

Preparing Your Business for Sale

In our Fall 2007 newsletter, we discussed succession planning for small businesses and indicated that the ideal lead time to prepare for a sale to a successor is seven to 10 years. If there is no plan to sell to an insider, a strategy is still required to prepare the company for a sale to a third party. This newsletter discusses some of the issues owners should consider when preparing their company for a sale.

A strategic plan should be prepared in order to outline what is required to maximize company value by the targeted sale date. Issues to be discussed in the plan include:

- 1. What is the company's competitive position in its industry and what is required to maintain or improve it by the targeted sale date?** This would include an industry analysis, assessment of competitors and expected changes in competition due to technological or input changes.
- 2. What is the company's sustainable competitive advantage?** And how can it be leveraged to the fullest extent in order to increase market share and profitability? A SWOT analysis (Strengths, Weaknesses, Opportunities and Threats) is one way to get the process started. Other techniques may be used as well.

After this analysis, the owner may conclude that a strategic acquisition of a competitor may be required in order to improve its position in the industry. Size matters when it comes to company valuations. A company needs to be of a certain size (usually expressed in annual sales or EBITDA) in order to increase the number of interested buyers to more than just a couple within its industry.

- 3. What is driving the inherent value of the company?** Is it the customer lists, technological know-how or the business relationships held closely by the owner? The company needs to have a strong management team exclusive of the owner and it needs to demonstrate that it can prosper without him after a sale.
- 4. Are the majority of the company's revenues generated by a few customers?** If a company's revenues are heavily concentrated to a limited number of customers, the risk increases that it will shrink or fail should a key customer move its business to a competitor. Customer concentration reduces overall company values.

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5. **Does the company generate a high percentage of recurring or annuity type revenues?** This tends to stabilize cash flows during non-peak or off-season periods and will increase a company's value. Service level or maintenance agreements are good examples of this type of revenue stream.
6. **Are the company's financial reporting and management information systems top notch?** Being able to generate timely and accurate financial and management reports is crucial for any buyer when considering an acquisition. These reports will be used by the buyer when analyzing the target so if there are issues, they will be uncovered during due diligence and may cause the buyer to terminate the acquisition or reduce the offer price accordingly.
7. **Are your current and two years prior annual financial statements reviewed or audited by an outside accounting firm?** A review engagement would be the minimum required for many buyers to consider an acquisition. An audit would be ideal since it provides more assurance to a buyer that the statements are fairly presented. However it is more expensive than a review. Regardless of what is chosen, this is something that should be commenced right away even if there is no specific target sale date.
8. **Can the company's debt be reduced or eliminated?** The equity value of a company with little or no debt will be higher than an identical company with debt. This is because the debt default risk is higher on the latter company, making its equity more risky. Moreover, if a target company has little or no debt, the buyer can add debt onto the target's balance sheet in order to finance the purchase price.

The above list is by no means exhaustive. There are many more issues that need to be considered. But if an owner plans to sell his company in the next few years, it follows that the sooner a strategic plan is put in place, the better given the numerous issues to be dealt with prior to a sale.

Aries Advisory Group can assist you with the development and execution of a strategic sales plan of your company. We can identify all issues an owner should review and rectify in order to improve shareholder value. And when it comes time to sell, we will be uniquely qualified to assist you with the sales process. Please contact us at info@ariesag.com or at (416) 467-7878 to see how we can help.