Texada Capital Corporation

Preparing Your Private Company for Sale ©

It's another great year. Sales are up. Profitability for the year is in the bag. The client group is diverse, steady and growing. The management team is rock solid. Economic forecasts are positive all around. Sell now? No way! Wrong.

There's no better time to sell your company than when everything is going extremely well. Selling a company is like a beauty contest: the most attractive companies get sold for the best valuations. To optimize your company's chances, start the prep work well in advance.

The amount of lead-time required to prepare your company for sale depends on what kind of shape it is in. Here are some of the factors the investment bankers will consider in arriving at their first cut at valuation:

1. **Three years of profitability or more.** Shows a trend that gives people greater confidence in your company's ability to make those projections you will develop. Increases your chances for a higher valuation. Increases the cash portion of the transaction. Investment bankers often see companies with less than three years of profitability. After a few bad years, the company has turned things around and wants a valuation based on the last twelve months, which were very profitable, or tougher still, the next twelve months, which hold great promise. The more you ask the buyer to take performance on faith, the lower the valuation or the lower the cash portion or upfront consideration for the sale. This is when an earn out may become part of the deal structure. The buyer is saying, OK,

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if you perform at this level, I will pay you accordingly; however, if performance isn't there, the price is reduced as portions of the earn out remain unearned.

2. **Audited or reviewed numbers.** Having an outside auditing firm involved in the preparation of the company's numbers and tax information always give the buyer greater confidence. The more reputable the third party review, the better for the buyer.

3. **Stability of Management.** Nothing warms a buyer's heart more than seeing a management team in place that has worked together successfully for a number of years. Many buyers want management as part of an acquisition, especially in these days of lean management teams. Often the buying company does not have sufficient personnel available to move to the seller's location. It's OK if the senior team plans to leave if the next level down is stable and experienced. Getting the carryover management team ready is part of the prep work required.

4. **Breadth and Stability of Client Group.** Client concentration tends to lower a buyer's comfort level. Buyers prefer five to ten major clients, each with less than 25% of the business. Contractual relationships with clients are appreciated; direct marketing companies, however, often have short termination provisions in such contracts making the contracts less valuable than in other market sectors. Buyers prefer to see a client base that has been with the company five years or longer. With respect to e-clients, buyers are now savvy about reviewing the financial wherewithal of such clients to determine whether or not the buyer should consider them as "real" clients. Post the severe March 2000 downturn in the technology sector, clients with Fortune 1000 name brand recognition gave a company greater value than a company with strictly e-commerce clients, with names still relatively new or unknown.

5. **A Clear Market Niche.** Not all companies have such a niche, but smaller companies with a well-defined niche, which are a significant factor in that niche, have a strong case for higher valuations. Examples might be call centers specializing in the technology sector, call centers specializing in accounts receivable management, printers which print the supermarket coupon sections in the newspaper, or logistics companies which specialize in trade shows.

6. **Technology: A Balancing Act.** Clients of direct marketing companies love those beautiful new facilities with the latest technology. The IT guru is key to the success or failure of such facilities. Find an IT guru who can also "sell" potential clients and things really start popping! What does this all mean for valuation? Beautiful facilities and the latest technology don't

come free. Intense capital investment can be a real drain on profits. In the final analysis, making money is what it's all about. For direct marketing companies, it's a balancing act. The facilities and current technology need to provide the clients with real financial benefits. If you're DSC Logistics, you solve the problem in part by linking your facilities to your client's facilities: the DowBrands plant in Urbana manufactures home care products which move via a conveyor system directly into DSC Logistics for storage, retrieval, assembly, wrapping and shipping. Other companies put penalty clauses into a client's contract for early departure if a significant technology investment was required for that client. Many direct marketing companies grew out of, and are paired with, more established, cash generating businesses which foot the bill for technology investments in return for a higher valuation on the direct marketing segment of the business. Most at risk are the newer direct marketing companies without a partner. With the venture money and IPO opportunities dried up for "clicks" after March of 2000, newer direct marketing companies are scrambling for capital and often find it by partnering with less glamorous businesses.

7. **Do Your Homework.** There are some other important steps that you should take to prepare for the sale of your company. See your accountant and tax advisor. Understand the difference in the net proceeds that you will receive in an asset sale versus a stock sale. Understand the difference to you if you are an "S" corporation versus a "C" corporation. Understanding the tax and cash consequences of a deal structure will make you a more effective negotiator. If you need to do some estate or financial planning work, get that work done so that you know what to do with the proceeds once you close.

   Ask your tax advisors, accountants and others to recommend a "deal attorney". It's extremely important to be represented in a sale by an attorney who has considerable experience in selling companies like yours: done at least ten to fifteen transactions in the size range of your transaction or larger. An experienced deal attorney will save you time and money, and can make the difference between a successful sale and a botched sale. He or she will know how to properly help negotiate the transaction documents, and will not waste time on the items that are not important. Most importantly, an experienced deal attorney will ensure that your due diligence on the buyer is done properly to minimize the risk of ugly surprises post closing.

8. **Make Sure Your Web Site is Current and Looks Great!** The first thing a potential buyer will do once your company is identified is look at your web site. There are some fabulous web sites in cyberspace. There are also many poor web sites. Treat your web site as one of your most important

marketing tools. It is! Make sure it is well written, not drab. Make sure your address and phone numbers are easy to find. The site does not need to be overly long or gimmicky. It does need to be letter perfect and a useful tool for your company, both in and outside the company. It has to load quickly and be easy to manipulate. You can give visitors options to prolong their visits or not.

Don't have a web site? Rethink your position unless yours is an extremely small company that plans to stay that way. Is a bad web site worse than no web site? Yes. You've given a potential customer a glimpse at what you can do, and turned them away.

Details

Keep certain basics in mind. If no one likes walking through the front door of your company because it looks tired, clean it up. A coat of paint doesn't cost a lot, but it's hard to repair negative first impressions. As an investment banker, if I don't want to be at the company a minute longer than necessary because the space is dirty or depressing, not only do I not want to bring potential buyers there, it's very likely that I won't take the assignment because I have to be in and out of that environment for the next three to six months myself.

If there are many unusual or excessive perks in the company that benefit the owners and those related to the owners, start to shift the cost of those perks to the individuals who benefit: boats, planes, multiple country club memberships, etc. It's normal for the investment bankers to adjust earnings for higher compensation to owner/managers. It's not normal for the company to be paying someone's alimony or house payments. Excessive perks can leave a more frugally minded buyer thinking that the difference in spending habits can't be bridged.