

# MAXI

## your selling price

Value creation methods stay the same, no matter the state of the economy

**N**ow that the global recession is receding somewhat, businesses owners wanting to sell are finding more takers than a few months ago. Unfortunately, those potential buyers are not as keen as they were when the economy was riding high, nor do they have as much cash in their hands to seal the deal. And that is having some impact

on how professional valuers are currently calculating business worth.

“It was impossible to sell anything between September 2008 and September 2009,” says Tom Strezos, a partner in charge of the private client valuation practice of Deloitte in Toronto. “Earnings multiples—the figures used to arrive at valuations—fell off the table because transactions were so rare.”

Howard Johnson, managing director of Toronto-based Veracap Corporate Finance,

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**Photography by Paul Lawrence**

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notes that “valuations are generally better now that they were a year ago, but they are certainly not at the levels we saw in 2006 and 2007, when there was an unprecedented buoyancy in the market.”

Nevertheless, “in turbulent or good economic times, for large firms or small, for public or private companies, the principles of creating business value remain the same,” ex-

plains Michael Epstein, a partner in the advisory services practice of PricewaterhouseCoopers LLP in Toronto. “Similarly, a company’s focus on its strategic goals must remain the same—optimizing your financial performance. Otherwise, you’re dead in the water.”

All three experts chant the same basic mantra—it takes time to sell a business to get the best valuation possible. You have to

make a plan, set long and short-term objectives and then do your level best to achieve them. “It takes time to build your business value and successfully execute your strategic goals to get the best results,” Epstein stresses. Ideally, businesses looking for buyers today should have begun to prepare for a sale at least two or more years ago.

Naturally, today’s tough business climate means that business valuations will be lower than in the halcyon days of 2006 and 2007.

Strezos notes that, in those years, average public price/earnings multiples were in the 22 times range; they then plummeted to half that or less in 2008–09. “Now, there’s a lot more buoyancy and activity has picked up and we’re getting back to pre-crash multiples, but they’re not yet what they were.” However, that doesn’t mean owners can’t improve their odds of getting a good valuation.

Now, as then, most business valuers describe what they do as an art, not a science, because their valuations can be affected by so many factors outside of a vendor’s control—the volatile economy, the failure or success of competitors, the health of senior management and simply the fickleness of the marketplace. Different valuers may well arrive at different valuations for the same business, using the same valuation parameters. Nevertheless, the art is based on a standard process that ultimately leads to arriving at a value for a business.

According to Donna Smith, of Thunder Bay, Ont.-based Bain Smith Business Valuation and Consulting Inc., that process begins with asking the prospective vendor for a whole lot of information, such as financial statements, corporate tax returns, shareholders, employees, financing, leases, suppliers, franchise or customer agreements, listing of the capital assets and their appraisals, ongoing or potential lawsuits, shareholder/management salaries and bonuses and relevant business plans and cash-flow projections from the past few years.

“We also tour the facilities and get to know both the owner and the business,” Smith adds. “By the time we leave our first meeting, we usually have a good sense of the business’ critical success factors, the business and industry risks, the key employees, competitors, suppliers and customers, the value drivers, the cash flows that can be expected in the future, redundant assets, if any, the owner’s and other non-arms length parties’ roles and the existence of discretionary, unusual or one-time items.”

Smith says she would also do some external research, studying the industry, competition, market and economy and looking for comparable market transactions.

Unfortunately, Strezos points out, owners’ expectations can get in the way of a realistic

evaluation. “Owners always overvalue their business—it’s their baby, their passion—and it takes someone like us to bring reality into the picture.” That doesn’t mean owners can’t go through some effort to bring reality closer to their expectations.

A quick to-do list for improving the attractiveness of your company, says Strezos, would include:

## IMPROVING PROSPECTS

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- ✓ **FOCUS ON** product profitability to increase your gross margins and your company’s profitability.
- ✓ **AIM FOR** strong and positive cash flows over the next few years.
- ✓ **SET UP** good barriers to entry into your market space.
- ✓ **MAKE SURE** all your corporate contracts are executed, up to date and nicely filed.
- ✓ **SET YOUR** legal matters in order.
- ✓ **ENSURE ALL** your filings are up to date, such as tax, financial statements or other compliance filings.

■ Focus on product profitability to increase your gross margins and your company’s profitability. “You need a strong income statement.”

■ Aim for strong and positive cash flows over the next few years.

■ Set up good barriers to entry into your market space. “If it is difficult to enter your market, that gives you a competitive edge.”

■ Make sure all your corporate contracts are executed, up to date and nicely filed.

■ Set your legal matters in order—“you don’t want any litigation to be going on.”

■ Ensure all your filings are up to date, such as tax, financial statements or other compliance filings.

Strezos also stresses the importance of a good capital management program. “Buyers don’t want to lay out a lot of money right away for capital assets. If you repair your machinery, keep it in good order and, say, replace it every five or six years, that will increase the value of your business.”

To that list, Johnson adds clearing out old or obsolete inventory, selling off redundant assets, securing management and key employees with employment contracts and creating “barriers to exit” that make it more difficult for customers to go elsewhere. Examples of such barriers would be long-term service contracts or maintaining a database of proprietary information that customers rely on.

Johnson also feels that it is essential to keep your website current. “A company’s website is one of the first things that a prospective buyer will examine when investigating a business that is for sale. It must appear professional and highlight the company’s unique selling proposition and key strengths.”

Epstein recommends creating that unique selling proposition by developing something completely your own. “You need to create a brand—a personality behind your product or service that makes it different and stand out.” He cites the case of Chiquita bananas commanding a premium price in the supermarket when “all they are is bananas—there’s no product differentiation in bananas, and yet people will pay more for Chiquitas.”

On the flip side, say the experts, relying on only a small customer base will decrease your business value, as will volatile or declining earnings, being in a declining industry or having outdated equipment. Over-reliance on one owner is also a no-no. “If something happens to that owner, what will happen to the business?” Strezos asks.

Adding up the pluses and minuses will get you only so far in valuing an entity. Although there are various mathematical ways of arriving at the magic number, Canada’s business valuers tend to stick to two basic approaches.

First is to apply an ‘earnings before interest, taxes, depreciation and amortization mul-



tiple' to EBITDA. The EBITDA times the EBITDA multiple generates the enterprise value of a business. Enterprise value refers to the total value of a company.

Johnson explains that “it is important that EBITDA reflect what a buyer or financial investor would expect the company to generate in terms of operating cash flow each year over the near to mid-term future period.”

He also notes that, while EBITDA multiples are inherently subjective, they are influenced by factors such as company

size, revenue stability, customer base, proprietary products or services, growth expectations, debt capacity and capital expenditure requirements.

Second is the discounted cash flow method, which—although complicated to work out—captures all of the variables that ultimately influence the return that a buyer realizes on his investment.

This method, says Johnson, is predicated on the principle that a dollar received at some point in the future is worth less than

**Valuations for businesses are better today than they were in the depths of the recession, says Howard Johnson, managing director of Veracap Corporate Finance, but still not back to pre-crash levels.**



**Whether the economy is in a downturn or rebounding, the fundamental principles of creating value in a business remain constant, stresses Michael Epstein, a partner in the advisory services practice at PwC.**

a dollar received today. “The discount rate represents a potential buyer’s required rate of return for a particular investment opportunity given the risks associated with it. A higher discount rate is required where higher levels of risk are perceived, or where the buyer believes that the projected cash flows would be difficult to achieve.”

In the end, it’s all about cash flow. “Business values are primarily based on a company’s future cash flow,” Johnson says. “Valuation multiples and rates of return are a function of a company’s risk profile and

growth prospects, as well as the optimism in the forecast cash flows.”

Preparing for a sale, Epstein stresses again, takes time. “Great companies work hard at optimizing their financial performance and building long-term value by reducing their vulnerability to the vagaries of the market.”

But what if you don’t have that time? If, for whatever reason, you need to sell suddenly? “Good economy or bad, you’re going to have a tough time of it,” Epstein warns. “In a forced sale, time is not on your side and you could end up with a fire-sale valuation.” **END**