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June 2016 - In This Issue:

SDE & BUSINESS VALUATION VARIATIONS

FINDING BUYERS FOR MY BUSINESS

WHAT IS MY BUSINESS WORTH?

WE BRING YOU SERIOUS BUYERS

COMMON BUSINESS SALES MYTHS

FINDING BUYERS FOR MY BUSINESS

In a recent meeting with the Owner of a Company I was asked "How do you find Buyers?" My typical response to that question is to rattle off - our website, national websites, our network of professionals, research, etc. Not sure why but I didn't say that - but I did said "Exposure Without Disclosure!". My further explanation was that we prepare a Profile that has enough information to intrigue possible buyers - "Exposure" but not so much as to identify the Company - to preserve Confidentiality - "Without Disclosure".

I went on to say that the Profile goes on our web site, national web sites, to our affiliates, and to target groups - Strategic Buyers, Private Equity Groups, Family Offices, and maybe specific targets for whatever reason, including input from the Owner.

SDE and Business Valuation Variations amongst Sellers, Buyers & Lenders

In the last issue, we provided a detailed 30-item normalization of Seller's Discretionary Earnings (SDE) for Mr. Husband's day care center.

In the example below, the seller's calculation of SDE equaled \$251,000, the buyer's evaluation of SDE totaled \$220,000 and the bank's SDE evaluation totaled only \$120,000.

Rather than repeat all the details of the 30 add-back items, below is a consolidated summary of the calculations:

	SDE per seller	SDE accepted by buyer	SDE accepted by lender
Total of EBITDA	42K	42K	42K
Add: Officer's Compensation (100%)	120K	120K	120K
Add: Wife's Compensation	-0-	-0-	-0-
Less: Impute salary to replace Wife	(15k)	(15k)	(15k)
Add: Daughters' Compensation	90K	90K	-0-
Less: Impute salary to replace Daughters	(31k)	(31k)	-0-

The Key is the Profile - to provide enough but not too much SPECIFIC information. From our literally decades of advising Business Owners - we know that it works.

WHAT IS MY BUSINESS WORTH?

It will cost you absolutely nothing and there is no obligation in giving us a call or an [email](#) to request a simple valuation of your business. Relying on a professional that understands your industry is important. It is also wise to work with someone who is aware of current trends; and that is working with both buyers and sellers daily. This approach insures you plan for and receive the maximum return on the transfer of your business.

INDUSTRY KNOWLEDGE & ACCESS TO BUYERS NATIONWIDE

Our presence as a Professional Business Broker is extended nationally as a result of being an affiliate of [BHarmony, LLC](#).



We also bring decades of experience and functional expertise in all the popular market segments as a result. Nothing takes the place or value in that of experience.

We partner with our clients to deliver solutions that help solve their most complicated needs prior to, during, and at the conclusion of the selling process. Our services are designed specifically to help small/medium size

Add: Rent being paid currently	36K	36K	36K
Less: Impute FMV of rent (60k)	(60k)	(60k)	(60k)
Less: Gain of sale of assets (non-recurring)	(15k)	(15k)	(15)k
Add: Owner's personal benefit from retirement contributions	12K	12K	12K
<u>Discretionary expense add-backs accepted by buyer, but not accepted by the lender:</u>			
Add: Charitable Contributions	2K	2K	-0-
Add: Owner's Health Insurance	5K	5K	-0-
Add: Golf club membership	12K	12K	-0-
Add: NFL Season tickets	2K	2K	-0-
Add: Cruise with spouse	5K	5K	-0-
Add: Residential housecleaning	3K	3K	-0-
Add: Residential garage door	2K	2K	-0-
Add: Residential painting	10K	10K	-0-
<u>Discretionary expense add-backs not accepted by the buyer or the lender</u>			

businesses and at a small business price. We go beyond the norm to develop new insights, prepare, market and drive results in the sale, thus insuring you receive the most value at closing. [Learn More](#)

AVOID COMMON BUSINESS SALES MYTHS

Myth #1 - I Can Sell It Myself

Myth #2 - I'll Sell When I'm Ready

Myth #3 - I Know What it is Worth

Myth #4 - It's Like Selling a House

We would welcome the opportunity to discuss these myths with you personally. [Email us.](#)

Next Issue

The Importance of Setting a Realistic Offering Price.

[Contact Us](#)

Add: Family cell phone	3K	-0-	-0-
Add: Family food purchases	4K	-0-	-0-
Add: Family restaurant meals	4K	-0-	-0-
Add: Family auto repairs	3K	-0-	-0-
Add: Family gas expenses	5K	-0-	-0-
Add: Unrecorded cash revenues	12K	-0-	-0-
Total Seller's Discretionary Earnings (SDE)	251K	220K	120K
Valuation Multiple	3.0x	2.85x	2.7x
Approximate Business Value	753K	627K	324K
	Seller's BizValue Estimate	Buyer's BizValue Estimate	Lender's BizValue Estimate

Lenders are very conservative in evaluating discretionary add-backs to SDE

Mr. Husband has a huge problem. He has run so many discretionary and non-business/personal expenses through his business that he has significantly degraded the value of the business. When it comes to discretionary expenses as add-backs to SDE, lenders will not usually accept them. Buyers have the opportunity to perform due diligence, so he might be able to convince them that some discretionary expenses are justified as add-backs to SDE by producing receipts for their review. But lender's underwriters are not interested in reviewing receipts to approve add-backs for discretionary expenses. It's just not going to happen. Most lenders limit their SDE calculation to EBITDA plus owner's salary and few other expenses. They will impute a salary expense to adjust for uncompensated spousal labor and they do want the cost of occupancy (rent) adjusted to fair market value. They may or

may not accept the owner benefit from retirement contributions as a valid add-back. But that's about it. Lenders are notoriously conservative and that definitely holds true in the financing of business acquisitions.

Because of discretionary expenses, the bank values the business at one-half its "true" value

In this example, the bank has valued the business at less than one-half the amount the seller feels his business is worth (\$753,000 vs. \$324,000). Mr. Husband has overpaid his daughters by \$59,000 and has deducted another \$72,000 of discretionary and personal expenses on the corporate tax return. His corporation's tax savings (at an effective corporate rate of 25%) on \$131,000 in discretionary expenses is about \$33,000. But, that \$33,000 in tax savings cost Mr. Husband \$429,000 in business valuation (vs. the lender - \$753,000 less \$324,000)!

This business may not be successfully sold. If it is, Mr. Husband will have to finance a substantial portion of the acquisition price

In light of the circumstances, at what value can Mr. Husband sell his business? Well, that's difficult to answer. Let's assume the buyer in this example makes a \$627,000 offer that Mr. Husband accepts. When the buyer applies for a loan to finance the acquisition, the lender's going to conclude the business is worth about \$324,000 (because they will not accept the \$59,000 in daughters' excessive salaries as add-backs, nor any of the \$72,000 of discretionary expenses). When a lender tells the buyer they can only base a loan on a \$324,000 valuation of the business, what's the buyer going to do? In most instances, with fear of overpaying as a result of the lender's valuation, the buyer will run the other way! It's a significant mental obstacle that is very difficult to overcome. Even if Mr. Husband has a buyer who is interested in completing the acquisition, he will probably have to finance more than one-half of the acquisition with a seller's note.

With adequate planning, Mr. Husband could have sold the business as it "true" value

This example highlights why planning for the sale of your business is so important. Mr. Husband's day care center really is worth about \$750,000, but it is very unlikely to be sold for that amount in its present condition. With three years of advance planning, Mr. Husband could eliminate all \$72,000 of

discretionary expenses. And, if he took the excessive \$59,000 paid to his daughters as additional salary for himself, that \$59,000 would be a valid add-back to SDE in the eyes of the lender. With those changes, his profitability would increase by \$72,000 and his salary would increase by \$59,000. Both the buyer and the lender would evaluate the SDE at the full \$251,000 and the business could easily be sold for about \$750,000 (assuming all other obstacles have been adequately addressed).

Small businesses are primarily valued based on Seller's Discretionary Earnings (SDE), but SDE can be subject to interpretation. It's important to understand that prospective buyers and lenders may not accept all the discretionary expenses and add-backs you might try to include in the calculation of SDE. Although you can negotiate with buyers' interpretations, there is almost no room to negotiate with lenders' interpretations and like it or not, lenders are a major factor in the successful sale of a business. However, with adequate planning (preferably three years in advance), this obstacle can be erased by eliminating discretionary expenses being run through your company's tax return.



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