Selling Your Business:
Considerations and Understanding Value

BDC's - Exit This Way Seminar

Preparing for a Successful Sale of Your Business

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You are Fortunate

- To be sitting here today
- Not because you are about to be entertained by very talented speakers
- Instead because you are fortunate to be
- Selling your business at a <u>very good time</u>

Buyers

for your company

Types of Buyers

- One of the best things about the current M&A market is the large numbers of buyers
- Buyers fall into four categories:
  1. Big Companies
  2. Medium and Small Companies
  3. Private Equity Funds
  4. Entrepreneurs – usually Boomers

There Are Many Buyers

- For many companies, the number of buyers is, for practical purposes, ‘almost unlimited’
- For company sales under $50 million
- It’s not unusual to have all four types of buyers
- Simultaneously trying to buy the company
- Each type of buyer thinks and acts differently

Big Corps Have So Much Cash

- Many big companies have so much cash that it’s a problem – shareholders complain
- Google has $20 billion
- eBay has $5 billion
- Amazon has $3 billion
- Microsoft has $35 billion
- Cisco has $43 million
- Apple has $97 billion ß cash and investments

How Big Companies Think

- One of my friends from a Fortune 500 company explained it this way:
  - We (big companies) know we aren’t good at new ideas or startups
  - We basically suck at building businesses from zero to $20 million in value
  - But we think of ourselves as really good at growing values from $20 million to $200 million or more

“Under $20 Million Is Easy”

- – A company priced at $100 million is already out of our sweet spot to buy
- – $100 million also requires board approval
- – But at $20 million, it’s really easy for me to get it approved just inside my division

- Many big companies are spending more on M&A than internal R&D
- Today, it’s the best way for them to grow

Medium and Small Companies

- For every Fortune 500 company that might acquire a company,
- There are probably ten times as many medium or small sized companies
- That would also be interested
- Many CEOs are surprised to see how many companies they hadn't thought of, or even heard of, end up on the qualified list

Medium and Small Companies

- In several ways, these smaller companies are better to deal with
- One benefit is that there are fewer decision makers – often it's just the CEO
- Meaning that these companies can often move faster than their larger competitors
- The disadvantage is that they will more often want to incorporate financing or structuring

Can Move Surprisingly Fast

- As an example of how fast these companies can actually move,
- Last year, I helped sell a local tech company to a US mid sized public company
- Even though it was a cross border transaction
- From the time the CEO first contacted me
- To the money being in the bank
- Was only three months

P-E Funds are Back

- During 2008 and 2009, when the mortgage crisis had paralyzed the credit markets,
- The P-E funds were sidelined because they couldn’t borrow
- Today the fiscal stimulus to accelerate the recovery has pushed the ‘cost of money’ lower than it has been in our lifetimes
- Vancouver examples are Krystal Financial, Matrix Partners and Yellow Point Equity

P-E Funds are Different

- The P-E funds raise money from large investors, very much like VC funds do
- P-E funds differ from VC funds in that they usually buy the majority, and often 100%, of the company
- They will often create an equity plan for the company management after
- Their business model is to buy companies, grow them, sometimes consolidate, and then sell them

P-E Funds Use Leverage

- The P-E fund managers usually use leverage
- The leverage on their equity multiplies their returns to make them competitive to VC funds
- Deals with P-E funds are the most complex
- P-E fund managers love Excel
- Their offers can be very difficult to analyze and to compare to other offers
- (Hint: Get help from Axel – aka Mr. Sub Debt)

Entrepreneurial Buyers

- A relatively new category of buyers is what I call the Entrepreneurial buyers, or Boomer buyers
- This group is showing up more and more often
- They are usually around my age or a little older
- Like many of us, have been eating well and working out for decades now
- Many thought they had retired

Enough Retirement

- After a few years of retirement, they realized they could only play so much golf and drive so many expensive sports cars
- They were bored and realized that all that clean living could mean they could be active for several more decades
- These boomers have capital and have friends who with more (money not usually a problem)
- The most fun they can remember is running companies

Dark Horse Buyers

- The fascinating thing about the entrepreneurial buyers is that they can be the most aggressive and fastest moving of all types
- Most of these guys made their money successfully running companies
- They are often the smartest guys in the room
- They usually operate locally and are most interested in transactions under $20 million

A Sellers' Market

- The large number of different types of buyers makes the current M&A environment:

  1. Fast moving and diverse
  2. Very interesting to work in
  3. A <u>sellers'</u> market

How Long
will it take to sell your company

Often the Biggest Question

- Many times in exits I have been involved with,
- The question which seems most important to the team and the board is
- Not “How much can we get?”
- But “How soon can we complete a transaction?”

How Long It Takes to Exit

- The short answer is usually 6 to 18 months
- From the time you engage the M&A Advisor
- Until the cash is in the bank
- But it can often take longer if the company isn’t ready, or if the structure needs to be cleaned up, or if the financials need improvement
- I’ll summarize the timeline in four parts

Part 1- Before Talking To Buyers

- About a quarter of the work includes:
  1. Building alignment around exit strategy
  2. Financial history and projections
  3. Creating all of the sales collateral
  4. Cleaning up the corporate structure
  5. Preparing the due diligence
- Usually takes 1 to 5 months

Part 2- Building The Sales Funnel

- The second phase includes:
  1. Searching for prospects that match
  2. Developing tactics on strategic value
  3. Initial contacts to 50 - 100
  4. Responding to 10 - 20 interested
  5. Starting due diligence with 5 - 8
  6. To get to an ideal short list of 3
- Usually takes 2 to 6 months

Part 3 - The Bidding Process

- The third phase is the most exciting and most intense
- Ideally three buyers will be in due diligence
- And actively negotiating, simultaneously
- The CEO will be fully engaged - and the limiting factor
- Usually takes 2 to 4 months

Part 4 - Negotiating and Closing

- Even after there is a binding term sheet and possibly a deposit
- It can take months for the M&A advisor, lawyers, accountants and board to complete the fine points of the definitive agreement
- And obtain all of the approvals from boards, shareholders and regulators
- This final phase is usually 1 to 3 months

Timeline Summary

- Once an M&A advisor has been engaged
- The exit usually takes 6 to 18 months
- Depends mostly on the company
- Most of the time is spent preparing the due diligence and sales collateral
- The next biggest time sink is scheduling
- Then waiting for the lawyers

How Much Money

can your company be sold for?

Valuation is Usually Simple

- I have a whole shelf full of books on valuation
- But in 95% of exit transactions, it’s really not that complicated
- Valuation is based primarily on:
  1. Financial fundamentals
  2. Industry comparables
- It’s not an exact science
- Requires lots of experience to be good at

Valuation Principles

- Most valuation methods are based on discounted future cash flow (profit or EBITDA)
- Recognizes interest rates and the imperfect predictability of future earnings
- An easier way to think of it is to imagine that the buyers want to finance the entire purchase with debt
- And have the company pay off the entire debt in 5 to 7 years

Valuation Principles – No Growth

Zero Growth	Profit in the year	Present value of this year's profit
End of this year	1,000,000	$820,000
End of next year	$1,000,000	$672,400
Three years from now	$1,000,000	$551,368
Four years from now	$1,000,000	$452,122
Five years from now	$1,000,000	$370,740
Six years from now	$1,000,000	$304,007
Seven years from now	$1,000,000	$249,285
Eight years from now	$1,000,000	$204,414
Nine years from now	$1,000,000	$167,620
Ten years from now	$1,000,000	$137,448
Total Present Value		$3,929,403

In this zero growth example the value is about 4x the current year profit (EBITDA)

Valuation Principles - 25% Growth

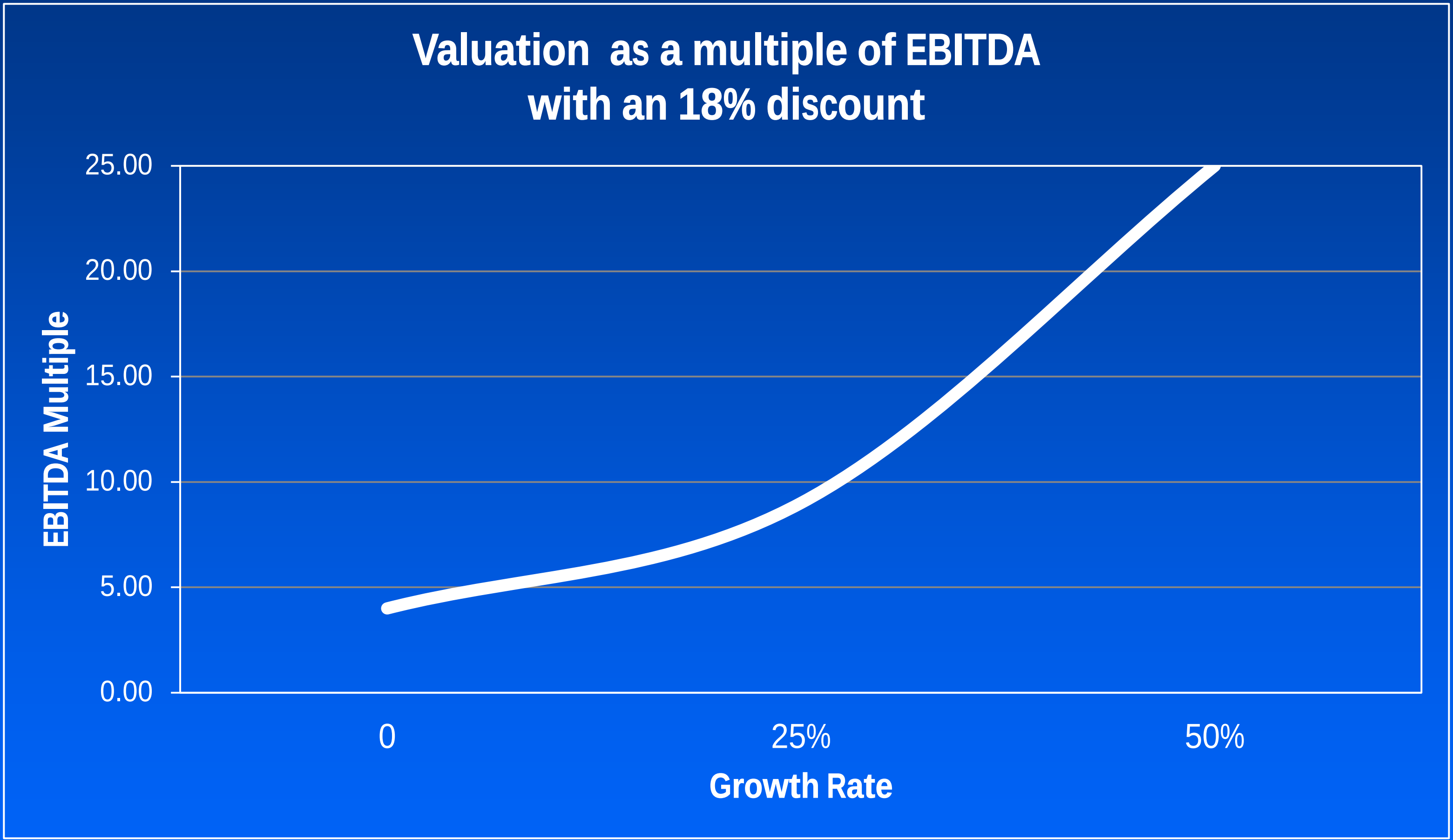
25% Growth	Profit in the year	Present value of this year's profit
End of this year	$1,000,000	$820,000
End of next year	$1,250,000	$840,500
Three years from now	$1,562,500	$861,513
Four years from now	$1,953,125	$883,050
Five years from now	$2,441,406	$905,127
Six years from now	$3,051,758	$927,755
Seven years from now	$3,814,697	$950,949
Eight years from now	$4,768,372	$974,722
Nine years from now	$5,960,464	$999,090
Ten years from now	$7,450,581	$1,024,068
Total Present Value		$9,186,773

In this 25% growth example the value is about 9x the current year profit (EBITDA)

Valuation Principles - Growth

- The $1 million profit, zero growth company was worth about $ 4 million
- The $1 million profit, 25% growth company was worth about $9 million – 2x more
- In the public markets rule of thumb is that the P/E ratio is about the same as the growth rate
- In other words a 10% growth company has a P/E ratio around 10x and a 20% closer to 20x

Valuation Principles - Growth



Valuation depends on the growth rate and the buyers perception of the profit predictability

Profit Predictability

- Predictability is a very significant factor in every valuation
- If the buyer is almost certain the future earnings will actually occur, valuation is close to the previous calculation
- But its never easy to predict the future – especially these days
- So the buyers will discount the price to factor in their perception of profit predictability

Liquidity and Control

- When looking at public comparables
- Remember that valuations for private companies are about 30 to 40% lower
- Called the ‘discount for illiquidity’
- A counter balancing factor is the ‘control premium’
- Buyers will usually pay significantly more for enough shares to have absolute control

Assets or Shares

- The same business can have a valuation that is a quarter to a third higher depending on whether it is a share sales or an asset sale
- The difference is due to:
  1. Tax
  2. Risk
- Sellers usually prefer share sales and buyers often prefer asset sales

Market Factors

- The same business can also have a very different price depending on the market
- We can all see the macro economic effects on public market valuations
- Private transaction valuations are even more volatile
- Both Down and Up

Please Don’t Pay for a Valuation

- There is an entire industry that charges companies for valuations
- Usually costs $15,000 to $50,000
- Those valuations are not to price exits
- They are more often for divorces or taxes
- If you really want to know what your company will sell for, find someone who sells companies like yours and ask them

Reference on Valuation

- For more detail on the previous examples
- And suggestions on the least expensive way to get an exit valuation for your company
- http://www.angelblog.net/Business_Valuation_-_What_will_your_company_sell_for.html

Maximizing Exit Value

- There are several non-operational ways to maximize the final selling price:
    1. Structural value increase
    2. Illuminating strategic value
    3. Capitalizing on Inefficient Markets
    4. Maintaining multiple bidders
    5. Sales and negotiating skill

Structural Value Increase

- Often small tweaks in the corporate structure can increase the selling price by 10 to 35%
  - These can be balance sheet changes
  - Asset vs. share sales
  - Financing mechanisms like sub debt
  - Tax innovations
- Opportunities are almost endless but can often add $ millions

Illuminating Strategic Value

- Identifying strategic value often creates the largest fundamental increase in selling price
- It’s not actually creating strategic value, it usually has to be there already
- But it often has to be “illuminated” for the potential buyers (often very challenging)
- This can often be the most valuable contribution from the M&A advisor

Capitalizing on Inefficient Markets

- Markets for selling a business, especially for under $100 million, are very inefficient:
  - Information is difficult to access
  - There are a small number of buyers
  - The market is illiquid
  - Often very few for sale (like yours)
- All of which can be big advantages for sellers
- Sellers often leave $ millions on the table – and never know – most buyers are pros

Benefits of Multiple Bidders

- An unsolicited offer is almost always a lost opportunity
- Every business sale should have multiple bidders to:
  - Maximize the final selling price
  - Increase the probability of completion
  - Close the transaction sooner
  - Demonstrate good governance

Selling and Negotiating Skill

- There is no question that some sales people are just better – often much better
- Selling a company is just like any other sale – but bigger and more complex
- An outstanding M&A advisor can often help to increase the final price by 50% or more
- http://www.exits-blog.com/great-ma-advisors-sell-companies-for-more/

Can You Really Get 50% More?

- I've seen a number of companies sold for 50% more than the sellers expected
- I've helped make it happen quite a few times
- Most shareholders find it difficult to believe that a really good M&A advisor can sell a company for 50% more
- Most of the time, everyone has to sign an NDA
- So the stories very rarely get told

Resources on Maximizing Value

- http://www.exits-blog.com/selling-a-business-can-increase-the-final-value-by-50-or-more/
- http://www.exits-blog.com/selling-a-business-inefficient-markets-and-business-valuation/
- http://www.exits-blog.com/illuminating-strategic-value-when-you-sell-a-business/
- http://www.exits-blog.com/company-sales-need-multiple-bidders-to-maximize-business-valuation/
- http://www.exits-blog.com/great-ma-advisors-sell-companies-for-more/

Your Exit - Summary

- Selling a business is probably the biggest financial transaction of your career
- It's exciting – and will certainly change your life
- If you are thinking about selling now, your timing is excellent
- I look forward to your questions
- Today, or anytime in the future.
- Thank you.

Resources

- www.Exits.com/Blog – blog on exits
- www.AngelBlog.net – blog for entrepreneurs and angel investors
- www.Early-Exits.com – book on exit strategies for entrepreneurs and Angel investors
- www.BasilPeters.com – for this PowerPoint and videos of previous talks