

MAXIMUM VALUE

Help clients glean the most when selling a business.

BY MARK GROULX, *president of A.I.M. Group Canada. mgroulx@aimgroupcanada.com*

THERE IS A GREAT DEAL of preparation required to maximize the valuation of a business that's looking to be sold.

First and foremost is to maximize the company's EBITDA. Although most theoretical models of valuation are based on discounted future cash flows, in the real world the biggest criteria for valuing a business is EBITDA or historical earnings.

Next comes maximization of the earnings of the business. Ideally, buyers want to purchase a company with increasing sales, increasing earnings and good prospects for these trends to continue. Companies that exhibit such trends get the highest multiples of EBITDA.

For most industries, the valuation of the company (or what someone is willing to pay for a privately held company, and analogous to market capitalization for public companies) is the EBITDA times a multiple. That multiple can range from one to 10 times but for most companies it's in the two-to-six range. Obviously, the higher the multiple the happier the seller.

Before looking at what merits a higher multiple, there is one elephant in the room that needs to be addressed. Many entrepreneurs put numerous expenses through their businesses that could be construed as personal. These can include non-active relatives on the payroll and personal expenses of all sorts. These expenses will affect the valuation of a business adversely, so it's best to get them cleared up before putting the business up for sale.

So how do you get the best multiple? The most important factor can be summed up in two words: recurring revenue. Some businesses are transaction-oriented. Once the transaction is complete, there is no more revenue to be generated from that customer. The insurance agency business is a classic case of recurring revenue. Every year we all get our property, auto, life and other insurance invoices and send in our cheques because we don't want to be uninsured. If a business owner can display evidence of recurring **continued on page 20**

continued from page 19 revenue, by showing that customers come back time and time again, it will increase the multiple.

Another important factor in maximizing the multiple is barriers to entry. If a client is in a business that's difficult to get into, particularly one that requires large capital expenditures, sophisticated intellectual property, or geographic dominance, then the barriers to entry are high and that pushes up the multiple.

Then there are synergies. I once sold a company to its direct competitor whose parent company was a supplier of raw materials but didn't supply the company I had for sale. The purchase, therefore, allowed the buyer to eliminate a competitor, and take the sales in-house—which led to economies of scale due to a decrease in overhead. At the same time, the parent company was getting a new customer for its raw materials. So, to say we got a high multiple would be an understatement.

Another thing to keep in mind is that buyers don't want to purchase companies that are run by one person with an iron fist. Such concentration of power dramatically increases the chances the value of the business will decrease once the owner leaves after a sale. Buyers prefer to see a company that runs like a machine. Information and process systems must be in place and automated. Files must be organized and computerized. The more the information systems are automated, the more likely the business can function without the owner's daily participation.

Further, management teams generally add value because they provide cohesiveness and move the firm beyond the founder. Unfortunately, some sales scenarios lead to management being made redundant, but that's a risk in any sale process. On average, it is better for the seller to have a good team in place.

Lastly, the business owner must be prepared for the sale. Make sure the selling client has shareholders' agreements up to date and that those agreements provide for a sale. Advise the client to simplify the company's share structure if there are multiple classes of shares. And speak to the company's accountants and lawyers about the Small Business Capital Gains Tax Exemption, which allows the first \$750,000 of capital gains to be tax-free for every selling shareholder.