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

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Basil Peters
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 than 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, how you sell it doesn’t have a very big impact on the price you receive
Efficient and Inefficient Markets

• The reason that how 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:

  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

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

In this zero growth example the value is about 4x the current year profit (EBITDA)
### Valuation Principles - 25% Growth

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

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

EBITDA Multiple

EBITDA Growth Rate

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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 perception 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 smallest amount possible
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 big advantages for sellers

• 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

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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 increase the final price by 50% or 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
• 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.com/blog/selling-a-business-for-50pct-more-case-studies/)
- [http://www.exits-blog.com/great-ma-advisors-sell-companies-for-more/](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:
  - 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

My contact information:

Basil Peters
Strategic Exits Corp.
Basil@Exits.com
1.855.55.EXITS (1.855.553.9487)

Thank you.