



Freed Maxick & Battaglia, PC
Certified Public Accountants



How to get what your business is worth

Using the selling process to boost market value

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theMax.

Owners of two private companies complete transactions on the same day to sell their respective businesses to two different buyers. The companies being sold are nearly identical. They offer similar products and services, serve similar markets and have similar revenues and profitability. Yet one sells for \$75 million while the other sells for \$105 million. What could account for this difference?

Despite surface similarities, there are probably hundreds of factors that make these two companies more – or less –attractive as acquisition candidates, thereby increasing or reducing their values to a buyer.

Sellers need to understand these differences in order to get what their business is worth, but sorting through such complexities can be difficult without significant merger and acquisition (M&A) experience. For this reason, many owners of small and midsized businesses seek professional representation when selling their companies – giving themselves a number of advantages in the marketplace.

Successfully selling your business

Just a few years ago, public companies were handsomely rewarded in the financial markets just for making acquisitions. Consequently, many companies grabbed up every potentially synergistic deal they could find, almost without regard for the price. Prolonged declines in the stock market and concerns about questionable accounting and business practices led to the demise of this trend, however.

Buyers now examine the values of potential acquisitions much more cautiously – conducting greater due diligence and exhibiting more skepticism about the seller's projected performance.

Premium valuations are still seen in the marketplace, but these values are typically obtained by sellers who are well prepared to run a thorough and efficient selling process. To increase your chances of achieving a successful and lucrative business sale, consider the following guidelines.

Assess and understand your company's market value. Many business owners are reluctant to invest in learning their company's true value in the market. Some are intimidated by the complexity of the process or don't feel they have the resources to conduct a valuation. Others may believe – probably erroneously – that they already know what their company is worth.

Selling a business without a comprehensive view of its market value is a bit like playing poker without looking at your cards. Conversely, knowing your company's value in advance puts you at an advantage. A valuation conducted by experienced professionals will help you confidently approach and negotiate with prospective buyers.

Explore a variety of buyer prospects. Many sellers assume their most likely buyer is a local competitor or major customer. These types of candidates may not be ideal, however, if their purchase decisions are driven by a desire to acquire assets, consolidate redundant functions and cut costs.

Wise sellers seek out the largest possible pool of strategic buyers willing to pay a premium to acquire the future potential and intangibles of the company – not just its tangible assets. These strategic buyers can include larger private and public corporations and private equity groups, both in the United States and abroad.

Many corporations seek smaller acquisitions of private companies to expand product lines and distribution channels, reach new customers and markets, and leverage existing technology and R&D capabilities.

International corporations also see excellent opportunities for growth and stability through acquisitions of private U.S. companies. The trend toward globalization and the resulting competition continue to stimulate interest by foreign buyers in U.S. companies of all sizes.

Answer buyer questions. Buyers want to reduce the price they will pay for a business. They attempt to do this by ignoring the seller's strengths and focusing on the company's weaknesses. Therefore, buyers go through significant due diligence to uncover as many weaknesses as possible to use in negotiations.

Nothing reduces valuations or destroys deals more quickly than surprises during the due diligence process. Hidden liabilities, conflicting data, vague information and red flags regarding management's ethics could cause a potential buyer to reduce the offering price or even withdraw from the process.

Prepared sellers have explanations to mitigate buyer's concerns and emphasize the company's strengths. A potential buyer who has confidence in the seller is more likely to offer a premium or at least fully value a company. To help gain and maintain confidence, a seller should be able to present the company's growth story confidently and consistently every time, highlighting supporting operating statistics and market research.

Hit performance expectations. A merger or acquisition can take two years to complete, giving the buyer plenty of time to determine the reliability of a seller's projections. Management should be cautious during this period about shifting focus from running the business to overseeing the impending sale and allowing the company's performance to deteriorate.

Pro forma statements are generally provided at the beginning of the process. Missing these projections or restating the pro forma statements could cause the buyer to lose confidence. Buyers will respond to missed projections by pricing in an "uncertainty" discount and questioning the accuracy of future cash flows. The question arises: If the seller can't accurately project the first few months, or even one year out, how reliable are projections two or three years out?

Streamline due diligence. Due diligence is a critical and sensitive period in the sale process and an area where the novice seller is often in a weak position. At this point, the buyer pool has been narrowed to just a few of the most serious candidates. As such, buyers have considerable leverage.

Sellers don't have to be powerless in this phase, however. In fact, due diligence actually presents an opportunity to maximize the company's value. By actively managing the process, providing quality information and moving with deliberate speed, sellers gain more control. Anticipating questions and being prepared to close the deal quickly disarms the buyer and reduces his or her bargaining power.

Studies show that the longer the due diligence process lasts, the more likely the initial offering price will be reduced. A streamlined, professional process decreases the amount of time owners and managers, as well as buyers, must dedicate to the process. When disruption to both businesses is minimal, value is more likely to be maintained.

Steps in the valuation process

The valuation process usually begins with recasting the business' historical financial statements, typically the balance sheet, income statement and statement of cash flows. As part of this recasting, certain expenses and extraordinary items legally used by private, owner-managed companies to define tax benefits are eliminated, and other adjustments are made to conform to generally accepted accounting principles.

Adjusted financial statements offer potential buyers a normalized view of the company's past performance. It's important to remember, however, that buyers buy the future not the past. Historical financials serve as a starting point for building pro forma financials, which look five years into the future and are the foundation of market value.

Pro forma financials require extensive market research to determine reasonable, supportable assumptions regarding revenue and profitability trends, growth rates, market dynamics and other factors.

Also integral to the valuation process is the identification and examination of intangible assets. These factors may be important contributors to the company, but aren't necessarily represented in the financial statements. These include a loyal customer base, patents and licenses, supplier contracts, trade secrets, and distributorships.

All of these elements – adjusted historical financials, intangibles and reasonable pro forma financials – come together to reveal the company's future potential and establish a valuation range that informed buyers will likely be willing to pay for the company.

How approach affects value

Maximizing the sale price of one's business is clearly a daunting challenge, and one that requires experienced professional advice. Beyond the core value drivers of the business, adequately preparing for the marketing process, identifying the largest possible pool of domestic and international buyers, meeting financial and operating projections, and effectively managing the due diligence process will positively impact valuation.

Sellers who take this disciplined approach position themselves to achieve a higher value for their company, regardless of market conditions.

How Freed Maxick & Battaglia, CPAs can help

Understanding your company's market value is critical to making smart decisions for the future. Freed Maxick's professional services team follows a strategic valuation process to determine how much a business is worth and identify potential market opportunities.

We conduct comprehensive analysis of your company, perform market research, and develop documentation showing the true financial operating potential of your business.

The result of this process is the platform, an evaluation document based on extensive research and analyses of your operations, financials and industry. A valuation platform and a disciplined selling approach can help you deal confidently with prospective buyers and get the right price for your business.

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