

HOW TO SELL AND VALUE A BUSINESS

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SRJWW

Growing Business Growing People

- **About Shaun Reeves**

- Chartered Accountant
- Business Advisor
- Business Director 27 years SRJWW
- Accredited Mindshop Facilitator (AMSF)
- Parochial Moreton Bay Region Resident
- Family Man, Father of 5 and Grandfather of 2
- **shaun.reeves@srjww.com.au**



- Established Divest Merge Acquire (Supertrac) 1999
- Principal – DMA, MNA Direct and SBS
- Transaction advisory services for hundreds of businesses total value >\$1 billion
- BEc, CA
- Extensive experience in commerce and industry
- General management in multinational corp for more than a decade
- Organisations: PwC, Australian Cement, Deloitte, Visy Industries and Ipec Holdings/Federal Hotels

Conversation Agenda

- **Ways to exit your business**
- **Non-traditional “sale” options**
- **Sale process**
- **Other considerations**
- **Sale readiness**
- **Value drivers**
- **Pitfalls**
- **Who can help**

A photograph of four business professionals in a meeting, overlaid with a semi-transparent red filter. The individuals are engaged in discussion, with one man on the left holding a tablet and another on the right holding a cup. The background is a plain, light-colored wall.

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WAYS TO EXIT YOUR BUSINESS

What owners want

- Fair Value
- Business to continue – sell to those they think will succeed
- Loyalty to staff
- Secure long-term lease for freehold property
- Minimise tax leakage
- Capital Out



Transition to family members

- Can't afford to give business to children
- More owners expect children to take over than actually do
- Most children want to do their own thing
- Only 20% of businesses actually sold to family members



Management succession

- If not selling outright, retain control and income
- Owner out, appoints family member, partner or manager
- Owner retains ownership – ie leaves capital in
- Continue involvement without day-to-day responsibility

Management Options:

- Family member
- Key employee
- Outside manager



Why appoint manager

- Owner's labour out but retains ownership – leaves capital in
- Interim step, safeguards needed
- Stable manager - easier to sell
- Additional risk - depending on performance
- Value may increase or decrease, affecting price



Reality

- How owners how EXPECT TO EXIT vs how they ACTUALLY EXIT:
- Sell to a 3rd party ~~60%~~ 80%
- Family Succession ~~30%~~ 20%
- Sell to management/staff ~~10%~~ minimal



Part sale to equity partner

- Equity partner - lower risk when owner stays
- Owner 'pre-sells' for later retirement
- Owner retains interest in day-to-day and future success
- Incoming investor has added security of smooth handover and transfer of goodwill
- Both parties need later exit strategy. Eg sale to 3rd party or recruit manager before owner retires

Merge with similar business

- Create more competitive business than individually
- Creates larger organisation to support stronger management team than each separately
- Owner retires - achieves management succession
- Subsequent sale



Sell outright

- Most common exit strategy 80%+
- Simplest, cleanest exit
- After sale, owner has little or no further responsibility
- “The Big Transaction” - single most important business transaction for owner
- Plan early, best possible advice
- Clear understanding of after-tax proceeds
- Needs specialist tax advice



Sell outright - more

Sale Preparation:

- Make sure the business is 'sale ready'
- Business Valuation
- Information Memorandum professionally prepared
- Properly marketed
- Don't try to negotiate by yourself



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THE BUSINESS SALE PROCESS

Information Memorandum (IM)

Sale
Preparation

Engagement

Document
Preparation

Marketing

Negotiation

Terms
Agreed

Completion

- Principal marketing document
- Pivotal element to marketing a business
- Provide sufficient information for initial assessment
- Build confidence to proceed with the acquisition



Information Memorandum (IM)

Sale
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Informs about the business:

- History
- Activities
- Operational facilities
- Financial performance
- Future prospects
- Opportunities to further develop the business



Data collection and research

Sale
Preparation

Engagement

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- Data Collection Form
- Covers details needed to prepare the IM



Targeted buyer identification

Sale
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Completion

- Profile buyers who will place the highest value on the business
- Pre-identified Target Purchasers
- Readily identify and target strategic buyers
- Database - the primary source of buyers



Database specification

Sale
Preparation

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Completion

- Majority of Aus & NZ businesses with 10+ employees
- 190,000+ companies, individuals and contacts
- Corporate, private and international investors



Database specification

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- Categorized by Standard Industry Classification (SIC) codes
- Key data on each company and individual
- Accumulated history and investment aspirations
- Migrants - majority of Australia's 4,700+ Migration Agents



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Active targeted marketing

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Completion

- Typical mailouts/emailouts to 1,000 - 3,000 target contacts
- Responses from 40+ Strategic Buyers for each Business
- 80% of businesses sold to buyers on database or referred by network
- Targeted and General Activities



Other marketing

Sale
Preparation

Engagement

Document
Preparation

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Completion

- Twitter
- LinkedIn
- Google+
- Various Websites



Summary of key buyer categories

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Same and related industries nationally and worldwide:

- **Suppliers, Common customers, Similar technologies**

Institutional Investors:

- **Private Equity firms, Investment organisations**

Registered, qualified private investors

Immigration Agencies

Professional services organisations:

- **Accountants, financial advisors and planners**
- **Lawyers, Bankers and other professionals**

Key Target List:

- **Target buyers known to Clients**

Buyer screening & IM release + Confidentiality

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- Security features to minimise risk of sharing with others
- Sign Confidentiality Agreement
- Complete Investor Registration
- Individually approved by Client
- IM issued to prospective purchasers
- Sent electronically



Qualifying and investigations

Sale
Preparation

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Completion

- Questions and Answers
- Meetings and Inspections



Expressions of Interest (EOI)

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Evaluated and ranked according to many factors, including:

- Requirements to lease or acquire any related property
- Flexibility with transaction structure and tax optimisation
- Price and pricing structure
- Financial capacity
- Ability to complete the transaction
- Strategic fit
- Speed and flexibility
- Quality of their advisory team
- Availability of others as a back-up
- Due diligence requirements



Negotiations

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Negotiating on Client's behalf:

- Focus on value drivers to improve price negotiations
- Leverage competition among bidders
- Capitalise on competitive tension



Terms sheet

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Document agreed terms – called any of these:

- Non-binding Indicative Offer (NBIO)
- Terms Sheet (TS)
- Letter of Intent (LOI)
- Heads of Agreement (HOA)



Due Diligence (DD) overview



- Co-ordinate and facilitate DD process between parties and their advisors
- Facilities to operate Virtual Data Rooms
- Allow intending buyers and advisors access to sensitive client files in a controlled environment
- Data held in secure location and accessed via secure log-in
- All access activity and downloads recorded

Transaction structuring

Sale
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Completion

- Liaise with tax advisors for most tax-effective outcome
- Recommend lawyers and other transaction specialists
- Ensure team appropriately equipped for the process
- Optimise transaction structure



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Contract preparation



- Recommend suitable commercial lawyer to engage to prepare the Contract of Sale
- Assist negotiating commercial aspects of the Contract of Sale and entire process to completion
- Liaise with legal and accounting advisors
- Assist negotiating warranties, indemnities and guarantees

Indicative timetable



Process Stage	Est. Weeks	Estimated Duration (weeks)
SALE PREPARATION	1 - 3	1-3
CLIENT ACTION ON RECOMMENDATIONS		
ENGAGEMENT		
Document Preparation	2 - 4	2-4
IM, financials & marketing docs approved		
MARKETING THE BUSINESS*	4 - 12	4 - 12 weeks
Offers received	1 - 1	
Negotiations	2 - 4	2-4
TERMS AGREED		
Contract preparation	2 - 4	2-4
Complete Due Diligence and other conditions	4 - 8	4 - 8 weeks
Contract Unconditional to Completion	1 - 2	1-2
COMPLETION	17 - 38	17 - 38 weeks

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SALE READINESS

Sale preparation

- Business owner's biggest, most complicated and important transaction
- Most owners are referred only when ready to sell
- May be too late to optimise the result!
- Understand how price is calculated with time to act
- Early advice can save owners \$000's
- Time to implement recommendations
- Opportunities to enhance value



Sale preparation program



- Baseline Valuation
- Sale-Fitness Check-up
- Analyse Issues & Value Drivers
- Balance Sheet Asset Review
- Sale Preparation Starter Pack
- Action Plan



Preparing for sale



- Mature businesses run comfortably by comfortable owners with low debt
- PROFIT UPLIFTS have multiplier effect
- Understand the importance of profit
- Cut unprofitable products & replace with new ones



Preparing for sale



BALANCE SHEET = BUSINESS WAISTLINE

- Remove surplus assets = increase the goodwill component
- Rationalise operations = two properties to one, reduce rent
- Remove surplus equipment, sell separately and operate without it
- Remove excess stock
- Tighter debt collection



Preparing for sale

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- **Business housekeeping**
- Reduce concentration of key customers
- Secure IP to improve maintainability of income
- Reduce dependence on owner



Preparing for sale

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- **Clean up properties**

- remove or gain approval for structures
- clean up sites



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Preparing for sale

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- **Clean up properties**
 - environmental contamination
 - address asbestos risks



Examples

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- Check reporting systems for inaccuracies and potential weaknesses, affecting the quality of data available; may impact on the sale process and price
- Remove all impairments to smooth sale process
- Tax Advice:
 - best sale structure
 - share sale vs asset sale
 - associated properties



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HOW MUCH WILL
BUYERS PAY?

How much will buyers pay??

- ROI based on future maintainable earnings (FME)
- Capitalisation rate (or multiple of earnings) method to value free cash flow
- Simplified formula is XY , where X is FME and Y is EBIT multiple
- Reciprocal of investor's required capitalisation rate
- E.g. investor requires 25% ROI, reciprocal = 4

How much will buyers pay??

- Value: includes all assets required by business
- Assets:
 - Plant and equipment
 - Stock: materials, WIP and finished goods
 - Working Capital: trade debtors, trade creditors and employee entitlements
- Investors look at total return ROI; on all assets employed
- Where high IP, value cannot be capped, market as EOI
- **SEE EXCEL WORKSHEET**

How much will buyers pay??

Valuation - Capitalisation of Earnings method

Normalised (Maintainable) EBIT	1,000,000	X	< >	Earnings before Interest & Tax; after Owners' costs
EBIT Multiple	4	Y	< >	Reciprocal of the Capitalisation Rate (ROI)
Capitalisation rate	25.0%	=		Rate of return on overall investment (ROI)
ENTERPRISE VALUE (EV) at 4x (Capitalisation rate 0.25)	4,000,000	Z		Value of the ongoing cash revenue stream

Working Capital Items

Inventory/Stock/WIP	1,000,000	< >	
Trade Debtors	1,000,000	< >	Included in value regardless of whether sold or not
Trade Creditors & Employee Entitlements	(500,000)	< >	Included in value regardless of whether sold or not
Net Working Capital	1,500,000		
Plant and Equipment (Est value)	1,000,000	< >	
Net Tangible Asset Value	2,500,000		
Goodwill (Derived)	1,500,000		
ENTERPRISE VALUE (EV) at 4x (Capitalisation rate 0.25)	4,000,000	Z	

Sale Contract Structure

Assumed asset sale vs share sale)

Business (Equipment and Goodwill)	2,500,000
Inventory/Stock/WIP	1,000,000
Excluded from Contract	
Trade Debtors	1,000,000
Trade Creditors & Employee Entitlements	(500,000)
Overall Proceeds to Owner/Seller & Cost to Buyer	4,000,000

A man in a dark suit and white shirt is looking directly at the camera with a wide-eyed, shocked expression. He is surrounded by a sea of crumpled white paper. In the foreground, a hand is holding a yellow highlighter, with the tip pointing towards the man. The background is filled with more crumpled paper and some scattered documents. The image has a semi-transparent blue and green overlay.

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THE PITFALLS –
HOW TO AVOID THEM

Here's what you're not told

THESE HORRIBLE STATISTICS WILL KNOCK YOUR SOCKS OFF!

- Only 20% of all of businesses for sale ever sell
- 90% of all of people who search to buy a business never complete a transaction
- These US small business stats apply equally to Aus/NZ small business market, ie 95% of all businesses <10 emp'ees



Here's what you're not told

THESE HORRIBLE STATISTICS WILL KNOCK YOUR SOCKS OFF!

- So we have invested about \$4M over 18 years in our M&A database to actively target strategic buyers
- Achieve best success rates possible, well above industry averages, approaching 80% of all clients engaged
- We won't take on a client's business unless we can identify and target strategic buyers on our M&A database

- Source of >85% of buyers of clients' businesses



What could possibly go wrong – for buyers?

BUYERS MAY

- Investigate hundreds of businesses without buying any
- Target businesses priced beyond their financial capacity
- Not know what they are looking for or how to find it



What could possibly go wrong – for buyers?

SOLUTIONS

- Decide target profile and confirm financial capacity BEFORE looking
- Systematically search ALL businesses matching the target profile, rather than only those currently on the market
- Half all owners will sell if approached by genuine buyers
- Most businesses where the owners are willing to sell are not actually on the market.
- Acquisition Searches will save time and deliver responses not found by anyone else, beating the crowd.

What could possibly go wrong – for owners?

OWNERS MAY

- Engage wrong M&A advisors - process, skill, marketing capacity
- DIY and end up in a mess
- Not properly prepare so not optimise financial outcome
- Engage wrong accountants or lawyers, sabotaging the sale
- Not obtain tax advice and pay more tax than necessary
- Not be fully committed and pull out at the last minute
- Not be properly briefed on how extensive the process is eg DD
- Not have adequate records, financial integrity or formalise commercial arrangements
- Set too high a price and miss out on selling to those who could afford it, if it were priced realistically

SOLUTIONS

- Engage the right advisors, ask trusted advisor who to engage

What could possibly go wrong – for M&A advisors?

M&A ADVISORS MAY

- Take short cuts and fail to market the business adequately
- Not properly qualify or advise clients with unrealistic expectations
- Not check owner has proper tax advice and know tax outcome
- Not prepare comprehensive IM so buyers can properly assess
- Invest/waste time manually researching possible targets
- Target the wrong markets or not target any markets at all!
- Not properly qualify buyers' financial capacity and/or suitability
- Invest copious time and money and not sell the business



What could possibly go wrong – for M&A advisors?

SOLUTIONS

- Join network - proven systems, processes, resources etc
- Market opportunities to identify and target strategic buyers



What could possibly go wrong – for everyone?

EVERYONE MAY INVEST TIME AND MONEY ON THE PROCESS, TO FIND:

- Legislative, legal or commercial reason why unsaleable
- Business performance takes a dive and is now not attractive to either buy or sell
- One or more key employees or customers leaves at the 11th hour, or potentially worse for the buyer if it happens just after the transaction

- The list of what can go wrong in M&A is endless and the ensuing potential waste is limitless
- Anyone who has lived and breathed M&A for any length of time has many war stories about what can go wrong, outside the M&A Advisor's control!



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**CHOOSING YOUR
ADVISORS**

Choosing your advisors

OWNERS' NEEDS

- Best outcome as quickly and safely as possible

CLARIFY EXPECTATIONS

- Decide what is most important to you:
- Proceeds up front or structured payments
- Price
- Timing
- Confidentiality
- Fit of new owners
- Property lease



Engage the right advisors

- Lack of sophistication and experience on seller side - major source of frustration for sophisticated buyers
- Clients don't know what they don't know
- Choice of advisors can determine the outcome
- How advisors are engaged encourages them to act predictably
- Engage:
 - M&A Advisors
 - Lawyers
 - Accountants
 - Specialist tax advisors



M&A referral due diligence

EXPERIENCE

Does the firm have a record of successful transactions of comparable size?

CREDIBILITY

Are the key advisors suitably qualified and experienced?

MANAGEMENT

Will the advisors personally oversee the project?

CONFIDENTIALITY

Does the firm understand and respect client confidentiality?

M&A referral due diligence

REGULATORY

Does the firm hold the appropriate licences?

MARKETING RESOURCES

Where does the firm source most buyers from?

PRESENTATION

Will the firm professionally present the business opportunity?

COMMUNICATION

How well does the firm communicate with clients?

M&A referral due diligence

COOPERATION

Can they work with us and other professional advisors?

PRELIMINARY VALUATION

Will the firm provide a valuation before the client commits?

PROCESS TO COMPLETION

Does the firm manage the full process to completion?

Profile of M&A advisory firm

DIVESTMENTS

- Does the firm market businesses nationally and globally?
- Typical EV of clients' businesses in \$1M-\$50M+

ACQUISITIONS

- Engaged by ASX listed companies, private equity groups and overseas listed companies seeking acquisition targets in specific industries?
- Acquisition targets are sourced using M&A database and marketing resources

Profile of M&A advisory firm

MERGERS

- Aggregations of similar businesses
- ASX listed & unlisted public companies seeking partners



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Profile of M&A advisory firm

TEAM

- Team of Accountants and other qualified professionals
- Wealth of experience in corporate advisory, business management and transactions
- Complemented by an experienced, capable marketing and support team



Profile of M&A advisory firm

M&A DATABASE

- Proprietary M&A database - primary source of strategic buyers
- Has delivered hundreds of sale transactions worth hundreds of millions of dollars over the past 15 years
- Covers all organisations in Australia with > 10 employees, and corporate, private and international investors



Profile of M&A advisory firm

M&A DATABASE

- 190,000+ qualified entries
- Ability to source and contact strategic buyers for \$M+ businesses, while maintaining confidentiality
- 40+ Strategic Buyers for each \$M+ Business on average



Profile of M&A advisory firm

NATIONAL NETWORK

- Primary source of new clients is referrals
- More than 80% of clients are referred by accountants, other business professionals and former clients
- Operates nationally with a network of member firms and business partners
- Member Firm offices in Brisbane, Sydney, Melbourne, Darwin, Mackay, Perth, Gold Coast, Cairns
- More joining





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SUMMARY

Summary

- Baby boomers are getting older and keener to retire
- The GFC took many good businesses off the market
- Now a greater backlog has been building
- Outright sale is the most common way for owners to exit
- Exiting has 2 aspects: Realise Capital and Withdraw Labour

- Many ways to exit, but most common is outright sale
- Clear profiles of buyers, each with their predictable strategies and motivations
- Valuing and Pricing a business has 2 components: $X = \text{FME}$ (future maintainable earnings) and $Y = \text{Earnings multiple}$

Summary

- Setting the price or opting for EOI depends on what's for sale
- Early preparation by owners and advisors is critical
- Choice of advisors is critical to a successful outcome
- Business owners are not aware of the many pitfalls until they are involved in the process

- Clients under-estimate the amount of work involved, the process steps, the diverse types of buyers and their motivations, due diligence and tax implications

Learn more about M&A process

LEARN MORE

Articles and videos by DMA's team published over many years

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