Making a worthwhile exit

We consider the factors which potentially **double the value** of your company

UK Plc peered out from the bunker where it had been hiding during the recession and sensed the sweet smell of recovery in the air. True, the GDP figures for the first half of 2011 suggest that the economy as a whole has been slow to move back into top gear, but the underlying trend is encouraging. One effect of this growing level of confidence has been to re-position corporate attitudes and culture. Board rooms across the country have been buzzing throughout 2011 with talk about mergers and acquisitions and disposals.

These were subjects distinctly absent from the corporate agenda – apart from the occasional fire sale – since the day that the banking sector drew down its shutters on lending at the start of the financial crisis.

Exit strategies are now being dusted down by shareholders seeking the right time to reorganise their business portfolios. Central to their thinking is that the value of the businesses involved needs to be maximised. But value is only a perception rather than a number carved in stone. Careful planning and a knowledge of the attributes desired by prospective purchasers can increase the desired valuation by up to 100%.

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own business attractive. This can mean that they have potential 'hidden' assets with real tangible value which never get recognised in the sale of the business."

That is the view of Darren Murphy, a director at Devonshire Corporate Finance Ltd, a specialist arm of the Kingston Smith Chartered Accountancy practice. He maintains that improved market confidence is seeing a steady rise in valuation multiples, with quality businesses once again in demand from buyers in the UK and overseas. "Companies that have been able to create a sustainable competitive edge are commanding premium prices compared to their peers."

Stressing competitive advantages

It is worth examining these competitive advantages which help establish this premium in the marketplace. They will necessarily relate to the individual enterprise, but Murphy identifies themes common across the corporate arena.

- Market leading status with a strong platform for future growth.
- Blue-chip customer-base.
- High levels of recurring revenues.
- Owned Intellectual Property with opportunities to exploit.
- Strong second-tier management team and loyal employee workforce.
- Internal infrastructure that can be scaled and leveraged.

Corporate textbooks may differ slightly on the most appropriate methodology for valuing a business but all appear to involve multiplying the value of historical and future cash flows by a number accepted for the sector in which the company is operating. The figure which results is the implied value.

Darren Murphy contends that this approach will usually undervalue quality businesses. "The traditional method does not factor in the value of sustainable competitive advantages such as management and staff, customers, internal processes and procedures and intellectual property."

Easy to ignore advantages

Left untouched, the argument runs, these sustainable competitive advantages will often be ignored in the sales process, leaving business owners uncompensated for their years of hard work in creating valuable goodwill assets.

The majority of companies can take action either to enhance the key business attributes which dictate premium prices or at least showcase them in the best possible light. "This grooming is an essential part of the sales process and a stage which often gets overlooked. It is inevitable that those companies will be offered for sale at less than their true worth.

"Every business has different attributes, at least some of which may be of interest to potential purchasers. The issue is that many company owners are focused on their internal operations and are therefore unaware of what would make their own particular business attractive to potential purchasers."

Businesses seriously undervalued

If Darren Murphy is right, it would mean that businesses are seriously under-valuing themselves by failing to realise these hidden but no less tangible assets. "We have completed in excess of 450 transactions and have therefore acted for many business owners who, with our guidance, have been able to highlight these aspects of their operations and significantly enhance the value of their company. Understanding what provides the greatest appeal to purchasers helps those owners to adjust their business model to meet that objective."

However attractive the prospect of releasing additional value might be, success is unlikely to be an instantaneous process. Experience at Devonshire Corporate Finance shows that the grooming should begin two to three years before the planned exit date. When companies have fundamental issues to address, such as the strengthening and incentivisation of secondary management teams, changes need time to take effect: they cannot be rushed.

Not every management is fortunate to be able to plan that far ahead. Some sales are inevitably driven by personal circumstances which dictate the timing of a sale.

According to Murphy, this is not necessarily a problem: given the appropriate guidance, owners can still ensure that their hidden assets are presented to potential purchasers in a way that improves the likelihood of securing a premium over a conventionally calculated price.

"Practical hands-on experience has shaped our belief that taking care to identify and exploit hidden assets is one of the five steps needed to maximise the business sales valuation."

Stimulus from tax changes

Improved economic prospects are not the only stimulus to the sale of businesses in the UK, however. Changes in government tax legislation has prompted a number of sales that might otherwise not have been attempted; certainly not in the short term.

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Measuring up prospective purchasers for your business

Factors which management should search for in selecting prospective purchasers include:

- Overseas companies requiring a growth platform in a new geographic area.
- Sellers of complementary products who could exploit cross-selling opportunities.
- Companies seeking an entry route into a new market.
- Customers and suppliers who may be looking for vertical integration opportunities.

The most common mistakes seen by Devonshire Corporate Finance, made by vendors during the sales process are:

- The sale has been triggered by an adversity which places control of negotiations with the purchaser. It is essential for Vendors to retain control of the negotiations in order to achieve the maximum possible valuation.
- No business plan has been prepared and no thought has been given to the true value that new purchasers could obtain from the business. This is a specialist exercise aimed at highlighting the real value of the business to potential purchasers, including hidden assets that cannot be seen in the financials.
- No use of experienced professional advisors. The sales process is both complex and time-consuming and the cost of doing it without that advice can be expensive in lost sale value. If vendors take their eye off the ball while selling, it can result in late price reductions and changes to the original agreed deal.
- No 'Plan B' in place, which limits the vendor's options and places control of the negotiations with the purchaser.
- No secondary management team in place, leading purchasers to believe that the business goodwill will leave with the vendor on exit.
- Wrong purchaser identified, resulting in a limit to the valuation achievable and/or post-completion problems.
- Wrong time for a sale, resulting in a limitation to the valuation achievable and often an unsuccessful process.
- Overseas buyers not approached, so that the market is more limited than it needs to be.
- All of these strategic flaws can have a direct impact on price: they are likely to result in additional warranties and indemnities having to be provided by the seller.

Simply approaching a small number of competitor businesses rarely generates the desired result because adding scale is not usually a motive which drives a premium purchase price. It is therefore essential that purchasers with strategic motives are identified and approached.

- Entrepreneur's relief has been increased to £10 million, resulting in active business owners paying only 10% tax on the first £10 million of capital gains. With tax rates currently in the political spotlight, this concession might only be available at this level in the short term.
- Bank Debt is once again available for funding well planned transactions, triggering interest in new acquisition opportunities.
- International buyers are active due to the weakness of the pound, making UK based businesses exceptional value for money. International buyers are often willing to pay an extra premium to obtain the infrastructure of a platform in a new market.

Professional experience

As Darren Murphy noted, grooming is integral to the process of maximising a business valuation on sale, but it is only one component of the process.

Having established a robust business platform to present to potential purchasers, owners are then faced with the arduous task of identifying a strategic buyer who will be willing to pay a premium for the benefits the business can provide.

These problems can be corrected or mitigated by bringing in experienced professionals before completion to shake up a bad deal. Murphy again: "We have many examples where premium prices were achieved after the vendors had signed up to poor deals before we became involved.

"Selling a business is a once in a lifetime transaction for most owners, and the recent market changes have created an opportunity for shareholders to achieve premium prices for their business. A combination of sustainable competitive advantages and the identification of a strategic purchaser really can double a business valuation. Grooming and purchaser research take the vendor a long way down that route."

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Real benefit from acquisition

Neither task might be within the experience of the board seeking a disposal. The received wisdom is that those involved in the sale should consider purchasers who could obtain a genuine and sustainable benefit from acquiring their business. "Purchasers should be able to deliver significant future growth using their own existing clients in conjunction with their service lines or products." §

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