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Is your company in shape to sell?

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More from Brad Cherniak

Steven Senne/AP Photo In today's market, buyers aren't rolling the dice and picking up businesses, as if they were playing Monopoly.

Focusing on one particular, critical aspect of an acquisition process — i.e. how a buyer begins to look at your company, what they see, and hone in on, at first introduction — can be critical. After all, this is what drives a buyers decision to purchase your company, and how much to pay for it. Failure to understand this usually leads to unrealistic expectations, and ultimately disappointment, particularly in current markets.

For the most part, the information here is for companies with approximately $5-million to $25-million in revenue. It also assumes a wide range of industries, from manufacturing to software to distribution, while recognizing there are certain industries that have their own unique vernacular.

With this context, the following is what today's prospective acquirers are looking at:

In the current market, what first catches their eye is the past one to three years of earnings before interest, taxes, depreciation and amortization, or EBITDA. This is essentially the company's gross cash flow from operations.

They may look at the most recent year, or the average of the past few years. They might be willing to look at the most favourable permutation from the seller's point of view — say, overlooking one bad year that occurred for identifiable, non-recurring reasons. But this is what they see before pretty much everything else, and it colours the rest of the discussion.

It will drive the type of buyer interested in your company, whether financial (private equity, venture capital or individual) or strategic (corporations in the same business). Companies with more than $5-million of annual cash flow will be appealing to a much broader audience than those with, say, $2-million or $3-million or less.

It will also critically drive valuation. It is the starting point for the buyer's thought process. Only then will they look at the unique aspects of the company, both positive and negative. On the positive side are patents and intellectual property, above-average future growth potential, recurring revenues, and synergies with the buyer's company. Negative factors include below-average profitability, weaknesses in the management team, and emerging challenges to the company or its business model in the marketplace.

What this amounts to is, with current market conditions, the vast majority of company valuations tend to be based on very conservative, traditional methodologies. Despite the large amount of uncommitted financial capital sloshing around in the capital markets, it remains a buyer's market.

The best most targets can hope for in this market is a multiple of this historical cash flow at the high end. The actual range of multiples is very industry, and market environment, specific. You will need to do some work to figure out the appropriate ranges.

You might be thinking this is an unfavourable way to value your company, that the past is largely irrelevant. Your company, you believe, is worth much more under a future-looking methodology. Perhaps. But if you

want to sell your company, it is what the buyer is thinking that is determinative. It's their money and the future is getting harder and harder to predict.

That's not to say you can't convince a buyer of the unique potential of your company, but again, it will generally only push them toward the upper end of the traditional multiple range.

Buyers today don't generally pay for future potential, because they consider themselves critical to achieving it. Why would they pay for something they would be creating?

Today, future potential is more important for increasing the probability of a deal, than for the valuation beyond the traditional multiple range relevant to your industry.

So what should a business owner do?

First and foremost, the process of selling your company is a time-, resource- and energy-consuming activity, which is not without risk to your company in terms of distractions and unforeseen effects on key employees.

For these reasons, you need to go into it with realistic expectations. You don't want to get into a long and bruising sale process that ends with you walking away from an inadequate and disappointing offer.

If you do the analysis upfront, and find you are not in the value range you want, you may be better off looking at ways to take the next six or 12 months, or longer, to increase your cash flow.

You may also look at alternatives to a sale, such as joint ventures, a staged exit, international expansion, or other strategic growth initiatives.

This way, you will be in better position to benefit from the improvements that can be made to your business — rather than the buyer.

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