

BUSINESS

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Calculating business' worth is an exercise in fluctuation

Experts recommend that owners have records in order before selling business.

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When Amy Kahl bought Suzen Sez Boutique, 2421 University Ave., last year from Susan Welch, her mother-in-law, Kahl said she accepted what Welch was asking.

"In our family, it was going to be fair," Kahl said.

Welch said she worked closely with her accountant to determine the purchase price by analyzing the value of fixtures, financial statements and inventory.

"Working with my daughter-in-law, I had to make sure those numbers would work for her," she said.

That kind of family transaction is com-

mon, but not all deals involve such friendly buyers and sellers or have such favorable outcomes. Some small businesses prove very marketable, while others fade out of existence.

The difference, said Michael Hoesley of CornerStone Business Services, is how a business has been prepared for sale.

"If you know what you're selling, you're going to end up with a higher price," he said. "That's why you see some little companies able to sell and others not able to sell."

Selling how-to

Business owners need to get their internal house in order before they sell, said Bruce Hutler, Virchow Krause partner in charge of business valuation and litigation support. Trying to convince a potential buyer that a business was profitable, for example, when financial statements show otherwise is difficult.

"Sometimes it's done on a fire-sale approach," Hutler said. "They should clean up financial information before

hitting the market."

When it comes to a sale, a company's earning potential is secondary along with customer lists, equipment, inventory and good will, Hoesley said. What's most important is the company's earnings and cash-flow history.

"Regardless of what industry you're looking at, the buyer wants to see money," he said, adding that credit availability also is a key factor.

But Hutler said intellectual property like customer or subscriber lists could be valuable to strategic buyers and he's seen bidding wars over unprofitable companies.

Hoesley, who has handled 160 transactions in a dozen states and five countries since 1985, said a company's structure also plays a role in a potential sale. Some companies are hierarchical, making it easier to transfer ownership, while others are centered on the owner.

He said replacing the president of IBM, for example, wouldn't dissuade

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people from investing in the company, while an experienced brain surgeon transferring his

practice to a younger associate might be more difficult.

In some cases, Hoesley said, new owners find they're not suited to the business for reasons that may not be apparent before the sale. When a profitable New Jersey bakery was sold

for \$1.5 million, the new owner had a major problem when he didn't want to get up at 2 a.m. to prepare the day's products. In another case, a buyer who bought a Washington, D.C., door construction company encountered great difficulty in

dealing with government contracts, and the business suffered.

Setting a price

Hoesley said many people don't realize that the value of

small, privately owned companies fluctuates along with the stock market, although it tends to be somewhat delayed.

"The valuation of closely held businesses was very high up to 2000," he said. "It's unlikely we'll see those types of

values for some time."

After a decline, Hoesley said values have rebounded, making it a reasonably good time to buy or sell a business.

External factors also affect a company's value, Hoesley said. Madison's furriers, for example, became less valued after years of animal-rights protests, and selling a travel agency became more difficult with the growing popularity of the Internet and online travel bookings.

In the smallest companies, Hoesley said, new owners essentially are buying a job for themselves.

Owners of more valuable companies often mistakenly view their businesses as jobs instead of investments, Hutler said. The structure of a business offer is crucial to a sale and some transactions are vague about whether working capital, inventory or other assets are part of the deal, he said.

"You need to understand exactly what's included in the purchase price," he said. "Is the buyer going to assume the debt of the company or is it the responsibility of the owner who's selling? Is the offer cash, stock or a note to be paid over a number of years?"

Companies sometimes are sold with seller financing, but he said if a buyer defaults, the seller may get back a business that's worth a lot less.

Hutler said some sales include "earn-out" provisions in which the business must perform for the owner to be paid a certain sale price. Sometimes some of the sale price is paid directly to the owner in recognition of the owner's contribution to the business.

Paying part of the price directly to the owner also could reduce tax liability but also could lead to discrepancies over the company's value.

Mark Bugher, former state revenue secretary, said in that job he sometimes found differences between the value of a business reported for tax purposes and the value reported to lenders.

Hutler said business owners sometimes are unrealistic about what the company is worth.

"Sometimes it's what they feel it's worth versus what the business justifies in actual value," he said. "They may pass up a fair offer."

He said transitions also can be difficult if a former owner stays on as a consultant but still wants to make decisions.

Ted See of Middleton has developed the Tascon Business Analyst, software designed to make business valuations based on optimum value.

"The very process you go through is the process of a full financial analysis of the company," said See, who also has written books about business valuation.

He said the software replaces various "rules of thumb" used in business valuation. One example is that a supper-club owner should sell at twice the gross profit.

"No one knows where that rule of thumb comes from," he said.

See said he's putting together a national distribution network for the software and also markets it through his Web site: www.thebusinessanalyst.com.