Northern Edge

Business Owner Insights

The 8 Keys to Getting the Best Price

A business owner's guide to selling businesses in the middle market

Introduction

There is a great deal of information and instruction on the subject of selling companies. Unfortunately, much of it is not actually based on real deal-making experience. This makes it very difficult for business owners to decide how to go about the most important sale that they are ever likely to face, or understand how to achieve maximum value.

At Northern Edge, our core belief is that selling a company is fundamentally a sales and marketing matter, which requires a very active effort.

The 8 essential principles discussed in this book spring from that belief, and are not just theory. They have been proven time and again with companies of all shapes and sizes, over our extensive history selling companies.

Why Sell?

Business owners are motivated to sell for a variety of reasons. Understanding your motives and objective is crucial because the shape and structure of your deal should be designed accordingly.

Typically, owners choose to sell for one or more of the following reasons:

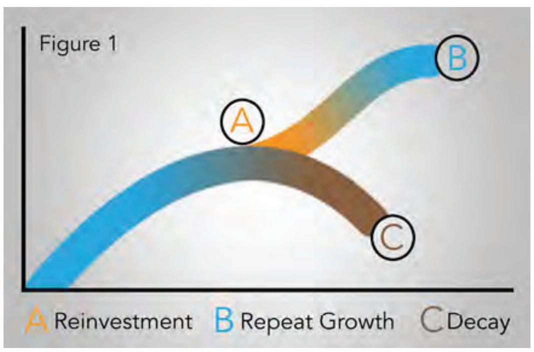
Change in Lifestyle
After many years in the business they have reached a point where they desire to do something different with their life. It is normal for people to radically alter their goals in life every decade, so don't be surprised if your objectives are changing too.

Entrepreneurs vs. Managers
Owners of private businesses are often entrepreneurs, who by nature are creative, full of ideas and energetic. For many, starting a business was the most natural thing in the world. However, as the business has developed, they have found themselves increasingly stifled by managerial responsibilities, such as employment legislation, personnel issues, health and safety matters, etc. They feel that the fun has gone from the business and consider a company sale as the logical and sensible way to exit and start a new chapter in life.

Time
It is not unusual for owners to sell their business due to the huge demands on their time, which leaves little to enjoy other activities.

The business simply becomes all-consuming, damaging their personal life.

Business Lifecycle
There comes a time when a sale is appropriate for both shareholders and the company. Many companies grow quickly in their early years (see Fig 1). In due course sales can start to plateau (A). It is often disproportionately difficult and expensive to break out of this plateau. A significant investment is usually required to hire key sales personnel, for new product development, or to implement a technology upgrade. If this investment is made, then the growth cycle could repeat itself (B). Without investment the company has a tendency to decline (C).

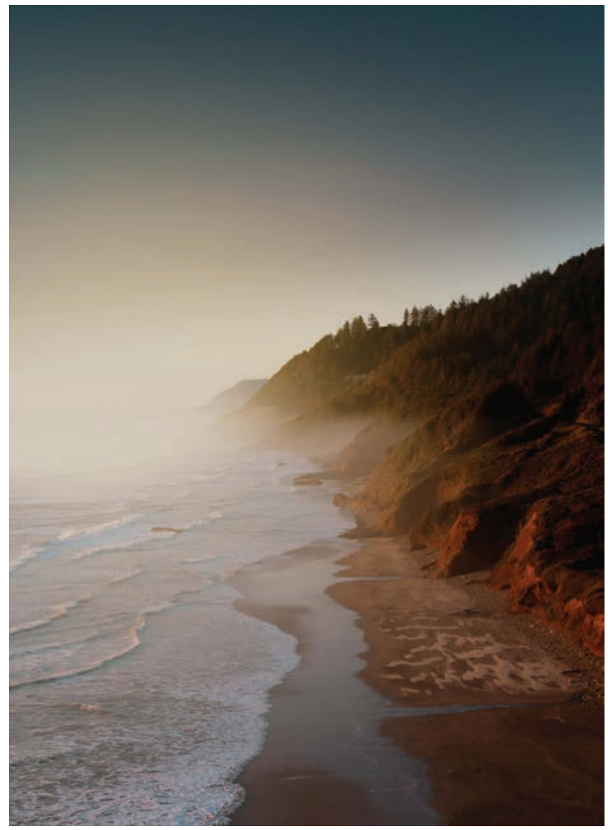


Why Sell?

For many owners it now becomes a matter of inclination – "Ten years ago we would have invested unhesitatingly, but today it is not appropriate."

For years they invested in the business, with the expectation that they would be able to begin taking money out in the future. The thought of postponing the payoff or borrowing heavily in order to begin re-investing in the company is not an option that the business owner is still willing to consider.

At this point both the company and shareholders usually benefit from a sale. The new owner will almost certainly be a larger company with resources available to grow the business by leveraging its capital, know-how, clients and channels of distribution.



The Essentials
to Getting the Best Price

1. REMEMBER, THIS IS A SELLING ISSUE

One of the greatest obstacles to selling a private company is passivity. Somehow it feels like a financial or even legal issue; many sellers then ask their accountants or lawyers to advise them. Not being organized to run and generally not possessing the skill set to manage a comprehensive process, the accountants or lawyers then communicate with a handful of buyers, nearly all of which are competitors.

Sending a few letters and several dozen emails is completely inadequate, and competitors only represent a part — and often not the best part — of the complete set of potential buyers.

Most company owners would never ask their professional advisors such as their accountants to sell their products and services for them, and yet this is often what is essentially being done with their greatest asset.

Selling a business is a selling issue and not an accounting issue. The principles that you apply every day to selling your products and services are the same principles that you will use when selling your company.

It is also interesting to note that the best buyers are often not looking to buy. They are usually successful and profitable, but an acquisition is very often not on the current agenda. This means that you have to go and find them — they won't come looking for you.

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2. BEWARE OF TRADITIONAL VALUATION METHODS

This section may sound a bit contradictory but bear with me. Almost every traditional valuation method boils down to short term return on investment. For example, if you value a company based on a multiple of its past profits, the multiple that you use determines how quickly you get your money back. The most commonly applied method for private companies is to assess the last three years average profits and look to achieve a return within 4-5 years.

At first glance this seems reasonable, however at Northern Edge, our contention is that it relates purely to past performance and assumes (very wrongly) that there is no value in future potential. We are convinced that the traditional thinking is wrong on this matter. Let me explain what we at Northern Edge have come to call our “2x rule”.

On average, at Northern Edge, we identify and talk to 150-250 potential buyers just to sell one company. It takes us some 4-5 months to qualify this list down to 5-10 serious candidates. At this advanced stage of negotiation (not before) we invite the candidates to put in a competitive offer using our very effective bidding process. Generally, we secure between 4 and 6 bids. The lowest bid is usually close to a traditional accounting valuation. The highest bid is frequently two times greater than the lowest.

Let me explain:

We sold a company specializing in hardness testing equipment. The company’s accountant had valued the business at $8.5 million and the lowest offer was precisely that. The company eventually sold for $19.2 million.

Then we sold a lighting manufacturer. The lowest offer was $16.5 million which was slightly above the industry average multiple. We finally sold that business for $58 million.

We could give you hundreds upon hundreds of examples... But more importantly, why is one company prepared to pay so much more than another?

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The answer has to do with:

— Establishing a competitive bidding environment

— Selling future opportunity

— The motivations a buyer has for purchasing a particular company

If somebody tells you that they can “value” your business, they can’t. Value is not about a multiple of past profits – it is instead about the motives of the purchasers. It is about what the business will look like under new ownership, not what it looks like under your ownership.

All of this means that you should NEVER take a company to market with a value attached. It is a grave mistake and one of the most expensive errors that occur in our industry.

3. SELL THE FUTURE

Nobody ever buys a company’s past, only its future.

What will your business look like once the buyer has applied their financial resources, sales skills and efficiencies? What will your business look like when they have opened it up to new markets and brought new customers to bear on your products and services?

The best buyer is likely to be complementary in nature. They can promote your products and services to their clients, and begin to sell their products and services to your clients.

When you are able to quantify these synergies, they become leverage points in negotiations, and in many instances form the basis for a separate Synergy Business Analysis. This analysis looks carefully at what the business would look like under new ownership.

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The aim of this analysis is to answer the following questions:

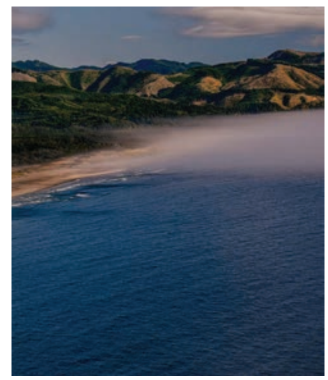
What would the business look like when the new owner brings their clients to your products or services?

— What would the business look like with fresh investment?

— What would the business look like with fresh energy, ideas and enthusiasm?

— What would the business look like with synergies and cost savings?

When you sell a company you should never sell what a company looked like last year under your ownership. You should absolutely never sell what a company will look like next year under your ownership. Neither should you sell what a company will look like in three years under your ownership.



4. CHOICE IS KING

The single most important issue when selling a company is to have a choice of buyers. Nothing else comes close.

Of all the factors that will influence price upwardly, the greatest is a competitive bidding environment. This is not only true of increasing price but, just as important, of maintaining price. If the buyer knows you can walk away, they are less likely to negotiate reductions in the agreed price — known as “price chipping.”

Of course this is true in any negotiation, and yet establishing competition remains the most compromised element of most traditional sales.

Having a choice also increases the speed of a deal, and your control over its terms.

It is fair to say that whoever establishes choice has the greatest control over the negotiation.

Without choice it may not be you.

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5. LOOK BEYOND THE OBVIOUS

If you restrict your search for a buyer to the "obvious candidates," then you will pay a heavy price. It is critical to look beyond competitors, and find potential acquirers outside your sector. Some of the best buyers are a surprise to the seller.

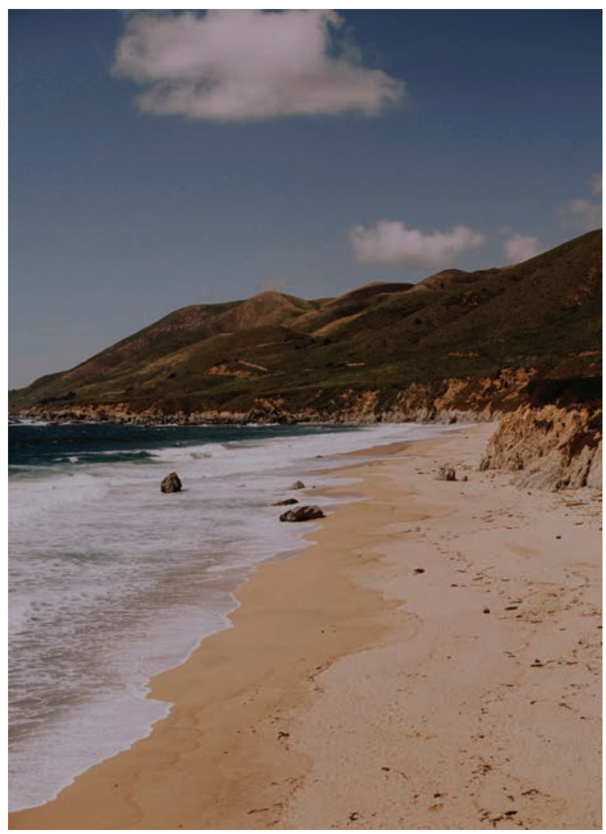
Your buyer is more likely to be complementary in nature than competitive. Their products and services are more likely to fit alongside yours than compete with yours. The critical issue is not that you sell common products and services but that you have common customers. Most of our deals are of this nature.

6. ALWAYS LOOK INTERNATIONALLY FOR A BUYER

It doesn't matter how large or small your company is, to fail to look overseas is another common and serious error.

An overseas buyer will often pay a premium price to secure a foothold in a new market, because the purchase of an overseas business can require less investment and be executed significantly more quickly than building from the ground up.

Even if you end up selling to a local company (which is reasonably likely) the fact that they are competing with international bidders could have a profound impact on the bidding process.



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7. BE PREPARED FOR THE COMING NEGOTIATIONS

Deals are built or broken during negotiation.

Asking the right questions, understanding deadlock, pre-handling objections, thinking on your feet, maintaining control, dictating terms and avoiding pitfalls are all vital elements necessary to ensure a good deal. Not only are some otherwise knowledgeable advisors poor negotiators, but often company owners make matters worse.

One of the best investments you could make is to undertake negotiation training at an early stage of the process. At Northern Edge, we take all of our clients through a Dry Run negotiation training meeting.

Although we handle all the negotiations for our clients, there will still be times when our clients will sit down and discuss the sale of their business directly with us and potential acquirers.

The Dry Run negotiation provides training in the following areas:

— Not conceding too early

— Being professional and credible

— Thinking benefits

— Establishing confidence in what we have to sell

— Never conceding but trading ("Win - Win")

— Planning the negotiation

— When to call deadlock

— Working as a team

— Developing trust

— Listening

— Preparing alternatives.

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8. FOLLOW A PROCESS

Preparation puts you in control of negotiations, and avoids the delays and surprises that kill a deal. For those reasons, you should define and follow a comprehensive process from the beginning. Our process for selling a company has the following stages:

A. Preparation

Gathering all of the information required to undertake the project, consisting of:

— A total review of your own company
— Establishing all the benefits you have to offer
— Thorough financial preparation
— Considering future opportunities
— SWOT analysis
— Market analysis
— Assessing the nature of possible buyers
— And more

Production of all documentation, including a Confidential Information Memorandum, forward-looking business plan, management presentations, financials (past and projected), and more.

Preparation for the upcoming face-to-face meetings with potential buyers.

B. Buyer Research

Exhaustive research to identify potential buyers both domestic and abroad, inside and outside of your sector.

C. Live to Market

A prospect generation effort of hundreds of phone calls, presenting the opportunity to senior business owners in a completely confidential manner.

Careful assessment and analysis of the feedback we receive from potential buyers.

D. Deal Making

First in-person meetings with potential buyers, to provide additional detail on your business, discuss the potential combination benefits, and directly assess the quality and fit of each potential buyer.

Manage the bidding process in a way that leverages choice and maximizes price.

Work with an experienced transactional attorney to manage the due diligence and legal matters. During this stage you must continue to maintain choice as it has a profound impact on the speed of the deal and, therefore, the likelihood of completion.

Discuss your business, its potential suitability for a sale transaction and the options available to you at an individual consultation with a senior Northern Edge investment banker.

You'll be able to discuss your position in complete confidence, and meetings can be arranged at a time and location convenient to you.

To schedule, visit www.northernedgeadvisors.com or call 877.592.EDGE.

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