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Zoellner, Garten & Co.
Cincinnati & Dayton OH
513-852-2400
937-677-2400

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Goodwill or No Goodwill

“Goodwill is the portion of the purchase price of a Business that is higher than the sum of the net fair value of all of the Assets.”

The price a buyer will pay for a business is based on the value the business produces. The “value” is often identified as Earnings Before Interest and Taxes (EBIT) or Earnings Before Interest, Taxes Depreciation and Amortization (EBITDA), or seller’s Discretionary Earnings (SDE) which adds the owner’s compensation to either EBIT or EBITDA.

Why is there no Goodwill? Reasons vary but it’s usually because the Business does not produce value that generates business value over the fair value of business assets. A few examples...

Example #1. During Covid in 2020 a manufacturer lost substantially all business from its largest (80% of Annual Revenue) customer. Revenue from other customers could not cover costs of production and overhead. Losses resulted, business buyers had no interest in it. Production machines were sold, and Liabilities were paid. In that case ALL Liabilities were paid.

Example #2. A Distributor could not get product due to higher prices, shortages, and vendors would not increase his line of credit to accommodate rising prices. Revenues declined and losses were incurred. Inventory on hand was liquidated, often at a discount to get rid of it quickly. The bank / lender was not paid in full, and the owner had to use personal funds to pay personally guaranteed company debt. Vendors unfortunately were not paid.

ECONOMIC TURBULENCE

A recent survey conducted by Homebase, the all-in-one team management app supporting over 100,000 local small businesses, has revealed that small business owners are not only concerned about economic turbulence but also actively planning to combat it. The study, which surveyed more than 550 small business owners, was released in conjunction with National Small Business Week and highlights the resilience of these enterprises amidst challenges like inflation, interest rates, and the possible onset of a recession.

Small businesses are critical contributors to the economy, employing nearly 61.7 million Americans or approximately 46.4% of private sector employees. They also contribute about 40% of the nation’s GDP, making their well-being a key barometer of overall economic health. “The optimism of Main Street burns bright,” said John Waldmann, Founder & CEO of Homebase, underlining the determination and resilience of small businesses in the face of adversity.

The survey revealed that almost 60% of small business owners identified rising inflation, interest rates, and a potential recession as their main concerns, a slight increase from 56% in the previous year. Issues related to employee retention and recruitment were also significant, worrying over a third of the respondents.

However, small business owners aren’t simply fretting over these concerns; they’re actively seeking solutions. Almost half of the respondents plan to invest in employee retention (47%) and recruiting and onboarding (45%) in the coming year. Surprisingly, about one in four plan to invest in HR technology or operational efficiency improvements (24%).

Example #3. During Covid, this restaurant and most others closed for a time, they had to reduce seats, and carryout sales that did not replace in-house dining. Post Covid things did get a bit better, but the health of this owner had been declining, hours were reduced, and employees were hard to attract and retain. The Assets were sold for what the approximate auction value was. In all of the above examples, there was no "Goodwill", only a "down and dirty" sale of Assets. The business owners did not personally benefit from the situations they found themselves in, in fact it was the opposite. What could they have done differently? Of course, the answer to that is hindsight and conjecture, but there are things to be learned and taken into account. A starting point to estimate the value of a Business and determine if there is Goodwill is to have an independent analysis of the business. Call it what you want, a "Business Valuation" & Acquisition professional's Opinion of Value" or whatever. What will be identified are positive attributes of the business and perhaps negative aspects that could dramatically reduce value.

One thing that cannot be denied, buyers will see both the positive and negatives of a business sale. Knowledge is power and the power to improve how the business is operating and things to focus on to retain and increase value.

In our experience, business owners rarely consider relevant factors that will impact the value of their business should they decide to sell. Being proactive and knowing value aspects should increase the value whether the business is sold or not.

Let's start the process (of course with no commitment) to discuss how we can provide an analysis of your business. We look forward to hearing from you.

Morgan Vaive, Vice President
morgan.vaive@zoellnergarten.com
859-957-9657
John W. Zoellner, President
jzoellner@zoellnergarten.com
513-382-3797

An interesting development is the growing interest in artificial intelligence (AI). More than a quarter of small business owners expressed interest in using AI to assist in their businesses, primarily for content development. Millennials are leading this charge, with one in seven millennial small business owners already using AI in some capacity, compared to one in 28 Gen X business owners.

The study also indicated a shift in the definition of success for small businesses post-pandemic. While revenue growth remains a top indicator, team growth and retention, along with improved operational efficiency, have gained importance. This change is likely linked to the ongoing employee labor shortage, which persists despite economic pressures that could potentially alleviate it.

Despite their concerns, small business owners remain hopeful. The word "optimistic" was the top choice when asked about the economy's impact on their businesses. In fact, nearly 60% of respondents expect their business to fare better in the coming year than in the previous one.

NEXT ISSUE

JUNE 2023 - BROKER INSIGHTS

[CONTACT US](#)



James R. Sachs, Sr. Vice President
Morgan Vaive, Vice President

John W. Zoellner
Zoellner, Garten & Co.
Cincinnati, Dayton OH
513-852-2400

Zoellner, Garten & Co. | 644 Linn Street, Suite 634, Cincinnati, OH 45203