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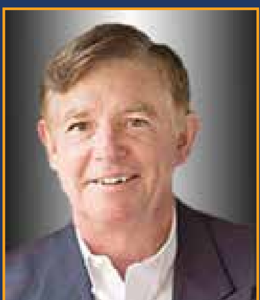
# Exit Planning - Why Knowing Your Valuation is So Important

*By Camm Morton, Owner of VR Business Brokers in Baton Rouge, LA*

Exit Planning is a Journey best started long before the actual exit. In the very first phase of Exit Planning, the focus is on the value of the business and its impact on the business owner's goals after the exit. In other words, can the owner comfortably retire with the current value of the business and their other investments? Without a pretty good sense of the value of the business, all exit planning decisions are flawed. So, do you know the value of your business or is the value you have in your head just a "hope".

Exiting your business can be a chaotic nightmare or a smooth transition, depending on when and how you prepare for it. This may be stating the obvious, but there are many told and untold stories of business owners who believed the selling price of their business would be the nest egg they needed to live comfortably in their retirement years only to be saddened by reality. So, what is the strategy to maximize the potential value of your business and how do you plan for the inevitable exit?

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Most importantly, as an owner, realize that any dollar earned, which does not remain with the company, impacts your company's potential value to investors. Buyers of small businesses are generally interested in purchasing a stream of cash-flows, which is evidenced by your tax returns and supported by your financial statements. We all recognize that some expenses of a personal nature can be run through our business and have the positive effect of reducing the amount of taxes we pay. However, your professional adviser can assist in identifying and reconciling the differences between your books and your tax returns to provide the buyer with an accurate picture of the available cash flow generated by your business. This is what the buyer is looking for, cash flow, as a return on their investment.

## Cash Flow

What exactly is cash flow? From an owner's point of view, it is the money left in the bank after paying all of the expenses, often thought of as net income. From an investor's standpoint, there are a number of adjustments which are made to get from the net income or earnings before interest, taxes, depreciation and amortization, EBITDA, to the annual adjusted cash flow of a business. Adjustments can be thought of as changes made to recognize the true amount of cash that is available annually to the owner as a return on the investment made. These adjustments will include items like interest, depreciation, owner's salary, and other personal items, such as cars, phones, travel, etc. Additionally, if there are any extraordinary expenses incurred by a company, they will have to be adjusted to reflect their specific impact on available cash flow. Your professional advisor can assist in analyzing the subject company's financial statements and tax returns to assist the seller or buyer of a business in calculating the true annual cash flow of the business.

## Valuation

What is the importance of cash flow when it comes to placing a value on your business? As previously stated, it is what the buyer is essentially purchasing. The present value of annual adjusted cash flow is used to determine a fair and equitable price to be paid for the small business. Cash flow value can be looked at from two perspectives to arrive at the current value of that revenue stream. Generally, the historical cash flow is weighted and used as a predictor of future money to be generated by the business. The application of a multiple of earnings is then applied to the average historical cash flow to arrive at the current value of the business. Also, if there is enough sophistication of both the current and future owners, adjusted cash flow projections can be made for future sales and subsequently discounted to the present value of those revenues and hence a fair price for the business. This is when it is really important to contact a professional advisor to discuss and understand all of the assumptions to be made which will affect projections and the discount rates to be used.

## Planning for a smooth exit

We advise potential clients to start planning early as they look too exiting their business and move into retirement. Every small business owner should have a valuation performed on a regular basis, i.e. five years minimum, so they will know where they stand at any given moment in time. Once the owner has discussed the initial valuation with their advisor it can be used as a benchmark. This consultation should provide the business owner with a general understanding of how the multiples work in their specific industry. From here, steps should be taken at least three years before placing a business on the market so the supporting financial documents will show the company in the best light. Owners spending which is not directly related to the operations of the company should be minimized or eliminated entirely from the books of the business so that the buyer can easily see the benefit of buying the business. Buyers, nowadays, have many options to consider and if it is too hard to understand the subject business they will simply move to the next opportunity which ultimately means that the business is worthless. So start planning today!!