National Tooling & Machining Association

NTMA

PRECISION

Business Management Advisory

For Precision Custom Manufacturers

PL20 File: PLANNING

ONE DOZEN WAYS TO INCREASE THE VALUE AND MARKETABILITY OF YOUR BUSINESS IN THE YEARS AHEAD

SUMMARY

The sale of a business is a long, often difficult process, usually requiring at least one year from start to finish. The following twelve areas merit a business owner's consideration well in advance of a contemplated sale:

1. SALES VOLUME

Too many company owners become complacent when they reach a certain level of sales, and their business seems to stagnate. However, to maximize the value of your company, every effort should be make to consistently increase sales. These efforts should include attempts to diversify into new non-traditional, growth-oriented markets.

A prospective buyer will perceive a well diversified customer base which includes a variety of industries as more stable than a narrow customer base in which sales are highly concentrated among several customers in only a few industries. An increase in sales volume based upon expanded customer diversification should be a primary near-term goal.

2. PROFITS

When positioning the company for greatest value, steps should be taken to maximize profits. One way to do this is to carefully evaluate non-essential or non-productive operating expenses. These are expenses which are usually incurred to reduce year-end pre-tax profit.

Naturally, you are not in business to pay maximum taxes and you should make every reasonable, legal effort to keep your company's taxable profit at acceptable levels. However, those non-essential operating expenses which had such a beneficial effect on your tax bill may frequently be invisible to an outsider, who instead, sees a smaller profit margin.

A recent history of improving profits is very attractive to a potential buyer. The reduction or elimination of non-essential operating expenses can help the business owner to more clearly demonstrate the real earnings potential of a company. Any tax minimization policies which are retained should be well-documented to establish the true profitability of the business.

3. STATE-OF-THE-ART TECHNOLOGY

Too frequently, owners of middle-market companies fear the changes and expense represented by those emerging technologies which are literally reshaping their industry. Rather than embrace new production and administrative technologies such as CNC equipment, CAD/CAM systems, and computerized off- ices, owners often stick with the "tried and true" technology of yesterday. By choosing to ignore progress, an owner loses ground - and his company quickly begins to lose value.

Every effort should be made to adopt those technologies which will shape the growth of your industry in the years to come. If you continue to do business as usual, you will find yourself incapable of effectively competing in the marketplace. Accept change. Embrace innovation. A failure to do so will prove devastating to the company you have worked so hard to develop.

4. GENERAL COMPANY APPEARANCE

Many owners fail to address the general appearance of their company adequately. The common belief is that if a company makes money, it is highly marketable. This is not always true. Buyers of businesses are consumers, and they pay as much attention to physical appearance as any other type of consumer. A clean, attractive company is a direct reflection on the management of that company.

Anything which enhances the impression a business creates is worth doing. Attention to such basic cosmetics as paint, lighting general cleanliness, preventive maintenance, and landscaping can achieve significant results.

By conducting an "appearance audit," an owner may identify areas which need to be addressed. The question a business owner must ask is: "How would a first time visitor walking through my company be impressed ... favorably or unfavorably?" If the answer is "unfavorably," corrective measures should be taken.

5. SECOND LINE MANAGEMENT

This is an area which cannot be over-emphasized. Companies that do not have strong, professional managers who support the owners' effort are not as attractive in the marketplace ... or as valuable. Each functional area of the business should be directed by a proven manager who is willing to remain with the company even if the ownership of that company changes. This is a critical concern to most purchasers of middle-market companies. If a strong second-line management team is not currently in place, qualified personnel should be recruited and installed in key positions.

6. PROFESSIONAL APPRAISALS OF COMPANY ASSETS

The cost of professionally appraising the tangible assets of the business is nominal when compared to the returns such an appraisal can provide. To determine the maximum fair market value of a privately held company, current professional appraisals on the company's tangible assets should be completed. If the real estate is to be included in determining the value of the company, an MAI-certified (Member of Appraisal Institute) appraiser should be engaged to conduct the real estate appraisal.

Likewise, a reputable, professional appraisal organization should be selected to determine the fair market continued - used value of all machinery and equipment. The orderly Liquidation value of the machinery and equipment should be established. This approach will provide the business owner with an idea of the high and low range of estimated value for his equipment.

Obviously, such appraisals cost money. However, in the event of a sale, the findings of these appraisals will generally provide returns to the business owner far in excess of their cost. Without such appraisals, the business owner may realize significantly less than the full, fair market value of the company's tangible assets.

7. LONG-TERM DEBT

In most middle-market companies, the lower the long-term debt, the better. Highly leveraged businesses do not offer prospective purchasers the financing flexibility of more nearly debt free businesses. Generally, relatively debt-free companies require less investigation, shorter negotiating sessions and raise fewer problems than their fully leveraged counterparts. By reducing long-term debt, a business owner increases the financing options which could prove to be very attractive to a prospective buyer.

8. SALES BACKLOG

If at all possible, a business owner should establish a history of favorable sales backlogs. In certain companies, this may be difficult to do. However, if it can be arranged, a "full pipeline" will work in your favor. A prospective buyer feels more comfortable when several months of orders are consistently on the books.

9. RECEIVABLES

Time spent concentrating on improving your company's receivables is time wisely invested. Receivables that are current are always impressive to a potential buyer. In addition, your prospect will frequently view the handling of receivables as a direct reflection on the quality of your management. If your industry is one which has "typical" receivable policies, working to make your company's receivables history better than the industry standard may pay dividends.

10. UNION STATUS

In general, a non-union organization is perceived as being more desirable than an organized company. If your company is not organized, you should take those steps to maintain that status. Rumors of a possible sale can fuel organization efforts in companies with employee relations problems. If your company is organized, you should work toward maintaining a favorable working relationship with the union. A history of employee cooperation and fairness is valuable when the company is reviewed by a prospective buyer.

11. INFORMATION COLLECTION

Certain information will be essential when you eventually have the company professionally evaluated or negotiate with prospective buyers. You should maintain a current file which includes the following information:

- Past five year financial statements ... plus current year-to-date statements ... all of which should be a true and accurate reflection of the company's financial position;
- Past five year tax returns-federal and state;
- All current promotional literature describing company products and/or services. Lease information ... including real estate leases, production equipment leases, computers, etc.;
- Current aging of accounts receivable;
- Current aging of accounts payable;
- Listing and copies of trademarks, trade names, patents or license agreements;
- Any existing employee agreements or contracts a summary review on key employees will be helpful;
- Copies of pension and/or profit sharing plans and trust agreements;

- Copies of long-standing contracts with customers and/or suppliers;
- Summary of existing insurance coverage ... especially product liability coverage and a history of claims; and,
- Summary of existing litigation.

By maintaining a current file of this information, considerable time can be saved when valuing the business. (Also review BMAs covering Selling a Business and Buying a Business.)

12. LEGAL MATTERS

The issues of liability and litigation have an important impact on the market value of a company. No one wants to buy another business owner's problems. Prior to evaluating the company, every effort should be made to resolve all outstanding litigation ... regardless of how minor.

Establishing your company's full compliance with applicable EPA requirements is also important. The company should be able to demonstrate how toxic materials are labeled, handled and "posted" for all employees' "right to know." The entire issue of compliance with environmental regulations is becoming increasingly important. It would be wise to address any problems now in order to avoid complications in the future.

CONCLUSION

The considerations we have discussed above represent a good starting point for your planning. Obviously, each business is unique, and other issues may also have to be addressed.

When is the best time to sell? The answer depends upon many factors ... personal as well as professional. However, all other things being equal, the best time to sell is when your industry approaches the top of its business cycle. If possible, plan to sell your business before you absolutely have to. With foresight, you can control your future, and not have circumstances dictate to you.

When the time is right, you should utilize the services of a professional organization which specializes in the evaluation and/or sale of privately held companies. This is a very technical field which requires special skills and considerable experience.

You should carefully select professionals who demonstrate the necessary experience and knowledge.

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