Effectively Selling Your Business at the RIGHT TIME, Under the Right Conditions

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This article is an actual Q&A from a recent Client seeking to conduct a valuation and sale of his 32 year old company. The seller asked 20 essential questions that would be useful to anyone considering a business valuation and/or the sale of their privately held company.

Recently a client wrote me with a list comprised of two comments and 20 questions about the confidential process of selling his 32 year old business. He had seen one of our full page, featured "Business for Sale" in *Inc.*™ magazine a year ago. He kept it for some time as many clients do; then reached out to investigate the sale of his business.

Following is a list of Q&As that we feel would be beneficial for those who are considering exploring their exit strategies and to obtain a Certified Business Valuation.

1. Comment: We would be planning to move east and would like to have our kids enrolled in school by Fall 2013 (this does not mean that I cannot remain a part of the business should I need to stay in an advisory role of some type);

Reply: That gives us one year which is in line with the term of our agreement. Training takes place after the Close of Escrow at no cost to the buyer from anywhere to 2-4 weeks. Thereafter, should the Buyer need you to serve in an advisory role, then a predetermined hourly rate would apply.

2. Comment: Despite the above goal, we do not want to position the business or come across as a rush or fire sale. We are eager but not desperate.

Reply: Understood. You never want to put yourself in a vulnerable position without pre-planning as we have done this past year. The biggest mistake a client can make is not creating an exit strategy well ahead of time to position their firm in its best light with ample time for the process.

Seller: "Here are the questions – not in any particular form.

Q. In the "ABC" seminar, they stressed the importance of interest rates/Treasury Bill returns and how that impacts the marketplace and the potential for the quantity and quality of offers. In other words, as T-Bills have very low rates of return in the current market, it places pressure on potential buyers to seek higher rates of return. The demand for investments increases and as a result drives up the prices that are offered. It was stressed that this low interest environment is optimal for the sale of the business and the potential value of the business. Have you found this to be true?

A: Valuing a small, privately-held business involves many variables but the two key variables are cash flow and risk. While T-Bills and other public cash generating assets contribute to the overall risk rating of a private company for sale, the impact is relatively small. Because a privately held company is not publicly traded it's the company specific risk (and the inherent risk that comes with all small privately held companies) that drives the main component of risk applied to cash flow. While low interest rates may increase activity for prospective buyers, it will not increase value for that sole reason. Outside influences of the market will not drive up prices that businesses will be sold; it's the company itself with strong financial performance and lower risk that will improve value.

Q. What methods do you use to value the business and how does your valuation impact the number of offers and quality of the offers?

A: Cost, Market, and Income are the three standard valuation approaches considered in appraising a business. This does not change from one appraisal to the next, only the methods used and weighted in the conclusion change from business to business based on their specific risk and cash flow characteristics. There is no way to quantify how the valuation will impact offers, that being said, the use of an independent appraisal from a qualified appraiser (one with a recognized accreditation in business valuations) will improve the chances of selling the business because the appraisal will provide credibility to prospective buyers and gives them a "starting point" in which to engage.

Q. "ABC" company claims that they base the value not only on current and past performance but on the potential of the business to grow earnings or continue operations. As a result, you can place a higher valuation on the business. Our impression is that buyers would argue this and use more traditional approaches to valuation. Your thoughts?

A: True value is the present value of future cash flow because that is what a buyer is buying. That being said, historical performance offers a glimpse of what type of performance the company has been capable of and can be used to determine the likelihood of what a buyer can expect moving forward with no material change to the operation. Future performance is a valid approach to value but that future performance must be based on the existing operation in place with existing structure in place that will provide any growth. For example, if the selling company has just hired a new sales director, or just developed a new product that was just introduced to the market, using projections for increases in sales and earnings is a valid approach to value. Using future cash flow from these changes will likely improve value assuming it's an improvement to historical performance. Likewise, you cannot sell a company (and place a higher value on it) for changes that the current owner has chosen not to implement that might be available to a new owner. Potential does not improve value.

Look in the upcoming Cascade Business News for Part II of a trilogy of the Q&A.

Ascend Capital Group (ACG) is a 24 year old M&A firm dedicated to performing business valuations and sell and buy-side transactions of privately-held, mid-market companies with values to $40M. If you are a Business Owner considering an exit, or requiring a business valuation, contact ACG today. We will customize a plan specific to your needs, guiding you smoothly through a complex process while you continue to run and grow your business simultaneously, seamlessly, and confidentially.

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