



The Business Value Manager

*Advice
for business
owners,
investors and
service providers
on how to build
value and wealth
through
investment in
closely held
companies.*

Why Planning for a Private Company Sale is Critical *And Reasons Why You Should Think About This Now*

INTRODUCTION

Planning when and how to exit from a private company is often so uncomfortable many owners refuse to seriously think about it. But some change ultimately has to occur and for those willing to plan well in advance, it can actually be a satisfying experience.

So, the key to success is to give yourself and other owners the time and a process to plan, first at the *owner or shareholder level* and then at the *corporate level*. This issue of "The Business Value Manager" explains what this involves and why you should start years in advance.

OWNER LEVEL PLANNING AND PREPARATION

Exit planning is much less stressful when owners recognize the breadth of options they have. While exiting may mean selling out completely and ending all involvement in the business, options include continued ownership or employment for the shorter or longer term. Shareholders who need to cash out could do so while others continue to own, sometimes with new sources of equity or debt capital.

Current shareholder rights are governed

by the company's existing shareholder agreement, operating agreement, employment contracts and similar legal documents, and you should review each of these at least annually.

The company's legal structure and tax status may create ownership transition opportunities or restrictions, so you are well served to retain competent advisors at the *beginning* of your planning process to enable them to identify and execute the best strategies from the start. Legal, tax, valuation and transaction advisors can anticipate problems and present options that give you the best chance for success, particularly if your ownership goals or timetables are in conflict.

At the ownership level, planning should begin with each owner identifying his or her primary financial and non-financial goals for owning their private company investment. That is, establish financial goals that you want to achieve. This should include

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the amount beyond a market based salary that you expect to take out of the business each year as your return on investment and the price you expect at some future date when you cash out. Also, identify your reasons beyond the money for owning the business. These non-financial goals could affect your financial return.

Next, you should discuss your goals and vision for the company with the other owners to identify where any inconsistencies or conflicts exist. You should resolve these before any corporate planning occurs because your strategy should be designed to achieve shareholder goals.

Once shareholders have established and agreed to their ownership goals, the next step is to understand the company's value and what factors most drive and threaten that value. Then compare the company's value to your expectations to assess whether or not your cash out price and date are realistic. You may find, for example, that your value can only be achieved if you are willing to own and build the company for six more years, rather than three. So, different goals and circumstances may require a different ownership period and corporate strategy.

The best way for shareholders to resolve ownership issues is through constructive discussion about them. Strategies and solutions are generally available when there is enough time for careful planning and execution.

CORPORATE STRATEGIC PLANNING AND PREPARATION

Once you have identified and agreed to ownership goals and a strategy and timetable for achieving them, the next step is to look at the company's competitive position to develop a strategy to maximize its performance, value and attractiveness for its likely future owners. Keep in mind that these future owners could be the current management and/or employees through a recapitalization or an ESOP, or it could be a strategic buyer, including a current competitor. Anticipating

potential acquirers and the likelihood of each ultimately owning the company could affect the company's strategy.

Corporate planning should begin with an evaluation of the company's competitive position, recognizing strengths, weaknesses, opportunities and threats, and what can be done to overcome the weaknesses or gaps that currently exist and the best strategy to exploit strengths and anticipated opportunities.

Keep in mind that as the strategic plan is prepared, it should be accompanied by forecasted financial statements to quantify the company's likely value at the end of each of the projected years. The forecast should include a capital budget for long term expenditures and a return on investment analysis for all major initiatives to quantify their cost and likely effect on a company's value. Naturally, major projects should all be considered against the owners' investment horizons, and what initiatives make the company most attractive to a potential buyer given the exit timetable.

This planning should also consider general economic conditions and conditions in both the company's and their customers' industries, particularly if these industries are cyclical. Plan to take the company to market during an economic upturn after at least one year of sound performance and when at least one additional year of higher growth can be anticipated.

If the anticipated sale date is less than five years away and it is likely that the buyer would be strategic, look at the company from the potential *buyer's* viewpoint to identify those factors that make the company more or less attractive to that kind of buyer. While owners should avoid any strategy that places the company at risk on a standalone basis, your best short term strategy to maximize value may be planning to be the optimum target in your market. Exit planning should recognize that buyers often regard management as a top consideration in assessing any

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target, and buyers may want to keep the management in place. So, evaluate your team, including their likely future tenure with the company, to identify which individuals would be most important in the sale process and where any future gaps are likely to occur. Key relationships with customers or suppliers and key technical knowledge should also be considered. A sound, deep management team is essential to get an attractive price.

In this strategic planning, identify what information about the company is most critical to its future success and, as a result, must be most carefully protected in the sale process. More commonly, information about customers and key employees, along with proprietary products, processes and similar intellectual property, must be most carefully protected. Identifying these items and planning for the most effective way to convey the strength of the company without revealing this detail until later in the transaction process gives the company maximum leverage.

Sellers should also recognize three key constituents and plan to most effectively deal with each. First, recognize *employees* typically regard any change in ownership as a threat. So, plan what employees will learn about transition plans and when they hear it. Recognize that your best employees, who will have the best employment opportunities elsewhere, must be protected, while your weakest employees will want to stay and buyers may regard this as a negative.

Customers are often what the buyer wants most in the acquisition, so a detailed plan to retain them and possibly increase their volume is critical. Most transactions cause a loss of some customers, particularly if the buyer is strategic and has a relationship with other key companies in the market. Identifying the optimum way to bring current and new customers to the new owner may have a greater impact on value than any other planning step.

The final constituent, *competitors*, could exploit any rumor about a change in ownership, which emphasizes the need for confidentiality in all transition planning. Consider competitors' best opportunities to gain an advantage from an ownership change and look for strategies to prevent this. In any case, agree on how to respond to formal or informal inquiries about changes in ownership.

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A final step in exit planning is to candidly assess the company's investment in tangible assets, employees, product lines and markets from the point of view of strategic fit. This is yet another analysis that is made much easier when done well in advance to create as much flexibility as possible. Assess the company's investment in equipment, including productions facilities, distribution centers, warehousing, and real estate in general to determine the minimum required level of assets given the company's volume and growth expectations. Dispose of any that are unneeded and that would reduce the attractiveness of the company as an investment (and use the cash proceeds to reduce debt). The same analysis should be done for each of the company's major product or service lines and associated employees and facilities. In particular, evaluate whether or not these are complimentary for the business both as a standalone entity and, more importantly, to a potential strategic buyer. It can be particularly troublesome for a company planning for a transition to identify late in the process that it has orphan business segments, product lines or production facilities that would be difficult to dispose of separately after a sale, and which may actually render the whole company less marketable.

CONCLUSION

Because an investment in a private company is often a major event in an owner's life, exiting that investment usually generates mixed feelings and sometimes conflicts. As this article explains, the best path to a favorable outcome is to address shareholder issues and strategic issues well in advance to give you the time to establish realistic financial and non-financial goals and a sound strategy to achieve them.



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The best selling book, *VALUATION FOR M&A: Building Value in Private Companies*, was co-authored by E&A principal, Frank C. Evans and David M. Bishop, and published by John C. Wiley & Sons, Inc. To order your copy, go to www.wiley.com/WileyCDA. For a preview, visit our website at www.evansandassociates.net, click the Publications link and Books.



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