, dance teachers who work for studio owners see, "Look at all this tuition money coming in. I could start a studio myself."

Years ago, we figured out how to pay our staff so that they would feel foolish to leave us. We paid them on a profit sharing model. We're set up as a c-corp. They are paid a base rate for their experience plus however many enrolled students per class.

They're incentivized. We have some teachers who are teaching and making $70 an hour teaching basic dance because they're great teachers and have retention in their classes, and the kids love it. They realize that they have it so good.

We're making ten cents on the dollar. They're making great money but we've learned to love the business. I think that's a great point to say, even someone listening to this and thinking, "I definitely want to own my studio because that's where most of the profit lies." Not necessarily. Keep going. Sorry about that.

Sean: Like I said, I own a company, DancePayroll.com. We do a lot of payroll. I see what a lot of instructors make out there. Many times, I wish I become a dance instructor as opposed to a CPA. I might be better off.

It is important though, and that's the underlying theme, when you're buying a business or if you're selling the business, it's important that if you're going to work there, you recognize you need to compensate yourself from a salary perspective. You also need to compensate yourself through profits.

If the business is only giving a salary and no profits, then the business is actually considered worthless. It's irrelevant how many students there are. It's irrelevant what the revenue generation is.

A lot of times, people come to us and say, "I generate $500,000, $600,000 a year in revenue." If your profit is nothing, then your business is really worth nothing. That's a difficult concept.

A lot of times, when I'm giving a seminar, I give a couple of examples and I spend a lot of time on this really making sure that people understand that the only way a business has any value at all is if it generates profits, which are very different than payroll.

Suzanne: That's awesome. I think that it's so important that people do that. They'll come to us and say, "So-and-so asked me to buy their studio. They said they have this list." That really means nothing. What stops them from picking up and moving to the studio down the street?

Help us understand how the studio owner or potential studio owner can know if a business is turning a profit. What documents do they need? Or what do they need to look at?

Sean: Sure. The profit and loss statement, as you mentioned, is definitely the first place we start. We make sure that that is synced up with the tax return. Let's say I'm the owner and I'm also an employee.

I would expect to see an employment salary in there for myself, whether it be an hourly wage or an annual salary. Then at the bottom of the profit and loss statement, you'll hopefully have a profit number, not a loss number.

It's important to recognize when we actually value businesses like this, we spend a lot of time what we call truing up the profit and loss. As an example, let's say for tax purposes, my goal is to reduce my taxable income.

One way I reduce, I own a gymnastics school. I have a four year old daughter. My daughter is on the payroll. I pay her, let's call it $5000 per year. Perhaps I'm overpaying her for her

services. Of course I wouldn't say that to be the case but if I was, you can see how that would reduce my taxable income as the owner.

It's basically shifting money from me to my daughter. We do that for a host of tax reasons. What I would have to do there is true up the profit and loss by adding that five grand back to myself.

Another example might be an automobile or a cell phone. Those are examples of items that we as owners use as a benefit. We run them through the profit and loss. If I were selling this business or valuing the business, I would add those expenses back to my profit and loss so I get a true profit number at the end of the day.

Suzanne: Okay, that's good. Here's a practical question for you. When a studio owner comes up and says, "Okay, I've been approached or am thinking of buying this business." Let's say you want to sell me your dance studio. I want to buy your business.

Would I say, "Okay, Sean, it's great that you want to sell me your business. I need you to show me" – do they say, "I need your bookkeeper to show it to me?" Do we sign a nondisclosure? How do we go about obtaining those records to make sure there's not something weird happening?

I think a lot of people rush into buying. They do it on emotion. They don't thoroughly think this through. We're all human beings and guilty of making quick decisions but really, I want to help people, as do you, do this in a way that makes sense.

What's the process of obtaining that information from a potential seller?

Sean: That's a great question and you're absolutely right. Many times, when I pick up a new client and they had done a recent acquisition, that's the first question I ask, "How did you value this? How did you determine what it was worth?" "Well, the prior owner said what she wanted. I felt that was reasonable so I paid it," with no viewing into the heart of the business, which is the financial statements.

Yes, you're going to want financial statements that are prepared, preferably by a CPA or a certified bookkeeper. That should also be accompanies by the tax returns. You probably want to look for two to three years of tax returns and bookkeeping records.

The bookkeeping records should match the tax returns but of course, there's a lot more detail in the bookkeeping than there is in the tax returns themselves. It's important that you get both those documents at a minimum.

Of course, then there are going to be other items you're going to want to see, copies of leases. You'll want to see employment contracts, and so forth, but from a valuation perspective, the most important thing is two to three years of tax returns and the accompanying financial statements, being profit and loss statements.

It's important that those are done by a professional, someone who has some bookkeeping skills.

Suzanne: Right. This is my side note for our members that would listen to this. This is my lack of love for balancing checkbooks is not my area of expertise. I don't like spreadsheets but I learned

early on that that's where I have to say, "This is my weakness. We have to hire professionals for this."

We have certified QuickBooks people that help us. We have proper things. Get those. As much as it might feel you don't have the time for that, when you started at the beginning of the call, Sean, even if you're not thinking of selling your business right now, putting these systems in place now is what will set you up for down the line.

I think that sometimes, we'll be like, "Oh, I'll get to that later. I'll get a real bookkeeper. I'll establish my business structure properly next year." You do have to begin with the end in mind and have that setup. Otherwise, like you said, you're just working a job and your business is not going to have any leverage if you do set it up as a salable studio.

Sean: I couldn't agree with that more. A lot of people don't actually hire out externally the bookkeeping. Many times, they'll do it annually. They'll piece it together when it's tax time. I personally can't understand that. I consider that like driving around in a different state without a GPS.

You're literally blind. I give a lot of presentations on budgeting and forecasting. My intention isn't to turn small business owners or dance studio owners into accountants or bookkeepers. My intention is to enlighten them into how much easier things would be with a little bit of advance help.

I think bookkeeping is so important. I don't understand how people can make financial decisions, "I need a new dance floor. I need to hire a new instructor. I need to do an advertising campaign. I need to purchase some new mirrors." How you make those decisions, "what should I be charging from a pricing perspective? Should I raise my raise my prices two percent or eight percent?"

Those types of decisions cannot be make properly without monthly if not at a very minimum monthly bookkeeping that coincides with your business. You can't wait until the end of the year to figure out if that worked or not.

I think with a little bit of bookkeeping, help with a little bit of budgeting on a quarterly basis, very high level. You'll see business owners go from willy-nilly, fly from the seat of your pants to really their businesses going to an entirely different level.

Suzanne: Exactly. I think the other thing is you don't have to feel embarrassed. You'll find the right person who will not make you feel embarrassed by that but really acknowledge you for taking the steps in the right direction. Let's dive a little deeper.

We know they need a profit and loss statement. They definitely need tax statements. They need really solid documentation. Obviously, the studios that are in a lease situation or are studio owners who might be selling the actual physical space, I would say more so we have the common leasing/renting option.

How does a potential studio owner or one know now what is the business worth? What are things that add value to the business that make it be profitable?

Sean: Got it, and a great distinction there. Many small business owners will at some point in time acquire the real estate. That conversation is 100% independent from the valuation of the

business. If someone were to own the real estate, it's generally a two transaction process. They might sell the business first and the real estate separate.

I would also suggest on a side note, if anybody does own the real estate or is considering it that they should incorporate that real estate in a separate entity or separate legal structure. In terms of the actual valuation of the business itself, just the real easiest way to sum this up is it's all based on profits.

So many times, we go for offering more product. "Should I have tap, jazz, ballet, and the new one I'm seeing action on the West Coast, a lot of my clients are actually doing pole dancing. Will that increase my value?" The answer is no.

"I'm going after students, I want more students, I want to have the most students in the area." That does not increase your value either. The only thing that really plays a major role is the profitability at the end of the year.

I give a really simple example when I do this presentation live in front of an audience. I say, "Would you rather own the studio that has 1000 students and loses money or would your rather own the studio that has 100 students and makes money?"

At the end of the day, the one with the 100 students that makes money is worth a lot more money than the one with more students that's losing money. A really simple summation there is the more profits you can generate, the more your business is going to be worth.

Suzanne: Can you give us an example of a studio that would be considered profitable? What are they doing that you see, either the way they set their prices, or is it payroll? Is it their business structure? Are they having employees, independent contractors?

What are some of the signs that could set someone up to be more profitable?

Sean: Great question. I actually do a whole presentation, maybe some thoughts for another one, on benchmark percentages but to give you a high level, in a dance studio, the two biggest things that are going to blow your budgets and numbers are your payroll and your rent.

Those two numbers, I've seen payroll get as high as 60, 65, even 70% of your revenue in dance schools, and your rent could be 10, 15, 20 percent. If you get someone who is on the outer limits of say 65% in payroll and 20% in rent, that's 85 cent for every dollar you make goes to just pay those items.

We haven't turned the lights on. We haven't advertised. We haven't paid insurance. We haven't bought office supply, and there's only 15 cents or 15% left of every dollar to cover all of that.

People that are on those outer limits, you can see how it's very easy for them to go bankrupt or lose money year after year. They don't keep those two in check. Just as a high level, I always recommend to my clients, the dance definitely has out of the gym, swim, karate, daycare businesses, dance definitely has the highest payroll percentage.

I see it creep up to that 45, 50, and 55 percent. I always tell my dance clients they should really do their best to maintain that below 50% of revenue. From a rent and lease perspective, it should never get above 20% and I like to see it closer to 15.

Suzanne: You make a good point there which is very painful and challenging for studio owners. "I need this great teacher but he charges $50 an hour minimum." They're struggling with, "How do I teach all these classes?" It's another topic for another day but it's a good point to note that those are good percentages to look at.

Let's go back to the original question which is are you buying a job or buying a business. A potential studio owner, let's say I'm buying your business. I'm looking at those numbers and say, "Well, Sean, you are the one taking all the classes. What am I buying?"

Sean: Great question. I like to use the replacement value scenario if you will. Let's say you're buying my studio. I'm a one-instructor owner shop. I'm teaching all the classes. There very well may be some decent value in that.

If I'm generating, let's say I'm working 40 hours a week teaching. I could go to work for the dance studio down the street and make $10 an hour, just keeping the math easy. Then I should be earning $400 a week in payroll.

You should see a payroll check coming to me for that amount of money. If you paid me that $400 in payroll and after all of my expenses, there was still another $400 left over in profit, then you can see that you're really generating $800 a week in that business.

That is what we would use to value the business. We would take away the payroll component because we consider that a normal operating expense. We would generate the value of the business on that $400 that's leftover, which is considered profits.

Suzanne: Okay. This is a question where some people will come to me and say, "I don't know if it would just be easier for me to start my own studio from scratch," meaning lease the space, fit it out, lay the floors, put up the mirrors, do the marketing, put up the Web site.

Is it more cost effective for me to do that or should I go through this long process to know what to pay for this business? Do you have any advice for people in that stage?

Sean: I do. I would always say this, and this is a general statement but I find it to work most of the time. Obviously most of the statements I say are broad based. You might be that one dance studio with 60% payroll and things are working wonderfully. Don't throw yourself off a bridge.

These are very broad statements. I'm talking to the masses. For the masses, you're always, always better off purchasing than you are starting. The reason for that is because you're buying a known commodity. You know how many students are there. You know what the payroll is. You know what the profits are.

If you think you can go in and buy that reasonably, and then hopefully make it a little better with some new ideas. Perhaps you bring a new specialty to the area. Perhaps you have some professional background which is going to draw some competition interest.

Of course, you're much better off going from that perspective. The problem with starting of course is there's a huge capital outlay at the beginning, which is no different obviously than purchasing but we don't know what we're going to get.

You might actually open up a dance studio in a town where no one wants to dance. You might be opening up in a town where families are leaving as opposed to coming. You might be opening up in a town where there's another dance school going in down the street that you don't know about, or one that's coming in a year after.

Buying is always the best route to go because it's the easiest, and you're buying a known commodity. Starting of course is cheaper at the beginning but we don't know if your business idea is going to work or not.

Suzanne: Right. That's again provided, as you just shared, that you get to the point of buying an existing business that's better off than starting as long as you've thoroughly gone through the books, you've reviewed all these statements. You know what you're getting into and what you're properly paying.

Do you have any examples? I guess it's hard to know what a price point would be that a studio owner, that you've seen sell. Like you said, it could be a studio that has 1,000 students or 100. Is there a ballpark pricing that you've seen people pay?

Sean: Yes. In general, this is again very high level terminology. We talked earlier about the profit and loss statement. After we remove a reasonable wage for the owner, we're left with this profit number.

Let's just say again for easy math's sake, that the profit number is $10,000 at the end of the year. If you're looking at two to three years of financial statements and that business is flat, in other words, it's $10,000 one year, $10,500 another, $10,000 the next year, that's a pretty flat profit business.

You would multiply that profit of $10,000 times two. The business would sell for $20,000 plus any equipment. We'd call it the market value of the equipment. If we were to go through and look at computers, desks, benches, chairs, mirrors, and dance floors, what would they be worth today in their current value?

If that number is $20,000, then you have $20,000 in equipment plus $20,000 for the profit piece. That studio would sell for $40,000. If you're looking at a two to three year trend and that studio is losing profits, maybe it was $15,000 one year, $12,500 the next, and it was $10,000 the third year.

That's a declining profit business. You would actually use that final year of $10,000 times one to one and a half. You'd get anywhere from $10,000 to $15,000 on the profit side, and again, we'd add that $20,000 of equipment so you'd be at a $30,000 to $35,000 value.

If the business is increasing, let's say in year one, you have $10,000, year two you have $15,000, and year three, you have $20,000 in profits, then we would actually take that final year of $20,000 and multiply that times three so you'd get a $60,000 in value plus the $20,000 in equipment. We'd have a purchase price of $80,000.

Suzanne: Okay, got it. Those are good numbers. You've given such great information, Sean. I know that our members listening might have follow up questions for you. You've been really generous with your time. If they are looking for expert advice, how would someone reach out to you?

Sean: I always like to give email as the best way. I am on the East Coast in Boston. My personal email for all my clients that I give out is sean@devercpa.com. I have a Web site, DeverCPA.com. There's a free newsletter. Sign up on there, just a bunch of pearls of wisdom.

Anybody can shoot me a question, going through the valuation process now and you want to bounce some ideas off me, I'm more than willing. Give me a day or so to return an email and I'll be happy to help you out.

Suzanne: Sean, you're heavily involved in this industry. You get the business. Like you said, plumbers and carpenters have different needs than dance studio owners and gymnastic owners. I think that all this stuff is information that helps studio owners make good business decisions.

Ultimately, you want everybody at the end of the day to have a little money leftover to maybe take their family on vacation, and really feel good about their business, love their business.

Thank you so much for being on this call today. Again, this was Suzanne with DanceStudioOwner.com and Sean Dever. We look forward to your success. Thanks so much, Sean. Have a good one.