

How to Value & Exit Your Business



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About Sunbelt

- Founded in 1978
- 240+ independently owned and operated offices in 11 countries
- Nearly 1,400 transaction professionals worldwide
- Manage thousands of transactions every year



The Market

- There are over 100,000 businesses in the Minnesota market
- National studies show that 1 out of 2 businesses will change ownership over the next 15 years. That equals 3,000 per year for the Minnesota market alone.



Why Business Owners Sell?

- Exit Scenarios:
 - Liquidate / Close the Business
 - Does not maximize value
 - Accident, Illness or Death
 - Succession
 - Successors must be identified, qualified, willing and able
 - Emotional choices do not maximize value; limited cash
 - Sale of Business
 - Realize true business worth
 - By choice, not by force!

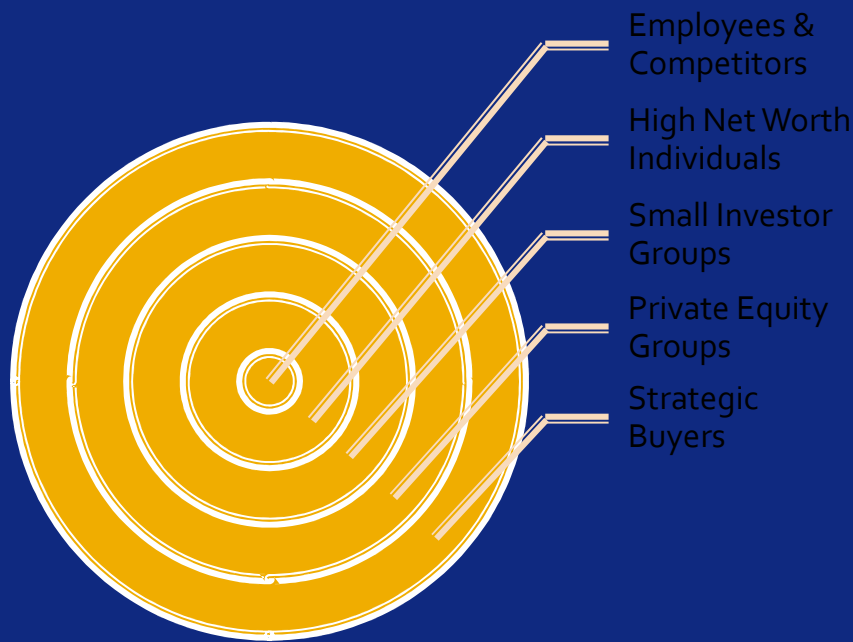
Why Business Owners Sell?

- Most Sellers sell for human reasons:
 - Retirement
 - Burn-Out
 - No Succession Plan
 - Death
 - 2nd generation not interested/not capable
 - Partner/Shareholder issues
 - Illness
 - New Opportunity, etc.
- Reasons also include financial reward, divesting of a non-core business and seeking an outside acquirer to take the company to the next level.
- It is not a matter of “IF” the business will change hands, but “WHEN”, “WHO” and “HOW”.
- Will it be planned or reactive?

The Total Universe of Buyers



The Total Universe of Buyers



- The farther away the buyer is, either by geography, customer mix, niche or knowledge, the more likely they are to pay the most for your business. You have something they don't.

Business Buyers

- Buy vs. Build
- Want immediate cash flow that will:
 - Service the debt
 - Pay the new owner a salary or ROI
 - Left over money for growth



Value to Buyers

- The value of a business may vary widely depending on the needs of the buyer (competitor vs. strategic).
- What is the value of your business to buyers?:
 - Earnings Stability
 - Customer Diversity
 - New Product/Service/Brands
 - Staff
 - Equipment / Facilities
 - Established presence in the market
 - Intellectual Property
 - Buy vs. Build (avoid start-up/expansion risk)

Valuation Methods



Business
Valuation

- Cost
 - Tangible Asset Value

- Market
 - Comparable Transactions
 - Industry Methods

- Income
 - Multiple of Discretionary Cash Flow
 - Multiple of EBITDA
 - Discounted Future Cash Flow

EBITDA/Seller's Discretionary Earnings

- Buyer most often buy to gain future income. Buyer's will focus on past earnings as a major indicator of future performance. Buyers do not pay for "growth potential".
- Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) is a common measurement tool of earnings
- Seller's Discretionary Earnings (SDE) is more common in smaller businesses. $SDE = EBITDA + \text{one Owner's Compensation}$ and is more often used when the buyer is likely to be an Owner/Operator.
- An intermediary can help determine whether EBITDA or SDE is more appropriate for your business

Recasting

- Recasting allows for repositioning of the financials to highlight benefits to the owner as well as one time expenses that will not recur after a sale (e.g. one time legal or consulting expenses)
- Recasting is used with both EBITDA and SDE.
- KEY CONCEPT: Every dollar is EBITDA and SDE generally means multiple dollars to your price. The recasting step is critical to making sure you do not leave money on the table.

Example of EBITDA

| | | |
|----------------|----------------------|-----|
| Net Income: | \$800,000 (Earnings) | (E) |
| BEFORE | | (B) |
| Interest: | \$100,000 | (I) |
| Taxes: | \$0 | (T) |
| Depreciation: | \$100,000 | (D) |
| Amortization: | \$0 | (A) |
| <u>EBITDA:</u> | <u>\$1,000,000</u> | |

Using a 4 time multiple the price would equal \$4,000,000.

Example of SDE

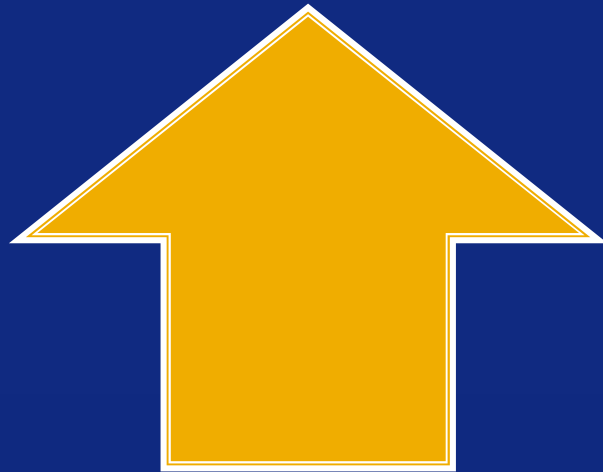
| | | |
|--------------------|----------------------|-----|
| Net Income: | \$200,000 (Earnings) | (E) |
| BEFORE | | (B) |
| Interest: | \$50,000 | (I) |
| Taxes: | \$0 | (T) |
| Depreciation: | \$50,000 | (D) |
| Amortization: | \$0 | (A) |
| <hr/> | | |
| EBITDA: | \$300,000 | |
| + Owner Salary | \$100,000 | |
| + Owner "Benefits" | \$50,000 | |
| + One Time Exp. | \$50,000 | |
| <hr/> | | |
| SDE: | \$500,000 | |

Using a 3 x SDE multiple the price would equal \$1,500,000.

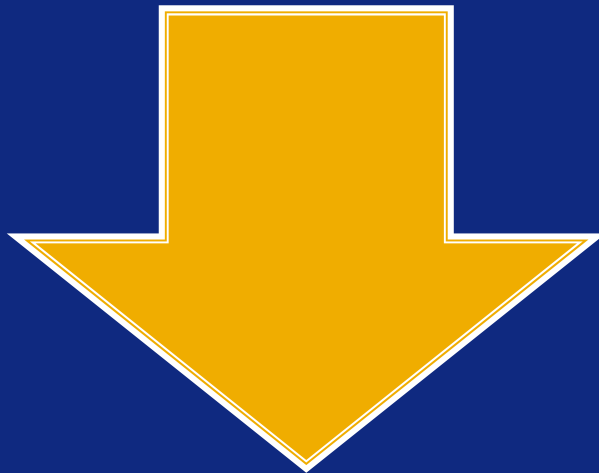
Multiples of EBITDA/SDE

- Average SDE multiples in the market are 2 - 4 times SDE.
- Average EBITDA multiples are 3 – 7+ times.
- Increase YOUR multiple by increasing growth opportunities and reducing risk.

Multiples are Driven by Risk and Growth



- *Growing Industry
- *Proprietary Product/High Barriers to Entry
- *Strong Brand
- *Intellectual Property / Patents
- *Consistent Revenues and Earnings
- *No Large Customer Concentrations
- *Management in Place



- *Inconsistent Revenues and Earnings
- *Heavily Dependent on Owner
- *Low Barriers to Entry
- *Few Assets
- *Mature or Declining Industry
- *Large Customer Concentration(s)
- *Low Repeat Customer Factor

What Buyers Want

- Buyers want to avoid risk and secure a return on their investment. The earnings must service the debt, pay them (or an operator) a wage and provide a compelling ROI.
- The more risk mitigation and growth opportunity there is in your business, the more a buyer is willing to pay.

Getting Paid/Deal Structure

Financing/
Structure

- Cash
- Promissory Notes
- Earn Outs
- Consulting Agreements
- Royalties
- Leases/Rent
- Generally, the more risk the buyers takes (more cash upfront) the less they will want to pay. Likewise, if a seller takes some of the risk (promissory notes, earn-outs) they should demand a higher price. This is also a strong signal the seller believes in the future of the business.

Understanding Your NET

- Price – Intermediary and accredited business appraiser
 - Terms – Intermediary and accountant
 - Closing Costs – all professionals
 - TAXES - Accountant
- Once you know these components, you can determine whether you can afford to sell at this time. If you can not, you now know the components you need to fix to reach your goal.



Going to Market

- Clean Up: Inventory write offs, A/R, A/P, personnel, environmental, deferred facility maintenance.
- Identify and understand your contractual agreements: Property Leases, Equipment Leases, Employment Agreements, Advertising Contracts.
- Invest time in the Confidential Business Profile the business broker/intermediary prepares. You **MUST** show the **GROWTH OPPORTUNITIES** and get the bad news out of the way in a tactful way.
- **STAY FOCUSED ON YOUR BUSINESS!**
- **KEEP IT QUIET!**
- Let your intermediary/business broker cast the net wide to find the most possible buyer candidates.

Marketing

- Confidential: all buyers sign a confidentiality agreement before receiving your name or information.
- Blind Profiles
- Internet
- Print
- Direct Mail
- Broker's database
- Trade Associations
- M & A groups

Offers

- Take full advantage of your intermediary – coordinate all discussions and offers through your broker as they give you time to strategize on your responses.
- Control your information. In most cases, only summary financial data should be supplied prior to an initial offer.
- Demand information on where the acquisition funding is coming from. Individual buyers should supply a net worth statement. PEG's and companies can supply financial statements and/or bank letters.
- Avoid “No-Marketing” clauses.
- Earnest Money
- Contingency Expiration Dates and other clear deadlines. Have an out if important dates are missed by the Buyer.

Offers



Evaluation Of Offers

- Maximize after-tax sales proceeds
- Have your intermediary coordinate your attorney and tax advisor to address tax planning strategies and other important transaction structure issues
- Target: Not necessarily the highest price, but the highest net after taxes AND the most likely to make it to the closing table

Due Diligence

- Keep “back up” buyers warm.
- Due Diligence is where your price may be attacked.
- Due Diligence deadlines are critical.
- Deals do not age well.

Closing

- Be ready for the “3 Deaths”.
- Third parties, such as landlords, are common deal problems.
- The broker should keep plan “B” and plan “C” buyers warm.
- Don’t take your foot off the gas until the deal is closed.