For sale

How to know you're ready for the market **Interviewed by Dale W. Hlaves**

You think it may be time to put your business up for sale and retire. But how do you know if the time is right? Is your business in good enough shape to be attractive on the market? Is it turning a profit and are all of your books in order?

"You need to understand how businesses are valued in today's business environment," says Vince Garozzo, an officer in the corporate practice group and a member of the board of directors at Greensfelder, Hemker & Gale, P.C. "All businesses are valued based upon the quality of cash flow they generate."

Smart Business spoke to Garozzo about what should be done to make sure a business is ready to be listed on the market.

Vince Garozzo
Officer
Greensfelder, Hemker & Gale, P.C.

How do business owners know their businesses are ready to be put on the market?

Business owners need to focus on improving and enhancing the sustainability of their cash flow. One way to do that is by generating more revenue, but another way is to manage the expenses and the growth of the company.

Most companies are valued and sold based upon a multiple of their cash flows. In today's environment, such multiples could be anywhere from five to seven times, depending upon the nature of the business. Sometimes, with a sophisticated technology company with a lot of potential growth, you could be talking about a multiple as high as 10 to 12 times cash flow. In particular, publicly traded buyers look for middle-market companies that are closely held and the founder (or next generation) is examining diversification alternatives. As their stock may be trading at 15 to 20 times earnings, it makes economic sense for them to buy a company on a valuation equal to five to seven times cash flow, drop it onto their own bottom line and watch the accretion to their stock price.

How does the market look right now?

In today's environment and due largely to the subprime meltdown over the summer, most of the active purchasers today are strategic buyers looking to make complementary acquisitions within their industry. These strategic buyers could be publicly traded or closely held, and may, in fact, be portfolio companies of existing private equity groups. Nonetheless, credit is much more difficult to attract under current market conditions, and leverage ratios are being ratcheted down, which has caused a decrease in the multiple of cash flow that a buyer is willing to pay. Consequently, it is currently a buyer's market.

So what can business owners do?

Basically, they need to analyze the quality and sustainability of cash flow and eliminate all unnecessary and related party expenses that a buyer would not otherwise incur on a post-sale basis. For example, many closely held business owners pay themselves a significant salary and bonus. A strategic buyer may very well eliminate the owner's compensation and replace him or her with a manager earning a substantially lesser amount. You may be better off to show earnings at an arm's length management-level employee as opposed to showing an owner pulling out $500,000 a year as compensation. Especially if the company is a S Corporation or a LLC, where the earnings all flow to the owner anyway.

It's also important to have a sustainable cash flow that is diversified. A buyer would rather buy a company that has 20 different customers that each make up 5 percent of total revenue as opposed to three customers that make up 33 percent each of total revenue.

Do business owners need to make repairs before a sale like a residential owner would?

There are many ways to make your company more appealing. One is to get your financial statements audited by an independent accounting firm. All buyers like to see audited financial statements of the companies they are reviewing. If you are reviewing a company generating $5 to $10 million in revenue, an audit might be too expensive. A company generating revenue in excess of $10 million generally should have its financial statements audited in order to provide more credibility to its financial statements and its earnings.

You also need to self-audit all of your contracts, licenses and intellectual property. You analyze and catalog what you have and make sure that it's in a written format. If possible, it is always ideal to avoid change of control provisions in contracts, so if you sell the stock of the company, you don't have to get the consent of the customer to close the transaction. Further, intellectual property is important because it provides another opportunity for the buyer to identify a continuing and sustainable earnings stream, and with the brand that is being purchased. <<

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Buying or selling a business is enough of a risk. Getting the deal done right should not be.

It is one of the biggest steps you'll ever take. You need the reassurance that every detail surrounding your financial investment is secure, and know someone is focused on your goals to ensure a smooth transition and completion of the deal. Our attorneys know the ins and outs of mergers and acquisitions, so you can cross that bridge with confidence. It makes a difference. Your bottom line will show it.

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