Gene Siciliano

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YOUR CFO FOR RENT®
For a few weeks, a few months, or a few years

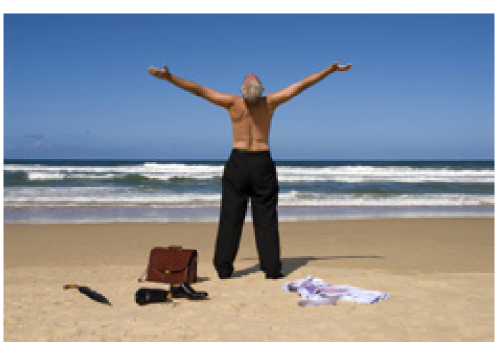
Selling the Business – Why Start Early?

Because we focus on helping privately owned businesses prepare for the successful exit of their owners, we meet a lot of owners referred by their bankers, attorneys, Vistage chairs and others. One of the most common questions we get: *"I'm not planning on selling the business for another 5 years or so. Why should I start planning now, when I'm still actively building it?"*

Exit planning will almost certainly take time and concentration away from the daily affairs of the business. No one wants to take his or her eye off the ball if it means missing an opportunity to close another account, boost this quarter's sales numbers, or enhance the efficiency of the team. So why not wait until you're really ready to go?

The short answer: because it's too late to polish the apple when you've already shown it to the potential buyer. Some examples of needed polishing…

- Your **accounts receivable** has old uncollectible balances that you've refused to write off "because they owe me." You'll likely never collect without going to court, and that outcome is always iffy, but you're still hoping something good will happen. The potential buyer, however, sees these accounts as evidence that there are likely more bad accounts that just haven't yet gotten old enough to stand out. The value of your AR just went down in the eyes of the buyer, and their offer price just dropped.
- Your **inventory** includes products that sell slowly, but there's still a market for them, just not a big one. You continue to carry them at full cost. The buyer challenges your inventory management, particularly if your sales history doesn't provide details by product. They apply a hefty discount to the inventory value that you still think is worth what you paid for it. Oops! You just lost money there too.
- Your **plant equipment** was acquired years ago, and your workers are accustomed to working with the old gear. But your maintenance costs and downtime have climbed as the equipment ages, resulting in a double hit to your bottom line. You've considered this a cheaper alternative than the huge cost of replacing a lot of equipment and training workers to use new technology. The buyer has to fix that, and your purchase price just went down again.
- Your **insurance** broker is a family friend you've done business with for years, and he always handles the renewal process with minimal effort on your part, allowing you to stay focused on the business. The fact that you haven't updated your coverage in over a decade is minor compared to the convenience of the relationship and the stable premiums. But during due diligence reviews your buyer finds that you are under-protected for today's risks, such as cyber threats. You just lost money again, and perhaps will have to provide a large contingency reserve.



> *"The boomers' biggest impact will be on eliminating the term 'retirement' and inventing a new stage of life... the new career arc".*
> —ROSABETH MOSS KANTER

These things are often tolerated in many ongoing businesses because "that's the way we've always done it." Let's look at the impact of these few issues on your potential sale price.

Assume a reasonably small business with a \$20 million balance sheet and a \$5 million EBITDA – the usual starting point for price negotiations. The due diligence reviews by the buyer's experts result in these proposed adjustments:

- Accounts receivable - \$1,200,000 in questionable balances to write off
- Inventory - \$725,000 in market driven markdowns to record
- Annual cost of upgrading equipment to today's standards - \$50,000 and up
- Added annual insurance costs for adequate liability protection - \$25,000

If we just stop there, **we've cut \$2,000,000 off the EBITDA** the buyer can expect to get (although you might convince them to spread some of that over multiple years if you're really a smooth talker). Let's then assume the multiple of your kind of business in today's very active market is about 5X (we've helped some deals in recent years close at 7 or 8). **Your hoped for \$25 million selling price just shrunk by \$10 million, or 40%.** And your contingency reserve, to protect the buyer from more future unknowns, might go up another million or two. Not to mention the size of the earnout you'll wait a few years for.

So, two questions remain: what does 'early' mean and why does it matter?

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Gene Siciliano is the founder and president of Western Management Associates, source of *Your CFO for Rent®* services for over 25 years. The firm provides interim and part-time CFO/Controller services, executive coaching and assistance in operational finance and exit strategy. Gene and his team of seasoned CFOs and controllers have a clear mission in their work with CEOs and owner/operators of privately owned companies. Their value proposition:

- Increase the company's net worth and profitability by improving the management team's financial proficiency and bottom line results, and
- Develop and execute strategies that will make your company more appealing to a buyer or investor, if and when the time comes for an ownership transition.

Selling the Business

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Let's answer the second question first. Even if you think your business is "sale ready" (*<u>and you are not the best person to make that assessment – honest!</u>*) Much like you go to a doctor for your check up, **you need an external, independent and unbiased source to assess your "sale readiness."** If the assessment says your business is in good shape, that's great! Congratulations. But if it shows that you've got issues that need to be addressed, then you can begin to implement the changes needed to tackle those issues. Remember, if you have issues that require changes, most can't be fixed overnight. It takes time to change business and accounting processes that will enhance the value of your business. If you need outside CPA audits (a frequent buyer requirement), this process could easily take several years.

"..it's too late to polish the apple when you've already shown it to the… buyer"

OK, so what does "early" mean? Early means NOW! It doesn't matter if you plan to sell the business in a year, or three, five or ten years. You really want to have your business "sale ready" at any time. While you may "plan" to sell the business at some point in the future, competitive activity, your health, the economy or other factors could put you in a position of having to, or

wanting to, sell your business sooner than you had planned. The best way to maximize the selling value of your business is to begin the preparation process today.

And that, dear reader, is the answer to the first question. Want to talk about it? Give us a call!

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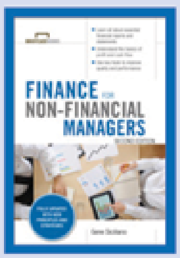

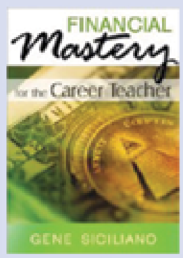

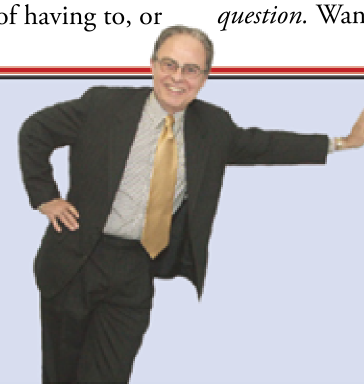

Gene Siciliano
WESTERN MANAGEMENT ASSOCIATES

P | 888 788 6534
O | 310 645 1091
E | info@CFOforRent.com

www.CFOForRent.com