

CHAPTER SIX



EXIT PLANNING:
MAXIMIZE THE
SALE OF YOUR
BUSINESS

By Dan Prisciotta, Mark Gould, and Mark Jordan

CASE STUDY

“Fortunately, I am not one of those business owners who made a multimillion-dollar mistake by thinking I could sell my company without the assistance of an M&A advisor. My M&A advisor helped me realize the true value of my company and designed a process to result in the best outcome for me. I am extremely thankful for the professional advice and guidance I received throughout the sale process, which in the end yielded a transaction value well beyond what I had initially imagined possible.”

The quote above is from a client whose service business was recently sold. It is with good reason that he professes his thankfulness to his M&A advisor: **We sold his business for 82.3 times the company’s past 12-month EBITDA and 13 times the following year’s projected EBITDA—an unheard-of multiple in any industry.** Several factors were leveraged in the

transaction to result in such an unbelievable value for the client's company. What follows is a case study of the sale path and process for this client.

The client's company was about five years old and growing rapidly in the medical services field. It was competing with a handful of much larger publicly owned companies. The client realized that in order to continue on its growth trajectory, the company would need the infusion of some substantial and much-needed working capital in the range of \$4–\$6 million. The client had planned from the beginning to build the business to be sold, but he felt that it was still too early in the building process to undertake selling the company because the revenues and profits had not yet reached the levels that traditional valuation models suggested could result in a transaction sizable enough to satisfy the client's objectives and help him achieve financial independence.

At this point, the client's financial advisors at Sagemark Consulting Private Wealth Services suggested that an M&A advisor be brought in through Equity Strategies Group (ESG) to evaluate the business and help the company satisfy its working-capital needs.

ESG began the process of capital raising and presale planning by initially conducting a series of interviews with the business owner to clearly establish objectives, gain a deeper understanding of the business and industry, and create a **marketability assessment**. This assessment is the result of financial statement analysis (three years of corporate balance sheets and P&L statements) and in-depth questioning of the business owners to truly understand their company and various value drivers that either enhance or detract from enterprise value. It also involved research of the industry, values of similar businesses, and knowledge of prevailing EBITDA multiples. You would be amazed by what can be accomplished through teleconferences, videoconferences, and the Internet as technology enabled ESG to ask the owner questions about the major factors that would affect the sale of the business (explained further in this chapter), assess the business, establish capital needs, and develop a range of market values for the business (which greatly exceeded the owner's estimate of the value of his business). Ultimately, ESG introduced the owner to several highly qualified M&A advisory firms in its national network. The choice of firms was made on the basis of several important criteria:

- ◆ Industry expertise (medical devices, in this case)
- ◆ Type of transaction desired (capital raising, leading to a sale of the business, either 100% or partial sale through an equity recapitalization)
- ◆ Size of the transactions proposed (you don't want an M&A advisor that is either too big or too small to meet your needs; you want a fit that is "just right," a firm that will provide senior-level attention to your business)
- ◆ Personality and chemistry of parties involved
- ◆ Finally, geography (because the firms chosen had multiple offices near the client's location, working together was convenient and cost-effective)

After interviewing several of ESG's possible candidates face-to-face, the owner chose the regional office of an internationally respected and seasoned M&A advisory firm to represent his company. After reviewing the company at length, the M&A advisor agreed that the company might be worth much more than the client had anticipated. This was due in part to the company's high growth rate, knowledge capital, systems and processes in place, and geographic competitive advantage. A two-pronged plan was implemented: working capital would be sought while at the same time feelers would be put out to a handful of private equity groups (PEGs) and synergistic companies to get an idea of market interest in an outright acquisition.

Initially, the outreach was to traditional funding sources, consisting primarily of companies that specialized in higher-risk capital such as mezzanine and PEGs. The client was thrilled by the strong response level that was received. However, upon carefully reviewing the proposals that came in from this initial outreach, the client realized that he would have to give up more equity than desired in order to obtain the amount of working capital preferred. This is where the situation started to get very exciting.

After consulting with the client, the team decided to focus more intently on the possibility of an outright sale of the company. Some of the PEGs initially contacted as funding sources had expressed an interest in an

outright or majority purchase. Follow-ups would be scheduled to initiate further dialogue about that possibility. Additionally, the client was aware of at least one other large synergistic company that had an interest in entering the space. That company was contacted to open a dialogue about the possibilities of utilizing the client's company as its platform for entrance into the market space. Both of these avenues could be explored without tipping off the industry competitors as to the client's intentions, and this is exactly how the process unfolded.

Similar to the intense interest received while seeking proposals to satisfy the company's working capital needs, the opportunity for an outright acquisition of the client's company resulted in equally heated competition. Proposals were submitted by quite a few PEGs, as well as the synergistic company looking to enter the space. These opening proposals, although varying to great degrees in their value propositions, all fell inside the range of what would be considered the market value of the company, based on generally accepted valuation metrics. It was now time for the M&A firm to earn its fee.

At this point, the M&A advisor put together a valuation package to share with the PEGs and the synergistic company that were vying to purchase the business. The results were well beyond expectations. The analysis estimated the value of the company to a PEG industry competitor and on a discounted future-earnings basis. All methodologies employed in the analysis were based on solid assumptions but pushed the envelope a bit on traditional thinking. As a result, the company's range of values derived in the analysis was far in excess of the offers previously submitted by the PEGs and the large synergistic company. Clearly, the contenders knew that their current proposals would need to be significantly enhanced if they wanted to stay in the running to purchase the company.

The M&A advisor's analysis proved to be very persuasive. Shortly after the analysis was distributed and a few questions were answered, new offers started coming in from the PEGs and the synergistic company. The new offers represented improvements on the original offers by 25%—to as much as 100%. Yes, that's right! One of the contenders actually doubled its initial offer, which was to the tune of an increase of \$25 million. The excitement was palpable.

But did the M&A firm stop there? No. Fast-forward a bit and the client accepted an offer for an additional increase of \$5 million (\$55 million total) from the large synergistic company, representing a value more than four times the client's initial value estimate for the company. Now this is where things really got interesting. During the period after the initial proposals to purchase the company were received but before the client was locked into a no-shop period, an outreach was made to one of the company's primary competitors to determine whether it might have an interest in acquiring the company. This particular competitor was targeted because it was owned by a large multibillion-dollar revenue company and was known to be suffering from some operational difficulties. Furthermore, the parent company was on a mission to acquire competitors, evidenced by the fact that it had already completed numerous acquisitions in other industries throughout the current year and in the past few years. Some limited financial information was shared with the competitor, and a few cursory discussions occurred, but before any meaningful dialogue could be established, the client had to act on the synergistic company's current offer, which included a no-shop period. The synergistic company's offer was too good not to sign acceptance; thus, dialogue with the competitor was ceased in compliance with the no-shop provision of the accepted offer. Would the client and his advisors be left wondering forever what might have been with the competitor if only the process could have evolved further down the path? Well, the simple answer is no.

The competitor refused to be deterred by the fact that neither the seller nor anyone on his team could discuss a transaction. Apparently, the competitor was very enthused about a potential transaction to acquire the client's company, and the lack of a dialogue or information exchange was not going to stand in the way. This became evident when a purchase proposal showed up from the competitor, even though no one was in contact with the company at that time because of the no-shop provision in force due to the accepted offer. The competitor's initial purchase proposal represented a \$5 million increase over the synergistic company's offer, which had already been accepted. Fortunately, the no-shop provision in the accepted offer was based only on elapsed time on the calendar. As such, the ability to open a new dialogue with the industry competitor was only a few weeks

away, and everyone determined that this was the right course of action, once the legal commitment to the synergistic company was satisfied.

After anxiously sitting out the waiting period for the no-shop provision to expire, the client and competitor promptly worked through a new letter of intent. From there, things progressed quite quickly to a completed transaction. The client, together with his advisors, was confident that the competitor was the best fit to purchase the company and lead it into the future. As it turned out, the client stayed on board with the competitor to lead not only his own company that had been acquired by the competitor but also the competitor's competing business in the same space. This is a transaction where both sides were happy with the outcome. The client got what he wanted, a transaction at top value and much-needed working capital for organic growth, and the purchaser got what it wanted, elimination of a competitor, market share, and knowledge capital to lead it into the future.

The seller (client) has said: "Thank you for all your hard work and good counsel this past year. This deal could not have happened without your keen ability to detect and project the hidden value in our business."

His attorney added: "I have been impressed by your energy and creativity and by your attention to the details great and small that can make or break a deal."

Lessons Learned

Several lessons can be learned from this case study, including:

- ♦ **Don't go it alone.** As identified in this case study, the final purchase price ended up close to \$70 million, whereas the highest financial buyer's offer was around \$40 million. The seller would have initially been satisfied with \$20 million, so you can imagine his appreciation. The cost of an experienced and capable M&A advisor will generally be more than offset by better deal terms and a price that will be obtained on the basis of only the M&A advisor's experience, efforts, and contribution.
- ♦ **It is important to define and control the sale process.** In the above example, potential buyers and offers were already in hand when the competitor was contacted. This created a competitive

landscape and may have helped in obtaining a better offer than would have been made in the absence of such competition.

- ♦ **Keep an open mind about potential transaction types that might meet your goals and objectives.** In this example, the owner initially was most interested in obtaining working capital. The M&A advisor was able to demonstrate that an outright sale might also meet the client's goals and objectives, so both avenues were pursued.
- ♦ **Don't underestimate the importance of timing.** The owner was trying to fulfill his own need for working capital but was also counseled by the M&A advisor to consider what was happening in the market space, as well as with some competitors. By considering a broader spectrum of items and issues beyond his own immediate need, he realized that the timing was great for an outright sale.

EXIT PLANNING

Have you put off the thought of planning for an exit from your business? Are there just too many moving parts and players? Or are you too busy running a successful business to have time to plan for your inevitable exit?

What is an exit plan? It is a comprehensive road map designed to help you successfully exit your business, on your own terms. It addresses the business, personal, financial, tax minimization, and legal issues involved. It is interrelated with all of the other chapters in this book. Your exit plan should also consider what your life will look like after you no longer own your business. The result of a proper exit plan is the creation and preservation of wealth for you and your family.

This section will focus primarily on sales to outside parties. Chapter five addressed other exit paths, such as transfers to family members or co-shareholders, management/ESOP, and IPO. The key to finding a buyer for your business is the M&A (mergers and acquisition) process.

THE M&A PROCESS

Anyone who has ever owned a business knows that it demands a tremendous amount of time and energy. Needless to say, many people contribute to the growth of a business. Many sacrifices are made along the way. But from the day the business owner sets out a shingle to the moment the doors are closed forever, that business itself takes on a life of its own. It's a round-the-clock job that demands the business owner's constant attention and focus. Regardless of the level of success achieved, every business owner ultimately reaches the point at which he or she asks, "What's next?"

The answer is a function of perspective. Some owners are simply tired of pushing the ball up the hill, while others are looking for a new challenge. Still others feel that they lack the skill set to develop the company beyond its current state. When a business owner contemplates selling a company, many factors, such as retirement, lack of capital, gaps in management, changing industry factors, or desire for greater liquidity, eventually lead him or her to consider several questions. "Should I sell my company now?" "Would I get more money if I waited until the next quarter?" "Who is the right buyer?" These questions can continue ad infinitum.

A business owner is faced with an abundance of decisions when considering selling his or her company. These decisions can be overwhelming. Timing is always an important factor. What if you, or your company, are not ready yet? How do you continue to grow and protect your value as you prepare?

CONTINGENCY PLANNING

What could possibly go wrong as you plan and prepare for your future exit? Have you implemented all necessary steps to ensure that your business continues even if you don't? How do you protect your business value and your family in the face of certain contingencies?

- ♦ Business and economic factors could change, some of which are beyond your control. In 2007, when the financial crisis struck, entrepreneurs who had been thinking about exit were stuck because the values of nearly every type of business were affected, liquidity

disappeared from the marketplace, and even interested buyers had extreme difficulties obtaining financing. So any business owners who had put off mapping out and executing an exit strategy were basically out of luck for the next few years while the financial crisis and resulting recession ran their course. Even once the economy began to recover from the recession, business values were still suppressed, financing remained difficult, and potential buyers were skittish. The lesson learned here is that you can't put off creating an exit strategy—if you do, you might have to wait three, four, or even five years for the market recovery, and you may not have that luxury. The M&A market goes in cycles. If the market continues its strong run and you and your company are ready to exit, this could be an opportune time. The next cycle may not occur until the 2020s. For many baby boomers, this may be too late. Explore your options. No one wants to sell at a fire-sale price or in a situation where valuations are less than optimal.

- ◆ Loss of key employees, due to leaving your employ to work for a competitor or strike out on their own. Designing an incentive program to retain your key people may serve as “golden handcuffs” and a reward for their loyalty. These programs include: qualified and nonqualified deferred compensation plans and synthetic equity plans, such as phantom stock, stock options, and stock appreciation rights or actual transfer of stock to employees.

You could also lose a key employee by reason of death. We work with a business that lost two executives in a two-year period. One loss was due to a heart attack, another an automobile accident. A third key person was severely injured in a skiing accident and survived but was unable to return to work for three years due to chronic back pain and medication issues. These contingencies can be mitigated through the use of key-man life and disability insurance plans to protect your company from loss.

- ◆ Where the business has multiple shareholders, a properly funded shareholder's agreement or buy-sell agreement is imperative (see Chapter 5 for a full discussion). This agreement should control

the transfer of ownership when certain events occur, such as an owner's death, disability, retirement, termination of employment, divorce, bankruptcy, and business disputes. The agreement should establish the value of the stock and buyout terms. Insurance provides the liquidity to efficiently carry out the buyout terms.

- ◆ Outstanding debt—Many business loans, notes, lines of credit, and mortgages consider the death of the owner, resultant change of stock ownership, and loss of personal guarantees a **default**. This gives the lender the right to call the loan and collect. How will your business handle this need for liquidity at the worst possible time? Repayment of debt may sap all of the cash and life insurance proceeds earmarked for buy-sell agreement purposes, estate tax payment, and other liquidity needs.

- ◆ If you are the sole shareholder, you can protect your family and your business in several ways if your premature death or disability occurs prior to the execution of your exit plan:
 - ◆ Get a new will and trust with specific instructions regarding the handling and disposition of your business.
 - ◆ Consider how your surviving spouse will derive an income for the rest of his or her life.
 - ◆ Provide for how future inheritances will be equalized among children who are active in the business and those who are inactive.

The focus of the remainder of this section is to provide insight on the mergers and acquisitions process *after* making the decision to sell your business.

Once you have decided to sell your business, your journey could take as little as a few months or up to several years. As with any journey, the more realistic your expectations are, the more likely you are to be pleased with the outcome. In light of that, make your first course of action one of gaining clarity with regard to the life cycle of the entire business sale process.

After gaining clarity, create a sense of structure and order out of what may seem like a disjointed collection of steps that need to be taken.

Following a proven five-step process will ensure that you retain a clear vision during what could easily become an extremely frustrating endeavor.

The first step is selecting an investment banker with whom to work through this process. Second, you and your investment banker will compile a plan for the actual sale of the business, including such items as defining your business's value and determining how to handle offers. Third, you will release information on a confidential basis about your company to generate buyers' interests. Fourth, once you have decided on a buyer, you will negotiate the terms and conditions of the sale. Finally, you will work with your investment banker, attorney, and CPA to complete due diligence and close the deal.

As you gain greater clarity as to what to expect during the process of selling a company, you will be more prepared to make the myriad decisions you will face throughout the journey. Deciding who will handle the process is your first major decision. You can either manage the process yourself or delegate it to an intermediary, typically referred to as an investment banker or a mergers and acquisitions (M&A) advisor. We will use the terms "intermediary," "investment banker," and "mergers and acquisitions advisor" synonymously.

M&A Success

The key advantages to utilizing an intermediary are best expressed with the acronym SUCCESS:

1. Strategic fit
2. Understanding the process
3. Creating multiple options
4. Communication and negotiation
5. Expectations are realistic
6. Stay focused on the business
7. Sustain momentum

Let's consider each of these benefits in more detail.

Strategic Fit

A strategic fit means that a synergy exists between the buyer and the seller. Synergy could take many forms, but examples include product, distribution, geographic, and management synergies. Product synergy occurs when the purchaser and seller have complementary products that, when combined, create greater value. Additionally, distribution synergy occurs when the purchaser's products can be distributed through the seller's customer base.

Another type of strategic fit is geographic synergy. This is when a purchaser needs a new geographic presence—where the seller is currently located. Finally, management synergy occurs when management gaps close upon the purchase of a new company. By striving toward a good strategic fit, the business sale yields greater value.

A skilled, experienced intermediary is adept at discovering synergy between buyers and sellers. He or she accomplishes this through a clear vision and definition of strategic marketability.

Understanding the Process

Understanding the process of selling a company is, in many respects, the most vital component to a successful divestiture. Since most business owners have experienced building a company, they naturally assume that they fully comprehend all of the aspects of selling the company. The reality is that they do not. An investment banker, who handles deals constantly, understands the process to a far greater degree.

Let's examine the process in more detail. The following steps illustrate the typical flow of a deal from beginning to end:

Step 1: Initial meeting with investment banker

Step 2: Financial review of the company to determine viability

Step 3: Finalization of engagement agreement with investment banker

Step 4: Presale planning

Step 5: Deal marketing

Step 6: Negotiation and execution of letter of intent

Step 7: Due diligence

Step 8: Closing

Steps 1 and 2, the initial meeting and financial review, are conducted to determine the probability of success and potential fit between the mergers and acquisitions firm and the seller before an agreement to work together is established. *Step 3 is the finalization of the engagement agreement* between the intermediary and the seller. The core process of selling a company begins with *step 4*, otherwise known as *presale planning*, and concludes with *step 8, closing*.

Presale planning is a vital part of establishing direction. It involves extensive company fact-finding and industry research. The objective of this step is to complete a deal book that outlines key information regarding the company.

Selling a business requires a tremendous amount of *deal marketing* while utilizing many different avenues, including industry contacts, databases, and private equity.

Negotiating requires management of all the relationships in a transaction with a keen understanding of each party's goals and objectives. There is no magic formula to succeed in this area, but just as in every other area of selling a business, good negotiation involves a specific process that will steer even the most knowledgeable individuals away from potential pitfalls.

The final step is *closing the deal*. Frequently and somewhat ironically, the most difficult step in the entire process is moving all of the interested parties to a successful closing. Even in the best of circumstances, this is a complicated process.

Creating Multiple Options

Creating multiple options relates to the ability to gather and manage several buyers at the same time. The most common mistake a business owner makes when selling a business is dealing with only one interested party at a time. This limits not only an owner's likelihood of landing a successful deal but also the number of potential offers.

If the marketing outreach process is managed effectively, it leads to a greater probability of securing several interested parties on each deal. Garnering multiple interested parties provides much greater clarity in evaluating the merits of each offer, and it increases the likelihood that a strong, reasonable value will be received.

Communication and Negotiation

Communication and negotiation are the foundation of every deal. Since many business owners see themselves as first-class negotiators, this is by far the most common stumbling block to the process. Much more goes into getting a good deal than one's ability to communicate.

Consider, for example, the owner who focuses exclusively on price in his or her negotiations. He or she may very well get the asking price, not realizing that the purchaser gladly agreed to it because the structure of the deal heavily favored the buyer. Another common development is "sowing the seeds of discord." In this instance, in an attempt to negotiate the best position, the purchaser or seller unintentionally insults the other, thereby creating an antagonistic relationship that impedes the ability to resolve future disagreements.

Another serious pitfall is disclosing an asking price too soon. Business owners often disclose their asking price too early in the process, thereby eliminating the possibility of securing a value beyond their desire.

Expectations Are Realistic

Few sellers have realistic expectations about the process in general. The questions abound: "Is it reasonable to ask for a confidentiality agreement before releasing any information?" "How much information should I release initially?" "When should I meet with the buyer?" "When should I expect a letter of intent, and what, exactly, should that contain?"

"What about earnest money—how much should I ask for and when?" "Who drafts the purchase agreement?" "When do I tell my employees I'm going to sell?" "How long should I allow for due diligence?" "Who pays for due diligence?"

These are just a few of the questions that come up during the process. Knowing what is reasonable dictates how you will respond to the buyer

and demonstrates your skill level. Your response also dictates who controls the process, who bargains from a position of strength, and whether you generate an acceptable outcome.

Stay Focused on the Business

The biggest risk a business owner faces when attempting to manage the process himself or herself is the inability to stay focused on the business during the sale process. The owner typically becomes distracted in two ways: time and mental energy. Given the time-consuming nature of the process, an owner might wake up one day to find that he or she is spending a majority of time on the transaction. In addition, when managing the process, the owner frequently becomes mentally drained. Both of these situations create a scenario in which the business suffers during a highly critical time.

Sustaining Momentum

Selling a business is like any other process in which sustaining momentum is critical. When you have positive momentum during the process, good things tend to happen. Conversely, negative momentum tends to feed on itself and diminish the viability of the deal.

Knowledge is power, especially when an owner decides to sell a business. For most owners, the business sale process is a mountain of uncertainty. As previously shown, the right advisor is critical for maximizing the selling price of your company. So how do you evaluate advisors and select the right one? The next section will help you identify what to look for in an intermediary and how to choose the best advisor to manage the sale of your company.

FINDING THE RIGHT M&A FIRM OR INVESTMENT BANKER

Intermediaries take on many different forms but generally fall into three broad classes of professional advisors. There are *Main Street* (often referred to as business brokers), *middle-market*, and *large-transaction* intermediaries. Certainly, the three classes overlap, but firms tend to fall into one of

these three groups. The primary differences among the groups are based on *deal size, methodology, type of buyer, and compensation.*

Methodology relates to the process and systems employed by the intermediary. *Main Street* firms work with a process more akin to real estate sales. They focus on acquiring a large inventory of listings, rely on business opportunity advertising, and co-broker deals with other Main Street brokerage firms. Additionally, Main Street firms tend to focus on local and community-based businesses, such as restaurants, dry cleaners, pet stores, auto body shops, lawn care companies, and convenience stores. Relative to the other segments, they spend a small amount of time on presales planning and packaging. Their informal marketing style is composed primarily of local mass advertising and contacts within their personal networks.

The *middle-market* mergers and acquisitions firms are characterized by heavy presale planning; broad, deep research; and wide marketing outreach. They spend significant time on the front end while developing a comprehensive deal book that outlines and discusses all of the key components of the business. Their methodology is heavily focused on researching the marketplace to identify strategic and private equity buyers and executing a comprehensive marketing campaign to attract their interest.

Large-transaction firms tend to employ a financial engineering methodology. They spend the greatest amount of time on presales planning and financial analysis. The universe of purchasers for large companies is much smaller, so less time is spent on actual marketing. Frequently, the ability to create financial synergy is the motivating factor behind large deals.

Deal size refers to the value of the transaction. Main Street intermediaries typically focus on transactions valued up to several million dollars. Middle-market firms generally focus on deals valued from \$10 to \$150 million, while large-transaction firms typically handle transactions more than \$150 million.

The *type of buyer* involved in a Main Street transaction is typically an individual characterized by the following: he or she is usually looking to buy a job, has minimal cash flow, is reliant on seller financing, and has little or no experience as a business owner. In middle-market and large-transaction firms, buyers tend to be larger privately owned companies, private equity firms, or public companies. They normally have cash available

for transactions or have bank financing in place, as well as experience in business acquisitions.

The *compensation* structure for a Main Street firm is usually 10%–12% of the transaction, paid at closing. Middle-market and large-transaction firms are typically paid in the form of a commitment fee, or retainer, paid in advance, credited against a performance fee paid upon closing. Commitment fees typically range from \$35,000 to \$60,000 for middle-market companies. Performance or success fees on middle-market and large-transaction deals frequently have a tiered structure starting in the 5%–6% range, depending on the company size, and often have additional performance bonuses based on the outcome.

As with any industry, you will find both quality firms and inferior firms. Main Street, middle-market, and large-transaction firms each have their own unique position in the marketplace. The question is not which type of firm is better but which one is best suited for your specific transaction.

The Five Keys to Choosing a Firm to Represent You

After determining which type of firm offers the best fit for your company, you can turn your attention to the selection criteria for help in choosing a specific intermediary. Obviously, knowledge of your industry is helpful, but expertise in the M&A process along with a proven track record of success is paramount. While you should evaluate a number of factors when selecting your investment banker, five characteristics are key:

1. **Passion**
2. **Promise**
3. **Process**
4. **Perseverance**
5. **Professionalism**

Passion

Does the investment banker you are interviewing have a sense of passion for his or her work and, more importantly, for the sale of your business? Passion for the project will make all the difference in the sale of your business.

Determine whether the banker works on high-quality engagements or whether you would become simply a number. Will you receive senior-level attention or be delegated to a newly minted MBA?

Also, you do not want to work with an intermediary who will take any deal that comes along. A firm dedicated to high-quality transactions will represent your company only if it senses a reasonable probability that value expectations will be satisfactorily met for all parties.

Promise

Does the banker keep promises? Integrity is the single most important factor in selecting the intermediary. Most of the time, you will not want anyone to know that you are contemplating selling your company. At the very least, you want to have control over who is aware of your plan. The firm you select must have tight control over how information is released to prospective buyers.

In addition, you need to know that your advisor will manage your expectations in accordance with reality. Is he or she simply telling you what you want to hear? Finally, you need a firm that maintains all requisite securities licensing.

Process

Does the investment banker have a proven process? Does he or she listen to your goals? Every transaction is different, and every business owner has unique objectives. Especially during the presale planning phase, an intermediary should focus on your desires, as opposed to a predetermined solution. A transaction is about more than closing the deal, and many intangibles need to be considered on the basis of the seller's objectives.

Perseverance

Because the process has so many uncontrollable variables, you will need to be certain that your investment banker will persevere, regardless of the challenges and how long it takes. The transaction life cycle is typically nine to 12 months, but it can take longer. Will your investment banker quit or lose interest if the road gets tough?

Professionalism

A true professional generally seeks to further himself or herself through academics or credentials and demonstrates a commitment to continuing education. It is also helpful to find an intermediary who has had personal experience as a business owner or who has prior mergers and acquisitions experience in working for a larger entity. An intermediary who has bought and sold businesses for his or her personal portfolio or for an employer will have much greater empathy for the seller.

Of course, even when your selected mergers and acquisitions firm meets all of the criteria and the fit seems perfect, don't expect assurances that the deal will go through. Naturally, if you spend time evaluating your options and if you select wisely, your opportunity for success will increase.

MAXIMIZING YOUR VALUE

The one thing that remains common among owners wanting to exit their businesses is the desire to find the best transaction for themselves and future leaders capable of taking their businesses to the next level. To find such a prospective buyer, you, the business owner, need to prepare in advance so others can see the value that your business offers and evaluate it accordingly.

Obviously, the best time to get out of a business is when performance is at a peak or is showing signs of continued growth. This gives the company maximum bragging rights as it touts such effective practices of an efficient team, a large and satisfied customer base, increasing profits, quality products, excellent goodwill, and other attributes associated with a successful business. Not surprisingly, buyers willingly pay top dollar to acquire such ventures.

Selling a business that is performing well is of mutual benefit to both the seller and the buyer. While the seller realizes a premium price promising a secure future, the buyer acquires a well-organized addition to the existing core competencies of the acquiring business. With minimal adjustments, the buyer can hopefully expand his or her reach with the newly acquired business.

Importance of Preparation

In most cases, sellers are inadequately prepared to sell their businesses. They simply do not put in the amount of time and effort required. A buyer has to find a business valuable enough to accept the risk of acquisition and receive the corresponding return. The advisory team representing the seller has responsibility to highlight positive features of the business. A well-prepared, carefully executed sale of a business can take anywhere from six months to a year—or even more.

Factors Affecting the Sale of a Business

Many factors add to the marketability of a business. Some of these drivers are external, while others are internal. External factors such as extent of competition (both foreign and domestic), barriers to entry, economic trends, market size, and industry growth are variables that are beyond your control. Everyone has the same constraints to work with, which levels the playing field in terms of the competition who might be selling a similar business to yours at the same time.

The factors you can control—ones that influence the appeal of your business—are internal to the organization. Some of these value drivers include sales trends, gross margin trends, profit trends, unique selling proposition of the product or service provided, low customer concentration, sales and marketing, low vendor reliance, management team, recurring revenue, accurate standard operating procedures, business plan, information systems, reputation, ease of transfer, process advantages, and intellectual property. As a business owner, your ability to positively influence the internal value drivers will directly impact the value of your company when it is time to exit.

It is wise to work on internal value drivers to build the best possible business you can so that you are always ready to sell your company when the time is right. The following provides an overview of the mission-critical drivers that require your attention as you strive to maximize the marketability and value of your business.

Sales Trends

We all know that the main objective of a company is to generate an acceptable return to its shareholders. It may be an oversimplification, but you can't have any earnings without sales. Be it a small mom-and-pop shop, an online retailer, or a giant brick-and-mortar store, if it does not generate sales, it has no chance of making money. Not surprisingly, then, a business with steady annual increases in sales is considered more valuable than others.

Gross Margins

Gross profit margin, or gross margin, is one indicator associated with the well-being of an organization. A high gross margin indicates strong company performance. You need to be concerned about a low gross margin in your company, especially if you intend to sell it in the near future.

Gross margin is a gauge of the efficiency with which a business is running. Though gross margin is an important indicator, business owners often fail to understand its significance and continue to operate ineffectively, resorting to lower selling prices and higher direct costs of their goods. In contrast, even a small increase in the gross margin significantly alters a company's efficiency.

Earnings

As a business owner, you already know that generating a profit is the final imperative for the business to keep running. Breaking even leaves you with insufficient funds to meet day-to-day expenditures or invest in expansion plans.

Real growth requires earnings. The ability to buy assets and new machinery, employ more people, invest in training, explore new markets, initiate novel research, contribute to charities, and indulge in product diversification takes capital.

Without profit, a business loses its sheen and quickly becomes an albatross. If your company does not show significant profits, the chance of receiving top dollar for it is greatly minimized. Identify the factors casting a negative impact on your profits. As a business owner, you must be in touch with everything that happens in your organization.

Unique Selling Proposition

Products and services offered by a company are its flag bearers. Consumers know the products they prefer, even when they may not be familiar with the actual company. Customers typically opt for goods with unique features, frequently referred to as the unique selling proposition (USP) of products.

Customer Concentration

Simply put, customer concentration refers to the degree in which a company has a substantial percentage of revenues generated by a small group of customers. High customer concentration points to a handful of customers contributing significantly to the total annual business of a company. The obvious disadvantage of this situation is the risk of incurring huge losses with the departure of any one of the top customers. In addition, these few customers tend to exert greater leverage against the business.

Low customer concentration, on the other hand, spreads sales across many customers so the business is never dependent on a handful of consumers. Needless to say, business buyers find a company with low customer concentration highly desirable.

Sales and Marketing

A good sales and marketing program is the driving force behind a successful company. With the advent of social media, the marketing landscape is evolving rapidly. Does your marketing plan include the tried-and-tested strategies that have worked for your company over the years as well as new initiatives designed to attract new customers? A good sales and marketing program is the driving force behind a successful company. Are your overall sales and marketing processes and plans well documented and consistently executed?

Vendor Reliance

Changes in business practices and outsourcing have increased the degree of vendor reliance. How will you manage if one of your key suppliers goes out of business tomorrow or is unable to meet your needs? What impact will it have? Do you have viable alternatives available? Have you considered that relying on only one or two key vendors will lessen the value of your business?

Good business practice dictates that you should have a diverse number of suppliers to protect yourself in the event that your vendor experiences problems.

Management Team

As a businessperson, you already know that running a business alone is impossible; you need a strong team. Recruiting a management team that is effective and efficient is critical for an organization to be successful over the long term. The quality of your management team can have a significant impact on the value of your organization.

Standard Operating Procedures

How would you like your organization to be structured: people dependent or procedure dependent? In a people-dependent organization, daily business operations take place because the person responsible for performing them is actually there.

Successful businesses are people independent. Standard operating procedures (SOPs) make the company procedure dependent because they free the organization from dependence on people's subjectivity. Think of SOPs as building blocks of a quality system. Following a quality system gives the assurance of quality products.

Business Plan

The business plan is a document outlining the goals, the vision of a company, and the strategies to be used to achieve success. It is a blueprint of business events to happen in the future. Business plans empower management to make informed decisions.

One very important point: your company will never be perfect. In fact, buyers of companies enjoy seeing the opportunity for improvement in a company; it offers them a chance to bring additional value posttransaction. In light of this fact, you should always keep striving to improve, but when you are ready to sell, take action.

Ofentimes people don't have the energy or drive to continue working on their businesses even as they realize that numerous aspects of their businesses are underperforming. As a result, they continue to hold on to

the businesses and watch them unmercifully decline. If you lack the will to continue investing and driving growth in your company, feel ill equipped to manage the future, or simply want to cash in some chips and diversify, then sell now—even if you feel that your company has room for improvement.

COMPANY ASSESSMENT

We have compiled a list of 23 value drivers and have associated a rating system that will help to determine your company's strengths and weaknesses. We call this list a company assessment. In preparation to sell a company, these 23 value drivers must be carefully considered. A good idea would be for you to rate your company and then have an investment banker rate it as well. Often, your perception is skewed on the basis of your perception of areas that you are directly involved with and the risk you associate with each one. For example, let's say that your business has a single client that comprises half of your total revenue. Let's also say that your company was built around this customer and the relationship is 10 years old. As the business owner, you have little fear of losing the client because of the great relationship you share. You sleep well every night, and everything is working just fine. However, the buyer sees it in a different light, and the risk is valid and measurable. It is valid in that the buyer does not have the same relationship with the owner of the other business and measured by the profit generated by this customer. In some cases, it may take a bit of time to address these issues and make your company ready to go to market.

The following list contains the categories that have been established as typical to most businesses in the middle-market range:

- Low customer concentration
- Low vendor reliance
- Low competition
- Uniqueness of your product
- High industry growth
- High barriers to entry

- Insulated from foreign threats
- Large market size
- High recurring revenue
- Positive sales trend
- Positive gross margin trend
- Positive profit trend
- High market share
- Strong management team
- Easy to transfer
- Technology/process advantages
- Intellectual property
- Distribution leverage
- Strong history/reputation
- Strong sales and marketing
- Strong infrastructure
- Strong information systems
- Accurate SOPs (standard operating procedures)/business plan

Understanding and correcting these issues may take some time and money. Remember that for every dollar of profit you add, and concentrating on high-risk dissipation, you will yield a multiple of that dollar paid, with more value added to the deal at closing. So an expense today is easily justified when you consider that it will be absorbed when the increased earnings are multiplied in purchase price.

A value driver measures systems, processes, and resources that create sustainable value. Rate your company for each of the following 23 value drivers by placing an “X” in the box that is most reflective. Use 1 for the

lowest score and 5 for the highest. Clearly more 5s are desirable. For drivers 24 and 25, place an “X” in the box that approximates your annual revenue and earnings numbers. Don’t worry about an overall score. The goal is to get a picture of where your strengths and areas for improvement are. Please take a few moments and complete the company assessment form for your company below.

Company Assessment					
	1	2	3	4	5
Value Drivers					
1. Positive Sales Trend					
2. Positive Gross Margin Trends					
3. Positive Profit Trend					
4. High Recurring Revenue					
5. High Market Share					
6. Uniqueness of Your Product					
7. Low Customer Concentration					
8. Distribution Leverage					
9. Low Competition					
10. Low Vendor Reliance					
11. Strong Management Team					
12. Strong Sales and Marketing					
13. Strong Infrastructure					
14. Strong Information Systems					
15. Strong History/Reputation					
16. Easy to Transfer					
17. Accurate SOP/Business Plan					
18. Technology/Process Advantages					
19. Intellectual Property					
20. Insulated from Foreign Threats					
21. Large Market Size					
22. High Barriers to Entry					
23. High Industry Growth					
24. Annual Gross Revenue	\$0 to <\$5M	\$5M to <\$10M	\$10M to <\$20M	\$20M to <\$50M	>\$50M
25. Annual Net Income	\$0 to <\$500K	\$500K to <\$1M	\$1M to <\$5M	\$5M to <\$10M	>\$10M

Courtesy of VERCOR Advisors

Marketability Assessment

The aforementioned 23 value drivers and company assessment are components of an overall marketability assessment of your business. The purpose of a marketability assessment is to help you determine whether a sale of your business to outsiders makes financial sense at this time. The marketability assessment is a decision-making tool designed to provide you with:

- ◆ calculations of the value of your business if you were to sell it to a qualified buyer today. A tight range of values is given, and they tend to be on the conservative side. Note that this differs from a historical appraisal prepared for gift or estate tax purposes based on Revenue Ruling 59-60 and similar methods. Those appraisals look backward; a marketability assessment is forward looking and endeavors to estimate what an actual buyer would pay for your company based on past, current, and future performance. It utilizes various databases to examine prevailing EBITDA multiples and other valuation methods applicable to your business and industry. It also studies comparable sales of similar companies by researching recent similar transactions, where data are available.
- ◆ recommendations to enhance value based on your company assessment, including the 23 value drivers.
- ◆ an overview of the current M&A environment and appetite for potential buyers of your business.
- ◆ information regarding the length of time necessary to consummate a sale and explanation of the steps involved.
- ◆ an understanding of the fees earned by M&A firms and investment bankers to help you achieve your exit goals.

The marketability assessment process also helps you select the “best-fit” M&A firm to represent you and your business based on the criteria described earlier and specific factors, such as:

- ◆ industry expertise
- ◆ track record of closing transactions

- ♦ proper match of transaction size/type
- ♦ consideration of the chemistry of players involved
- ♦ geographic considerations—local, national, international reach

What is required to prepare a marketability assessment? A thorough review of your company's recent and projected:

- ♦ profit and loss statements
- ♦ balance sheets

Most importantly, a marketability assessment requires an understanding of your goals and objectives and your company's strengths and weaknesses through a dialogue and review of your company assessment.

In summary, the marketability assessment provides a critical foundation for you and your advisors to determine whether you and your business are ready to sell to an outside party and what the potential range of values might be and to evaluate possible M&A partners who could help you execute your exit. A sale to an outside party is, in the vast majority of cases, the preferred exit strategy to maximize the value of your business.

Tax Planning for Your Exit

You knew this was coming—you can't make sound plans to exit your business without considering the tax consequences and your overall plans for financial independence. As our cautionary tales sprinkled throughout this book reveal, business owners who fail to create and execute a holistic wealth preservation plan along with their exit strategy are courting trouble. Without a comprehensive tax strategy, the IRS, not you or your family, will be the ultimate beneficiary of much of your hard work. And, as we've noted, we haven't met a business owner who was planning to leave much of his or her life's work to the federal government. But that is exactly what will happen without proper tax planning. Even if you have commenced an exit plan, that plan will benefit from being revisited today in light of ATRA of 2012 and a comprehensive plan to defend your wealth.

CHAPTER SUMMARY

For most business owners, exit planning represents a once-in-a-lifetime event and the largest financial decision they will ever make. An exit plan is a comprehensive road map designed to help you successfully exit your business, on your own terms. It is interrelated with the other chapters in this book and results in the creation and preservation of wealth for you and your family.

The focus of this chapter is to help maximize the sale of your business to an outside party. There is a definite process to follow. Don't go at it alone—selling your business is not a do-it-yourself proposition for a variety of reasons. A team of professionals, including your financial advisor, exit planning specialists, an M&A advisor, or investment banker, along with your CPA and attorney, will provide expertise toward a successful outcome. In addition, if you decide to sell, it's important to define and control the process; otherwise, it can drag on for months or even years without a favorable outcome. It's also a good idea to keep an open mind about the potential types of transactions that might meet your goals or objectives because an option may come along that you hadn't considered that could result in an even better outcome than you had initially envisioned.

It is important to protect yourself, your family, and your business if you are not ready to exit today. Contingency planning addresses the what-ifs that could occur between now and the time you exit, such as death and disability of key employees, the need for a shareholder's agreement, and proper wills and trusts. External factors beyond your control, such as an economic recession or a change in tax laws could adversely affect your ability to sell your business when you desire. Even if you're not entirely sure that you want to sell, it may be worthwhile to begin exploring the exit planning process to preserve your options. Use the company assessment to evaluate the 23 important value drivers. Such an exploration may reveal that you need to do more work internally before a sale at the price you desire is feasible.

If your goal is to proceed with the sale of your business, preparation of a marketability assessment is the next step. This will help determine how marketable your business is and at what valuation range based on financial statement review, analysis of comparable transactions, and an

understanding of your company's unique strengths. It will also highlight recommendations to enhance value and provide an understanding of the marketplace and the M&A process and fees.

The key to M&A success is best expressed with the SUCCESS acronym: strategic fit, understanding the process, creating multiple options, communication and negotiation, expectations are realistic, stay focused on the business, and sustain momentum.

Finding the right M&A firm or investment banker to represent you and your business is critical. There are various types of professional advisors who work in different portions of the market and on differently sized deals. There are five keys to choosing a firm. These are passion, promise, process, perseverance, and professionalism. Many factors affect the sale of a business, including mission-critical drivers that must be attended to in order to maximize the value of your business. This is a fine balancing act, because you need to own, control, and drive the exit process while not neglecting the factors that are likely to make your business attractive to potential buyers.

EXIT PLANNING: MAXIMIZE THE SALE OF YOUR BUSINESS

Questions

An exit plan is customized to fit the needs of each individual business owner. There are several common elements that comprise a proven step-by-step process.

1. **Exit Objectives:** Have you determined your planning objectives with respect to exiting your business, such as:
 - ◆ Your desired departure date? Now? One year from now? More than five years?
 - ◆ How much income do you need to achieve financial security? (This is expressed as a lump sum or annual income amount. Remember to include inflation and taxation and consider your longevity.)
 - ◆ The person to whom you want to transfer your business?

2. **Valuation:** Do you know how much your business is worth in today's economy?
3. **Making the Business More Valuable:** Do you know how you will effectively increase the value of your business prior to exit?
4. **Sale to a Third Party:** Do you know how to sell your business to a third party in a way that will maximize your cash and minimize your tax liability?
5. **Transfer to Co-owners or Family:** Do you know how to transfer your business to family members, co-owners, or employees and pay the least possible amount in taxes while enjoying maximum financial security?
6. **Contingency Planning:** Have you implemented all necessary steps to ensure that the business continues even if you don't? Have you provided for your family's security and continuity if you, your partner(s), or key employees die or become incapacitated?
7. **Wealth Preservation Planning:** Have you planned for the distribution of your business and other assets while minimizing exposure to the 40% federal estate tax? A will is not enough. Business owners need advanced-level planning to address their unique circumstances.