Preparing Your Business For Sale

How to make your business stand out in a crowded market

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Introduction

So you've decided to exit your business and want to put it on the market. You are about to join over 70% of Australia's business owners who are looking to retire over the next decade. With this number of businesses becoming available, it is going to be a buyers market.

Business owners who don't start planning well in advance are leaving themselves open to stress and chaos - for themselves, their family and their staff. Preparing the business well ahead of time will ensure you maximise its attractiveness to potential buyers when it comes time to sell.

> *The average entrepreneur spends 80,000 hours building their business but only about six hours planning its transfer.*

Planning for the sale well in advance allows you to ensure the areas that will be most critically assessed by a potential buyer are sound and being prepared in advance also allows you the opportunity to take advantage of unsolicited offers, and react to favourable market conditions.

What are potential buyers looking for?

Many business owners make the mistake of thinking potential buyers will pay for the company's asset value. While this will be part of their evaluation, most prospective buyers are looking for the potential in the business. This could be the potential to make money, the potential for them to consolidate their own business and improve productivity or even the potential to reduce competition.

Regardless of the reason a potential buyer will be interested in your business, having your business well prepared for sale will ensure you get the best price.

Potential buyers are looking at the businesses profitability and sustainability. Generally they will be looking for the following:

1. Proven success
   A track record of consistency against your business plan; showing steady growth will give the buyer confidence in the business's potential, especially if this has been over an extended period of time.

2. Solid future prospects
   While a successful track record will show the business is capable of achieving results, a good pipeline of potential business will give the buyer comfort that these results will be possible in the future.

3. Sound relationships with key customers
   Long-term relationships with key customers will give the prospective buyer a level of comfort, but if these relationships are not formalised (ie in writing/contracts) that level of comfort will be reduced.

4. Policies and procedures are well documented
   With most businesses the owner wears many hats. But the potential buyer will want a business that can run without you. Unless there are clearly documented policies and procedures that will help the new owner take charge and staff continue to do their job, the value will be decreased.

Identifying the Ideal Buyer for your business

In order to develop the planning for selling your business; it is worthwhile considering who will be most interested in buying your business. Will it be a business that is similar to yours, or a supplier, or a customer? Will it be a business from another location or region, a corporate business or an individual?

The benefit of developing the profile of the likely purchaser will assist you in planning for the sale of your business. It will ensure that you do improvements and changes that will be valued. Conversely, it will ensure that you don't undertake activities and expense that will not be valued by the prospective buyer profile.

If in your industry, larger corporations have been buying companies like yours, the value of your brand may not be of value when compared to the intellectual property (such as design, software, patents) owned within your business. If this is the case, then spending time and money on ensuring that your intellectual property is fully protected is going to ensure that you maximise the sale price.

In addition, having the profile of the buyer identified, you will be able to start promoting your business

What drives the value of your business?

Every business has certain key elements that will most directly impact operating performance. These are your businesses value drivers. How these value drivers are managed will have a major impact on your business' performance and hence it's overall value. While the specific drivers will vary from one business to the next, there is always a set of generic elements that should be primed to maximize your sale price.

These include:

Operational

1. Strong brand
2. Product/service sustainability
3. Staff – motivated, self-starters, work as a team
4. Sound organisation structure
5. Succession plan for key staff
6. Solid customer base
7. Documented policies & procedures

Financial

1. Positive trend in key financial indicators
2. Strong balance sheet
3. Tax and statutory affairs in order
4. Long term liabilities (eg long service leave, accrued holidays)

<u>People</u>

Your people are critical to your business and potential buyers will be looking closely at your staff. In particular buyers will want to know the staff are capable of continuing to conduct the business without you. They will also be keen to see whether your business is 'right-staffed' – are you carrying more employees than you need? Are your staff adequately trained? Are job descriptions in place?

If you think you may be over-staffed, you need to start considering your options as early as possible. Any staff unlikely to be required in the business going forward should be trimmed prior to entering sale negotiations. It may be possible to achieve this through natural attrition but any redundancies need to be carefully planned and implemented.

You also need to review all staff entitlements and ensure these have been adequately provided for. Employees carrying large amounts of leave will be a burden to the incoming owner – all staff commitments must be 'clean' for the potential buyer.

And don't forget your management team. Incoming owners will generally be looking to inherit a quality management team. While in a lot of small businesses the Managing Director/Owner (MDO) is likely to take on many of the management tasks, there is likely to be some trusted individuals who help with decisions. These people should be given appropriate titles, job descriptions and the organisation chart should reflect their positions. Key staff should also be contracted and these contracts should have a clear 'non-complete' clause to give the buyer confidence they will not look to start up in competition taking customers with them.

<u>Revenue, Profit and Cash Flow</u>

Starting to prepare early for the sale of your business provides you with the opportunity to make the financials most attractive. Over time many businesses get 'lazy' in managing financials and some minor housekeeping can make a big difference to the bottom line. Start by putting effort into maximising short term profitability and reducing costs that would not apply to the business under new management.

It makes sense that the more profitable your business the more attractive it will be to potential buyers. Some things to look at there include:

- Reviewing your compensation package and personal expenses
- Reviewing any payments to family members
- Reducing non-essential expenses
- Reducing travel and entertainment
- Put off any non-essential purchases
- Talk to your accountant about what other actions may be possible to improve the profit position. For example, changing how costs are handled, depreciation applied or inventory reported can have a big impact on your reported profit.

While a strong balance sheet and good P&L is going to be favorable, incoming owners are going to want to see strong cash flow. Taking action to improve cash flow will not only make the business more valuable, it will benefit you while you are looking for a buyer. Things to consider include:

- Reduce debtor days and minimize uncollected receivables - put in place procedures to manage this
- Review your sales strategy and look at generating more revenue. If you have had a strategy that focused on long-term sales, you should consider looking at shorter sales cycles to increase cash through the door.
- Review inventory and reduce stock where practicable.
- Write off bad debts

<u>Balance Sheet</u>

First you need to look at your assets. Do you have assets that may not be considered valuable or in fact not needed by the buyer? If so you should consider getting these off your balance sheet. If you have property, equipment or inventory that is surplus to the business, consider selling before the potential buyer looks into the business. And make sure your assets align in reality to what is claimed on the balance sheet.

Where the business has acquired assets that are more 'lifestyle' than business, these will need special attention. If you wish to retain some of the company assets post-sale (eg your company vehicles, boats, property etc), you may need to be buying these back from the business. Of course you will need to look at how to extract this in the most cost effective and tax efficient manner. If the business owns the property on which it operates, there may be potential to generate a post-sale income through buying the property and leasing it back to the new owner. There is a lot to consider here so take advice early.

On the other side of the balance sheet, one of the most overlooked items are contingent liabilities. A contingent liability is a potential liability – one that may occur in the future and depends on another event occurring. These may include lawsuits or regulatory compliance issues. On your balance sheet the contingent liability should only be recorded if the contingency is probable and the amount can be estimated. But as these 'hidden' liabilities can be real deal-breakers, where there is no accounting record of the liability, disclosure is still required.

Accounting Procedures

If you are a small/medium sized enterprise (SME) you are likely to have been minimising tax where possible through paying legitimate personal expenses through the business (and in some cases not so legitimate practices). While these practices will reduce your tax and help your personal finances while you are running the business, your P&L will be negatively impacted. It is important these practices be 'cleaned up' well before potential buyers are going to do their due diligence – you need to do whatever it takes to make your EBIT(Earnings Before Interest & Tax)) look as good as possible.

And finally, one of the two certainties in life – tax. There are many things to consider relating to tax such as agreeing your tax calculations, maximising any previously ignored losses and, of course, the impact of capital gains tax. Make sure you take advice on maximising your tax position.

Recast the Financials

Now this may sound a bit 'dodgy', but it is a legitimate financial procedure, especially for businesses preparing for transition. As mentioned above, most SMEs are managed to minimise taxable income. Recasting is the term given to redoing the company's financial reports (usually for 3 – 5 years) to show the actual financial position of the business. As most buyers will be looking for at least 3 years of figures, this process may add significant value to the potential purchase. Expert advice should be sought to recast financials; and changes to historical statements must be carefully documented. Potential tax implications must also be considered.

Forecasting

The prospective buyer will be looking at the future potential within the business. It is therefore essential that you have a clear set of forecasts based on a sound foundation. Typically businesses will have forecasts relating to sales, profits, production but others indicators may be included depending on the type of business. Having a track record of meeting your projections over a period of 3 – 5 years will help you gain the maximum sale value.

So what's my business worth?

This is the question every person selling their business wants answered. There are many ways for a business to be valued, but generally it comes down to two key principals based on the assets of the business and/or the profitability of the business.

<u>Assets Based Valuation</u>

This approach values the business based predominantly on the value of its assets. This approach is often used for businesses that have substantial tangible assets such as service contracts but also for businesses with significant non-tangible assets such as a long term clients or intellectual property.

<u>Earnings Based Approach</u>

This approach is more common and considers the estimated future profitability of the business in determining the value. In summary, the process usually considers the profit history of the business (3 – 5 years adjusted for anomalies) and multiplies this by a Price/Earning multiple. While there are standard P/E multiples for specific industries, the multiple used can be influenced by the overall quality of the business.

When looking for a valuation of your business, expert advice should be sought. The valuation process may be undertaken by a registered business valuer as part of the sale process, or you may choose to have the business independently valued prior to commencing the sale process. But remember, the value of any business eventually comes down to what someone is prepared to pay, making the business look the best you can will always add value.

Conclusion

Remember, in starting the 'spruce up' process you are looking to achieve the following:

- Maximise sales
- Maximise recurring profits
- Remove non-business related expenses
- Show a clean balance sheet
- Determine if further investment in the business will deliver a positive return
- Secure long term relationships with key staff, clients and suppliers

Starting to prepare your business for sale is something that should be commenced well before you start the actual sales process. Starting to prepare your business for sale early will allow you to take control of the sale and not be forced into a sale under the buyer's terms. Negotiation is inevitable, but with proper preparation this can be done on your terms. And going through this process in advance of commencing the sales process it will not be as obvious to the prospective buyers – it will appear the be 'business as usual'.

And finally, remember you still have a business to run while you're undertaking these extra tasks so ensure you get the best professional advise available.

By starting to plan early and undertaking the steps outlined in this white paper to 'spruce up' your business you'll stand out from what is becoming a crowed market and get the best return on your lifetime investment.