Realizing Value Through Divestiture

Steps to maximizing owner equity

By Carson O'Neill

I was recently involved with a situation which exemplifies the dilemma of many owners in the medium business sector. This particular company was a well established manufacturer of branded products with annual sales between $ 5 million and $10 million. While the business had grown over the course of many years, profitability was modest.

For personal reasons, this owner had made the decision to divest the business and, at first glance, the prospects of doing so looked bleak. But upon closer examination, some positive factors were uncovered. This operation did have a major 'asset', by virtue of the brand presence in the marketplace and participated in an industry which was consolidating. These industry dynamics allowed us to appeal to strategic acquirers who were best positioned to benefit from the company's assets.

Based on these strengths, this business was sold in four months. The owner realized cash for the assets of the business as well as the goodwill value of the brands.

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Further, the owner secured some upside based on the performance of the business for the twelve months following closure of the sale of the business.

The Owner Cash Trap

With the median age of business owners in Canada now 60, within the next ten years, more than half the owners of Canada's 180,000 private companies with anual sales over $500,000 will retire. With many now in need of cash, an increasing number are pursuing divestiture as a vehicle to realize their equity. This column examines the divestiture option and provides some fundamental guidelines for owners evaluating this process.

To fund expansion and minimize debt load, owners in the medium sector frequently tend to reinvest most of the profits in their business and, over a number of years, draw modest salaries. In many cases, this leads to an owner "cash trap" whereby far too much of the owner's personal net worth is tied up in the various assets of the business. On the basis that it's well managed, the divestiture alternative can often represent an attractive solution.

Developing a Divestiture Strategy

In assessing the feasibility of any divestiture, the initial step is to examine the issues of the existing operation as they relate to allowing the current owner to realize on their equity in the business. One consideration is the transferability of the business to a new owner, such as the physical relocation to the acquirer's facilities. There are always exceptions to the rule, but businesses that are not riveted to their buildings are often more easily divested. This assessment should be rigorous and identify the major assets and liabilities of the business as seen by potential acquirers. Properly done, it will help determine the best way to package the company to maximize owner value.

The Role of Valuation

An important component for a successful divestiture is the valuation of the business and owner financial expectations should be clarified prior to the initiation of the divestiture process. While earnings multiples represent a common benchmark, equally important may be the post purchase cost savings that the existing business will contribute to a strategic buyer.

In most cases, this number will vary depending on the strength of the strategic fit with the buyer. As such,the owner will probably rely on an estimate range, subject to verification by market factors.

If a synergistic buyer can be found, owners can often realize goodwill value even if they have a modest track record in terms of profitability.

A common myth in the divestiture business is that a business requires a large earnings multiple to be successfully sold. If a synergistic buyer can be found, owners can often realize on the goodwill of their business even if they have a modest track record in terms of profitability.

The Need to be Proactive

To ensure that the owner realizes value, it is imperative that the divestiture be done on a proactive, not reactive, basis. Many owners wait too long to initiate the process of divestiture and, in the process, needlessly place themselves in a position of vulnerability.

Most divestitures take four to six months and owner interests are inevitably best protected if they are not rushed in this process.

Through a proactive approach, the owner is better positioned to pursue back up alternatives should they be unable to secure an equitable deal. A further consideration is that, by starting early, the owner may uncover barriers to their planned divestiture and as a result, make the necessary adjustments to the business. Owners should recognize that from the point of initiation, most divestitures take four to six months and owner interests are inevitably best protected if they are not rushed in the process.

Owner-managers may also tend to avoid considering divestiture due to confidentiality concerns, however, the reality is that the "quiet deal" with a close colleague is rarely the best deal for the owner. Owner value is best realized when the business is sold at its peak and the best strategic buyer is found.

Be disciplined; retain the appropriate experts and be proactive in the solicitation/ negotiation process.

About the Author
Carson O'Neill is the Founder and Principal of Rincroft Inc., a privately held firm which specializes in the divestiture of medium sized businesses. Prior to founding Rincroft, Carson spent twenty years in corporate life, including five years as Vice President Marketing and Sales for the Canadian Division of a multinational health care organization and three years as President/ CEO of a publicly held consumer products company.
