EVERGREEN™ EXITS

A DIVISION OF EVERGREEN WEALTH SOLUTIONS

SETTING A PRICE FOR BUYING OR SELLING A BUSINESS

FROM THE DESK OF: EDWARD BARONE

In the overall U.S. business landscape, mergers, takeovers, and buyouts are occurring at a steady rate. If you were to place your business on the market would you know what it is worth? Setting the price is often the most important aspect of the transaction.

Many business owners tend to base their companies' worth on "sweat equity." However, that does not have much to do with market value. To learn the true value of your business, you need a more scientific approach, starting with a valuation method. The most common methods are the following:

1.Comparables. Value is determined by the ratio of sales price/earnings of recently sold companies (similar in nature to your own) multiplied either by your earnings, or by your revenues.

2.Discounted cash flow. Value is determined by your company's projected cash flows discounted back to the present at a rate that incorporates risk.

Other factors also come into play, such as company size, industry, customer base, growth potential, competitive positioning, product mix, technological capabilities, and management talent. It is also important to realize that a company's value will vary with different buyers. Some buyers identify synergies and are willing to pay a premium; others will try to undercut naïve sellers who do not know their own company's value.

So, how do you become more knowledgeable about your company's worth? Retain the services of a professional valuator —a qualified individual who is objective, understands the buyers in your market, and has years of appraisal experience.

THE IMPORTANT ROLE OF TAXES

In all the excitement of buying or selling a business, it may be hard to focus on taxes, but they affect the real price of the business. So when trying to assess the real price of
your business, look at the components that make up the real price, including:

The type and quality of the consideration
The timing of the payments
The tax effect of the transaction.

These components overlap, with the type and quality of the consideration and timing of payments greatly impacting the overall tax effect of the transaction. To determine the real price of your business, you will need to compare the tax effect of various reporting alternatives and a range of prices. Intangible assets, such as goodwill and intellectual property rights, both inside and outside the business (if any) will need to be identified. You should also consider other interrelated agreements, such as employment, consulting, or noncompete. In other words, hold off on negotiating until you know what you really have and what your possible options are.

TAXABLE OR NOT?

The majority of businesses are sold in taxable transactions. Nontaxable transactions include mergers and situations where the seller takes as consideration buyer stock or qualifying property in an exchange. Although the general tax-planning rule is to avoid or postpone tax, there are some advantages of a taxable sale, such as:

When the seller gets cash, concerns about the quality of buyer stock or the limitations inherent in selling buyer stock are nonexistent.
The buyer does not have to contend with the seller as a shareholder and can get a stepped-up basis in the assets.

The parties do not have to worry about the technical requirements of a tax-free or tax-deferred transaction.

A taxable sale can be structured as either an asset sale or a stock sale. In general, the seller wants a stock sale and the buyer wants an asset sale. See the chart on the next page for a comparison of these two alternatives.

ASSET VS. STOCK SALE

ASSET SALE	STOCK SALE
Seller: Potential double taxation resulting in less net, after-tax proceeds. Potential ordinary income, recapture, or higher tax rates on some assets. Business can generally sell without minority shareholder consent.	**Seller:** One level of taxation. Capital gain treatment. Minority shareholders may not want to sell.

TIMING OF PAYMENTS

Sales are often structured as installment sales whereby the payments are extended over a number of years due to the buyer's lack of sufficient funds on hand. Installment sales are also useful since many small businesses are sold with an "earn-out" provision, in which the buyer pays a contingent amount over a number of years, based on the company's performance. Use of the installment method for tax purposes is advantageous for the buyer as it helps match the recognition of gain to when cash is actually received.

If you are considering a change, be sure to consult your tax professional to help determine the true value of your business, and your attorney to review the sale documents for accounting and tax considerations.

Are you ready for next steps? Click to complete our Business Readiness Survey and connect with our team.