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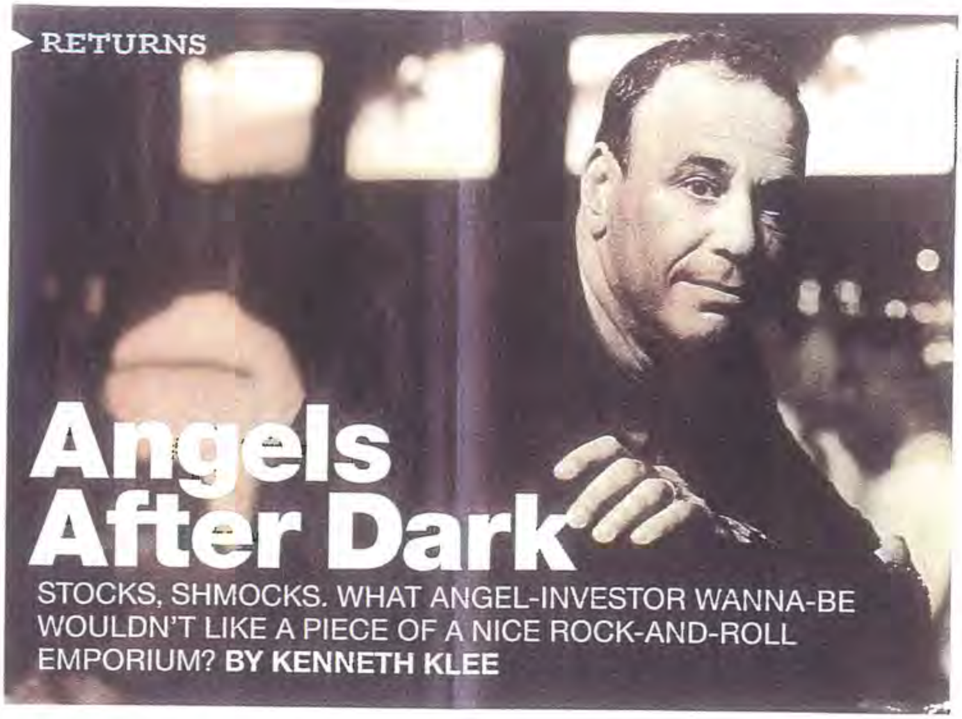

Angels After Dark

STOCKS, SHMOCKS. WHAT ANGEL-INVESTOR WANNA-BE WOULDN'T LIKE A PIECE OF A NICE ROCK-AND-ROLL EMPORIUM? **BY KENNETH KLEE**

Fed up with growth stocks that shrink? Me too. Maybe we'll feel like talking stocks again in a month or so. But meanwhile let's look at something completely different—a glamorous, dynamic arena in which smart entrepreneurs continue to deliver dazzling returns to their backers. I'm referring, of course, to nightclubs.

Bear with me here. Many nightclubs, you see, are built with backing from outside investors (angels), and the people who run happening places with jam-packed dance floors say that those investors can earn annual returns of 30%. Now, you may want to take the figures provided by certain operators with a grain of that coarse salt they use on margarita glasses—but no more than you're already applying to the annual reports of some major corporations.

Nightlife is a big business. *Bar & Nightclub* magazine figures that clubs account for about 60,000 of the 220,000 liquor licenses in the United States. Leaving aside strip clubs (which rarely need outside investors, thanks to profits we can fairly describe as obscene), there are three general club formats: mix-and-mingle, live music, and dance. Throw in sports bars, beach clubs, and so forth, and you start to see why industry sales run in the tens of billions annually.

Each club format has its own business dynamic, says **Jon Taffer,** president of **Adventure Studios Entertainment,** in Burbank, Calif. A dance club can flame out in four years and still be a success; a mix-and-mingle may last a decade or more but with slimmer margins. Overall, says Taffer, about 70% of clubs fail before earning back at least a modest return. Why? Partly because getting entertainment right is tricky, but mostly because many people start clubs for noneconomic reasons. In a market like Miami, say, where liquor licenses abound, there are few velvet ropes barring entry to the business. So a party-hearty plumbing-supply guy or a jazz-loving orthodontist can build a hot spot to suit himself—and then scratch his head when the booze evaporates or the crowds just don't come.

The successful operators swear by market research and live by a fundamental rule: The fun is for the customers, not the owners. "To us, liquor is for selling," says Taffer. Investors are expected to be all business, too. "Don't call us if you want to be cool," says Steven Adelman, a managing partner at the Lyons Group, which runs Avalon, a big Boston dance club, and 19 other properties ranging from restaurants to live rock-and-roll venues. Atlanta real estate investor Harris Tessler knows the value of a low profile. He owns a piece of a hip Atlanta club, but hardly anybody there knows him. "When I go there, they charge me a cover," he says.

The club game is played at different levels. Taffer and Adelman are in the big leagues, launching multimillion-dollar properties in multiple markets. Taffer has formed a partnership with Viacom to develop a pair of "TV Land" restaurants in Orlando and Las Vegas. Adelman is working on a $4-million nightclub in Hollywood. Both men tap networks of wealthy investors who are able to sink $500,000 apiece into the limited-liability corporations that are used to structure most projects. Meanwhile, Tessler—who still names real estate as his main business—tackles smaller projects in second- and third-tier markets where competition isn't so fierce. His first club investment was an upscale pool hall in Lexington, Ky. One of his current projects is an Atlanta bar called Mint Julep.

A couple of fundamental rules apply at every level, however. First, investors should expect to get their principal back early on. During the 18-month honeymoon that most clubs enjoy (the novelty brings in the crowds), Taffer dedicates 80% of cash flow to repaying backers. The second commandment is to control fixed costs, which have ruined the party at many a club. Taffer believes that a nightclub should pay no more than 10% of its revenues in rent.

But those are just the basics. You'll have plenty else to think about when you arrive at your club, anonymously, to sip a glass of mineral water and see how your investment is doing. Are those bartenders pouring with precision? Bar-operations guru Robert Plotkin advocates hiring bartenders who have a year of experience, but no more. That way they can be trained to your own exacting standards. Now then, if it's ladies night, where are all the ladies? It's easy to fill a place on weekends; promotions that draw crowds on weeknights can make the difference between success and failure.

Of course, you're not going to be running the place; you just need to be able to tell if the people running it for you are doing a good job. You can get a feel for the issues they face by visiting NightclubBiz.com. On the site's message boards you'll find folks chatting about such things as bouncers who start fights, whether it's a good idea to keep a snitch on the floor to combat drug use, and other hot topics.

Nightclubs are not a business for everyone, that's for sure. But they're at least as interesting as, say, hedge funds for retail investors or some of the other adventures Wall Street has cooked up for us in recent years. Maybe a little more respectable, too.

Financial writer Kenneth Klee (kenneth.klee@verizon.net) knows nightclubs better than he should.