$3 Trillion AVAILABLE TODAY

10 Factors Business Owners Must Consider to Attract Investors

By Shareef Batata

Business buyers just can't seem to find the right companies to invest in. Today, private equity funds are sitting on $1.2 trillion; 85 non-financial corporations are holding onto $1.8 trillion. In short, there's approximately $3 trillion available in the U.S. today to either buy or invest in successful, middle-market companies.

Due to the scarcity of solid investment opportunities, U.S. equity markets are at record highs, blowing away previous peaks seen before the Great Recession of 2008.

With money piling up and the number of high quality opportunities to invest being down, now is the ideal time to sell a company. Despite the excess supply of dry powder (idle money earmarked for investment), investors remain very selective about where and when they elect to deploy their funds.

Today's investors have a ROI-driven checklist they use to determine if they will use their cash to buy or invest in a company. Business owners can use this checklist to more effectively prepare and engage with prospective investors. Here are the top 10 factors you need to consider to get your share of the $3 trillion treasure chest available today:

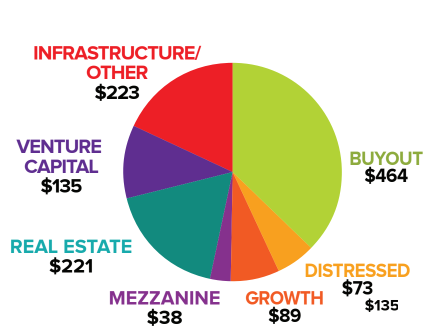
CLEAR COMPETITIVE ADVANTAGE

Also referred to as your "secret sauce," this is what makes your business unique and worth an aggressive pursuit by an investor. Your sustainable difference or advantage can classically be categorized into one of three buckets: 1) a proprietary technology/capability (patents, special processes, etc.); 2) a captive, loyal customer base with solid growth potential; and 3) potential economies of scale leading to a substantial cost advantage by allowing you to produce a product or provide a service at a lower cost than your competitors.

STRONG MANAGEMENT TEAM

Often, investors choose to back executives rather than operations because they know that with the right management and strong financial backing, they can achieve stellar results. For owner/operators who want to sell their businesses,

Private Equity Funds (USDbn)
April 16, 2015



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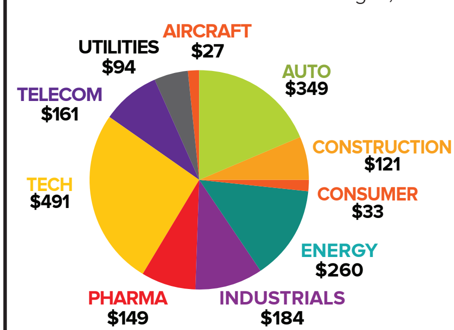

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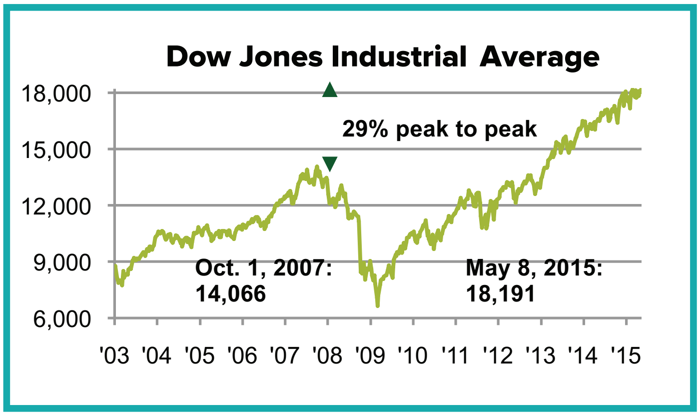

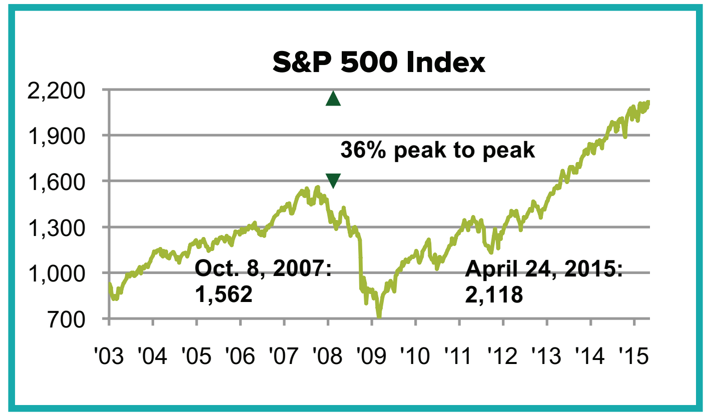

this aspect of succession planning is critical. Existing owners must show how they have a strong team in place now and clearly outline how their exit strategy will not adversely affect future company performance.

CUSTOMER DIVERSITY Most investors are leery of businesses which depend too much on a single customer to drive sales and/or profitability. Customer concentration can jeopardize a company's future performance, as the loss or one major client, for whatever reason, can immediately and dramatically impact the company's financial viability. Owners thinking of selling should diversify their customer base (e.g. 10+ major customers). Doing so will enhance company value and make it easier to attract potential investors.

RELIABLE CASH FLOW Cash is king, but not all cash flow is created equal. Investors prefer recurring revenue more than repeat revenue or project-based revenue. A recurring revenue stream is exemplified by a monthly subscription or long-term contract that generates consistent, reliable cash flow over an extended period of time. Software licensing, fitness centers, and cable TV are examples of subscription-based revenue streams.

In comparison, repeat revenue is generated when the same customer comes back for more but on an optional rather than automatic/predetermined basis. Most retail businesses have a repeat revenue stream dependent upon customer preference. Lastly, project-based revenue streams are built around single projects. This is most common in the construction

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and service industries. Companies built around project-based revenue tend to achieve lower valuation multiples than those generating either recurring or repeat revenue.

GROWING MARKET AND MARKET SHARE Investors commonly acquire businesses to enhance their own organic growth. The existing and future market for your product or service must be large enough to allow for growth, and there must be opportunities to both expand and defend market share. Declining markets are avoided since they frequently lead to undesirable price wars for products and services that drive down sales and profitability.

FAIR MARKET VALUE EXPECTATIONS Successful business owners are rightfully proud of their business, what they have accomplished, and the value they've created. However, investors are only willing to invest when it makes financial sense to do so. Due to a lack of market knowledge, owners tend to conceptually inflate the value of their companies, which creates a conflict in expectations.

From the buyer's perspective, an investment may only be viable if the investor can sell the company in the future and be confident they will generate an attractive return for their investors. If the buyer is a publicly traded company, they want to see value of their stock increase. Owners who expect a higher than average market multiple of earnings (e.g. 10x EBITDA) may find it difficult to attract any investors. Over-valuation can kill buyer interest and dramatically extend negotiations.

CULTURAL CONSISTENCY While financial factors play a pivotal role in an investor's decision, company culture is also critical. Company culture plays a key role in how seamless the post-merger/acquisition and integration will be. Investors and company owners need to share consistent values and philosophies in the way they deal with customers, owners, employees, partners, suppliers, etc. Common values are crucial to the success of integrating the two organizations. This is especially true if the business being acquired involves multiple branches or facilities.

OWNERSHIP SIMPLICITY Privately held businesses that are owned by a relatively small number of shareholders are often referred to as "closely held" companies. The more complex the ownership structure becomes, the greater the potential challenge when trying to sell or find an investor. It may be necessary for a majority owner to consolidate his or her holdings before a sale in order to reduce or hopefully eliminate potential issues. Active partner buyouts are a common way to simplify ownership structure when heading into a potential sale. The more simple and easy owners make it for investors, the more likely the transaction will be completed.

PREPARED TO TRANSFER CONTROL Owners have to be prepared to consider different post-transaction scenarios. Most strategic investors prefer to buy a 100 percent stake in a business with the potential for a stock swap. By comparison, private equity and other financial sponsors normally want to acquire a 51 percent or greater stake in a business with management "rolling over" equity and having the opportunity to sell the balance of their share of the company at a later date. This ensures owners stay actively involved in leading the transition after the deal is closed, and it provides owners an incentive to drive company performance. Although some private equity groups are willing to take a minority stake in attractive companies, minority transactions are much less common. Regardless of the transaction scenario, the owner must be prepared to transfer some or total control to the investor.

THE RIGHT MOTIVATION Investors are most interested in buying or investing in successful companies that simply require a good financial partner to reach the next level of success. They are looking for winners, not losers, and demonstrable instances of profitability with a positive horizon. Owners must be ready to present a positive explanation as to why they are selling or seeking an investment.

In summary, there are literally trillions of dollars waiting to be invested with investors actively seeking successful middle-market companies that can provide a solid ROI. Privately held companies that exhibit the attributes outlined are particularly attractive to investors at this time.

Business owners who plan ahead for a potential transition of ownership of their businesses tend to get higher valuations than those who do not due, in part, to the heightened demand for quality businesses in the current marketplace. However, these valuations are cyclical, and timing the market is very difficult. With approximately $3 trillion available in the U.S. today to either buy or invest in successful, middle-market companies, businesses that are prepared to stand up to the scrutiny of the very selective investor pool will be well poised to take advantage of this unique market opportunity. **N**

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