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July 2020 - In This Issue:

OWNERS WITH UNREALISTIC PRICE EXPECTATIONS

JULY 2020 THINGS... By John Zoellner

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BUY - SELL - NEITHER?

Business owners, we hope you and your businesses are doing well. We have heard from some business owners that have had a decline in revenues, had to furlough or lay off employees, and are struggling. Others have told us that they are doing "just OK" and some have said they are thriving.

A question to consider is "How healthy do you think your business will be in 2021?" The Covid-19 issue has been with us for the first half of 2020 and is likely to be around for a while longer, and we still don't know what "a while" means. The last time we had a significant economic downturn, it began in 2008 and lasted for several years. During that time, we worked with several business owners that were actively buying or selling. Why were business owners buying and selling during that time? That is a great question and has many parallels with what we are experiencing today due to Covid-19.

OWNERS WITH UNREALISTIC PRICE EXPECTATIONS

Owners with Unrealistic Price Expectations

If you owned a home with five bedrooms and three baths in a neighborhood with similar homes selling for \$450,000, and you decided to sell, would you put it on the market with an asking price of \$700,000? Of course not. You would know it would be a big waste of your time and effort. The same applies to your business. If the business is worth \$450,000 and you are trying to sell it for \$700,000, you are wasting your time and effort - and it will frustrate you unnecessarily.

Via public records, the market comparisons for housing are well established, so estimating the fair market value for a home is not all that complicated. Evaluating the value of a business is much more complex. As a reminder, small businesses are valued based on the common denominator of Seller's Discretionary Earnings (SDE) and comparative valuations are not nearly as easily determined.

How businesses are valued based on Seller's Discretionary Earnings (SDE)

When it comes to valuing a small business (under \$3,000,000 in value), Seller's Discretionary Earnings (SDE) is the common denominator to which a multiple is then applied. The multiple can be a function of many simple and complex factors, including the industry, but one of the primary factors is the level of SDE itself. Buyers are willing to pay a higher multiple for higher SDE.

The following is representative of the range of multiples at various cash flow levels as an example only:

<u>SDE</u>	<u>MULTIPLE</u>	<u>BUSINESS VALUE</u>
\$50,000	1.0-2.5	\$50 K - \$62.5K
\$75,000	1.1-1.8	\$82.5K - \$135K
\$100,000	2.0-2.7	\$200K - \$270K
\$200,000	2.5-3.0	\$500K - \$600K

Some businesses had a decline in revenue and found it easier to replace lost Revenue through an acquisition rather than by growing through increased sales effort. Other business owners that were doing well or maybe even going through a tough time found buyers willing to pay a fair price. Business owners looking to sell looked ahead and for many different reasons determined that they might be better off selling and retiring or doing something else.

"Everything is for sale" is a familiar phrase. Business owners deal with customers, vendors, employees, financial institutions, and yes - the government. Dealing with these when necessary is part of business ownership, but there are times - too many times - when we feel like we have to deal with all of those aspects at the same time. It can be frustrating and devastating for the business and more so for a business owner.

Buying a business for the first-time is a huge step, one of a handful of major experiences in a lifetime. Existing businesses that acquire another business face many challenges, particularly the first time making an acquisition. Does it get easier? Yes, but the experience will be different.

It is always wise to consider all options and make educated decisions after examining all aspects of a major decision. As a business owner, look ahead, think about the future for your ownership of the business. Do you want to continue? Is selling a possibility? Is growing via an acquisition a good thing? Sometimes the best decisions are the ones where we continue as we have been. In

\$500,000	3.0-4.0	\$1.5M - \$2.0M
\$1,000,000	3.25-4.25	\$3.25M - \$4.25M

CAUTION: The above multiples do not apply to all industries. For instance, the construction industry would typically have lower multiples than displayed above. An honest, well thought out, and researched valuation by your broker will position your offering with the most profit and ease of title transition for you.

The multiples are driven by a range of factors, but mostly by financing formulas and the buyer's need to have a reasonable return on investment after paying debt service on the acquisition and paying himself a reasonable salary for his efforts in running the newly acquired business.

In most instances, qualified buyers will not be open to consider an overpriced business.

In most cases, businesses priced outside these guidelines rarely sell. Many serious prospective buyers have already been through the ordeal of dealing with sellers' unrealistic expectations and will not even take the time to further investigate a business they know is overpriced from their own experience or prior market searches.

Trying to sell an overpriced business will be one of the most painful things you ever attempt to accomplish. If your expectations are unrealistic, it will simply not result in success. You will regret the day you ever started the process.

Most small businesses sell at 1.0 - 2.5 times SDE as a general guideline. Again, your broker can provide you with comparable pricing and expertise known to him that have sold like your business.

Yes, your friends and other claimants may have advice for you like "public entities are valued at 10 - 15 times earnings." But that is not the reality for small businesses. Most small businesses (because so many have SDE of \$100,000 or less) sell at a multiple of 1.0 - 2.5 times SDE.

Unfortunately, overpriced businesses are common, accounting for a large percentage of the reasons businesses are not ultimately sold. An owner that has been through the painful process of trying to sell his overpriced business may feel so "burned" by the process that he decides not to sell at all, and the business is just liquidated, or withers away. It's a shame.

Most businesses with adequate SDE, assuming there are no other significant obstacles, can be sold relatively

those situations, it is good to know what alternatives and additional options have been explored.

We have been receiving a lot of inquiries from business buyers that say they need to look at things differently than they did only a few months ago. Let's have a conversation, with no objective except to explore options.

NOTE: And remember, confidentiality, ethics, and legality are the primary foundation of our business.

Why wait? Call now. You have nothing to lose except a few moments out of your day.

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painlessly - if they are reasonably priced. Working with us will move your level for a successful, equitable and profitable sale to you, the seller, and transition your life's work to the new owner. You, your employees, vendors, contractors and the buyer are pleased with the transaction.

Win - Win as it should be.

NEXT ISSUE

Business Acquisitions That Cannot Be Financed

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