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Best Practices for Due Diligence in Laundromat Acquisitions

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Best Practices for Due Diligence in Laundromat Acquisitions

The most challenging aspect of purchasing an existing laundromat is the process of independently verifying the income, expenses–and ultimately—the net profit figure upon which one's purchase offer is based.

Self-service laundries remain primarily cash-intensive businesses. And while a prospective buyer of a laundry may want to believe that a seller is accurately representing the business for sale, there is no way to ensure that this is the case without taking the necessary steps to make sure the facts match up to the seller's claims.

Furthermore, even if a seller keeps excellent records and is diligent in reporting income, a buyer's due diligence process may turn up things that the seller may have unintentionally overlooked or simply taken for granted, but which nonetheless may affect the business's bottom line, and in turn, the buyer's offer price.

This paper will endeavor to offer prospective buyers a set of basic tools to use to corroborate the information provided by the seller. While no one technique or tactic is foolproof, taken together these approaches may help one get more comfortable with "the numbers," as well as give one a clearer picture of the business one is proposing to purchase.

What do we mean by "due diligence"?

For the purpose of this paper, we will examine due diligence in terms of some of the methods a buyer can use to prove that the seller of a laundry is telling the truth—by ***verifying the income and expenses*** claimed by the seller, ***inspecting equipment and mechanical systems***, and ***confirming the integrity of the premises*** in which the laundry is housed.

At the same time, there are a number of other processes critical to a comprehensive due diligence program that are not examined in this paper. These include:

LOCATION ANALYSIS. This entails a detailed examination of the laundry location. It incorporates the results of a full demographic study, an inspection of the physical location, an exploration of the surrounding and adjacent neighborhoods and communities, an investigation into any planned construction or development, and details on traffic patterns, parking and adjacent businesses. Integral to a location analysis is a *competitive analysis* that examines head-to-head challenges that exist on the laundry's periphery—including other coin laundries, apartment laundries, and in-unit washers and dryers. Because the results of this analysis can produce a thumbs up or down on whether to proceed further, it typically is performed before delving into any of the other aspects of due diligence.

LEASE REVIEW. This is a complete inspection of the terms of the lease by a qualified professional to examine factors such as the length of the lease, rent structure, rent increases, lease extensions, "triple-net" charges, assignability, repair and maintenance clauses, permissible uses and other considerations.

STORE VALUATION. This is a complete workup of a laundry's value using a suitable valuation method that considers factors such as the intrinsic value of the store, return on investment, net income, the length and terms of the lease, the age and condition of equipment, the level of competition, local demographics, the store's amenities, the local cost of living, and other issues.

These three due diligence processes are examined in detail in the following CLA publications:

- Demographic Analysis & Site Selection for Self-Service Laundries
- The Laundry Owner's Guide to Leases
- How to Value a Coin Laundry

1. Key concerns

How does due diligence for coin laundries differ from that for other kinds of businesses, and how does one begin the process?

When it comes to taking the word of the seller of a self-service laundry, a prospective buyer—whether an industry veteran or someone just entering the business—encounters a number of key obstacles:

- It is very difficult to verify the income of a business that is all or mostly cash.
- The physical appearance of laundry equipment is often a poor indicator of age and condition.
- Mechanical systems that function today may fail tomorrow.

For these reasons, a prospective buyer must be willing to dig into details and "get one's hands dirty," and/or solicit the aid of experienced professionals who will. There are no shortcuts.

At the same time, with a conscientious effort—and using time-tested methods—a buyer can determine the age and condition of the laundry's equipment, ascertain the viability and true condition of the premises, and conduct analyses that will allow him or her to generate a number that "gets close" to the true income of the business.

INITIATING DUE DILIGENCE

For a meaningful due diligence to commence, a seller necessarily must hand a prospective buyer the complete records of the business—something many owners typically will not do on the basis of a letter of intent alone, which is not enforceable, or without some financial consideration that confirms that the buyer is serious.

The reason for this is that the seller must be assured that the potential buyer is not simply on a fishing expedition. The seller neither wants to waste time with someone who is not fully earnest about buying the laundry, nor provide insights on the operation to someone who may be looking to compete with—rather than purchase—the business. While there may be exceptions where an owner will proceed on the basis of a letter of intent alone, most will require a more substantial commitment before opening the business for the buyer's examination.

This means that in most cases due diligence begins when the buyer has made an offer on the business, made a 5 to 10 percent *security deposit*, and entered an *agreement to purchase* the business after a specified *settlement period,* subject to any agreed-upon contingencies. Once there is a legally binding agreement in force with financial consideration, the seller will be more amenable to cooperating with the buyer's due diligence efforts.

CONTINGENCIES

The buyer's contingencies typically include successful completion of a satisfactory review and verification of all income and expense records, inspection and approval of the equipment and premises, and review and approval of an acceptable long-term lease. The more specific the contingencies that the buyer is able to include in the agreement, the easier it will be for him or her to exit the deal if things turn sour.

The settlement period—which is typically 30 days but, depending on the deal, may stretch to 45-60 days—not only gives the buyer time to perform due diligence, but also provides the buyer with time to modify the offer by negotiating purchase-price reductions based on any negative findings. In most cases, buyers should not agree to a settlement period shorter than 30 days.

A buyer also may want to include a provision that provides for an extension of the settlement period under certain circumstances—for example, to accommodate additional time to negotiate an acceptable lease.

An ideal purchase agreement would take a cue from the "blue sky laws" that prevent securities sales agents from promising unrealistic returns and misinforming investors about investment risks. Such an agreement would allow a prospective buyer to exit the deal if *any* information provided by the seller proved to be inaccurate.

However, a buyer is unlikely to strike such an inflexible, broad-brush agreement with a seller. That is all the more reason for a buyer to make sure contingencies are spelled out specifically in the agreement.

A forward-thinking buyer also would be wise to consider including a clause that provides protection after the purchase is made, should it become apparent that the facts diverge from the seller's claims.

A purchase agreement, for example, might include a clause specifying that the buyer has recourse if gross revenues over the first eight months are a certain percentage less than the amount represented by the seller. The agreement could specify, for example, that if the laundry consistently underperforms by more than 15 percent over that period—generating say $4,000 per week in gross income as opposed to the $5,000 per week claimed by the seller (a 20 percent shortfall)—then the buyer would have access to legal remedies.

COMING UP WITH A NUMBER

For many years, buyers valued coin laundries based primarily on a multiple of gross income. However, over the years, as methods of valuation became more sophisticated, buyers began to use a more accurate indicator of a laundry's value—a multiple of net revenue.

This transition necessarily complicated the task of valuation by requiring potential buyers to arrive at this net figure by focusing in detail on both revenues and expenses. Unfortunately, this also introduced the opportunity for less principled sellers not only to over-report revenues, but also to under-report expenses.

And while it is no easy task, verifying revenues by extrapolating from machine usage, and water, gas and electric bills, is in many ways more straightforward than verifying expenses, which may include unseen, undocumented cash payments for things like machine repairs and other labor.

At the same time, a buyer who requests, obtains and closely examines all of a seller's records has a greater than even chance of teasing out any anomalies in the seller's claims and arriving at something very close to the actual revenues and expenses of a given business.

The following sections explore some of the strengths, weaknesses, advantages and pitfalls associated with various the methods used to verify laundry revenues and expenses.

2. Revenue verification

How does a buyer go about verifying the seller's claimed income?

A buyer is well advised to keep one thing in mind when beginning to the revenue verification process: It is, quite simply, a lot of work to verify the income on an all-cash or mostly cash business.

That said, there are a number of tactics which, taken together, can accomplish the task to within a margin that is comfortable to the buyer.

Water and utility consumption analysis

The cost of water, as opposed to water *usage*—together with sewer, gas and electric costs—comprise an expense that is often used to gain a ballpark look at a laundry's overall performance. A buyer can quickly produce an expense ratio—the percentage of every dollar of wash and dry revenues that is spent on those combined utilities—to see if a laundry is performing more or less efficiently than the national average, which is about 25 percent of revenues spent on all utilities. In this case, however, the emphasis is on "average," because stores with all new machines may spend only 15 percent of revenues on utilities, while a store with old equipment may come in at 30 to 35 percent.

That is why utility consumption analysis—particularly that of water—is one of the most useful and widely employed methods of verifying coin laundry revenue.

WATER

When verifying coin laundry revenue, there is a saying in the industry that "water is the one thing that cannot lie."

In simplest terms, what is meant by this is that a store's total water usage is documented, and income is closely tied to water usage. That is, each machine uses a certain amount of water per cycle, and there is a specific amount of gross income associated with each cycle. And by applying the math, one can produce a wash income estimate to compare with the seller's claims.

When it comes to using utility billings to verify revenue, water is the best indicator. A carefully performed water analysis backed with detailed usage reporting from the seller can generate an income estimate that comes within 5 to 10 percent of actual washer income.

To perform an analysis, one needs to obtain at least one year's worth of *water bills* from the seller (two years' worth is preferable); the *manufacturer's specifications* for each type of washer in the store to find the amount of water used per cycle; *vend prices* for each type of washer; and the average percentage of *non-wash-related water usage* for things such as sinks, toilets, leaks and mopping, which typically stands at about 5 percent. (Also note that water probably will be billed in cubic feet. To convert this to gallons, one cubic foot of water equals 7.481 gallons.)

Note that in the case of a shopping center where a laundry's water usage is not metered separately, one cannot perform a water usage analysis.

WATER CONSUMPTION. The water bill shows how much water that came into the laundry. It does not, however, show how that water was used. There is nothing to prevent an unscrupulous seller—anticipating that a buyer will conduct a water analysis—from running thousands of gallons of water into the drain in the months prior to putting the property on the market. Or from running empty washers and dryers to crank up water, gas and electric bills to make the business appear busier than it is. For that reason, it is key to carefully analyze how water is actually used by the laundry's machines.

MANUFACTURER'S SPECIFICATIONS. Water analysis today can be especially challenging because most laundries have a mix of washers—three, four or five kinds with different load capacities. And because nearly all of those washers are in some way programmable, their water consumption levels may or may not be set to the manufacturer's default. An owner, for example, may have set a machine to eliminate rinses or prewashes, or to cut back on water levels.

One enhanced way buyers can ensure they are working with accurate numbers is to attach *flow meters* (with the seller's permission) to each type of machine, or even to each machine, and run a wash through that machine to get its true water consumption—and better figures to use in the water analysis.

TURNS PER DAY. Thanks to the audit functions in today's washers, more sellers also are able to provide buyers with specific information on how much of their income derives from each type of machine—either a percentage of income per type and/or the number of cycles—or turns—per day per machine type at a specific vend price.

OTHER FACTORS. While a buyer may go to pains to collect and use detailed information in conducting a water analysis, he or she should be aware that a range of factors can skew results. Hoses and pumps may leak. Faucets may drip or toilets may run. A water heater or boiler may be malfunctioning in some way.

Water consumption compared to income also may appear high because an attendant or relative has decided to become a "silent partner" and skim off some cash. In fact, performing a water analysis in many instances has revealed the presence of such individuals.

When doing a water analysis for a laundry with a wash-dry-fold service, one also must subtract the water used for that service from the water used by self-serve customers. The service is typically charged either by the pound or by a flat rate for a bag that holds a certain number of pounds of laundry.

For example, by knowing how much water it takes to wash a load in the 50 lb. washer that used by the owner for that service, as well as the price per pound charged for that service, a buyer can use the total wash-dry-fold income that was recorded and back into an estimate of water used by that service.

One also must take into account how the attendants who perform the service operate the machines. For example, if they run the machines with quarters, one must consider how those quarters are tracked and accounted for. *This also is important to know in the co-collection process detailed later in this paper.*

BASIC WATER CONSUMPTION ANALYSIS

Here is the simplest method of analysis that uses water consumption to estimate income:

Total gallons of water used per year (minus non-wash usage)

Combined total gallons of water used per one cycle for all washers
X Combined total vend price per one cycle for all washers = Total estimated annual washer Income

MORE ACCURATE WATER CONSUMPTION ANALYSIS

Armed with four key pieces of information—(1) *total annual water consumption;* (2) *percentage of income from each washer type;* (3) *gallons of water per turn for each washer type; and* (4) vend price, one can perform a more precise water analysis to generate a more accurate estimate of annual washer income. Here is an example:

1. For the first step, one calculates the amount of water consumed by each washer type. In this example, there are three types.

Washer type	total gal. of water consumed per year (adjusted)	X	percentage of wash income	=	gal. of water consumed per washer type
Topload	1,500,000		60%		900,000
25 lb. frontload	1,500,000		28%		420,000
35 lb. frontload	1,500,000		12%		180,000

2. Now, using information on the gallons of water used per turn by each washer type, one next calculates the total number of turns that were paid for during the year:

Washer type	gal. of water consumed per washer type	÷	gal. of water consumed by washer type per turn	=	number of turns per washer type per year
Topload	900,000		32		28,125
25 lb. frontload	420,000		62		6,774
35 lb. frontload	180,000		85		2,117

3. Finally, one multiplies the number of turns by the vend price per turn to estimate the annual income for each type, and then adds those sums together to arrive at a total estimated annual washer income:

Washer type	number of turns per washer type per year	÷	vend price for a single turn for each per turn	=	estimated annual income for each washer type
Topload	**28,125**		**$1.25**		**$35,156**
25 lb. frontload	**6,774**		**$2.50**		**$16,935**
35 lb. frontload	**2.117**		**$3.50**		**$7.409**
	Total estimated annual washer income				**$59,500**

GAS CONSUMPTION ANALYSIS

A buyer may also choose to perform a gas consumption analysis to estimate dryer income in the absence of, or in addition to, a water analysis. It typically is regarded as secondary or fall-back method of generating an income estimate.

To perform an analysis, one needs to obtain *gas bills* for the last one or two years from the seller in order to determine total annual usage; and the *manufacturer's specifications* for each type of dryer in the store to find the amount of BTUs (British thermal units) consumed by each. One also must obtain manufacturer's specifications on BTUs used by the store's *gas boiler and/or water heater* in order to deduct it from the total gas usage.

To conduct an analysis, all gas amounts must be converted to BTUs. Bills typically show gas usage in units of Ccf, or hundred cubic feet, and/or therms (TH). One therm equals 100,000 BTU. According to the U.S. Energy Information Administration, in 2014 the average heat content of natural gas for the residential, commercial and industrial sectors was about 1,028 BTUs per cf (cubic foot), so one Ccf = 102,800 BTUs, or 1.028 therms.

Using information collected through observation, one then determines how long it takes to dry a load of clothes generated by each of the laundry's washer types.

Because of the number of variables, however, it is extremely difficult to perform an accurate gas analysis. A dryer manufacturer's lab-based specifications on BTUs of gas consumption may vary significantly from the performance of the dryers actually installed in a laundromat. The amount of gas a dryer *should* be using may not be the amount it *is* using.

Moreover, efficiency levels may be negatively affected by factors such as improperly maintained venting, and the lack of sufficient make-up air. Additionally, dryer efficiency may decline over time as the equipment ages, and consumption increases. As noted above, to further complicate the issue, an analysis also must account for gas consumed by other equipment, such as boilers and water heaters, which also may not be operating to specifications.

DRYER INCOME ANALYSIS

The water usage total gleaned from a water analysis is also a key factor in performing a dryer income analysis, which can produce a more accurate estimate of dryer income than can rule-of-thumb estimates.

For years, when top-load washers were the standard in coin laundries, the rule of thumb was that a laundry's dryer income was 50 percent of its washer income.

While the *average* wash-dry ratio today typically runs more in the range of 35 percent—that is, dryer income equals roughly 35 percent of a laundry's washer income, or about $35 for every $100 of washer income—income estimates may be affected by a number of variables, just as they are with water analyses.

Key among these factors is the level of efficiency with which the laundry's washers extract water from clothes. The more water that is wrung out by the washer, the less dryer revenue. Clothes washed in older, standard extract machines that spin wash at 80 g's require far more drying time than clothes washed in washer-extractors that spin at higher g forces.

Dryer pricing strategy should also be a key factor in determining the proper ratio of washer to dryer revenue. One will observe a wide range of dryer pricing from laundry to laundry, so a higher priced dryer vend price scheme will produce a higher percentage of dryer revenue to washer revenue – while the opposite will be true of laundries with a lower vend price approach.

Factors to consider may include:

WASHER MIX. As noted above, if a laundry has mostly front-load and/or high-g washers, which that extract more water and reduce dry times, the wash-dry ratio will be lower than in a laundry that runs only top-load washers, in which clothes retain more moisture and take longer to dry.

OLDER DRYERS. Older gas-guzzling models tend to be less efficient than newer versions.

FREE DRY. Some laundries, particularly those with high-extract washers, may build business by offering customers free drying.

INADEQUATE VENTING. Dryers may be using more gas because venting is not properly maintained and cleaned.

ALTERED TEMPERATURE SETTINGS. An owner may have lowered the operating temperature of the units.

The following method, which uses some information gleaned from close, in-store observation, can help construct a more accurate estimate of dryer income that goes beyond rules of thumb.

1. Using only the first step from the basic water analysis formula described earlier, one can divide *the total gallons of water used per year* (minus non-wash usage) by the c*ombined total gallons of water used per one turn for all washers* to determine the ***combined total washer turns per year.*** For example:

1,500,000 total gallons of water used per year (minus non-wash usage)
--- **=** **1,013 turns per year**
1,480 combined total gallons of water Used per one cycle for all washers

2. Next, one determines the combined total pounds of clothes washed per year for all washers as follows:

washer type	number of washers	X	washer capacity per type (lbs.)	=	combined total pounds of clothes washed per one turn per washer type
Topload	24		12 lbs.		288 lbs.
25 lb. frontload	6		25 lbs.		150 lbs.
35 lb. frontload	4		35 lbs.		140 lbs.
	combined total pounds of clothes washed per year for all washers				**578 lbs.**

3. Now one performs some in-store observation to see how many pounds of wash customers typically dry per dryer load. Noting the size washers each specific customer is using, perhaps one estimates that on average, customers are putting about 20 lbs of wash into each 30 lb. capacity dryer pock. One then notes the vend price per dryer cycle, in this case, 25¢, and how many dryer cycles it takes for a customer to dry each load—three cycles, in this case.

4. At this point, one can perform the calculation to generate the annual dryer income:

$$\frac{\textbf{1,013 turns X 578 lbs.}}{\textbf{20 lbs.}} \quad \textbf{X} \quad \textbf{25¢ vend price} \quad \textbf{X} \quad \textbf{3 dryer cycles} \quad \textbf{=\$21,956}$$

Using that number ($21,956) and the typical percentage that the store's dryer income would represent based on the efficiency with which the laundry's washers remove water—for the purposes of this example, a wash-dry ratio of 25 percent, based on the laundry's 180 g washers—one now can back into the wash income, which would be 4 X $21,956, or $87,824.

The laundry's total wash-dry income therefore would be $21,956 (dry) + $87,824 (wash), or $109,780.

Other revenue verification

CO-COLLECRION PERIOD

In a perfect world, a laundry would have all new washers and dryers with high-level audit features that include income reporting. A card store or a coin/credit/debit store equipped with such machines, for example, can keep track of all income electronically, making accurate income verification much easier.

But in fact, with about 80 percent of facilities still relying on all-cash income, coins continue to rule the industry. Consequently, the time-tested method of verifying income is for a buyer to simply physically count the income every day alongside the owner.

This involves being at the store each day - or at each collection (typically weekly) - over a given period of time to empty the coin boxes and count down the income with the seller. If some of the income comes from card swipes, electronic reports from those machines also must be tracked and recorded.

An additional benefit of counting down the money each day is that the buyer also can gather information about the amount and percentage of revenue the seller earns from each group of machines, as well as get a better idea of how income is split between washers and dryers, which can prove valuable to the analyses detailed earlier. For example, if the co-collection period runs for several weeks and the wash-dry ratio is 45 percent rather than the more typical 35 percent, a dryer analysis can be recalculated based on actual observations rather on than a general assumption based on the g force of the washers.

Because cheating is always a possibility even during the co-collection period, a buyer also can help make sure the seller has not added a handful of quarters to each machine by checking to see if the money counted in each coin box is an exact multiple of the vend price of that machine—e.g., if the vend price is $1.50, the total contents of the box should be exactly divisible by $1.50. That observation also will tell the buyer how many turns each machine does each day.

While not every buyer may want to do it, the surest method to ensure the sellers' honesty during the co-collection is for the buyer to spend as much time as possible—or perhaps the entire day—at the store. One reason is that, in addition to salting boxes, a seller could simply feed coins into all the machines and run them empty, both to increase water usage and jack up the purported "income" in the coin boxes. In the case of laundries where much of the income is generated via card swipes rather inserted coins, the same caveat applies.

Even checking machines once a day may not be enough to ensure that the seller's representation is on the up and up. The most scrupulous approach for co-collecting in a laundry that is not 24-hour would be to empty the boxes in the morning, remain on the premises throughout the day, empty them again in the evening before closing—and then on the store's opening the following morning, examine the boxes once again to make sure they are still empty.

Night-time or closed hours offer yet another opportunity for an unscrupulous seller to cheat by salting the boxes with extra quarters when the buyer is not at the store. To guard against that, a buyer may be advised to surreptitiously jot down the water meter reading each time the boxes are emptied and the coins counted to make sure the amount of water usage tracks the amount of income. Matching those numbers up also would tip off the buyer if a seller has run water into the drain to inflate apparent usage.

Because a 24 -hour store makes it easier to do things such as inflate income by running empty machines, if there are serious suspicions about the integrity of the seller, a buyer may want to go the extra step and stake out the store around the clock (see below).

Some experts also recommend that if a buyer has done a two-week collection period, for example, at some point thereafter the buyer should ask for the owner's books in order to compare the buyer's records for the two weeks with the seller's own entries to see if they correlate.

One extra benefit of being onsite is that—in the case of an attended laundry—by spending time alongside the seller or attendant, one can obtain a bit of free training on how to run that particular laundry.

Another advantage to staying on the premises throughout the day over the co-collection period—in addition to possibly picking up some operating knowledge from the owner—is that it gives the buyer a chance to see how the laundry is used and who is using it. And by observing customers, remaining onsite could fend off any attempt by the seller to have accomplices visit the store and simply feed quarters into the machines and run them empty.

Also, if there is another aspect to the business—a wash-and fold business, for example—a potential buyer also could use time onsite to observe how customers are treated by the attendant, and to see if the business involves many smaller customers dropping off individual bags of laundry, or just a few large commercial accounts who drop off 20 bags at a time.

OBSERVATION/"STAKE OUT" METHOD

Most coin laundry professionals do not put much stock in a straightforward "stake out" of a laundry as a way to ensure no unscrupulous activities are taking place. Almost all agree that, in most cases, having someone sit in a car outside the premises—or inside the laundry itself—for hours on end or even around the clock, simply to keep watch and count customers tends to be more wasteful than productive.

On the other hand, as noted above, there is value in a prospective buyer spending as much time in the laundry as possible during the due diligence period—not only for co-collection income verification purposes, but also to learn as much about the business and customer base as possible.

VERIFYING ANCILLARY INCOME

Most laundries generate some revenue beyond what's generated from self-service wash and dry. This revenue may vary greatly from laundry to laundry – particularly if a laundry derives sales volume through wash-dry-fold and/commercial accounts. About 90 percent of a typical laundry's income derives from self-service wash and dry, with the remainder coming from various ancillary sales. These include wash-dry-fold, commercial accounts, vending and other ancillary income. However, a laundry with a particular focus on wash-dry-fold and commercial accounts may see this ancillary income constitute as much as 50 percent of total volume.

Laundries often have decent paper trails for most ancillary income. A buyer should examine and verify one or even two years' worth of records related to these revenue sources.

WASH-DRY-FOLD. Coin laundries typically track this service using the same ticket-and-receipt method used by dry cleaners. That means that there are hundreds or thousands of little tickets that can be added up to verify total wash-dry-fold income. A laundry may also use a point-of-sale system that generates a sales record for the service. Some laundries may maintain a separate bank account and/or set of books for wash-dry-fold, which if properly maintained can aid the verification of income and expenses.

As noted above, double-counting of income for wash-and-fold is sometimes an issue when the operator's quarters are used to start machines. Buyers also should be mindful that in an owner-operated store may be more lax in recording wash-dry-fold cash sales.

While not directly related to actual verification of income, industry experts note that it is important to pay special attention to any commercial accounts, particularly any that comprise a large share of total wash-dry-fold income. For example, if one or two commercial clients account for a very large share of that total ancillary income, a buyer may want to contact those commercial customers to gauge their level of satisfaction, and to ascertain whether they intend to remain customers after the sale. A seller may well intend to shift those large clients to a new or different store. A buyer may in fact want to obtain a non-compete agreement from the seller to insure against that possibility.

VENDING MACHINES. A buyer may tap a number of sources to verify income from vending machines that provide soap, soda, snacks and other items. These include the seller's records of purchases of items to fill the machines, point-of-sale records generated by the machines, and the sales records of the vendors who supply the machines.

OTHER. There is a wide range of other ancillary income possibilities that may have to be considered on an ad hoc basis in terms of assessing income. These may include income from *drop-off dry cleaning, video games*, and *various concessions* that might be granted on the premises. In each case, a buyer should request complete receipts for the previous one or two years.

COIN-CHANGERS WITH AUDIT FEATURES

In a perfect situation—one in which all the quarters in a coin-changer are used only in that laundry—using the audit feature of coin-changer and/or counting its contents should produce a number that is consistent with the self-service aspect of the business. That is, all the quarters sourced from the machine were used to operate washers, dryers and vending, and the bills taken from the machine each day would track the amount taken from the machines' coin boxes.

In reality, such a match-up may be skewed by a customer bringing in a pocketful of quarters from home or, conversely, taking a pocketful home. Likewise, nearby apartment dwellers may be in the habit of walking over to the laundry to get $10 worth of quarters to use in the apartment complex's machines.

So any use of these audit numbers should acknowledge some margin of error. Those numbers also may be more useful when bolstered by onsite observation of how customers are using the changer.

INSPECTION OF FINANCIAL DOCUMENTS

Once a purchase agreement has been signed, a buyer should ask the seller to provide all of the business's records for the prior two years in order to verify both income and expenses. The seller with nothing to hide should be willing to open the books and put everything on the table.

While the buyer is most interested in the actual information contained in the records, the condition of the records also can provide insights into the business. Records that are orderly, up-to-date and comprehensive, for example, instill more trust than do poorly kept, scattered or incomplete records, which are more likely to raise red flags.

For the purposes of verifying income, key items the buyer should request include *tax returns, profit and loss statements, collection records, check book registers,* and *bank and credit card statements.* To ensure a speedier process, the buyer should try to obtain the financial documents from the seller at the office or location where those records are kept to ensure all records are available and handed off at the same time.

TAX RETURNS. No one is likely to over-report income to the Internal Revenue Service or any other tax authority, so when it comes to verifying income in the cash-intensive laundry business, tax returns can be depended upon only to indicate what the minimum income of a laundry might be. So it provides a starting place for gauging actual income.

COLLECTION RECORDS. Depending on the sophistication of the owner's recordkeeping, these may range from computerized spreadsheets to hand-written notes on weekly collections. Because they are subject to manipulation, collection records in themselves need to be verified by making sure they correlate with bank deposits and other financial documents, and the results of other analyses detailed in this paper.

PROFIT/LOSS STATEMENTS. While these statements can provide a definitive overview of the business, they are of greater use once the income and expense figures on which they rely have been verified.

BANK DEPOSITS. Buyers should examine bank deposit amounts—plus records of income attributable to credit card swipes in the case of a card-equipped store—to see how they match up to claimed revenues. However, one caveat is that bank deposits typically reflect only the amounts an owner has actually claimed on tax returns.

Aside from verifying income, an examination of these documents also can reveal other things as well. A checkbook register, for example, could show that rent, utilities and other expenses are not being paid on time—potentially indicating declining revenues, poor management, skimming by the owner, or even theft by an employee. Tax records also can reveal name of the legal entity that owns the laundry, which can be used for other deeper research concerning the seller; or show that certain items—such as the cost of vended goods sold—have not been declared on tax returns, resulting in a tax liability not reflected in the seller's information.

All of this serves to remind that when examining a laundry's financial documents, buyers at all times should keep in mind the cash-intensive nature of the business, and understand that most of these records are only as accurate as the owner wants them to be. A buyer should also realize that each document is a piece of a larger puzzle, and that it is the buyer's job to make sure the pieces fit together properly, with no anomalies that could indicate potential misrepresentation by the seller.

> ***Note that all of these methods of verifying income produce estimates rather than firm numbers. The purpose of these verification exercises is not to come up with a number that perfectly matches the seller's claims, but rather to arrive at an estimate—independently calculated by the buyer—with which the buyer is comfortable.***

3. Expense verification

What are some of the key items to examine in verifying a coin laundry's expenses?

Buyers who put a greater emphasis on verifying revenues than on verifying expenses do so at their peril, and would do well to remember that net income—the money that goes into one's pocket—is whatever amount remains after all the many costs of doing business have been subtracted from those revenues.

That is why it is the buyer's job to make certain that every expense is accounted for—and accounted for in the correct amount.

WHAT TO ASK FOR

In addition to the ***financial documents*** listed earlier that also are used in revenue verification, a buyer needs to see every document, invoice and receipt related to an expense incurred by the business over the prior two years.

Lease. Unless the buyer also is purchasing the building in which the laundry is housed, the lease will be the most important document the business possesses, and the cost associated with the lease is one of the major expenses. For the purposes of this discussion of expenses, the key concern in looking back at two years' worth of lease expense is the amount of rent that was paid under the lease, plus any associated *CAM charges*—which include *Common Area Maintenance, taxes* and *insurance*. A buyer also might want to note any charges related to other *specific obligations* spelled out in the lease, and if any *rent escalation* took place over that two-year period. It is essential to identify all lease-associated costs to ensure that total rent does not exceed the industry standard of about 20 to 25 percent of gross revenues.

UTILITY BILLS. As the experts note, utilities cannot lie. On average nationally, about 20-25 percent of a laundry's revenues are spent on utilities, depending on the locality. Moreover, utilities generally cannot be paid in cash, so the funds used to pay them have a paper trail. With bills in hand, it is easy to come up with annual totals for each utility serving the laundry. While the key ones are obvious—*water, sewer, electric,* and *gas*—one must make sure any others—such as *phone, Internet* and *satellite or cable TV*—are accounted for. Another is *garbage collection*, which in some jurisdictions is billed along with water and sewer.

SERVICE CONTRACTS. A buyer should require a full accounting of all costs related to service contracts associated with the laundry. These may be related to:

Site maintenance, including janitorial services, parking lot sweeping and plowing, landscaping and pest control.

Equipment service and maintenance, for laundry equipment, water systems, HVAC systems, boiler or vending machines.

Service provision and maintenance, for music feeds, security and alarm service, or advertising systems.

Professional services, such as tax consulting and legal services.

PARTS AND REPAIRS. Receipts for any parts and repairs not covered by maintenance contracts. These costs in particular frequently are overlooked or underreported.

MISCELLANEOUS ITEMS. Receipts for cleaning supplies, light bulbs, tools and other items.

WAGES AND EMPLOYMENT TAXES. All records associated with any wages paid. This review of payroll records should be augmented by further observation of how the laundry is actually staffed. For example, is the laundry owner himself working regular shifts that don't show up in the payroll records? Do the books adequately reflected the true labor required for processing wash-dry-fold and commercial accounts in cases where the attendant(s) "operate" that part of the business independently?

VENDING SUPPLIES. Receipts for purchases of soda, snacks, soap and other vended items.

INSURANCE POLICIES. In addition to finding out the dollar amount of premiums for purposes of expense verification, an examination of policies also provides the opportunity assess whether the coverage they provide matches actual needs.

TAX BILLS AND LICENSES. Copies of tax bills and licenses for all applicable jurisdictions and uses.

CONCESSIONS. Records related to income generated by any concessions in the store.

WHAT TO LOOK FOR

In addition to totaling up and verifying the more straightforward expenses for which there are good paper trails—such as utilities, taxes, service and insurance policies, and vending supplies—buyers need to dig deeper to identify other unreported or overlooked costs.

CHECK REGISTERS. Checking account registers can be used to verify bona fide expenses, as well as to reveal isolated nonrecurring expenses the seller may have overlooked in a normal expense report—or perhaps hopes to conceal.

These records also can disclose spending that should not have been made from laundry accounts. This may include an owner's spending on personal items, or on home or non-business obligations. These inappropriate expenditures are important to identify, because checks written off business accounts to pay for a new home appliance, roof repairs at a residence, or home Internet come straight off a laundry's bottom line.

MAINTENANCE RECORDS. A buyer needs to pay special attention to records related to maintenance and repair costs for several reasons. Giving the seller the benefit of the doubt, one reason may be that one-time ad hoc purchases and payments come frequently enough that some may fall through the cracks when an owner records expenses.

But there are two other very important factors that can work together to the detriment of an unwary buyer.

First, there many opportunities for an owner to pay cash for parts and repairs of the laundry's machines and mechanical systems.

Second, an owner who spends a large share of revenues each month on repair expenses is not likely to want to reveal to a potential buyer the true cost of maintaining the business's old or failing equipment, particularly in an industry where technicians charge $80 to $100 for the first half-hour. A seller also may wish to conceal repairs to a water heater that is about to fail, or to an HVAC system that is limping along.

A buyer, therefore, should be suspicious of a seller who claims to pay only a few hundred dollars a month to keep a laundry full of 10-year-old machines up and running. Across the board, industry experts agree that owners tend to "undersell" to some extent the amount of repair and maintenance a given laundry requires. Or, as one laundry expert put it more bluntly: "Everybody lies."

While actual repair expenses may be two or three times what a seller claims, the only real way to gauge the truthfulness of a seller's representation of maintenance and repair costs—in addition to examining receipts—is a close inspection of the laundry's systems and equipment to determine their condition (see below).

4. Assessing the physical plant

How does a prospective buyer go about conducting a detailed inspection of a laundry?

A good offer to purchase a laundry must be contingent upon the results of the buyer's inspection of the equipment and premises. The buyer must make the most use of the settlement period—typically 30 days—to turn up any shortcomings in the condition of the equipment, the site's mechanical systems, and the premises itself. Each fault the buyer discovers can translate into a reduction in price, as well as help the buyer avoid operational problems down the road.

Just as the revenue and expense verification methods described in the preceding sections were used to verify the seller's representation of the monetary side of the business, likewise buyer's close examination of the physical plant can help establish that the seller is telling the truth about the condition and intrinsic value of the business.

Equipment inspection and review

Just because a washer or dryer is working at the moment does not mean that it is not limping along and ready to break down the day after the sale closes.

At the close of escrow, all equipment should be in *good working order*. That means that no equipment should be in *imminent need of repair*. For example, if several machines have noisy bearings or leaky seals, they are in imminent need of repair and should be fixed before close of escrow. If the buyer refuses to repair the machines or make a purchase price adjustment, the buyer should have the option of exiting the deal if he or she is not willing to accept those deficiencies.

REQUESTING AN EQUIPMENT INVENTORY

The buyer needs to request a complete inventory of washers, dryers and any other equipment in the laundry, including the model and serial number of each piece of equipment.

The numbers are key because they are unique identifiers a buyer can use to determine when the machines were manufactured and sold. Not only have sellers have been known to misrepresent the age and condition of equipment, but some brands more than others also retain a cosmetic appearance that can make a machine appear a lot newer than it is. A buyer with serial numbers in hand can contact the manufacturers or distributors of the equipment and easily verify the age of each machine in the laundry.

FINDING AN EXPERT

Unless a buyer is a coin laundry professional with some mechanical aptitude, it is unlikely that he or she will have the technical expertise to satisfactorily inspect the equipment in the laundry. More laundry purchasers today are likely to be new to the industry, and/or looking to purchase a laundry as an investment or retirement business. Therefore it is more important than ever for buyers to seek out a qualified independent technician—one who knows the commercial laundry industry—to conduct these inspections.

There are a number of ways to go about finding these experts. In addition to tapping *professional organizations* like CLA, one can find the names of qualified technicians from other *laundry owners,* as well as from *equipment distributors*. *Business brokers* who specialize in self-serve laundries may also be able to guide a buyer to a reputable technician. In all cases, a buyer needs to seek out an expert who services coin laundries and knows what to look for in that commercial environment, rather than just someone who repairs and services washers and dryers. As an added bonus, in addition to finding things that are wrong that may be fodder for price negotiation, a good technician also may discover other things which—while they may not be outright problems—can be improved after the purchase to make the laundry operate more efficiently and profitably.

LOOKING FOR DEFICIENCIES

A buyer's designated service technician should inspect and test every washer and dryer, and check the condition of everything behind the bulkheads.

WASHERS. In washers, the tech should look for things like loose bearings, worn-out belts, and leaking seals, hoses and plumbing. The inspection should include a close look under and behind each washer to detect signs of rust, mildew or leakage. Washers must be properly mounted and leveled.

DRYERS. The technician should check dryers for things like loose or sagging baskets to see if rollers are working properly. The tech should see if the owner has allowed lint to build up and thereby restrict airflow and increase gas usage—and pull the specifications for the laundry's specific dryers to ensure there is enough makeup air for those models. An inspection also should check the venting, gas hookups and wiring to ensure each machine was properly installed and no shortcuts were taken.

Techs should run each washer and dryer to test its operation. Rather than running machines empty, the best possible scenario would be to see how they operate with a load of wash. For example: How do a washer's bearings sound and perform when spinning a full load? And how much heat and time does it take a dryer to dry a load of towels?

There are other considerations as well:

'MILEAGE.' As with cars, the condition of washers and dryers is as much affected by "mileage" as it is by age. A washer that does five turns a day compared to one that does three turns a day takes on 66 percent more wear each day. Assuming the two machines operate 365 days a year for five years, the three-load machine would have done 5,475 turns over that time, while the five-turn machine would have done 9,125. All things being equal, and assuming they were both new at the start of that period, one would expect the former machine to be in much "newer" condition than the latter.

Likewise, the actual condition of a five-year-old machine that does two turns a day may be comparable to that of a one-year old machine that does 10 per day. Being onsite—during the co-collection period or otherwise—will help a prospective buyer get a fix on how intensely machines are used, as well as which machines are working and which are not.

COSMETIC APPEARANCE. Customers want a clean, new-looking store. So it is also important to make a close visual inspection of the equipment to ascertain if machines have been painted to make them seem newer, or if paint is chipping away, or there are any signs of corrosion.

EASE OF SERVICE. A tech should make sure that there is sufficient room behind each machine to properly service it. Less room means more repair time and more associated cost.

ELECTRICAL. In addition to the breaker panel, each machine should have a separate electrical shut-off.

Infrastructure/mechanical systems review

Various aspects of the physical premises the laundry occupies serve to contain and protect the laundry's equipment, connect it to the outside world, and provide a comfortable and welcoming environment for customers.

Therefore, as part of due diligence, the buyer of a laundry must take care to ensure that the building, mechanical systems and various other infrastructure that make up the premises are as sound as the laundry equipment which that location contains.

As noted in the preceding equipment section, most buyers today tend to be new to the industry. Consequently, just as homebuyers engage professional home inspectors to examine a prospective purchase, laundry buyers must engage the appropriate professionals to inspect the various technical, mechanical and structural elements of a laundry.

Also, as noted in the previous section, the buyer can use any deficiencies or problems discovered during a review of a laundry's mechanical systems and infrastructure either as leverage in negotiating a lower purchase price, or grounds for exiting the deal.

HVAC AND OTHER MECHANICAL SYSTEMS

Heating, ventilation and air conditioning systems, together with gas, water, sewage and electrical systems, might be compared to the organs and systems in a human body. They all need to be healthy and sound for the total organism to function properly. The failure of one part can take down the entire enterprise.

So while a buyer naturally may become preoccupied with the condition of washers and dryers, he or she needs to put equal emphasis on ensuring that all the mechanical systems upon which those machines rely also are in good condition. Buyers need to engage qualified technicians to conduct professional inspections of the following:

PLUMBING. Water is the lifeblood of a laundry. Filling machines as quickly as possible helps move customers through and free up machines. So while many locations may have a one-inch or one-and-a-half-inch supply line, laundries should have a two-inch line. Shutoffs should be properly located and operable. The entire water supply system—from the meter to each machine, tank or boiler on the supply system—should be checked by a qualified commercial plumber familiar with laundries for leaks, corrosion, and proper sizing and installation.

GAS SUPPLY. The gas supply system should be inspected by a reputable gas fitter to make sure it is not only sound, but adequate. For example, most coin laundries will require a two-inch gas meter rather than a one-inch one to ensure a sufficient supply of gas to fire the dryers and water-heating system when they are at peak usage.

ELECTRIC. It is not unusual for shortcuts to have been taken in electrical repairs over the life of a laundry. That is why an electrician who is experienced in commercial installations needs to inspect and approve all electrical wiring on the laundry premises, including connections to all machines. All hardwired machines should have individual breakers and emergency shutoffs. Lighting and fans should be working and in good repair.

DRAINAGE. A professional who inspects a facility's drainage system will need to make sure that the system is designed to handle the amount of water the business uses. In a laundry, a sound drainage system is as critical as a sound water supply. Washer drains, for example, must be properly sized to accommodate the water capacity of the washers they serve. And because the main drain must be able to handle all the laundry's washers spinning at the same time, most facilities will need at least a six-inch main drain rather than a standard four-inch one, and perhaps a larger one depending on the number of machines in the laundry. And because taking large amounts of water out of the laundry is as important as bringing large amounts in, drains must always be clear of obstruction. That's why a buyer would be well advised to invest in video inspection of the laundry's drain lines. The facility also should have adequate floor drains, and a backflow preventer is advised to prevent flooding.

AIR CONDITIONING. In addition to checking the age and condition of the A/C system, a qualified A/C contractor should determine whether the size of the system is adequate for the square-footage of the facility.

WATER HEATING. The failure of a $25,000 water heating system can put a dent in the budget of a new owner. Moreover, an average of two-thirds of the water used in a laundry is hot, so it is critical to keep those systems running efficiently. A professional should inspect the age and condition of boilers, heaters, tanks and peripheral equipment; as well as assess the condition and adequacy of ductwork and venting, and the adequacy of make-up air.

DRYER VENTING. As noted earlier, improper, impaired or insufficient dryer venting can affect the performance and gas consumption of dryers. Any insufficiencies must be identified and addressed before the purchase.

FLOORS, CEILINGS AND OTHER AREAS

A buyer should remember that some of a laundry's critical deficiencies may be located overhead, behind a wall, or just under foot.

FLOORS. Stress cracks in concrete floors and loose or cracked tiles near hard-mounted washers could indicate that the wrong kind of concrete was used to pour the floor.

ROOF, CEILING AND WALLS. The HVAC contractor who inspects the system should always go onto the roof to check the condition and adequacy of venting. Likewise, a building or roofing contractor should check the soundness of the roof, look for leaks, and see that flashing is in good condition. One also should look for stains or mildew on ceiling tiles or drywall, which may indicate roof leaks not detected by inspection from above. While stains may be minimal, hidden damage above may be more extensive and cost thousands to fix.

BASEMENT. If the facility has a basement, the presence of moisture or mildew could indicate leaks from above. Also, evaluate the strength and condition of supports in the case where hard-mount washers are installed above a basement.

Summary

It should be clear from the preceding pages that conducting due diligence for a coin laundry is a complex enterprise, with many moving parts. But one must necessarily wade into the details in order to make the best possible decision on this major financial investment.

It also is essential to remember that due diligence is part art and part science. One uses the science part of due diligence—which involves data collection, industry averages and standard calculations—to generate "best guess" numbers to use in decision-making.

One then applies the art part of due diligence to look at those numbers in the context of one's own particular situation—in a way that considers one's own finances, abilities and risk tolerance—and then to make a more nuanced and individualized decision.

One caveat: In the case of coin laundries, "best practices" simply means that they are among the best ones available to tease out the truth in a cash-intensive industry. At the same time, if those practices are applied conscientiously, there is a far greater chance of making the right decision.

It is also important to note that the information contained in this paper is intended as a primer and is by no means exhaustive. It is meant to provide a first look at a complicated process by highlighting key concerns, laying out some commonly accepted methodologies, and pointing the way to the further resources one needs to make a wise and informed decision.

*[**Editor's Note:** The suggestions and guidelines within this white paper may or may not apply to your particular business situation. Therefore, it is strongly suggested that you consult your attorney before signing your lease or any other legally binding documents.]*

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