

BY PLANNING, OWNERS CAN MAXIMIZE VALUE OF BUSINESS, PERSONAL WEALTH

From 1997 to 1999, the Richmond area saw a significant number of small and middle market companies sold to larger, closely held companies as well as public companies.

Recent market events such as the downturn in market values of companies traded on Nasdaq, the difficulties experienced by new companies in accessing capital through initial public offerings, and the tightening of financial markets in making debt financing available for leveraging, have resulted in a decline in the number of these types of transactions locally and nationally.

In fact, some of these transactions are now being undone, as is evidenced by Align360's re-acquisition of itself from Renaissance Worldwide Inc. earlier this year. As reported in the March 4 edition of the Richmond Times-Dispatch, Renaissance acquired the forerunner of Align360, the McClain Group, in 1997 at a price of \$15 million. However, management recently purchased Align360 at the substantially lower price of \$5 million, with Renaissance retaining a 25 percent interest, even though revenues had tripled over the three-year period.

Such dramatic changes in value are not often contemplated by the owners of small, closely held businesses who may be dependent upon the value of their businesses to fund their retirements.

Many such owners fail to develop a business plan and, in particular, their "exit strategy," or plan for transferring ownership of the business.

The adage "A failure to plan is a plan to fail" is a real threat, as the lack of a strategy may result in an involuntary transfer of ownership through death of the owner, divorce, disputes with other shareholders or bankruptcy.

What planning should an owner be doing to maximize the potential value of the business and to develop an exit strategy? The fundamental question of "What is value?" should first be answered.

Value means different things to different people. Value is not simply what the owner believes it to be. Nor is it the company's "book value." Rather, value is forward-looking. The key to maximizing value is to maximize the potential for future economic income that the business can earn given an acceptable level of risk.

As part of the planning effort to maximize value, an owner needs to know the current status of the business

before he can look forward. The first step in this process is to assess the company's current financial position. This may require the retention of a certified public accountant to conduct a review or audit of the records and to prepare financial statements in accordance with generally accepted accounting principles.

The next step in the planning process is to determine the business's current value. The valuation should be performed by a qualified business appraiser who possesses specialized certifications in valuation such as the Accredited in Business Valuation certification awarded by the American Institute of CPAs or the Accredited Senior Appraiser certification offered by the American Society of Appraisers.

As part of the valuation process, a business appraiser can assist the owner in assessing the business's "value drivers" and risk factors, which affect the company's future earnings prospects.

When considering factors with impact on the value of their businesses, many owners focus on revenues, profits or net assets. However, there are many factors, external and internal, that may influence value.

External factors include financial markets, availability of capital, interest rates, economic trends, demographics, industry conditions and trends, market share, the competitive environment and government regulation.

Internal factors, in addition to financial performance, include the rate of growth and volatility, the seasonality and cyclical nature of sales, size in terms of sales or assets, depth of management, geographic market presence, customer concentration, types and diversification of product or services, and intangibles such as name and reputation, customer base and assembled work force.

Since the business owner cannot exert any control over the external factors, in planning for the maximization of value, the owner should identify internal factors that are the value drivers for the business as well as factors that represent potential risk.

The product of this effort should be translated into a written business plan that will service as a road map for the future direction of the company.

The plan should include performance objectives for the various financial and operational factors so that the company's progress can be measured, as well as strategies for accomplishing

these objectives. Further, the plan should discuss strategies for minimizing risk.

The planning process may result in the realization that additional funding will be required in order to achieve the desired financial objectives. The owner must assess his willingness to assume the related risk as well as determining if he has the required time horizon to achieve the desired objectives.

Consideration should next be given to planning for the owner's future exit strategy. It is important during this phase to involve other key professional advisers. Such advisers include corporate and trust and estate attorneys to assist in drafting shareholder agreements as well as personal wills and trust documents, insurance specialists to assist with writing the appropriate types and amounts of insurance, and tax consultants to assess the tax implications of alternative strategies.

With this team in place, alternative strategies may be developed to determine the best exit strategy for the particular owner. Assuming that there are other current owners of the business, one possible strategy is to transfer ownership to another owner. Such a transfer can be effected through a Buy/Sell Agreement.

Another strategy is to transfer the ownership interest to other family members through either an outright sale or the gifting of interests over time as part of an estate planning strategy.

Transfers of ownership interests to employees is another viable option. Such transfers may be accomplished through establishment of an Employee Stock Ownership Plan, which provides for transfers over this time with significant tax advantages or through a management buyout.

Finally, sale of an interest to third parties may be a viable alternative. In evaluating the range of values for purposes of negotiating a sale, the owner should assess synergies with potential acquirers as well as potential earnings growth after sale because these factors will make the business a more attractive acquisition candidate.

Harold G. Martin Jr., MBA, CPA/ABV, ASA, is the Principal-in-Charge of Business Valuation Services for Keiter, Stephens, Hurst, Gary & Shreaves, P.C., a full-service CPA firm based in Richmond. For further information, please contact him by phone at (804) 273-6240 or e-mail at hmartin@kshgs.com.