

# SELL YOUR ORDINARY COMPANY FOR AN OUTRAGEOUS PRICE



A PRACTICAL GUIDE TO SELLING YOUR BUSINESS FOR TOP DOLLAR

BY KEVIN M. SHORT

**SELL**  
**YOUR ORDINARY COMPANY**  
**FOR AN**  
**OUTRAGEOUS PRICE**

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## Introduction

For years, I've been preoccupied by a nagging question: "Why do similar companies sell at wildly divergent prices?" While I admit that this question does not rank with "What is the meaning of life?" or "What goes on in the teenage brain?" like those questions, it has given me its share of sleepless nights. Unlike those two profound questions, however, my ultimate question is one that I had hope I might one day be able to answer.

When I started my career as an investment advisor, I bought companies as investment vehicles for clients. I would analyze both the current and potential value of companies using every available financial measure. If, for example, Acme Company and Beta Company were of similar value, they'd sell at roughly equivalent prices. But every once in awhile, I'd watch Beta sell for two times the purchase price Acme. What was going on?

As an investment advisor, my job was to find the best return for my clients—a task made easier if I didn't overpay for a company. So, my interest in answering the question of why comparable companies sold at varying prices was limited to making sure I wasn't the one paying the outrageous price.

Note: Throughout this book, I define "outrageous price" as one that is at least two times the EBITDA multiple of an average company in its industry.

In 1991, I entered the world I occupy now: investment banking in the mid-market. That means I represented then, and do today, owners who want to sell their companies valued between \$10 million and \$150 million.

I chose investment banking as a career for reasons both practical and emotional. After I sold my investment advisory company to my employees, I spent several years running a number of companies I had purchased. While I loved the challenge of finding new sales outlets, increasing customer loyalty and launching new product lines, I did not enjoy the too many hours I spent managing personnel. When the opportunity arose to sell my company (at a price that gave my family financial security) I debated. Sell, but then what would I do? Or, stay, grow the business and hope conditions would be favorable at a later date when I was ready to sell? After consulting my family and my advisors, I took the leap and sold.

For six months after closing, I spent time with my wife and our children that I'd heard about but hadn't really met. I thought about what I wanted to do next and considered everything from full-time charity work to creating an incubator for business start-ups. I was acutely aware of the tremendous opportunity I enjoyed to choreograph the next step in my life so I spent hours reading every book about decision making that I could get my hands on. I wanted to make sure I made the best possible decision as I took my next step, but I also wanted to erect a practical framework to support the intuitive way I'd been making decisions throughout my life.

When a friend proposed over lunch one day that I join as a partner in her investment banking firm, I recognized that I had experience in both buying and selling companies as well as the financial analysis skills to do the work. I knew that I could bring valuable insights into how owners think because I'd been an owner and would be again.

It wasn't much of a surprise when I began to observe the same phenomena as an investment banker that I had as an investment advisor: seemingly similar companies were selling at very different prices. Again, I wondered why that occurred and sought the data that might give me an answer. The companies I'm talking about here, however, are privately held so there are no public statistics to dissect; only veiled hints from former owners who hold their cards close to the vest or incredibly tall tales from owners boasting during a charity gala.

As an investment banker, my motive in answering my ultimate question changed as I had a vested interest in making sure that my seller clients got as much money for their companies as possible. I quickly understood that, as it does in all transactions, leverage played a key role. If the seller had leverage, the sale price went up. If the buyer had it, the sale price was held in check. My ultimate question then evolved into: How can I increase my clients' leverage? Or more intriguing still: Can I create leverage for sellers?

The search for this answer led me to return to the books. I found that Michael E. Porter's work about competitive advantage gave me a springboard for answering my ultimate question as his life's work centers on identifying the feature (or features) of a company that create value. If you are an owner interested in improving your company's

competitive advantage over its competitors, I recommend that you read one of Dr. Porter's books. Or, you might also seek the counsel of one of the 2,080,000 companies or individuals that appeared when I recently conducted an on-line search for "competitive advantage consultants."

But there was more to my search than simply identifying a company's competitive advantage and I suspect that there was an element related to the relationship between the buyer and the seller. Moreover, is there something about the relationship between what the seller has to sell and the impact the seller has on the buyer? Does *the sale process* that we use in these transactions produce an outrageous price?

At about this time, the red-hot M&A market started to cool. Tight credit and economic uncertainty increased the number of aborted transactions and potential sellers grew justifiably wary of investment bankers promising solid, much less outrageous sale prices.

My focus necessarily turned to creating a process that would stack the deck in my clients' favor. I describe the process that I developed to minimize an owner's risk of not closing and to minimize sale price—one I call The Proactive Sale Strategy™--in Part I (the first five chapters) of this book.

When the M&A market is percolating, it is not difficult to get good prices for good companies, but even then, it is the Proactive Sale Strategy that lays the groundwork to transform a good price into an outrageous one, and maximizes a seller's probability of closing.

In less certain market conditions (or especially when there is a multitude of sellers and few buyers), the Proactive Sale Strategy not only reduces the very real risk of a buyer walking away from the transaction to find greener pastures, but it is the key to obtaining the best possible—and on occasion outrageous—price.

As you read this book, I think some of the emotional reasons that prompted me to embark on a career in investment banking will become clear. First, there's a little larceny in my heart. I freely admit that I take great pleasure in getting an owner \$8 million for his/her company from a buyer rather than \$4 million. I get a kick out of making my clients lots of money. I knew going into this career that figuring out how to make clients money gets my juices flowing, but I didn't anticipate that it would lead to a book.

Secondly, I love gamesmanship. I relish the intricate planning that goes into setting the stage for a transaction and into the timing and precision of delivering carefully scripted lines. I revel in the fact that there's rarely a predictable plot line to the outrageous sale process and that I must deftly and extemporaneously handle the many personalities and problems that inevitably arise. (We'll discuss both personalities and problems later in this book.)

But perhaps what I enjoy most is that the Proactive Sale Strategy and the Outrageous Price Process demand both right-brain analysis and left-brain intuition. There's no way to successfully orchestrate both processes without the two sides firing in perfect synchronization. That excitement keeps me coming to work each day, pausing to refine my hypotheses, and spending my remaining free moments writing a book.

When you complete this book I hope you will share my excitement about the possibility of not only closing a sale successfully, but of getting an outrageous price for your company. I also hope that you'll understand that I'm not a guy who's been walking around for years hoping to write the next great business book. I'm not an academic; I'm in the marketplace doing deals because I make a great living doing it, and because I love the process. My hope is that by the time you turn the last page, you'll see your company and its prospects for sale in a whole new light. If I can do that, I've succeeded.

Kevin M. Short

# Chapter One

## The Proactive Sale Strategy: Reducing Seller Risk and Increasing Sale Proceeds

### **Obstacles to Closing A Sale: Real and Imagined**

By and large, business owners are a schizophrenic group. When starting their companies, they put everything they own on the line. Typically they pour into their companies every dime of their personal funds, pledge their family homes, and borrow from family members and banks fully confident in their ability to pay off those loans. Even though they risk financial destruction (and often divorce) in doing so, they readily accept overwhelming odds as part of the package.

When it comes to selling their companies, however, owners have little stomach for risk. Having poured heart, soul and nearly every waking moment into nurturing their companies, few are confident about or eager to cash in their chips and walk away.

In my career as an investment banker, I meet successful business owners every day who are, at some level, thinking about how they will jump off the locomotives that their businesses have become. But they hesitate. Some for good reason: their companies are simply unprepared for sale. Typically, “unprepared” means that without the owner’s involvement, the company’s continued profitability is uncertain, at best. These owners have failed to install the systems and management teams that enable a successor owner to operate the company successfully.

So let’s set aside the group of owners that justifiably hesitates to exit and sell because they have not done the planning necessary to create saleable companies and focus on another group.

These owners have saleable companies but complain that they cannot sell their companies today (or anytime soon) because the economy is too uncertain, buyers have fled the marketplace, and/or that the buyers who remain are bottom feeders willing only to pay bargain-basement prices.

Let's, for the moment, assume that all three of these boogeymen are real and are crouched and ready to pounce on any owner naive enough to put his company on the market. How then to account for the sales that are happening—even in a tough economy? Further, how do we explain the fact that some companies are not only selling at healthy prices, but are selling at outrageous prices (two times value)? Those are the questions that fascinate me and are the ones I will try to answer in this book.

So yes, I agree that owners do well to think twice about selling their companies, but not because of the current state of the economy or the presence of bottom feeders. Bottom feeders are all-season creatures and the economy has always been and will always be cyclical.

I believe owners should think carefully before putting their companies on the market because statistics clearly indicate that only about 50 percent of the companies put on the market ever sell. Wow.

Suddenly the reluctance to sell makes sense. Let's look at what the owner stands to lose if she puts the company on the market and fails to close the deal.

- Loss of customers, employees and vendors;
- Loss of fees paid to advisors;
- Cost of owner's lack of focus on running the company; and
- Owner's personal disillusionment.

In my mind, this list is far scarier—and deadly—than the boogeymen that keep most owners awake at night.

### **Loss of Customers, employees and/or vendors.**

In an effort to gauge saleability and price, some owners decide to tell “just a few people” that the company is for sale or attempt to negotiate with an interested buyer without representation. In the first case, owners have no control over who learns about the contemplated sale. Employees, customers, vendors and bankers all nurture and plug into various grapevines and will likely react less-than-favorably to rumors of a sale.

Let's assume that employees, vendors, lenders and customers don't abandon your ship when they hear your company is for sale. At a minimum, this juicy information has them looking for the nearest exits. Competitors will do everything they can to exploit the

uncertainty a rumor of a sale creates to lead your customers and employees to their greener pastures.

To owners who are tempted to go it alone or wonder just how far competitors will go, I relate the story of one owner (let's call him Fred) who called me after having been approached by a competitor about a possible sale. Fred had allowed the competitor (now acting as a potential buyer) to meet with his employees and customers. Within days of these meetings, the competitor/buyer began to hire Fred's best employees and to steal his best customers. When Fred confronted his "buyer," it coolly informed Fred that it was no longer interested in pursuing the transaction. Too late, Fred realized that this competitor was never interested in pursuing this transaction.

### **Loss of Advisor Fees.**

More cautious owners will spend thousands of dollars to hire an investment banker to take their companies to market. They bring in their attorneys to perform due diligence and their accountants to straighten out and audit their financial records. During the several months that it may take to discover that there's no suitable buyer interested in purchasing the company, the owner has paid the investment banker a hefty upfront fee and monthly retainers.

### **Cost of Owner's Lack of Focus.**

Harder to calculate, but no less damaging is the price the company pays as its owner spends more time (and energy) thinking about and working on a sale than on the company's profitability. The Proactive Sale Strategy takes about 18 months to execute, and the timeframe for a well-structured, well-planned sale (from the date the owner hires me to closing) is between eight and 12 months. If those timeframes are longer than you expected, consider that the sale process for owners who enter the sale process armed only with the hope that the right buyer will appear can last years, assuming the transaction closes at all.

### **Owner Disillusionment.**

It is not uncommon for owners to retain me after they have either attempted—unsuccessfully—to negotiate a transaction themselves or used an inexperienced advisor. Remember what happened to Fred? After that last phone call with his competitor both Fred and his remaining employees were demoralized. Fred’s loss of faith in the sale process persuaded him that he was stuck in his company. This loss of faith and subsequent belief that one is stuck makes it especially difficult for owners to rebuild their management teams and to regain momentum.

An owner’s loss of faith in the sale process is similar to the loss of faith in the justice system that an innocent person might experience after having been convicted due to incompetent legal advice. In either case, the wronged person must re-group and use exactly the system he now distrusts, to regain what he is due (his freedom or a reasonable purchase price).

In the face of these real risks—and the perpetual presence of bottom feeders and a cyclically uncertain economy—what can owners, who want or need to sell within the next year, do to not only close the deal, but close it at the best possible price? I’m so glad you asked.

### **What Now?**

I’ve spent the last 20-plus years of my career immersed in bringing sellers and buyers together. During the M&A market’s heyday, the high tide raised all (or nearly all) boats, but I noticed that two nearly identical companies might sell for two radically different multiples. In the heat of battle I couldn’t take time to do more than resolve to think about it later, something I’ve done over the past two years.

With the cool objectivity hindsight affords, I reviewed these deals looking for a pattern, not sure if I would find one. The possibility existed that the companies that sold for twice the multiple of their very similar counterparts did so because one was inherently outrageous: it had discovered a cure for cancer or the eat-all-you-want diet pill. That proved untrue.

I then looked at the buyers who paid these outrageous prices; maybe they were outrageously naive. Since most of them are (and were at the time) major corporations with legions of expert negotiators working on their behalf, that hypothesis did not hold water.

Then what was it?

After reviewing the details of numerous transactions in the middle market, I discovered what makes one company sell at twice the price of a very similar company. While that was an interesting academic exercise, the more important finding—for my clients, for my business and for you—is that there is a two-part process that we can use not only to reduce the risk of not closing (in difficult markets when sellers far outnumber buyers) but also to secure the best possible—and sometimes even outrageous—sale prices.

### **The Proactive Sale Strategy**

I've named the rigorous process I use to position a company to sell to a well-financed buyer at the best possible price The Proactive Sale Strategy™ (PSS). Prospective sellers engage in this process *before* putting their companies on the market. The PSS reduces the seller's risk of not closing by putting energy, resources and effort—in advance of any sale—into

- understanding the seller's asset,
- identifying and remediating any issues that could prevent a sale,
- uncovering (and often enhancing) the company's competitive advantage and
- identifying prospective buyers.

In its concentration on the buyer's needs, and in other ways that we'll discuss later, the PSS is different from every other sale process out there.

Let's look at each step of the Proactive Sale Strategy briefly here, and in more detail in the following chapters.

#### **Step One: Assessing Sale Readiness.**

Entering into any endeavor before one is ready can, and usually does end in disaster. Consider the hiker who ventures into the wilderness without adequate supplies or equipment or the student who sits down to a final exam without having opened a book. Not as common a nightmare, perhaps, but one with disastrous financial consequences is the owner who enters the M&A marketplace without careful preparation.

For that reason, our first step in the PSS is to ask the owner to answer a multitude of questions designed to assess how prepared the company—and the owner—is for sale. We probe several important areas including: Owner's Exit Goals, Exit Strategy Awareness, Advisors, Company Systems, Competitors, Potential Buyers, Industry Acquisition Activity and Competitive Advantage.

We need to know what expectations owners have about their exits and then ask if various constituency groups within the company (such as other owners, key managers, etc.) share those expectations. We take a quick snapshot of the advisors an owner is already using, before diving into all of a Company's systems with an eye to understanding and how transferable, scalable and reproducible they are.

We then look at a company's environment: its competitors, possible buyers, and current acquisition activity in its industry. Finally, we take a second look at the Company's systems to determine which one(s) might make the company different from its competitors and thus valuable to a buyer.

### **Step Two: Pre-Sale Due Diligence.**

In this Step, we dissect all of the information we collected and analyzed in Step One. The owner's answers to our Sale Readiness questions guide us as we put the company under a microscope to see if it can withstand the scrutiny of a buyer's due diligence. Buyers pry open every dark closet and turn every stone before taking a seat at the closing table. For that reason, owners must not only reveal to use every skeleton in every closet, we must remove them or minimize their potential negative impact upon the buyer. Preparing for due diligence *before* the sale process begins saves time during the sale process, and thus reduces the risk of a failure to close.

### **Step Three: Identify the Competitive Advantage.**

Again in Step Three, we turn to the preliminary information about the company that we collected in Step One. As you know a competitive advantage is the product a company makes or service it offers either better or more cheaply than its competitors—over time. In the context of the Proactive Sale Strategy, however, we are looking for an existing, or potential fit between the seller’s competitive advantage and the buyer’s need. Better yet—and absolutely critical to getting an Outrageous Price for your company—we are looking for a way that the seller’s company: (1) can (or could, if given time and preparation) meet a buyer’s immediate need, or (2) could pose an imminent threat to a buyer.

#### **Step Four: Identify the Buyers.**

At this point in the process we focus our attention on potential buyers in the marketplace. Our goal is to identify which companies in the M&A marketplace can use their significantly greater resources (such as access to capital, more efficient processes, deeper or wider distribution channels, or massive sales force) to make more money from a company than can its current owner. Identifying the potential buyer, or possibly buyers, takes a huge amount of research, but pays equally huge dividends as it significantly reduces a seller’s risk of not closing.

Once we have identified the buyer(s) that could benefit most from acquiring a company, we will gather competitive intelligence about these buyers. We look for information about:

- 1) Past acquisitions;
- 2) Prices paid;
- 3) Changes in their strategic acquisition plans;
- 4) Problems they may be encountering in their industry,
- 5) Changes in their industry position or reputation,
- 6) Personnel changes; and
- 7) Changes in their regulatory environment.

Using information about a buyer’s preferences and behavior we can deploy (during the Outrageous Price Process) a strategy to make that buyer aware of the value in

the acquisition. We'll talk about ways to inject awareness of the seller's company into the consciousness of the selected buyers.

Once we have determined how to catch the buyer's eye, your third party intermediary can actively, yet anonymously, engage the prospective buyer. When an intermediary engages a potential buyer, it contacts representatives of each prospective buyer on a seller's behalf without revealing the selling company's identity. Owners simply cannot maintain their confidentiality when representing themselves.

As the relationship between your intermediary and potential buyer grows, we learn more specific details about what a buyer typically pays for companies in the seller's industry, who its negotiators are, what attributes it looks for, and what problems it commonly encounters. We use this information so that when the seller announces its intent to sell, it does so with all its ducks in a row.

The Proactive Sale Strategy reduces a seller's risk of failing to close the deal, but it also increases the seller's chances for getting the sale price he or she wants—even in a tough M&A market. It does so by carefully preparing the seller's company, aligning the seller's assets to the buyer's needs, and understanding and acting upon the buyer's priorities and preferences.

For all these reasons, let's look at each step in more detail beginning with Step One: Assessing Sale Readiness.