

Succession Planning and Maximizing the Value of Your Business

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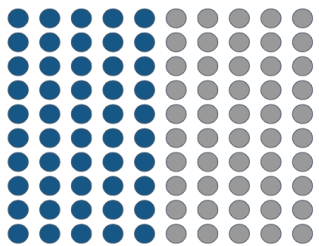
**Tactical Skills
for the Growing Business**

Agenda

- Where are you?
- Murphy – Who We Are
- Succession Planning
- Valuation Methodology and Building Value In YOUR Business
- Exit Strategy Do's and Don'ts

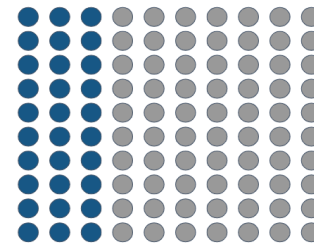
Where Are You?

Revealing Facts



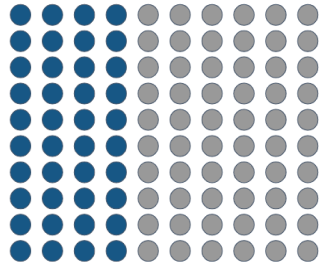
50% of business owners expect to sell in the next 10 years

50% of small business owners have NO strategic plan

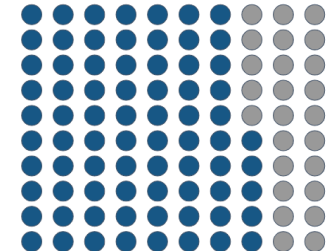


30% of business owners have NO estate plan beyond a will

40% of business owners plan to invest or acquire another business

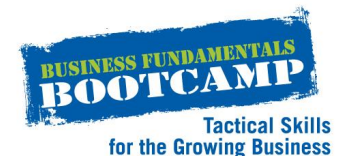


75% of owners do not have an exit or transition plan



Murphy – Who We Are

- Since 1994
- National Coverage with 125 offices and 5 in NJ
- National Advertising Presence
- Top ranking business broker website , www.murphybusiness.com
- Experienced Professionals facilitating billions of dollars in business sales



To Broker or Not To Broker

- Value of Utilizing a Broker (order of importance is up to the seller):
 - Time!
 - Professional Packaging & Marketing!
 - Confidentiality!
 - Get the right PRICE!
 - Understand the process and how to get deals done!
 - Higher success rate in selling by using a broker
 - It is impossible to know all of the above, plus tax issues, legal issues, etc. That is why sellers hire professionals.

Bottom Line

- Properly Plan Today to Harvest Value From Your Business Tomorrow!



Benefits of Selling vs Liquidating

- Selling can provide a smooth, transparent transition that maximizes the value of the business and relieves you of most contractual obligations.
- Liquidating or “Winding the business down” does not:
 - Maximize inventory or assets. Liquidations are typically done at pennies on the dollar.
 - Business expenses continue to occur until the inventory liquidation is completed
 - Relieve you of contractual obligations including:
 - Lease
 - Advertising, phones, etc.
 - Franchise
 - Provide you any residual for your franchise, customer base, signage, build-out, etc.
 - Provide potential retention of employees.

Succession Planning: The First Steps

- “Begin with the end in mind” Stephen Covey
- Understand the timing involved
- Understand the buyer will need to acquire financing to purchase your business. How does a bank determine the value of a business and how much to lend?
- Plan ahead for the steps you will take when the business is sold
- Can you afford to sell?
- Are other important decisions in sync with selling?
- Recognize the process is unique!

Today's Buyers

- Much more discriminating – want only ‘good’ businesses, and will pay a premium for them
- Many are first-time buyers, and given the economy, are very apprehensive!
- Have a lifestyle that they want to maintain or improve

Big Business vs Small Business Sales

- Small Business Sales is a most unique process.
- Most buyers and sellers use the stock market or real estate transactions as a reference point
- Three sets of “Sports” rules:
 - Big Business (football rules)
 - Real Estate (basketball rules)
 - Small Business (baseball rules)

Big Business (Football Rules)



- Owners (stockholders) are absentee
- Sophisticated financial statements
- Goal of financial statements is to show maximum profit to drive stock valuation
- Tax returns tell a different story

Real Estate (Basketball Rules)

- Open Marketing – no confidentiality!
- Easy to value using comparables
- All sales recorded
- Low down payment, and normally accessible bank financing



Small Business (Baseball Rules)

- Unique Sales Process!
- Owner closely involved in day-to-day operations
- Checkbook accounting versus sophisticated financial statements
- Typical financial document is the tax return
- Goal of the tax return is to show minimal profit, so recasting the financials becomes necessary to see the true owner's benefit
- Confidentiality is critical...no open marketing
- How is it valued?



Valuing a Small Business

- Important to all parties: Seller, Buyer and the Bank
- Formal valuations are recommended (Murphy Valuation Services has performed thousands)
- Not cost prohibitive

Seller's Discretionary Earnings (SDE)

- SDE or Owner Benefit is what you make in the business.
- Businesses sell as a function of SDE.
- Therefore, to maximize your value at exit, you need to maximize your SDE during ownership.
- The best way a business owner can maximize profits? Follow your proven system!
 - Build wealth and equity strategy over time.
 - Leave money in the business.
- Your proven systems and standards exist to maximize the value for you business.

Your Business vs Your Car

- What happens when you drive off the new car lot?
DEPRECIATE!



- Businesses are the same when you open the doors.
- Only the well kept good ones APPRECIATE!



Assets vs SDE

- When a small business has little or no cash flow, or does not have at least 3 years history, the sales price typically will be determined by assets (inventory + fixtures)
- Goodwill is measured by SDE
- Profitable businesses can typically sell for MORE than assets using Seller's Discretionary Earnings (SDE).

Seller's Discretionary Earnings

- Seller's Discretionary Earnings **(SDE)** a.k.a. Owner Benefit is a common valuation method
- Most business owners do their taxes not to pay taxes – Recasting is necessary
- $SDE = EBITDA + \text{owner's benefit} + \text{one time expenses}$
- **EBITDA** = **E**arnings **B**efore **I**nterest **T**axes **D**epreciation and **A**mortization
- Owner's benefit include auto, insurance, retirement plans and other expenses the business pays for the owner.

Valuing a Small Business – Multiples of SDE

- Once SDE is determined, now apply a multiple
- Multiples vary by industry and company size. 1.5 – 3.0 is more common for retail service businesses.
- Multiples may also vary based on assets, inventory, market position and many other factors
- Businesses with tangible cashflow are much more likely to be eligible for bank financing at sale

Valuing a Business – Terms

- Value does not always equal Price
- Terms Matter!
- All Cash = lower sale price
- Terms MUST allow a new owner to:
 - Service the debt
 - Pay themselves a salary
 - Meet the franchisor's standards (if applicable)
 - Generate a return on investment
- Financing is an important element of the sale.

Seller Financing

- Most Brokers Advise Their Seller's to Consider Seller Financing
- Seller Financing Has Many Advantages:
 - Higher Price Through Re-casting
 - Potential Tax Savings
 - Income Source
 - In Today's Lean Market, Banks Are Very Tight...May Be The Only Way!
 - Changes the Buyer/Seller Dynamic

Timing

- Sell when business is GOOD to maximize your price
- Most buyers, lenders and valuation companies look at the last 3 years financial results. If you don't have 3 years history, difficult to maximize value!
- Selling a business is a process. Timelines vary. Average sales cycle is 6-9 months. It may take as long as 12-18 months to sell.

Tips to Maximize Value

- Have updated financial statements. Most buyers and banks look back 3 years.
- Declare all of your income if you are not interested in seller financing.
 - Show profit, cash flow.
- Clean up A/R, A/P; handle any employee issues.
- Rely on professionals
- **PREPARE NOW TO INCREASE YOUR PRICE LATER!**



Do's and Don'ts

- Do market Confidentially!
- Do price it right (would you buy it?)
- Do invest in an independent certified business appraisal
- Do have all financial and tax records completed for buyer review.
 - Delays or lack of proper financial documentation create red flags – Buyers disdain red flags
- Don't let internal problems fester -- Buyers disdain red flags
- Do understand financing and impact
- Do understand the buyer (individual, financial, strategic)
- Don't get discouraged...Be ready for the “3 deaths”

Do's and Don'ts (Continued)

- Do be available to help transition/train the new owner
- “Sprint to the finish”!
 - Case Study
- Many Sellers don't sell when business is good. That's a mistake! Remember, each dollar in Owner Benefit is multiplied to reach a selling price.
- Do consult with your accountant and tax attorney. Are you financially ready to sell?
- Do Remember: Highly negotiated and fluid process

Summary

- To sell for more than assets:
 - Profitable Businesses sell for more using the SDE method
 - Reasonable price with terms
 - Sell when business is good
 - Ready the business for sale
 - Strategize with professionals

ANY FINAL QUESTIONS?

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