Selling Your Business:

Why You May Not Want to Wait

Can valuations of privately held businesses really continue to rise or are we on the cusp of an owner-demographic bubble?

By Lance R. Tullius

Valuations of privately held businesses have been on the rise for several years, dating back to the end of the most recent recession. Given the depths the world economy hit not that long ago, it's quite impressive, and perhaps amazing, to consider just how bullish the mergers and acquisitions market has been for private businesses. I've been in the M&A business for almost 25 years, and the recent years are the best I've ever seen. But is this nearing its end, or is there another gear left?

Recall that in its darkest days, the recession felt dire. Bad news came from every direction and in forms never before seen. Corruptness, greed, ignorance, over-valuation and senselessness combined to crush hopes, dreams and even modest lifestyles. To imagine, back then, that we would ever see markets as good as they recently have been seemed impossible. The Dow Jones dropped from a high of over 14,000 in

October 2007 to a low of just over 6,000 in March 2009. We lost 10 years of value appreciation — unprecedented since the days of the Great Depression.

So what did people do? They prepared for the worst: they cut expenses, saved and hoarded cash, and largely ceased investing, both individuals and businesses alike. As they always have, and likely always will, things eventually got better; but unlike most past market dips and dives, although investing returned, spending at anywhere near the same pace has not, even to this day. Fears of overextending still drive people and business — to the point that businesses are still slow and cautious to hire, and consumers remain relatively frugal.

A PERFECT STORM. The result has created an interesting "perfect storm," with unprecedented levels of pent-up cash on the balance sheets of corporations and institutional investors combined with challenging organic growth prospects because of continuing consumer skepticism. Interest rates remain lower than ever, meaning access to cash is as easy as ever, but also that cash is not a particularly attractive financial asset to possess. Growth is as hard to come by as ever before, but it also is as sought after as ever before. Thus, with cash in heavy supply and growth in high demand, that growth is being bought in the form of business acquisitions.

This acquisition movement has been sustained for roughly five years, a fairly long period of ongoing momentum. Some argue that there is no end in sight, pointing primarily to the still vast supplies of cash all over the world. But most are convinced that we have, in fact, already reached a peak in valuations of private businesses and a settling is on the way. But these folks aren't arguing that cash is drying up, or even that acquisitions will necessarily slow down. Rather, they point to other interesting prospects.

A recent article by Axial Networks stated that each day for the next 18 years, roughly 8,000 baby boomers will turn age 65. Think about that: That's almost three million people turning 65 every year. Add to that the estimate that roughly 70 percent of all business are owned by people over age 53, and think about the impact that will have on the merger and acquisition climate over the next 20 years. If we go a step further and imagine that all the owners over the age of 53 decide to sell their businesses, the article says the amount of capital required to close all those transactions would exceed $10 trillion dollars.

A NEW BUBBLE. The article further suggests that while there has been a stock market bubble, a housing bubble and a dot-com bubble, never before have we seen an owner-demographic bubble. But this bubble is coming. It's likely inevitable. There's estimated to be about $535 billion available to acquire businesses; that's not enough to acquire anywhere near all the businesses that are expected to be on the market in the near future. The bottom line is that there will likely be far more businesses wanting to sell than there will be legitimate capital available to acquire, an absolute inverse of what has existed for some time now.

Contributing perhaps less, yet still figuring to be influencers in the likely forthcoming decline in valuations, are other macroeconomic factors. Interest rates will rise at some point. We don't know when, but it's certain that it's coming. At that point, money will become more costly, and valuations will decline. It's basic math.

CONSOLIDATION IMPACTS. Even today, with so many acquisitions having taken place, many industries have seen consolidation. As industries consolidate, buyers generally pay less to acquire. This is simply an effect of supply and demand. In the early stages of industry consolidation, a key driver is the many buyers and few sellers. Consolidation then advances as more sellers come to the table, eventually satiating the appetites of the buyers. During this phase, buyers sometimes cannibalize each other, with certain buyers acquiring other buyers, and, in the process, making the market for acquisitions less competitive. Eventually, as buyers grow exponentially through this acquisition movement, the landscape of the industry changes dramatically, with consolidation largely in the rearview mirror.

The buyers are much larger now; they have satisfied many of their strategic acquisition initiatives; and, while they may be still open to acquisitions, they become more selective and essentially opportunistic. In such a movement, which has been evidenced historically across numerous industries, valuations almost always come down.

To suggest then that valuations still have ample room to rise is to ignore that these developments will occur or that they will have the expected impact. To me, they all seem as close to inevitable as you can get.

That doesn't necessarily mean that if you're a business owner you should absolutely move to sell right now. As an owner, you have your own unique objectives and reasons for being in business and, potentially, your own plans for succession and exit. But all business owners should be informed and factor outside developments and prospects into your short- and long-term planning. Because I believe that if all business owners who anticipate selling in the next five years (of which I assure you there are many) were to do so, a very compelling case could be made for selling your business now in the midst of what, today, remains a great seller's market. **PCT**

The author is a partner at Tullius Partners, an investment banking firm specializing in merger, acquisition and financial/strategic advisory services for select industries.