

On The BLOCK

The process of selling an HVAC/R business.

BY MARK GROULX

The recent sale of two HVAC/R service companies, one in central Canada and one in Atlantic Canada, affirm the demand in the marketplace for the acquisition of HVAC/R contracting companies. These fall into two categories: those that specialize in commercial and industrial customers, and those focussed on the residential market. There is also demand for distribution and manufacturing companies but these categories require much larger earnings to get buyers' interest.

Commercial and industrial companies will get higher multiples of EBITDA – Earnings Before Interest, Taxes, Depreciation and Amortization (see *below*) than residential contracting companies because of their recurring revenue. In some cases commercial companies will have customers for decades. This provides a revenue stream, which has a good degree of certainty and allows the buyer to pay for that future cash stream. As such, residential businesses will sell for 2.5 to five times EBITDA, while commercial company prices range from four to six times EBITDA.

THE STEPS TO TAKE

First and foremost you need to get the company and its records in order. This could take anywhere from two to six months. Your tax planning should already be in place and you should check with your accountant to confirm that the sale of your business has been considered as part of your tax planning. During this phase of the process your advisor will collect information on the operations of the business, including: the ownership; employees; statistics and trends in the industry; competitors; your competitive advantage; and your historical and projected financial information. With this information your advisor will prepare a Confidential Information Memorandum (CIM) describing the

main aspects of your business. This exercise will also help prepare you for the due diligence requirements.

Academically speaking, the value of any company at a point in time is the net present value of its future earnings potential. A more practical way of expressing this sentiment is achieved by putting a multiple on your EBITDA. EBITDA is simply calculated by adding your interest expense, depreciation and amortization to your pre-tax earnings found on your income statement.

Determining what multiple to choose is a function of estimating how sustainable the EBITDA will be in the future and what growth prospects there are for the EBITDA. The more sustainable and the more growth expected results in a higher multiple.

For purposes of determining a valuation of the business, the EBITDA will be reduced by any capital or other annual expenditures that are required to sustain the business. If you have long-term debt on your balance sheet the proceeds will be reduced by the amount of debt the purchaser is acquiring.

In summary, if you generated \$2 million in net EBITDA last year and you have good prospects for continued profitability, a conservative estimate would be an \$8 to \$10 million purchase price. There are always other factors that may help or hinder the multiple. Your geographic location





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may be a plus or minus depending on the buyer, specific customers, personnel qualifications and so forth. Each buyer has hot buttons and cold. The exercise is to find the group that is the best fit.

Strategic buyers in your industry are the best prospects and, more often than not, that will be a larger, direct competitor. Financial buyers such as private equity firms are also becoming more active for the larger deals. Your advisor will prepare a list, with your assistance, to determine the best prospects.

Before any information is sent to prospective buyers they will be required to sign a Confidentiality Agreement.

The Confidential Information Memoranda, which is often called The Book, is the thorough summary of your business referred to in Step 1.

Prospective buyers will want to have site visits and ask additional questions specifically relevant to them.

Letters of Intent are non-binding letters outline the price and structure of the proposed transaction, as well as the broad terms and conditions the prospective buyers are proposing. It forms the basis for negotiations that will lead to the final deal.

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Hopefully you will get a few Letters of Intent, which need to be negotiated for better terms and to determine who you want to enter into an agreement with. It is not just price that is the determining factor in most deals.

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Buyer's Due Diligence involves the buyer reviewing all legal, accounting, tax, banking, human resources, health and safety, information systems, real estate and other material contracts. They will also make investigations into products, customers, outstanding litigation, environmental issues and so forth. This is a time-consuming process and requires a great deal of preparation.

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The lawyers paper the legal documentation for the deal but negotiations continue throughout this stage of the process.

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Money changes hands and the keys are passed to the buyer at the final step – **the Closing**.

Selling a business is a complicated, time-consuming and often stressful event. Given the magnitude of these transactions, retaining the advice and assistance of a professional with experience in the financial transaction markets may be prudent. That person will not only manage the process while you continue to run your business, but will also act as a buffer in the negotiation process. **HPAC**

Mark Groulx is president of A.I.M. Group Canada. He can be reached at mark@aimgc.ca. Groulx will be speaking at CMX/CIPHEX on March 26, 2010. Watch for more on buying and selling a business in upcoming issues.

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