7 Essentials To Sell Your Company At A Premium

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All too many mid-market CEOs sell their companies for far less than what they'd hoped for because they hadn't prepared for the "exit day." In my research and experience, I've found seven strategies to be essential for executives who someday want to cash in on all the hard work and risks they took.

The story of one such firm, which was launched in the early 1980s and became an industry leader, demonstrates the hazards of being unprepared for the exit day. In 2007, the company scorned a buyout offer in 2007 that was four times earnings before interest, taxes, depreciation and amortization. The offer was full value—about what their investment bankers had expected, and was the norm at that time for companies of that size and performance. Holding out for more, the owners were forced to sell the business in distress in 2011 for just enough cash to pay off the bank and the remainder in seller-financed debt, which is now in default. The owners walked away from 30 years of toil with only their memories.

How does this happen? Mid-market CEOs underinvest in training themselves on how to prepare their firms for an exit. Many believe this is the role of the investment banker, the reason they earn their hefty fees of 3% to 10% of the sale. While the bankers play a critical part in many exits, there is much they cannot do such as creating a healthy business, building long-term relationships with industry buyers, and planning the seller's personal future. Furthermore, the investment banker's incentive is not 100% in line with the seller's. Since they get paid primarily upon sale, for them any sale is better than no sale. They also have other clients, and they may put their best people on those clients where they think they can earn the most; that may not be you.

What's more, many mid-market CEOs are inexperienced at selling a business, and preparing for a future sale – especially if it is many years away -- rarely feels urgent. Other priorities jump ahead, and CEOs don't build skill or knowledge on how to exit until the event is upon them. This dramatically increases the risk of having to accept an unattractive offer.
CEOs who want to sell their business someday must manage the exit from the start, even if it isn't for many years. There are seven essentials for a pleasurable exit:

1) **Building a strong, "hair-free" business.** Too many problems, oddities and "situations" needing explanation and excuses scare off buyers. Problem employees, failed products still bumping along, and underperforming locations are just a few examples of that dreaded aspect of deals the investment bankers refer to as "hair." One firm lost a premium public company suitor when the lavish vacations and owner's perks run through the company books cast the owner's ethics as "shady." Know what will be perceived as hair, and plan to trim it back before it grows, or at least several years before a sale.

2) **<u>Prime the business for growth, and prove it.</u>** Most business that aren't growing face serious internal and external obstacles to growth. Buyers will only pay a premium when they feel certain that "growth is around the corner." Neil Shroff, managing director of Orion Capital Group (an investment banker), says, "Sellers often walk in my door the minute their revenues increase after having stayed flat for years. If you are relying on a recent growth trend to justify an aggressive growth forecast (and an increased valuation), the first thing buyers will do is to ask why, to discover if it is real, sustainable, and scalable. They are always skeptical." Any reasonable buyer will be able to identify unsustainable growth that comes from an upward blip in the economy, from price discounting, a marketing blitz, or just luck. It's your job as a future seller to find the levers to top- and bottom-line growth and deliver quantifiable results. It is not easy.

3) **<u>Building a business designed to attract specific buyers.</u>** Think forward five years from now and identify what the strongest companies in your industry will be fighting over. Create a company that, if acquired, will help them win. For example, one firm developed the first electronic devices in its industry that could automatically communicate via the web. Management intentionally established the company's market presence in several key verticals where several behemoths were battling for dominance. Those big companies were hungry for the web-communications technology and bid up the earnings multiple to triple what comparable firms had been receiving in this industry. Ask yourself this: Who would likely buy my business, and what tempting product/service/market position can I create that will entice them to overpay?

4) **<u>Create relationships with potential buyers</u>**. We like to do business with people we know. Give potential buyers the opportunity to know you -- even years before you intend to sell -- to understand who you are as a person and to understand your business. It makes them more likely to think of you first when they decide to acquire. In the process, you'll get to know them and will better understand their objectives and business needs. Investment bankers will ask you for a list of strategic buyers at the beginning of the sale process. As you network in your industry over time, build your list.

5) **<u>Plan your life after exit.</u>** Too many reluctantly decide to sell, begin the process but then abort as a deal comes to the table. Often it's because the CEO/owner has nothing to look forward to and equates selling the business with being put out to pasture. The best investment bankers will avoid any seller they suspect of being a reluctant or unreasonable seller, because such behavior will cost them all their fees. Indecisive sellers can also hurt themselves. One firm had a last-minute change of heart and jilted its biggest potential strategic buyer in 2008. Three years later when it decided to sell again, the strategic buyer, irritated at being left at the altar, compared the seller's actual 2008 to its forecast and found a 45% underperformance! The buyer made its new offer low, reflecting the credibility gap. Having the next chapter of your life clarified and in front of you will keep you rational as the process rolls along.

6) **<u>Run the sales process well.</u>** The sales process, although far from being the predominant element of M&A value creation, is a critical one. Investment bankers often play a critical role here but must be managed by the selling firm's CEO. Don't delegate final authority and responsibility. Just like an attorney, investment bankers are expert advisors, but the final decision comes from you. While some CEOs have M&A experience and the skill set to represent their own firm, others can use investment bankers to get a step up in results that more than pay for their fees. Neil Shroff says, "Sellers must be explicit about what valuable competitive data should be disclosed, and when. All too often, investment bankers hand over valuable competitive data that should never be disclosed until the due diligence phase, or not at all." Read here for an article on the use of advisors in M&A transactions.

7) **<u>Avoid post-sale headaches.</u>** Many business exits are marred by litigation and problems after the deal closes. Earn-outs for top management are often a culprit, along with other surprises that derail the business. Particularly in seller-financed deals, the business itself is collateral, and the seller often gets a business back that is in need of repair for a few years before it's ready for sale again. Choose a strong and competent buyer (even though it may not be the highest bidder), and be helpful to the buyer during integration and beyond.

These seven essentials are a tall order. That's why exit planning must be a part of your strategic planning effort every year, not just when the exit day is near. Take actions that keep your business ready for exit at all times.