# HOW TO SELL AND VALUE A BUSINESS

DIVEST • MERGE • ACQUIRE
SUPERTRAC



# 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





#### 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 <u>actually</u> 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 <u>ACTUALLY EXIT</u>:

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 <u>after-tax</u> 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







## Information Memorandum (IM)

- 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 Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

#### Informs about the business:

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







#### Data collection and research

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







#### Targeted buyer identification

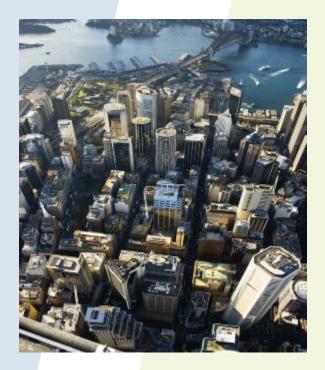
- Profile buyers who will place the highest value on the business
- Pre-identified Target Purchasers
- Readily identify and target strategic buyers
- Database the primary source of buyers





## Database specification

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







#### Database specification

- Categorised 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









## Active targeted marketing

Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed 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

Marketing

Negotiation

Terms Agreed

Completion

- Twitter
- LinkedIn
- Google+
- Various Websites





DIVEST • MERGE • ACQUIRE
SUPERTRAC

## Summary of key buyer categories



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

- 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

- Questions and Answers
- Meetings and Inspections







### Expressions of Interest (EOI)

Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

#### 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

Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

#### Negotiating on Client's behalf:

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







#### Terms sheet

Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

#### Document agreed terms – called any of these:

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





DIVEST • MERGE • ACQUIRE

#### 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

- 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





## 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	Es We	st. eks	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 w eeks
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 w eeks
Contract Unconditional to Completion	1	2	1-2
COMPLETION	17	38	17 - 38 weeks







#### 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

Sale Preparation

Engagement

Document Preparation

Marketing

Negotiation

Terms Agreed

Completion

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







Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

- 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







Sale Preparation

Engagement

Document Preparation

Marketing

Negotiation

Terms Agreed

Completion

#### 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







Sale Preparation Engagement Document Preparation Marketing Negotiation Terms Agreed Completion

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



Sale Preparation

Engagement

Document Preparation

Marketing

Negotiation

Terms Agreed

Completion

- Clean up properties
  - remove or gain approval for structures
  - clean up sites









Sale Preparation

Engagement

Document Preparation

Marketing

Negotiation

Terms Agreed

Completion

#### Clean up properties

- environmental contamination
- address asbestos risks









### Examples

Sale Preparation

Engagement

Document Preparation

Marketing

Negotiation

Terms Agreed

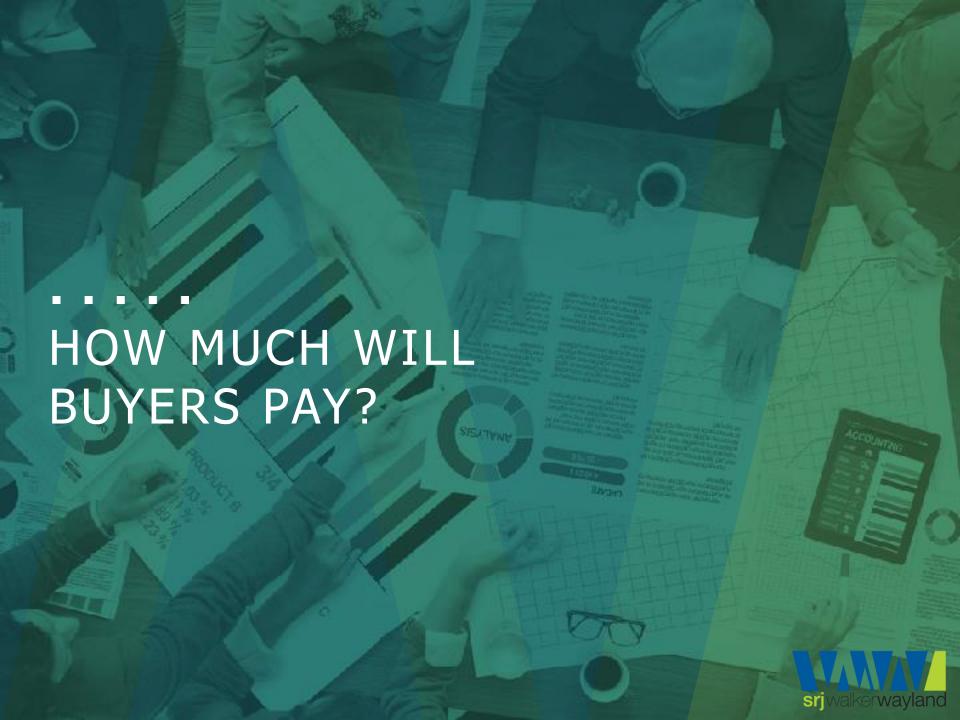
Completion

- 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





DIVEST • MERGE • ACQUIRE



# 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

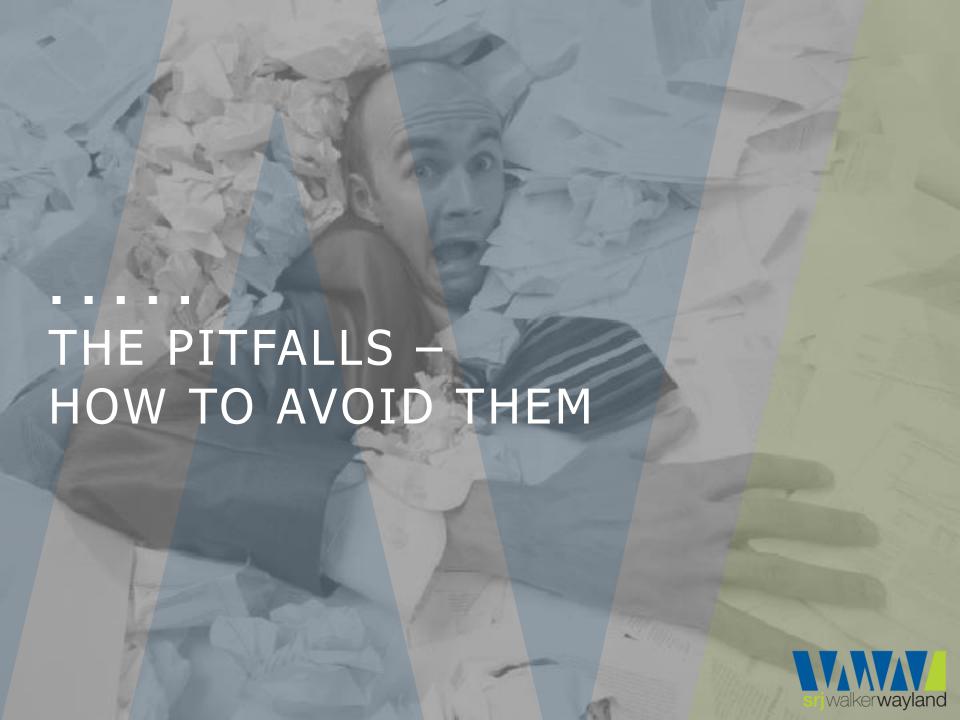


# How much will buyers pay??

Valuation - Capitalisation of Earnings method					
Normalised (Maintainable) EBIT	1,000,000	<		>	Earnings before Interest & Tax; after Owners' costs
EBIT Multiple	4	<b>(</b>		>	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 2	2			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 2	Z			
		•			

Sale Contract Structure	
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

Assumed asset sale vs share sale)



### 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</li>









### 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

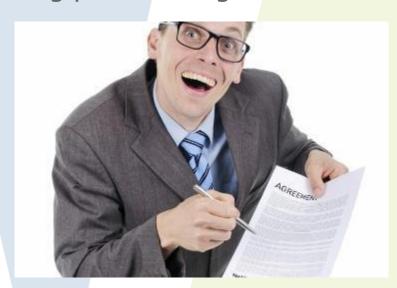




### What could possibly go wrong – for M&A advisors?

#### **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!



### 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?



#### **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



#### **MERGERS**

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









#### **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





#### **M&A DATABASE**

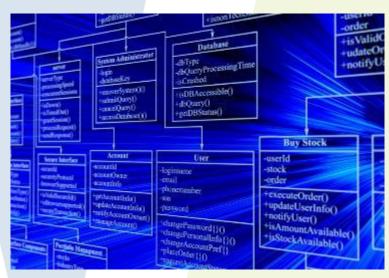
- Proprietary M&A database primary source of strategic buyers
- Has delivered hundreds of sale transactions worth hundreds of millions of dollars over the past 15 years
- Covers all organisations in Australia with > 10 employees, and corporate, private and international investors





#### **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





#### **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







### 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 = FME (future maintainable earnings) and Y = 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

Visit websites: www.divestmergegcquire.com

www.mnadirect.com

www.srjww.com.au

