

Selling Your Business: What Happens in a Buyer's Market?

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For almost two decades the M&A market has favored sellers, who have become accustomed to a competitive bidding process with multiple buyers, higher than historical multiples, purchase agreements with favorable terms, and relaxed partnerships with strategic and financial partners. As we head into the second half of 2022, it is clear that the M&A market is transitioning to a buyer's market. Several strong economic and demographic trends are causing the M&A market to shift to a buyer's market. The demographic trends are:

- Aging business owner demographic is changing historic supply
- Consolidation and vertical integration activity are beginning to normalize
- Higher interest rates are impacting borrowing economics for buyers
- Competitive bidding for platform companies is causing price retraction for add-ons

Recession on the Horizon

To add to the headwinds in the M&A markets, the state of the economy has bolstered talks of a recession heading into 2023. Some of the economic data:

- Historic higher than expected 0.75 basis point rate hike in June
- Lowered real growth expectations, with Conference Board GDP estimates reduced to 1.3% for 2022 and 0.2% for 2023 ¹
- Supply chain issues that continue to disrupt manufacturing, goods, and services
- Oil prices, while having abated slightly in recent months, remain elevated
- Fastest inflation increases in the past 40 years, with current inflation running at 8.5 % in July

As a business owner, do you have enough gas in the tank to make it to the next recovery and/or until the next seller's cycle?

Recessionary Side Effects for Business Owners

- 1. Cash Flow Challenges:** Limited access to capital at higher rates.
- 2. Lower Margins:** Expending valuable resources on low-margin products/services negatively impacts cash flow.

¹ <https://www.conference-board.org/research/us-forecast>

3. Ineffective C-Suite: Little or no management team to run the business after your departure.

4. Bad Decision Making: Lack of financial transparency limits fact-based decisions.

How Preparedness Planning Impacts Sale Value

Preparedness planning ensures that business owners receive maximum value at sale. It also ensures sellers receive the unlocked value and not the buyer. Below are multiple ranges and how lack of preparedness minimizes value.

EXAMPLE OF VALUE RANGE BASED ON MULTIPLES OF EV

Why should owners prepare before selling? In this example, there is a \$13.5 million gap between a 4x multiple and 7x multiple at sale.

Annual Revenue	\$30million
EBITDA	\$4.5million
Sale @ 4x	\$18million
Sale @ 5x	\$22.5million
Sale @ 6x	\$27million
Sale @ 7x	\$31.5million

Enterprise Multiples

	2017	2018	2019	2020	2021
\$0-\$25m	7.37x	7.6x	7.4x	7.5x	7.1x
\$25m-\$50m	9.2x	8.1x	7.3x	8.8x	7.6x
\$50m-\$100m	9.0x	8.9x	8.4x	9.4x	8.6x
\$100m-\$250m	9.0x	9.6x	9.8x	9.4x	8.8x
\$250m-\$500m	10.1x	9.6x	9.7x	8.9x	10.0x
\$500m-\$1B	11.4x	9.6x	9.6x	9.8x	9.3x

U.S. DEAL BY SECTOR: LOWER MIDDLE MARKET		HIGHEST PRIORITY ISSUES FOR BUYERS
Sector:	Transactions (6/30/22)	
1. Business-to-Business	609 YTD	1. Acquiring capabilities to fill internal operating gaps
2. Business-to-Consumer	214 YTD	2. Taking advantage of disruptive opportunities to extend offerings/ capabilities
3. Technology	208 YTD	3. Exploring acquisitions in adjacent markets
4. Healthcare	198 YTD	
5. Financial Services	145 YTD	

Understanding How We Got Here

The average age of a business owner in 2005 was mid-to-late 40s. In 2008, many business owners suffered large losses in value due to the Great Recession of 2007-2009. Over the next ten years, many business owners rebuilt enterprise value, and those that sold between 2018-2019 realized some of the highest valuations and sale prices in

20 years. It is important to mention that business values, deal terms, and multiples were favorable to sellers during this time. A large reason was the \$2 trillion in dry powder from financial buyers competing to acquire companies.

Fast forward to June 2023, and we see:

- That same business owner is in their late 60s or early 70s;
- Has been through one of the most challenging business environments due to the pandemic; and,
- Is staring down one of the most challenging economic downturns in the past twenty years.

Things to Think About

- Cost of goods/services sold will continue to go up, causing some of the increase to be passed on to the customer, potentially pricing products/services out of the market.
- Buyers request four years of financials when performing due diligence. Financials trending flat or upward during those four years positively impact your sale. Financials that are volatile or trending downward will negatively affect business value.
- Over the next eight years, 8.4 million business owners will try to sell their businesses, creating a competitive seller's market.
- Are you and your business prepared if a buyer knocks on your door?

Impact of Economic Cycle

- More competition creates a more selective buyer's environment.
- The purchase terms are more restrictive and will have a higher performance matrix if there is an earn-out attached to the sale.
- We expect lower multiples, especially for less attractive businesses.

Six Business Recommendations

1. Conduct a pre-due diligence audit as a key part of business planning.
2. Focus on your P&L, control expenses, and review all product and service margins.
3. Hire a consultant to work with you and your management team to minimize value risk and create a preparedness plan to unlock value.
4. Invest in building an advisory board that has operational experience.
5. Think about a growth partner to help you grow over the next five years and increase market value.
6. Remember, it costs money to sell your business, which you will lose in a failed attempt. Also, if you try to sell again, you will still have to pay for the services needed to get through the transaction.

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