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BUILDING VALUABLE COMPANIES

Selling your company

You have a business plan for running the company; now make one for selling it

By Dennis J. Rusconi and Wooda McNiven

As the 2003 third quarter draws to a close, there is a sense of cautious optimism that merger and acquisition activity is on the rebound after a three-year cooling-off period.

According to Thomson Financial, completed U.S. transactions in June 2003 increased 4.7 percent, compared to June of 2002. The total disclosed value of these transactions was $37.6 billion, which was a 39.2 percent increase from June 2002 transactions and the highest level achieved in six months.

Overall second-quarter activity was down compared to the same period in 2002. However, it was up 23.4 percent from the first quarter of 2003.

Middle-market M&A activity did not fare as well as the overall market in the U.S., particularly in the lower middle-market segment, or for deals valued at less than $100 million. The number and total value of lower middle-market transactions decreased by nearly 5 percent for the first six months of 2003, compared to the same period in 2002. Additionally, the median EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) sales price multiples has declined from 6.1 to 5.6 times EBITDA between 2002 and 2003.

Still, it's important to note that the lion's share of M&A activity occurs in the lower middle-market segment and this is where expectations are rising — particularly among potential buyers.

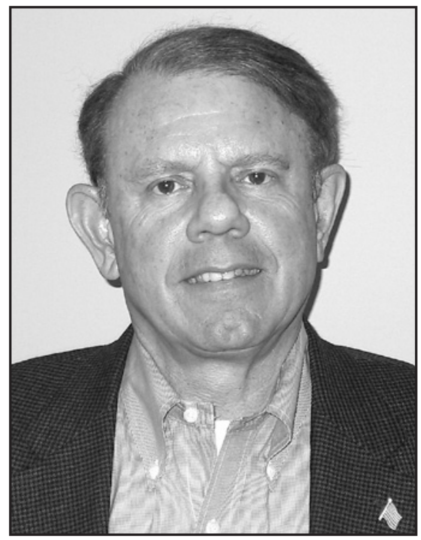
The Boston Consulting Group, in a study entitled "Winning Through Mergers in Lean Times," said, "… mergers that take place during periods of below average economic growth have a higher likelihood of success. And they generate considerably more shareholder value …" Buyers know this is a good time to act, as the nation's economy is growing but at a much slower rate compared to previous economic recoveries.

In addition, there are other good reasons for buyers to be more motivated now than they have been these past few years. Valuation expectations between buyers and sellers are more closely aligned. Sellers are beginning to realize that the high multiples of the late 1990s are a thing of the past. This alignment affords buyers the opportunity to potentially meet their return on investment requirements. Additionally, private equity is plentiful, with an estimated $100 billion or more awaiting suitable investment opportunities. The single-greatest challenge facing buyers right now is a dearth of good, quality companies at reasonable prices. But even this condition is on the verge of turning around. Baby Boomer business owners are now beginning to seek liquidity and retire, and this trend will gain momentum in the next 10 to 20 years. For business owners who fall into this category, *now* is the time to start shaping your future to achieve the desired results when your company is offered for sale.

The recommendations listed below are an overview of items business owners need to consider.

1: Consult with trusted business advisors to formulate a comprehensive business plan

Part of a good business plan is a thorough market analysis. But too often, business owners working to grow their firms spend their time chasing sales,



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rather than tracking down evidence that the opportunity they perceive to be present is truly there. An objective and well-presented market analysis demonstrates an understanding of the marketplace's dynamics and the company's place in it. The best marketing analyses will draw heavily upon trade literature and authoritative third-party informational sources.

2: Develop a sales and marketing plan

Next, it is essential to make a logical transition from the market analysis to a sales and marketing plan. The market analysis is objective and explains what drives demand. The sales and marketing plan, however, must describe the steps the company will take to translate demand into sales. This part of the plan

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should be highly detailed. Part of a sound business plan includes the presentation of the management team, their experience, expertise and specific responsibilities. If personnel with needed skills are not currently part of the team, acknowledge this, and draft job descriptions and profiles for positions to be filled when the company is in a position to make new hires.

3: Prepare honest financial projections and valuations

The projections of revenues and expenses must be realistic and achievable. A comprehensive business plan charts a company's course. Many potential buyers will be attracted to a company that has a clear vision of where it wants to go and how it intends to proceed.

The company CPA and lawyer can provide a wealth of additional advice and specific measures that can be acted upon quickly. One measure that can be implemented immediately is to upgrade the company's annual CPA-prepared financial statements and reports to a reviewed level, or better yet, an audited level. This gives potential buyers a much higher confidence in the accuracy of the company's operating results.

Another good idea is to have a valuation performed on the company by an independent and certified valuation practitioner. Valuations provide useful insight on how to increase the company's value, which can be incorporated into the business plan.

4: Prepare the company for sale

Work to eliminate all non-business expenses and convert all excess operating assets and/or non-business assets into cash. De-leverage the company to the maximum extent possible.

Now also is the time to re-invest in the company. Buyers factor into their valuation models future capital expenditures. The more a business owner modernizes the company prior to sale, equipping it adequately for future operating needs, the less the potential buyer will have to plan for future capital expenditures, thus resulting in a higher valuation.

If bank loans are needed to purchase new equipment, interest rates are lower now than they have been in 40 years. Moreover, new tax rules also allow businesses to expense up to $100,000 in new equipment, up from $24,000 in 2002. Owners should meet with their CPA about the threshold limits regarding this new rule.

5: Get some good advice

Consider consulting with a full-service business intermediary well in advance of selling the company. These professionals have first-hand knowledge of what makes or breaks a deal, and what sort of conditions need to exist in order for sellers and buyers to arrive at a mutually successful conclusion. This is exceedingly important information, as sellers are seldom completely free of the transaction after the closing. More often than not, there will be certain post-closing conditions, such as escrow windows, warranties and representations, and earn-out periods. Advance knowledge will help sellers mitigate and manage these possibilities to extract full value for the transaction as expeditiously as possible.

Planning ahead and taking sensible measures will enable the company to be an attractive investment opportunity. ■

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