



Are You Ready?

Developing an Effective Exit Strategy

It is estimated that seven out of ten privately held businesses have no succession plan to transfer the business to the next generation of owners. What does that mean to you? It means that if you do not currently have a plan in place to transfer your business to family members, existing partners, management or employees, someday you will think about selling your business. And, that day might come sooner than you anticipate. Here is a list of the most common reasons why owners sell (or otherwise discontinue) their businesses:

- Burn-out (this is the number one reason for selling)
- Health issues
- Personal diversification
- Retirement/semi-retirement
- Death
- Divorce/partner disputes
- Business growing too fast
- Second generation not up to the task
- Loss of market share

Don't make the mistake of thinking that just because you are not currently ready to retire that you have plenty of time to prepare your business for sale. "I wish I had started planning my exit sooner" is one of the most common "I wish" comments we hear from owners.

The sad truth is that many business owners do not take good care of their most valuable asset: the business. They don't groom someone to continue the business in their absence, and do not keep the business in salable shape during the time they operate the business. They get too bogged down in the day to day business operations to worry about--or plan for an event that they perceive won't occur until sometime in the distant future; selling the business. Unfortunately, fate sometimes dictates circumstances beyond your control, and tough decisions must be made. If your business isn't ready to sell when the time comes, what are your alternatives?

Our philosophy is this...If you are considering selling your business or some other kind of liquidity event, due to retirement, market timing, relocation, poor performance, or other personal reasons such as family, health or burn-out, you should start preparing at least one to two years in advance. A more valuable business, producing more cash flow now, increases the value of the business, and attracts more qualified buyers or investors. You will have the opportunity to consult with family and trusted advisors to make sure the personal, tax, and legal aspects of this decision are considered and there is time to appropriately plan how to invest the proceeds of the sale.

A planned sale allows for your goals and objectives on your timetable. You may begin to identify potential buyers. You may be able to create an attractive acquisition candidate. You can begin to understand why a buyer may want to buy. You might learn why buyers would not want to buy—and be able to fix the problems. You may begin to realize the worth of your business now, and learn how to increase the value as part of your retirement planning.

Four Ways to Leave Your Business

There are really only four ways to leave your business. (1) Transfer ownership to your children or other family members. Unfortunately, many children do not want to become involved in the family business, or may not have the capability to operate it successfully. (2) Sell the business to an employee or key manager. Usually, they don't have enough cash, or interest, to purchase the business. And, like offspring, they may not be able to manage the entire business. (3) Selling the business to an outsider is always a possibility. (4) Liquidate the business - this is usually the worst option and the last resort.

When to Start Working on Your Exit Plan

There is another old adage that says, "you should start planning to exit the business the day you start it or buy it." You certainly don't want to plan on misfortune, but it's never too early to plan on how to leave the business. If you have no children or other relative that has any interest in going into the business, your options are now down to three. Most small and mid-size businesses don't have the management depth that would provide a successor. Furthermore liquidating doesn't seem attractive. That leaves attempting to find an outsider to purchase the business as the exit plan.

The time to plan for succession is indeed, the day you begin operations. You can't predict misfortune, but you can plan for it. Unfortunately, most sellers wait until they wake up one morning, don't want to go to their business, drive around the block several times, working up the courage to begin the day. It is often called "burn-out" and if it is an on-going problem, it probably means it's time to exit. Other reasons for wanting to leave is that they face family pressure to start "taking it easy" or to move closer to the grandkids.

Every business owner wants as much money as possible when the decision to sell is made. If you haven't even thought of exiting your business, or selling it, now is the time to begin a pre-exit or pre-sale strategy.

So what should you as an owner be thinking about if you are considering exiting?

Below are a few major areas to consider. Think about what you would want to know and review if you were the buyer and not the seller.

Financials

Since all business sales are based upon a multiple of the cash flow (either EBITDA or Discretionary Cash Flow), the owner must have all of the financial records segregated and in good order. At a minimum, we would suggest having three years of financial statements and tax returns. If there are substantial differences between taxable income and book income (e.g. cash basis vs. accrual), those must be identified and explained. Culling out all

significant discretionary expenditures along with isolating any unusual and non-recurring expenditures and losses will be important.

Operations

You will want to identify all products and services provided by your company and the specific markets served. In this review, it will be important to define the strategic advantages enjoyed by the company in its respective niche as well as comparative gross profit margins for each product and service.

Growth Opportunities

While buyers will purchase a business at a price predicated on current and historical cash flows, the main impetus for the purchase will be the ability of the buyer to grow the business at a rate that exceeds the norm for similar opportunities. It is important for the seller to visualize those growth possibilities and define them tangibly in terms of product extensions to current lines, existing products to new markets, better market penetration, wider geographical distribution and etc. It would be even better if the growth was already being reflected in the performance of the company. That's why we encourage owners to improve and grow the business in advance of selling it.

Management Structure

In addition to transitioning the current customer base in an acquisition, the buyer will have concerns about the depth, breadth and ability of the current management team and their willingness to stay on board after the deal is consummated. The seller should have an organization chart which defines the direct reports to the CEO along with their titles and responsibilities. Ideally, you would have a management profile available that gives a brief resume of each manager along with his salary history and longevity with the firm.

Deal Structure

The preponderance of transactions in the sale of privately held companies are handled as an asset sale (versus sale of stock). This type of sale will result in the buyer receiving a stepped up basis in the assets purchased (which generates future tax deductions) while concurrently avoiding unwanted contingent liabilities that result from a stock sale. The owner must sit down with his CPA and/or attorney and understand the tax implications of this transaction under each scenario so that he will not be surprised at closing or worse yet, when preparing his individual and corporate tax return. Remember, it's not what you get but what you keep that counts!

Available Financing

Most owners would prefer to be cashed out of the transaction at closing and do as little owner financing as possible. To a large degree, this will be dependent upon the basic cash flow add backs including net income, depreciation, interest and owner compensation. Most lending institutions whether SBA or conventional, will typically shun discretionary add backs falling outside these parameters. In aggregating these cash flow components, the financing companies will consider: required compensation of new owner, debt amortization

period, debt coverage ratios and available collateral to determine the extent of financing offered.

As you can well see, there are a multitude of items that must be addressed in the sale of any existing business. The more time spent in developing comprehensive answers to these questions and issues upfront will pay dividends in the end with an easier due diligence period as well as a smoother close

Combine Value and Strategy To Produce Results

It should be obvious that building an effective exit strategy takes planning and execution long before a sale occurs. In addition to the issues discussed above, other important issues to consider include evaluating the tax consequences of a business sale and attempting to institutionalize your business' base of intellectual capital so the buyer knows that the business' goodwill will not leave with you. Successfully taking these steps will enhance your opportunity to receive one of the benefits of entrepreneurship when your business is ultimately sold: Value creation.

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