# Preparing your Business for sale

Seminar Series Notes Session 5 of 6

## How to value your business

# Karen Tobeck

Only 20 % of baby boomers are expected to sell their businesses successfully. There will not be enough buyers. Some people delayed selling because of the GFC and that adds to the glut of businesses for sale. We tell our clients to have their business “Always ready for sale”.

You do not want to become a “redundant owner” or “zombie owner” of your business because you won’t get the money you want for the sale. Getting stale means your business can suffer.

## Ways to improve value

Advisory team – you might have heard of a Board of Directors, advisory team or business consultant – they all do a similar thing. A team is best because one advisor may not be able to give a business everything they need. A diversity of talent helps. They will help to improve processes in the business. A good structure and people knowing what they are supposed to be doing in the business is important to a buyer. None of us have the skills to be top of the game in every part of our business – we need to ask for help.

A local engineering firm client of Monteck Carter together looked at job efficiency (complete on budget and on time), they needed to know when they went over budget on a job before it was too late. They also had staff issues when they couldn’t do what they promised they could do and so needed more training. We helped them get in a good recruitment person. They also had high inventory and poor cash flow – financial people can help you collect debts quicker. A team of an HR person, a financial person and a systems person would be good.

A lazy balance sheet means people aren’t taking charge of the items on the balance sheet – inventory, not utilising borrowing when you could be or investing money.

What are the real critical issues for the business and how can you be sure you are getting a return on investment spend? Each business is unique and finding the right group of people for the needs of that business is key.

Management Reporting – this is about knowing what’s happening in your business on a regular basis. Can you explain to the Bank why you need more on an overdraft? You must have a strong understanding about why hiccups happen so you can explain. There are good technologies to help with this.

Key Performance Indicators - which critical issues can you track on a regular basis? Example of a dashboard of Business Intelligence for a business – these are becoming really popular. This gives a quick overview of your current business situation.

All these three issues will help you get your business ready for selling.

# Bruce Cattell Business Broker with Link Business out of Ellerslie, Auckland

There are 120 brokers working across the world (AU, USA, South Africa, NZ) and are the biggest brokerage in the Southern Hemisphere. We sell Small to Medium sized Enterprises which are privately held. Bruce specialises in larger businesses, manufacturing, engineering, media, import and distribution form $1m to $15million size range.

The market now is that good businesses coming for sale are in demand. Quality sells. A lot of the businesses for sale now are rubbish. Selling a good business in the past 2-3 years has given good results. 18 of the ones I've worked on in this period have had multiple offers made to buy them. Banks are also well and truly open for business – it's now easier to get finance from banks to buy. ASB, BNZ and ANZ are aggressively competing for business and KiwiBank strong in asset backed businesses. This impacts on the demand.

The 6 Steps of the Business Sale Process.

- Prepare and Plan to Sell – for some this takes 3 years and some 3 weeks.
- Valuing the business and setting the price.
- Finding the right help. You will need an accountant, lawyer, a broker all who've done it before.
- Marketing the business. The way to get multiple offers is because of a good price, well presented and wide marketing.
- Negotiating the sale and surviving the due diligence.
- Settlement and Possession

Today we are only talking about the first 2.

If you do not plan to sell your business you will end up exiting your business in an un-planned manner. This could be due to health, financial or relationship problems, or with customers / suppliers.

## Who is your likely buyer – strategic or financial ?

My clients fall into two groups, Strategic buyers are acquiring to see the value in your business in what It's going to add to their business. If your business gives an uplift to their business value, it's strategic. They may not focus on a return on investment approach when they come to buy. That can be a higher price, or not.

If you get a direct solicitation from a competitor – proceed with caution. The best strategic buyers are not your competitors (they end to go 4/5 of the way through and then pull out). The ideal strategic buyer is complementary to your firm or operating in a different region or country. We see Australian firms buying NZ firms to overcome the slowness of their economy at present.

## What makes your business attractive to a strategic buyer?

Most buyers are financial buyers – they are probably people like us who are buying a business and focused on the returns on their investment and future upside. They are buying an income for themselves / their family.

These are mostly private individuals and sometimes small syndicates e.g. ex-pats from Europe who come back here to raise their kids aged in their 40s. Small investment businesses like Challenge Partners are also an example. They could also be immigrants.

## Buyers are Simple Folk – What are they looking for?

- They want everything and don't want to pay a lot for it! They will look for
- Profit history over successive years – an important driver of the value. It's OK to have had a dip in the recession as long as you have an upward trend or flat over a long period of time. We don't want a downward slide.
- Acceptable ROI – what returns will they get at the end of each year? How sustainable is that income over a few years. This depends on the characteristics of your business. Can you make it look safer, more predictable? If a business sells for 4x its profit that's a 25% ROI.
- Cashflow – common sense a business needs to also have cashflow to sustain debt and have a history of doing this.
- Stable staff and team – the new owner doesn't want to lose all the employees after a purchase.

- Systems and Infrastructure – this is really important because a well-systemised business makes it easier to understand and it looks safer to buy. Pay attention to this. Call it a 'user manual' for your business so your staff know what they are doing.
- Strong brands – this is important because this could be your own brand or those you are dealing with. Marketing, what you stand for, what's your point of difference – what it means to the wider world adds value. If you are selling other people's brands that's fine too as long as the relationships with those owners transfer with the business.
- Markets and businesses that are in growth – they want some upside, not buy in a sunset business sector. Some things are more in vogue – buyers like import distribution businesses, niche manufacturing businesses, services businesses of certain types as long as they aren't overly dependent on the owner. If your industry isn't in a growth sector, head into a growth area for when you come to sell.
- Secure customer relationships and good customer spread – if 80% of your sales are from a single customer you have got a problem. Ideally you want your biggest customer less than 20% of your revenue. If it is larger than this have a long-term contractual relationship and be a larger business.
- Secure supplier relationships – have good contractual relationships if you can. They must be structured so that they will transition to a new owner.
- A business that can run without the owner – this is your biggest challenge. The closer you can get to this the more value you will put on your business because it looks safer and more predictable. Buyers accept a lower ROI.
- Location – if you're based in Auckland there are more people who want to buy a business here than in New Plymouth! Be in a major conurbation.
- Sound reason for sale – retirement is the best reason. It must be plausible and give the buyers comfort.

In Addition Bruce believes

- Presentation is very important – when a broker brings in potential buyers the way the building, the accounts, the staff, the stock all look like are important. If the trucks are dirty and the staff look like pirates and the owner needs a scrub the buyers will form an opinion. Freshen up with paint, mow the lawns, make the accounts and dashboard look good ahead of due diligence. Make it look like you're on top of your numbers – if it looks that way they will have more confidence in your business.

- Competition – when you are into the process, you have to get some competitors amongst the buyers. The biggest uplift comes when people compete to buy your business.

These things are the basis of your planning and preparation – anything you can do in all these areas will translate into more value.
Take charge while you can.

## Valuing y our  Business

You should be valuing your business every year – buy a book, talk to your accountant, ring a broker. Make this one of your annual tasks. If you are going to exit you must keep an eye on this.

- Share Sale or Going Concern? In New Zealand fortunately we don't have Capital Gains Tax when you sell your business – in the UK many sales have to be share sales for tax reasons. Here there are seldom reasons to do a share sale so you can sell as a going concern, which is simpler. All the debtors, liabilities and shares are left behind for the vendor to deal with and the assets, staff are transferred to a new company.

- Asset Valuation, Profit Multiple Valuation or a Comparable Valuation – all different methods. Today it's more often a combination of these. Asset valuations are when we look at what the business assets are worth. Normally the way businesses are valued are a profit multiple based on profit times a multiple. Sometimes comparable is appropriate. Bruce uses comparable sales a lot when doing profit multiple valuations. Profit before tax multiplied by 1x to 5x = Fair Market Price Range. This fits 90% of privately held sales which Link Business works on.

- What profit and what multiple? From the high end where they have real IPR and are well prepared for sale with good ticks in the boxes above and at the bottom end it's the owner who's integral to the running of the business or the customers are concentrated or the business is in a sunset industry.

- Different ways of measuring profit:
  - Ø EBPITDA – earnings before proprietor, interest, tax, depreciation and amortization. Also known as Sellers Discretionary Earnings or Net Cashflow. Tends to be used for small firms.
  - Ø EBITDA – Earnings before interest, tax, depreciation and amortization after management costs and market rates. A different valuation method. – Tends to be used for larger businesses.
  - Ø EBIT – earnings before interest and tax, after management costs at the market rates.
  - Ø Normalised or adjusted profit "Add backs". We can use the 'real story' and put a multiple against it and give you a real multiple. Vehicles, interest on loans, business related travel, wife working, entertainment, the boat and the marine rental and the diesel, school fees, racing car. Some of this is straightforward. If we can identify the expenditure we can back it out and the business looks more profitable and that translates to a higher value. It has to be provable and documented.

- Don't steal from yourself. If you want to sell based on a profit multiple every dollar you put onto the bottom line will get you a multiple back, tax free. If you steal cash from your business we can't count or prove it.

Putting it all together it takes, Planning / preparation, presentation, Valuation Method and Competition.