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Professional Accountants are Key to the Success of a Business Sale

Mark Ostryn – Strategic Transactions and Valuations

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Professional Accountants are Key to the Success of a Business Sale.

Mark Ostryn, Director – Strategic Transactions & Valuations

Key Takeaway: Professional accounting firms trusted by mid-sized businesses are in a remarkable position. Successful firms dedicate themselves to building, protecting and realising their clients' wealth.

More than 50% of business owners hope to exit in the next 5 years. This is a great opportunity for accounting firms to provide their owner clients with quality advice helping your client make better business decisions.

More than half of the wealth of the owner of a mid-sized business is contained within his or her business. It's also the piece of their overall wealth that they have most direct control over. Their shares and their investment properties fluctuate in value without any input from themselves, while their business needs their ongoing attention.

So, regardless of whether your client is considering exit, they must be proactively working to improve the value of their major asset. And you, their accountant is trusted, more so than any other professional advisor, to make sure that happens. **This is a win-win proposition for the accountant deriving recurring professional fees from highly satisfying work.**

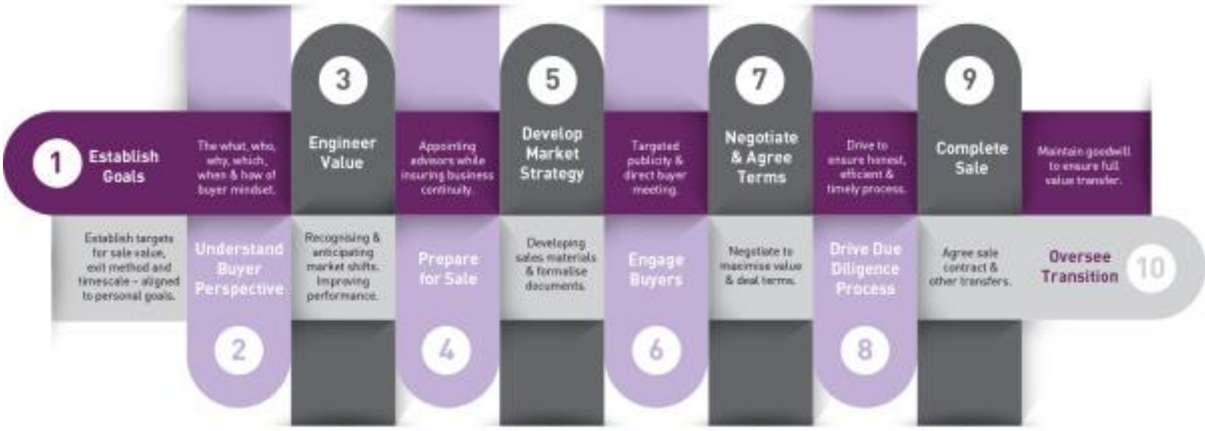
Key Message

One key message that accountants must get across to their owner clients is:

Small increases in net annual business returns, make dramatic differences over time. A business worth a $1m growing at 10% per annum will result in almost $1m worth of extra value in 10 years compared to an owner than a business growing at 5%.

I've had the pleasure of partnering with numerous accounting firms who work tirelessly with their clients by proactively assisting them to create, build and protect their value.

All these professionals recognise that, regardless of the owners' timeframe to exit they must be proactively strategizing to improve their clients cash flow, growth prospects and eventually their sale price. The exit, either via trade sale, family succession or partnership / management buyout typically follows the following ten steps:



1. ESTABLISH GOALS

Encourage your client to set financial goals and timeframes for exit. Your client should also understand the current value of their business. M& A advisers like myself, using our Value Discovery services (see appendices), can provide an indicative and independent current value. The gap between the sale value they need and its current worth is a "value gap."

Financial Exit Goal – Current Business Value = Value Gap

This value gap must also take into account the other exit liabilities such as capital gains tax, and other commitment such as partners and minority shareholders.

2. UNDERSTAND BUYER PERSPECTIVE

No matter what your clients' business is valued it, the figure remains theoretical until a buyer agrees to pay that amount. Ultimately fair market value is based on

*"what a knowledgeable, willing, and unpressured buyer would probably pay to a knowledgeable, willing, and unpressured seller in the **market**."*

and that price will depend upon the number and interest of buyers and the competitive tension created between them.

At this stage, your client has to work to re-engineer their business around what they perceive that buyers are looking for. You, the accountant can be their arm's length external advisor, challenging your client by seeing the business like an outsider would.

One way to help your client is to look at the most likely potential ***motive*** that a buyer would have for acquiring the business. Typical motives may include:

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- Consolidation and economies of scale
- Geographic expansion
- Increase market share
- Acquire customers or distribution channels
- Expand or diversify products.
- Acquire intellectual capital
- Defensive move- to prevent competition
- Hire key people

Of course, buyers may have more than one motive. For example, an overseas acquirer may wish to expand geographically with their product portfolio while acquiring the sellers' products for their existing territories.

3. ENGINEER VALUE

Closing the value gap is all about growing the business simultaneously protecting its value. Growing the business involves automated businesses processes, ensuring it's scalable, that the businesses revenues can recur and that costs are known and contained. In the words of Daniel Priestley, author of the latest best-selling book, 24 Assets, "Income follows assets." Owners need to work hard to cultivate their brand, market, product, systems, culture and funding assets, such that they are truly valued by their successors.

The accountant is well placed to advised their owner client on what the financial drivers behind creating assets. These would include processes for improving cash flow, optimising performance, developing efficiencies, generating extra revenue or reducing costs.

It's not just the verbal advice that matters. Financial updates for a board, senior managers or other stakeholders need to be clearer and considerably more decision focused. That requires better use of illustrations and short sentences to drive the key points home, rather than endless pages of numbers.

Several progressive accounting firms have also incorporated the use of Business Intelligence tools. These take data from several external and internal sources, to give your clients drop visualisation tools that analyse and explore insights.

4. PREPARE FOR SALE

Owners enjoy the most successful transactions when they have fully prepared for them. Many transactions fail as a consequence of inadequate information or the delay in providing it. At this stage, the Accountant needs to help ensure that the financials are all in order,

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ready for inclusion in the data room. The accounts should be normalised to remove the financials of none-core businesses, one off expenses, and personal expenses that should never have been included in the business.

A trusted accounting advisor will also be involved in reinforcing your clients' growth projection. Acquirers price a business based on future cash flow projections. While your client cannot explicitly say that "the business will grow x% in 20xx" they need to have justifications on hand including:

- Projections with reasonable assumptions based on historic trends and expected future occurrences.
- Updated industry data including benchmarks and robust industry reports.
- Details of precedent private transactions that justify a specific value.

5. DEVELOP MARKET STRATEGY

This is a key pre-market step where sales materials such as the Information Memorandum are produced, a valuation can be obtained and the M&A advisor works with the client to produce a short list of prospective acquirers. If the client needs a formal valuation, be sure to help them hire an arms-length valuation firm. It would not be independent if you, their accountant was to do it themselves.

Pricing the business is a challenge. Don't let the price be dictated by the initial offer of a potential acquirer who demands exclusivity on the transaction. Rather consider the factors that would help assess the expected level of competitive tension that could be generated by competing bidders.

- Opportunities for growth in sales within market
- Opportunities for competitors to consolidate and create efficiencies.
- Opportunities for new players to enter the market.
- Opportunities for businesses to capitalise on your intellectual property assets – intellectual property, customer database, distribution channels, brand, skilled personnel etc.

6. ENGAGE BUYERS

At this point, your vendor client is, through their advisors, approaching prospective clients and assessing the level of market interest. While the M&A adviser tends to take the leading role with the approach to market, accountants are able to use their leverage as "most trusted adviser" in helping clients making better financial decisions by acting as a sounding board.

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Accountants can also assist with the evaluation of prospective buyers & their capacity to fund the acquisition.

7. NEGOTIATE AND AGREE TERMS

There is often an extended period where the prospective buyer understands the sellers' business. This is in order to assess the value of the business to the buyer, and how, the business may be of value in a merger situation with the buyers' current business.

In order to do this, your client owner may require guidance on whether certain sensitive financial materials that may compromise the business be released. This occurs when competitors seek to merge two businesses.

Moreover, business owners frequently don't understand some of the numerical information and your role is to build client trust by ensuring that the numerical information provided is understood.

This client trust is absolutely invaluable when offers are received from potential acquirers and they fall below your clients' expectation. Emotions tend to run high in such adversarial circumstances, and the accountant should proactively be called upon to bridge a price expectations gap.

Finally, agreement to terms, frequently involve a financial modelling process that takes into account a negotiation based on profit opportunity, risk, timing and structure. A full schematic is included in the appendices.

8. DRIVE DUE DILIGENCE PROCESS

Due diligence has a nasty way of lengthening transaction timescales and reducing the deal price. Your assistance is essential in getting the accounts clean, for example ensuring that the add backs are verifiable and defensible, being responsive to the scrutiny of the acquirer and generally ensuring that the transaction proceeds smoothly.

It's important for the financial adviser to maintain constant contact with the legal team. Many of the contract amendments resulting from the due diligence will have financial implications that need to be considered.

At due diligence stage, with documents flying around from M&A firm to your client lawyer to the buyers' lawyer, the importance of you having efficient workflow processes are integral. Track the materials are integral as the findings of the due diligence may have consequences for the final sale contract.

9. COMPLETE SALE

The final deal structure can be as important as deal value. There are various components of the deal that require the accountant to wade in and analyse.

One possible challenge is that of the earnout. Around 50% of all sale contracts for mid-sized businesses have an earn out clauses that relate future performance, with or without the departing owner, to the final payout. Some are based on future profitability, some of revenue, and some more are even determined by nefarious benchmarks such as new client acquisition. It is important for your client to revenue the upside opportunities and downside risks in such structures.

Alongside the possible earnout there are several considerations including the transfer over of employees and their entitlements, the finalisation of work-in-progress, stock in trade and overall working capital and the adjustments required in the final contract.

10. OVERSEE TRANSITION

The success of the post-acquisition transition, whether it's simply a new owner, or a full merger with the acquirers' business, is integral to maintaining and growing the business value. Nothing can turn a smart purchase into a dumb purchase faster than the loss of key staff or customers.

Some of the accountants' challenges include standardised financial reporting and accounting systems, client workflow and decision processes. The quid pro-quo in maintaining your watchful eye on the key value drivers post-acquisition is that you maintain the client and are able to help chart its future progress.

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THE VALUE DISCOVERY METHODOLOGY

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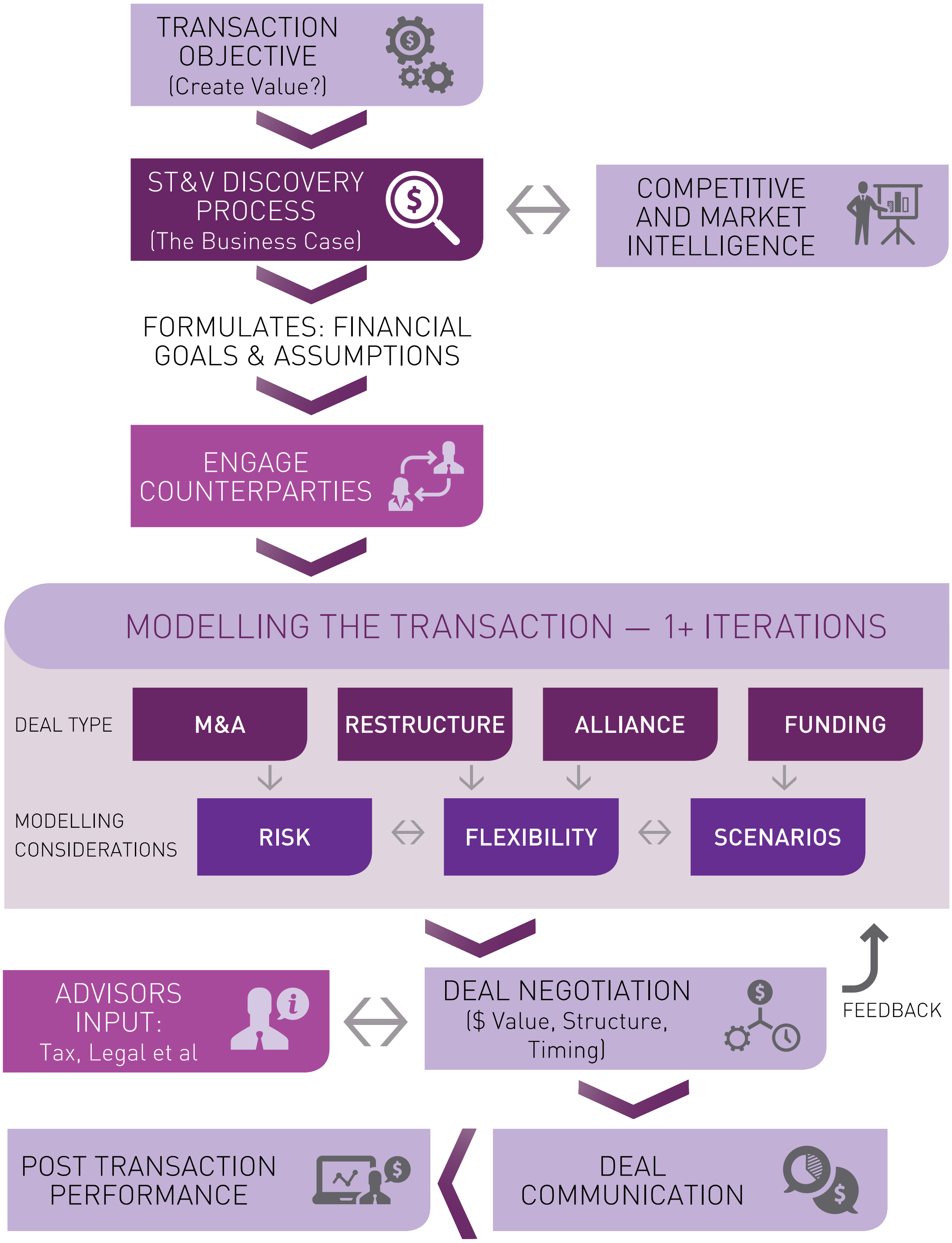
MODELLING THE TRANSACTION



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