HOW TO INCREASE BUSINESS VALUE AND PREPARE FOR SALE OR SUCCESION

EXIT & SUCCESSION

EXIT & SUCCESSION

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This is just a small part of the comprehensive resources that I can offer to help you in this area. Please contact me and I will send you a more detailed information pack.

LETTER TO BUSINESS OWNERS

Thank you for joining the thousands of business people who have chosen this series of E-Guides and business information to assist them in managing their business.

Your first step is to read this booklet cover to cover to give you a great overview of the process. Then at the end of the booklet I have included a list of next steps for you to consider.

On behalf of myself and the MAUS international network of advisors....Good Luck!

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Your Goal – Avoid this problem!!

....most business owners do a great job in establishing and building their business but are disappointed when it comes time to reaping the rewards!

It is unfortunate that many of these business owners who spend years building their business will receive only a fraction of what their business is actually worth. Or if ownership is transferred to a family member then seeing the legacy destroyed through lack of preparation and planning.

This guide on Exit & Succession planning will help you to prepare your business for a successful transition. It will also help you to address critical personal goals and business factors that should be tied into the process.

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Important Points in this Booklet

- Most Business Owners make more out of selling their business than they do through annual company profits.

- The majority of business owners do not think strategically about their exit from the business...they just sell when they have to or wait until it is too late and the business fails.

- Research suggests that there is a high probability that developing an exit plan 12-36 months prior to selling the business will dramatically increase the value of the business and the ultimate net proceeds that the business owner(s) will receive.

- The Exit Plan should consider market, personal and business cycles matched against personal goals and expectations.

- Specifically an Exit Plan will review:
    - The best time to sell /transfer the business, taking into account
        - Personal timing
        - Business timing
        - Overall marketing timing issues.
    - To whom and for how much. This should take into account the net proceeds that will be received by the owner(s).
    - Details on what will need to do be done to ensure that this transition will occur successfully.
    - Details on life after exit and personal goals and lifestyle and expectations.

Understanding Exit Planning

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What is Exit & Succession Planning?

Exit Planning refers to the process of helping the business owner(s) leave or exit the business and ensures that a successful transition of ownership will transpire in a timely, efficient and effective manner.

The goal in most cases is to maximise the financial returns to the business owner, however in cases of family succession this may be secondary.

Two types of plans need to be prepared in order for a business owner to successfully leave or exit the business.

Personal Goals & Action Plans

The personal goals of the business owner(s) must be taken into account and plans must be made to ensure that “life after transition” goes smoothly. Personal financial planning and tax planning will need to be considered to ensure the maximum net proceeds and transfer of wealth.

Business Goals & Action Plans

The business value of the enterprise needs to be maximised prior to the transition. This will ensure that the business owner(s) receive the maximum return on their investment.

Plans must be put in place to transfer the management roles and responsibilities that were previously performed by the business owner(s). (Management succession).

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If a management succession plan is considered at least 12-36 months prior to selling then it is likely that internal structures will lower the risk of failure of a new business owner. This will ultimately increase the value of the business.

Why prepare an "Exit, Succession or Business Owner Retirement" Strategic Plan for your business.

No matter how much you enjoy working in your business, inevitably there will come a time when you will need to retire or sell your business.

A business owner can retire in several ways. Each has implications, not only for you as the owner, but for the business and the business adviser. An Exit & Succession plan will help you to consider a variety of different options before you make the final decision.

In order to retire from the business the business owner can choose to:

- sell the business
- transfer ownership and control of the business to family members
- allow the business to cease – particularly if the business is small and closely tied to the owner's personal involvement

- retire from active involvement (or scale down involvement) by
- taking a new partner or appoint a manager.
- allow existing partners or family to run the business and maintain a passive involvement

Each option has its merits and drawbacks. However it is essential that any decision regarding retirement be made early so that death or infirmity does not force an unfortunate decision on the owner or the owner's family.

Most business owners are only concerned with selling their business to a third party. Therefore the primary driver for preparing an Exit Plan is to maximise the value of the business in this sales process.

To ensure you get the best price for your business if you decide to sell, you need to start planning for such a sale well in advance. You also need to consider the issues that could cause you problems.

Common problems at the start of the process.

1. Most business owners feel their business is worth more than is justified by the marketplace
2. Most business owners books and records may fail to reflect the true worth of the business
3. Most business owners have backdated compliance and financial statements.
4. Most business owners have little systems and processes in place
5. Most business owners have never reviewed their business from an “attractiveness to a buyer” perspective so there are fundamental problems that will drag the value down

Building your Wealth

Business Value increases over time! – The Value Enhancement Gap.

Your business SHOULD become more valuable the more that you work on it.

TRUE STORY:
David is the owner of a software business with a turnover of $1 million dollars. David originally thought his business was worth between $800k- $1.2 million dollars. This however was not enough for him to retire. Over a 2 year period David worked with an Exit Planning Advisor on key ways to improve the value of the business.
The success: At the end of this period David went to market and within 3 months had received a contract for $2.6 million dollars.

Key questions

1. What is your business worth now?
2. What could your business be worth in 12-36 months' time if you worked on a value improvement plan?
3. What is the "Value Enhancement Gap" or the financial benefit of working on the business? (Ie the answer to Quest (1) minus the answer to Quest (2))

How do we increase the value enhancement gap? ...We work on improving sales and profitability. But we also work on other factors that will improve our value.

Example of two companies with the same revenue and profit but completely different values.

If we look at one particular industry and take two companies with similar sales and profit performance for the last year, one might justifiably pay more for one business than the other for the following reasons:

- One business may appear to rely on the directors and owners, while the other appears to rely on numerous staff members. If the reliance is spread across the entire workforce then a potential buyer has less risk.
- One may be a start up company and the other may be an established company with a 5 year trading history
- One of the companies may have spent a considerable amount on R&D that will lift future profits
- One may have developed long term contracts that ensures profitability in future months and years, whereas the other may have to rely on winning contracts or work on a weekly basis
- One may have an easily identifiable and loyal customer database and the other may have a high turnover database
- One of the companies may have developed a product that is positioned in a growth market and the other may not
- One may be in a better geographical segment
- One may have a more recognisable brand
- One of the companies may have developed a worldwide patent that locks the brand into immediate worldwide distribution

- One company may dominate a niche whilst the other is a smaller player with less competitive advantage in a wider market
- One business may be a strategic fit to the buyer’s existing business, which will improve the profitability of that existing business
- One may have strong internal systems
- One may be able to negotiate a better deal based on future profits rather than historical performance.

So clearly, two businesses with the same recent sales and profitability but different future potential may be valued at different ends of the spectrum.

Think about these examples...What can you do to increase your business value?

Baby boomers – a threat to your wealth!

Most business owners have as much money tied up in the business as they do in their house. Given that 70% of business owners plan to use their business as the primary source of retirement, this asset needs to be managed to maximise the value.

There is no doubt that, as the baby boomers near retirement and the average age of small business owners increases, the age-old laws of supply and demand will come into play.

In such a crowded marketplace business owners will need to present their business in an appealing, professional manner to stand out from the competition and achieve the maximum return.

There will be two results

1. YOU MAY NOT BE ABLE TO SELL YOUR BUSINESS: Some business owners will not be able to sell their businesses

2. YOU MAY HAVE TO SETTLE FOR A LOWER PRICE: Other business owners will not be able to achieve the sale price that they want for the business.

It stands to reason that the more you can sell your business, the more you will have in retirement. That is

why you need to understand this process and work on a plan to maximise the attractiveness of your business to potential purchasers. Most of this work is done 12-36 months before putting your business on the market.

Improving the Attractiveness of your business

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What makes a business attractive & worth more?

Buyers look for a return on their money. The higher the perceived return on investment the more attractive the business. And of course the more attractive the business the more buyers are prepared to pay.

Peter Hickey in his book "Sell your Business" pioneered the development of two scales that a business needs to score well on to maximise the value.

Attractiveness Index:

This lists the factors that make your business attractive to a potential buyer

Readiness Index

You may be the most attractive business in the world but if you are not ready to sell then your value will be diminished. Readiness factors include areas such as employment contracts, up to date financials, trade- marks, supplier and customer contracts etc.

Utilising a tool such as the "attractiveness index" provides your business with a benchmark guideline based on research into hundreds of different acquisitions. It will give you a guideline as to how attractive your business is to a potential buyer.

Attractiveness will be relevant to the type of buyer

Attractiveness will be relevant to the type of buyer and the reason they are buying.

When an owner/operator considers buying a business they are essentially buying themselves a job. The average spending of these buyers would likely be $100,000 to $1,000,000 and any business for sale over this category may be unattractive.

A multinational or large company that buys a business for strategic reasons will rarely spend under $1,000,000. A multinational would not look at a business unless it had enough profit and upside to justify the stringent due diligence, legal and accounting fees.

Within the owner/operator category there are essentially two types of people. These include buyers which are purchasing for leisure and hobby reasons and those which are buying to “get ahead”.

The former will be made up of people that are reasonably well off and are either in the twilight of their careers or are looking to take it a bit easy. They are essentially looking at buying a job in an industry which they enjoy working in. They want good profits and a job that is not stressful in a situation where they don’t need to work too hard.

Owner/operators that are buying to “get ahead” will be after maximum returns. Their choice of industry is dependent upon growth, profitability and their experience. They are not concerned about working hard or long hours as long as there are solid returns.

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Who will pay the most for your business?

On the balance of probability another company that is looking to strategically invest in a business will pay more than anyone else for your business.

Strategic investors (a large business that buys another business) are generally looking to expand or eliminate a competitor. They might be looking to expand and see the strategic benefits of the following:

- Products or services to add to their base
- Intellectual property
- New distribution channels
- Locking in supply
- New ways of approaching customers
- Management expertise
- Brand expansion
- International expansion
- Competitor buyout
- Employee Skills

They may well pay a premium for your business because you might be able to accelerate their expansion. And as they already understand the market and may have personnel, systems or channels then the risk of acquiring your business is less than a financial investor or an individual.

One of your exit options should be to consider this type of exit strategy.

The key is to provide a potential buyer with security

The primary reason someone buys a business is to get a return on the investment. Each potential acquisition will be judged on the level of future profits the buyer believes the business can generate and the level of risk attached to reaching these targets.

Buyers will minimise their risk by carrying out a thorough due diligence and investigate the business. Sellers can maximise their position by being prepared for the scrutiny that prospective purchasers will put the business under. The more prepared the seller the higher the ultimate price that they may negotiate.

- Ensuring there is a sound financial history.
- Records of a steady increase in profit for the last two to three years, with a similar increase in sales over the same period.
- Positioning the business as a good low risk return on the investment.
- Highlighting an established customer base, sound internal systems, market awareness and credibility, an operational framework and cash flow.

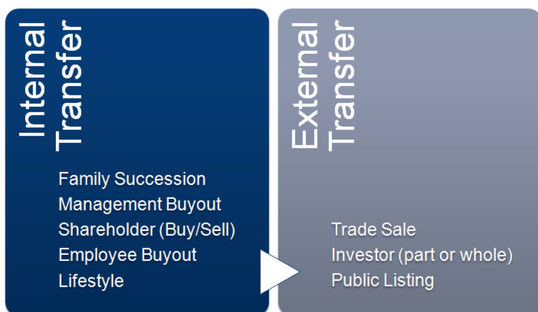
- Highlighting positive industry trends.
- Highlighting company awards, testimonials or even an ecologically responsible product or service.
- Ensuring the business does not appear to be reliant on the owner and that there is a succession of employees that could take over the existing owner's job when he/she departs.

Types of transfer methods

What are the types of ways you can exit your business?

The majority of business owners that wish to exit their business will either sell the business to a third party or allow a family member or part of the management team buy into the business.

List of Transfer Methods



In some cases an entrepreneur may wish to exit a business but cannot find a buyer prepared to offer a commercially realistic price. Rather than reduce the sale price, an owner may decide to pull back from the day to day running of the business and appoint outside management.

Sometimes a buyer is not in a position to purchase the entire business but can afford to become a part owner. In this situation it is important that the original owner thinks carefully about offering someone a majority stake in the business, as this effectively means he or she will

lose control of all strategic and operational decision making.

In some instances the best investors are already a part of the organisation. In a management buy-out, an owner offers employees the opportunity to buy into the company, often funded over time, out of the growth of the business. There is risk attached to this arrangement because if the business's profitability declines, it may be difficult to make payments. For this reason it is recommended that management buy-outs only take place if the owner is a secured creditor and appropriate guarantees are in place.

An Initial Public Offering (IPO) is the process by which a company is listed on the Stock Exchange and it is usually a way for a medium sized business to obtain the capital needed to grow into a large business. It requires a sizeable financial investment to prepare for listing and there are significant demands on the business owner's time in the lead up to the float. An IPO is usually not an option for a small business.

What is Succession Planning?

There are two types of succession plans that should be drafted.

1. Managerial Succession: The first is the transfer of managerial control.
2. Ownership Succession: The second is the transfer of assets or ownership.

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Management succession planning is one of the fundamental roles of the owner of a business. There are two primary responsibilities in this regard:

(1) Selection and grooming of a successor; and (2) determining those factors which are most essential to managing the company in an effective and efficient manner to facilitate continuing growth and development. Key questions:-

- Who will take over management of the company on the owner's death or retirement?
- Is he or she suitably qualified?
- Is he or she suitably interested?
- How do employees and other family members feel about the choice?

The options available in terms of naming a successor or leader include:

- choosing among family members
- forming a committee structure of family members
- selecting a manager from outside the business or
- selecting a key employee to run the business.

There is no one correct selection method; however the following should be kept in mind:

- the nature of the business
- its life cycle stage
- qualifications and abilities of family members and
- expectations and capabilities of senior executives.

Family Businesses & Succession Planning

A large portion of small businesses are family businesses and in many cases it is the wish of the owner to keep the business in the family. Currently around 10 per cent of business owners have acquired ownership through family transfer.

Of the family businesses with employees, three quarters employ at least one family member. Research also shows that 92 per cent of family business owners are prepared to pass the business on to children and 57 per cent are prepared to sell it to them.

Sometimes emotive factors come into play in family businesses, which change the family dynamics and can negatively impact the business. An example of this may be intergenerational conflict.

In a family business, it is essential that a Succession Plan is created and well documented, and that family members are aware of its contents. Some family members may automatically expect to be given first right of refusal for purchase of the business.

It is common to have a combined ownership structure split between a husband and a wife. When divorce or separation has interrupted a good relationship, selling the business and transferring shares becomes difficult. It is best to consider this possibility when a business is started and structure it accordingly.

Valuation Methodology

Valuation

To create an effective exit strategy, it is vital to understand how businesses are valued. An accurate valuation allows the business owner to make a realistic estimate of the profit from a sale, and whether this is going to be sufficient to meet future needs.

There is a common misconception that valuing a business is a simple financial calculation that is done with a great degree of certainty.

This is not the case!

The valuation of a business is extremely complex because of the diversity of companies, industries and individual business performance that need to be considered.

The true value of a business is what any potential buyer is willing to pay at any particular point in time, and this fluctuates depending on whether the settlement involves cash, shares or debt financing. Other factors such as timing of payment and the workout involved will affect the price.

Through years of R&D, some companies have developed IP, packaged it and built it into a recognised brand name. In this case the valuation mechanism needs to not only value current sales, but also to take into account the past development that will generate sales in future years.

An investor that buys this type of company will reap the rewards of the previous investments into R&D.

Valuation Methodologies

There are three different approaches that are commonly used in business valuation:

- The income approach,
- The asset-based approach, and
- The market approach

The Income Approach generally looks at future income or cash and discounts it to today's value. An example is the "Discounted Cash Flow" method.

The asset-based approach bases its valuation on the assets of the business. For example "Net Asset Value."

The Market Approach compares the business against other businesses in the same industry and takes into account size and location and other specific business factors. An example of this is the "Multiples of EBIT" approach.

Each technique has its advantages and drawbacks. These must be considered on a case by case basis and most valuation professionals will use a combination of approaches.

The two most popular valuation methodologies used are a straight multiple using EBIT (Earnings before Interest and tax), and Discounted Cash Flow (factors in future income at a discount to today's value).

Most micro businesses that are sold to an owner/operator are sold for 1 to 2 x profits but buyers will sometimes pay a higher multiple depending on the accepted industry benchmark and the strategic fit with other business interests.

Over a period of time, an industry usually develops its own rules of thumb by which a business is valued and

this is a useful benchmark when selling to an owner/operator.

Whilst it is tempting to think that all valuations are based on sound business principles, past performance and future potential, one need look no further than the high tech crash of 2000 to see that emotion and the right market timing plays a role in determining the value of a business.

Throughout the last 1990s global investors, large and small, invested enormous amounts of money in risky start up businesses whose own financial projections showed little chance of becoming profitable. Inevitably, by the early 2000s, major corrections took place on stock markets and the focus for investors went back to businesses with solid financial performance and a proven track record.

Despite this, it is important that business owners understand that when they are presenting a valuation to a potential buyer, they are not selling just the book value of the business, but also a vision for its future growth.

Marketing & Selling your business

How to market and sell the business.

Prepare a Marketing Plan

When it comes time to actually sell your business then the first thing you need to do is to develop a broad based marketing plan based on financial or strategic investment considerations. This plan is tailored to suit your business. Look at your industry and your business. Look at the possible types of business buyers and then construct a campaign around this target market. You or your advisors can also make direct contact with acquisition managers of large companies and promote your business to them.

The final marketing campaign will generally include a combination of the following:

- Newspaper advertising
- Campaigns direct to potential buyers
- Internet advertising
- Magazine advertising

Prepare a "More Information" kit

Any potential purchaser will need to be sent more information.

- You will most likely need to prepare a detailed Information Memorandum (Company Profile) and a
- One page"Outline of your business" .

Example Simple “Due Dilligence” Checklist

The bigger your company the more detailed this documentation. This document explains your markets, products and financials and is a detailed listing of your business strengths and market opportunities. It also lists your intellectual property and your intangible assets.

Negotiation

During negotiations, you and your advisors should concentrate on:

- Initiating contact with the decision makers
- Establishing trust and confidence in your business and the negotiation process
- Building a relationship and a rapport with potential purchasers
- Ensuring a negotiation style that places you in the best position to maximize the price.
- Exploration of deal winning formulas such as strategically examining your business and the potential acquiring partner and developing a blueprint for how the merged synergies may operate.
- The selling of the vision of the potential combined entities to maximize price.
- Conducting a due diligence process.

Agreement

Once agreement is reached, you or your advisors should draft an action plan to ensure the transaction is completed in an efficient and timely manner. A contract is issued and then signed by both parties.

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Company Documentation	
Company formation “memorandum of incorporation”	❒
Current share registry and documentation	❒
Address and contact details of other shareholders	❒
Business & Strategic Plan	❒
Financial	
This year's tax return (including P&L and Balance Sheet)	❒
Last year's tax return (including P&L and Balance Sheet)	❒
Previous tax return (including P&L and Balance Sheet)	❒
Current Debtors List	❒
Letter from debtors verifying amount owed	❒
Current accounts payable	❒
Management report showing increase by category	❒
Management forecast current year	❒
Management 5 year forecast	❒
Isolation of payments to associated personnel	❒
Depreciation schedule, purchase and book value of assets.	❒
Superannuation payments and verification by accountant that all commitments have been met	❒
GST payments and verification by accountant that all commitments have been met	❒
Name and BSB of bank	❒
Credit and overdraft facilities	❒
Bank loan obligations	❒
Inventory list and audit	❒

Intellectual Property	
List of all trademarks and documentation and	❒

expiry	
List of all patents and documentation and expiry	❐
Copyright ownership of software and agreements	❐
Web site	
List of all domain names, documentation and expiry dates	❐
List of all hosting agreements and documentation	❐
Contracts	
List and documentation of all leasing agreements	❐
List of all contractors and photocopies of agreements	❐
Insurance documentation	❐
List and supply details and documentation of any other contract the company has	❐
Database	
Number of customers	❐
Photocopy of customer list and verification	❐
Number of enquires	❐
Verification of method obtained and privacy opt in lists	❐
Photocopy of enquiry database	❐
Employees	
Organisational chart	❐
Number of employees over last 2 -3 years	❐
Salary paid to each employee	❐
Employment letter	❐
Employment manual	❐
Performance Reviews	❐
Other commitment or obligations	❐

Next Steps

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Self-Education & Self Help

Books: There are many books on the subject of Exit & Succession. We recommend the $10 Trillion Opportunity by Jackim & Christman or *Sell Your Business" by Peter Hickey*

Software: In terms of practical self-help solutions. MAUS business systems has a range of software that will help you to improve the value of the business. This includes titles on Business Planning, Job Descriptions, Policies & Procedures, Performance Review, Information Memorandum Writer and more. The software can be found at www.maus.com. Free trial downloads are available.

Appoint an Advisor

You may need to appoint a number of advisors throughout the process. Some of the areas you may need professional help:

- Exit Planning Coach
- Financial Advice
- Business Valuation
- Tax Planning
- Legal Issues
- Personal & Business (*including Shareholder Alignment & Timing*, *Strategy & Value Creation*)
- HR & Succession Issues
- Equity Capital Raising
- Business Broking & Transition Issues
- Investment Banker

We would strongly recommend that you appoint an advisor 12-36 months prior to selling the business. You will need to appoint someone that understands the entire Exit Planning process. This person can then help you project manage the entire process and advise when other advisors should be called.

FREE “Attractiveness Index” report prepared for your business.

As a starting point every business owner should look at reviewing their “attractiveness” to a potential buyer.

Ask your business advisor for a free report

References

This publication was adapted from the wealth of information in the MAUS Business library and the book “Sell Your Business” by Peter Hickey

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More Information

MAUS has an international network of Business Advisors that specialise in Business Planning.

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Advisory Engagement Offer

We are willing to offer all prospective clients an initial free engagement meeting to determine any possible needs and brainstorm or propose solutions.