Do you have an Exit Strategy?

Are You ***POSITIONED FOR TRANSITION***?

By John Howard, Founder and Principle Adviser

The value of a company is determined by several variables. As in any investment, the value is best assessed in terms of risk and reward. **The *BEST* Evaluation (Business Evaluation Salability Tool)** is designed to assess both the level of risk and reward and translate this data to a price. We then examine the probability of sale and the cash outcome to the seller based on financing.

BEST 1

This report is a comprehensive look at the business, the market for sale, different potential buyer types, risk analysis, salability and optimum financing capabilities. Included in the report are:

- Overview of Business
- Risk Analysis
- Financial Analysis
- Multiple Valuation Models
- Anticipated Value Range of the Company
- Buyer Type profile
- Optimum financing capability
- Industry Peer Comparison and Risk Mitigation Analysis as it relates to final valuation
- Industry Overview *

* *Industry Overview is provided under a third party vendor agreement. In some cases, the unique nature of the business may preclude its availability*

BEST GTS

This report is specifically geared to company owners who would like to grow the company. It contains all of the same features and benefits of its predecessor report and then adds a new dimension. By considering the goals of the owner and the nature of the industry, the *BEST GTS **(Growth & Transition Strategies)** Report* analyzes the company's Strengths, Weaknesses, Opportunities and Threats (SWOT) and makes specific strategy recommendations to increase the company's value. For example:

- Differentiation
- Buyer – Supplier Pricing
- Fragmentation
- Integration (backward, forward)
- Capacity Enhancement
- Mobility Barriers
- Pre-emptive Maneuvers
- Life-Cycle
- Acquisition

Buyer Type

Unlike real estate, businesses have more than one value. A competitor might pay a low price to put you out of the market as a competitor and automatically increase his own market share. An individual buyer will pay another price based on subjective and objective risk-reward parameters. A strategic buyer may pay the highest price based on the synergies, economies of scale, market extensions and other perceived benefits to its existing operations.

Risk

In connection with a business acquisition, risk is determined by assessing a variety of elements including but not limited to:

- How much influence does the existing owner have over the business
- What is the likelihood that financial trends will continue
- What are the future growth possibilities
- How difficult will it be for a new owner to transition
- What is the employee situation
- Product – service diversity
- Customer – industry diversity
- Supplier dependency
- Size of market
- Branding or proprietary products or technology
- Industry Life-cycle
- Competition
- Customer concentrations
- Repetitive nature of sales
- Seasonality
- Legal issues
- Environmental concerns
- Location – occupancy costs – lease term
- Ratio of Fixed to Variable Costs
- Ability to obtain financing

Reward

Reward is a measurement of financial return against the level of risk. Typically, we measure financial reward in terms of discretionary cash flow. In some situations, as in some strategic targets, we may calculate the financial return from **gross profit** versus **discretionary cash flow**. Typically, in a strategic acquisition, we establish an anchor-value, also called a worst-case value. The reason we do this is because a strategic target may be worth different values to different suitors. For this reason, we typically advise that these companies be offered for bid – we do not put a price on it.

For example:

A manufacturer of widgets is deemed to have strategic value. We establish an anchor price of $3,000,000 (assume 4 x Gross Profit based on our risk and financial analysis). The company is marketed without a price and we get two offers:

Offer One: another widget manufacturer is currently operating at 70% of Break Even and sees the addition of this company's production as a means to get them into the black. **They offer $3.4MM**

Offer Two: This is a company that sells a different product (gadget) to the **same market** as the subject and sees a two-fold opportunity here. First, the suitor presently shares about 10% of the subject's client base who buy their "gadgets." They see an opportunity in the other 90% of the subject's customers who presently buy their gadgets from other companies.
"What if we combined our "gadgets" with their "widgets" and offer both as a package for a reduced price to the combined customer base? We could double the size of our company in three years and have a strategic advantage over our competitors that sell one or the other."

After several hours of deliberation and detailed projections and planning, the company sends in an **Offer to buy for $4.6MM.**

Since every strategic buyer has different motives and strategies, each one's valuation will differ and this is why we recommend going to market without a price. The anchor value is computed for internal purposes only and comes into play as a baseline measurement from which we compare competing offers. Without a baseline or "anchor" value, we would have no idea whether we were receiving a good offer or a bad offer.

Salability

While every business has some value (worst case – net asset value), how do we know if the business will sell? Experience has a lot to do with it but consider some of the other factors:

- **Ability to be financed:** The smaller the "out of pocket" cash investment, the larger the buyer market. Favorable seller financing will often make or break a deal. Some businesses have debt structures that make them almost impossible to finance. For example, a business with a market value of $2MM has $1.2MM in secured debt and its cash flow can support a loan of $900,000. If a seller is unwilling to hold a note, we need a buyer that will come out of pocket $1.1MM plus closing costs. Unless this was deemed to be a strategic target, this business will have a very low probability of sale.

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- **Asset vs. Stock Sales**: Other issues may arise from the type of business entity. For example, a C-Corp. that has been historically profitable may have a value of $3MM as a “stock sale.” Many buyers shy away from “stock” sales because of the automatic assumption of historical liabilities (known and unknown). To sell the assets as opposed to stock means the seller will incur an additional tax bite of $400,000. Therefore, he adjusts the asset price upwards to offset the incremental taxes but the buyer scoffs at paying a higher price for the same risk and return he’d be receiving at the $3MM price. Fortunately, for larger deals, there are new mechanisms for handling these issues.
- **Other**: Partner-disputes, contracts, leases, licenses, loss of key personnel etc. may all represent salability issues.

The evaluation of a business is an art as well as a science. There are so many variables that affect value and salability. There is no substitute for experience in these matters.

Start *NOW*…with my *POSITION FOR TRANSITION* program.

It provides focused leadership, operational and financing solutions that owners need to increase

business value and achieve the maximum sale price. With a defined exit roadmap and time-phased action plan the owner will have determined “Where-to-Play” and “How-to-Win” as they transition away from their most precious asset and reap the rewards of many years of service. My program consists of:

- Business evaluation and valuation – establish base value and context with our **Business Evaluation and Salability Tool (BEST)**. We evaluate income, asset or cost and market approaches as well as the adjusted cash flow, rules of thumb and market comparables techniques.
- Create the transition roadmap with time-phased actions by applying SWOT, market positioning tools and the 9 drivers of corporate value and success to build market positioning value and equity. These are the key success factors that separate the best from the average…and **increasing the ability to generate cash flow for the owner’s benefit is the most important!**
- Verify with a periodic health checkup to ensure that value is increasing to plan – increased positioning value transferable to a strategic buyer commands an acquisition premium.

POSITION FOR TRANSITION^{TM} gets you ready for a rich retirement with a defined exit strategy. Your company is the most valuable asset you have and someday you'll be looking to cash-out. Every incremental improvement for growth and transition will bring more value and a higher sales price for your company – the big bucks that allow you to retire!

The Profitability Catalyst is an advisory practice affiliated with Merger and Acquisition firms and experts in the financing arena with many years of combined experience. Besides performing evaluations, we can refer the marketing and financing of the sale of our client companies. This gives us a distinct advantage over our competitors and usually results in better prices, less risk and more cash to our clients at closing.

Stay Healthy, Profit and Grow!

Contact John @440.759.1915 for a FREE and confidential Exit Strategy advisory session
or learn more at ***www.theprofitabilitycatalyst.com; POSITION FOR TRANSITION.***

John Howard is known as *"The Profitability Catalyst^{TM}"* due to his tested-and-proven strategies and frameworks for increasing cash flow, profits and ROA…backed-up by his B.S. degree in Chemistry and MBA in Business Systems. He has worked in and with both small and Fortune 500 manufacturing companies for over three decades, including ADC Telecommunications, ABL Canada and U.S. Steel and played key roles in founding or launching four companies. Specializing in turnaround or growth situations, John helps companies respond to rapid change by working with leadership and management to help them become more profitable, flexible and higher velocity organizations; keys to long-term endurance and growth. His advisory insights into the human side of change management provide ***"Game-Changing Guidance for 100% More Profits!"***