Selling your business

Advance planning is needed to get your best deal

By Norm Gaither

You have had a hard day. Two employees did not show up for work. Customers demand the impossible and then argue about the price. Fill rates from your tire suppliers are poor and you have to call several sources to just get tires. Last year was the worst year in business and you lost $87,809. You are frustrated and tired of the hassle. Why not just sell the business and enjoy retirement?

Hold on, take a deep breath. Now would be the worst time for you to make this decision.

Selling any business takes a lot of preparation. This is not something you do on the spur of a moment. There are many legitimate reasons to sell your business: health problems, divorce, competition, financial losses and economic downturn. These are all logical reasons to sell, but here is the big question: Is it the right time? As a business broker for more than 25 years, I've seen quite a few owners sell their business prematurely and they suffered the consequence of lower value. The biggest problem with selling too early is that you will not make the best deal and will, for sure, leave money on the table.

Plan in advance

Long before you decide to sell your business, you should start planning. My recommendation is at least three years in advance. You should also consult your accountant, attorney and a business broker. You need these key advisors to guide you through a very tough process. With the current economy, you may have had losses for the past several years and think it's time to cash out. This would be the worst time for anyone to sell a business. Would you buy a company that is losing money? Sometimes it takes up to five years to get your company in order.

Your accountant can give you the financial results on your company for the past three years. Anyone interested in purchasing your company will need this information as well as the last three years' tax returns.

How much is your business worth?

Many times business owners think of these factors to determine the price tag for their business: 1) they've been in business for 25 years, 2) they have annual sales of $1,000,000 or more; and 3) they have a large customer base.

Some, if not all, of these variables will help, but the real value of your company is your profitability.

Profits determine selling price

If your company is showing a loss for the last several years you will most likely not get the top dollar for your business. Put yourself in a buyer's shoes. If you are looking to invest your money in something, wouldn't you want the largest return on your investment? Buyers are not interested in how much you sell. They are only interested in how much you take to the bank. Now that you understand the reality, let's have a look at an example of one company's experience.

Example #1 income statement (see page 52). The company for the past three years has lost money but the seller wants to sell the business for $1,200,000. Most people arrive at their asking price based on how much they need to retire, not what the company is worth. Why does the seller think his business is worth this amount? From his perspective: 1) he has assets of $750,000; 2) he has been in business for 25 years, and 3) he thinks he deserves $450,000 of goodwill.

Sadly, this is how many tire store owners price out their business. They think just because they have been around for 25 years they should get a lot of money for goodwill. The problem with this thinking is most buyers won't pay this price. The buyer can buy these assets anywhere and the equipment and inventory would be in better shape. As for goodwill, if a business is losing money why would any buyer pay a premium? It all comes down to how much profit your company will make. If you spend the next three years getting your company in shape and making profits, then someone may pay your asking price.

First, fix the company

Let's try to fix this company and see if we can make the kind of profits we need to get the sellers' asking price. In the New Year One (example #1A, page 54), the owner makes a few changes to his sales and gross profit, and then decreases some of his expenses. Look at the difference in the bottom line! (To be fair, making changes to your business is not easy.)

When Dealer Strategic Planning 20 group members convene three times a year, they discuss the actual steps you can take to decrease expenses, increase sales and, thus, increase profitability. It is much easier when you have peer support to make these changes. Several tire dealers join our groups just to make these improvements before they put their businesses up for sale.

We now get to New Year Two and continue to make improvements. By making these improvements, the profit increases exponentially and the business price tag increases. Finally, in New Year Three we have fixed the company. Now, let's see what someone may be willing to pay for it.

Formula for sellers

Many buyers who have purchased tire stores in the past as well as any banker, accountant or broker will use a method to determine how much a business is worth called EBITDA or earnings before interest, taxes, depreciation and amortization. This is simply the most accepted way to value a business. The only other consideration would be for owner's adjustments or onetime expenses.

This is again why you should always have professionals help you when selling a business. Your advisors are very familiar with this term and know how it works to determine how much your business is worth.

Here's another important point: value the business but not the real estate. You can decide to keep the real estate and lease it back to the buyer or if you want to sell the property and building separately, have a professional commercial real estate broker value your building so that you can get the maximum value for the property. Maybe your location is better suited for a restaurant and they might be willing to pay a premium for the real estate.

Now that we know what the process is to value the business only (no real estate), let's apply it to the company starting with the Income Statement for Old Year #3 (example #1, page 52):

Earnings	$(87,809)
Interest	$ 11,518
Depreciation	$ 8,555
Amortization	$ - 0 -
Owner adjust:	
Salary	$ 40,000
Travel	$ 9,845
Vehicle	$ 4,000
EBITDA	$(13,891)

Most people will pay a "multiple" of EBITDA for a business. Four years ago many tire dealers were able to get five times EBITDA when selling their business if, of course, they made a profit. In the current climate, many buyers are only willing to pay three times EBITDA. Even if you make a profit, you may want to wait until the market changes for the better, maybe then you will be able to get five times EBITDA. If we apply three or five times to this business it won't matter because it's not worth much. This is why you must take three to five years getting your financial house in order.

Three years later

It has been three years for this tire dealer trying to fix his business. Maybe he joined a 20 group to take advantage of experienced store owners to help him identify and make changes. Look at the Income Statement for New Year #3 (example #1A). As you can see, he added sales incentives and his sales went up a little. He pushed his gross profit up only 1% each year. He had a store manager who was not doing the job so he let him go. The owner decided to get back into the business and run it himself. All of these changes would have been made by a new owner, so by making them the current owner has not only increased his profits, but he has increased the value of the sale of this business. The EBITDA value of the business on New Year #3 will be:

Earnings	$147,323
Interest	$ 7,800
Depreciation	$ 8,555
Amortization	$ - 0 -
Owner Adjust:	
Salary	$ 40,000
Travel	$ 9,845
Vehicle	$ 4,000
EBITDA	$217,523

WOW! Just by getting back into the business on a day-to-day basis and making small changes to his business, the owner has now made it attractive for purchase. If the market is right and he could sell this tire store at a five times EBITDA (not counting real estate or the building), he could make $1,087,615.

Liabilities stay with the seller

Now the next most important thing in selling a business is to remember that you are still responsible for the liabilities of the company. The new buyers will pay a price that they think is fair, but only for the assets of the company, not the liabilities. Originally the seller wanted to sell his business three years ago for $1,200,000. Now, at best, he can get close to $1,100,000 before paying off the liabilities. Another surprise may be by selling the company for $1,100,000 there may be some tax liability from the sale. Always check with your accountant early so he/she can decide what, if any, taxes will be due from the sale of your company.

So let's review. The first thing we do once we decide to sell is get our financial house in order. Be sure to contact your accountant, attorney and a business broker. This process will take at least three years or longer, if you are not making a profit. If you own real estate, get a commercial realtor to value the building. Often a business broker can help sell the company and value the real estate. Once you have taken these steps you are ready to sell and enjoy the fruits of your labor. ■

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EXAMPLE #1
YOUR COMPANY NAME
INCOME STATEMENT
FOR THE YEAR ENDING — 12/31/XX

	OLD YR. #1		OLD YR. #2		OLD YR. #3	
SALES	$1,500,000	100.0%	$1,450,000	100.0%	$1,400,000	100.0%
COST OF SALES	825,000	55.0%	812,000	56.0%	798,000	57.0%
GROSS PROFIT	675,000	45.0%	638,000	44.0%	602,000	43.0%
EXPENSES:						
SALARIES/STORE	200,000	13.3%	200,000	13.8%	200,000	14.3%
SALARIES/OFFICE	40,000	2.7%	40,000	2.8%	40,000	2.9%
SALARIES/OWNER	87,500	5.8%	87,500	6.0%	87,500	6.3%
PAYROLL TAXES	44,602	3.0%	44,602	3.1%	44,602	3.2%
BENEFITS	51,915	3.5%	51,915	3.6%	51,915	3.7%
RENT	57,000	3.8%	57,000	3.9%	57,000	4.1%
INSURANCE	26,715	1.8%	26,715	1.8%	26,715	1.9%
GENERAL TAXES	18,901	1.3%	18,901	1.3%	18,901	1.4%
LEGAL & ACCOUNTING	3,800	0.3%	3,800	0.3%	3,800	0.3%
SUPPLIES	15,745	1.0%	15,745	1.1%	15,745	1.1%
DEPRECIATION	8,555	0.6%	8,555	0.6%	8,555	0.6%
GAS, OIL & REPAIRS	38,519	2.6%	38,519	2.7%	38,519	2.8%
MAINTENANCE	4,619	0.3%	4,619	0.3%	4,619	0.3%
ADVERTISING	25,000	1.7%	25,000	1.7%	25,000	1.8%
UTILITIES	18,503	1.2%	18,503	1.3%	18,503	1.3%
TELEPHONE	8,805	0.6%	8,805	0.6%	8,805	0.6%
DATA PROCESSING	12,503	0.8%	12,503	0.9%	12,503	0.9%
INTEREST	11,518	0.8%	11,518	0.8%	11,518	0.8%
TRAVEL & ENTERTAINMENT	9,845	0.7%	9,845	0.7%	9,845	0.7%
MISCELLANEOUS	5,764	0.4%	5,764	0.4%	5,764	0.4%
TOTAL EXPENSES	689,809	46.0%	689,809	47.6%	689,809	49.3%
NET PROFIT BEFORE TAXES	(14,809)	-1.0%	(51,809)	-3.6%	(87,809)	-6.3%

EXAMPLE #1A
YOUR COMPANY NAME
INCOME STATEMENT
FOR THE YEAR ENDING — 12/31/XX

	NEW YR. #1		NEW YR. #2		NEW YR. #3	
SALES	$1,450,000	100.0%	$1,500,000	100.0%	$1,575,000	100.0%
COST OF SALES	797,500	55.0%	810,000	54.0%	834,750	53.0%
GROSS PROFIT	652,500	45.0%	690,000	46.0%	740,250	47.0%
EXPENSES:						
SALARIES/STORE	170,000	11.7%	180,000	12.0%	180,000	11.4%
SALARIES/OFFICE	35,000	2.4%	35,000	2.3%	35,000	2.2%
SALARIES/OWNER	87,500	6.0%	87,500	5.8%	87,500	5.6%
PAYROLL TAXES	25,000	1.7%	25,000	1.7%	25,000	1.6%
BENEFITS	35,000	2.4%	35,000	2.3%	35,000	2.2%
RENT	63,000	4.3%	63,000	4.2%	63,000	4.0%
INSURANCE	22,000	1.5%	22,000	1.5%	22,000	1.4%
GENERAL TAXES	16,000	1.1%	16,000	1.1%	16,000	1.0%
LEGAL & ACCOUNTING	3,800	0.3%	3,800	0.3%	3,800	0.2%
SUPPLIES	14,000	1.0%	14,000	0.9%	14,000	0.9%
DEPRECIATION	8,555	0.6%	8,555	0.6%	8,555	0.5%
GAS, OIL & REPAIRS	23,000	1.6%	23,000	1.5%	23,000	1.5%
MAINTENANCE	4,619	0.3%	4,619	0.3%	4,619	0.3%
ADVERTISING	19,000	1.3%	19,000	1.3%	19,000	1.2%
UTILITIES	18,503	1.3%	18,503	1.2%	18,503	1.2%
TELEPHONE	8,805	0.6%	8,805	0.6%	8,805	0.6%
DATA PROCESSING	8,500	0.6%	8,500	0.6%	8,500	0.5%
INTEREST	7,800	0.5%	7,800	0.5%	7,800	0.5%
TRAVEL & ENTERTAINMENT	9,845	0.7%	9,845	0.7%	9,845	0.6%
MISCELLANEOUS	3,000	0.2%	3,000	0.2%	3,000	0.2%
TOTAL EXPENSES	582,927	40.2%	592,927	39.5%	592,927	37.6%
NET PROFIT BEFORE TAXES	69,573	4.8%	97,073	6.5%	147,323	9.4%