



The Cerius Guide to a Successful Exit Strategy: What You Cannot Afford NOT to Know



Preface: Planning Your Business Exit Strategy

You have worked hard to build a company. But now what? The “next steps” for your company can vary greatly — possibly an initial public offering, approaching private equity groups for a cash infusion, or perhaps selling the company, maybe to a partner or key employee through a buy-out or cash out. This paper focuses on the importance of thoughtful preparation when that next step is selling your business — and the serious ramifications to your company’s value if you do not prepare.

There is a direct correlation between preparedness and maximizing the value of your company. You want to get the reward from your efforts that you deserve and you certainly want to avoid leaving money on the table. In addition there are personal considerations — you want to avoid partner or family conflicts, keep employees happy, and leave a legacy you can justifiably be proud of.

What You Don't Know Can Hurt You

There are several risky “sandtraps” to play through when planning an exit strategy. Here we are going to consider six areas of business risk that can imperil a financially and personally successful sale — and look at what skills you need around you to successfully navigate the business challenge implied by each. The six sandtraps are:

- Improper understanding of market and market dynamics,
- Unstable or poorly balanced revenue flow,
- Lack of accounting and operational excellence,
- Under — or over — valuation of your business,
- Poor tax planning, and
- Lack of a plan for your own future role in the company.

Fortunately, business owners do not need to try to figure this out alone. At each step, a pro can provide the necessary guidance with the specific skills required.

Improper Understanding of Market and Market Dynamics

Like the punch line of a joke gone bad, poor timing can make your business transition utterly flop. John Brown¹, a professional exit planner, reports that the market for mergers, acquisitions and high venture capitalist activity moves in five year cycles. Business owners need to do their homework early to make the changes that will make their enterprises more attractive to the market at the right time — when money is available and the buyers are ready.

You need to know your potential buyers: who are they, what drives them, when they are ready to move, and what they seek. Are they looking to simply generate more sales, to expand their geography, to adopt new offerings or technologies, to enter new markets, or to augment their management and technical staff? With that direction, you can take steps to position your company for maximum value to several potential acquirers — enhancing your sale price through compelling value and, often, competitive bidding.

➤ ***This is not the time to hold a finger up to test the wind — plan ahead and engage a professional in Market Analysis to give you advice on the timing of your next move. You will only get one chance and you cannot afford to get the timing wrong.***

Why Preparation Matters in Maximizing Your Business Value

Three privately-held hardware reseller corporations with \$30 million annual revenue decided to sell in a two year timeframe. Here are the results:

Company A — Did not prepare for sale, and is still on the market

The \$2 million Joe is offered is ridiculous, — only 2x EBITDA. He turns it down. His broker recommends that Joe involve a business consulting firm specializing in company sale preparation to help make changes, and then try again in a few years.

Company B — Did not prepare for sale, sells for \$7 Million

Fortunately, a slight up-tick in a product line brings revenue up. The owner, John thinks he should get a lot more than \$7 million for his 25 years of hard work, but is having some health issues, and takes the \$7 million. Sells for 4x EBITDA.

Company C — Plans, makes changes, sells for \$38 Million

Using a business consulting firm to plan 2 years in advance of sale and make the needed changes, Jane productized services into multi-year contracts, formalized four secondary distribution channels, documented and routinized sales and delivery operations, implemented five key process financial controls. In the process, Jane increased gross margins from 13% to 20%, and sales by 7% then 12% annually. Sells for 9x EBITDA.

¹ Cash Out, Move On: Get Top Dollar and More Selling Your Business. John H. Brown and Kevin Short. Business Enterprise Institute. 2008.

Unstable or Poorly Balanced Revenue Flow

It goes without saying that investors or acquirers of your company want to know that it will continue to maintain and increase that value after their investment or acquisition. Paramount here is solid and predictable revenue based on recurring business, stable customers, and a healthy balance of repeat sales and new customer acquisition. Too heavy a dependence on one or two key customers, sales that are opportunistic, or sales that involve unique deliverables that depend too much on one or two key individuals are risky — and may not survive the transition.

➤ ***A team of professional advisors can help you analyze your current revenue and revenue forecasts, and determine the best steps to prepare forecasts that create enthusiasm among potential acquirers.***

Lack of Accounting and Operational Excellence

Equally important to proving predictable future revenue is providing evidence that your financial history, accounting practices, and your business operations are accurately represented, transparent, repeatable, and consistent. You need to not only represent the current value accurately, but you also need to show that the current operating infrastructure will scale to accommodate growth, or reliably migrate into the acquirer's environment. If you are planning an initial public offering as part of your exit strategy, seeking an acquirer who is public, or wishing to assure your acquirers that your operations will support their ultimate IPO, your SEC reporting must be in place with a history of professional audits. And today even private companies strive for the governance represented through compliance with Sarbanes-Oxley.

➤ ***Here is the place for a professional evaluation team consisting of operations and compliance experts, a CPA, and an IT expert.***

Under — or Over — Valuation of Your Business

Business owners all think their company has value. Typically, they begin the process of considering a sale by thinking “I want to sell my company for \$X,” rather than carefully considering and ascertaining the true market value of the business. The correct step at this point is rather like reverse due diligence — not what can I make, but what is the value of my company to the market. Here the sustainability of the value proposition must be carefully evaluated: is value solely in the intellectual property represented by the employees — who might leave? What property, assets, inventory, patents, etc., hold real and sustaining value? What unique propositions does the company offer the market? What methods and technologies are inherent in the business and how do I protect them? Business owners run the risk of overvaluing the company based on emotion, or undervaluing it, based on lack of knowledge of current market value and a true understanding of asset worth.

The value of your business only partly reflects the value of your offerings. Your business may provide a key added ingredient to your acquirer, in terms of cash, geography, capabilities, market penetration, or even in terms of reducing competition. While the initial valuation is usually based on revenues and pre-tax profit calculations, other factors can dramatically alter the initial “financial” valuation.

➤ ***Required in this step is the expertise of experienced professionals to help you gauge value — without emotion — and help you prepare wisely for entering the market with a realistic company valuation.***

Poor Tax Planning

Whether you are cashing out of a family business or selling your share of the company to a team of partners, know that the tax implications of each choice need to be identified well before you begin. The detail of taxation is well beyond the scope of this paper, but plan on a qualified tax professional to give you appropriate guidance. Whether you are looking at the financial or estate planning that may precede a retirement-instigated cash out, or the taxation effects of a sale to family, partners, or employees, this is one place you cannot afford to leave decisions to chance. Perhaps your sale is structured to give you recurring revenue from the business over time rather than a one-time cash out. Different exit models have varying tax ramifications; rely on an expert to ensure the best approach that will preserve as much of your hard-earned capital as possible.

➤ ***A tax professional with experience in managing business cash-outs and buy-outs is an absolute necessity, or your retirement plans may be seriously impacted by unanticipated tax consequences.***

Lack of Planning for Your Own Future Role in the Company

Too often, all the attention is paid solely to the business consequences of the exit strategy. It is also important to think about your future role, either with your existing company or with another as you plan your personal next steps. As a founder or CEO, you may be planning retirement, but perhaps want to remain as a board member, or maintain partial involvement managerially or financially in the business. Perhaps you want to give equity to your family members, partners or employees to motivate them to continue to make the company successful as you back out. And more than one deal has been soured by a late realization that the founder wants to remain involved and works to convince the acquirer that the company can't succeed "without me".

Frequently, the transition to new ownership is far rockier than it would have to be, only because the future role of the current business owner is not given any thought. Be sure you know what you want, and what you will accept. If you do expect a continuing role in the company, be ready to negotiate it as part of the deal, and get the terms — including termination options — in writing. Perhaps a retention bonus is appropriate to ensure smooth transition. But don't let your ego get in front of your business head.

➤ ***A professional personal career or retirement planning consultant can help you understand the ramifications of different choices and the consequences of the path you choose. Not just focused on youthful career-climbers or job searchers, these professionals can help the exiting business person consider not only how and when to give up the reins, but suggest other interesting aspects of post-sale life than may not have been contemplated — including entire new careers, rewarding volunteer work, serving on boards, mentoring, college teaching, travel — or improving a golf game.***

Getting the Professional Advice You Need

Cerius Interim Executive Solutions provides companies like yours with two levels of assistance in preparing a successful business exit. Cerius Interim Executives form a team of advisors specifically experienced in the exact areas where you need it, when you need it. This team helps you clarify and articulate your business and life objectives, analyze the position of your company in the market and ascertain its evaluation with you. The Cerius Team will also help uncover areas of exposure or risk so you can prepare and address them before planning your next step.

➤ ***And with the plan in place, Cerius Interim Executives will work with you to implement the changes you need to position your company for the most compelling acquisition. Whether it be in market expansion, operational improvement, financial management, sales execution, or general management — this team will share with you commitment to the plan.***

Conclusion

You've invested blood, sweat and tears in managing and growing a successful company. Your company took planning — perhaps years of planning — and investment, to get where it is today. At the point of considering your exit, plan ahead: invest in the team of professional advisors you need to ensure you receive the maximum value for your efforts. The expertise required to orchestrate a successful exit is different from the expertise you used to build the company. Get experts to help you understand the market and articulate your company's value within that market. Have outside evaluators assess the internal operations and validate your plan to demonstrate predictable ongoing revenue streams. Work with CPAs and tax professionals to ensure auditable accounting and a clear understanding of the tax ramifications of various sales strategies. And think about your ongoing role, should you choose to have one — maybe as one of the key executives in the purchasing company, a consultant to the new owners, or a board member. And if it is having more free time to do other things, your future role may not involve the company at all.

About Cerius Interim Executive Solutions

Cerius Interim Executive Solutions is the largest provider of interim executive management services in the US, with proven experience in helping small to medium-sized enterprises achieve their strategic and tactical business objectives. We are dedicated to enabling our customers to succeed with our results-oriented executives who bring broad industry and business experience, fill critical gaps in your management team, round out skill sets, or help deal with a crisis. Through a deep resource pool comprised of over 500 executives, we offer a full services portfolio across all management disciplines from which we develop a customized interim executive solution tailored to your needs. You gain immediate access to a carefully selected skill set with the additional leverage of reach to the larger pool of Cerius executives -- to develop new strategies for growth, carry out organizational or cultural change, manage complex projects, or fill business-critical roles currently vacant.

When your business plans call for a move to the next step, call Cerius.

To learn more, contact us at 949-250-0500, or visit our Web site at www.ceriusinterim.com.