

FOR IMMEDIATE RELEASE

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RE: THE CATCH 22 OF SELLING "CASH" BUSINESSES

"I want a business that generates lots of cash!"

This is a familiar refrain heard by business brokers throughout the country - a request from buyers looking for businesses where the customers pay in cash as opposed to checks or credit cards - cash that can be "creatively sheltered" from the grasp of the IRS.

Cash businesses are easily identifiable: Laundromats, bars, restaurants, gas Stations, convenience stores and most other small retail establishments. It is no secret that some of the cash generated by these businesses never shows up on the stores' cash register receipts or profit and loss statements. But apart from being an act of tax defiance, are there other, long-term ramifications to consider before "stealing" from one's own business?

One potential rude awakening occurs when these business owners decide to sell their "discretely profitable" businesses. In establishing the value of a business, cash flow is king, not *cash!* When the cash flow, i.e. true profit, is hidden, so is the value of the business.

I recently met an owner of a cash-generating business doing about a half million in actual sales, but showing only \$455,000 on his tax return. Like most business owners, he wanted to sell his enterprise for the highest possible price so he could retire in style. Although he had the higher sales figure documented in an obscure notebook, it didn't make any difference in my evaluation, which relies on provable numbers - numbers that can be substantiated by the tax return (signed under penalty of perjury). Unfortunately, due to his limited *provable* cash flow, the evaluation came out less than we knew was the *real* value of his business.

Faced with this dilemma, some owners tell me, "Leave me alone with the prospects and I'll show them the real numbers." The only reasonable response to this illogical suggestion is, "Life is too short to spend it dodging the IRS." It would be absurd for any owner to turn over a second set of books to a perfect stranger, yet it is done every day, throughout the country, by business owners more focused on price than self preservation.

In another, slightly more covert approach, owners encourage prospective buyers to "monitor" the traffic and sales of the subject business over a fixed period of time. This method is intended to show would-be buyers that the number of customers times the average sales ticket equals the true sales volume of the business for that period. However, this approach does not take into account such variables as seasonal fluctuations, sales promotions, economic cycles or the

seller's ability to muster his friends and relatives into an army of short-term customers.

And while we're on the subject of cash-generating businesses, another potential problem is the propensity for that cash to slip into employees' pockets before it can be ensconced in the owner's. Most owners of *cash* businesses agree that they have to maintain a strong presence in the business every hour it is open in order to guard the cash - a sad but true reflection of our society.

It is fair to conclude that owners of cash businesses must make a choice: whether to enjoy *preferred tax treatment* during their terms of ownership and forego the true value of their enterprise at the time of sale; or pay the piper his due each year and receive a fair market price.

Conservative owners tend to pay the piper while their more liberal counterparts perceive their cake as forever whole even though they constantly nibble at it. Moderates, on the other hand, eat away for five years, stop eating for two years, and then sell their regenerated cake at close to full value.

As a business broker, I can only sell what sellers can prove.