

How to Exit Your Business with a Maximum Market Value

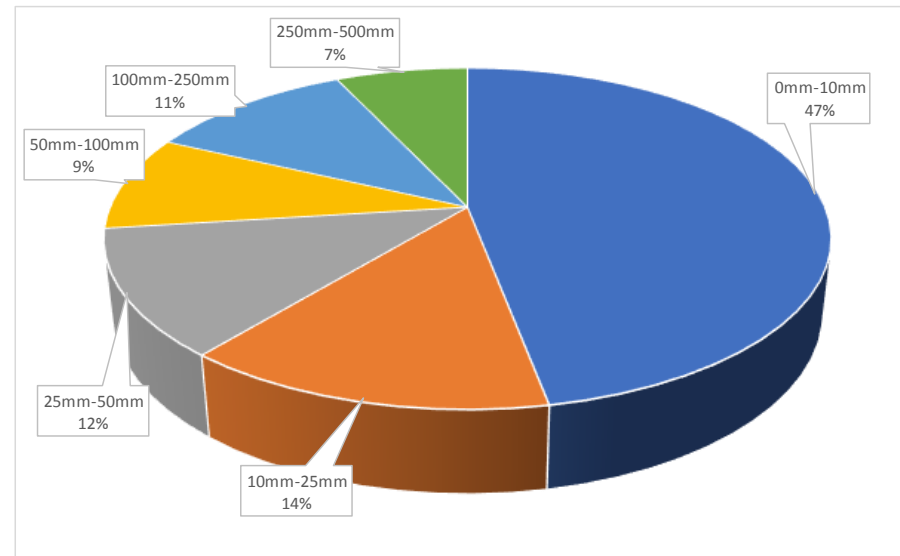
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Valuing a Business is a Process



US and Canadian M&A Activity



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Mistakes to Avoid

Top 5 Reasons why business owners evaluate their companies for less than maximum value...

- Did Not Know Value – No Professional Consultation
- Inadequate Documentation of Company Performance
- Selling to the Wrong Buyer
- Improper Transaction Structure
- Value at Wrong Time of the Business Cycle



Myth of Multiples and Formulas

“No formula can be devised that will be generally applicable to the multitude of different valuation issues...”

“Because valuations cannot be made on the basis of a prescribed formula there is no means whereby the various applicable factors in a particular case can be assigned mathematical weights in deriving the fair market value.”

IRS Revenue Ruling 59-60



Maximizing Market Price

M&A Market Cycle

- Interest Rates
 - Inflation
 - Tax Rates
 - Demographics
 - Economic Cycle
 - Capital Availability
 - Foreign Exchange Rates
- ...are all beyond your control



What Should be Your Perspective?

Explain the Past – Sell the Future



Changing Your Focus

Past:

- Historical Financials
- Tax Returns
- Business History
- Hard Assets

Future:

- Recast Financials
- Pro Forma Future Earnings
- Market Research
- Identify Intangible Assets

What is the Buyer Buying?



Recast Past Three to Five Years

- Owner-related Direct Expenses
- Owner-related Indirect Expenses
- Excess Family Personnel
- Non-recurring Bad Debts
- Discontinued & Non-related Products/Businesses
- Real Estate/Facilities
- Discretionary Professional Fees
- Extraordinary Expenses
- Non-recurring Expenses and Income



The Goal is to Measure True EBITA

E = Earnings

B = Before

I = Interest

T = Taxes

A = Amortization (Depreciation)

EBITA = CASH FLOW



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Identify Intangible Assets

- Advertising Campaigns
- Advertising Materials
- Backlog of Contracts
- Branding
- Computer Database
- Computer Designs
- Contracts
- Copyrights
- Credit Files
- Custom-Built Factory
- Customers
- Delivery Systems
- Distributorships
- Employee Manuals
- Experienced Drawings
- Experienced Workforce
- Favorable Financing
- Franchises
- Government Programs
- Growing Industry
- Key Employees
- Know-how
- Licenses
- Local Wage Level
- Location
- Low Turnover
- Loyal Customer Base
- Mailing List
- Management
- Name Recognition
- Patents
- Proprietary Designs
- Reputation
- Royalty Agreements
- Security Clearances
- Skilled Employees
- Supplier Base
- Supplier Relationships
- Systems/ Procedures
- Technology
- Tooling
- Trademarks
- Trade Secrets
- Training Procedures



Ownership Perspective

Explain the Past

Sell the Future



Estimate Market Value – Looking into the Future

- Discounted Cash Flow Analysis
- Private & Public Companies
- Comparable Company Market Value
- Asset Value Analysis



Rules of Thumb by Industry



Publishers - Valuation

Rules of Thumb:

- 75 to 100 percent of annual sales includes inventory
- 6 times EBIT
- 5 times EBITDA

Publishing is a diverse business. Electronic publications have higher multiples. Specialties such as scientific and technical publications have higher multiples. Magazines would be somewhere in the middle, with good trade magazines worth more than consumer magazines. City and local magazines are worth the least of the magazines with competition intense. Most print publications will have an electric or digital component and if they do not the value is negatively impacted.

Publishers - Continued

Rules of Thumb, Continued:

- Profit margins. Rank of the publication in its specific niche is very important. The number one publication in a category, such as construction, is worth far more than the number 2 or lower publication.
- Revenue per page for magazines, cost per page.
- A general benchmark has been one time sales but this is more difficult to measure nor because declining sales.
- In magazine publishing there are numerous indicators for efficiency such as revenue per page, cost per page. Beyond these, publishing associations collect data from publishers so that statistics such as G & A as a percent of revenue are available.



Publishers - Continued

Benchmark Data:

Statistics	
Number of Establishments	2,939
Average Profit Margin	7.80%
Revenue per Employee	\$387,700
Average Number of Employees	25.6
Average Wages per Employee	\$70,919

Industry Costs	
Profit	7.8%
Wages	18.4%
Purchases	60.2%
Depreciation	1.3%
Marketing	3.2%
Rent & Utilities	0.5%
Other	8.6%

Products and Services Segmentation	
Textbooks	28.5%
Other Books and Services	27.2%
Adult Trade Books	18.6%
Professional, technical, and scholarly books	18.2%
Children's and juveniles' books	7.5%

Industry Trend:

- The trend is clearly to digital and electronic products. Also, the valuable businesses have a very highly defined niche and a leadership position in that niche.
- Internet will continue to negatively impact many segments of the publishing business



Bank - Valuation

Rules of Thumb:

- 1 to 2 times Book Value
- 15 times EBIT

Benchmark Data:

Statistics	
Number of Establishments	85,279
Average Profit Margin	18.0%
Revenue per Employee	\$391,200
Average Number of Employees	15.2
Average Wages per Employee	\$73,742

Products and Services Segmentation	
Real Estate Loans	40.0%
Depository Services	27.0%
Loans to Individuals	15.5%
Commercial Loans	14.5%
Other Loans	3.0%

Bank - Continued

Benchmark Data, Continued:

Major Market Segmentation	
Retail Customers	54%
Corporate Clients	43%
Other Clients	3%

Industry Costs	
Profit	18.0%
Wages	21.2%
Depreciation	3.6%
Marketing	1.5%
Rent & Utilities	9.8%
Other	45.9%

Market Share	
Wells Fargo & Company	18.8%
JPMorgan Chase & Co.	14.9%
Bank of America Corporation	12.0%
Citigroup Inc.	6.4%

Industry Trend:

- Consolidation of smaller banks, high scrutiny of risk in making loans, lower profit due to building up of capital and reserves.



Auto Dealer - Valuation

Rules of Thumb:

- 0 to 10 percent of annual sales plus inventory
- 0 to 5 time EBIT
- 0 to 4 times EBITDA
- Depending on the franchise, it's 3 to 6 times EBITDA plus real estate and hard assets
- Total transaction value in the industry currently ranges from 2 to 4 times pretax earnings



Auto Dealer - Continued

Rules of Thumb - Comments:

- Be aware of rental cost paid to owners of dealerships. Be aware of compensation to owners, family members, and general managers.
- Automobile dealerships should have net income of around 2% of total revenue if domestic and higher if import. Service department customer pay labor, gross profit should be between 65% and 70%, parts GP between 30% and 40%. A multiple of 4 to 6 times net income is typical. Imports bring a higher multiple than domestics. Larger stores in a mid-size or large market bring a higher multiple than smaller, rural stores.

Auto Dealer - Continued

Rules of Thumb – Comments, Continued:

- The two most important characteristics are brands sold and location within a market. Competing outlets affect value. Market analysis, including measuring consumer demand in the area, is critical. Facility age is also a factor.
- New auto dealerships usually have 4 profit centers: parts, used cars, F & I, and service. New car sales typically have very little margin. Ask a dealer about their absorption ratio (an industry term that indicates how much of their back-end is absorbing their overhead). Any new buyer would have to be approved by the manufacturer (Ford, GM, Toyota, etc.). Key people: used car manager, parts manager, service manager.
- The current value is 2 to 4 times net profit of the most recent year. However, the new car franchises that are bringing up to 5 times net profit are Honda, Toyota, and Mercedes Benz.

Auto Dealer - Continued

Benchmark Data:

Statistics	
Number of Establishments	21,976
Average Profit Margin	1.7%
Revenue per Employee	\$640,200
Average Number of Employees	43.1
Average Wages per Employee	\$48,870

Industry Costs	
Profit	1.7%
Wages	7.7%
Purchases	84.0%
Depreciation	0.3%
Marketing	1.1%
Rent & Utilities	1.1%
Other	4.1%

Products and Services Segmentation	
New Vehicles	57.0%
Used Vehicles	24.0%
Parts and Repair Services	15.0%
Finance and Insurance	4.0%



Auto Dealer - Continued

Benchmark Data, Continued:

Share of Total Dealership Sales Dollars in 2013	
New Vehicle	57.1%
Used Vehicle	31.8%
Service and Parts	11.6%
Source: 2014 National Auto Dealers Association Data	

Expenses as Percentage of Annual Sales	
Cost of Goods	75% to 80%
Payroll/Labor Costs	8% to 10% of gross profit
Occupancy	10% of gross profit
Profit (Estimated Pretax)	1.5% to 3%

Industry Trend:

- The small dealership owners are being acquired by groups and larger corporations.



Accounting Firms/CPAs- Valuation

Rules of Thumb:

- 100 to 125 percent of annual revenues plus inventory
- 2 times EBIT
- 2.2 times EBITDA



Accounting Firms/CPAS- Continued

Rules of Thumb - Comments:

- Premiums paid above 100% of gross revenues for above average net income (of 45%), location (major metro area), special expertise (tax, etc.), established clientele with above average fees.
- Even distribution of revenue from tax return preparation and accounting fees is better.
- CPAS commonly use 1 times gross although we have frequently exceeded that amount.



Accounting Firms/CPAs- Continued

Rules of Thumb – Comments, Continued:

- Product mix and any special areas of practice can affect selling price to the right buyer. There is always the possibility to split up a practice among two or more buyers if specialty work is involved.
- Revenue composition is important; retail tax, writeup, monthly accounting, review work, audit, consulting, types of revenue streams – all have an effect on sale's price.

Accounting Firms/CPAs- Continued

Benchmark Data:

Products and Services Segmentation	
Auditing and Assurance Related Services	46.2%
Tax Services	35.4%
Consulting	16.2%
Other Services	2.2%

Major Market Segmentation	
Corporate Clients	68.5%
Individuals and Small Businesses	27.2%
Government Agencies	4.3%

Statistics	
Number of Establishments	121,125
Average Profit Margin	14.4%
Revenue per Employee	\$181,600
Average Number of Employees	4.4
Average Wages per Employee	\$65,666



Accounting Firms/CPAs- Continued

Benchmark Data, Continued:

Expenses as Percentage of Annual Sales	
Cost of Goods	0% to 5%
Payroll/Labor Costs	25% to 35%
Occupancy	10% to 25%
Profit (estimated pretax)	35% to 45%

Industry Costs	
Profit	14.4%
Wages	36.2%
Purchases	4.9%
Depreciation	0.9%
Marketing	1.5%
Rent and Utilities	5.3%
Other	36.8%

Market Share	
PricewaterhouseCoopers	9.3%
Ernst & Young	8.7%
Deloitte Touche Tohmatsu	8.5%
KPMG International	4.2



Accounting Firms/CPAs- Continued

Industry Trends:

- The merger wave among CPA firms is expected to continue it's strong pace.
- Another overlooked factor: the search for talent. Unemployment remains low in the accounting profession and many smaller firms find themselves in an increasingly competitive market for the next generation of leaders. As recruiting battles heat up, buying or selling a firm make sense as a growth strategy or exit plan.

Accounting Firms/CPAs- Continued

Industry Trends, Continued:

- Employee costs as a percentage of sales is an important number. 40% or less is considered good. Above this leaves little room for profits.
- Many Baby Boomers are getting ready to retire.
- Industry trend is upward due to increased tax and government regulations on businesses and individuals.
- Industry regulation makes entry difficult yet demand for services continually increase.



Accounting Firms/CPAs- Continued

Industry Trends, Continued:

- More consolidations. More minority and foreign ownership.
- An increase in the number of small firms changing hands due to the average age of firm owners approaching retirement age.
- Although the marketplace of accounts is aging, there are excellent opportunities for the future entrants into the industry. Future government legislation will result in fewer competitors in taxation. The audit market has slowed with legal difficulties, but other sectors have expanded with government legislation.



Computer Consulting Valuation

Rules of Thumb:

- 100 to 125 percent of annual revenues plus inventory

Comments:

- Many consulting businesses are one-person operations or are headed that by someone who has the contacts and may basically be “the business”. This person may be the goodwill, and without his or her presence, the business.



Computer Consulting Valuation - Continued

Benchmark Data:

Statistics	
Number of Establishments	478,999
Average Profit Margin	7.6%
Revenue per Employee	\$199,200
Average Number of Employees	4
Average Wages per Employee	\$85,467

Industry Costs	
Profit	7.6%
Wages	42.5%
Purchases	18.8%
Depreciation	1.1%
Marketing	2.4%
Rent and Utilities	5.2%
Other	22.4%

Major Market Segmentation	
Financial Services	26.0%
Communications and High Technology	20.0%
Federal and State Governments	15.0%
Manufacturing Industried	15.0%
Other Sectors	14.0%
Retail Stores	10.0%

Computer Consulting Valuation - Continued

Benchmark Data, Continued:

Products and Services Segmentation	
Computer Systems Design, Development, and Integration	36.3%
Computer Application Design and Development	25.8%
Other Services	17.0%
IT Technical Support Services	10.1%
IT Computer and Network Management Services	6.0%
IT Technical Consulting Services	4.8%

Computer Consulting Valuation - Continued

Industry Trends:

- A highly-segmented industry will continue. Of those that run multi-person businesses most have fewer than three owners. Corporations have two to three non-owner employees. Almost 90% of firms earned \$500,000 or less, while 4.4% earned \$1 million or more. 75% of ICCA Consultants have over 15 years experience in their field.



Real Estate Offices Valuation

Rules of Thumb:

- 33 percent of annual sales (real estate offices) includes inventory
- Price will depend on agents splits.



Real Estate Offices Valuation

Benchmark Data For Real Estate Agency Franchises:

Products and Services Segmentation	
Residential Real Estate Agency Franchises	68.5%
Commercial Real Estate Agency Franchises	31.5%

Statistics	
Number of Establishments	26,756
Average Profit Margin	19.9%
Revenue per Employee	\$105,000
Average Number of Employees	13
Average Wages per Employee	\$42,393

Major Market Segmentation	
Sellers	45.0%
Lessors	30.0%
Buyers	25.0%

Industry Costs	
Profit	19.9%
Wages	40.6%
Purchases	12.8%
Depreciation	2.0%
Marketing	1.6%
Rent and Utilities	7.1%
Other	16.0%

Real Estate Offices Valuation

Benchmark Data For Real Estate Sales & Brokerage:

Statistics	
Number of Establishments	852,931
Average Profit Margin	10.6%
Revenue per Employee	\$109,800
Average Number of Employees	1.3
Average Wages per Employee	\$45,262

Major Market Segmentation	
Sellers	45.0%
Lessors	30.0%
Buyers	25.0%

Products and Services Segmentation	
Residential Sales	53.5%
Residential Rentals	13.0%
Commercial Rentals	12.5%
Commercial Sales	10.5%
Other Services	7.0%
Sale or Rental of Land	3.5%

Industry Costs	
Profit	10.6%
Wages	41.5%
Purchases	10.1%
Depreciation	2.1%
Marketing	5.0%
Rent and Utilities	4.4%
Other	26.3%

Industry Trend:

- Clear trend to establish national branding

Insurance Agencies/Brokerages Valuation

Rules of Thumb:

- 125 to 150 percent of annual sales includes inventory
- 150 to 200 percent of Commission Revenue
- 4 to 5 times EBIT
- 4 to 6 times EBITDA



Insurance Agencies/Brokerages Valuation - Continued

Rules of Thumb, Continued:

- Under \$1 million commission, Multiple of Gross Commission Income – 1.25 to 0.85, depending on carriers represented.
- Non-Standard Auto Insurance Agency. Insurance Commission Income, excluding add-on coverage's, times last year's retention, 0.2 to 1.0 times commission income.
- Surplus Lines Agency; 0.8 to 1.0 times commission

Insurance Agencies/Brokerages Valuation - Continued

Rules of Thumb, Continued:

- 100% of annual commissions; applies to multi-line agencies doing \$100,000-\$200,000 in gross commissions.
- 1.0 to 1.5 times annual revenue commissions
- 1.5 times annual commissions (property and casualty)
- 2 times annual revenues (standard agency)
- Agencies with more revenue (\$1.5M) + in commissions) are typically valued at 5-8 times EBITDA. This roughly translates into 1.5-2+ times commission revenues. Hard markets yield more contingent income and increased pricing on carrier premiums. EBITDA margins after recasting should come in between 15%-40% depending on size; any brokers above \$2 million in commissions due to economies of scale issues.



Insurance Agencies/Brokerages Valuation - Continued

Benchmark Data:

Statistics	
Number of Establishments	428,990
Average Profit Margin	10.5%
Revenue per Employee	\$143,100
Average Number of Employees	2.3
Average Wages per Employee	\$48,598

Major Market Segmentation	
Businesses	45.7%
Individuals aged 45-54	11.8%
Individuals aged 35-44	11.1%
Individuals aged 65 and older	10.1%
Individuals aged 34 and younger	8.7%
Individuals aged 55 to 64	46.1%
Government	4.3%

Insurance Agencies/Brokerages Valuation - Continued

Benchmark Data, Continued:

Products and Services Segmentation	
Commercial P&C Insurance	32.4%
Personal P&C Insurance	25.0%
Health and Medical Insurance	13.2%
Life and Accident Insurance	11.3%
Other Annuity and Insurance	8.8%
Insurance Administration and Risk Consulting	6.0%
Annuities	3.3%

Industry Costs	
Profit	10.5%
Wages	34.0%
Purchases	1.9%
Depreciation	1.3%
Marketing	1.4%
Rent and Utilities	1.5%
Other	49.4%

Insurance Agencies/Brokerages Valuation - Continued

Industry Trends:

- Agencies will become more productive as the market continues to harden. This will be done through the staff handling the same accounts, while adding new revenue because of increased rates. Also, there should be improved automation and streamlining of the work that is to be done. Paperless systems are becoming the norm in many firms today. Insurance companies will be pressured to follow the lead from agencies and become more automated, as well. Because insurance carriers are not as automated as agencies, often a lot of the burden falls on the agents.
- The industry will continue to consolidate due to the demand for purchasing agencies



Insurance Agencies/Brokerages Valuation - Continued

Industry Trends, Continued:

- P&C – minimal growth; Health – shrinking competition and revenues due to reduced compensation rates under PPAC (Obama administration)
- ‘Standard agencies’ revenue will improve as business revenue increases. Small standard agencies will be relegated to small business. Consolidation will continue with regional brokers acquiring strong local standards.
- Good career path for young people. The insurance industry will continue to prosper. Service businesses will be desirable.

Do you have a business that we didn't talk about?

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