A Few Questions Owners Should Consider When Preparing for an Eventual Exit

(Accepted for publication in Staff Digest early 2014)

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Introduction

Ultimately, if there is not a family successor, an ESOP or other plan for an internal buyout, almost all owners will eventually be considering some form of external exit. While many have a well thought out exit plan and succession strategy — unfortunately many do not.

For those who never got around to it, we have had the unhappy experience of watching a spouse or “significant other” trying to manage, resurrect or even close down a business they did not plan to run. We have seen this in cases of unexpected stroke or other disabling conditions, and terminal illnesses—all of which can be devastating for the partner that ends up having to deal both with their spouse/partner’s situation and also with the responsibilities of the company. While this represents an extreme case, it may be useful as a reminder that proper planning can be a very prudent investment.

Part of this planning can involve simply asking questions and beginning to think about the answers.

Some Basic Questions to Consider

Having gone through the planning and sale of multiple phases of selling our own operations, I had the opportunity to learn some invaluable lessons about what works and what does not.

More often than not, people start by asking M&A advisors like us what price they might get for their company. Clearly this is an important consideration, and relates to the financial planning side of an exit plan. We will discuss this in a limited way below. However, a more basic question should really be addressed first.

“What Do You Really Want Post-Transaction?”

It might be useful to consider the adage to “begin with the end in mind” as Covey suggested in his well-known book 7 Habits of Highly Effective People. To really begin
to make an exit plan, one needs to understand where you want to be—beyond the money you might make, what do you want to be doing with your time?

In thinking about Covey’s question in effect one must assess where one really wants to be after the sale closes, or at least after some period of transition, earn-out or other arrangement. This involves the physical location, but also what you want to be doing. Is the goal to be totally retired playing golf, sailing, scuba diving—or will you be bored and wish you were still running an organization? Are there health considerations? Are there family issues that need to be addressed? Is it just a case of burnout?

Sometimes taking out some of the risk with a partial buyout and/or finding a way to work on a part-time basis that allows for moving closer to what really got the individual into the business in the first place is a potential answer.

“What is the real reason that the owner(s) are selling?”

This is one of the most common questions buyers ask us when first discussing a potential acquisition. It is also is closely related to the discussion above—because the acquiring company or individual wants to know if there are problems, and how well the transition is likely to occur. With an understanding of our client(s)’ true reasons and ultimate goals, we can work to frame this in a way that is both truthful and also considers the buyer’s likely interests.

In the case of someone who still wants to be involved, but wants to move closer to the kind of work that got them into the business originally, this is a very different discussion than someone who “just can’t take it any more”. For example, some owners get tired of doing the back office administrative work and minutia of compliance and other bureaucratic tasks. They long for the days of going out and finding new business and building relationships.

If that is the primary driver, and especially if the owner is willing to stay for a time and transition to this role, this allows us to present a logical, understandable scenario. The buyer may find this attractive as a way of keeping the owner engaged for at least a transition, and doing something they enjoy much more than the administrative chores.

“Are You Interested In Maintaining Some Ownership or a Continuing Role For Some Period?”
Most service businesses have a certain degree of dependence on the owner. For this reason, typically buyers like to have some sort of involvement of the owner post-transaction. This does not necessarily require maintaining an ownership stake.

In one case, we represented two entrepreneurs who were equal partners who wanted to sell, but with very different personal goals. One really wanted to exit to have more time with her children. The other partner really enjoyed developing training programs and helping to develop teams to build new business—but still wanted some flexibility to spend more time with her family.

Fortunately, after framing the goal in a positive light, this scenario was seen as a plus by the ultimate buyer we secured. The buyer really didn’t need both founders, but highly valued having one founder still actively involved and helping maintain relationships with clients. It also allowed the buyer to tap into the talents of one of the selling owners to help them expand their business by adding more capabilities through the training in other regions. For the selling partner who wanted to stay on in a part-time role, it assured a continuing income stream and a potential upside associated with generating new business. It ended up a win-win.

For other owners it may be appealing to have some upside potential and some continuing influence on the business they founded. One way of doing this is by maintaining a stake in the company. This might take the form of a partial buyout, recapitalization or other arrangement that allows the owner to maintain an ownership position in the business but still take the majority of their “chips off the table” to reduce their risk exposure.

An example of this with a past client was a firm for which we were able to arrange for a very favorable recapitalization with a smaller private equity firm. They received an excellent price at closing, but still maintained a modest stake in the company going forward. The owner stayed involved as did the key staff, but a new CEO was brought in along with capital to significantly grow the company. The private equity group, working with the founder and new CEO, was successful in growing the firm from one location providing travel staff to a national footprint with offices in over 60 locations around the country helping it to become one of the fastest growing staffing companies in the US. Over time, the small amount of retained equity was estimated to be worth more than the entire value of the company at the time of the recap.

“Will the Likely Value of My Business Be Enough to Meet My Financial Goals?”
This flows from one of the most common questions we get from sellers – “What is my business worth?” and the variation of this theme from buyers – “What are the seller’s price expectations?”

In trying to give a seller an idea of potential value, there are many factors to consider. They include understanding volume, revenues, gross profit levels, unadjusted profits, niches, markets, location(s), leadership, transition plan, key employees, contractors/corporations versus employees, types of customers, customer business concentration, opportunities for growth, how well the business has held up through the tough years, its current trajectory and forecast, growth trends in the sectors served and the markets served, etc. These and other factors are used to come up with some potential likely sense for how desirable the company might be. Understanding reasons for the sale, whether all or part, involvement post-transaction etc. also have an impact. Then we need to do a detailed analysis of the financials to estimate an adjusted EBITDA (Earnings Before Interest Taxes Depreciation and Amortization) to come up with some potential ranges of what the company might bring from various buyers.

Looking back to the initial goals the owner is seeking to achieve post transaction, and working with the owner’s financial planning advisors, one can determine whether the business could support a price to meet these goals or whether additional time and work would be needed to grow or fine tune the business to yield more value.

The variation of the question posed by buyers also flows from the information gathered up front. However, we never have a set asking price. Instead, we can provide feedback that we feel the client’s expectations are within the ranges we have seen in the market. The art of the M&A process is managing the relationship between buyers and the seller, then finding a way to come up with a price and structure that provide an optimal solution for our client. This includes working to tailor the potential deal to meet the needs of the client’s particular situation while simultaneously working to achieve a structure that will work well for the client and buyer relationship post-transaction—especially if the owner is likely to stay involved.

“How Long Do I Need To Plan For A Transaction?”

There are multiple aspects to this question. First, one must think about the longer term goals noted above. If, for example, an owner wants to have completely exited within say 4 years, they need to work backwards.

The actual time from deciding to proceed to successfully closing a transaction is dependent on many factors, including how well the company fits with buyer interests
(based on many of the items above), the owner(s)’ own timetable, valuation expectations and how extensive a market search is desired. Generally transactions rarely can be done in less than 3-6 months, and this generally only occurs if a buyer is already identified or if everything falls into place unusually quickly.

Given the time needed to gather documents, organize and prepare the business profile, review information to be prepared for future due diligence, marketing, initial meetings, “managing” the flow of interest to attempt to have relatively concurrent discussions, follow-on questions, negotiation of initial term sheets or letters of intent, due diligence, development and negotiation of the definitive agreements and finally closing—the time is generally considerably longer. More commonly, the time period is around 9-12 months, but can be even longer depending on the particular business, expectations and the market conditions.

Given the time for planning and potentially taking time to tune-up the business to help optimize value (especially if the likely current value does not meet financial planning goals) the time associated with the transaction as noted above, and adding any post-transaction transition involvement required—the real time period involved could be a number of years. It could be argued that if an owner is looking to fully exit in 3-4 years that they should really be preparing now.

**Summary**

This article only touches briefly on a few of the many questions that need to be asked. Further, the facts will vary widely based on each client’s situation. However, critically assessing one’s ultimate goals, the motivation for selling and then finding a way to position this most favorably for a potential buyer can help your M&A advisors to find fits with potential buyers that may provide an outcome that optimizes the goals of all the parties.

Asking and answering other basic questions with your M&A and other advisors can also help to decide on the appropriate time to begin planning for a potential transaction, whether the business in its current form can meet your financial goals, what steps to take to potentially improve value, determine when it is time to proceed, and help to decide what types of transactions to pursue.