ink ADVISORY

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WHEN TO SELL YOUR BUSINESS AND WHEN TO DEVELOP: HOW TO AVOID MISSING THE MOMENT?

M&A Insights

WHEN IS THE BEST TIME TO SELL A BUSINESS, AND WHEN – TO GROW IT FURTHER?

If you don't make the decision yourself the market will make it for you

Many companies reach a point in their development when growth slows down. On one hand, previously set goals are achieved, sales and profits are stable. On the other hand, stagnation starts creeping in – product and service lines are not being improved constantly; top management and personnel lose their motivation and drive.

If you see this – the company has hit its plateau. Owners often see this stability as a sign of success, but in reality – it is a dire warning of the things to come.

If no active measures are taken at this stage, within 2–3 years:

- the company will begin to lose market share;
- key and ambitious employees will jump ship;
- product and service offerings will become obsolete and the company will fall behind its competitors;
- the business will exhaust its growth potential, stagnate, and its shareholder value will stop growing or even decline.

Symptoms of an approaching plateau signal to the owner that there is a narrow window of opportunity and it's time to make a key decision about the future of business. Two optimal investment decisions are possible: **(1)** find internal strength and new ideas to actively grow the business or **(2)** reap the benefits of hard work and sell the business.

Many owners choose a third path – the easiest and yet the least advantageous: they neither sell their business nor pursue active growth strategy, instead drifting along without strategic changes. This leads to erosion of market value even if the cash flows remain stable.

Life develops in cycles, so even if the path of active growth is chosen, sooner or later the owner will detect the signs of an approaching plateau and face the same dilemma again.

Path 1: Active Growth

If you're ready to invest time and resources – choose the **Growth Path** that involves:

- reviewing strategy and market positioning;
- expanding into new markets and product segments;
- boosting productivity through introduction of new technology;
- raising capital to fund development programs;
- active M&A transactions to consolidate the market.

Suitable, if:

- the owner has new ideas, ambitions, and energy;
- the market is growing, but competitors are growing faster;
- the company's potential is not yet fully realized

Path 2: Sell

If the inner drive is gone, but the business is still attractive to market players – **Sell**:

- to a strategic buyer interested in synergy;
- to a financial investor who will scale the business and exit later;
- to the team or an outsider with capital through MBO / MBI.

Suitable, if:

- cash flows are stable;
- the market is saturated and stagnating;
- new development programs are unlikely to yield sufficient returns;
- conditions in the financial markets are favorable for exits

COST OF DELAY: HESITATION CAN REDUCE BUSINESS VALUE BY 40-50%

The market value of a business is largely determined by investor perceptions of its future prospects. When investors buy a company or a share of a company, they are essentially buying its future cash flows – or at least, how they perceive them. Less commonly, investors may have an interest in the company's assets — licenses, equipment, etc. Even less commonly they use this tool to simply get rid of a competitor.

To simplify valuation, buyers and investors often use a method where a company metric (typically EBITDA, but can be something entirely different) is multiplied by a factor (a multiple), and net debt is subtracted – the multiples (or comparables) method.

Investor expectations are always reflected in the multiples. If investors believe growth is slowing down and the company or even the industry as a whole has reached the plateau, the multiples sharply drop.

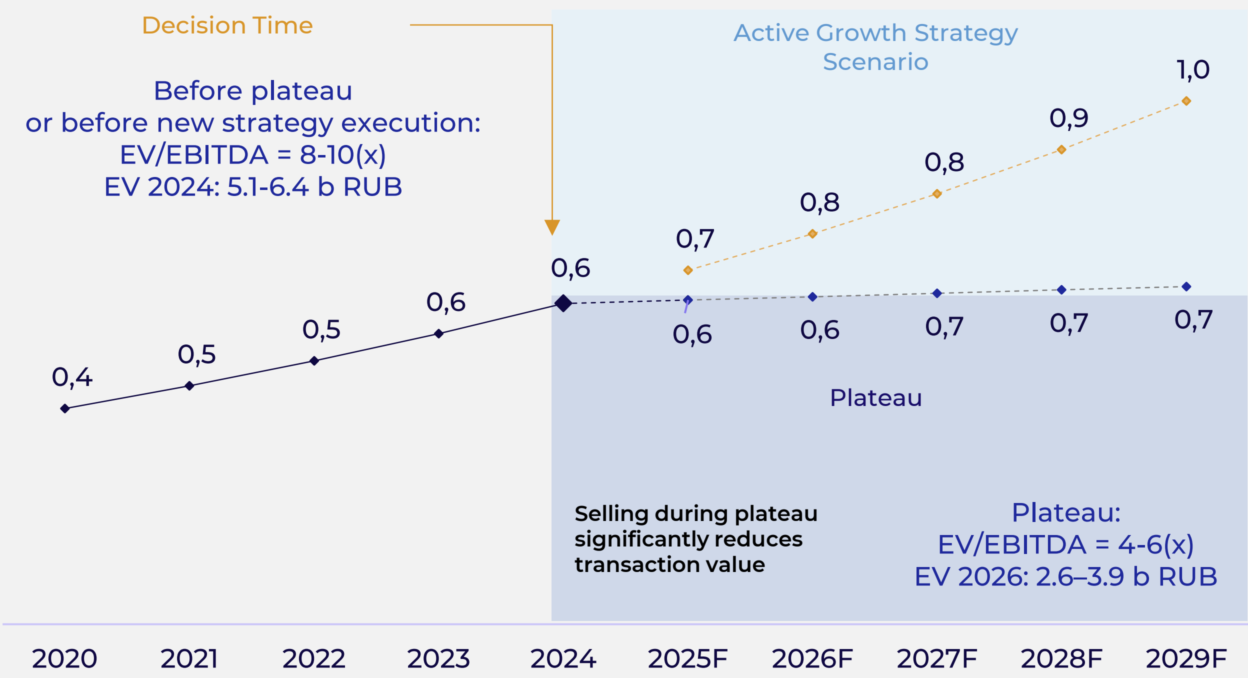
Conversely, if they see a company introducing new technologies and taking active strategic steps to strengthen or gain market leadership, the multiples can increase. Often even within one industry there may be outliers – the best performing companies enjoy higher multiples as the investment community perceives them to be better investments.

This means the period just before the company reaches its plateau is the optimal window for exiting – from that point and on market value declines unless active company development resumes.

Morgan Stanley research[1] confirms this: when a company generates value above its cost of capital (ROIC > WACC[2]), EBITDA multiples are significantly higher.

In the case described in Exhibit below, the company displays signs of an approaching plateau. Without a decision to sell or pivot strategy, its value could plummet by 2025-2026.

Exhibit: The Case of a Russian FMCG Company
Historical and Projected EBITDA from 2020 to 2029, b RUB



[1] Valuation Multiples as of April 23, 2024

[2] ROIC – Actual return on Invested Capital (Equity plus Debt) vs. WACC – Required return

HOW TO AVOID MISSING CRITICAL JUNCTURE?

The most common mistake owners make is missing the timing to either sell or scale up. De facto, the owner chooses to continue extracting profits – at the cost of long-term value.

What happens when you hit a plateau?

Many business owners try to "buy time". The business appears to be operating well and generating stable cash flows, but:

1. **Company stagnation is already underway:**
   - processes and technologies are not evolving;
   - product and service offerings are not modernized;
   - motivation of top managers and personnel is on the decline;
   - no innovation or fresh ideas;
   - efficiency and competitiveness decline.
2. **The market environment changes:**
   - consumer preferences shift;
   - new strong players enter the market;
   - advancing competitors consolidate the market and benefit from economies of scale;
   - market leaders introduce new products and technologies;
   - consumption and demand may lag behind growing supply.

As a result, the company's profit potential and margins visibly drop – and investors see it too. Multiples fall, and over the next 2-3 years the business may lose significant value.

At this point it is no longer possible to sell the company at valuation multiples the company enjoyed a few years prior, unless the owner undertakes major transformation of the company.

How to know you're at a crossroads

You are likely at a strategic decision-making point if you observe:

- slowing revenue growth: it's becoming increasingly more difficult to grow fast, and maintaining current levels of growth demands ever increasing effort and cost;
- operational efficiency is declining, and any improvements are only temporary;
- your team is stretched: managers are overloaded, staff turnover and burnout rise;
- the external environment has changed – new technologies, players, and distribution models. You're falling behind competitors;
- there is no clear strategy for the next 2-3 years, or it doesn't involve active growth/investment – the plans resemble past versions;
- investors show interest, but you delay meetings because you don't know what to say;
- you feel tired and don't enjoy the business anymore – no new ideas or inner drive.

The more of these boxes are checked, the more likely it is that you're at a decision-making point: to grow further or to sell.

WHERE DO WE GO FROM HERE?

If you realize you're at a decision-making point, don't delay. Whatever path you choose, it will require time and resources to execute – but the markets won't wait.

Evaluate the situation and make a decision

It's often hard to assess situation objectively and without a bias. That's why involving external help is key.

Together with your external advisors, you can:

- define long-term goals and design a growth strategy;
- evaluate whether the company's growth potential is achievable or if it is close to hitting a glass ceiling;

or

- get an expert opinion on company valuation and its investment appeal;
- prepare ("package") the business for sale at a maximum premium possible;
- launch the sale process, find a buyer/investor, and close the deal.

Redefining corporate strategy and introducing new people and ideas takes time. Preparing the company for a sale and the actual divesture are even more time consuming, so don't waste too much time and act.

ABOUT US

ink Advisory is an investment banking group founded in 2024 by a team of professionals with decades of experience in the US, CIS and the EU.

Prior to establishing ink Advisory, the team had been known in the investment banking market as Lead Advisory division of Crowe CRS (Russaudit).

ink Advisory advises clients in M&A deals, establishing joint ventures and raising equity, and builds corporate strategies and capital growth strategies.

Contact us to learn how we can help you.

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