

Value-added exits

How an intermediary can extract the most from a business sale **Interviewed by Paul R. Harvey**

When the day arrives for a business owner to transition his life's work on to the next custodian, many complex issues must be addressed to realize maximum value at closing.

Entrepreneurs with a significant emotional stake in their business often are tempted to tackle the sale process. They know the business inside and out and believe they are best suited to bring it to market. But owners who want to maximize value should turn to an intermediary to develop and implement their exit strategy.

"An intermediary is skilled at negotiating and — more importantly — understanding all the ways to extract value and put a price tag on that value," says R. Todd Lazenby, managing partner of WP Capital Partners LP. "Nine times out of 10, the intermediary can garner a much higher total result than if the client did it on his own."

Smart Business spoke with Lazenby about exit strategies, adding value to a sale and what separates brokers and investment bankers.

What is the difference between a broker and investment banker?

Brokers are highly qualified to deal with smaller, fairly simple businesses up to approximately \$12 million that don't have the corporate governance issues and capitalization issues like multiple levels of debt and equity, a large number of shareholders, dissenting shareholder transactions, different classes of shareholders and other concerns.

Investment banks add value to larger transactions with their ability to bring a much broader scope of potential investors or buyers to the table, and their ability to structure transactions that create higher yields for more complex companies.

Sellers should be aware of this difference.

What categories are analyzed before a business is brought to market?

An in-depth evaluation of the company's business model, its core competencies, the quality of books and records, the level of automation and types of technologies that



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are employed, its supply-chain, its organizational structure, and the scalability of the company are critical up front.

Typically, the depth and breadth of management should be a key concern. Who are the people? What kind of culture has been engendered? Does the company revolve concentrically around the entrepreneur or is a team executing on all cylinders? Prospective buyers have to be able to evaluate post-closing execution risk.

One of the most important factors for positioning the company and maximizing its value is identifying competitive and comparative advantages that the company has relative to competitors. What is its pricing model — is it leaving money on the table? Does it understand its point price elasticity of demand; if it raises or lowers its price, how will a change affect the demand function?

Finally, the company's costs and margins must be scrutinized. Buyers will want a guarantee of future acceptable margins, especially if the purchase is highly leveraged. Another crucial area reviewed is the delivery channel used to get products or services into the market. Does a heavy customer concentration issue exist, or is there a diverse array of clients? These are critical items that drive ultimate value.

How and when are problems with these areas addressed?

Some categories should be addressed before going to market while others can be adjusted during the process. An experienced intermediary can play a critical role in assisting companies to shift their business models, before and during the marketing phase. I've advised companies on radical moves such as changing their entire revenue model, focusing on recurring revenue, switching from a P.O. (purchase order) basis to a contract basis, or switching from sole sourcing to competitive bids.

Can the previous owner remain involved with the company?

Owners frequently misconceive that they will be obfuscated after spending their life building the company. Actually, there are methods that create liquidity for the seller but allow him or her to stay on board longer-term. Sellers can become owners in the new enterprise. We will typically negotiate operating covenants or blocking rights, so they have a strong voice in how the company functions thereafter.

What should a seller look for in retaining an investment banker?

The broker or investment banker hired should be sophisticated in his or her approach to valuing a company and demonstrate a track record of performance in this regard. Analysis of all components is crucial.

Many times, splitting the company into pieces and having the parts individually valued maximizes aggregate value. One entity may generate strong recurring revenue or maintain critical operations and relationships, while another controls intellectual property or holds new products that haven't yet been patented or brought to market. Identifying and quantifying these value drivers is the key.

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