Maximizing the Value of Your Exit Strategy

Do you have an exit strategy for your company? Do you know what you need to do to get the maximum value for your company? This article will give you six ways to maximize you company's value.

Written by:
Brent Freeman

Maximizing the Value of Your Exit Strategy

Having an exit strategy two to three years ahead of time allows you to maximize your company's value .

This article addresses common misconceptions and mistakes that we have found business owners make when selling a company without an exit strategy in place. Recognizing these misconceptions and mistakes – and how you can avoid them – come from three decades of selling privately held companies. If you are looking at retiring and or selling your company in the next three years, this is a must read.

I fail to understand how good business men and women can invest 20 to 30 years of work in building a company that has supported their family, provided for retirement, employed countless folks from the community, supplied a great product or service to their customer base, but when asked if they have an exit strategy for their business, they look you straight in the eyes with a blank stare - like you just asked for their first born.

Just recently, my partner Bill and I had been called by the president of a multi-state wholesale distribution business that has historic revenues in excess of $15,000,000 annually to meet with him and the board about selling their company. The President explained that their goal was to sell the business in the next 12 months as several of the majority owners were ready to retire. As Bill and I started to ask our usual questions regarding the business it became very clear that the owners did not have an exit strategy and had done absolutely no work in preparing the company for sale.

After identifying the Company's goals with the President and working with their Comptroller in reviewing their financials, we had some good and bad news for the board. The good news was that if they followed our recommendations. We were confidant we could sell their business for a very fair and equitable price of five to six times their adjusted cash flow. The bad news is it would take 18 to 24 months to implement the changes and realize the effects of these changes that were required to drive that kind of multiple. If the goal was to start marketing their company in the next 3 to 5 months, then company would only be able to benefit from the value of their assets, at best.

Having an exit strategy and or succession plan for your company is just as important if not more important as having a business plan. It is not that difficult and can easily be incorporated into the year-end planning and company's ongoing three-year strategic plan. From our three decades of dealing with business owners who are selling privately held companies, we find the following are common mistakes and / or misconceptions:,

Create a Turn Key Business: A common strategic mistake that we find is that business owners have not created a business that is capable of running without them. They are still the driving force behind sales and the day to day operation of their business. Ask yourself the following questions:

- What would happen to your business if while on vacation sailing with friends your ship was lost and you were stranded on a desert island for 3 months?
    - Do you have the sales force in place to continue to increase sales.
    - Do you have the management team in place that could manage the day to day operations of your business?
    - Are you the "secret sauce" for that is responsible for the success of your business? Have you hired your replacement?
    - Have you transferred the knowledge that drives your business into written process and procedures?

Potential buyers will want to know that the company they are buying is capable of continuing or improving on the financial performance that you have represented. If you created a turnkey business it will not only enhance the potential purchase price for your company but will widen the pool of potential buyers as well.

Consider the following strategic action items:

- Hire or identify your replacement one to two years before you want to retire or sell.
- Transfer as much of the short and long term business operations knowledge into written process and procedures.
- Broaden the roles of responsibility for your management team, to ensure 'coverage' of critical operations.
- Have a written succession plan. If you were on that island for 3 months, who is in charge and does everyone in your company know who that individual is.

Maximizing Profitability: I am sure that you see the heading "Maximizing Profitability" and you're thinking that business owners are all about making as much money as possible. I would generally agree, but it would surprise you that this is not always the case. We had two companies just this last year that simply chose not to maximize profitability.

The first company was a multi-state wholesale distribution company with $15,000,000 in revenue. The company was at best break even on a cash flow basis. At this level the owners were all being paid a comfortable salary and they knew that they needed to make some hard decisions, but due to the family culture of the organization, they were unwilling to do so. They had several locations that were very unprofitable and needed to be closed. Closing or consolidating some of the locations would have dropped the savings straight to the bottom line and instantaneously made their company saleable.

The second example was a mid west manufacturer that had revenue in excess of $12,000,000 and was losing money. It was a multi-generational family-owned business with a lot of family members in the business at very high salary levels. Working with the president of the company on a restructuring plan, it became apparent that the owners were unwilling to take the necessary steps to implement the restructuring plan that would move them from a loss to profitability.

Other common areas that can increase profitability include:

- Close or sell product lines that are losing money.
- Fire unprofitable customers.
- Examine margins on a quarterly basis.
- Always be looking to cut operation cost.

Remember that when selling your company, the profitability that you are able to show is worth a multiple. If you are able to increase your profitability from $150,000 to $300,000, the additional $150,000 may be worth a multiple of 3 to 5 times in enterprise value. *The $150,000 in increased profitability is worth an additional $450,000 to $750,000 in the overall company's enterprise value.*

Base Valuation at Year End: One of the first steps in preparing an exit strategy is to define the amount of cash you would like receive via a sale. To do that you must understand the "enterprise value" of your company. Public companies spend a tremendous amount of time and resources knowing exactly what their value is. It is my experience that lower middle market companies spend little or no time on valuation until it is time to sell and then they usually call an investment banker to educate them on what their company's enterprise value is. Owner's tend to concentrate all of their activity on running the business and making a profit. Taking the time at year end to calculate and understand the value of your company is important to know. It not only can tell you where you are relative to achieving your goal, but what you need to do to strategically to get there.

I am a big fan of a rolling three year strategic plan with one year budgets that drive current year's performance. Knowing and tracking year over year Enterprise Value is key to improving the value of your business and achieving your retirement goal.

Accounting: Advisors that deal with small business will tell you that they hold their breath on every new engagement when the owners hand over the financials for review. You have one chance to make a first impression on the market and with a potential buyer. Establishing the value of your company will come down in large part to your profitability. Buyers need to be able to look at the last three to four years' financials and tie them to your tax returns. Having a clean set of financials establishes creditability with your buyers and in return they will feel confident that all information is received is true and accurate, and will be more are secure in the purchase of your company. The following are a few of the more common items that should be avoided.

- *Mixing cash and accrual accounting methods.* This will cause problems when the buyer tries to tie month end profit and loss statements to balance sheet. They will not balance.
- *Not tracking revenue and expenses by location, profit center or product.* If you have multiple locations you need a track all revenue and expense by location. Any potential buyer will want to know the revenue, expense and margins associated with each location. The same holds true if you're a manufacturer with multiple products. You need to be able to track all expenses and revenue by product and or product line to establish margins.
- *Including owner's salary and benefits with the rest of your employees.* It is very helpful for potential buyers to be able to identify the owner's salary and benefits. Your advisor will break them out to establish cash flow or calculate EBITDA but it makes it a lot cleaner if they are separated.

Facility Maintenance is Critical: Although somewhat obvious, maintaining your facilities is very important to potential acquirers. The following are a few ideas that help buyers see value in how your business is being operated and it can make an impression with potential buyers.

- Keep your operation clean and organized. A clean operation is associated with strong financials.
- Budget for maintenance on a yearly basis. This includes setting up accruals for large projects.
- Keep records of all maintenance projects and expenses.
- Don't defer facility maintenance projects.
- Make sure that all hazardous material are disposed of and have records that document the process and procedure for disposal.

Reduce Your Time to Sell: A common misconception with most business owners is the time and effort that it takes to sell a privately owned business. When we and walk business owners through the process of taking a business to market, they quickly come to the realization that it will take a good deal of time and effort. The average time to complete a sale from the first meeting to the owners receiving a check is - as a rule of thumb - nine months. We have closed business in as little as three months to one that took three years. The steps below are the major items that need to be covered to sell a privately owned business.

- Defining your Mission and Objective
- Developing Marketing Material (Confidential Acquisition Profile or CAP) & Guidance Through Legal Preparation
- Creating a Market Through Sales and Marketing
- Managing the Letter of Intent Process
- Managing the Due Diligence Process
- Definitive Agreements and Closing Phase
- Post Closing Activities

Confidential Acquisition Profile (CAP): Preparing your company for market will take 30 to 45 days. During this time, an advisor should develop a comprehensive Confidential Acquisition Profile (CAP) or more commonly known as an Offering Memorandum. To do this right and place your company in the best position of strength, the CAP should cover the following;

- Executive Summary
- Introduction
- Company Forecast
- Competitive Position
- Market Analysis
- Product Description
- Distribution
- Sales and Marketing
- Intellectual Property
- Financial Section
    - Sales History
    - Gross margin Analysis
    - Recast Income Statement
    - Sales Performance Table
    - Balance Sheet Analysis
    - AP and AR History and Analysis
- Inter Company Details
- Facility
- Personnel and Benefits
- Environmental
- Owner/Purchaser Transition
- Transaction Structure

Making a Market: Once the offering memorandum is completed then the marketing begins. Marketing should include printing, media advertising, internet advertisement, direct mailing, strategic calling and E-mailing a blind profile to both a proprietary data base as well as to private equity and portfolio companies. The process to implement the marketing program and to create buyer activity can take between 60 – 90 days.

Obtaining Letters of Intent: Once a potential buyer steps forward, then the process of discovery starts. Walking the buyer through the offering memorandum, coordinating conference calls and presenting the Letter of Intent to a seller can take 14 to 45 days.
Agreement Drafting Facilitation: The definitive agreement is the most difficult segment of the process. This can take from 45 to 90 days.

As you can see it takes time, effort and patience to successfully maximize the value of a privately held company.

While on the Market, keep the company at or above budget. As you can see from the topics above, it will take time to sell most business. It is my experience that the biggest single factor that leads to a transaction failing to close after a letter of intent is signed is not because of discovery in due diligence, but because sellers take their eye off the ball and sales fall below budget or past year's levels.

Several years ago we had a client with budgeted monthly sales of $850,000 dollars. Through the first four months of their fiscal year they were at 110% of budget. They had scheduled a three week vacation out of the country a year in advanced and were looking forward to the trip as it was well deserved. On their return from vacation they went to a national convention for a week, putting them out of the office for about a month. In addition, they had not created a turnkey business as the current president was the driving force behind the company. During this time, a buyer was identified and a Letter of Intent was negotiated. No sooner had the Letter of Intent been signed when sales dropped 20% and then an additional 10% the next month. In this case the seller was very lucky to have a buyer that saw the cause and effect, and was willing to continue with the purchase - but at a reduced purchase price. The lesson? While your company is on the market - right until the day it closes - show up and run your business as if you were going to keep it another ten years.

For additional information please contact The Lawn & Garden Performance Group LLC
www.LGPG.com (480) 840-6023