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Sizing up the challenge

We talk a lot about strategic plans, but rarely about strategy. A successful strategy increases *enterprise value*. Enterprise value is the financial worth of your business. It is calculated by multiplying earnings before interest, taxes, depreciation and amortization (EBITDA) by an EBITDA multiple. Therefore, your strategy must address a simple mathematical truth: Increase both EBITDA and the multiple.

So far, so good, right? But how do you do that? The only way is to manage the "four horsemen" (see below) of EBITDA and the multiple — and do this in an economy not likely to return to the glory days for at least the next five years. That is the horizon on the commercial real estate cycle upturn.

If you haven't recognized it yet, the landscape industry business model and platform — upon which we have been standing the last 15 years — is burning. What worked for you in the past *will not* work in the future. You need a new strategy.

There are three steps in determining your strategy:

1. Size up the challenge.
2. Assess key business performance benchmarks.
3. Determine a few critical priorities and the required financial investment.

In this article I address the first step, and will address the other two in future columns.

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Meet the four horsemen

The four horsemen of enterprise value are revenue growth, margin performance, cost growth and revenue mix.

For example, take a business with a 40/60 revenue mix of maintenance/construction and an operating profit of $140,000. When we adjust operating profit for interest, depreciation and owner add-backs, we get an EBITDA of $300,000. Applying industry multiples of 5.00X and 1.50X for maintenance and construction, respectively, we arrive at an enterprise value of $870,000.

Now, let's *size up the challenge* to see what it would take to double enterprise value in four years (2010 to 2013). With a shrinking gross margin due to pricing, we have to grow revenues between 12% and 15% annually while adding overhead at only 7% per annum; at the same time, we shift to a 50/50 mix.

In other words, we have to add more than $250,000 in revenues every year — primarily in maintenance — while still selling $1 million in construction. We will need to price and manage operations such that margins get no worse than the projection.

Finally, we have to slow down cost growth. Because variable costs for equipment usually run 15% of revenue, equipment costs consume most of the allowable cost inflation. In simplest terms, this strategy allows for no additional non-billable staffing.

While this is not a small undertaking, it is achievable — and it is what is required to double enterprise value. Knowing the size of the challenge, we can proceed to the next step: assessing key performance benchmarks to determine the business drivers that will get us there.

So, while you are putting your head down and running as hard and fast as you can working your tactical to-do list, you might want to pick your head up and make certain you're not headed for a cliff or a wall. Start thinking about the wisdom of your strategy.