Preparing an e-Commerce Company for Sale and Maximizing its Value

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The best time to prepare an e-Commerce company for an eventual sale is now. To maximize its valuation, build the company in a manner which makes it attractive to buyers.

Businesses are typically valued as a multiple of EBITDA (Earnings before Interest, Taxes, Depreciation, and Amortization). EBITDA is a shorthand for pre-tax cash flows. Theoretically, it may not be correct to use EBITDA, but it is the industry standard.

EBITDA multiples can range from a low of 2x-3x to 15x-20x or above. Most profitable e-Commerce businesses sell for between 5x and 15x EBITDA.

What drives the difference?

What do buyers want?

Businesses are valued on many dimensions, but four characteristics stand out:

1. The industry in which the business competes
2. The size of the business
3. The potential for growth of the business
4. The profitability of the business

The Industry

Industries that are expected to see growth are more highly valued than slow growing, mature industries. Also, non-inventory service businesses are valued more highly as the marginal cost of goods can be practically zero. A company which sells widgets must have and ship widgets. That is a real cost of goods.

Size

Size is valued for several reasons:

1. Large companies presumably have stronger management teams and more systems and controls than smaller ones. Therefore, they are not as "fragile."
2. The larger business may "move the needle" on the income statement of the acquiring firm.
3. Businesses with scale provide the opportunity for more debt capacity. Debt capacity lowers the amount of equity needed to purchase the company, and, therefore, increases equity returns.

Growth

Acquirers buy the future. That's why growth is important. 5%-15% sales growth is "normal." However, 20%-30% growth per year is exciting to buyers.

Profitability

Isn't this why we are in business?

What else drives value?

Proprietary products are important to e-Commerce businesses because they provide a barrier to competition from the likes of Amazon and others. Price comparisons are more difficult if the products are not the same.

A strong management team provides comfort to the acquirer that the business is not overly dependent on one individual.

Strong and accurate financials, both past and present, provide the basis for confident forecasts of future performance.

A large customer database that can be remarketed to drive LifeTime Value ("LTV").

A large source of qualified prospects provides confidence that the business can continue to grow.

Repeat business drives LTV as a company remarkets to customers. Prior customers typically respond better and spend more than prospects.

High search engine rankings are important, but they are out of one's control. SEM, emails, snail mail, and paid marketing are in a company's control, and therefore are valued. As the budget for marketing increases, sales and scale should presumably increase accordingly.

High average order value typically enables significant spending for customer acquisition.

Strong reviews and high net promoter scores are nice selling points.

What diminishes value?

Working Capital Requirements

Businesses that carry and ship product have inventory and fashion risks. Also, as a company grows, investment in additional working capital eats into available cash flows. Furthermore, obsolete or slow-moving inventory typically penalizes the purchase price.

Poor Information Systems

Information is needed to invest. Poor systems reduce the confidence in the numbers. Furthermore, it points to needed future capital investments.

Concentration

Vendor or customer concentration (typically greater than 25% of purchases or sales) creates risk that changes made by 3rd parties will affect sales and profit.

Remember, too much reliance on Amazon and other marketplaces is problematic. Amazon is a competitor, not your partner.

Don't let any one marketplace represent more than 10% of annual revenue. While there are companies that specialize in buying Amazon only brands, these investors typically only pay a modest EBITDA multiple. Many traditional acquirers don't like marketplaces because...

1. Some marketplaces own the customer, making it difficult to remarket.
2. Marketplace fees are expensive.
3. A marketplace has access to the company's data and may knock off the product or force a company into a wholesale relationship.
4. Marketplace changes rules without regard to one's businesses.

Can an unprofitable e-Commerce company be sold?

Yes, but these are some questions to consider:

1. Is there a path to profitability?
2. Can the acquiring company reduce expenses or increase sales to make the acquired company profitable?
3. Are there proprietary or unique assets that bring value to a buyer?
4. At what price?

Other e-Commerce Specifics

What is the effect of drop-shipping inventory for those companies that use drop ship as a strategy?

There are two conflicting philosophies:

1. Typically, the business is a low working capital company, which increases value.
2. However, the products are not proprietary. That characteristic is more important unless the business has a lock on the customers. The value of a business is either in owning the product or owning the customer.

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