VALUE IS NOT ABSOLUTE

SELLING A BUSINESS FOR MORE THAN FAIR MARKET VALUE INVOLVES KNOWING YOUR TRUE VALUE TO THE BUYER.

By Dexter W. Braff, MBA, MS

Imagine a scenario in which a company is pursuing a large managed care contract that could generate an additional $2 million in revenues and $300,000 in earnings. The company cannot cover a small segment of the contract's service area and the request for proposal specifically stipulates that the provider cannot subcontract to outside providers. They have identified an acquisition candidate that would solve their problem. The candidate generates $1 million in revenues and $200,000 pretax. From a fair market value perspective, this specific buyer is irrelevant. The price would be based solely on the candidate's performance. But from an investment value perspective, the picture changes entirely.

For this particular buyer, the candidate controls $3 million in revenues ($1 million on its own and $2 million from the potential contract) and $500,000 in earnings ($200,000 on its own and $300,000 from the contract). The investment value to this particular buyer is substantially more than fair market value because of the unique benefits this buyer can derive from the transaction. In this case, the buyer, given the particular strategic objectives, brings as much, or even more, to the valuation equation than the seller.

Of course, buyers rightly prefer not to pay for value that they bring to the table, but they will do so, albeit reluctantly, because it makes good financial sense. Consider our example above. Let us say that this particular buyer generally requires a 25% pretax return on its investment. On the seller's own merits, the maximum price it would pay for our acquisition candidate is $800,000 ($200,000 in earnings divided by $800,000 price equals a 25% return). With an additional $300,000 in earnings from the managed care contract riding on the acquisition, however, the buyer could pay substantially more for the company and still anticipate an aggregate return of 25% or more. Although the price might be more than fair market value, it is nevertheless a good deal for both the buyer and the seller.

There are several fundamental strategies sellers can employ to drive their pricing above fair market value and capture the elusive and highly desirable investment value premiums. First, recall that these premiums evolve from how well the seller's company meets individual buyers' strategic objectives. Accordingly, sellers should present their company to a broad cross section of strategic buyers. Broadly categorized, these buyers include horizontal integrators—HME, infusion, and home health agencies; vertical integrators—hospitals, nursing homes, insurers, and managed care providers; and venture capital-funded new market entrants. By presenting to multiple qualified buyers, each pursuing multiple acquisition strategies from vastly different perspectives, sellers maximize the opportunity to match their particular strengths with a buyer's unique needs. The better the fit, the higher the potential premium.

Second, sellers should steadfastly avoid the unsolicited inquiry trap. This trap occurs when a buyer calls a seller expressing interest in possibly acquiring the company. If the seller agrees to begin sharing information with the buyer, the investment value opportunities are severely constrained. From a negotiating standpoint, the seller is strictly in a reactionary position, often giving up control over the content, timing, and flow of information.

Third, sellers must correctly identify their sources of value. Most focus almost entirely on revenues and earnings, factors that, while very important, primarily support a fair market valuation. Instead, emphasis should be placed on identifying the types of intangibles that frequently drive investment value. These include breadth of geographic coverage, market penetration, name recognition, strength of infrastructure, access to managed care, creative use of management information systems, unique product and service programs and packages, and access to restricted licenses.

Fourth, to optimally position their company, sellers should do everything possible to know each buyer's strategic objectives. For publicly held companies, this information can often be derived from annual reports, press releases, and securities analysts' reports. For privately held firms, sellers can obtain strategic insights from marketing materials, competitive intelligence gathered by sales representatives, and feedback from previous sellers, if any. The perceptive seller will gain clues from the buyers themselves based on what they focus on during initial discussions. Sellers also should simply ask buyers why their company interests the buyer. You will be surprised with the depth of response you may get.

When these strategies are combined with a patient, confident, and problem-solving negotiating style, buyers and sellers can pull together outstanding transactions. □

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