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EXIT: Staged Right Contracting Business – December 2006

Have you formulated an exit strategy for when the time comes to sell your business? It can be difficult to do find the time to do so when you're engaged in the daily struggles of operating an HVAC business, but delaying your planning can cost you significantly. The best way to maximize the eventual sale day payoff is to build an exit strategy now.

An exit strategy is a plan to successfully relieve yourself from the ownership of your business. To execute a successful exit strategy, several key steps must be followed. The steps include:

1. Define the reason for exiting
2. Establish a time frame
3. Understand the market and potential buyers
4. Gain an understanding of the value of your business
5. Set realistic expectations
6. Prepare to business to maximize the sales price
7. Build an advisory team

Define the Reason for Season:

Defining a reason as to why you will sell your business helps you to set a goal and establish a time frame. Setting a goal now will be beneficial later when transactional stresses tempt you into second guessing your decision. Your ultimate goal should be to one day sell your business and cash in on the asset that you have worked so hard to build; other reasons for selling include retirement, failing, health, burnout or new opportunities.

Establish a time frame:

Time frames can vary, but generally speaking, the longer you have to execute your exit strategy, the better the final outcome. Establishing a time frame is imperative and for businesses that have suffered recent setbacks, several years may be needed to make required adjustments. Time frames should be considered estimates, certain events may force you to adjust your target. Other factors, such as an owner's failing health, may dictate an abbreviated plan from the start. Rolling out of bed one morning and deciding it is time to sell today, regardless of the reason, is the worst time to establish an exit strategy.

Brandon Jacob operates *Contractors Financial Opportunity* (www.Contractorscfo.com), a financial consulting firm which specializes in business valuations, transactional support and exit strategies. Mr. Jacob calls upon his sixteen years as a CPA as well as industry insight gained as a valuation analyst and acquisition specialist in the HVAC, plumbing and electrical trades. Mr. Jacob brings big business experience and expertise to small business owners who would otherwise never have access to such resources. To contact Mr. Jacob, call him at 713/426-4041 or email him at Brandon@Contractorscfo.com.

Understand the market and potential buyers:

You should give some serious consideration as to who you want to target as a buyer. Necessary preparations will be different if you intend to sell to a group of employees or family members versus a third party. Third party buyers located, stay connected to several different sources that may lead to a suitor. Owners commonly mistake that their best competitor will swoop down and buy the business when the time comes to sell. While your competitor may be willing to buy your business, he will value your company's goodwill less than someone who is not already operating in your market. And the value may be substantially less.

Another blunder is to believe that the "second waive" of consolidators will be your salvation. While building your business to sell to a strategic buyer is a good move, expecting the second coming of publicly traded consolidators is akin to hoping for an onslaught of qualified service technicians to appear at your door. Strategic buyers can be a local utility, a buying group, or a larger HVAC business not currently operating in your market. They are strategic buyers, expect them to proceed with caution and be prepared to offer to them a well operated business.

Gain an understanding of the value of your business:

At the beginning of your exit strategy plan, you should gain an understanding of the value of your business. Accomplishing this now will not only communicate where you are today, but also help set realistic expectations for your exit strategy plan.

Valuations can be calculated by valuation professionals. Avoid "rule of thumb" guesstimates that are handed out for little to nothing. To accurately calculate the fair market value of your business, a valuator must consider several attributes of your business as well as analyze several years of historical financial information.

Typically a valuation professional will communicate the value of your business in the terms of "Fair market Value". Fair market value is defined by the Internal Revenue Service's Revenue Ruling 59/60 as the price in which at which property would change hands between a willing buyer and a willing seller when the buyer is not acting under a compulsion to buy and the seller is not acting under a compulsion to sell and both parties have a reasonable knowledge of the facts. A buyer may offer you more or less than fair market value for your business, depending on his compulsion. Having an understanding of your company's fair market value is an excellent tool to use as a measuring stick to judge any offer.

Set realistic expectations:

Setting realistic expectations is key. Without realistic expectations, one runs the chance of passing on an excellent offer, just because it does not meet the seller's expectations. Worse yet, you may let your business go for less than what it is actually worth! Often contractors base expectations on wants and/or needs and not on sound business valuation principles. Building expectations upon "pie in the sky" hopes and dreams will cause an owner to falsely over value his business.

Prepare to business to maximize the sales price

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With an understanding of your company's current fair market value, the next step in executing your exit strategy is to build value into your business.

Some ways a business owner can increase the value of his business are to:

1. Produce and demonstrate several profitable financial periods
2. Maintain clean and consistent financial statements
3. Demonstrate several periods of revenue and earnings growth
4. Organize and maintain company records

Operate and Demonstrate Several Profitable Financial Periods:

The surest way to predict future results is to analyze past performance. This rings true in the world of business valuation. Therefore, buyers will focus on a target company's historical earnings. Commonly, a buyer will analyze the three most recent years, but there are no hard and fast rules, buyers may want to research as far back as five years.

The business must produce financial statements that demonstrate the company's ability to generate profits. Without, the company's fair market value and subsequently the purchase price offered by any buyer will suffer. Typically, a buyer will analyze the target company's adjusted historical earnings. Adjustments to the financial statements enable the buyer to predict what the true earnings of the target company will be going forward (post purchase).

Adjustments to the historical financial statements can include excessive owner's salaries as well as certain discretionary, non-reoccurring and extraordinary expenses. While a buyer may consider certain adjustments or addbacks as they are sometimes referred, a buyer preparing his business for sale should eliminate expenditures that will be difficult to prove as adjustments. In general, if you are serious about executing a highly profitable exit strategy, run your business like it was a publicly traded entity.

Demonstrate several periods of revenue and earnings growth:

Along with the ability to show positive historical earnings, your company should be able to demonstrate that it is flourishing via an increase in annual gross revenues and net income dollars. Businesses that fail to show growth, or worse yet, show a decline, will attract less buyers and those buyers that they do attract will be less likely to act in any type of compulsion to purchase your business.

Maintain clean and consistent financial statements:

It is not enough to just eliminate extraordinary expenses; your financial statements must also be clean and consistent. Avoid adding and eliminating to your chart of accounts and stick with a set group of expenses that together make up your total direct costs. A buyer will want to understand your gross profit margin and without a consistent set of direct costs, that would be impossible.

Consider having a consultant or CPA analyze your financial statements on a monthly or quarterly basis. Be sure that whoever you engage conducts his analysis with understanding of your intentions. While you may already be working with a CPA who completes your annual tax return, this may not be the best person to assist you with strategizing your exit.

Organize and maintain company records:

Failure to organize and maintain proper company records can be fatal to a successful exit strategy. Whether you are selling the stock or assets of your business, a buyer will want to fully study all business records. This includes corporate minutes, employee files, vendor files, vehicle titles and customer databases. The longer you have to plan your exit, the more likely these documents will be in the order for when a discriminating buyer requests to see them.

Build an advisory team:

For many business owners, selling your business will be a once in a lifetime event. The strength of your team will determine how successful this process will be. Failure to seek professional help and “go it alone” is a recipe for disaster.

As you execute your exit strategy plan, you may find it necessary to utilize certain professionals for very specific pieces of the transaction. Waiting until a difficult tax issue to arise three days before close is a poor time to be searching for a qualified tax professionals. Start seeking these professionals now, although you may not need them until later (or maybe not at all). Key team members include:

- Certified Public Accountant – While your current CPA will be part of your team, consider his/her transactional experience before using him for valuation and advisory roles.
- Business Valuation Professional – To set realistic expectations and gain an understanding of the current fair market value of your business, use a professional that understand not only business valuation philosophy, but also someone who knows the HVAC business.
- Advisor/Intermediary – Consider the advisor that not only can market your business, but can guide you through the entire process, including guiding you through due diligence.
- Transactional Attorney – A key member to your team. A transactional attorney will be required to review all legal documents. Like your CPA, be sure that the attorney that you use for the sale of your business has transactional experience.
- Tax Accountant/Attorney – Have a go to person in the event a “sticky” tax situation arises and threatens your deal. You may not have to rely on this individual for your sale, but you will be glad you have someone identified if the need arises.

The above is represents the essential deal team members. Others professionals that you may include on your team include peers, a financial planner, a real estate agent (if the sale of real estate will be part of the transactions) and industry consultants.

Conclusion:

Sooner or later, you will relieve yourself from ownership of your company. In order to guarantee that the high risks of ownership payoff, be sure to maximize your company’s value on the sale day by formulating an exit strategy today.