How Much Will Your Company Sell For? – Understanding the Valuation Process

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Most Owners Sell Below Market

- My most valuable point this morning is that
- About half of the people who sell their companies get less than the fair market value
- I've seen companies sold for tens of millions less that the price they should have received
- And many times the sellers don't even realize they left millions of dollars on the table

Our Experiences Mislead Us

- How can that happen so often?
- Selling your company is surprisingly different from other large value sales
- Most of us are familiar with selling cars and houses
- When you sell a house, <u>how</u> you sell it doesn't have a very big impact on the price you receive

Efficient and Inefficient Markets

- The reason that <u>how</u> you sell your house doesn't have a very big impact on the price is
- Because the real estate market is "efficient"
- Economists describe many aspects of efficient markets but in simple terms, efficient markets:
  1. Are transparent with readily available data
  2. Have many similar 'products' for sale
  3. Have very large numbers of buyers
- The M&A market is extremely inefficient

Selling in an Inefficient Market

- When you're selling your business
- In the very inefficient M&A market
- The price you'll receive depends on dozens of factors that aren't even a consideration in efficient markets
- The difference to your shareholders could easily be 50%
- Think about how much money that is and how hard it was to earn it

Factors Affecting Your Price

- The three most important factors that determine the price you'll receive for your business are the:
  1. Fundamentals of your business
  2. Current M&A market
  3. Quality of your exit team

Valuation – Art and Science

- I have a whole shelf full of books on valuation
- But in 95% of exit transactions, I never need those books
- Valuation is based primarily on:
  1. Financial fundamentals
  2. Industry comparables
- It's not an exact science
- Requires current knowledge in the vertical to be accurate

Valuation from Fundamentals

- Most valuation methods are based on discounted future cash flow (profit or EBITDA)
- And factors in that a dollar you might get in the future is worth less than a dollar in hand today
- 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 all of the 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

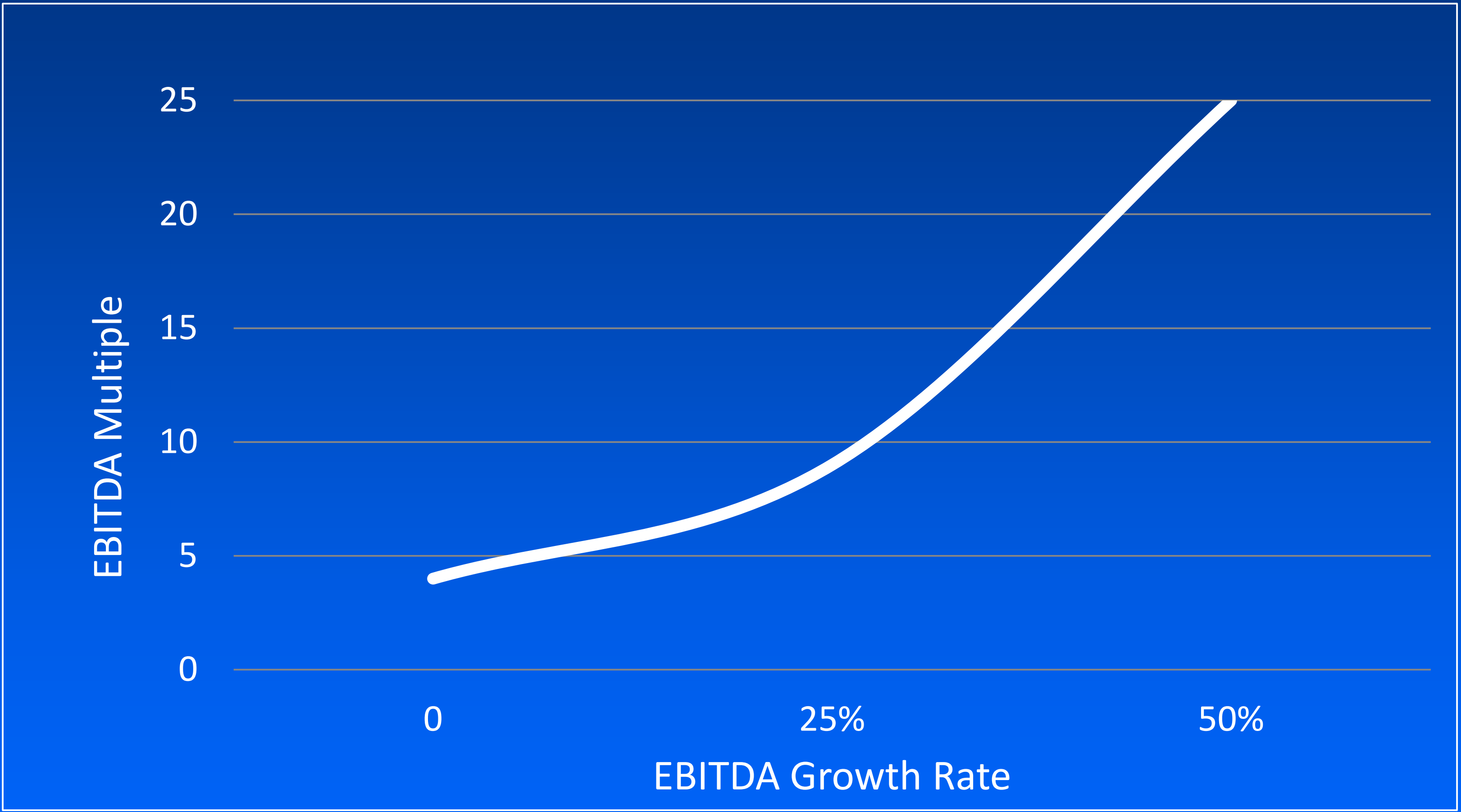
25% Growth	Profit in the year	Present value of this year's profit
End of this year	$1,000,000	$820,000
End of next year	$1,250,000	$840,500
Three years from now	$1,562,500	$861,513
Four years from now	$1,953,125	$883,050
Five years from now	$2,441,406	$905,127
Six years from now	$3,051,758	$927,755
Seven 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

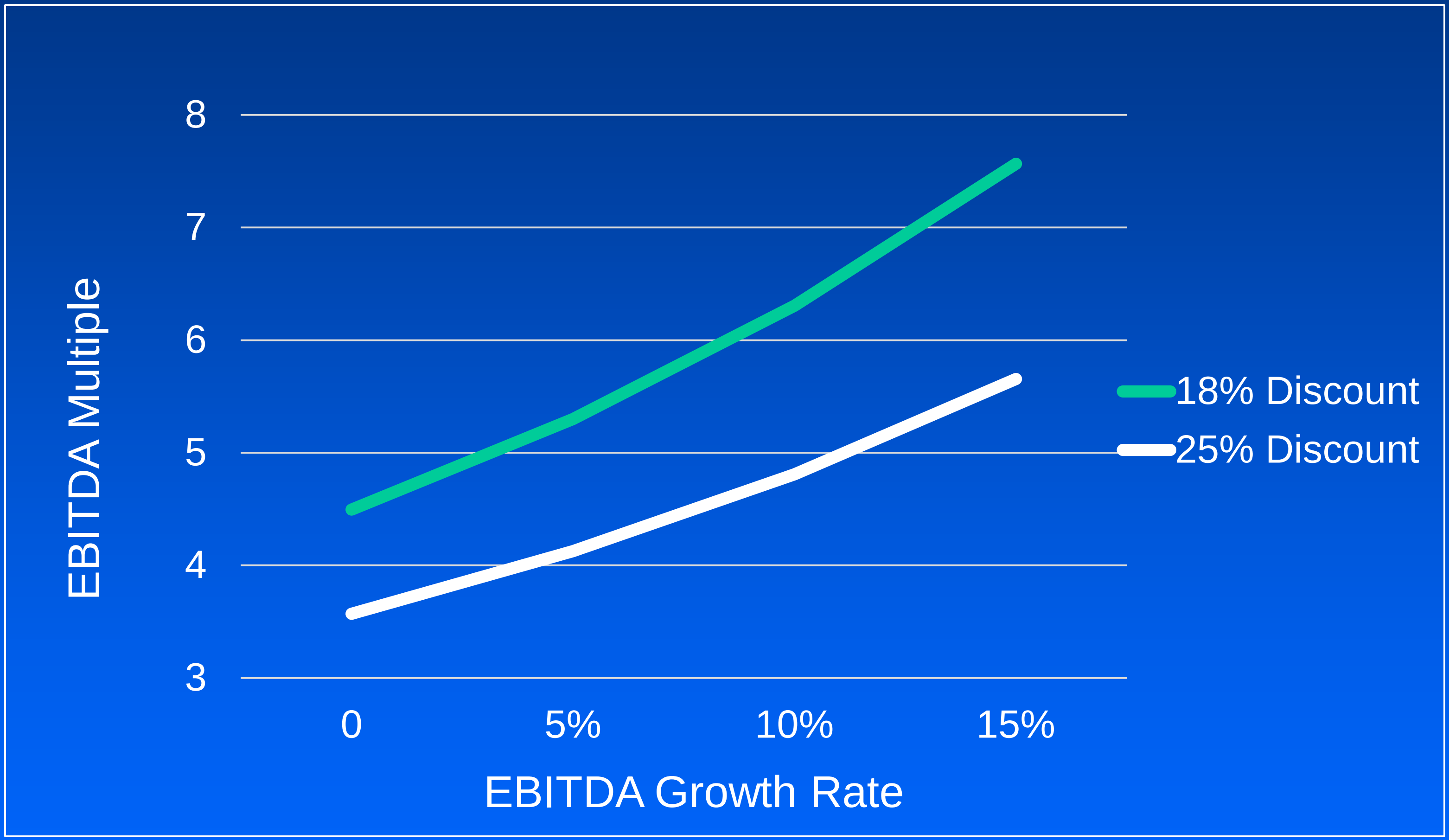
- The $1 million profit, zero growth company was worth about $ 4 million
- The $1 million profit, 25% growth company was worth about $9 million – 2x more
- The public market rule of thumb is the P/E ratio should approximately equal the growth rate
- In other words a 10% growth company has a P/E ratio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

Valuation Principles - Growth



Valuation depends on the growth rate

Valuation and Perception of Risk



Valuation also depends on the perception of risk

Risk = Profit Predictability

- Predictability is a very significant factor in every valuation
- If the buyer is almost certain the future earnings will actually occur, the risk is low and the discount factor is correspondingly low
- But it's never easy to predict the future – especially these days
- So the buyers will discount the price to factor in their <u>perception</u> of profit predictability (risk)

Other Fundamental Factors

- There are many other factors that can affect the final valuation
- For example, customer concentration
- Industry trends and cyclicality
- Regulatory environment
- Most of these are just other inputs to the final determination of growth and profit predictability

Assets or Shares

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

The Market Matters a Lot

- 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 – for example the S&P or NASDAQ indexes
- Private transaction valuations are even more volatile
- Both up and down

This M&A Market is White Hot

- This is certainly the best M&A market we've seen for at least the past 15 years
- Valuations are very favorable to sellers
- Transactions can complete in just 3 – 4 months
- Transactions are happening every day that I would not have thought possible five years ago
- I think most company shareholders should be at least thinking about whether this might be an opportune time to exit

The Buyer's Job

- Almost all of the buyers I've worked with are very nice people
- They're also very smart
- And experienced – some have bought dozens of companies
- The important fact to remember is that
- Their job is to buy your company for the <u>smallest amount possible</u>

Your Exit Team

- To get a good price for your business you need an exit team at least as skilled as the buyers
- The team includes:
  - The CEO
  - Your M&A advisor
  - Your M&A lawyer
  - An external accounting firm
- The M&A advisor is the “quarterback”

Maximizing Exit Value

- For most companies there are many ways to maximize the selling price
- A full discussion of the strategies and tactics could easily be a week long workshop
- Here are some highlights

Maximizing Exit Value

Some of the generally applicable ways to maximize the final selling price include:

1. Increasing the growth rate
2. Structural value increases
3. Capitalizing on inefficient markets
4. Illuminating strategic value
5. Maintaining multiple bidders
6. Sales and negotiating skill

Increasing Growth Takes Time

- This is “Exit Planning” or “Growth Consulting”
- Many companies ready to sell aren’t operating at their maximum growth rates
- Our firm has succeeded in increasing the growth rate in about half of our transactions
- The challenge is that this takes time
- At least several quarters of actual results are required to be convincing to buyers

Structural Value Increase

- Tweaks in the corporate or deal structure can increase the selling price by 10 to 25%
- Sometimes called “Financial Engineering”
  - These can be balance sheet changes
  - Asset vs. share sales
  - Financing mechanisms or deal structures
  - Tax innovations
- Many possibilities and can add $ millions

Capitalizing on Inefficient Markets

- Markets for selling a business, especially for under $100 million, are very "inefficient":
  - Information is difficult to access – no transparency
  - There are a small number of buyers
  - Very few for sale (like your company)
- All of which can be <u>big advantages for sellers</u>
- Monetizing these inefficiencies takes a great deal of skill and experience

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

Benefits of Multiple Bidders

- Closing on an unsolicited offer (i.e. a single bidder) 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 <u>increase the final price by 50% or more</u>

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
- 80 to 90% of the time, everyone signs an NDA
- So the stories very rarely get told

Resources on Maximizing Value

- http://www.exits.com/blog/selling-a-business-for-50pct-more-case-studies/
- 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/

Want To Know Your Value?

- Would you like to know the value you could receive for your business in this market?
- If you want to run the numbers on your fundamentals, here's the math you need:
- http://www.exits.com/blog/business-valuation-what-will-your-company-sell-for/
- I'm also pleased to provide a free valuation estimate here or later by phone or in a meeting

Opportunity to Learn More

- If you'd like to learn more about selling your company for a higher price,
- Day 2 of the Business Transitions Forum starts tomorrow at 8:00 AM with
- A 2 hour workshop I'm presenting:
- "How to Finish Big – Tactics to Maximize Your Selling Price"
- There's still time to register

Thank you and Contact Info

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Thank you.