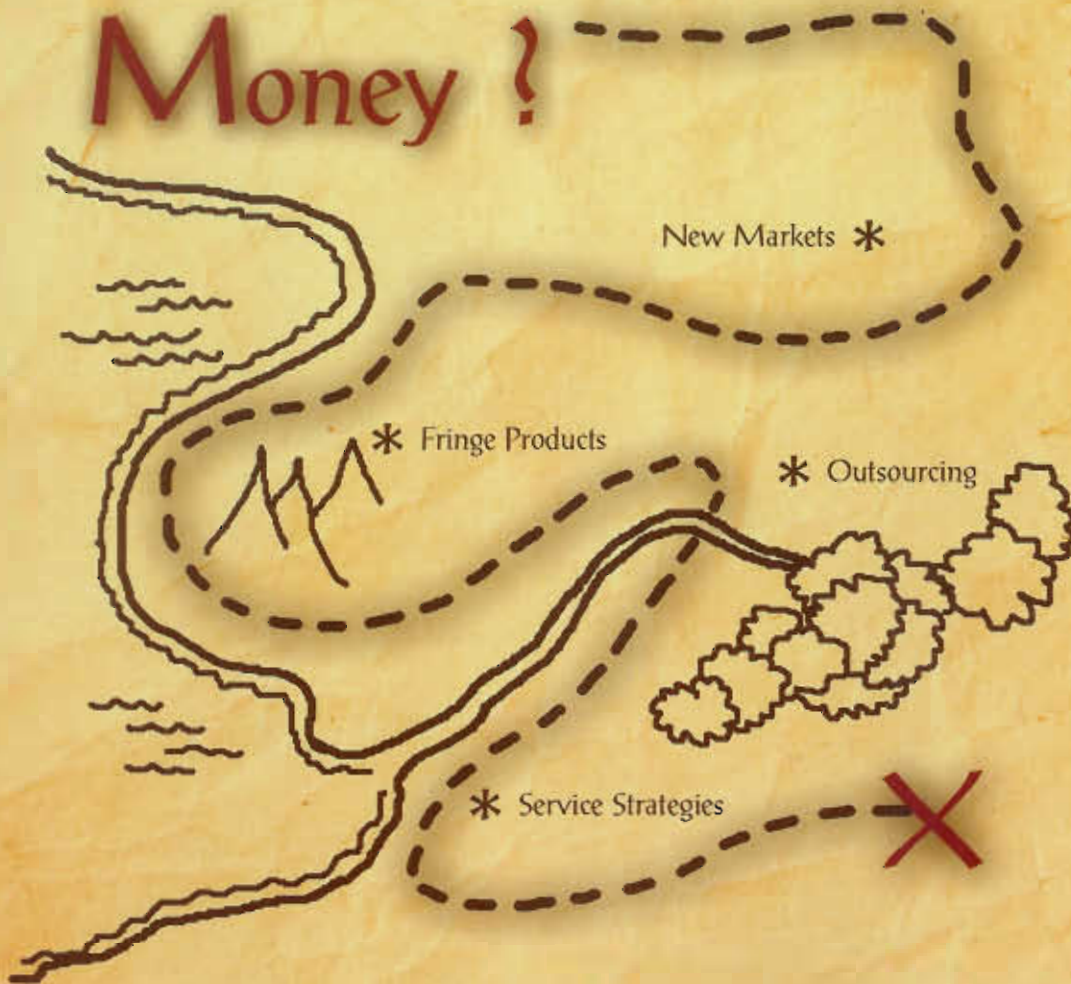


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SUCCESSION PLANNING

SUCCESSION PLANNING

By David M. Kauppi

BEFORE YOU SELL YOUR MATERIAL HANDLING BUSINESS

How to receive the best deal the market has to offer

If you're a business owner, chances are you're thinking about what you'll do when your working days are over. As William Rothwell, a professor at Penn State University, noted in the foreword to 2002's *Exit Right: A Guided Tour of Succession Planning for Families in Business Together*, "More than 40 percent of the people who run the closely held operations that comprise 80 percent of the North American economy will retire by 2007."

Even if you currently view the idea as unlikely, you are wise to consider the possibility of selling your material handling company. The decision to sell is too often a reactive one rather than a proactive one—the primary reasons are a serious health issue, owner burn-out, the death of a principal, general industry decline or the loss of a major customer. Advance planning can ensure that you exit your business from a position of strength, not from weakness due to necessity.

BETTER EARLY THAN LATE

The biggest mistake business owners make is waiting too long to sell. Have you ever heard, "I sold my business too early"? Compare that with the number of times you've heard somebody say, "I should have sold my business two years ago." Unfortunately, waiting too long is probably the single biggest factor in reducing the proceeds from the sale of a privately held business. The erosion in business value typically is most pronounced in the last year before exiting. An individual who

spends 20 years running his or her business and controlling the outcomes often behaves differently in the exit from his business. Exit your business from a position of strength, not from the necessity of weakness. Don't let that next big deal delay your sale. You can reward yourself for that transaction you project to close with an intelligently written sale agreement containing contingent payments in the future if the sale is made.

PLAN YOUR POST-SALE TIME

Figure out what you will do with your time once you are no longer working 60 hours per week. We all create business plans, both formally and informally. We plan for vacations. We plan our parties. We need to plan for the most important financial event of our lives—the sale of our business. Typically, a privately held business represents greater than 80 percent of the owner's net worth. Start by planning how you want to enjoy the rewards of your labor. Where do you want to travel? What hobbies have you

been meaning to start? What volunteer work have you meant to do? Where do you want to live? What job would you do if money were not an issue? You need to mentally establish an identity for yourself outside of your business.

MAXIMIZE YOUR VALUE

Get your business ready to sell. Now that you are excited about the fun things you'll do once you exit your business, it's time to focus on the things that you can do to maximize the value of your business upon sale. First, engage a professional CPA firm to do your books. Buyers fear risk. Audited or reviewed financial statements from a reputable accounting firm reduce the perception of risk. Do not expect the buyer to give you credit for something that does not appear in your books. If you find that a large percentage of your business comes from a very few customers, embark immediately on a program to reduce customer concentration.

Buyers fear that when the owner exits, major customers are at risk of leaving as well. Start to delegate management activities immediately and identify successors internally. If you have no one who fits that description and you have enough time, seek out, hire and train an individual to stay on for the transition and beyond. Buyers want to keep key people who can continue

the momentum of the business. Analyze and identify the growth opportunities that are available to your business. Get rid of that outdated inventory. It just clutters up the place, and the buyer will not pay you for it anyway.

DON'T FORGET TO RUN THE BUSINESS!

When you are wearing all the hats already, trying to sell your company yourself can hurt your business. A major mistake owners make when exiting their businesses is to focus their time and attention on selling the business as opposed to running the business. This occurs in large publicly traded companies with deep management teams, as well as in private companies where management is largely in the hands of a single individual. Many large companies that are in the throes of being acquired are guilty of losing focus on day-to-day operations. In case after case, these businesses experience a significant competitive downturn. If the acquisition does not materialize, their business has suffered significant erosion in value.

For a privately held business, the impact is even more acute. There simply is not enough time for the owner to wear the many hats of operating the business while embarking on the full-time job of selling the company. The owner wants the impending sale to be totally confidential until the very last minute. If the owner attempts to sell the business himself, by default he has identified that his business is for sale. Competitors would love to have this information. Bankers get nervous. Employees get nervous. Customers get nervous. Suppliers get nervous. The owner has inadvertently created risk, a potential drop in business and a corresponding drop in the sale price of his business.

GENERATE COMPETITION

To maximize your selling price, you must get multiple buyers interested in buying your material handling business. The typical business sale transaction for a privately

held business begins with either an unsolicited approach by a competitor or a decision on the part of the owner to exit. If a competitor initiates the process, he or she typically isn't interested in overpaying for your business.

In fact, just the opposite is true. He or she is trying to buy your business at a discount. Outside of yourself, no one is in a better position to understand the value of your business more than a major competitor. He will try to keep the sales process limited to a negotiation of one. Generally, unsolicited buyers are not the ultimate purchasers. If they are, then the final purchase price is, on average, 20 percent higher than the original offer.

If the owner decides to exit and initiates the process, it



In the Winter 2007 issue, Gary T. Moore gave tips from a business owner's perspective on **When To Sell Your Business**. Read the article in *The MHEDA Journal Online*.

usually begins with a communication to a trusted advisor—an accountant, lawyer, banker or financial advisor. Let's say an owner is considering selling his business and he tells his banker. The well-meaning banker says, "Another of my customers is also in your industry. Why don't I introduce you?" If the introduction results in a negotiation of one, it is unlikely that you will get the highest and best the market has to offer.

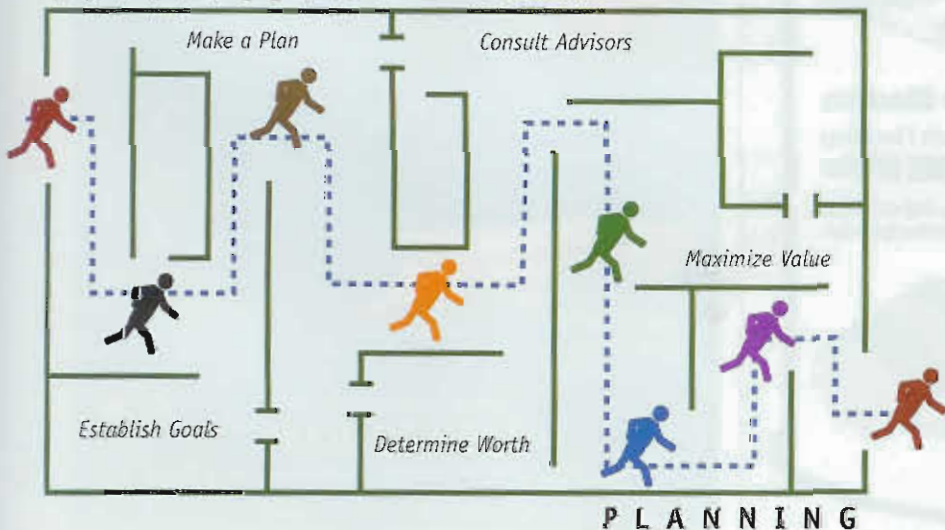
HIRE TRAINED PROFESSIONALS

You improve your odds of maximizing your proceeds while reducing the risk of business erosion by hiring a firm that specializes in selling businesses. A large public company would not even consider an M&A transaction without representation from Merrill Lynch, Goldman

Sachs, Salomon Brothers or another high-profile investment banking firm. Why? With so much at stake, they know they will do better by paying the experts. Companies in the \$3M to \$50M range fall below their radar, but there are mid-market M&A firms that can provide similar services and process.

Engage other professionals who have experience in business sale transactions, especially the unique valuations of material handling dealers. You may have a great outside accountant who has done your books for years. If he has not been involved in multiple business sales transactions, you should consider

S U C C E S S I O N



engaging a CPA firm that has the experience to advise you on important tax and accounting issues that can directly result in swings of hundreds of thousands of dollars. What are the tax implications of a stock purchase versus an asset purchase? A lower offer on a stock purchase may be far superior to a higher offer on an asset purchase after the impact of taxes on your realized proceeds. Is the accountant who does your books qualified to advise you on that issue? Would your accountant know the best way to allocate the purchase price on an asset sale between hard assets, goodwill, employment agreements and non-compete agreements? A deal attorney is very different from the attorney you engage for everyday business law issues.

Remember, each element of deal structure that is favorable to the seller for tax or risk purposes is

generally correspondingly unfavorable to the buyer, and vice versa. Therefore, the experienced team for the buyer is under instructions to make an offer with the most favorable tax and reps and warranties consequences for their client. You need a professional team that can match the buyer's team's level of experience with deal structure, legal and tax issues.

HAVE REASONABLE EXPECTATIONS

You need to be reasonable in your expectations on sales price and terms. The days of irrational exuberance are over. Strategic buyers, private equity groups, corporate buyers and other buyers are either very smart or do not last very long as buyers. Generally there is a range of sales prices for similar businesses with similar growth profiles and similar financial performance. That being said, however, there is still a

range of selling prices.

So, for example, let's say that the sales price for a material handling business is a multiple of between 4 and 5.5 times EBITDA. Your objective and the objective of a good

Exit your business from a position of strength, rather than from weakness due to necessity.

M&A advisor is to sell your business at the top end of the range under favorable terms. If your business is marginally profitable, the market may be simply the fair market value of your assets minus your liabilities. If you have lots of high margin ser-

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10 Tips to Prepare for the Sale of Your Company

1. Sell early.
2. Plan for life after the sale.
3. Maximize the value of your company.
4. Stay focused on running the business.
5. Create competition to buy your company.
6. Hire trained professionals to help you.
7. Keep price expectations reasonable.
8. Don't hide problems.
9. Be flexible and creative if necessary.
10. Sell from a position of strength.

vice revenue, a robust rental business and annual maintenance contracts, you will be more valuable to potential buyers. In order for you to sell your business outside of that range you must have a very compelling competitive advantage, collection of intellectual property, unusual growth prospects or significant barriers to entry that would justify a premium purchase price.

Think about the process of detailing your car before you offer it for sale. A good M&A advisor will assist you in that process for your business. With a 4 to 5.5 multiple as the metric in your industry and if you had an EBITDA for the last fiscal year of \$2.5 million, your gross transaction proceeds could range from \$10 million to \$13.75 million. A skilled M&A firm with a proven process can move you to the top of your industry's range. The impact of hitting the top of the sales price

range versus the bottom more than justifies the success fee you pay to your M&A professionals.

DISCLOSE PROBLEMS UP FRONT

If your company has any issues like a pending legal action, underfunded pension, groundwater con-

tamination, etc., get those issues out on the table early in the merger/acquisition discussions. A seemingly insignificant minor negative revealed early in the process is an inconvenience, a hurdle or a point to negotiate around. That same negative revealed during negotiations

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or, worse yet, during due diligence, becomes, at best, a catalyst for reexamining the validity of every piece of data or, at worst, a deal breaker.

No contract in the world can cover every eventuality if there is not a fundamental meeting of the minds and a trust between the two parties. Unless you are lucky enough to get an all-cash offer without any reps and warranties, you are going to be partnered with your buyer for some period in the future. Buyers try to keep you on the hook with reps and warranties that last for a few years, employment contracts or non-competes that last, escrow funds, seller notes, etc. These all serve a dual role to reduce the risk of future surprises. If future material surprises occur, buyers tend to be punitive in their resolution with the seller. Volunteer to reveal your company's warts early in the process. That will build trust and credibility and will ensure you get to keep all of the proceeds from your sale.

EVERYTHING IS NEGOTIABLE

You should be flexible and open to a creative deal structure. Everything is a negotiation. You may have in mind that you want a gross purchase price of \$13 million and all cash at close. Maybe the market does not support both targets. You may be able to get creative in order to reach that purchase price target by agreeing to carry a seller note. If the sale process produces multiple bids and the best one is \$11.3 million cash at close, you may counter with a seven-year seller balloon note at 8

percent for \$3 million with \$10 million cash at close. If the buyer is a solid company, that may be a superior outcome than your original target because the best interest return you can currently get on your investments is 4 percent. Be flexible, be creative, and use your team to negotiate the hard parts and preserve your relationship with the buyer.

EXIT ON PURPOSE

You may have spent your life's work building your material handling business to provide the income, wealth creation and legacy that you had planned and hoped for. You prepared and were competitive and tireless in your approach. You have one final act in your business—make that your final business success. Exit on purpose, from a position of strength, and receive the highest and best deal the market has to offer.

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LETTING GO

Continued from page 88

be in place by the time the Successor is 35 years old.

Letting go was a tough decision. The decision had many ramifications, not the least of which were concerns for the business, my family and my own brain cells. The thought of leaving the industry was sad for both Carol and me, especially knowing we will miss the annual MHEDA Convention, our vendors' meetings and other industry events, and mostly the friendships we've made over the years. (Don't be surprised if we show up on a few doorsteps during our retirement travels!)

Eventually my decision was made. The successor to the business was our son Scott. Not only was he chosen, he also had to choose. Did he want to be in the material handling industry? Work with his father? Ultimately be responsible for all aspects of a business? Could he manage the commitment to purchase the business? He has since proven to himself, customers, vendors and employees that he has what it takes to be a fourth-genera-

tion successor to a business in the material handling industry. The successor to R. H. Brown Co. began his career at the age of 26. The R. H. Brown Co. is fortunate to be in competent hands.

Letting go is a big decision and an emotional one. One way or another, a simple thought or event will motivate the decision. Make the decision on your terms.

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