Building value in your company: 7 things you must do to increase company value

By Larry Turner

Your business provides value to you through your salary and the ability to fund a lifestyle. Some areas of your lifestyle that may be funded could include the ability to travel, and finance personal activities that you might not otherwise be able to afford. Many times business owners look at those items that the business has funded as well as expected future earnings to establish an expectation of what the business is worth.

A buyer will be looking at the business from a perspective of past performance and current business structure. The buyer will not value your business based on optimistic future business projections, especially if those projections are based on activities and trends that have not been realized in the past. These dynamics will require you to look at the company differently in the few years prior to putting the business up for sale to provide for the maximum return. The operational actions during that period are different than when you are running the business for your personal needs if you want to maximize your financial outcome at the time of selling your company.

Consistently improving cash flow

Free cash flow is the main measurement for company valuation when it comes time to sell your business. A common measure of free cash flow is “earning before interest, taxes, depreciation and amortization” (EBITDA), and provides a measurement of company performance without accounting for the items not included in EBITDA.

As an owner looking to sell your company you need to increase EBITDA year over year for the 9 to 36 months prior to selling your company in order to realize the highest value for your company. This may mean managing your company differently over that period of time than you have in the past. Most owners of private companies manage their business to minimize taxes, which means many investments in the business are expensed in the current year.

In an environment of maximizing value, you need to review all business expenses and work with your accountant to properly account for those investments that can be depreciated over a period of time. This increases your asset base as well as provides further investment in the company that is backed out when a buyer looks at company EBITDA performance – it increases the EBITDA, which increases the value of your business.

Growth story

One of the key areas to steadily improving EBITDA is increasing revenues. A growth story provides background to the prospective buyer on the why and how of the revenue growth. The growth story becomes a basis for the prospective buyer to plan growth going forward, which provides a higher valuation for your company.

We see many companies fall into a stagnant growth mode as the owner and business reaches maturity. This results in a lower valuation of the business, because the new owner needs to recharge the company and find growth opportunities. In these situations many owners can stimulate growth through programs that leverage current company capabilities.

These programs include adjacent growth programs, which may include new products developed for current markets, moving into adjacent market segments with current product offerings, or increasing sales channel capability with your current market and products. Whatever the plan to increase sales you will be best served if you can position those efforts into a credible growth story that can be succinctly conveyed to a prospective buyer and provide a basis for increased company valuation.

Capable management team

Most owner-run businesses revolve around the owner making many of the decisions. In these organizations, the company cannot continue without the owner on a daily basis. Many buyers are looking for a standalone business with management teams that can run the day-to-day activities after the owner is bought out and has moved on. Key management positions need to be filled with strong individuals with the technical ability to run their function – they should be considered “A” players.
Solid performance history
A base of business, strong balance sheet along with robust historical revenue and EBITDA is an important consideration when evaluating a business for purchase. The performance history needs to be a 9-36 month history of increasing sales and EBITDA to help increase the valuation of your business. Far too often we get involved with companies that have stagnated and have had flat revenue and EBITDA the last few years. While this is better than declining sales and EBITDA, it does not achieve the valuation for your company that you would hope for. In cases where the sales and/or EBITDA have been flat or declining, it is important to put in place actions that quickly increase both of these key areas as outlined above in the growth story section of this article. The sooner you increase one or both areas, along with developing a growth story behind the improvement, the better you will fare during the sales process.

Diversified customer base
Buyers of businesses are interested in where the revenues and sales for a company are based. This is an indication of the amount of risk that may or may not exist in future revenues. The smaller percentage of revenue that is dependent on a group of customers the better. A company that has 30 customers that reflect 20% of their annual sales represents much less risk than a company that has only one or two customers that amount to 20 percent of their annual sales.

Recurring revenue stream
Recurring revenue streams also limit the risk to a potential buyer of your business. If your revenues are based only on the sale of product that is a one-time occurrence then there is a need every day, month and year to sell new product. Recurring revenue streams allow you to book revenue on a regular basis even if you sold the contract many months ago.

By having a base of business that can be relied on every month through an accrued sale made months ago it takes risk out of the performance of business. Examples include selling annual or multiple year service contracts, upgrades, etc., but in some cases there may be limited ability to sell ongoing contracts based on your business or markets served. In these cases it is important to identify those recurring sales that take place without a formalized contract; these include consumable sales, parts sales, and on-the-spot maintenance activities.

Proper accounting for owner expenses
Many business owners include expenses that at the time of sale can be pulled out to “normalize” the profit of the business. The difficulty in normalizing at the time of sale is it creates uncertainty with the buyer as to the real profits of the company and in many cases the normalization process pulls 100% of the owner’s expenses out of the business, which is unrealistic. We have also talked with private business owners that have no real idea as to how much of past expenses the business incurred were related to direct normal operating of the business or are above what might be expected for a similar sized company.

Examples include first class airfare and top tier hotel rooms for the owner and spouse to premier destinations domestically or internationally; salary and bonuses above industry norms for the owner and family members regardless of company performance; cross billing from another owner related corporation that may be billed as a business expense but goes away if the owner is out of the business. Preparing your company for a sale means that you will need to restructure what you take of business, and may mean your annual taxes will be higher.

Many closely held companies are managed to minimize taxes, which reduces the amount invested in the business and limits annual net profits along with EBITDA. For the 12 – 36 months prior to putting your company up for sale it is advised that you restructure your activities to proactively normalize your books for the sales process, which will come back and payoff in the end.

Preparation is key
The key to maximizing your return at the time of sale is preparation prior to putting your business on the market. Results can be a 5 to 10 time improvement in what you take home at the end of the transaction. These improvements can be related to direct improvement in operating results (which can include sales, profits, EBITDA, improved processes, documented business processes, or new product develop turnaround), a shift in your business revenues that result in recurring revenues that can increase the multiple on EBITDA for your business, or positioning your business as an industry leader in a niche or segment that attracts strategic buyers for your business.

All of these actions are realistic and only limited by the amount of time you have prior to putting your business up for sale, your patience, and interest in making the necessary investments to implement projects outlined earlier in this article.

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