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Acquire to Sell and Other Value Improvement Strategies

A number of the projects I have worked on for small businesses have involved the goal of maximizing the value of the client business. Why this became a paramount goal of the client varied. The most common case is to get ready to sell the business. However, in one case it was due to the realization that cash flow and net asset value had to be improved first before a needed capital plan could be implemented.

Unless you are an owner who has had a professional business appraisal, you probably don't have a particularly clear vision of the value of your business. Many owners can understand the concept that the value of the business is dependent on the earnings potential of the business in the buyer's hands. However, earnings are only part of the story of value and improving earnings of a business is not necessarily the quickest or best road to increased value.

Increasing the value of a business does not always mean increasing sales, increasing margins or reducing costs. While these are great things to do, other things affect the value of a business to a third party buyer or a lender. Some if these negatives are special risks, weak financial controls, a need to divest unproductive assets, or a weak management team. So diversifying the customer base, installing the ERP or MRP system, dumping that brown field property or hiring a stronger management team may have a greater effect on the value of the business than a 50% increase in sales.

The reason why these items affect value is sometimes overlooked, but not really difficult to understand. A narrow customer base is risky and a buyer will be concerned about the stability of the business. Weak financial controls mean that historic numbers may be suspect and recent profits an artifact of bad inventory control. The brown field property may be a known and understood risk to the seller, but to many buyers even a hint of environmental risk is enough to massively discount a deal. The need to immediately replace a management team after the closing is not something most buyers want to deal with.

A buyer will see all of these items as costly items that the buyer will need to fix after the closing. The cost of these fixes will be overestimated by the buyer and deducted from the value. I have seen items that the owner thought were manageable and not worth fixing turn out to be a deal killers because the potential buyer simply didn't want to take the risk.

Another often overlooked way to get a business ready to sell is to buy another business. This, of course, runs against the grain for many business owners who are thinking about selling a business. This issue most recently came up when a colleague and I were discussing possible exit strategies for a potential client we were talking with and the client was considering a possible acquisition. He wanted to know whether that was wise since he was thinking of selling out.

This situation reminded me that some years ago I represented three brothers who owned a business and were interested in selling. A buyer had made an offer. Based upon advice, the brothers knew the offer fairly valued the business; however, the offer was not adequate for them to retire on. To achieve their goal they had to increase the value of the business. The thing that brought the potential buyer back to the table within a year was that brothers went out and bought another competing and complementary business. This purchase did not increase the book value of the business, but did increase revenues and net income. This single move was enough to obtain an increase in the offer for the business of over 50% and ultimately make the sale with the seller assuming the entire debt for the newly acquired operation.

Buying another operation will not always improve the value of a business, but in the right circumstances and with the right acquisition it can increase the value far more than the cost of the acquisition and, like in the case of the brothers, an acquisition can stretch the selling price to the “enough to retire on” level.

So what did we tell the potential client? Sorry, I can’t disclose that.

- *Greg Meurer*

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