(by Tim Skarda)

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Increasing the Value of Your Business

Keep your financials clean and stay focused to maximize the selling price of your company.

After years of hard work, the culmination of your entrepreneurial career is the sale of your company, and your plans most likely depend upon selling it for the maximum value. However, most sellers never realize that by simply knowing what buyers want, they can maximize the transaction.

Earnings are the first and foremost factor all buyers look for when purchasing a business. Also referred to as owner's benefit or cash flow, it is the amount an owner receives on an annual basis. To calculate earnings, add owner's compensation and owner's perks to earnings before interest, taxes, depreciation and amortization (EBITDA). This is the bottom line number buyers look at to evaluate a company's financial performance.

Keep Financial Statements Clean

Every buyer first asks, "What are the company's earnings?" Unfortunately, many business owners purposely reduce earnings by stuffing personal expenses into tax returns in order to decrease tax liabilities. This practice can reduce the value of the company.

Buyers may understand the owners' desires to lower tax liabilities, and they realize that perks can be "recast" in the financial statements to reveal the company's true profi tability. However, excessive amounts of add-backs can make even the most seasoned buyers leery. And, reduced earnings may deter many qualified buyers and their lenders upon first glance.

Purposely reducing your earnings will also negatively affect your buyer's financing options. Lenders are typically conservative in accepting recast figures, and they usually determine their loan amounts based on the earnings from the tax returns. Because the value of your company depends upon the amount buyers can pay, the less assistance the buyers receive from a bank, the less they can afford to pay for your business. To increase the value of your company, maintain clean financial statements three years prior to a sale.

To understand the importance of a clean financial statement, consider the following situation: Your company has annual earnings of $250,000, but you expensed a $10,000 personal vacation to lower earnings to $240,000. Depending on your tax rate, you may have saved around $4,000 in tax liability. However, if your business sells for three times earnings, a $10,000 deduct could result in $30,000 less on its sale price.

Show Potential and Stay Focused

A company's earnings projections also are very important to buyers. While the company's historic performance reflects its foundation, the buyer wants to be reassured that the income stream they purchase will continue moving forward. Steady, controlled growth is more attractive than sporadic, unpredictable performance. Likewise, increasing revenues with consistent, stable expenses are key signs that a company is becoming more efficient.

Buyers also are sensitive to your company's present financial performance. Business owners often inadvertently neglect their companies toward the end of their careers, causing "hiccups" on the interim financials. Buyers may see the dip in numbers as a sign that the company is weakening. Stay focused on running your business in the months prior to the sale and do not let the sale process distract you. Hiring a team of experienced advisers (i.e., attorney, accountant and business intermediary) to assist you through the sale process can help mitigate this threat.

After years of investment in time, energy and money, your future may depend upon successfully completing this once-in-a-lifetime transaction.

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