

Maximizing Value Before the Sale

To a greater extent than other types of companies, the value of a manufacturer is likely to be driven by the quality of its products and its efficiency in producing them. On the other hand, the value of wholesalers and smaller service companies often depends on the owners' relationships. As a consequence, the value of a manufacturer is more likely to be impacted by management's efforts in preparing for the sale of the company.

Selling a company at the right price and terms often takes a year or more. Owners who desire to sell their companies to outsiders should begin to maximize the value of their companies at least two years, and preferably three or four years, prior to the sale. Selling before you have to allows you to take a deliberate approach to what is probably the most important deal of your life.

There are a number of methods of increasing value within this time horizon, and the increased payoff can be enormous relative to the company's current value. Some of these methods are discussed below.

Increase Profitability

The sales price of a privately held manufacturing company is often based on a multiple of earnings before interest and taxes (EBIT). In recent years, this multiple has fluctuated between four and six. Certain niche manufacturers may obtain multiples of eight or more. Thus, one additional dollar of profit today may be worth four to six dollars to the owner in the future.

Buyers tend to base their purchase offers on the most recent three or four years of earnings. A trend of increasing revenues and profits is the key to obtaining the best price. The reliability of earnings over a long period of time assures the buyer that it should pay top dollar. In addition, payment of the purchase price will be closer to the much desired, but rarely achieved, all cash deal.

Increasing profitability in the company is not always easy. The first step is to eliminate unnecessary administrative and operational processes. These processes tend to be non-value-added procedures that your customers will not miss.

Because the cost of capital is high, it should only be invested in high-return activities. It is important to avoid carrying unnecessary assets, such as past due receivables, unused or slow-moving inventories, and underutilized machinery. Certain expenses should be reduced or limited. For example, healthcare benefit expenses should be capped, and certain other discretionary expenses, such as entertainment, bonuses, conventions, and executive perks, should be minimized.

Know the Buyer

Strategic acquirers are not entirely bound by a valuation formula based on earnings. These buyers are seeking certain business attributes that your company possesses or could obtain, and which enhance the value of your company because they tend to drive profitability. They include reputation, proprietary products, defensible market position/share and, above all, growth.

In addition, management, financial, and manufacturing controls should be in place and the company should not depend heavily on a few customers or vendors. Opportunities to expand overseas are particularly desirable as we move toward an increasingly global economy.

Understanding what buyers are looking for in a company also allows you to identify potential buyers. Develop a list of possible buyers and their requirements, and begin to model your company so that it will be attractive to these buyers. If possible, develop business relationships with these prospects. This allows you to negotiate over several years, maximizing the overall price and reducing the amount of non-cash terms in the sale.

Financial Information

Most buyers expect to have access to audited financial statements. These should be prepared at least two years prior to the time you want to sell. The audit process provides a more accurate picture of the company's financial performance and enhances credibility.

It is also important for management to demonstrate that its reporting systems are simple, accurate, and timely. Focus on flash reports, such as collections, scrap, sales, and marketing reports. Management should also continually measure the company's overall performance through the use of financial benchmarks, such as unit cost, and simple financial ratios, such as sales and gross profits per employee.

Build a Management Team

It is critical for the new owner to be able to depend on your management team after the sale. Too many deals have gone sour due to a lack of effective management. The best management situation is a well-disciplined, committed, multi-functional team that will demonstrate its desire to work for the new owners. Prospective buyers will recognize this willingness and pay for it.

Maximizing Value Before the Sale (Cont'd)

Implement Total Quality Management

Companies with an active quality management program are more desirable than those without. If you have not yet implemented a quality management system, the three- to four-year time frame should provide ample time. Among its many benefits are the elimination of business processes that have no value to customers, increased cash flow, better asset management, a more efficient sales force and distribution network, and reduced scrap and downtime. In the meantime, you will work more closely with your customers, building customer loyalty. After all, the prospective buyer is buying your customer list-there are few other strategic reasons to buy your company.

Consult a Professional

Many owners feel that the use of an intermediary is expensive and reduces their control over the selling process. However, it is important for owners to minimize disruption, develop and manage the process, search for the right buyer, and maximize their net proceeds. A professional intermediary, such as your accountant, can help ensure that the company has been fairly valued. The valuation process is an important one-every company is different and requires an independent analysis.

The mechanics of selling your company are best accomplished by a knowledgeable professional who can guide you through the complexities of the selling process. Selling your company can be very difficult and should involve the company's professional advisors in each of their respective disciplines.

Avoid Deal Killers

The most common deal killer is an insistence on a high price that cannot be justified by the expected return on investment. Other issues that buyers tend to shun are mandatory pension contributions, contracts that cannot be modified, and long-term leases. Environmental problems that cannot easily be remediated are also serious obstacles. Be a clean company-with no environmental, safety, or compliance problems. Good housekeeping, repair, and maintenance are essential for making a good and valuable impression.

Be Open to Change

Given the time, most companies can improve their earnings. In some cases, a manufacturing company in a crowded niche should consider purchasing other companies or product lines to improve its own strategic value to potential buyers. Owners should be open to change in their own organizations to enhance value over time.