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Value Doesn't Grow On Trees…Or Does It?

We all know that "money doesn't grow on trees." And neither does business value. You can't just wait until you are ready to leave your business to find out how much "value" you need or want and how much "value" exists in your business. By then it will be too late. The tree metaphor is relevant, though. Value is something that you can grow, nourish and ultimately harvest in your business. Let's look at an example.

Picture three identical companies each engaged in moving time-sensitive freight for customers. All have a national presence, $2M in EBITDA (Earnings Before Interest, Tax Depreciation and Amortization) and about $25M in annual sales. It would be logical to assume that they all have about the same value.

In fact, one had little value, one sold for 3.5 times EBITDA and one sold for 5.5 times EBITDA. The difference in value was $3M to $7M to $11M.

Neither gross sales nor EBITDA alone determined the price and terms of these deals. The key to the variation in purchase prices was the presence or absence of value drivers in the companies as well as the ability of these value drivers to survive the owner's departure.

Value drivers are internal characteristics of a company that buyers look for in acquisitions. You'll see that it doesn't matter if you plan to keep your business forever, transition it to family members, sell it to your management team or find an outside buyer - value drivers

can give you more options, more flexibility and more money from your ownership interest. Strong value drivers are those that are effective and will continue to operate once the original owner departs. Consequently, those are the value drivers that increase both EBITDA and the multiple of EBITDA buyers may be willing to pay.

We may measure the effectiveness of value drivers in two ways: 1) their positive contribution to cash flow and 2) their ability to continue to contribute to cash flow under new ownership.

Think of it this way: why would anyone want to buy your business if its continued success is dependent on you-the departing owner? Buyers are more likely to pay top dollar for businesses that will not miss a beat when the original owner is no longer in charge.

Success in business is determined not by how well you run the business, but by how well the business runs without you.

Let's look at the three freight-moving companies more closely to see what motivated buyers either to open their wallets or walk on by.

Company A: The owner/operator was responsible for management, operations and his personal and industry contacts were the source for new business. All roads ran through the owner so without him, the business had little value.

Company B: This company had a capable management team. Many of its systems and procedures were state-of-the-art. There was, however, one glaring weakness: the major customer, responsible for over 50 percent of the company's revenue, had a decades' long relationship with the company's owner, not with the company.

Buyers are much less likely to pay millions for customer accounts that can, and indeed often do, go elsewhere the day after they find out the owner has sold the business.

Company C: Finding the owner of Company C wasn't easy. She spent weeks on vacation or visiting grandchildren and when she was in town, was engaged in a variety of civic and charitable activities. She made workplace appearances only sporadically and left operations in the hands of her stable, effective management team.

She had deliberately created plenty of diversification in her company's customer base knowing that one day she'd sell the business. She had thought about what she would look for in an acquisition so had included customer diversification as one of many attributes or value drivers she wanted in her company. She understood that value drivers were necessary to maximize sale-ability as well as the sale price and amount of cash she could demand from a buyer.

Interested buyers were delighted that she had changed her role in the company over the years so that a new owner could step in, almost unnoticed.

There are a number of value drivers that are critically important to today's buyers. The

value drivers that are most important to your business may or may not be the same as those that were identified for Company C. What we can say with some certainty is that value drivers can help your business value grow to bring you closer to the value that you need. If you are interested in learning more about them, we will be happy to sit down with you and talk about how value drivers might improve your business value.

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