THE EXIT PLANNING REVIEW™

Issue 199 November 15, 2010

Determining Business Value: Step Two of The Seven Step Exit Planning Process™

For many owners, the answer to one question determines their ability to leave their companies: “How much money will I get when I sell?”

This question is indeed critical, and answering it is the second step of The Seven Step Exit Planning Process™. Realistically, you can’t exit your business unless you achieve financial independence, and the primary source of that independence is likely to be the funds you receive for your business when you leave.

Let’s look at fictional owner Ron Nee, the owner of Landscaping Supply Company, to see why a valuation—well before your exit date—is so important.

For years Ron figured he could sell his business for more than enough money to retire comfortably. He based that belief on his understanding of his industry’s valuation rule of thumb--a percentage of gross revenue. Using that rule, Ron calculated his company was worth about $2 million—more than enough to finance his post-exit life.

When Ron decided that it was time to sell and met with a transaction intermediary, he learned that the rule-of-thumb approach didn’t apply. Ron discovered that buyers for the company would base their offers on cash flow rather than on revenues (the basis for Ron’s estimate).

Because Ron relied on an incorrect assumption about the value of his business, he had wasted valuable time coasting along to his exit date. Had he retained a professional to estimate value or provide a range of likely sales prices before he was ready to exit, he could have spent his time focused on increasing the value of his business.

How can you avoid Ron’s predicament?

Ron Nee failed in a critical aspect of ownership: knowing the worth of his business. By not getting a professional valuation or estimate of value, he never knew how far away he was from exiting. He had no accurate information on which to base a plan to grow value.

Benefits.

This issue brought to you by:

John Dini
MPN Incorporated and The ExitMap®
jdini@mpninc.com
http://www.exitmap.com

John F. Dini is recognized as one of the foremost authorities on business ownership in America. He coaches hundreds of CEOs, speaks to national groups of business owners, and writes a weekly column for business owners "Awake at 2 o'clock in the Morning."

With over 10,000 hours of face-to-face coaching with entrepreneurs, John specializes in defining an owner's financial and life objectives, and the steps that make them come true. He approaches exit planning in cooperation with legal, risk and tax professionals, focusing on the strategic and operational aspects of a business exit.

For 25 years, John and his staff have worked tirelessly to live their mission. "We are passionate about working with business owners who compete aggressively, play fair, and work to improve their community and the lives of their employees."

The Exit Planning Review™ is published by Business Enterprise Institute, Inc.

An accurate valuation of your current business resources:

- Tells you—objectively—how much value you need to add to the business.
- Provides you the ability to monitor your progress toward your ultimate financial objective. For example, if Ron had discovered that his business was worth $1.5 million (pre-tax) instead of $2 million, he could have created and implemented a plan to increase value to $2 million by the time he wanted to exit. His plan could have included interim goals and laid out strategies to achieve each interim goal.
- Determines whether and when you can reach your Exit Objectives.
- Provides a basis for estimating, *and minimizing*, tax consequences of exit path alternatives.

If you are ready to exit your business today, tomorrow or in ten years, you need more than a thumbnail sketch of (or "rule of thumb" approach to) value. An experienced appraiser should be able to answer the question, "Can your company be sold today for enough money, after-tax, to allow you to reach all of your exit objectives?" If the answer is no, you can use that knowledge as the basis for a plan to build business value.

Cost.

The cost of hiring an appraiser or business intermediary varies substantially. For example, if you and your business are several years away from a transfer of ownership, a full-blown valuation may well be unnecessary. Instead, you need a value approximation (or range of likely sales prices).

If you are ready to exit and plan to sell to a third party, a transaction intermediary can prepare a range of likely sale price. If you plan instead to transfer your company to employees or family members, a certified business appraiser can prepare a "calculation of value."

Estimates of value, thorough valuations, and marketability appraisals all have their places. Don't skimp on obtaining the valuation you need, but don't secure a more precise valuation before you need it.

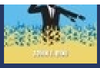
What If?

Finally, let's return to Ron's situation: what might have happened had Ron obtained a business appraisal and learned—well before his target exit date—that his company would likely sell for a price *that would meet his financial objective?* Should he have taken immediate action to sell? What would you do if today you learned that you could exit for an amount of after-tax cash that would meet all of your financial objectives?

How would the knowledge that your business is 60%, 75% or 110% of what it needs to be worth affect your actions? Life offers no guarantees regarding your health or longevity and today's volatile economy provides an excellent reminder that there are plenty of circumstances beyond an owner's control. For all these reasons, *knowing* the value of your company is a fundamental, indispensable element of sound decision making.

In the next issue of *The Exit Planning Review™* we will discuss Step Three of The Seven Step Exit Planning Process™ —Growing and Preserving Business Value.

Subsequent issues of The Exit Planning Review™ provide unbiased and advertising-free information about all aspects of Exit Planning. We have newsletter articles and detailed White Papers related to this and other Exit Planning topics. If you have any questions or want additional Exit Planning information, please contact us.



The second edition of his premier book *11 Things You Absolutely Need to Know about Selling Your Business* is available in paperback, Kindle and Nook.

Download your FREE copy of our 45 page eBook on preparing for the imminent tidal wave of businesses for sale:
Beating the Boomer Bust