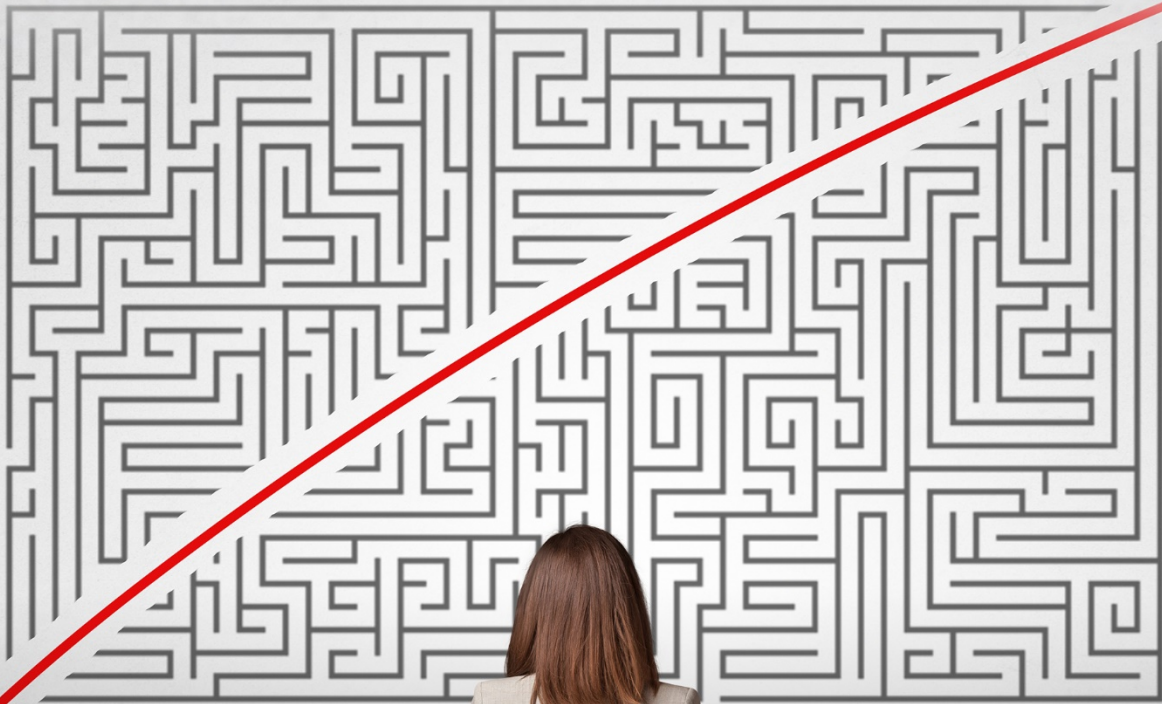


# THE SECRET TO SUCCESSFUL EXIT STRATEGIES

DEVELOPING AN EXIT PLAN NOW  
CAN DOUBLE YOUR COMPANY'S VALUE WHEN IT COMES TIME TO SELL™



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CEOs Advising CEOs

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## INTRODUCTION

I have been founder or cofounder and CEO of 6 corporations over my 35 year career and have exited 4 of those corporations. Two of the exits were a disaster, and two of the exits were successful where I was able to sell the businesses at a significant premium. Through the school of hard knocks, I discovered the wrong way to exit a business, learned about all the mistakes you can make without proper advice, and finally got it right through implementing the counsel of great advisors and a team approach to Exit Planning.

My research has shown that as a result of (1) mistakes made by the seller, and (2) the superior knowledge and experience of the buyer (the buyer has done this before), most businesses sell for approximately 70% of full value. I also discovered that the development of a professional Exit Plan, the avoidance of common seller mistakes, and the early implementation of steps taken to increase company value can result in a business sale of 150% of full value. What that means to you is that through proper planning, you have the potential to double your company's sale value over a typical result.

This article will give you the thinking behind this startling statement.

## EXIT PLANNING



Do you expect to be doing what you're doing now for the rest of your life? ..... Of course not!

..... then you need an exit plan. And even if you do not intend to leave the business for many years, there are aspects of an exit plan that you need to understand and begin now.

How long will it take from the time that you are ready to sell or transfer your business until you will be free to be doing something else? Most entrepreneurs are surprised that the answer is 4-5 years ..... 1-2 years to sell the business, and most buyers will require that you stay on for 2-3 years. And if you transfer the business to family or employees, you are still likely to be involved for many years.

There are lots of ways to sell a business more quickly, but you will leave money on the table, and not be a happy camper. As in all things in life, there's a right way to do it, and a wrong way to do it. The right way to do it will result in a much greater pay day for you, and will position you to live the life you want to live.



Eventually every owner leaves his or her business - exit planning will help you leave it with a huge smile on your face. Exit Planning is a general and specific business planning tool. It is part of a deliberate, customized process that helps business owners manage the business toward a set of exit goals and decide how best to achieve them. An exit plan can help maximize your financial return this year, every year and especially the year that you sell or transfer your business while minimizing your tax liability.

Even if retirement is in the distant future, understanding the process now can help you manage your business in a way that will make you more money now and make it easier to leave when you are ready. If you die or become disabled before retirement, exit planning can help ensure that your business survives and that your family gets taken care of.

## WHAT IS EXIT PLANNING?

- A general and specific business planning tool
- Determining when, where and how you will leave the business
- A step by step plan to sell or transfer the business
- A tool to maximize the value of the business
- An essential and important component to your Estate Plan
- A Collaborative Effort by You and Your Advisors

## CREATING THE EXIT PLAN



Far too many business owners fail to plan for their eventual exit from the business. Many owners get caught up in the details of running the business and just do not make the time for proper planning.

In the world of business, there is a huge misconception about what an exit plan is. When most business owners are asked what their exit plan is, they say something like, “I’m going to sell to a competitor ..... or go public ..... or turn it over to my kids. That’s 1% of what an Exit Plan is, and once you understand the other 99% of what an Exit Plan is and its benefits, you will decide to develop your exit plan NOW.

Business owners tell me all the time, I wish I knew that 10 years ago, I could have saved myself a lot of grief, made a lot more money along the way and had a bigger pay day at the end.

As an entrepreneur, you have worked long hours, worn all the hats and risked your life’s savings for a better future for yourself and your family,..... you’ve sacrificed just about everything to build something of value. A properly designed exit plan can have a huge impact on the level of that value.

## KEY PRINCIPLES OF EXIT PLANNING



Kirschner and Lewyn, an Atlanta based exit planning advisory company, has developed a process called the Business Owner Succession System or B.O.S.S.

The key components of this system are:

- Building Value
- Management Succession
- Zero Estate Tax Planning
- Pre Transaction Tax Deferral/Avoidance Planning
- Personal Wealth Focus
- Legal Issues
- Transaction Planning/Execution

## WHAT'S MY COMPANY WORTH?

### CLASSIC VALUATION MEASURES

Understanding the value of your business also represents a key element of the exit planning process. There are five basic approaches to valuation:

- a. Asset-based value. This method includes book value, adjusted book value, liquidated value and replacement value.
- b. Earnings-based value. For businesses without a lot of assets, earnings provide a more reliable indication of value. Earnings-based values can vary widely depending on a number of factors, such as pre- versus post-tax or current versus future earnings.
- c. Cash flow value. The most common cash-flow method involves discounted cash flow, whereby you project future earnings and value that stream of earnings by discounting it according to an agreed-upon number.
- d. Public company multiples value. This method compares public company multiples to private companies by identifying what a similar company is worth in terms of price to book, price to earnings, price to sales, and price to cash flow.
- e. Multiple. Most professional evaluation companies will not use this approach, yet it is the most common concept talked about at the cocktail parties, because of its simplicity. This is a quick and dirty way to estimate value.

The multiple is "X" and you multiply that number times the "recast" or "adjusted" EBITDA. "Recast" EBITDA is your net profit before interest, taxes, depreciation and amortization adjusted so that owner related expenses have been eliminated (see next page). Generally, you would pay off debt (if any) out of the proceeds, and if the buyer is also buying the real estate (if any), you would add that in. Many buyers do not want to purchase the real estate. Each industry has its own typical way deals are done. If you do not sell the real estate as part of the deal, you can structure it so the new owners lease it from you.

What's your multiple? The best way to find that out is to go to your industry association and find out what companies have recently sold for, and what multiple of earnings that was. Do not use multiples of public companies. Public company multiples are generally 2-4 times higher than yours will be and if you use a public company multiple, you will be very disappointed. In other words, if your multiple is around 5, public companies in your industry multiples could be anywhere from 10-25.



Most privately held company multiples will range from 3-7, with rare exceptions lower and higher than that.

So, to illustrate using an example using the "Multiple" concept:

1) If an industry has examples of companies that have recently sold for an average multiple of 5 (this is called the average "comparable" multiple)

2) Your company has "recast" net profits (EBITDA) of \$1,000,000

3) Debt of \$500,000 and

4) Real estate of \$700,000

.... Your company is worth approx. \$5,000,000 (if you keep the real estate)

Your company is worth approx. \$5,700,000 (if you sell the real estate in the deal)

.... and either way, you pay off the debt personally.

This is an oversimplification, but real estate and debt are variables, and to have a common industry multiple, you have to take it out of the multiple number itself. Remember, this is a quick and dirty way to estimate value, and is not what you will see from a professional appraisal of your company value.

Business Valuation is as much an art as science, and in the final analysis, the true value of a company is in the eye of the buyer.

## ELEMENTS THAT DETERMINE VALUE

### 1) The Past

- “Recast” Financial Statements
- Tax Returns
- Business History

### 2) The Present

- Current “Recast” Financials

### 3) The Future

- “Recast” Pro Forma Financial Statements

Recast or restated financial statements (P&L and Balance Sheet) increase net profits by taking into consideration the following categories of expenses or issues:

- Owner related direct expenses
- Owner related indirect expenses
- Surplus/shortage of personnel
- Non-recurring bad debts/reserves
- Discontinued product lines/business
- Real estate/facilities
- Discretionary professional fees
- Extraordinary expenses
- Excess cash
- Pro Forma – 3 Years Projected P&L and Balance Sheets
  - This should be done assuming that your expenses and use of assets are such as to maximize profits. In other words, take out all the items and issues noted above in the recasting section.
  - You must sell this, and it needs to be believable.
- Marketplace
  - You must provide research (preferably independent research) that shows the buyer what’s going on in the future of your marketplace, and how your projections fit in.

**What is the buyer buying?** .... Explain the past ... Sell the Future

“Buyers buy a Documented, Believable Future”

4) What are your intangible assets? Examples of Intangible Assets:

Advertising Campaigns, Advertising materials, Backlog, Brands, Computer databases, Computer designs, Contracts, Copyrights, Credit files, Custom-built factory, Delivery systems, Distributorships, Distribution Channels, Employee manual, Engineering drawings, Experienced design staff, Favorable financing, Franchises, Government programs, Growing industry, Know-how, Licenses, Local economy, Location, Low employee turnover, Loyal customer base, Mailing lists, Management, Name Recognition, Patents, Proprietary designs, Recession-resistant industry, Reputation, Royalty agreements, Security clearances, Skilled employees, Supplier base, Systems & procedures, Technologically advanced equipment, Tooling, Trademarks, Trade secrets, Training procedures.

5) Value Detractors

The value of your business **will be discounted** if you have any of the following issues:

- Sustainability of the business is questionable without you; or you are extremely difficult to replace because of your personal relationships. This will result in a big discount.

(this one could be a deal killer)

**If you have this problem, you must fix it!!!!**

- Poor Management team
- Poor systems
- Poor documentation
- Poor accounting records
- Legal problems
- High employee turnover
- Risk of losing key personnel
- Lower gross margins than industry standards
- Lower net profit than industry standards
- Obsolete assets

- History of declining sales
- History of losing market share
- More than 10% of sales are concentrated in 1 customer (the higher the %, the higher the discount; if you have 30%+ in 1 customer, expect a discount of at-least 25%.
- Plan for the future is weak
- Lack of R&D or weak new products/services on horizon
- The business is a “commodity business”
- Barriers to entry are low
- Industry is in a down market
- Interest rates are high
- Availability of capital is low
- Inflation is high
- U.S. Economic cycle is in down market
- M&A market is weak
- Anything that increases the buyer’s risk

From the bullet point list above, you should be able to easily identify what’s wrong with your business. FIX WHAT’S WRONG AND YOU WILL INCREASE THE VALUE OF YOUR BUSINESS BY 10-50%. And guess what else will happen?

..... **you will make more money year in and year out.**

6) Value Enhancers – Opportunities to Increase Proceeds:

- Strategic fit with Buyer .... The following are possible synergies:
  - Eliminate duplication of overhead
  - Consolidate product distribution
  - Use of Intellectual Property
  - Brand leverage
  - Sales force leverage
  - Buyer sells its products to Seller’s distribution channels and customers



- Seller sells its products to Buyer's distribution channels and customers
- Supplier leverage: Buyer may be able to leverage supplier relationships with increased purchasing volume

**A good strategic fit can increase the value of the deal by as much as 50%.**

- Strong market differentiators .... The more of the following differentiators you have the more valuable your company will be:
  - Critical advantages
  - Technology advantages
  - Intellectual property
  - Competitive advantages
  - Market leader
  - Positioning
  - Brands
  - Low cost producer
  - Price leader
  - Strong vision for future
  - Quality
  - Contracts with customers
- Good Management team
- You are not indispensable
- You have successor in place
- Your industry is hot
- Good systems
- High employee moral
- Strong back-log
- Higher gross margins than industry standards
- Higher net profit than industry standards

- History of increasing sales
- History of gaining market share
- Plan for the future is strong
- Strong R&D or great new products/services on horizon
- No single customer is greater than 5% of your business
- Maximize Intangible Assets
- Barriers to entry are high
- Industry is in an up market
- Interest rates are low
- U.S. Economic cycle is in an up market
- Availability of capital is high
- Inflation is low
- M&A market is strong
- Negotiate with more than one buyer
- If dollar value is low, foreign buyers will pay more
- Anything that reduces the buyer's risk

It is your job to prove the value of your business, not to allow buyer to discover its value.

## OTHER ISSUES THAT WILL IMPACT SALE VALUE

**Position for the transaction.** Selling a business is much like selling real estate -- in order to receive full value, you have to get it in top shape. Because positioning a business for sale can take several years, you should be managing the company to a set of standards that will maximize value. By focusing on the areas needed to maximize value, you will get the business in shape to sell.

**Time your exit.** You will receive more value for your company if you choose to sell it at the right time, which means paying attention to market and business conditions such as:

- Interest rates (low interest rates is a good thing)
- Merger and acquisition trends (activity in this area is high)
- Investment capital availability
- Economic cycle (sell when you are in the beginning of an up cycle)
- Taxes
- Foreign buyers

You will be able to get up to 50% more for your company if most of the above conditions are positive.

What kind of lead time do I need to plan for?

- Exit Planning begins the day you start your business.
- Can take up to 2-3 years to perfect the plan. You could do it much faster if that was all you were doing, but you have a business to run, so you will do different parts as you have time. And remember, part of the plan is fixing what's wrong with your business. This takes time, and the benefits are immense regardless of whether you sell or not.
  - Don't wait ..... the plan will make you more profitable NOW
- 5 years till you're out.
  - 2 years to put plan into place
  - 1 year to sell the business
  - 2 years to work your way out

- **The Exit Plan** will give you the framework for everything you need to do.

Other Opportunities to Increase proceeds

- Consulting Agreement
- Performance Agreement
- Bonus Agreement
- Earn out Agreement



## VALUE SUMMARY – WHAT IS EXIT PLANNING WORTH TO YOU

If you put 10 Business Owners who have sold their business in a room together and asked them if they were happy with the outcome of the sale, how many of them would say yes?

..... the answer is 2-3.

Why is that????

It's because selling your business is unlike anything you have ever done before. If you do not know what you're doing, there's a hundred different ways to screw it up .... And another hundred ways to do it right. PLUS .....The process of selling your business will be very unfulfilling and make you crazy if you do not know what to do and what to expect.

From my own experience and research, most deals get discounted by an average of 30% because of AVOIDABLE mistakes by the seller.

### 12 Biggest mistakes:

- There was no Exit Plan.
- Bad Timing.
- Forced Sale.
- You “took your eye off the ball”, lost your focus on running the business because you got too involved in the process of selling the business, and the business deteriorated.
- You are hard to replace because of special skills or relationships.
- Poor management team.
- Legal problems.
- More than 30% of business is with 1 customer.
- You only had one buyer.
- You gave the wrong reason for selling.
- You tried to negotiate the deal yourself.
- Not being on the same page as your partners.

Any one of those mistakes could result in your deal being discounted by 25% or more.

Do you want to get 150% of full value for your business?

The 8 Most Important things to do to increase your chances of selling your company at a significant premium:

- Have an Exit Plan.
- Hire smart, experienced advisors
- Right Timing.
- Have 3-5 Buyers creating a limited auction process.
- Great Management Team.
- Good Strategic Fit With Buyer.
- Industry is in Up Cycle.
- Strong, Believable Growth Projections.

## VALUE OF EXIT PLANNING

..... Let's assume that full value for your company is \$10M. Merger & Acquisition Industry experts (on the buy side) will tell you that the average deal gets done at 70% of full value because of mistakes made by the seller.

For this example that puts the typical result at \$7M.

But with an Exit Plan, great advisors, and the knowledge you've gained from understanding the process and preparing your company for sale, you will not be typical.

If you, therefore, avoid the mistakes AND do the right things that will enable you to earn a premium, you could end up with a result of selling the business at 150% of full value:

Potential result - \$15M

What that means to you is that:

**Proper execution of the Exit Plan could be worth as much as doubling the price of your business ..... and that could mean millions of dollars in potential benefit to you.**

## ABOUT THE AUTHOR: TOM CRAMER

Tom Cramer is the Founder and Co-Chairman of The Brain Trust, an association of CEOs, company presidents and business owners who come together to provide insight and solutions to shared business hurdles. Its purpose remains to provide best practices and ideas with leaders and entrepreneurs.

To fulfill this mission, The Brain Trust organizes Atlanta area CEO Peer Groups of up to 18 individuals. Each member is a CEO, President or General Manager of a non competing company. Groups meet once per month for a half day where members learn from experts and give advice and counsel to each other.

To learn more about The Brain Trust, click on the following link:

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