THE EXPERTS

EXIT STRATEGIES

Most exit plans involve selling the business

It has been my experience in 45 years of working with businesses and being a business owner myself that owners have not carefully thought through what will happen at the end of their working life and how they will exit their business.

Reasons for exiting your business vary but they all require much forethought and planning to decide the best path to take. It is also important to establish an "exit strategy" now to enable dealing with unexpected and stressful situations such as poor health, divorce or death. The goal of any exit approach is to maximize the value of the business. Here are three options to consider.

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- **The successor plan.** This is a good path for exiting if your business is stable and financially strong. Seeking a strong replacement candidate, whether family member or otherwise, to groom and train to successfully manage the business in your place may be a daunting task. This plan needs to be implemented in a timely manner to identify the successor and meet the retirement goals of the owner.

The reason to use this approach is to perpetuate the enterprise for future income and potentially improve the value of the business for a later sale. Keep in mind that this may be the riskiest approach if the successor fails to successfully operate the business. Then you need to step back into the business.

If you choose this option, maintain a tight rein on the financials and stay in contact with customers.

- **Closing your business.** It is relatively easy to close a business and sell the equipment and inventory. There is synergy in selling the assets collectively instead of treating them separately. The whole is often worth more than the sum of the parts. That doesn't mean it is the right exit strategy.

My advice to clients is "never close a successful business." Your company has been nurtured, molded, modified and developed by you into a valuable asset. The "goodwill" or reputation that you have created in your company has value. Many business owners overlook goodwill as an asset and discount this accumulated wealth.

- **Selling your business.** Many small business owners do not have an exit plan even though their ultimate end goal is to sell the business or in case of an unexpected situation that forces an unplanned sale. Selling your business requires pre-planning and having the foresight to operate the business to its maximum value. This necessitates having strong historical and current financial statements.

Your company should show a consistent history of positive sales and cash flow growth and clear reporting of expenses. Most importantly, the expenses should closely correlate to its industry standards.

No new business owner wants to incur the expense of relocating the business. Buyers will want a fair and long-term lease in place so you may need to assist the buyers with the lease or work with a business broker who is mediating the transaction on behalf of the buyers.

If the owner of the business is also the owner of the real estate, there are several questions to consider: Will the owner sell the property with the business? Can the new business owners afford the property owner's asking price? Will the cash flow of the business support the mortgage or the rent of the real estate and still pay for the purchase of the business too?

In this case, if the seller finances a portion of the business sale, he can be more flexible with his payback than a bank would be on the real estate loan. If the business cannot afford to pay both payments, the buyers will have to lease the property from the seller at some negotiated fair rental rate and term.

With the exception of closing the business, all the exit strategies ultimately involve selling the business. The sale of a successful business requires that many components come together to paint a picture of value and a clear path for the potential buyer to feel confident in the future success of the business.

Buyers want to project themselves into the business and see themselves supporting their family in the same manner as the seller has throughout the years.

Build confidence by showing buyers good historical financial statements. If the business does not own the real estate, you want to be in good standing with the property owner and show buyers a strong lease with a fair rent and renewal options. Real estate is important because it adds value since banks typically will only lend on hard assets to buy a business. Today, many banks are not lending on cash flow. While owning the real estate is not necessary, a good lease with fair terms and options in place will also support and add value to the asking price.

Value is a subjective number; however, what is extremely important is how your business is financially performing. The buyers will carefully examine the financial statements. Each industry has its own set of standards, or theoretical costs, which are used to evaluate management results. Experienced buyers and business brokers know these standards. They can be used to value your business or to "recast" the financial performance of the business in order to establish an optimal asking price.

Recasting financials shows the potential cash flow of your business using the theoretical costs against the actual costs on the financial statements to demonstrate the potential income to the new owner if the business was operating in accordance with the industry standards. This process is primarily used when financials show negative profit. Often I will recast financials to show sellers where the money is hidden and how to properly show these on their financial statements.

This process along with adding back expenses is often used to show maximum potential cash flow even if a business is performing profitably.

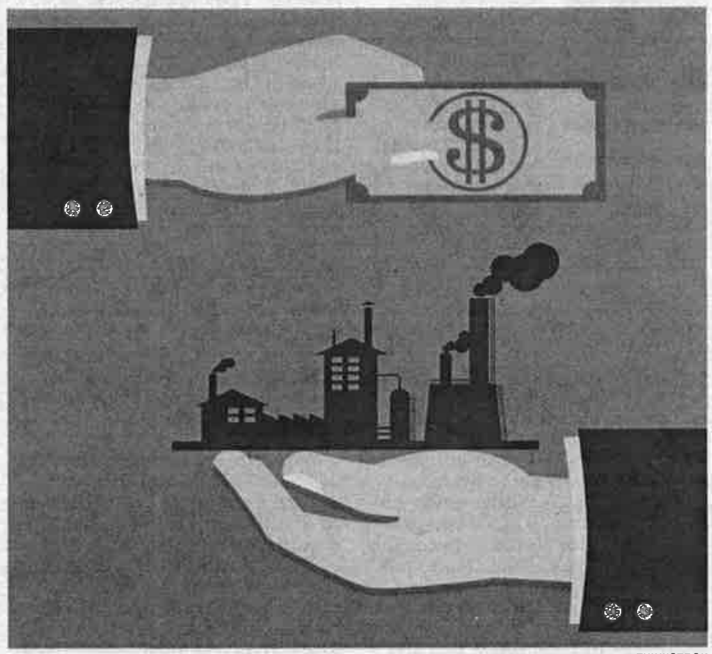
Business financials will frequently include extraordinarily high salaries for a spouse and children that are not active in the business. Business owners will include fees and expenses for hobbies such as boats, golf memberships and personal travel.

While recasting financials provides the buyers with a much clearer picture of the value and opportunity, it does not mean that the buyers will be willing to pay for that potential, as the real business value to them is what they see on financials. To the seller, that means having the foresight to pay more attention to the controllable costs of the business and could even mean modifying their accounting practices.

Small businesses operate to maximize their cash flow and pay less in taxes. This is a short-sighted approach as it often means using all tax-loop holes by charging the business's non-essential expenses.

Understand that buyers only believe and buy what they see on the tax returns.

A third-party evaluation and recasting cash flow of your business to establish the fair and reasonable asking price for the business is always a prudent decision before going on the market. Don't be a dreamer. Be realistic. Today, even lenders are looking for a cash flow analysis and professional valuations of the businesses they are considering financing.



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Once a complete financial analysis has been made, a business can be placed on the market to be sold confidentially. A business that can show it is providing a good income will sell quickly and bring maximum dollars to the seller.

Have an exit plan in place, educate yourself early, know how to gain the most value for your business, review financial information and make changes in your systems and procedures to maximize the value. Taking these steps will help you sell the most valuable asset in your portfolio – your business.

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