HOW-TO

Overcome exit-planning myths

BY JEFF HARKNESS

Have you heard the phrase timing is everything? It's difficult to make money these days, which are different compared to five or 10 years ago. The economy, immigration reform, fuel costs, taxes, Obamacare and pricing competition keep companies guessing and on their toes.

So, what's your plan? Do you have an exit strategy? Do you have an operating strategy that coordinates with your exit plan? Are better days ahead after November? Take control, and start planning.

The bottom line is you have to be a smarter owner, with better people and processes. Success requires thinking differently and takes planning with the right team of advisors. You need people who challenge you, not just "yes" men who charge a fee.

Too may advisors say you're ready and tell you there are tons of buyers in the space, but we don't see it that way. You miss vacations, school events and ballgames. You work long hours and fight fires daily, but the sacrifices are worth it because you've built a thriving business.

Negative factors and risk surround the industry, so where are you headed? How and when do you cash in your chips? You only get one shot at your exit, so get it right.

Start by sifting through the advice from accountants, attorneys, consultants, business brokers and former business owners who suddenly are experts in deal-making. Avoid making mistakes by addressing the following three myths.

#1 Private equity is an option for most sellers.

The industry is full of companies backed or owned 100 percent by private equity firms. Success stories exist, but most private equity companies (those not already operating in the industry as competitors and buyers) are only interested in companies that drive $2 million to $3 million in adjusted EBITDA (earnings before interest, taxes, depreciation, amortization and add-backs). The revenue base must be reoccurring, typically with commercial maintenance contracts or turf care service. Size and scalability are important but so is a strong and deep management team.

Most landscaping companies don't fit that size and earnings profile. There are probably better options available than private equity. Beware of the talk that private equity is a great option and readily available. Know who you are and what options are in play for your company.

Second, private equity buyers purchase controlling interest; thus, selling anything less than 100 percent of your company (51 percent or more) means you don't call the shots. You might be able to make day-to-day decisions, but if push comes to shove or the business isn't performing, you're the guy who gets kicked to the curb.

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Deal structure and documentation are negotiable but important. While this strategy isn't impossible to make work, there must be unique circumstances, agreements, a common vision and a business model to make it work.

#2 Your company is worth your revenue or five times your earnings.

Earnings, or free cash, drive the value of your organization, not revenue. The more profitable a company is, the more valuable it is. Historical performance of more than 12 months becomes less important in a value analysis.

Given uncertain market conditions, a look at a company's trailing 12-month performance becomes important. How are you trending? Are you on budget for your 2012 plan? Reporting strong earnings often counters what companies do for tax planning purposes (i.e., show as little profit as possible).

We support not paying more taxes than necessary, but this becomes a balancing-act equation, and it's important to coordinate a profit plan with tax planning and the timing of an exit. Be diligent when recasting financial performance to include add-backs, depreciation and interest. An updated valuation should become standard practice in an organization following close-out of a company's fiscal year.

YOUR DEAL AND STRUCTURE WILL ONLY BE AS GOOD AS THE TEAM WHO NEGOTIATES IT. BEWARE—THE INDUSTRY IS FULL OF PRETENDERS.

Next, don't discount or ignore the importance of your company's value drivers or detractors. Is your company marketable? Revenue ruling 59-60 defines value as: "the price at which the property would change hands between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, both parties having reasonable knowledge of the relevant facts."

Translation: It's worth something only if someone will write you a check. So what factors are important, and how do they affect your multiple? Consider these factors carefully and have an execution plan:

- intangible value, such as goodwill and reoccurring revenue accounts;
- financial ability to generate an ongoing profit stream;
- condition of equipment and fleet;
- type of business and its financial and market history;
- economic outlook for the industry in

which the business resides;

- stability of workforce and structure of the management team;
- strength of a company's balance sheet; and
- strong financial reporting and operating systems.

#3 The amount of purchase price determines whether a deal gets done.

Each deal is unique. In every transaction, there are motivating factors for sellers and buyers. Owners need specific answers to the following questions:

- What are your goals?
- Have you quantified them?
- What's your timeline?
- What's the market bearing?
- What are the tax consequences?
- Is the company built and positioned to be marketable?
- If you keep operating the way you are, what impact will time have on your value?
- What risks exist in my industry and business?

A sound exit strategy often is time executed and planned throughout a 24-month period. Market conditions have an impact on deal structure, which means how and when someone gets their money. Structure kills more deals than valuation or purchase price, which can include or exclude balance sheet adjustments (debt and working capital), require owner financing, include/exclude real estate, and involve employment agreements and noncompetition arrangements. Often, earnouts or payouts are tied to profit or revenue. Getting paid 100 percent cash at closing is rare because of economic conditions, pricing and competition; however, conditions and terms are negotiable.

Your deal and structure only will be as good as the team who negotiates it. Beware—the industry is full of pretenders. If an advisory team hasn't closed more than 12 deals in the Green Industry, keep looking. Make sure your operating plan coordinates with your exit strategy, and get it done. LM

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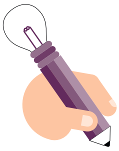
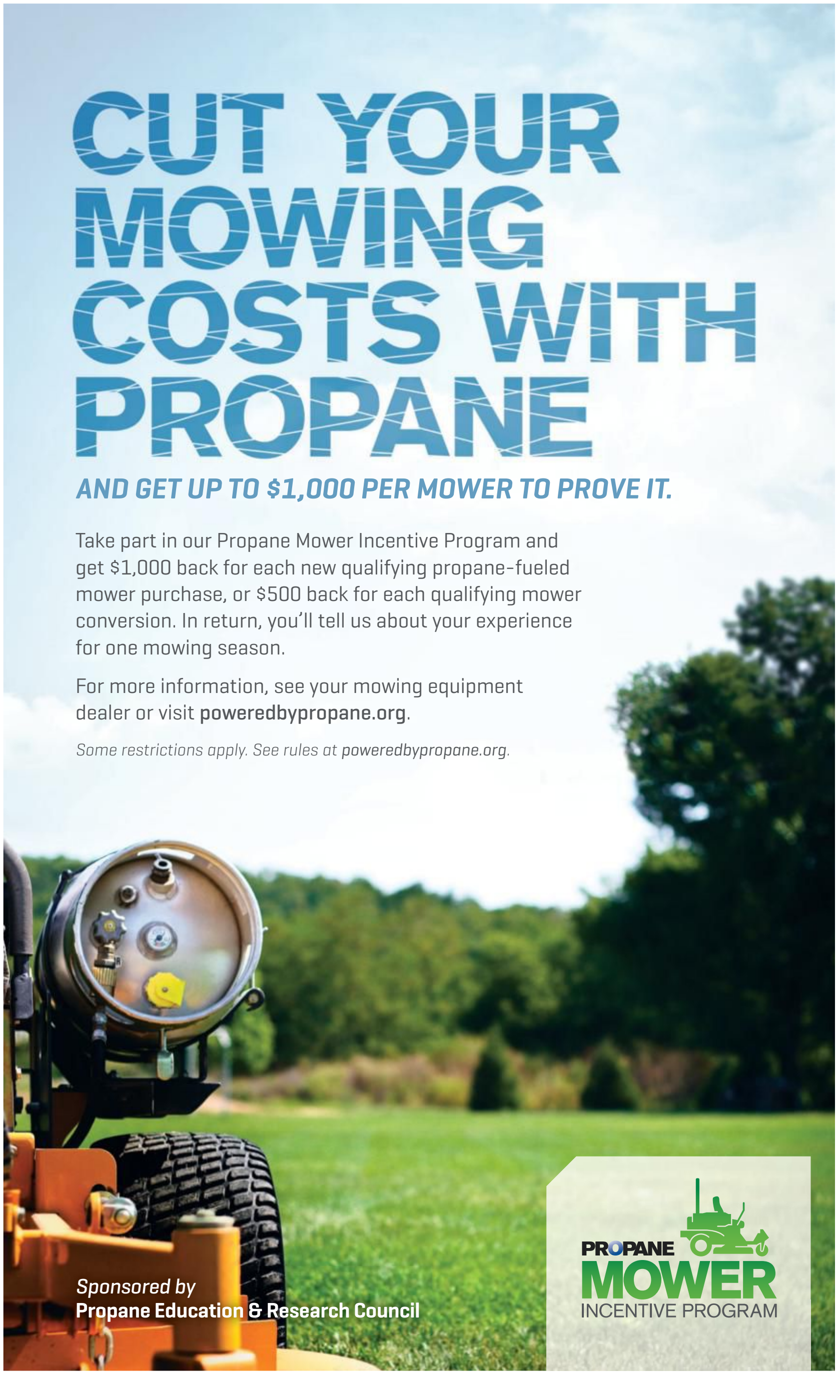


QUICK TIP

Beware of the talk that private equity is a great option and readily available. Know who you are and what options are in play for your company.



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