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How and Why Buyers View Valuations Differently Than Sellers

Although merger and acquisition activity continues at a robust pace, there are many potential transactions involving the sale and purchase of a business that are never consummated because the buyer and the seller cannot come to an agreement on transaction price. To understand why it is so difficult to reach a mutually agreed-upon purchase price, it is important to analyze the motivations and perspectives of both the seller and the buyer:

Typical Approach of Sellers and Buyers in Company Transactions

	Seller	**Buyer**
Objective	Maximize sale price	Minimize purchase price, but must bid high enough to win a competitive auction process
Time Horizon	Transactional; sale is a one-time event	Long-term: buyer must live with this decision (and operate the company) for a long time
Valuation Technique	Multiple of EBITDA (often lacks analytical rigor)	Discounted cash flow (often includes considerable analytical rigor)

As presented in the chart above, sellers often view the sale of their business in a transactional way. They are often not concerned about the buyer overpaying for the business. In fact, they typically negotiate to maximize the sale price, regardless of the company true "fair market value". They often justify desired prices with multiples of earnings before interest, taxes, depreciation, and amortization ("EBITDA"), but there are many issues with this approach.

- GBQueue Blog: Top 5 Reasons that EBITDA Multiples are Dangerous

In contrast, when buyers are acquiring a company, they will typically have to live with the consequences of their purchase for many years, since they will be the one that must operate the company, pay off transaction financing, and provide a return to investors. As a result, buyers will often conduct much more rigorous valuation analyses than sellers, often utilizing discounted cash flow techniques that project company performance for several years into the future, and then discount future

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cash flows to present value using a “hurdle rate” or investor’s required rate of return.

Successfully negotiating a purchase price that is acceptable to both a seller and a buyer can be extremely challenging, and it often the primary obstacle to consummating a transaction. Of course, both parties are often well-served to engage experienced financial/valuation advisors that can represent their financial interests, yet provide independent and objective advice. Importantly, advisors must understand and appreciate both parties’ motivations and perspectives with respect to valuation and purchase price.