

Your Bottom Line

Do You Need an Exit Strategy?

Benjamin Franklin is credited with the adage, “In this world nothing is certain but death and taxes.” That statement is as true today as when he wrote it over 200 years ago. You can add another truism for today’s business owners: You will exit your company one day in the future.

The exit from your company may be planned or unplanned. The best approach is to plan for an exit that benefits you, family, employees, and company. The beginning of the process is to understand there are certain things that you can and cannot control. Items you can’t control are the economy, fair market value of your assets, income and estate tax rates and many others. These are mainly long-term issues.

In the short-term there are certain things that are under your control that require focus and attention, such as:

- Improving certain efficiencies within your business
- Getting your financial records in good order
- Improving the value of your business
- Building a successful exit strategy team

There are many ways to exit a company that could include:

- Work in the business until you die
- Semi-retire
- Liquidate the business
- Sell the business

There are several types of buyers of private companies. They include:

- A strategic buyer
- Management Buyouts (MBO)
- Family members
- Employee Stock Ownership Plan (ESOP)
- Private Equity Groups (PEG)
- Others

There are advantages and disadvantages to each type of buyer along with how the deal is structured. The first phase of a successful sale is improving the profitability of your company and having the right advisors at the right time. The late Dr. Stephen Covey talks to the simple concept of starting with the end in mind.

“To begin with the end in mind means to start with a clear understanding of your destination. It means to know where you’re going so that you better understand where you are now and then the steps needed for a future exit.”

The process of placing a consistent dollar value on your business can be frustrating and subjective. There are many valuation methods, but the EBITDA method is most common for existing manufacturing companies and will be used throughout this column. EBITDA is a major indicator for value, for PEG’s and other investors. The definition of EBITDA is “earnings before Interest, taxes, depreciation, and amortization.” Robert Scarlata stated the main indicator of value to a PEG, or other buyer, is EBITDA. It provides a framework that allows buyers to compare “apples to apples” instead of “apples to oranges” when viewing businesses with different structures.

The next two steps in an EBITDA valuation are to calculate any EBITDA adjustments and then apply a multiple to the adjusted EBITDA for a purchase valuation. EBITDA adjustments (positive or negative) are made to remove expenses or revenue that may not be carried forward into the new business. Both buyer and seller will spend a good amount of time understanding and negotiating potential adjustments.

Below is a simple example of adjusted EBITDA with a multiplier applied and the impact of process and other efficiencies on the valuation:

Description	Scenario A	Scenario B
Adjusted EBITDA	\$3,000,000	\$3,000,000
Increases to EBITDA efficiencies	500,000	1,000,000
Increased adjusted EBITDA	3,500,000	4,000,000
Negotiated multiple factor	5X	5X
Valuation	\$17,500,000	\$20,000,000

In this example a \$500,000 increase in EBITDA raises the valuation by \$2.5 million.

Every transaction requires some form of due diligence where the seller is required to provide detailed historical and current information on markets, sales, operations, and financial statements. It's not uncommon for a sale to fall apart during this phase. The major causes are declining profits, problems discovered during due diligence, or the owner changing their mind. I've been involved in the sale or purchase of 12 companies over the last 15 years and while each transaction may be considered unique, there are certain guidelines to follow that will get you the best deal.

The most important step is to be proactive and plan well in advance of when you want to exit your company.

I'm available by phone, email or in person if you want to discuss this or other topics.

Jim Forrest
CPA/MBA
(781) 727-5660
forrestjim@live.com