Is There a "Right" Time to Buy or Sell a Company?

by
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This question comes up again and again when an owner is considering the far-reaching step of selling a company, or on the other side of the coin, when an enterprise is considering an acquisition. Following are a few key points to keep in mind when answering this question.

1. Economic Trend: Boom or Recession?

In the second half of the 1980's, the major industrialized countries achieved substantial economic growth. Corporate profits were at a high level. At the same time, the number of companies disposed of increased considerably. Often so-called controlled auctions drove company prices to new record highs. Economically speaking, it was a sellers' market. The picture has been different in the beginning of the 1990's. Major national economies are stagnating or in recession, and in general, we can speak of a buyers' market. However, this should not be misleading: companies are still being sold, and at fair prices. The decision-making process has become more rational and critical. Those parties with more short term and financial interests have retreated. If there is a strategic fit, companies are also bought during economic hard times.

2. Interest Rates: High or Low?

The price of capital has an influence on the purchase price. The lower the average interest rate of the time period based on assessment, the higher the capitalization factor for sustainable earnings - under otherwise equal circumstances - and therefore, a higher purchase price as well.

Nevertheless, the seller should not be advised to wait for interest rates to come down, because the reinvestment of the purchase amount would take place at the same interest rate structure. A low interest rate on the money and capital market is often to the advantage of the acquiring enterprise. As one result, this lowers outside financing of the purchase price. In addition, experience has shown that more liquidity flows into the stock market during low interest rate phases such that the P/E ratio, and therefore the stock exchange capitalization, are high, and equity financing by way of a capital increase is comparably favorable.

3. Exchange Rate Parity: A Strong or Weak D-Mark?

Exchange rate parity must also be taken into consideration when making an international acquisition. Spreads of 10-15% are not unusual during dramatic exchange rate fluctuations. This corresponds to price differentiations over which there are generally heavy negotiations.

With the financial devices used today, such as currency and exchange rate swapping, the exchange rate as a whole plays a minor role. It comes into play only when it can be used to reach a final negotiation agreement.

4. The Financial Picture of the Company: Profits on Record High?

Naturally, an owner would like to bring the company to the negotiating table during strong earnings, but in addition to current development, it is also important to take a look back at the company over a sufficiently broad time span. One must be able to recognize what a company is capable of under various economic conditions. This makes the current earnings a relative issue. A decrease in earnings or a temporary deficit situation should not be seen as an obstacle either. It then becomes essential to prepare thoroughly and set up a goal-oriented plan of action to estimate the worth of a brand name, of the business structure already in place or the reconstruction value of a production; then to document it in a convincing manner to demonstrate the way back to profitability.

5. Is There an Obviously "Wrong" Time?

Occasionally, situations come up that can be qualified as "too late" or "too early". This could be said if the technology upon which a company is based becomes obsolete or the operating license or authorization is lost or invalid. This would also apply if the company undergoes such a dramatic restructuring that the prospective position of the company is unpredictable, or if there is a financial bottle neck such that the future of the company cannot be guaranteed.

An example occurred at the end of last year when Lufthansa announced its intention to buy an interest in the American air carrier, Continental Airlines. This was not a convincing move for any of the parties involved, including Lufthansa's own stockholders, because of the substantial financial losses of Lufthansa itself at the time.

6. Conclusion

The time chosen to buy or sell a company should not be forced and the negotiation process itself should persuade. Consider the example of the family business where there is no suitable successor. The owner recognizes the foreseeable necessity of selling the company in order to ensure its long-term survival and wants to sell it while he/she still has control over the business. There is also the desire to retain the basic structure of the company and ensure continued development. Other influential factors such as earnings, the general economy, the trend in the particular industry, interest rates and exchange rates are seldom advantageous simultaneously. With professional preparation, a distinction can be made between what is only situational and what can be changed structurally, through which means, at which time and in which circumstance.

From the view point of the company looking to buy, an acquisition should occur at a time when its own core business is healthy, so that the necessary management and financial input do not present a large risk.

Handelsblatt on 29.04.1993

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