

### Are You Planning To Sell Your Business?

In this issue of Business Forward, our feature articles are on maximising the sale value of your business.

From the moment you acquire or commence a business you should assume that one day you will want to sell or merge it with another business. To enable the best possible return, you should always keep the business in a 'saleable state'. If you decide to sell your business today and want it listed for sale in 6 weeks' time, most probably you will not be giving yourself enough time to maximise the potential return. Ideally, the best way to sell a business is over a 2 – 3 year period. This period will allow enough time to finetune the financial results and ensure that appropriate systems and records have been put in place to enhance the value of the key intangible asset in the business – **Goodwill**.

Goodwill is an intangible asset. This means that its value is in the 'eyes of the beholder'. Whilst your personality, skills and marketing ability have been important in the establishment of the business, when someone looks to buy it, they ask:

- Can the business function without you?
- If you are not there will a lot of the customers walk?
- If you are not there will the loyal staff remain?
- If you are not there will the suppliers continue to supply at negotiated terms?

Another key question that a purchaser will ask is 'Is there a system?' Systems mean that the business can operate without the owner. It is recommended that you prepare a detailed summary of what happens in the business relative to delegation to management and staff so that the business can function effectively, whether you are there or not. If it can, and the business is profitable then this should mean that you could significantly enhance the valuation of goodwill in the sales negotiations.

Over the next 10 years there are going to be more businesses for sale than there are potential buyers. This is because many 'baby boomers' will be wishing to retire. And young entrepreneurs are always trying to sell what they have developed, and later on start a new business.

The effects of the global financial crisis also need to be factored in. Many businesses have not been sold in the last couple of years as vendors withdrew their businesses from sale because of concerns regarding the global financial crisis. All of this is contributing to a large number of businesses being listed for sale.

#### Key questions are:

- Are there going to be enough buyers?
- Is your business going to be attractive enough to obtain the price you think your business is worth?

Selling a business is very complex. There are also important taxation and capital gains tax implications in the sale of a business. You should seek our advice to enhance the value of your business.



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CHARTERED ACCOUNTANTS

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## Maximising the Sale Value of Your Business

Closing a sale is not easy (especially at prices vendors want). It is therefore best to go about selling a business on a very simplistic basis. There are a number of stakeholders involved in a business sale including landlords, accountants, solicitors, franchisors, government departments and business brokers.

Because a sale could involve all of these people and, in some cases others as well, the sale of a business does take time. In fact many people believe the effective minimum time to sell a business is 8-10 months and in many cases, an effective sale will take 3 years to achieve.

What's involved in the sale process?

- Prepare business for sale documents including, vendor's due diligence review
- Advertise and market the business for sale
- Find the right buyer
- Have detailed negotiations with the potential buyer
- The buyer will then undertake their due diligence process which would normally involve the buyer's banks, solicitors and others, including government departments, landlords and franchisors
- The settlement process

All of this takes time.



To maximise the vendor's return from sale of the business involves implementing a 'sale of business system' including:

- Review the systems operating in the business - could improvement be made?
- Eliminate unnecessary expenses and wastage
- Ensure all business sales are properly accounted for in the books of the business
- Maintain an up-to-date database of customers showing name, address, email, details of sales made etc.
- Update the business' intellectual property register, including details of patents, copyright, trademarks, trade secret agreements, any special arrangements, design registration, domain names etc.
- Ensure that all team members and contractors have signed intellectual property agreements and that these are filed correctly
- Customers operating as companies - ensure debtor's personal guarantee documentation has been securely filed
- Ensure the visual aspects of the premises maximise EBIT (earnings before interest and tax) because most business valuations are calculated on EBIT
- If you are operating a larger business and a potential exit is an IPO (Initial Public Offer), think about having an audit prepared
- Develop a management team - can they run the business without you?
- Have team members been effectively trained and motivated to perform outstanding services?
- Have you got happy customers? If a potential buyer surveys your customers, what will the response be?
- Dispose of old stock
- Update machinery
- Ensure 'debtors' days outstanding' are brought into line with agreed terms

Check KPI (Key Performance Indicators) for your business against industry best practice benchmarks, especially relating to debtors' days outstanding, stock turn, gross profit percentage and sales per employee.

## An Important Message

While every effort has been made to provide valuable, useful information in this publication, this firm and any related suppliers or associated companies accept no responsibility or any form of liability from reliance upon or use of its contents. Any suggestions should be considered carefully within your own particular circumstances, as they are intended as general information only.



## It is a Good Idea to Think of Exit Strategies

- To which of your competitors do you think you could sell?
- Are there larger companies who would be interested in purchasing your business on a 'trade sale basis'?
- Should you be considering an IPO (Initial Public Offer)?
- Could a staff team member or members be interested in buying your business?

To get an understanding of what your business is worth, it is good management practice to have your business independently valued annually. This gives you a realistic appraisal of what the business is worth in the market place. Business valuations normally use multipliers based on Price Earnings Ratios for public companies, with appropriate adjustments being made for a business being operated as a private company. Public companies are normally valued at a higher multiplier because of the requirements for higher levels of corporate governance, accountability and the necessity to keep the public continually informed.

However, many private companies have been able to significantly increase their valuation by adopting many of the attributes of a listed public company - audits, corporate governance, accountability, management team training, external directors etc., so that the business is able to be valued at a higher price earnings multiplier. This can be achieved by implementing systems and strategies to run the business efficiently, thus significantly contributing to an increased valuation for that business.

### Example:

The All Ordinaries Price Earnings Ratio for public companies on ASX at 5th October 2010 was 16.15. An 'average' public company earning an after tax profit of \$1M would be valued at \$16,150,000.

A company about to complete an Internal Public Offer is 'normally' valued at about 2/3 of the 'all ordinaries index' which would be 10.76. Such a company with an after tax profit of \$1M would be valued at \$10,760,000.

A private company is normally valued at 1/3 of the public company ratio. In this example, a private company with an after tax profit of \$1M would be valued at  $5.38 (16.15 \div 3) \times \$1M = \$5,380,000$ .

A private company which has adopted many of the attributes of a public company (audits, higher corporate governance, management team training, external directors, regular board meetings etc.) might be able to argue that the valuation multiplier should be higher than 1/3 of 'all ordinary price index' and closer to the value of a company undertaking an IPO, say 8 times. The private company's valuation could then be after tax profit  $\$1M \times 8 = \$8M$ .

If you are planning to sell your business in the next 3 years, now is the time to start the planning process. If you would like to have a discussion with us regarding the development of a strategy to maximise the sale value of your business, please do not hesitate to contact us.

## Business Plans - Questions to Consider

### Debtors

- Is there a system to ensure that debtors' tax invoices are prepared accurately?
- Are the tax invoices sent to the debtors as soon as possible after the product/service is delivered to the customer?
- Are debtors' statements prepared promptly at the end of each month?
- Are they immediately sent to the debtor?
- Does the business offer discounts for early payment?
- Does the business refer problem debtors promptly to a debt collection agency?
- Has your business considered debtors' financing or factoring to improve cashflow of the business?
- How long after the end of the billing period do you forward your debtors' statements to customers?
- Have you confirmed in writing your terms of trade with your customers?

There are over 50 questionnaires relating to the preparation of a business plan. Call us if you'd like to discuss debtors or your business plan overall.

## Debtor Management Is Important

With debtors' days outstanding being in excess of 54 days, debtor management has never been as important as it is today. If you are giving credit to your customers, then effective debtor management is very important:

- Ensure any payment arrangements with a debtor are confirmed in writing, including details of any key dates.
- Follow up with the customer to ensure that payments are made on the key dates.
- Review dealings with a private company.
- Obtain individual directors' guarantees.
- Ensure tax invoices are prepared correctly in accordance with the customers'/clients' format requirements and sent to the customers/clients promptly by the stipulated dates.
- Ensure follow up of customers'/clients' invoices from the due date to ensure prompt payment or, if the customer/client has a query, resolve the query as soon as possible.
- Monitor debtors' aged analysis on a weekly basis, calculate debtors' days outstanding and maintain your business' terms of trade (e.g. 30 days).
- If payment is not received, ensure prompt referral of problem debtors to a debt collection agency.
- Utilise a 'debtors' days outstanding chart' to identify the cashflow improvements that would occur if debtors paid in accordance with your stated debtors payment policy.

If you would like to receive a debtors' days outstanding calculator please contact us.

*In God we trust; all others must pay cash.*

American saying...

## The *smart* way to pay... **feesmart**

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*feeSmart* is a monthly payment option we offer clients who prefer to fund their professional fees over a six or twelve month period.

We know that our clients using *feeSmart* are generally quite capable of paying their professional fee as a lump sum BUT they simply prefer to manage their cash more efficiently.

If you would like to use this service, or would like more information, please contact us.

## What's It Mean?

**Accounts Receivable** (also known as sundry debtors) is the amount owed to the firm by customers in the form of regular accounts for sale of goods or services. It is normal to prepare a list of accounts receivable (sundry debtors) at the end of each reporting period. It is good management practice to prepare a debtors' aged analysis which shows the time period that the debt has been outstanding to your business (normally shown as 30 days, 60 days, 90 days etc.) but in some businesses it is shown as 7 days, 14 days, 21 days etc.

Accounts receivable (sundry debtors) management is an activity that should take place each week and should be reviewed by senior management.

**Capitalisation Rate** - in valuing ongoing businesses that have been operating for some years, the future maintainable profit is expressed at a capitalisation rate.

The capitalisation rate is the rate of return that a prudent, arm-length investor would require from an investment in this type of business after the allowance of reasonable management salaries.

The capitalisation rate normally reflects a mark up on prevailing interest rates to reflect the risk of the business, lack of negotiability of shares, economic conditions, restrictions on entry into the business, size of the share parcel (of the company) and general business risks. For example, if a business had an after tax profit of \$110,000 (it was considered that reasonable management salaries had been paid) and the capitalisation rate that had been agreed upon was 20%, the business valuation would be:

$$\frac{\$110,000}{20} \times \frac{100}{1} = \$550,000$$

Be sure to read each article with the mindset 'How this could apply to our business'. Thinking of it that way will guarantee that you get value. Also make copies for each team member. To really make sure something positive happens, work with us to talk your team through ideas.

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