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Wealth Planning Update

What drives company value?

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Key takeaways:

- Proactive presale planning before taking your company to market can help maximize value in a sale.
- "Think like a buyer" to increase the attractiveness of your company and improve business valuation multiples. Business value can be impacted by many internal and external factors.

What this may mean for you:

- Whether you plan to sell in the next 12 months or 12 years, these value-driving steps can have a dramatic impact on the value of your business.

You've concluded that it's the right time to sell your business. That decision may have been driven by business conditions, current market valuations, family obligations, or it just may be the right time for you. To help maximize the result of your hard work in building and growing your business, take a step back before going to market and take a critical look at the enterprise to make sure it is showing its best.

Presale planning can help maximize value

Prior to committing to a sales process, in order to ensure the best outcome, take the time to assess your company's attractiveness and readiness to go to market. While there are many ways to value a company, the most commonly used equation is straightforward…cash flow (EBITDA — earnings before interest, taxes, depreciation, and amortization — is the common shorthand) times a multiple equals sale price. There are opportunities to improve both EBITDA and the multiple ahead of a sale. The leverage in these improvements can be significant. For example, an improvement of $1,000,000 in EBITDA at a 5x multiple is $5,000,000. That same improvement at a 6x multiple is $6,000,000. Let's take a look at opportunities to drive value ahead of going to market.

EBITDA improvement

Cash flow is the lifeblood of any business, and it is on that stream of future cash flows that a buyer is basing their investment decision. So where can we look for areas to improve EBITDA?

- Understand how and where your company makes its money. Shift investment from low-margin contributors to high-margin ones. A strategic planning process can be helpful in mapping out these shifts and refocusing company energy and capital.
- Over time, spending can acquire a certain inertia and start to creep up. Implement a zero-based budget for a fresh start. And, if your company does not already, build an annual budget and hold the team accountable for results.
- Align employee compensation with performance-based results. Reward employees for the same results that will increase the value of the company in a sale. This may seem obvious, but many bonus plans are outdated and reward behaviors that, while once important to the company, no longer contribute in the same way to the bottom line.
- A note about COVID-19: All companies were affected by the COVID-19 disruption, some negatively, some positively. Understand and quantify the financial effects of COVID-19. Performance for the affected period may be normalized by buyers as they analyze your company's cash flow. And remember, these adjustments could cut both ways.

"Think like a buyer" to improve multiples

Buyers value stability, predictability, and opportunities for growth. Buyers devalue risk. Take off your owner's hat for a moment and look at your company objectively, as a buyer would. What are the key areas in your company that provide these attributes, and what are the areas that can be improved?

Financial track record

Positive indicators: revenue growth, stable or increasing margins, consistency of performance.

Opportunities:

- Improve EBITDA — see above
- Tighten up working capital requirements
- Limit discretionary owner expenditures

Systems and operations

Positive indicators: systems are up to date and meet industry standards, operational procedures are in place and well documented.

Opportunities:

- Upgrade or implement new systems so they are tested and up and running well ahead of going to market
- Develop and document standard operating procedures
- Consider outsourcing functions that aren't core to the business

Performance relative to peers

Positive indicators: market share, product or service differentiation, scale

Opportunities:

- Sharpen your marketing message
- Become more visible within your industry
- Consider an acquisition to build scale or fill holes in your product portfolio

Diversification

Positive indicators: diversity among customers, suppliers, and products

Opportunities:

- Diversify your customer base — no one customer should provide more than 25% to 30% of revenue
- Add suppliers to create redundancy in the supply chain
- Expand your product portfolio to reduce dependence on any one product

Strength of management team

Positive indicators: an experienced team with a proven track record

Opportunities:

- Fill in any functional gaps on the team
- Create a decision-making process that gives the team some autonomy and doesn't require all decisions to be made at the ownership level
- Consider implementing a liquidity bonus plan to drive performance — any plan should include a retention feature to keep key employees in place for new owners

Another note about COVID-19: Companies that outperformed their peers could command a premium. Strong management teams shine under tough circumstances.

Whether you are ready to go to market today or not for a couple of years, take the time to understand how buyers would view your company. It is a great way to improve current performance and increase the likelihood of a successful sale process. Even if you have no plans to go to market, these value drivers can make your company healthier, more profitable, and more valuable if and when you do decide to sell. Please reach out to your Wells Fargo relationship manager to learn more about ways to drive value in your business today.

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