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Considering an exit?

Building profits and increasing the value of your company in the current environment is a challenge. Does it seem like today's economic climate and political agenda are working against you? Health care mandates, expiring tax cuts, immigration reform, high fuel costs and little change in the housing market—shall I go on? If you're considering an exit in the next six to 18 months, make sure you have a plan to quantify these fundamental deal points.

Enterprise value

The goal is to make money now. Earnings, not revenue, is the biggest driver behind valuation. Look at your "LTM" (last 12 months) of performance and "recast" or "adjust" the net income to normalize costs or reflect owner add-backs. While profits are recovering due to better and leaner management, they are not where they once were. Twelve percent to 15 percent adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) is more the norm but not top of the table. Examine your value drivers and value detractors and get a professional to update your valuation each 6-month period on a rolling basis.

Impact of the balance sheet

A strong or weak balance sheet can affect your total purchase price consideration. While each deal is unique, understand that retained assets or liabilities can be negotiated just like your multiple or adjusted EBITDA. Cash, timing of a closing date, working capital requirements or the payoff of long-term or short-term debt all contribute to your net purchase price.

Tax consequences

Most deals in the Green Industry typically involve purchasing assets rather than stock. Liability risk and tax treatment usually drive the deal structure. S corporations or LLCs have more favorable tax treatment when assets and goodwill are being sold, but C corporation shareholders can minimize the "double tax" impact of an asset deal through careful negotiating and the use of personal goodwill.

In practical terms, purchase price in an asset deal is allocated between Fixtures, Furniture & Equipment (FF&E), goodwill and non-competition agreements. (See IRS form 8594 and engage a tax advisor for more specifics.) The allocation or breakdown should be documented in the purchase agreement and negotiated and agreed to by each party. Dollars allocated to goodwill have the most favorable treatment for a seller because they are treated as capital gains at the federal and state levels. Buyers can amortize this expense at 15 years. Dollars allocated to FF&E should reflect the fair market value of the assets at the time of closing. This is negotiable but must be defendable. Buyers will look to drive this value up as they are allowed to depreciate these assets over five years to help pay for the transaction. Sellers must recapture depreciation as it relates to each asset and the amount of depreciation taken as of the sale. This means it costs the seller more in taxes on dollars allocated here.

Lastly, dollars allocated to non-competition agreements are taxed at ordinary income tax rates. This is bad news for the seller, but not great for the buyer, either, as a 15-year amortization applies. Get it right. It's not what you make, but what you keep. Be smart and creative.

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