PRIVATELY HELD COMPANY

the report on transaction issues

Alamo Corporate Group Inc.

Alamo offers a range of intermediary services including mergers, acquisitions, divestitures, buyer identification, management buyouts, debt restructuring, business consulting, business valuations and equipment appraisals. Our services while targeted and focused are highly confidential.

Can You Really Afford to Sell?

In many cases, the sale of a small company is "event" driven. That is, the reason for sale is often an event such as a health decline or illness, divorce, partnership issues, or even a decline in business.

A much more difficult reason for selling is one in which the owners simply want to retire and live happily ever after. Here is the problem:

> Suppose the owners have a very prosperous distribution business. They each draw about $200,000 annually from the business plus cars and other benefits. If the company sold for $2 million, let's say after debt, taxes and closing expenses, the net proceeds would be $1.5 million. Sounds good, until you realize that the net proceeds only represent about 3 1/2 years of income for each (and that doesn't include the cars, health insurance, etc.). Then what?

The above scenario is not atypical, especially in small companies. These are solid companies that provide a very comfortable living for two owners. In the above example, the owners obviously decided they couldn't sell because it didn't make economic sense to them. The business was worth much more to the owners than to any outside buyer. Perhaps they thought that an intermediary could produce a buyer who would be willing to pay far more than the business was worth. But, the M&A market is a fairly efficient one.

So, what should they do?

Continued on Inside

... the owners simply want to retire and live happily ever after.

IN THIS ISSUE

Can You Really Afford to Sell?
(continued from front page)

The downside is that competition could enter the fray and their business would not bring in the same cash flow.

The business could also suffer because the owners are not continuing to build it. They apparently want to retire and take life easy, and this mind-set could dramatically undermine the business.

If the owners are forced to sell the business because it is declining, they, most likely, won't even receive the $2 million they might have received earlier.

On the other hand, the owners, ready to begin their happily ever after, could bring in a professional manager. This addition would cut their earnings slightly to pay for the new manager, but it would also reduce their responsibilities and give the business a chance to grow with new energy and ideas.

If you are considering selling your company in the next year or so, the time to start is now.

Planning ahead can significantly add to the eventual selling price.

A visit with a professional business intermediary is the first step.

Why Deals Fall Apart – Loss of Momentum

Deals fall apart for many reasons – some reasonable, more unreasonable.

For example:

- The seller doesn't have all his financials up to date.
- The seller doesn't have his legal/environmental/administrative affairs up to date.
- The buyer can't come up with the necessary financing.
- The well-known "surprise" surfaces, causing the deal to fall apart.

The list could go on and on, and this subject has been covered many times. However, there is a hidden reason that can occur, usually about three-quarters of the way to closing. It is often first seen as a lack of, or loss of, momentum on either the buyer's or the seller's part.

No one notices at first. Even the advisors who are busy doing the necessary due diligence and paperwork don't notice it.

An experienced business intermediary will notice it. He or she will recognize the early warning signs. The buyer can't get through to the seller, calls are not returned, or the reverse happens. One or the other calls the intermediary who assures the caller that he or she will call the recalcitrant one and have him or her get in touch.

The intermediary calls and receives the same response. Calls are not returned; one side or the other begins to drag their feet in providing documents, financial information, etc. To the experienced intermediary the "red flag" goes up. Something is wrong. If not resolved immediately, the deal will lose its momentum and things can fall apart quite rapidly. What is this hidden element that causes a loss of momentum? It is generally not price or anything concrete.

It usually boils down to an emotional issue. The buyer or seller is getting "cold feet." It often is the seller who has decided that he really doesn't want to sell and doesn't know what to do; so he just tries to ignore the proceedings and the lack of momentum occurs. It may also be that the buyer has discovered something that is quite concerning and doesn't know how to handle it. Sometimes, the chemistry between buyer and seller is just not there, at least for one of them. Regardless of the reason, this loss of momentum should be addressed if the sale is to have any chance of closing.

Because it often stems from an emotional issue, it has to be faced directly. An advisor, the intermediary, or someone close to the one dragging his or her feet should immediately make a personal visit. Another suggestion is to get the buyer and seller together. The sooner this loss of momentum is addressed, the better the chance there is for the deal to continue to closing.

What are Your Company's Weaknesses?

Every company has weaknesses; the trick is to fix them.

Some companies on paper may look the same, but one may be much more valuable than the other, due to weaknesses in one of them.

Fixing or improving company weaknesses can not only significantly improve the value, but also increase the chances of finding the right buyer. Not all problems or weaknesses can be resolved or fixed, but most can be improved.

There is a saying that the test of a good company president or CEO is what happens to the company when he or she leaves.

Here are some common weaknesses that buyers can be concerned about and that may cause them to look elsewhere for an acquisition:

"The One-Man Band"

Many small companies were founded by the current president and he has made all of the major decisions. He has not developed a succession plan and has no one in place to take over if he gets hit by the proverbial truck. He is the typical one-man band and, as a result, the company is not an attractive target for acquisition.

The One Product

Many one-man band owners run companies created and based on the manufacture and sale of one product; or the creation and development of a single service. Henry Ford made a wonderful car – the Model A, but that's all he made. General Motors decided that enough people would like something different and were willing to pay for it. Fortunately, for Ford, he caught on quickly, but he almost went out of business because of the mindset that one model fit everyone.

Declining Industry

Companies that are in a declining industry have to be smart enough to see it and make changes. One example was a company that made ties. They were smart enough to see the decline in this apparel item and switched over to making personalized polo shirts. A company can still make ties but has to have the foresight – and ability – to move into new product lines.

Customer Concentration

This area is a major concern to most buyers. It is not unusual for the one-man band to focus on what made the company successful – one or two major customers. The owner has built the relationships over the years and these relationships are seldom transferable. Finding new customers may take time and money, but it is absolutely necessary if the owner ever wants to sell.

Aging Workforce/Decaying Culture

Young people are not entering the trades, leaving many jobs such as tool and die positions filled with "old hands" who will soon be retiring. Technology may be able to replace them, but that decision has to made and implemented. No one wants a business that will have idle machines with no one trained to operate them or repair them.

There are many other areas that could be considered company weaknesses. If there is a Board of Directors or an Advisory Board, perhaps they can help the one-man band create a succession plan and just as importantly – a successor. And, certainly the time for this is before the decision to sell is made. Whether current ownership plans on staying-on, or eventually selling the company, the good news is that resolving company weaknesses is a win-win situation.

Some Well-Known Truisms!

- When someone asks you what a business is worth, you need to ask him, "Are you a buyer or a seller?"
- One can't sell a business to someone who doesn't want to buy it.
- Conversely, one can't buy a business from someone who doesn't want to sell it.
- The term: "Don't worry, it's a done deal," should cause great concern among the parties involved.
- All businesses that go down the drain have one thing in common – They have all run out of money!
- A deal that looks too good to be true – usually is.

Remember, It's Not Always the Price

Here are a few deal scenarios where the price was not the deciding issue in which buyer's offer was ultimately accepted. The winning buyer may be the one who *really* understands the situation and what the seller really needs.

A business intermediary *really* understands what is important to sellers and can usually solve issues as they arise.

- **Understanding reps and warranties**
  One seller had 60 shareholders who needed to walk away from the deal.
  The losing buyer wanted all selling shareholders to be accountable for the "reps and warranties."
  The winning buyer waived the reps and warranties at closing.

- **Offering future upside**
  A seller's management team wanted some future upside in the deal.
  The losing buyer offered all cash and normal compensation.
  The winning buyer offered 80% cash, 20% stock plus a three year earnout on revenues...including acquisitions.

- **Understanding timing**
  A seller was in a situation where time was of the essence.
  The losing buyer needed a 30-day due diligence period plus a 60-day window to close the deal.
  The winning buyer offered to close within 40 days of the Letter of Intent and agreed to have limited due diligence.

Alamo Corporate Group Inc.

Independent Services for Business Buyers & Sellers

This latest issue of The Privately Held Company is compliments of Alamo Corporate Group. Alamo and its affiliates have specialized in ownership transfers of closely held companies since the late 1980's.

Alamo Corporate Group
1303 Walnut Hill Lane
Irving, TX 75038

817-615-8393
info@alamocorporategroup.com
www.alamocorporategroup.com