BSCAI®
July/August 2011 Volume 31 • Number 4

SERVICES

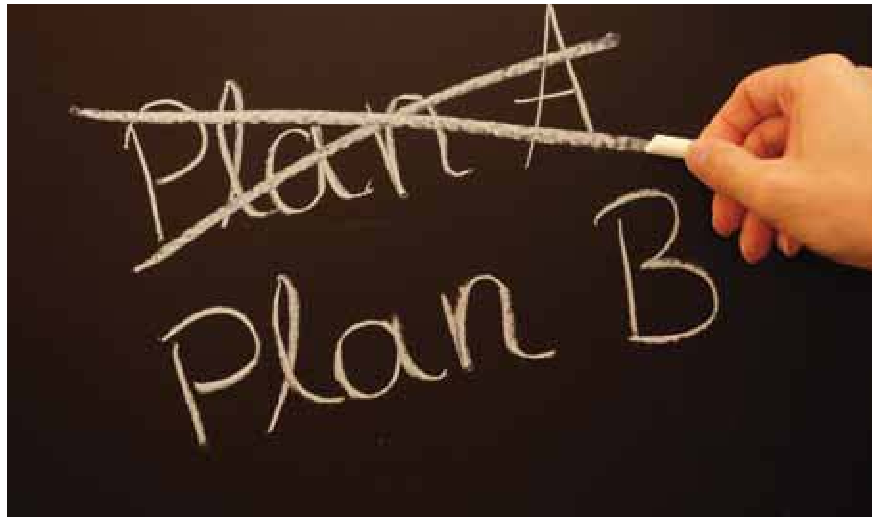
The Official Magazine for the Building Service Contracting Industry and the BSCAI

ADVANTAGES OF THERMAL SURFACE DISINFECTION

WHY RENT VS. BUY?

BUSINESS ETHICS: DO WHAT'S RIGHT OR WHAT'S RIGHT NOW?

(Adequately) Preparing for a Sale



By Lance Tullius

Even if selling your business is the furthest thing from your mind, you absolutely should have a plan in place to sell. Yet most business owners for which selling their business isn't presently top of mind, like within the next year or so, don't have a plan for their exit. Let's start with why not. After all, most owners of privately held businesses have an overwhelming amount of their personal wealth invested in their business. The sale of that business, whenever it comes, will very likely be the single biggest financial event of their lives.

Why Not?

I believe one fundamental reason for the lack of time given to adequate preparation for a business sale is the simple fact of getting bogged down in the minutia that is so ever-present for us all. Any type of long-term planning in today's world takes true discipline. It's not a coincidence that the most successful businesses are led by people who put long-term planning and vision at the top of their list of priorities. But I also believe that there's more to it than to suggest we're simply too busy with "stuff" to focus on the big picture. Men and women with the courage to go out on a limb and start a business from scratch, then build it into something that provides for hundreds—and in some cases thousands of families—deserve more credit than this.

It's my conclusion that most business owners simply don't believe in the powerful, and frankly proven, connection between calculated planning for a sale and capturing absolute peak value for their business when they do sell. I'm not saying that they don't believe making their business a better business will increase the odds that buyers will attract to their business and pay them the value they want. To the contrary, this is exactly my point. Too many business owners have this exact take; that is this relatively loose connection that if what I am building is something I consider to be a good business, at some point in the future someone will come to me and pay a king's ransom for it. This mindset leaves way too much to chance. And it's this very perception that erects a big brick wall between them and the clear path that is truly before them to take a conscious and calculated initiative towards creating their own road map to not only making their business as valuable as possible, but also knowing exactly where to go when the time is right to capture that value and turn it into cash. They say "luck is what happens when preparation meets opportunity." I say that success happens when adequate preparation is applied regardless of whether opportunity hits you between the eyes. Put another way, with respect to your own future exit, good planning exponentially increases the likelihood you'll get the value you want out of your business, yet by virtue of doing so, you've done nothing to remove your chances of getting lucky.

You've also heard the saying, "you don't know what you don't know." This is another phenomenon that, in my opinion, speaks to why few business owners consciously plan for the exit of their business. They're simply not aware that they don't know the series of steps to take to put their business in a position to command maximum value. They know enough to be dangerous—to themselves that is. Many of what I consider to be the most astute business owners, when it comes to the subject of business valuation, second naturedly recite their normalized EBITDA (earnings pre of interest, taxes, depreciation, and amortization) as A, have heard that businesses in their industry trade in the range of B to C times EBITDA, and therefore conclude their business is worth somewhere around D. In doing so, they miss the mark on so many levels.

How to Plan?

While we're tossing around clichés, none should apply more to preparing your business for sale than that of "beauty is in the eye of the beholder." While I'm always reluctant to analogize the sale of a business to that of a home, it sometimes makes for a good one. Real estate professionals suggest that the toughest homes to sell are those that are way outside of the "strike zone," meaning there are characteristics of these homes that are so different from what the mainstream homezowner is looking for. The guy that has the huge lion's bust erected on the façade of his home to symbolize his pride, or the couple that has designed their home to be in stark contrast to any others in the neighborhood, will likely have a tough time getting top value for their home. Not a bad thing, particularly if they understand that. Problem is, most business owners expect to monetize the value of their business someday. To do so, the business should be built keeping in mind the types of businesses buyers most want to buy. This may seem counterintuitive in that as far back as most of us can remember, we're taught that to get ahead and get noticed, we have to be different. And nowhere does this seem to apply more so than in business. Building a business that is way different from the mainstream in your industry may serve you well as you're operating it, and I'm not suggesting that it won't have value when you go to sell it. Rather, it very likely won't have the value you expect it to have, and perhaps more important, won't have the value to the buyer that is capable of paying you the most for it. While good businesses can provide many benefits, financial and otherwise, to their owners over the course of their ownership tenure, the opportunity to create real wealth from a business comes through building value, which is maximized when the buyer that can pay you the highest price has great interest in owning your business.

Every business has various metrics, dozens such of what I refer to as Key Value Metrics, that individually and collectively impact and/or drive value. A business owner needs not only know what each and every one of these metrics are for their business, but also how to measure them and what their impact is on their company's value. I've seen companies with great revenue trends and excellent profitability, that when the owner went to sell, he or she was underwhelmed at the worth of the business. They assumed incorrectly what made their business valuable. So the first step is to *know* what creates value, and then one must align the tactics through which they operate their business with the overall strategy they are trying to achieve.

Another pitfall that fells business owners is the lack of appreciation for the impact that being organized in every respect has on business value. Nobody can fully appreciate the importance of this until they've gone through transactional due diligence, which is the gate that must be passed through to get your deal done and fully recognize your wealth. From financial statements, to labor tracking/reporting systems, job costing reports, corporate governance, employee eligibility, worker's comp exposure, liability recognition, and beyond, to survive due diligence and convert your business' wealth to cash, you behoove yourself to understand every pertinent report, make sure it's in the best possible shape, and organized to the nth degree.

Failure to Plan

While I never like to dwell on the negative (which is why I've chosen to address this last), failure to adequately plan for the future sale of or exit from your business comes with significant potential costs. Among those is the vulnerability you expose yourself, your family, and all of your employees to by not planning and preparing. All of us aspire for the day when we decide that we want to sell our business and we're fortunate enough to have built a business that is highly sought after, or the day when a surprise buyer knocks on our door and is practically begging to pay us a premium for the business. But without a calculated plan, this doesn't often happen. And unfortunately, it is all too often that a business owner is forced to sell due to health or other unforeseen circumstances, business or otherwise. By not having prepared the right way, a business owner facing these circumstances is severely compromised. Reversely so, good preparation allows you to be calculated in maximizing your value but also nimble so that in the event an unexpected opportunity comes before you, you can seize on it and leave nothing on the table.

Speaking of failure, I'd be remiss not to address the possibility of a failed transaction. Many, if not most would-be sellers make the mistake of thinking that once they've negotiated the transaction and have an executed document that references the terms and conditions to the transaction, the most difficult part of the process is behind them. To the contrary, with confirmatory due diligence looming ahead, this is the stage where most transactions fall apart. In fact, some in the mergers and acquisitions business will tell you that roughly 75 percent of all transactions for which an offer or letter of intent is agreed to don't make it to closing. Whether or not this figure is correct, it's safe to say that the statistic is high. Again, preparation helps you ensure that your transaction will close. You must know the buyer you are engaging in the deal with, their history of closing, why they might not close, and their capability to close (i.e. what's going on in their world right now). You should also understand the condition of the broader financial markets and economic climate and how they might affect your transaction. And last, but not least, you must make sure that all of your ducks are in a row as you proceed into due diligence. This is where exceptional organization will benefit you tremendously. Just think: you've negotiated a transaction that you're happy with, you're preparing for life after your business, another entity is now deep within your business conducting what is likely invasive due diligence, you've perhaps disclosed the news to select key employees, and not least of all, you've started to spend meaningful dollars on legal, accounting and other advisory costs towards completing the deal. And for whatever reason, the deal falls apart. The costs: lots of little pieces that you must begin to pick up and put back together, while at the same time, getting yourself back up off the mat after what almost assuredly would be an emotionally exhausting setback.

So do yourself a favor. Don't let all of what you've put into your business be done in vain. Start the preparation today so that when you do sell, you can experience what all sellers should: a gratifying and fulfilling milestone in your life that perhaps can positively impact generations to come.

Lance R. Tullius is Managing Partner of Tullius Partners, an investment banking firm that specializes in providing merger and acquisition and financial/strategic advisory services to companies in the building service contracting industry..