

## Why Some “Ordinary” Businesses Sell For Massive Premiums?

A study was done recently to determine how business valuations have evolved over the years and it came as no surprise to me that in the past twenty years, small businesses have typically sold for around two times the seller’s discretionary income total. The same holds true today yet a certain segment of the market commands an enormous multiple regardless of the business’ size.

I’ve always said that there are certain fundamentals that any business can have which will increase its value when the time comes to sell. These include:

- Clean books and records
- A reasonable selling price
- Good terms including seller financing
- An easy transition period to a new owner
- Non specialized skills required to run the business

These are all things that any seller can work towards implementing so that they ultimately get a higher price. However; there are certain components that some businesses have can dramatically increase the multiple to five, seven and even ten times as opposed to the general 1-3 times valuation.

The businesses today that command these multiples include: marinas, alarm companies and storage businesses. There’s also been an inflated market created by medical related businesses although this may be more so because buyers have a delusional view of this industry segment. Instead, let’s focus upon why these other businesses sell for such high multiples:

### **Recurring Revenue:**

Any business that has a built in revenue base will command a higher selling price. It’s a whole lot more enticing for a buyer to know that they will have an immediate and locked in long-term revenue stream the day they get the keys to the business.

One of the most challenging aspects to business is when you have to “go into business everyday”. When you have a company whereby there are contracts in place, written or verbal that provide you with a base income every month, it’s a huge benefit. Marinas, storage companies, alarm monitoring companies, service businesses such as water and coffee suppliers to offices, equipment maintenance companies with annual customer contracts, all fit this bill.

The concept of recurring revenue is not only attractive; it just makes good business sense. It’s far easier to expand a business knowing that you have a base to work from everyday. It’s also a lot easier to sell additional products or services to a customer who is already buying from you.

**“Buy land - they’re not building any more” – Will Rogers**

Perhaps this statement explains the gold rush we've been experiencing in the state of Florida. Investors and developers are making gobs of money throughout the state, and have been for about fifteen years and there is no let up in sight. Now, it's not an easy game to get into but think about the offshoots to this concept and marinas are a perfect segment that is taking advantage of this scenario. Furthermore, there is a moratorium in some parts on building new marinas. These factors are pushing the prices up dramatically. A marina that owns the land is commanding up to ten times the Net Operating Income while ones on leased land, with a long-term lease, are still getting 4-6 times the NOI. These are insane numbers when compared to other businesses for sale.

### **Limited Specialized Knowledge**

Any business where a new owner with general business skills can take over an run will improve the value versus ones where specialized knowledge, experience, licensing etc is required. Take a look at storage units. They are all over the place and they're building more of them. It has been an absolute explosion in the past several years (I've always wondered what people did with all this stuff before?). While no business is easy, you certainly do not need a ton of experience to take over a business such as these. Of course, no business is easy; and I've always said that the business in the world is everybody else's. However; one can easily adapt to this environment and quickly ramp up to the skills needed to successfully manage it, and better yet, to have it operate absentee. Think about it: you have a storage building with limited capacity, and once the space is filled, you can't really go out and market it more. You can increase the fees, improve client turnover, but once it's filled, it's filled. And, best of all, the checks come in every month.

### **It's A Beautiful Thing when it's Harder to Lose an Existing Customer than To Gain a New One**

Nobody thinks about changing alarm companies unless they incur a break in and the alarm doesn't go off. Likewise, if you have a water supply business, or marina and you provide the services you're expected, people don't change. Storage businesses are even better examples: people just keep their "stuff" there year after year and never move it. Actually, it's a beautiful thing when you own this kind of business. These are the ones where customers either don't give a second thought to paying the monthly fees, or they realize that it's simply not worth the hassle to change to a competitor. In other words, you'd have to really mess things up to lose a customer.

By the same token, getting new business is not easy for the same reason that it's hard for one business to lose a customer; it's difficult to gain one from the competition. But, the costs and time required to keep an existing accounts are infinitely less and easier than getting a new one. This is a very attractive concept for any prospective business buyer especially ones with limited professional or entrepreneurial experience.

The question you must ask yourself if you're thinking about buying a business is what you want from the business. While some businesses command massive premiums, the

potential growth may be limited. However; the downside risk is far less than other types. Also, these lend themselves to absentee run situations which make them even more attractive to some. On the other hand, if you have entrepreneurial blood running through you veins, you'll probably be bored with these particular types and so there are many other options available to you as well.