The Worst Time To Sell A Privately Held Business

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"When is the best time for me to sell my company?' – a question we have heard time and time again from business owners. "says Achim Neumann, President, A Neumann & Associates LLC, a New Jersey based Mergers & Acquisitions advisory and Business Brokerage firm, "And the question becomes even more important in the current economic cycle."

After many years of excellent growth, business owners start questioning, if an economy supported by a favorable tax environment, low interest rates and significant available equity funding will continue to support growth in their companies, plus provide a good environment to sell their business in the near future – all of this with the background that most economic indicators continue to predict growth, albeit at a lower rate, with seemingly little support for an imminent recession.s

Furthermore, with many business owners approaching retirement within the demographic "baby boomer" shift, they are asking themselves this question more so with respect to lifestyle decisions than to financial concerns.

Setting aside lifestyle considerations for a minute, selling a company always starts with a proper initial company business valuation regardless of the economic cycle. As we have seen so often on the television program, Shark Tank, a correctly valued investment opportunity will attract buyers, an overpriced proposition will result in little interest.

Such business valuations, conducted by accredited, national business valuation firms, usually view a seven-year financial period for formulating a value – three years of projections, the current year-to-date with comparison to the previous year and the past three years. Historic financial data is based on tax returns adjusted for discretionary owner expenses and one-time events in order to derive the true cash flow generating capabilities of the company. Said financial review is typically supported by a review of a company's operation and market position.

Challenges come into play when there is little consistency in this seven-year review period, as investors always prefer to see stable environments and consistent trends. Most often, there is the 'hockey stick' scenario: a declining past trend of sales or EBITDA (Earnings before interest, taxes, depreciation, and amortization), is all of the sudden met with vastly optimistic projections for the future of the business' performance.

How does the micro-economic effect of poor forecasting or the macro economic impact of the economy as a whole impact the opportunities to sell a company?

Focusing on the macro economic impact and the right timing of selling a company, let us assume a company has had consistent growth in the past five years in top and bottom line. Furthermore, assuming a 2019 economic decline, the company's sales are predicted to decline by 15% to 25%.

For a contemplated valuation to be performed in 2019, such sales / EBITDA decline would land within in the previously mentioned valuation review period. The financials would show continued growth from 2016 to 2018, a decline in 2019, and reduced forecasts for 2020 to 2022. Thus, investors would immediately attempt to shift any perceived future risks to sellers, for example, in the form of a large earn-out for future performance. In other words, such 'dip' has an immediate impact on buyer expectations for the future.

As we have seen quite often in the 2008 recession, some business owners might suggest to wait a year or two hoping for a rebound.

However, within the previously stated seven-year valuation review period, even if a business would only show a 'dip' in 2019 with continued growth there after, the historic cash flow 2018 to 2020 would still be 'visible' as a trend line in a 2021 valuation and thus, the business would not be ready for a business valuation before 2022 without showing any inconsistent trends.

UPCOMING ROUNDTABLE EVENTS

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Consequently, from a pure business valuation point of view, “waiting just one more year” truly translates into waiting three more years and, adding an additional year to actually sell a business, the business owner’s retirement plans were really delayed by 4 years – for a transaction in the spring of 2023. Needless to say, the underlying significant assumptions that there is no prolonged recession, the company will continue to perform without further ‘dips’ and there will be no health issues by ownership are strong assumptions, indeed!

In sum, any business owner contemplating a business sale at any time within the next three years, should not wait too long but rather take advantage of the current economic climate. A potential economic decline can quickly translate into a five-year delay for obtaining maximum value.

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