

Hidden Drivers of Business Value

Presented by:

Roland Davis

M&AMI, BCA, CBI, SBA

DAVIS

BUSINESS APPRAISERS

Background as both an M&A for 20 years and a business appraiser for 10. Selling over 200 businesses and providing valuations for 300 enables me to help you by bringing a unique perspective from both experiences.

5 Factors

Seasonal Revenue
Customer Concentration
Private Equity QofE Firewall
High Demand Listing
Restaurant Analytics

Factors that can affect business value.

Upfront Potholes



Provide Detailed Analysis in Prospectus

First always identify listing potholes to any qualified buyer in the prospectus. In each of the 5 factors, we will offer suggestions to minimize their impact.



Value Killer

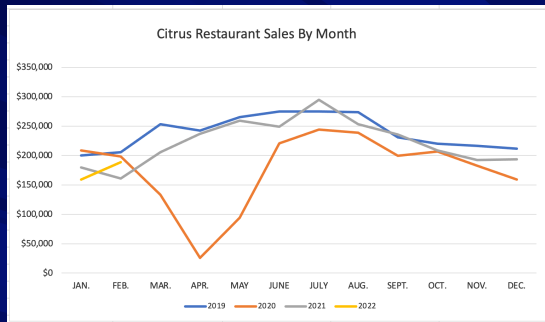
More than anything else not being able to produce financials or data will immediately reduce any business value.

Seasonal Revenues



- Cotton Gin
- Heating Oil
- Putting Golf

The primary reason is increased risk due to cash flow volatility, which raises the cost of capital, often resulting in lower valuation multiples. Seasonal businesses frequently face higher operating risks in the off-season, including maintaining fixed costs with low income. I have sold and valued many seasonal businesses with minimal discounts to value. Here are 3 examples.



Month	2019	2020	2021	2022
JAN.	\$200,055	\$208,233	\$179,711	\$158,000
FEB.	\$205,700	\$198,568	\$161,054	\$188,000
MAR.	\$253,035	\$132,931	\$205,452	\$188,000
APR.	\$242,500	\$26,195	\$236,933	\$188,000
MAY	\$265,121	\$94,104	\$259,276	\$188,000
JUNE	\$274,993	\$220,809	\$248,615	\$188,000
JULY	\$274,489	\$244,065	\$294,609	\$188,000
AUG.	\$273,503	\$238,612	\$253,216	\$188,000
SEPT.	\$230,552	\$199,614	\$235,477	\$188,000
OCT.	\$219,905	\$206,519	\$208,755	\$188,000
NOV.	\$216,260	\$182,760	\$192,017	\$188,000
DEC.	\$211,468	\$159,204	\$193,325	\$188,000
YEAR	\$2,869,437	\$2,111,697	\$2,668,440	\$347,000
TTM				\$2,674,000

- Sales
- Cash Flow
- Inventory
- Working Capital
- AR/AP
- No Forecast
- No Surprises
- Bank
- Buyer Confidence
- Wait a Year

This is an upfront pothole. You need to present clear evidence of what the seasonal effect looks like and how the current business is managing it. The most important is monthly cash flow. The business needs to demonstrate it has effectively buffered this effect.

Customer Concentration



The Greatest Risk to a Business Value

Not if a Discount, It is How Much of a Discount

Customer concentration will result in a discount of up to 30%. You need to understand what factors will determine how severe a discount it will be and how to predict it.

Concentration Discount Factors

How Long a Customer

Contract In Place for X Years?

Government or Private

Collective or Individual

Name	2023	2024	2025	Average
Trident Communications	39.0%	1.0%	57.8%	32.6%
City of Hampton Combined	40.0%	18.0%	29.5%	29.2%
Sheriff Department	4.4%	56.0%	8.2%	22.9%
Top 3	83.4%	75.0%	95.5%	84.6%

Longer customer history with committed long-term contracts in place will minimize the discount. All Federal contracts have a Termination for Convenience clause. This means they can cancel the contract at will. Finally, each customer has to be defined. On the slide :Trident is a General Contractor to which the business subcontracts. The City of Hampton consists of many individual department contracts and the Sheriff's department is one entity. Of all 3, the Sheriffs department is of most concern.

HELP!!!

DISCOUNTS!



How can you as a broker guess the discount?

Discount Judgement Guideline

Customer Concentration (Sales of Top 5 Customers/Total Sales)	
0	Less than 1%
1	1% < x < 10%
2	10% < x < 20%
3	20% < x < 30%
4	30% < x < 40%
5	40% < x < 50%
6	50% < x < 60%
7	60% < x < 70%
8	70% < x < 80%
9	80% < x < 90%
10	90%+

INDICATED SPECIFIC COMPANY RISK PREMIUM	10
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1% of Risk Premium = 3% Discount of Value

Here is a guideline The risk increases as the percentage of concentration increases. In the Case of 84% the discount would be 27% with no other factors considered.

Private Equity Hurdles



I sold several companies to private equity. It can be a great solution, but requires tremendous preparation with substantial due diligence. Also be aware the odds of successfully completing due diligence to closing is a big hurdle.

Value Double Dip



Business Valuation is for Business Value.
QofE (Quality of Earnings) is a Forensic Earnings Attack

The first challenge will be independent judgment of value. There is a difference between business valuation and Quality of Earnings. It is about 4x more expensive and 100x more intense. Have a business valuation completed prior to listing in the prospectus.

Quality of Earnings

Quality of Working Capital USD	12/31/2018	12/31/2019	12/31/2020
Current Assets			
Cash	\$ 6,150,320	\$10,822,145	\$ 14,338,717
Accounts Receivable, Net	1,819,547	2,289,497	2,103,224
Related Party Receivable	3,639	3,682	3,682
Employee Loan Receivable	1,386	2,816	1,141
Prepaid Insurance	-	-	60,899
Costs in Excess of Billings	-	436,235	189,042
Prepaid Taxes	12,999	(25,092)	3,566
Total Current Assets	7,987,891	13,529,283	16,700,271
Current Liabilities			
Accounts Payable	\$ 933,109	\$ 1,257,806	\$ 599,396
Related Party Payable	3,993,739	6,191,261	10,555,000
Billings in Excess of Cost	1,175,850	3,877,354	1,277,422
Accrued Payroll	-	-	30,272
Insurance Withheld	22,487	22,015	29,660
Other Payables	9,112	30,624	-
Allowance for Contract Losses	-	29,740	-
Deferred Income Tax Payable	243,261	215,495	174,320
Loan Payable to SH - Current	96,658	98,728	120,300
Total Current Liabilities	\$ 6,474,216	\$11,723,023	\$ 12,786,370
Net Working Capital, as reported	\$ 1,513,675	\$ 1,806,260	\$ 3,913,901

Quality of Earnings (QoE) is a deep-dive, forensic analysis of a company's historical financial performance to determine if earnings are sustainable and real. Business Valuation is the process of applying formulas (such as multiples or discounted cash flow) to determine the overall economic value of the business. In short: QoE validates the numbers; Valuation sets the price. Here is a quick example of QofE concern for working capital. They will go through each and every contract.

Firewall

- Compilation, Review or Audit in Prospectus
- Business Valuation in Prospectus
- EBITDA - Reasonable Compensation
- M&E and Real Estate Appraisal in Prospectus
- CPA Prepared
- Employee Agreement with NC
- Companies/Divisions Combo & Individual
- Prepare Finance Employees for Tsunami
- Cash Free Debt Free with WC

To manage the firewall, here is a bullet list of key items needed prior to the QofE

High Demand Listing



Maximize Price and Leverage Competition

My first experience with a very high demand listing was with a Trailer Park. I was overwhelmed with the response . Wasting a lot of time with prospective buyers. Another broker gave me his solution and it worked!

Evaluate on Comparable Basis

Proposal Structure with Deadline:

- Purchase Price - Total Price
- Form of Consideration Structure
- Escrow
- Financing
- Working Capital
- Due Diligence with Work Plan
- Level of Review
- Timing
- Termination, Agreement or Reject All

Set a deadline for a very detailed LOI. Ensure they all know how many others will be submitting offers. Force detail. No exceptions

Mobile Home Park

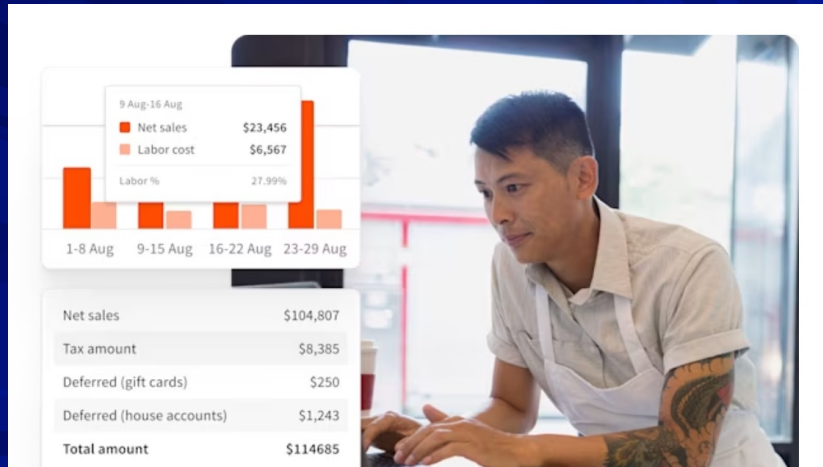
- 15 Buyers within a week
- Set Deadline for Proposal for Two Weeks
- Received 15 Proposals, Selected Two
- One Week for Best and Final
- Selected one
- Result - Cash, 20%+ & No Contingencies



This is the timing and result. I have this detailed in the download you can receive from Stacey.



Restaurant Analytics



Immediate Value Impact

The final factor is one that really developed in the past 5-7 years. That is the acceptance of TOAST as an analytic tool for restaurants. Having this software program and detail analytics will dramatically increase the value. I sold a 2 location restaurant chain to private equity in 2022 solely because Toast produced this level of detailed data for multiple years.



You will know if they have TOAST when the waitress has this handheld device.

Hour	Net Sales	Order Count	Guest Count
4	\$0.00	0	0
5	\$0.00	0	0
6	\$8.14	2	2
7	\$12,226.19	482	837
8	\$23,980.04	670	1378
9	\$32,436.91	809	2003
10	\$38,211.44	859	1914
11	\$39,015.74	887	1934
12	\$37,178.73	798	1832
13	\$28,699.83	607	1366
14	\$10,977.00	307	581
15	\$74.18	14	14

Here is just one example of data. Sales by the hour. And this is the tip of the iceberg.

Sales Categories	Category	Order Count	Item Count	Gross Amt
	Food	5008	18475	162200.5
	Liquor	590	1095	9280
	Bottled Beer	33	59	206.5
	Wine	1444	3096	21196
	Beverage	3751	7822	29701.52
	Retail	20	40	653.97
	<i>No Category</i>	0		
	Total			223238.49
Revenue Centers	Revenue Center	Order Count	Item Count	Gross Amt
	Dining Room	3373	21595	158562.29
	Bar	1580	6339	43888.98
	Patio	383	2653	20787.22
	Online Ordering			
	<i>No Revenue Center</i>	0		
Dining Options	Dining Option	Order Count	Net Sales	
	Curbside	190	5782.85	
	Dine In	5168	214526.36	
	To Go	77	2498.99	
	<i>None</i>	0	0	

Sales by item, by location within the restaurant, by dine in options and so much more. It does the same type of data by food item, by waitress etc. Really helps control labor and inventory. This is precisely what a valuator or buyer wants to see.



So much different that the old way years ago when the owner and buyer guessed or dreamed what was going on. If a Restaurant has TOAST or comparable product it will sell.

Financial Documentation & Housekeeping

- Record all sales and expenses
- Eliminate co-mingling assets
- Do your own due diligence (WYB it)
- Eliminate marginal “perks”
- Compliance with taxing authorities
- Clean the balance sheet and income statement. Compilation – CPA Often
- Organize and make records from Broker

We have talked about several factors but all value is anchored on documentation. As a broker I always insisted I had the data first that I could convey immediately if requested.

Considerations in Determining Value

- Seller's discretionary earnings/cash flow
- Value of tangible assets
- Value of intangible assets (reputation, goodwill, copyright, etc.)
- Comparable sales
- Replacement value
- Marketability factor
- Market segment
- Territory rights

Finally, here are really the key factors for business value for any business

For More Information

Presented by:

www.DBValue.com

Phone: 757-652-8417

DAVIS

BUSINESS APPRAISERS

Over 20 years many brokers helped me. I am no longer competition to you. What I do want you to know is you can call, text or email me anytime with questions or situations you want advice on. I want return the favor that enabled me to have a great career in business brokerage.

The presentation with notes and additional content can be downloaded.

Traits of a Marketable Business

Increasing Revenue & Cash Flow

Business buyers today look for operations with revenue and cash flow increases of at least 5% per year for the last 3 years.

Complete Financial Documentation

Buyers want provable cash flow; a truly marketable business will be capable of providing the following financial records for at least 3 years:

1. Federal Tax Returns.
2. Income Statements (including interims not older than 60 days)
3. Balance Sheets.
4. Sales Tax Records.
5. Payroll Records.

Continuity of Ownership

Has the business been owned by the seller for at least 5 years?

Facility Lease/Ownership

Buyers look for businesses with leases of at least 10 years remaining on a lease with annual increases of about 3%. Most buyers strongly prefer a gross revenue to rent ratio of no more than 6-8%.

Pricing, Terms & Valuation

The pricing of a business for sale is the single most important factor determining whether or not it sells. Regardless of how well positioned a business may be relative to other factors we have been mentioned, an overpriced business will often remain on the market for a very long period of time, receiving minimal buyer attention.

Terms of Sale

Other than pricing, the terms of sale are the most critical component determining the marketability of a business. For the businesses that are incapable of producing complete documentation of financials (see above) sellers should expect to finance 50 to 70% of the sale

Condition of Premises

The condition of the operation is extremely important, especially if the business deals directly with the public. A neglected facility is a frequent reason why buyers walk away from transactions or make offers significantly lower than the asking price

Existing Management & Personnel

Buyers need good people with good morale to ensure continuity. Is there management experience within the staff?

The 5 Basic Questions Always Asked by a Buyer

A good Business can answer the following questions with ease.

1. What's for sale?
2. Why's it for sale?
3. How was the price determined?
4. What financing is available?
5. What's the opportunity?

Davis Business Appraisers

364 Lomond Loop Chesapeake, VA 23322

Tel: 757-652-8417 Email: DBAValue@gmail.com

Visit us online at www.DBAValue.com

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Customer Concentration

If a firm derives a large percentage of annual sales from a few customers, the risk to the firm increases, as losing a major customer and source of revenues may have a significant adverse impact upon the performance of the company. As the customer concentration (measure by sales of top five customers divided by total sales) increases, the specific company risk premium should increase as well. If the company's top five customers account for more than 90% of total annual sales, a rating of ten is appropriate. A rating of zero is appropriate if the sales of the top five customers account for less than 1% of total annual sales. We suggest using the most recent fiscal year sales figures unless there is an anticipated change for the future (i.e. the loss of one of the top five customers in the next year).

While this factor analysis is not perfect, it represents an attempt to provide the business appraiser with a method of reinforcing the estimation of the specific company risk premium. As previously discussed, the estimation of the specific company risk premium is solely a matter of the appraiser's subjective judgment, and an incorrect estimation of this risk premium may have a significant impact upon the value estimate of the privately-held business. Therefore, there is a need for a quantifiable analysis for the specific company risk premium to further strengthen business valuations and to limit the appraiser's exposure to attacks on credibility and results. The factor analysis present herein, provides a foundation for business appraisers in developing the specific company risk premium.

Customer Concentration (Sales of Top 5 Customers/Total Sales)	
0	Less than 1%
1	10% < x < 20%
2	20% < x < 30%
3	30% < x < 40%
4	40% < x < 50%
5	50% < x < 60%
6	60% < x < 70%
7	70% < x < 80%
8	80% < x < 90%
9	90% < x < 95%
10	95%+
INDICATED SPECIFIC COMPANY RISK PREMIUM	
10	

Thank you for your continued interest in pursuing a potential acquisition with Selling Company, Inc. (“the Company”). Broker and the Company enjoyed meeting you. We believe that the information contained within the Data Room and the Confidential Investor Presentation is comprehensive enough to enable interested parties to perform an evaluation of the business in order to submit a letter of intent (“LOI”). Accordingly, we request that all interested parties provide, in writing, a non-binding LOI to Broker.

Letters of Intent are due on **Date at 5:00 p.m. EST**. Please email or fax your LOI to the attention of XYZ at Broker at _____ In order to allow the Company and Broker to evaluate proposals on a comparable basis, we would appreciate it if you would include the following:

- (i) **Purchase Price:** The total consideration to be paid by purchaser (purchase price) for 100% of the Company on a cash-free, debt-free basis.
- (ii) **Form of Consideration; Structure:** Indicate the form of consideration including:
 - a. The amount of cash and any earn-out. If there is a seller note or earn-out, please outline the terms and other pertinent information.
- (iii) **Escrow:** Indicate the amount, if any, and length of time that funds will be required to be held in escrow upon closing.
- (iv) **Other Conditions:** Describe any unusual or non-standard requirements regarding:
 - a. Indemnification requirements
 - b. Representation and Warranty provisions
 - c. Non-competition parameters
- (v) **Financing:** Please indicate whether your offer is contingent on financing, and if so, your process for securing such financing.
- (vi) **Working Capital:** As indicated in the CIP, the working capital to be delivered at Closing will be the average of the Company’s last 12 months of working capital (excluding cash) since the acquisition will be cash-free and debt-free.
- (vii) **Closing Diligence Requirements:** Please describe what due diligence you require and provide a work plan and associated timetable for completing this work as expeditiously as possible.
- (viii) **Level of Review:** A statement regarding the level of review that your proposal has received in your organization, including what internal authorizations were received to make your proposal.
- (ix) **Timing:** An indication of your proposed timetable for consummation of a acquisition, including any need for regulatory, corporate, or other approvals (both internal and external) necessary for you to submit and close on a definitive proposal.

After receiving the letters of intent, the Company, with the assistance of its advisors, will promptly evaluate all proposals received. The Company and Broker expressly reserve the right, without prior notice to you or other interested parties, to (i) terminate the process contemplated hereby or change the process at any time, (ii) enter into an agreement with any buyer at any time, regardless of the price and terms being offered by such party and other potential interested parties, and (iii) reject any or all proposals for any reason. In no event will the Company or Broker have any obligation to an interested party except pursuant to a definitive written purchase agreement, if any, entered into by the Company and the owners with such buyer.

Each potential buyer should assume that it may not be given the opportunity to submit subsequent proposals or to negotiate with the Company. In addition, no disclosure should be made with respect to your plans or interest regarding this proposed acquisition during this process without prior approval by the Company. A determination not to proceed with you in no way limits your obligations under the executed confidentiality agreement previously entered into between you and Broker, as representative of the Company (the "Confidentiality Agreement"), and the Confidentiality Agreement is incorporated herein by reference. Naturally, you will bear all costs of your investigation and evaluation of the Company, including fees and disbursements of your counsel and advisors, and the Company will bear all its own costs.

If you have any questions regarding the procedures governing this invitation, please feel free to contact us. Please direct all requests and inquiries only to Broker. We wish to reemphasize that under no circumstance should the management or the owners of the Company be contacted directly, without express prior permission from a Broker representative.

On behalf of the Company, we appreciate your interest and your cooperation in complying with these procedures.

Sincerely,

Records, advice ease business sale



By **MARCUS GREEN**

magreen@courier-journal.com

The Courier-Journal

Rhonda Gribbins has a knack for organization she attributes to a nightmare that haunts most small-business owners: the Internal Revenue Service.

When she sold R&R Limousine Service in February, her meticulous financial records were essential to a quick sale that fetched six times the 1998 purchase price. "I had everything at (the buyer's) fingertips. We closed in 10 days," she said. "I mean, that's just completely unheard of."

No statistics track how many small, closely held companies are sold each year, but estimates from the 2003 Business Reference Guide anticipate 250,750 firms will be sold this year.

And selling — or buying — a small business isn't as simple as settling on a fair price. Besides financial and tax issues, legal issues must be considered. That's where brokers, attorneys and accountants come in handy.

But an important key to any sale is solid financial records. The seller might know the business inside out, but the potential buyer does not.

Unfortunately, those records aren't always as pristine as Gribbins'.

"You would think that a lot of businesspeople would have great financial records," said David Hinton, president of Venture Resource, the Louisville business broker that handled Gribbins' deal and that has mediated the sale of more than 670 companies in its 23-year history.

Yet, he said, many entrepreneurs are more skilled at building and running the business than at keeping books. The failure to have complete and accurate financial data can break a deal.

Hinton said Venture Resource requires three years of any company's financial history, which



BY ARZA BARNETT, THE COURIER-JOURNAL

Owner Carey Fieldhouse, left, said R&R Limousine Service's thorough records helped her buy the company.

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to get the
C-J delivered
door each

can include tax returns, income statements and balance sheets.

Victor Meyerowitz, a certified public accountant with Meyerowitz and King PLLC, said financial record-keeping is a frequent stumbling block small businesses face at selling time.

He cited one case in which the owner of a manufacturing company had developed his own system of valuing inventory. However, the owner's inventory valuation lacked the detail that potential buyers wanted. "It broke the deal," Meyerowitz said.

Because the financials are often the catalyst behind a sale, Meyerowitz recommends that the process start as early as three years before serious negotiations start.

One optional part of the selling process is a business valuation, which objectively evaluates a company's worth. But Meyerowitz cautions that a valuation can be expensive and is not always necessary, especially for smaller businesses.

Carey Fieldhouse, who bought Gribbins' business, said the deal was made because the R&R Limousine Service had thorough financial statements. "That was the biggest thing for me because I was able to track all the numbers she provided me."

Owners looking to sell their businesses can expect to face a lot of decisions and technicalities, and professional help is warranted.

Brian Mazar, president of the Louisville and Lexington offices of Empire Business Brokers, said that many business owners don't have the expertise to effectively navigate the selling process. A business broker also guards the confidentiality of the companies they represent.

In finding a broker, a referral from someone who has worked with one is a good start, said Tom West, publisher of Business Brokerage Press in Concord, Mass. So is knowing that a broker is a member of the International Business Brokers Association, which certifies brokers.

Ron Green, business development officer at the Louisville Enterprise Group, an affiliate of Louisville Development Bancorp, consults with businesses that typically have less than \$1 million in annual sales. Potential buyers are usually aware when a company is for sale, or the business for sale already has interested parties, he said.

Green said companies interested in listing their businesses to a national audience are likely to request a broker's services. "You're going to definitely need a broker to do those kinds of activities."

Business owners should also enlist the help of their lawyers and accountants.

A lawyer can identify and remedy problematic contracts, said Middleton Reutlinger attorney Hank Alford.

For example, consider a noncompete agreement, "probably the most important asset you're buying," Alford said. A buyer's worst-case scenario is for the seller to start an identical business that cuts into a market the buyer just purchased.

Louisville attorney Stuart Adams said a lawyer can also help structure a deal that reaps the best tax benefits for a seller. In addition to capital gains taxes on the sale of a business, a seller must decide whether to receive deferred payments that spread income over several years, or receive cash, which is taxed during the year the business is sold.

Entrepreneurs might face other decisions before a sale. A common dilemma is whether a business for sale should continue making investments in its operations or let the new owner handle improvements, Hinton said.

Venture Resource is brokering the sale of a trucking company that Hinton said is financially strong. "But they're at the point where if they need to go after new business and they're going to expand much more, they have to go out and buy new equipment."

And then there are the intangibles that the seller must face: Am I leaving the company in good hands? Is the chemistry right? Is the buyer worthy to continue what I have started?

Those were questions facing Gribbins, a former forklift driver at Sam's Club who had grown her company from six to eight vehicles while adding 25 part-time employees and three full-time workers.

She was adamant that she sell to someone who was not already operating a limousine firm in the Louisville area to keep the integrity of the company's name. She said the chemistry was right with Fieldhouse, who had been looking to buy a business for more than a year.

In return, Gribbins said she was brutally honest about her business. "If you sugarcoat it," she reasoned, "it's going to come back on you."

She warned Fieldhouse that the month of August would be so uneventful that she would pick up the phone just to check for a dial tone. She shared bank statements and payroll records. Employees were not spared a truthful assessment either.

"I told her, 'This driver whines, but he's a good driver. This one will bend over backwards for you because he just wants to work,'" Gribbins said.

One out of four businesses will change hands each year, Hinton said. In many cases, he said, business owners are simply tired of putting in long days or have been scrambling to find reliable employees.

They need a break.

"When we sell one," Hinton said, "we know within about four or five years that if we've done a

good job, they're going to be coming back to us and say, 'Get me out of here.' "

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