Maximizing the Value of Your Business

February 29, 2016

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Las Vegas, Nevada

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Maximizing Value of Your Business

- Establish valuation and measurement tools.
- Develop steps to assess and improve the value of your business.
- Identify enhancements, and remove barriers, even if no plan to sell.

Maximizing Value - Overview

- Valuation – GPS System
- Critical Factors
- Planning Ahead
- Sales Channels and Processes
- Risk Management
- Sale Process
- Tax Efficiency
- Deal Issues
- Lessons Learned
- Strategy and Tactics

Valuation

- Guidance system for measuring progress
- Multiple of EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)
- Add back interest bearing debt (equalizer)

Valuation Example

Profit before Taxes	$400,000
Depreciation	150,000
Owners Compensation	100,000
Interest	50,000
EBITDA	$700,000
Multiple	6
	$4,200,000
Interest Bearing Debt	(1,000,000)
Net Valuation	$3,200,000

- Perform annually, in a practical way
- Understand industry rules of thumb

Factors Impacting Valuation

- Diversified and diluted customer base
- Marketing / Sales Methods and Prospects
- Proprietary product or service (barriers to entry)
- Management Team – depth and strength
- Strength of balance sheet/access to capital
- Eye of the beholder

Critical Factors (continued)

- Documentation and continuous improvement of processes, e.g. a/r management, terms and conditions
- Sources of supply, for products and services, capital equipment, and space (current focus)
- Scalability; growth, especially exponential growth
- Proactive risk management

Case Study – Executable Improvements

- Price increases (90% of the work, for 110% of the price)
- Owner's compensation
- Excessive rent
- Accretive earnings (value to buyer, not necessarily seller)

Planning Ahead

- Plan for anticipated or unanticipated change in:

Internal	External
Employees	Customers
Management Team	Suppliers
Processes	Bank
Technology	Advisors
Margins	Sales Channels
Demographics	Demographics

- Broad strategic view of any internal or external resource

Buying vs. Building a Channel

- Channel Definition – any developed means to reach customers, e.g. direct, dealers/ distribution, internet, manufacturers reps, etc.
- Building
  - Tends to be risky, time consuming and capital intensive
- Buying
  - Rely on the trial and error of others
  - Licensing or rental may be attractive

Case Study – Building vs. Buying a Channel

- Cell phone towers → multi-user agreements
- Approaching accounts of recently purchased competitor
- Acquisition of small competitor with existing sales at targeted accounts (consider key employees and sources of supply)
- Manufacturer's reps with relationships at prospective customers

Sales and Marketing Channels

- Direct sales
- Catalog
- Distribution
- Internet
- Indirect sales

- Continual search for new channels
- Drop worst performing channels
- Expand best performing channels

Indirect Selling

- Position company as expert, and resource
  - Creation and capture of "needs"
  - Training sessions on customer focused considerations, onsite
  - Indirect product specification
- Service technicians
  - Strengthen customer experience
  - Ask 3 to 5 leading questions e.g. plant expansion, current challenges, future plans
- Join an association of your customers
  - Presence and availability
  - Knowledge of customer's industry
- Indirect selling creates barriers to entry, exclusivity – count "touches"

Case Study – Barriers to Entry

- Retailer provides 15% discount to college students (touches, and pre-emptive pipeline)
- Build relationships pre-emptively with emerging customers

Create Barriers to Entry

- User's groups for software company
  - Exclusivity
  - Shows you care, if suggestions are acted upon
- Avoid competition
- Ask your customers for differentiating factors, and suggestions for improvement
- Speed

Management Team

- Sustainability of management team
- Equity Participation for Management Team
- Bonuses, Retention Arrangements
  - Stay (payable for service post – deal)
  - Severance payable if not re-hired
- Alignment of interests vs. potential for risk

Important Factors (continued)

- Past and future capital expenditure program
- Assignability of customer or supplier contracts
- Legacy costs, e.g. out of date facility with excessive overhead; defined benefit pension plans
- Non-compete agreements
- Timing relative to business cycle

Sources of Capital

- Self; Investors
- Bank; Finance or Leasing Company
- Employees
- Customers
- Suppliers
- Government

Risk Management Case Study - Intellectual Property

- Stress test of intellectual property
- Software programmer, gone 10 years, may have claim to software.
- Confidentiality and Non-Compete Agreements
- Work for hire agreements
- Documented processes (e.g. onboarding customers, suppliers, acquisitions)

Risk Management

- Counter argument to balance sheet strength; security interest to bank
- Holding company structure

Holding Company

LLC
Operations

Rent, management fees, licensing, loans, etc.

LLC
Intellectual property, real estate, equipment, vehicles, "risky" division of business

Sale Process

- Confidentiality Agreement
- Term Sheet – structure and tax planning
- Letter of Intent – confidentiality, exclusivity
- Due Diligence checklist - script for questions
- Negotiations
- Drafting – changes in terms

Sale Process (continued)

- Rounds of review (leverage, reasonableness)
- Agreements
  - reps and warranties
  - escrow / holdback
- Schedules, Exhibits and Disclosures
- Closing – electronic
- Post-Closing

Case Study - Tax Efficiency

		Inefficient	Efficient
Purchase Price		$4,000,000	
Taxes	A	800,000	
Net to Seller		$3,200,000	
Post-Tax Cost to Buyer		$4,000,000	
Taxes to earn $4,000,000	B	2,400,000	
Pre-Tax Cost to Buyer		$6,400,000	
Total Taxes (50%)	A+ B	$3,200,000	
Compensation, rent, consulting, etc. to Seller			$5,400,000
Taxes to Seller (40%)			2,160,000
Net to Seller			$3,240,000

Deal Issues

- Escrow or Holdback: 5% to 25% of purchase price
- Financing (20% - 30% of equity)
- Plan for real estate (non-operational assets)
- Earn-out (generates capital for buyer, and manages risk)
- Business cycle; cash on the sidelines
- Managing advisors (manageable risk; what's good?)

Deal Issues (continued)

- Security and control of intellectual property
- Key suppliers
  - Interruption (replacement available quickly)
  - Pricing power
- Under promise, and over deliver (projections and budgets)

Deal Issues (continued)

- Monthly, weekly, and daily results
- Dashboard/monitoring system for KPIs
- Scalability
- Speedy and credible responses
- Deal room software
- Disinterested sellers
- Assurances regarding employee retention

Special Issues

- Estate Planning
  - Successor decision makers
  - New law
- Investment Advisors / Planners
  - Super man complex
  - Build relationships
- Alignment of interests

Case Study – Alignment of Interests

- Sales compensation based on margin
- Payment based on percentage of net income changed to percentage of sales
- Customer and supplier notices (avoided by stock rather than asset deal)

Special Issues (continued)

- Business brokers
  - Buy or sell side
  - Knowledge of industry
  - Payment contingent on sale
  - Deal inventory
  - Build 2 or 3 relationships years ahead of time
  - “Free” evaluation of business
- Cultural and personality fit

Learning Experiences / Deals

- Management of public relations and confidentiality
- Seller's role post transaction
- Distressed buyers (reacquisition opportunity)
- Reinvestment of proceeds (in stock market)

Lessons Learned: Strategy and Tactics

- Strategy – meet quarterly to:
  - Identify goals
  - Set priorities, and establish tactics
  - Manage risks
- Examples of tactics
  - Risk management
    - Holding company
    - Terms and conditions
    - Intellectual property
  - Capture opportunities
    - Alignment of interests
    - Acquisitions
    - Management team

Lessons Learned

- Valuation as a score card, guidance system
- Build a channel vs. finding, buying or renting one
- Cross-compare channels
  - Apply to sales, supply sources, recruiting, etc.
- Plan for management team
- Manage risks
  - Intellectual property
  - Holding company
- Anticipate demographics
- Develop barriers to entry

Lessons Learned

- Document and secure processes
- Implement tax efficiency
- Understand timing of Business Cycle
- Establish alignment of interests
- Assess investment and estate planning
- Others?

Rules of The Road

- What gets compensated, gets done.
- If you’re riding a dead horse, get off.
- If something is working well, do more of it.
- Get the right people on the bus.
- If you want to change the people, change the people.
- Hire slowly and fire quickly.
- Pay attention to where you are in the business cycle.
- Work smarter, not harder.
- Work on the business, not in the business.