

When Is the Right Time to Sell a Business?

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Determining the right time to sell a business is often a matter of making an educated choice. There are, of course, some instances in which a business owner is forced to sell due to distressed situations arising from health issues, partnerships disputes or business underperformance, among others. For the most part, the decision to sell can be anticipated and planned for—particularly when it involves retirement, a change in lifestyle, or a move to “bigger and better things.”



Once the decision to sell has been made, the next issue a business owner must confront is *when* it is the right time to sell. Businesses operate in an environment governed by cycles, some of them general in nature, such as macroeconomic cycles, and some others more specific, such as industry or even company cycles. Hence, the decision to “time the market” is not a trivial one, as it can greatly impact the ultimate value realized by a business owner.

What we refer to as the “market” is the compilation of economic conditions, interest rates and the tax and regulatory environment—all of which have a significant impact on timing the sale. Case in point, prevailing interest rates will affect the required return on investment a buyer will require on the purchase of a business. This is because buyers will compare the return they expect to achieve from buying the business with the

alternative returns that can be achieved elsewhere through alternative investments. Ultimately, the lower the buyer’s required return, the higher the value such buyer may be willing to pay.

The “market” by its very nature goes through a series of recurring cycles—a dynamic that often leads to imbalances either on the demand or the supply side of the market. When these circumstances are extreme, we tend to regard them as “bubbles” and business owners who are able to recognize these conditions will try to sell into the bubble. However, the problem is that bubbles are quite difficult to recognize during their gestation and they tend to collapse rather abruptly.

For example, during the late 1990s a number of industries experienced imbalances mainly as a result of the “dot com” and technology booms. The emergence of Internet and e-commerce technologies created a business frenzy fueled by widely available venture capital. This, in turn, led to the abandonment of sound business models in the name of the “new economy” and the disregard for bottom line results for the sake of capturing market share. By the end of the decade, this situation proved to be non-sustainable. The “dot com” bubble burst in what became the “dot bomb” recession of the early 2000s.

So, what clues can we rely on to recognize the emergence of a bubble? For the most part, bubbles tend to last three to four years—although this is just a rough generalization. Their emergence is probably preceded by some form of “buzz,” and as a re-

sult, many companies in the related industry begin to sell for multiples that far exceed the norm (usually 60% - 100% above). An important point to emphasize is that the highest multiples are likely to be paid when the bubble is about 75% through its ascent. This is the point where there is still foreseeable growth to be realized by prospective buyers and it is this potential growth that constitutes a significant driver behind the buyer's willingness to pay more for a business.

Aside from the issue of market timing, there is the issue of age. In other words, should the age of the seller be taken into consideration in deciding when to sell a business? More specifically, should a 60-year-old owner contemplating retirement take advantage of the opportunity to sell the business at the top of the valuation cycle or as close to it as possible? Or in contrast, should a 25-year-old owner wait for the next cycle to sell? In either case, the answer lies in the fact that age is not a good criterion to use when deciding whether or when to sell a business. It is highly unlikely that a bubble will recur in the same way in the same industry. Therefore, owners fortunate enough to be operating in an industry that is undergoing a bubble seriously should consider selling whatever their age.

A potential argument for waiting for the next industry cycle is that through several more years of top line growth and profits, the business might generate a higher valuation. But this is an option fraught with countless risks as the prospects for the industry, the business' potential and the owner's staying power may change at any moment. Consequently, the valuation multiple that the business will command is likely to be different. For instance, if an owner chooses not to sell at the top of a bubble at a

valuation of say, 10 times operating earnings, then she is betting that she will be able to realize a higher value some years later. But, the underlying assumption is that she will be able to obtain a higher valuation resulting from an equal or greater valuation multiple applied to a larger operating metric. However, this is a big gamble as valuation multiples are significantly impacted by the prospect for continued growth.

Although there are numerous reasons that may drive a business owner to sell his or her business, market conditions play a prominent role on the ultimate timing and value for the transaction. Temporary imbalances in an industry are unlikely to be repeated in the same way for the same causes. And, to the extent they do, it is likely to be in a different form involving new business processes or technologies. Therefore, regardless of their age, business owners operating in an industry which is undergoing bubble conditions should seriously consider taking advantage of the increasing valuations that result before the inevitable collapse.

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