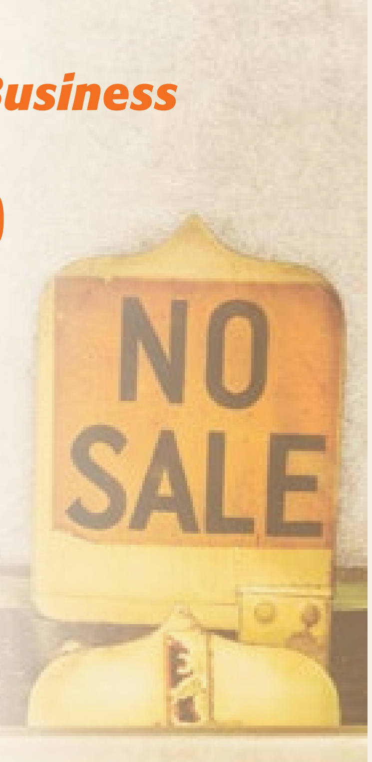
Reasons A Shop Doesn't Sell For Top Dollar



by Art Blumenthal, MBA, CBI

Many auto service shop owners and tire dealers have focused virtually their entire lives on growing and developing their businesses. When it's time for a change – retirement, moving on to another career opportunity, family or health issues, etc. – a seller can find that a huge gap exists between what they had hoped the business would be worth and what a buyer will actually pay.

In my experience as an automotive service-specific business broker, I have been able to identify 10 problems that can undercut an asking price. In the July/August 2016 issue of *Shop Owner*, the countdown of problems 10 thru 6 was published. I am presenting the rest here along with the good news that each can be remedied if given enough time. Here is the countdown of problems 5 thru 1 that you should watch out for:

5. Owner is Aging and Has Slowed Down

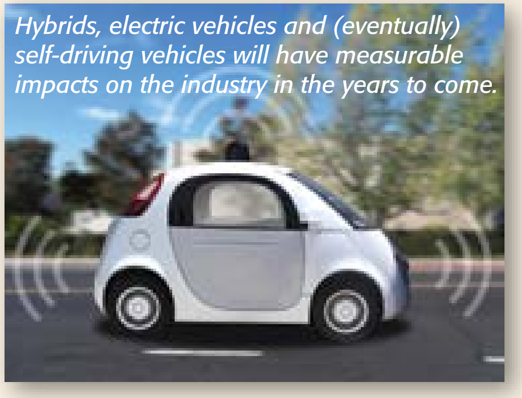
It is not uncommon for a business owner to become complacent after running a shop for many years. This loss of energy or lack of "fire in the belly" has a way of spilling over into the business fundamentals: marketing and advertising for new customers decreases; investment spending on equipment upgrades and facility improvements gets cut back; innovation and employee training on new technology comes to a grinding halt; and the business glides on autopilot.

An owner who has become overwhelmed and burnt out almost unavoidably transmits their lack of zeal and drive to their staff and customers in a number of subtle ways. The net result is that the company's performance slowly begins to deteriorate. Reduced customer satisfaction is reflected in poor Internet ratings/reviews and decreased visits. Unfortunately, this situation can become even more pronounced when the owner finally makes the decision to sell the business and mentally "checks out" at the most important time for ensuring a high value.

4. Profound Industry and Specialty Changes

In the early 20th century, those who owned livery stables either converted their businesses to service automobiles instead of horses or became extinct. Significant change still occurs in the early 21st century. The future outlook for the aftermarket industry and the specialties within it will have a direct impact on the valuation and marketability of a business during a sale.

For example, transmission specialists or carburetor specialists, once thriving segments of the auto service industry, are no longer growth businesses. Tire dealers who have not expanded their businesses to include a high percentage of underhood auto service may face stiff and unbeatable competition if a big-box tire store selling highly discounted tires moves in next door. Hybrids, electric vehicles and (eventually) self-driving vehicles will have measurable impacts on the industry in the years to come.



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Businesses facing obsolescence or those mired in a shrinking industry will face an uphill battle when it comes time to transitioning or selling the company. Business owners can avoid this situation by maintaining a diverse offering of products and services that are relevant to the market. Not only will this assist in mitigating the impact from declining sales, but also will demonstrate to a prospective buyer that the business has a clear path to growth in the future.

3. Choosing the Wrong Lender

The time between obtaining loan application approval to securing transaction funding is a process that can take 10 weeks or more. Many deals have fallen apart during this period because the buyer became aligned with the wrong financial institution or loan officer. There is nothing worse for all parties involved to find out six weeks into the process that either the loan terms previously promised were not correct or, worse, that the bank underwriter declined the loan.

In the field of business acquisitions, not all banks/lenders are the same. One bank may turn down a borrower for a SBA 7a loan, while another institution will readily accept it. Every lender has its own unique and frequently modified lending criteria. Additionally, there are third-party financial service companies that can prequalify a buyer, package a loan and coordinate the approval process through one or more financial institutions that are most likely to

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fund a particular business acquisition.

Buyers should consult with the business intermediary representing the sale to determine which lender has prequalified the transaction for funding. A business intermediary who has a track record with a particular bank can serve as a great coach to help navigate the buyer through the process and provide tips on how to answer questions that are likely to come up during the underwriting process. Therefore, buyers need to ensure they are working with the right lender from day one or else valuable time will be wasted that can cause the deal to become compromised or lost to another, better prepared candidate.

2. Commercial Property Issues

The mantra "location, location, location" applies not just to residential properties, but also to the retail locations of businesses in the tire and auto service industry. An aftermarket business buyer will seek assurances that they can either purchase the real estate outright or be able to sign a long-term lease with the landlord with renewal options.

Banks will want to see that the buyer has the right to operate their business at the location for at least 10 years from the projected closing date. Additionally, buyers don't want to feel that they may have to relocate or close the business as soon as they have paid off the loan. Buyers want to know that if they decide to sell the business after a few years, there will still be at least 10 years left on the lease. Ideally, having a lease with options totaling 15-20 years or more will help maximize the value of the business.

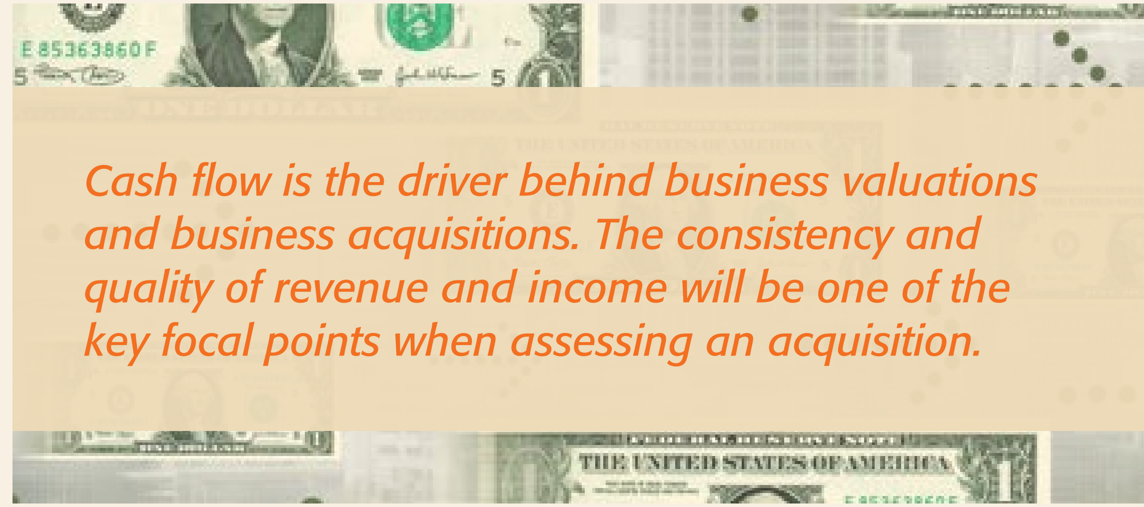
Besides lease options, the type and size of the facility can also have a material impact on the sale. If the facility is not large enough to provide the enterprise a sustained growth path, a buyer could become disinterested. Another issue could be the value of the property or the rent was determined before the recession and is now overpriced in terms of current market value or the ability of the business to afford the rent from the current cash flow. Ideally, the rent as a percentage of sales should not exceed 7%. If rent is above 10% of sales, then expect that the value of the business will significantly decline.

Business transactions involving the sale of commercial real estate can be hampered by Environmental Site Assessments (ESA's) – Phase 1 and Phase 2. A property that is contaminated from underground lifts or floor drains can be very costly to clean up and will have an impact on the closing. When this situation arises, it will be important for the buyer and seller to have a clear understanding of the costs involved to resolve the issue, which party is responsible and whether a price offset will be warranted.

Other complicating factors involving commercial real estate include working out who is responsible for performing any needed deferred maintenance or complying with current building codes.

1. Decreasing Revenues/Profits

The majority of buyers are seeking profitable businesses with year-over-year increasing revenue and profits. When a business has a less stellar track record with varied results or possibly declining revenue and/or profits, complications with the business sale are likely to occur. Not only will decreasing profits and revenue impact the availability of third-party funding, but they will also impact the business valuation. While buyers traditionally purchase businesses based on anticipated future performance, they will value the business



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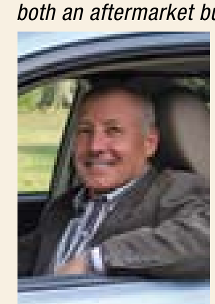
on its historical earnings in this case — with the major focus being on the previous 12-24 months. The seller should be able to articulate accurate reasons for the decline when there are deteriorating financials. Many lenders will decline a loan if there is a 15% or more annual decline in sales or cash flow unless it can be clearly shown that the reason for the decline is no longer applicable and the financial performance has rebounded in recent months.

Cash flow is the driver behind business valuations and business acquisitions. The consistency and quality of revenue and income will be one of the key focal points when assessing an acquisition. It all relates to risk. Those aftermarket businesses with dependable recurring revenue, reasonable expenses, acceptable profit margins and the financials to prove it all will be in the greatest demand.

Summary

Most aftermarket business owners are emotionally invested in their businesses. It is not uncommon for the seller to become so emotionally attached that they look past some rather glaring problems that a business intermediary, lender or prospective buyer will immediately recognize. It is natural for a seller to want to obtain the highest price possible for their business, but ignoring any potential problems will only provide the seller with unrealistic expectations. One of the duties of a qualified business broker is to be honest and direct in educating a business seller on potential challenges, the range of realistic transaction prices and the most creative terms and structuring options that might be utilized. Knocking out any potential issues up front rather than late in the sales process should be what every business owner strives for when approaching the sales process. **SO**



*Leveraging more than 30 years of experience as both an aftermarket business owner and aftermarket technology executive, **Art Blumenthal LLC** provides business intermediary and advisory services to both buyers and sellers of industry businesses of all sizes. Art is a member of IBBA (International Business Brokers Association, Inc.). For more information, to get your business "Sellability Score," or to initiate a no-obligation confidential consultation, visit **www.art-blumenthal.com**.*