Miles Dolphin
CONSULTING GROUP

The First Steps In Selling Your Business

By Tim Miles

There are many reasons you may choose to sell your business. It can be a strategic, sometimes emotional and unfortunately, often it is forced upon you due to unforeseen circumstances.

The main reasons we have seen drive owners to look to sell include:

- An opportunity arises that you can strategically take advantage of
- The owner is either fatigued or burnt out
- Strong, increasing competition
- Nearing age of retirement
- Unforseen circumstances such as physical or family illness, divorce, death, partnership breakdown.

Whether the reasons driving our clients are planned or unplanned, the process is the same. The more you understand the process, the more you can avoid the pitfalls and maximise your financial return.

The Miles Dolphin Approach

When business owners first approach us for advice on how to sell their business, our first step is to complete a very simple appraisal of what we think their business is worth. We do this to identify whether we broadly agree with our potential new client on a realistic price for which they can sell their business.

Unfortunately, the majority of the time we have to reset the client's expectations of how much their business is worth because most owners think their business is worth more than it actually is.

Our approach initially in selling your business includes:-

1. Understand what your business is worth in the current market and what you will actually receive when you sell your business i.e. what will be the 'net proceeds' of the sale.
2. Calculate how much you really need from the sale of your business to fund your lifestyle.
3. Work out what you will do with your life once you sell your business

Once we have answered these questions we can then develop a plan to achieve both your personal and financial goals. We will assist you to get your business ready to sell and attractive to potential buyers so that you can ultimately receive the money you need from the sale of your business to fund the lifestyle you desire.

1. Understanding what your business is worth

Your business is an asset in which you have invested (*time, sweat and money*) in and if you are selling that asset, you are selling it to a potential investor who will require a return for their investment.

SME businesses in Australia are generally valued using the Capitalisation of Future Maintainable Earnings (CFME) valuation method. This is a very complicated way of saying that the future earnings of the business are multiplied by an 'earnings multiple' based on the return on investment required by a potential buyer.

Simply put:-

- ◊ By "earnings" I mean "profit", and I mean the "Earnings before Interest and Tax" or "EBIT"
- ◊ The EBIT is the future maintainable earnings i.e. the EBIT that is expected to be achieved consistently by the business in the future
- ◊ The "Earnings Multiple" is based on the return on investment (ROI) required i.e. a 25% required ROI would result in an earnings multiple of 4 (1 divided by 25%)
- ◊ Earnings multiples in Australia for privately owned SMEs can vary greatly but are normally between 2 and 5 and, in a normal market, most likely between 3 and 4
- ◊ This calculates the "Enterprise Value" (EV) which includes all things required to produce the EBIT, including:
  - Management and staff
  - Plant & Equipment
  - Debtors and Creditors
  - Employee leave liabilities
- ◊ The Enterprise value specifically excludes excess cash in the business and any external debt

Additionally, to determine what you will receive 'in the hand' when you sell your business you need to calculate the net proceeds of the sale after deducting costs and taxes associated with the sale.

To calculate the net proceeds:-

- ◊ Calculate the Enterprise Value (EV) as outlined above
- ◊ Add excess cash and deduct any external debt from the Enterprise Value to calculate the value of the equity or shares in your business
- ◊ Deduct other costs and taxes such as:-
  - Merger & Acquisition Advisor fees
  - Professional fees such as accounting and legal fees associated with the sale
  - Any income tax and/or capital gains tax associated with the sale

I must reiterate the importance of seeking the appropriate advice from your accountant, lawyer and other advisors, so please don't skimp on these costs. This could be the difference from making a sale or not. We had one client that had two failed sales processes prior to engaging us. Emotions fly high when you start to negotiate a price on your business – it is important you surround yourself with solid professionals who can help achieve the best outcome and keep you on track.

Let's put this in practice....

As an example, a client recently expressed an interest in selling their business. We quickly worked out the value of their business to be approximately $4.5 million..

This was close to what the owners were expecting to receive from the sale of their business. However, then we started deducting debt and other costs as follows:-

Enterprise Value	$4,500,000
Add: surplus cash	$500,000
Less: external debt	($1,000,000)
Equity Value	$4,000,000
Less: Merger & Acquisition Advisor fees	($250,000)
Less: Accounting fees	($50,000)
Less: Legal fees	($50,000)
Less: Taxes	($500,000)
Net Proceeds	$3,150,000

So once we worked out that the client would actually receive just over $3 million, they weren't as keen to sell their business. The client felt that it was better to continue to own their business and make the profits that were currently being achieved.

2. *Calculate how much you really need from the sale of your business to fund your lifestyle.*

The next step is to take a reality check. Whilst we all have a figure we **want** our business to achieve, there is real power to be gained knowing what you **need**. Having this answer upfront enables you to answer three really important questions.

◊ Can I afford to sell my business now?
◊ Is there is a gap between what my business is worth and what I need?
◊ If yes, how much work is required to close that gap and am I prepared to do what it takes?

In the case above, we continued the conversation to identify how much they really needed to fund their lifestyle after the sale of their business. Was $3 million enough?

Our initial thoughts were that, combined with their other investments, it would be more than enough, but they weren't convinced, so we agreed that the next step would be for them to meet with their financial advisor to make this assessment.

3. *Work out what you will do with your life once you sell your business*

Selling your business will fundamentally change your life. If you are not working in your business, you are most likely thinking about it. Understanding the size of the gap and how you will fill it is part of understanding if you, the person, are ready to sell. Here are some questions to consider:
◊ Are you really ready to sell, or do you just need a break?
◊ Do you still enjoy owning the business with all the associated risks and hard work?

◊ Is there more you want to achieve in the business?
◊ Will you be required to stay in the business post the sale? If so, for how long?
◊ Will there be any restrictions on you competing with whoever buys the business?
◊ What will you do with your life once you sell the business?
◊ Will you be able to let go and pursue other interests?
◊ Can you retire?

This is the one time in business that you don't want to take the gamble of doing it by yourself and learning along the way. Once your business is sold, you can't get it back nor can you change the outcome. If you are thinking about selling, seek as much professional advice as you can. Talk with your business advisor, accountant and lawyer to make sure you really do reap the rewards of all your hard work.