

**Exit Planning for Business Owners Series**

**What Creates Value in Your Company?**

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Long before you are ready to think about selling your company, you may want to think about what creates value in it. The following are key factors in creating value.

**Seller's Reputation**

Your business is known for its character and reputation in the industry. Your personal ownership especially shows through if you have used your own name as part of the company's name. An owner's competence and attention to detail become evident through every aspect of the business. This does begin to factor into value at the time of sale. A prospective buyer needs to feel comfortable with the owner/seller, and with the reputation the seller has built up over many years. A seller's reputation can make or break a deal with a buyer.

**Product-Line Quality and Depth**

Quality products stand the test of time. The value of quality products is higher and lasts longer than other products because they are often the market leader. Add depth to a product line with strong core product sales and you will improve your company's chances to achieve success and lasting value. Create an ongoing list of new products and you will make the company still more attractive to buyers who want to assure there is new product to drive the company forward in the future.

Because buyers think in terms of purchasing companies for their future revenue streams, strong sales of core products are a key value component and help predict future revenues. Buyers will analyze sales by product and by channel, placing higher value on recurring sales at full retail and in non-returnable sales channels. Although buyers also want and need to see products under development, they generally place less financial value on unreleased new products because the high costs of taking new products to the marketplace offsets much of the initial revenue stream.

Companies with focused product lines that lead a market segment have relatively high value. Product lines that are scattered over numerous market segments are less attractive to buyers, because they know that widespread disparate marketing expenditures produce lower returns due to lack of focus and synergy.

Buyers want to see strong sales in several channels, including domestic and international sales, special sales, and on the Internet.

### **Intellectual Property**

In addition to the physical assets of a business there are often some forms of intellectual property, as well as licensing, or production contracts to be dealt with. Buyers may be acquiring Web sites, company names, trademarks, or copyrights that often can be as important as product inventories. All of a company's intellectual property must be in order and assignable to have value for a buyer. Make sure that you have the right to assignability in all of your current and future agreements and contracts.

In addition to reviewing contracts for assignability, prospective buyers will perform due diligence on ownership rights to Web site names, trademarks, and copyrights. Ensure that you own what you are proposing to sell.

Buyers see additional value in intellectual property that can repurposed into their own product lines or into new media or product formats. Therefore you should also ensure that you have the right to use and sell your company's intellectual property in all kinds of forms.

### **Financial Information**

Financial information provides the basis for all valuation analysis. Prospective buyers use financial information and valuation methods together to determine a purchase price. When financial information is clean, easy-to-understand, and quickly retrievable, it will not pose problems during the sales process. Otherwise, financial information will become a major issue in the sale process and the value of the company can be greatly reduced.

A prospective buyer who cannot rely on a seller's financial information will perform more due diligence on the seller's company. A buyer who cannot get comfortable with the seller's financial information may decide not to make an offer.

Audited financial statements, the gold standard in accounting information, provide additional credibility and support for the seller's financial representations.

## **Profitability and Gross Margins**

Profitability adds value today and for the future. A buyer will view a historical trend of profitability as the strongest indicator that it is making a solid investment in a healthy company with good potential that can provide a positive return on investment.

A buyer also needs to understand a seller's gross margin. Gross margin analysis focuses on pricing strategies, manufacturing costs, and fulfillment costs (whether these are internal or outsourced). Buyers generally analyze gross margin by product looking for issues and opportunities.

## **Business Operations**

Acquisitions of companies whose revenues are less than \$25 million are generally structured as asset purchases rather than share purchases of company stock. The buyer usually purchases selected assets and consolidates business operations for economic savings.

To make realistic financial modeling assumptions for combining the seller's operation into the buyer's company, a buyer needs to understand the seller's operating costs. Buyers also want to see that the seller is running operations efficiently during the acquisition process.

As we have noted before, every owner of a company should run the business as if it were for sale every day. Following this advice will equip you to respond to sale opportunities, which tend to arise unexpectedly, especially when the business is growing. This approach will also make your company easier to run and more profitable whether or not you ever decide to sell it.

The next article in this series will cover options for transferring ownership of a company.

**The Siburg Company** is a boutique consulting firm specializing in financial and operational consulting with an emphasis on mergers and acquisitions.

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