By Rock LaManna

Can we cherry-pick the data used in valuations?

When printing company owners order a valuation, they often ask if we can cherry-pick the information to create the business's financial picture. They have a number in mind and know which data would support that number.

You may think, "No, you can't do that. There are rules about valuations." Or, you may think, "Why not? A valuation is an arbitrary number."

Let's start with what a valuation is supposed to accomplish and who "creates" it.

WHAT IS A VALUATION?

A valuation is a compilation of data that creates a snapshot of a company's financial performance. Your valuation from 10 years ago – or a few years from now – will look different than the one we prepare for you today.

We calculate a numerical range, your valuation. With that number, you can start thinking about an asking price. Or, you can use the insight from your valuation to strengthen your company and help you with planning.

Across all industries, 70% to 80% of transactions fall apart because of "unreasonable economic expectations" of the seller. It is critical for a seller to know what the company is worth and why.

WHY DO A VALUATION?

There are typically four reasons why owners in the graphic arts industry call us for a valuation:

1. Preparation for a sale
2. Succession/tax planning
3. Adding/exiting partner
4. Legal requirements (ESOP, divorce, etc.)

Especially in the graphic arts industry, succession is a common way to transfer the business to the next generation. When we work with family businesses, the valuation helps the family manage their collectively-held asset. A central report like a valuation helps all parties feel confident about the data.

The reason for the valuation will drive who should do it and the methods used.

WHO CREATES THE VALUATION?

At LaManna Consulting Group, our valuation team is made up of financial experts and market research experts. With our industry background and technical knowledge, we can assemble and interpret the correct data. We also have an external valuation company we can refer you to or who can assist us when necessary.

Our team provides a Broker's Opinion of Value, sufficient for many scenarios. Depending on the client's needs, we evaluate financials, assess the market, review comparables, and build a professional, defensible valuation.

CAN WE PICK THE IDEAL DATA TO BUILD THE VALUATION?

In hockey, cherry-picking is also called loafing or floating. It happens when a player does not play defense with the rest of the team but remains near the opponent's goal to be ready to score. The phrase has a negative connotation because it suggests an unfair advantage and goes against the generally-agreed upon approach to the game.

Cherry-picking in valuations is misleading and reduces credibility. Cherry-picking omits, ignores or suppresses evidence that could lead to a complete picture. We need to choose the data that gives the best view and is helpful for our client's decision-making. We have an obligation to create a credible and defensible valuation.

You can see why cherry-picking data does not serve a client, especially if it paints a skewed or inaccurate picture of the strength of the business. And it certainly doesn't help the sales process if an owner bases an asking price on unrealistic numbers.

If the valuation shows that the business cannot command the asking price for which the owner had hoped, we can work with the owner to strengthen the company. With our guidance, the owner can build the business in ways buyers tend to value and are willing to pay a premium.

WHICH DATA IS USED FOR THE VALUATION?

We start with current market conditions and comparables, using the most up-to-date and thorough information for the geographic area and the type of business. Current data is essential because markets can change. Understanding the graphic arts industry – especially labels and packaging – is vital. Valuations based on outdated information or an uneducated view of our industry do not serve the seller and can create a false picture of the future of our sector.

Next, we look at the company's finances. Typically, we use the most recent three years of financial reports and tax returns. We may contact your CPA and tax preparer. We are building a case for your valuation based on the information you give us. The quality of your data determines the quality and credibility of your valuation.

CAN WE GO BACK FURTHER THAN THREE YEARS FOR DATA?

At LaManna Consulting Group, we look at three years of history and the current year. If the current year is far enough along – and there is

confidence in the projection – we will use it as one of the three years. Some valuation methods use a larger timeframe, but we do not use those methods.

Why three years? Three years is the minimum to build the kind of financial and operational documentation buyers want to see. Without an agreed-upon snapshot of performance, the buyer and seller are challenged to agree on a fair asking price.

Remember that the valuation helps you, the owner, understand your business and how to prepare it for sale, succession, or to grow.

Buyers interested in your business will do rough calculations to see if your asking price is in the ballpark. If your price seems realistic, they will order a valuation from their own experts. They typically will not look beyond the three-year window. If the number they come up with is substantially different than your asking price, they may negotiate or walk away.

If the prospective buyer is interested and wants to continue the process, you must support your asking price with the kind of evidence a buyer would find credible. These are situations where we hand match you with a buyer and pursue an off-market sale so we can build a case for your value and business potential geared to that specific buyer's criteria. This takes an experienced matchmaker.

WHAT ABOUT GOVERNMENT STIMULUS MONEY?

If you received stimulus money during the pandemic, we must reflect that in the valuation. Otherwise, your financials might suggest you were more profitable than you were.

If you are not forthcoming with data that a buyer needs, you can come across as untruthful, which is a weak place to start a negotiation.

HOW DO WE HIT THE NUMBERS?

Sellers should order a valuation two or three years before a sale. This runway gives the owner the time to make adjustments. As you prepare for sale, remember that a buyer may not value the same things you do, which is why it is essential to work with an advisor on your pre-sale strategy and planning.

Let's start with a quick comment that should reassure you in these unsettling times. A valuation is not an asking price – nor is it the amount a buyer will ultimately offer. Your valuation is a formula based on your EBITDA or other financial data, thresholds, current industry multiples, and other factors. The offer also includes the terms, which can be a substantial portion of the total deal package. To command top dollar with optimal terms, you'll need to position yourself to lead with your aptitudes and strengths.

To improve our clients' numbers in the areas that a buyer will value, we usually start with sales and profitability. The time it takes to achieve target sales revenue and profitability is why we recommend you have a valuation done two to three years before considering a sale.

Your uptrends and the improvements you make must be visible in your financials. Many entrepreneurs camouflage profits to the level the law allows to reduce their tax burden.

As we prepare your valuation, we will consider as many factors as possible to put your business in the best light. Our goal is to show a pattern of solid and consistent financial performance, supported by documentation that is relevant and defensible.

Having an industry expert by your side advising through the valuation process will help you properly document and defend your value and potential in the buy-sell arena. It may be daunting to think about getting a valuation right now, and the results may not be as you hoped. We tell our clients bluntly: face the truth. Don't start one of your life's most critical financial processes with incomplete or cherry-picked data. Remember, your business valuation is a tool to help *you*. Let's work together to make it a good one. **LNW**

Rock LaManna is The Deal Flow Guy. He helps qualified buyers and investors find businesses that are ready for acquisition or transition. On the sell side, he helps owners improve their businesses, increase value, and position strategically in anticipation of sale, exit or succession. Sign up for his newsletter at TheDealFlowGuy.com and start the process.