RKJ PARTNERS
LOWER MIDDLE-MARKET INVESTMENT BANKING

RKJ Partners, LLC is an Atlanta, Georgia based investment banking firm designed to specifically assist lower middle-market growth companies in executing transactions less than $100MM.

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Seven Drivers to Maximize Value in the Sale of Privately Held Businesses

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Focusing on how a buyer evaluates a business will impact your valuation

At this point you have put in years of "blood, sweat, and tears" to get your company to the point it is at today. If you are considering a sale or planning for an exit, it makes sense to analyze the strengths and weaknesses of your company and adjust certain items to yield the best possible value on what is likely your most valuable asset.

We suggest that you look at value drivers from the eyes of a buyer – as ultimately this is the lens that will determine fair market value in your transaction. Addressing these value drivers will help you sell at the higher end of the range of purchase price multiples for your specific industry. While some of these items are easier to change in the short term than others, it must be noted the significant effect each tangible and intangible value driver can have on a company's overall value. Even as little as a swing of a 1.0x's multiple in a mid-sized business can have a multi-million dollar increase on its value.

STRATEGIC VALUE DRIVERS:

Customer Diversification – How much of your revenue is concentrated into your largest account? In your top 5 accounts? When too much of your business is concentrated in too few customers, it is perceived as a negative in the acquisition market. The concern is that if a major customer leaves, the business could be negatively impacted. There are no hard and fast rules here, but generally if you have one customer approaching 15% of your business, you are getting into the "danger zone." On the plus side, if no single customer accounts for more than 5% of total sales, that is viewed as a real plus. If you find yourself with a customer concentration issue and are planning an exit,

start focusing now on a program to diversify. One quick fix: make an acquisition of a competitor with customer diversity, integrate them, and then take your company to market.

Management Team – Many smaller companies have an owner who functions as senior management, middle management, and in some cases, front-line worker. Buyers often see risk in what will happen when the incumbent owner is no longer there. Your ability to build a management team that will remain in place post closing will have a direct correlation to the comfort level of the buyer. Don't have a GM or similar middle manager? Go hire one. Further, work to lock them into the business post transaction – non-competes, employment agreements, and inventive plans go a long way towards keeping your management team in place. Do not let the market punish your valuation when this is a relatively easy area to impact.

Sales Team – How are sales generated in your company? For business that do (or should) have an active sales effort, we cannot overestimate the importance of separating sales from the owner. A buyer will constantly worry that revenues will evaporate post-closing if it is the owner that is the focus of the sales effort and maintains all of the customer relationships. Ideally you should develop a sales team and begin to transfer customer relationships to them well in advance of a transaction. As with management, ensure that they have well written non-competes and employment agreements with the company.

Recurring Revenue/Predictable Revenue – The holy grail for many acquirers is a recurring revenue stream – and even more so when that recurring revenue stream is contractual. Keep in mind that an acquirer buys a company for the value of a future earnings stream, and a valuation is often the result of applying a discount for risk to future earnings. In IT companies, those revenues might be in the form of licensing fees or annual maintenance agreements. For insurance companies, it's policy renewals. For defense contractors, it's a contract for the widgets you produce (caveat: beware "indefinite quantity, indefinite time" arrangements).

Recurring revenue is inherently less risky for the buyer than one-time sales. A great illustration would be comparing retail companies to insurance businesses. Retail companies are discounted for lack of recurring revenue, while insurance deals are compensated for the surety of their revenue stream. To maximize value, take a critical look at your customer base and wherever possible, develop a recurring revenue stream.

Effective Use of Professionals – Buyers look to past financials as an indicator of future performance. Buyers also evaluate the veracity of those financials based on the quality of work done by your staff and CPA firm. The quality of that work and your approach to strong financial controls serves to reduce a buyer's perceived risk regarding your business. The same goes for a strong attorney. When a company has a long relationship with a well-regarded legal team, the perception of the buyer is that you have received years of good advice on properly safeguarding the company. These items work their way into valuation by reducing the perceived risk of purchasing your company.

Additionally, there are many instances in which non-traditional transactional matters arise such as selling to members of a management team; transactions between partners/partnership dispute resolutions; family business transition plans; companies looking to enter into a merger relationship, and many more. An investment banker's experience

with these specialized scenarios enables them to apply the creativity and knowledge necessary to maximize the probability of achieving the desired outcome. An intermediary understands and can address the tax implications, legal issues, and regulatory hurdles that commonly arise during the business sale process and as such, should be utilized in conjunction with the CPA's and attorneys to achieve the optimal selling price and transactional structure.

Develop & Execute a Growth Plan – We routinely encounter companies that can verbally suggest a number of areas to grow. Relatively few take the time to formally document how they can execute these growth initiatives, and fewer actually begin the process.

Ask yourself what additional markets you can enter. What customer types offer the best margins? Can you reuse product lines / intellectual property for other purposes? Can you cross sell additional product lines into your customer base? Document how you would grow. Better yet, go out and start harvesting the low hanging fruit. A buyer will naturally look at projected growth with a skeptical eye; after all, if it's so easy to grow in these areas, why haven't you done it? Write the plan and demonstrate how it can be done.

Window Dressing Matters – It may seem trite, but how will your company show to an acquirer? Is your corporate image crisp? Are your financial statements in order and well kept? How about customer files? Is the physical facility clean? Is plant and machinery well maintained? Does your website convey the value and expertise of your company? Take a critical look at all of these areas. As much as your industry reputation matters, items like the above will continue to differentiate you from the market. It is up to you to decide if that differentiation is positive or negative.

CONCLUSION:

In the end, valuation is driven by bottom line profit, but influenced by many of the above-mentioned factors. Addressing these "soft" factors can make the difference between a low-range multiple and a top of the scale transaction. Work with your advisory team to start to segment away from the pack. Getting the best return on the asset you've worked a lifetime on is important, so put in the work now to get your transaction completed on the best possible terms.

ABOUT RKJ PARTNERS, LLC

RKJ is an established advisor to leading lower middle-market growth companies. We provide our clients with experienced-based solutions and unbiased advice. Our comprehensive array of strategic advisory and execution capabilities allows us to meet the needs of our clients and provide an outstanding level of service in connection with a variety of transaction processes, including:

- **CAPITAL ADVISORY**: RKJ possesses substantial expertise in assisting lower middle-market clients raise capital to fund growth strategies. Whether the capital source is senior debt, mezzanine/subordinated debt, private equity, or venture capital, RKJ has both extensive and relevant relationships within the capital community to enable the deployment of optimal solutions for our clients.

- **MERGERS & ACQUISITIONS**: RKJ serves as a trusted advisor in executing merger and acquisition transactions for lower middle-market clients. In addition to our significant investment banking transactional experience, RKJ's bankers have owned businesses and have served in interim CFO roles for clients. Because of our experiences as business owners and senior level managers, RKJ's bankers are able to bring a unique perspective to the mergers and acquisitions process. RKJ's mergers and acquisitions services include:

  - Buy-side and Sell-side Advisory
  - Divestitures
  - Leveraged & Management Buyouts

- **STRATEGIC ADVISORY**: RKJ provides financial advisory services to owners, management, shareholders and their boards to assist in the evaluation strategic alternatives and options for extending and/or maximizing shareholder value. RKJ's advisory services include:

  - Business Valuations
  - Capital Structuring & Planning
  - Negotiating Joint Ventures
  - Strategic Business Development