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April 2020 - In This Issue:

**INADEQUATE SELLER'S
DISCRETIONARY EARNINGS - TAKE
SPECIAL NOTE**

**THINGS THAT INFLUENCE
BUSINESS VALUE**

**APRIL 2020 THINGS... By John
Zoellner**

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By John Zoellner, BCA, MCMEA

Office - Home - Where?

OFFICE. Since I started my business in April 1988, I've always had an office and an Administrative Assistant. Now since March 26, 2020, I have an office that I only go to for mail and to get files I need to work from home. As things have "slowed" I now have little work for an Administrative Assistant to do I had to lay her off - hopefully temporarily.

HOME. I'm sure I'm not much different than a lot of others that are for the first time, working from home. IT SURE IS A LOT DIFFERENT FOR ME - a "New Normal" that could not have been anticipated. Communication via e-mails and cell phone works, but not having access to all files and information I have at the office presents challenges. Fortunately, my lovely wife and my sometimes pesky dog are cooperating and supportive. It's an adjustment

Inadequate Seller's Discretionary Earnings (SDE) When Selling a Business

Most small businesses are valued as a multiple of Seller's Discretionary Earnings (SDE). In a recent Issue, we briefly defined SDE as the net income (or net loss) on the company tax return + interest expense + depreciation expense + amortization expense + the current owner's salary + owner's perks.

(CAUTION: as indicated, there are many other factors that might affect the calculation of SDE.)

AND, SIMPLY STATED...Inadequate seller's discretionary earnings (below \$100,000) can be a major obstacle to the successful sale of a business. Most buyers are looking for six-figure plus income potential.

To justify the investment to acquire a business, most prospective business buyers need to pay themselves a reasonable salary for their efforts in running the business. The pool of buyers looking for the potential to make six figures (\$100,000+) is huge, which creates demand in excess of supply, ultimately leading to higher multiples to maximize business valuations. For a prospective buyer to pay himself close to a \$100,000 salary (after debt service on the acquisition), he'd have to acquire a business with Seller's Discretionary Earnings of about \$150,000 at an acquisition price of approximately \$375,000 to \$450,000. (CAUTION: The above are general numbers that may not apply to all industries or situations).

Seller's Discretionary Earnings below \$100,000 is a major obstacle.

Most of the time, if other obstacles are not significant, businesses with Seller's Discretionary Earnings between \$100,000 and \$150,000 in SDE can be sold. As SDE decreases from \$100,000, so does the likelihood of a successful sale.

creating discipline that seemed to be there when I went to the office every day.

The personal good things...I am taking more time for breakfast and to read the newspapers. My wife encourages me to eat lunch which I wasn't too good about, and we have been walking more just because we can. So that part of today's New Normal is good. The personal not-so-good...we have gone to our local grocery at 7:00 am to avoid crowds and have a chance to buy things in short supply, but we haven't been able to do any socializing with friends and neighbors nor have we been able to eat out or have a drink at our favorite hangouts!

The Business good things - I believe to some extent I'm more efficient getting things done, maybe because I have to be. I've taken on the work my Assistant was doing so I am now more familiar with how much time things take and what obstacles exist getting them done. I've been looking at future Revenues, estimating what is possible and when it might materialize. I've been looking HARD at Expenses - what's needed and what isn't, as reducing costs should always be done but often isn't when Revenues are steady, and things generally good.

WHERE. The future - what might it look like? I've heard and read so many things, some actual experiences but mostly a lot of speculation. Today's New Normal will - hopefully - transition and become another "After Coronavirus Normal" - call it ACN. How can we ever trust that it's safe to interact with people again? How can we get over the thought of dying from something we can't see or anticipate or influence, much less control? Will we really be more careful about

If SDE is below \$75,000, the likelihood of a successful sale is greatly diminished. In today's business climate, obtaining lender financing for business acquisitions that have less than \$100,000 in SDE is extremely difficult.

To increase the percentages of a successful business sale when the business cannot be financed, Seller's Discretionary Earnings above \$150,000 significantly improves salability.

Here's the bottom line: other than a Business Owner's Failure to Plan for a Sale, the single largest obstacle to a successful sale is having SDE below \$100,000. And the chances of a successful sale increase significantly if SDE is \$150,000+. As SDE increases beyond \$150,000, the likelihood of a sale greatly improves. If a sale is not adequately planned however, obstacles other than Inadequate Seller's Discretionary Earnings (SDE) can, and will, generally present additional challenges.

Now that you know \$100,000 - \$150,000 in SDE is a good minimum goal you should strive for, do you know your current SDE? If you are short of that level, with a few changes you can probably reach that goal. But first you have to know where you are before you can determine how to get where you want to go.

THINGS THAT INFLUENCE BUSINESS VALUE...TECHNOLOGY

Whether you are considering **Selling or Buying a Business**, or need a **Business Valuation** for any purpose, it's important to understand what influences value. One influencer that is often overlooked or missed entirely is Technology. Technology is much broader than computer hardware and software. Listed below are a few things to consider:

Technology Questions & Considerations

- How is software used in the Business?
- What software applications are being used?
- Are your software applications current?
- Do you have any custom/proprietary software in use today?
- Does current hardware meet the needs of the Business?
- How often is hardware reviewed and upgraded?
- Who performs system maintenance?
- Who is responsible for the overall technology function?
- How well is your data organized and is it secure?

things, or will we soon forget how it is today?

Businesses - who will survive? To a significant degree survival may be a function of how soon ACN arrives, and what that is. Will ACN be similar to what happened after the 2008-2010 - strong businesses got stronger, and a lot of the weak disappeared? Our economy - we had as recent as weeks ago a very strong and growing economy with virtually full employment. Today unemployment is growing daily, and a lot of businesses are or soon will be experiencing trouble that they won't be able to recover from.

Personally, I admit I'm stuck in a "I'm not sure what to think" place. I feel different with the current situation than I felt when we had super high interest rates - Prime Rate over 20% in the early 1980's, and the huge slowdowns in 2001 before 9/11 happened and in the 2008-2010 slowdown. Why? Because this current situation is almost impossible to quantify and anticipate ending to allow us to as individuals and as employees and business owners to return to anything close to what it was before coronavirus. The bottom line for me - since I have no better alternative, I'm going to keep on keeping on as best as I can both personally and as a business owner.

My wish is for everyone reading to be physically and emotionally healthy. If you have a few minutes, let's conceptualize this crisis based on our combined experience, what we can control and our shared confidence that our businesses will survive and get better as a result of our dedication to beating this

- How proficient is the staff with the current technology?
- What is the average annual spend on technology over the past few years?
- What is the likely budget requirement on technology for the next two to three years?

Technology Considerations if selling a business

- How dependent on technology is the Business?
- How well does the business operate under the current technology?
- Is the business leveraging the right technology?
- What are the likely upgrade or replacement costs of the technology?
- If the potential buyer is another business, are systems in the businesses compatible?
- How proficient is the staff with the current technology?

In today's ever-changing business landscape, technology not only supports the current needs of the Business, it must be the foundation for future growth. It also has a significant impact on a business' value as it directly impacts EBITDA. Any upcoming costs to maintain or upgrade technology will reduce EBITDA and impact business value. When we begin the process of appraising or selling a business, we look at all important aspects of the business which includes current and future state technology requirements.

If you are considering Selling your Business or Buying a Business, or need a Business Valuation for any purpose, please contact us - we have experience. Everything we do is confidential.

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NEXT ISSUE

Low Or Inconsistent Gross Margins

CONTACT US

**shared, unanticipated
invisible enemy.**

**COVID-19 WILL SAY "THEY
NEVER SAW US COMING!"**

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