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## CHUCK BUCKLEY AND FRIENDS' CROSS-COUNTRY RIDE TO D.C.

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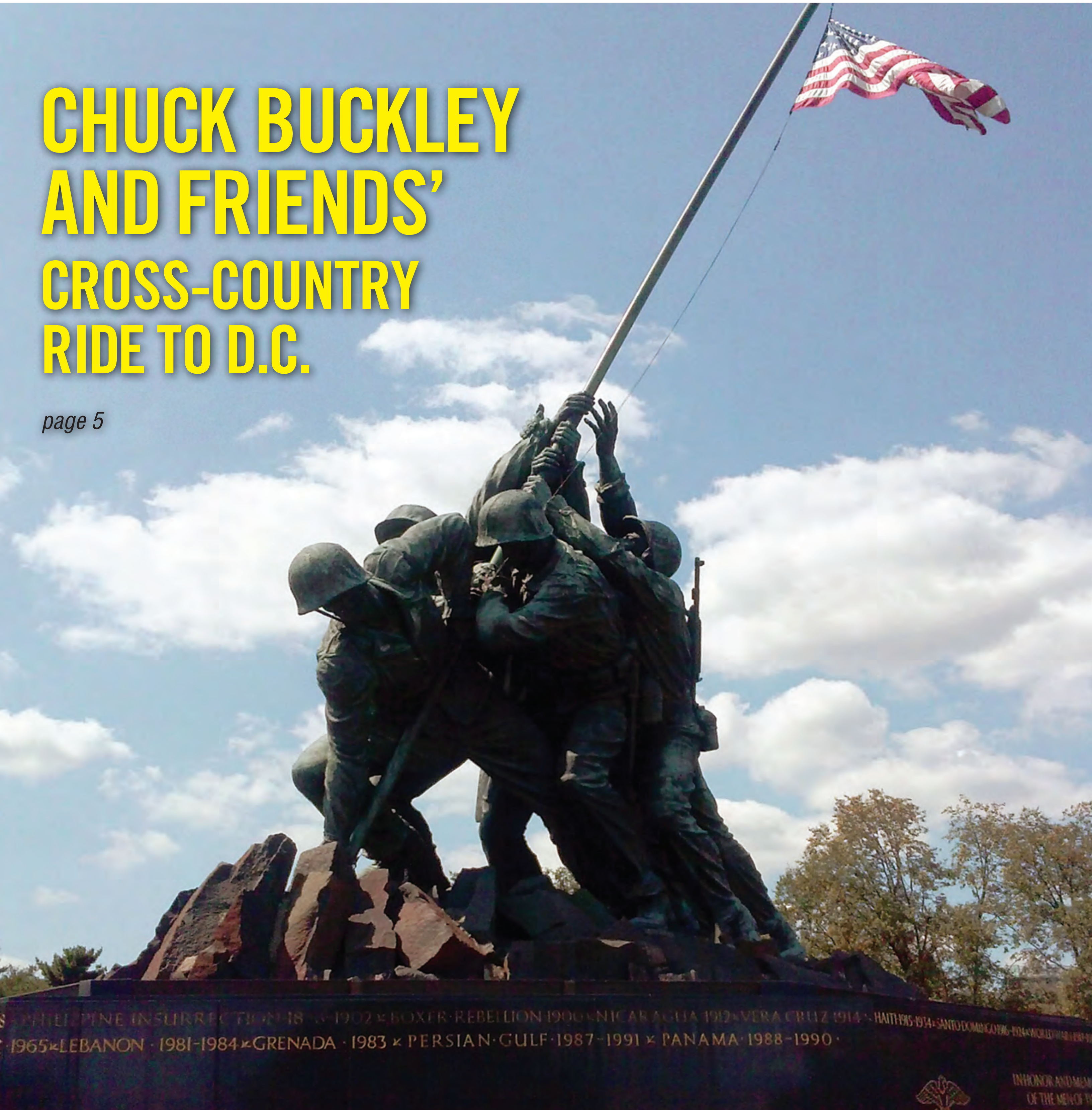

# Desperation in a Business Sale Deflates Value


**BY LAURA MARKEE**
*Markee Valuations LLC*

## CAPTURING VALUE THROUGH STRATEGIC PLANNING AND FLEXIBILITY OF OPTIONS

The very nature of the words "supply" and "demand" suggest immediacy, particularly "demand." The American Heritage Dictionary defines "demand" as "to ask for insistently," "to require" or "an urgent requirement or need." As demand's partner, supply seeks to "satisfy" this urgent requirement or "to make up for a deficiency."

Whether one is buying (demand) or selling (supply) a business, "an urgent requirement" to do either is a poor position from which to invest or divest precisely because of the lack of options. At the very least, the option to walk away from a transaction is an extremely valuable alternative to "an urgent need" to transact in the near-term. This article outlines three examples that illustrate the value of being able to "walk away" in negotiations or to simply wait patiently to create additional transaction value.

## CREATING OPTIONS: THE BENEFITS OF OUTLINING GOALS AND TIMELINES IN ADVANCE

Alternatives, or options, incorporate time, which is valuable. Additional time provides the opportunity to collect, digest and act on information one would not otherwise have at one's disposal. For example, is today or next year the best time in the economic cycle to sell or buy? Is the market for the company's products expanding or contracting? Are there more and better acquisition targets in the market? Could additional potential buyers be identified for the business to uncover additional value?

Additional time could provide a seller three potential buyers rather than one. The same can be said of a buyer, who could use time to find a better investment option. This is supply and demand at its most basic level. In the end, options provide time to process and act on the information to make an improved buy/sell decision.

Even if a recession were to unexpectedly arrive, long-term planning can provide the tools to not just survive, but to thrive. Consider the dramatic swings in the stock market. The Dow Jones Industrial Average closed at over 18,000 in the first half of 2015. Back in October 2007, the index peaked at over 14,000, but declined by more than 50% in the following months, to a low of 6,547 in March 2009. If an investor was forced to sell a stock position in 2009, the likelihood is that it would have been at a low price. The option to hold the stock through the recession and sell when economic recovery is underway provided the holder the ability to maximize value.

So how does a buyer or seller of a business create these options? For a seller, knowing one's financial timeline and goals in advance affords the time to determine the financial value of the business well before the target divestment date. Further, flexibility in the transaction timeline provides additional time to find potential buyers for one's business, uncovering additional value. For a buyer, time spent "window shopping" various businesses could uncover an opportunity that would have otherwise gone unnoticed.

For both the buyer and the seller, be willing to be creative in the negotiations. Not all transactions need to be concluded on the sale date. An intrinsic option built into the purchase and sale agreement can create value for both parties.

## OPTIONS STORY: THE VALUE OF A PLATFORM

We recently worked with a client in the food industry in Portland, Oregon, who is considering selling a portion of the client's business in a very short timeline. Because of this timeline, our client will probably be unable to capture the maximum potential value.

Portland's food scene is unique and burgeoning. Not a day goes by without the opening of a new restaurant, food cart, brewery or urban farm. Portland is the 10th fastest growing city in the U.S. and attracts people who value a high quality of life and place a lot of value on a robust culture of appreciating fine food. Invariably, the influx of food-oriented immigrants combined with current residents creates unique demand for established food delivery "platforms" for those interested in entering the food market expediently. Through these "platforms", an operator can expand into catering, restaurant supply and farmers markets.

This food industry client is considering exiting the retail food space to concentrate exclusively on their wholesale business. With fifteen years of building clientele and an established reputation, the retail platform is ready-made for expansion into catering, restaurant supply and farmers markets.

Unfortunately, the stress and effort needed to maintain the retail business has already passed the breaking point--the seller wants "out", and has exhausted the "walk away" option. Unless the seller gets lucky, the sale of the business will likely only reflect the present value of future cash flows from the existing retail operations.

Had our client considered exiting a year or more ago, they could have created a "walk away" option by investing time to find a buyer who would not only recognize the cash flow from the retail platform, but would also recognize the incremental value that the existing business platform provides. We estimate that if our client had taken the appropriate steps to prepare and market the business with the expansion, the right buyer who recognizes the value of the base platform could reasonably justify paying double the base cash flow valuation.

## OPTIONS STORY: THE VALUE OF GROWTH

Another client of ours is selling the client's business in the health and beauty industry in Portland and is debating growth assumptions with a potential buyer. The client benefits from knowing their financial situation and having the flexibility to "walk away" from a deal and is able to use this negotiating position to capture the value of growth in the company.

The percentage growth assigned to a valuation of future cash flows is among the most contentious assumptions debated by buyers and sellers. It is no wonder it is so hotly debated given that a 1% difference in growth rate assumptions can easily equate to a ten percent difference in sale price.

During these debates, entering into a "walk away" option can benefit both parties. Walking away allows sellers to prove that their growth rate assumptions are reasonable and amends the potential buyers' doubts. The sellers also buy time to look for more receptive buyers.

Alternatively, a modified version of the "walk away" option can be employed to cover the debated growth rate risk. Instead of paying one lump-sum for the business at close, the buyer could purchase the company at the buyer's growth rate valuation and negotiate a performance payout for the incremental growth purported by the seller. Whether or not the seller's growth prediction comes to fruition, both the seller and buyer have struck a fair deal.

Through knowing the value of the client's company and personal financial needs and goals, this client is likely to be able to accurately capture the value of the company by finding a price and structure that match the research. If the owners had not planned ahead and were forced to sell on a short timeline with limited knowledge of the market value of their company, they would likely have missed this opportunity to capture value. With a bit of flexibility and creativity in the transaction structure, the buyer and seller are more likely to create a deal that satisfies both parties.

## OPTIONS STORY: THE HIDDEN COST OF RETIREMENT

It is astounding how many clients approach us with the intent to sell and understand the value of their business right when they are ready to retire. Presently we have a rural hardware store owner who wants to divest but is running into the same issue we see repeatedly: the price is not high enough, yet she wants to retire. While there is no guarantee that the sale price could or would have been higher, the now-expired option to continue the business (or "walk away") would have improved her negotiating position and thus the final settlement price.

Hypothetically, let's assume our client knew in 2010 that she wanted to retire in 2015. She would have had the business appraised, informally "shopped" the business, and generally kept an eye out for market trends and opportunities. Essentially, she would have operated from 2010 to 2015 with a valuable "walk away" option.

In doing so, she would have not only known the sales price was insufficient for retirement but could have taken action to increase the value of the business. Alternatively, she could have sold in 2011 and invested the proceeds in a higher-yield investment to reach her goals. Further, she could have fielded a greater number of offers and perhaps uncovered a buyer who saw strategic value in the operations and valued the business beyond the base cash flows.

## CONCLUSION

These three examples all illustrate how understanding one's personal and professional financial situation, timelines, and goals well in advance of buying or selling a business can significantly improve the outcomes of both parties in the transaction. Understanding one's financial situation through forecasts is never perfect and can also be very inaccurate due to forces beyond our control--the economy in 2008 and 2009 is a great example. Nonetheless, planning for even a hazy future is better than no planning at all because it provides the user with valuable options in uncertain markets.

In the end, no one wants to "have to sell" or "have to buy". Knowing where you are and where you want to go with the option to "walk away" provides insulation from the urgent need to do those things we would rather not do.

*We would love the opportunity to discuss your business valuation needs. Please contact us at 360-601-0713, or at Laura@markeevaluations.com.*