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(by Tim Skarda)

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Pre-planning can help you get the most for your business.

Mitigate the Risk Factors Affecting Your Company's Value

When it's time to sell your business, the true value of your company is ultimately determined by the amount a buyer is willing to pay. As such, when preparing your business for sale, it is important to understand what buyers look for.

When purchasing businesses, buyers look for an income stream that will yield a desired return for their investment. Earnings are great indicators of the company's future projections, but buyers also take into account the internal and external risks that could affect the company's future performance. Therefore, one simple way to maximize the value of your company is to understand and mitigate as many risks as possible. Following are a few of the most common risks.

Diversification

Many companies tend to be overreliant on certain customers, suppliers, product lines or employees. As a result, when one aspect of the business encounters difficulties, the company's bottom line can be significantly affected. The best way to prevent major fluctuations is to diversify and have multiple channels of income and resources to cushion the impact of negative events. Diversification also will help the company's earnings counter against seasonal trends, market cycles and other predictable and unpredictable situations

Infrastructure

When buyers purchase a company, they are highly concerned with issues of transferability. If the business owner tightly holds the reins to the operation, the company may have little chance of surviving the transition unscarred. Instead, owners should strive to make themselves as replaceable as possible in the years prior to the sale. A stable infrastructure, including a key manager, a well-trained staff, effective operational and accounting systems and documented policies and procedures, will help buyers gain confidence in the company's continued performance after the transaction.

Assets

The quality and efficiency of equipment in an asset-intensive company will greatly affect the value of the business. The better the condition of the assets, the less upfront capital buyers will need to invest toward repairs, maintenance or, even worse, replacement of old equipment. Similarly, the value and risk for companies reliant on intellectual property or other proprietary contents will depend upon ownership and licensing rights.

Appearances/Organization

Appearances create the first impressions for any prospective buyer. A clean, well-organized work environment reflects directly upon the company and its management systems.

Buyers will unquestionably request a wide array of company documents, such as financial statements, tax returns, customer and vendor contracts and past corporate minutes. By making this information readily available and easily accessible, sellers reveal a company's organization, efficiency and transparency. Any missing documents or questionable records could seriously hurt the transaction.

Ability to Finance

When purchasing a business, most buyers will require some form of financial assistance, whether from a bank, a Small Business Administration loan, a private equity fund, family or friends. Since the value of your company is dependent upon the amount buyers will pay, the more financing buyers obtain, the more they can afford.

While buyers may look at recast financial statements, lenders are typically more conservative and rely on tax returns to make their decisions. Therefore, minimize "perks" expensed through the business at least three years prior to the sale to ensure that tax returns reflect the company's true earnings. This will help reassure lenders of the company's performance.

Terms and Structure

When it comes to structuring the deal and agreeing on the terms, certain tax and legal implications benefit buyers more than sellers, and vice versa. Buyers may pay more for an asset sale than a stock sale because of the financial and legal benefits. In addition, if the seller is willing to shoulder a portion of the price through seller financing or an earn-out, the buyer may agree to a higher price. However, sellers should be fully aware of the risks associated with these types of structures.

Every company has its own unique set of risks and opportunities associated with its operation. While owners cannot foresee all risks, preplanning for a future exit can help mitigate the predictable ones. Understanding what buyers look for will help you better defend your price expectations.

Tim Skarda *is the president of Allied Business Group, a mergers and acquisitions and business valuation company based in Leawood.*

(913) 897-3599 //
www.AlliedBizGroup.com