CLAYTON CAPITAL PARTNERS

Exit Planning NAVIGATOR

Exit Planning Strategies for the Entrepreneur

Issue 43

Sold! To The Highest Bidder

In today's recovering Merger and Acquisition marketplace, an all-cash buyer is as rare as a balanced federal budget. Those buyers who do arrive at the closing table with cash with cash in hand are not overburdened with huge bagfuls.

Almost as uncommon as the all-cash buyer, is the offer of a valuation multiple that approaches (much less matches) the multiples of the late 1990s.

Let's look at another hypothetical example: Casey Green, the owner of a custom publishing company. He carefully made the decision to sell and, through the efforts of an effective business broker, found a buyer who was prepared to offer Casey the purchase price Casey felt he needed and deserved. There was only one problem. The buyer's offer was not all cash; it was not even predominantly cash.

Like Casey, what today's would-be sellers of great businesses are seeing are buyers offering attractive purchase prices to be paid in currencies other than cash.

Instead, today's typical $5 million transaction (the purchase price of Casey's company) might be paid $1 to $1.5 million in cash, one-quarter as a seller carry-back promissory note (generally unsecured) and the balance as an "earn-out." Also, sellers are often required to retain a portion (10 to 25 percent) of the business that they have just sold.

If we assume that Casey's company has earnings before interest, taxes, depreciation and amortization (EBITDA) of at least $1 million, the $1.5 million cash payment represents less than two years' cash flow. The balance is paid only if the company (that Casey no longer controls) performs well under new ownership and, perhaps, under new management.

Rather than grabbing highest bidder by the throat, a better approach begins with determining what cash amount you want and what you need in order for a sale to proceed. Once you determine that amount, it becomes your focus. Remember, the cash amount is the only "sure thing" in the transaction. Should cash flow falter, earn-outs and promissory notes may evaporate (or become subject to litigation).

Casey, like many owners, was not in a position in which he *had* to sell his business. Although the purchase price offered to him was acceptable, the terms were not. It made little sense to Casey to sell if that sale left him dependent on the future performance of the company for the majority of the purchase price. Casey learned two important lessons. The first was that his transaction intermediary (business broker) naturally sought the highest bid. His broker's commission was based, after all, on the *total* transaction value, not just on the cash portion.

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(continued)

The second lesson was that instead of focusing on what his business was worth, Casey needed to pay close attention to how much cash (or other not-at-risk-assets) he needed to achieve financial security/independence. By doing so, Casey avoided the road that too many sellers go down: selling to the *highest*, but often not the *best*, bidder.

Casey understood that he had but one shot at financial security. He intended to sell his business for an amount of cash that would assure his financial security. Casey was not averse to receiving additional money, but he was focused on getting what he needed—in cash— rather than on a promise of much more.

Today's moral: Analyze any purchase price in terms of satisfying your Exit Objectives. Is your need for financial security best satisfied by an earn-out, a promissory note or by cash?

Subsequent issues of **The Exit Planning Navigator®** *discuss all aspects of Exit Planning.*

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