



Illes Investment Banking
— Capture your future —

Three Achilles Heels of Deals
OR
How to Improve Your Company's Salability

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Introduction

This presentation was created in 2015 for a select group of business owners who were thinking about selling their companies. It is a summary of three key issues that affect company value. They have been determined through our observation of countless transactions within a wide range of potential buyers.

These three key issues (1) owner dependence, (2) business concentration, and (3) compliance had a direct impact on the transaction price, and in some cases even resulted in a deal collapse.

If you are considering the sale of your company, be aware of these three issues. These “three Achilles heels of deals”!

The information provided here is an overview of these three important deal breakers. If you would like more detail, or wish to ask about your organization, please contact us. Our contact information is located on the first and last slide of this deck.

Company Vs. Business

- Think about your company as an ENTITY.
- How would it operate without you?
- Have you set it up for new ownership?
- What is holding the company back from new ownership?



Value Traps

- Are these “pot holes” or “gold mines”?
- Are they obstacles or value creators?
- Turn “pot holes” into “gold mines”.



Three Areas That Trap Value

1.

- Owner Dependence

2.

- Business Concentration

3.

- Compliance

Focusing on these 3 areas will improve your company's salability!

Achilles Heel #1

Owner Dependence

- Owner/Founder (the Seller) deeply involved in all aspects of the business.
- Key decisions are left to “the boss”.
- Key customers want to talk to “the boss”.
- So, what happens when “the boss” is gone?



Larger companies, especially publically held companies, are typically less dependent on a key executive. But even some big names have had issues with owner dependence. Think GE and Jack Welch, Apple and Steve Jobs (the second time), and Microsoft and Bill Gates.

Achilles Heel #1

Owner Dependence – The Solution: Experienced Team

- Build a management team to run your company.
 - Chief Operating Officer/Chief Financial Officer
 - Vice President of Sales/Marketing
 - Director of Operations/Manufacturing
- An independent management team runs a transferable company. This arrangement improves the seller/owner's quality of life as well.
 - Shorter work days/weeks.
 - More vacation (not working vacation) time.
 - Time with family, hobbies, friends.
- Seek experienced industry leaders and give them the time to fit into your company.
 - Note hiring family members can be problematic. Buyers will be concerned that family members will leave once transaction is complete.
- Board of Advisors.
 - Critical to supporting and mentoring a management team.

Some of our best clients work 30 hours a week because they have a great team helping them to run the company!

Achilles Heel #1

Owner Dependence – A Case Study



Client "A", a business services company. The owner grew her business through organic activity and mergers/acquisitions.

Along the way, she built a great management team.

Because of this team, she worked only 30 hours per week. She was then able to spend time with her family and on charity work. When at her office, she focused on business development while her team focused on business operations.

Her business is well positioned for a sale when the time is best for her.

Achilles Heel #2

Business Concentration

- Many companies start with one product or customer.
 - Often a invention/key relationship of the founder.
- As the company evolves that foundation product/customer remains a significant part of the business.
 - Very comfortable and “stable” or stale?
- There is risk (price discount) in having a dominant product/customer
 - What happens when the product becomes obsolete or raw materials unavailable?
 - What happens when the key customer can't reach the boss and gets the wrong answer from someone, then leaves?
 - Will regional economic trends impact the business because it lacks a national presence?



Achilles Heel #2

Business Concentration – The Solution

- Develop or acquire complimentary products.
- Acquire new customers or related customers.
- Expand your trading geography to show that a larger universe wants or needs your product.

Don't change your company into something that it isn't. However, be aware that complimentary or diversified revenue streams are more attractive to potential buyers.

Achilles Heel #2

Business Concentration – A Case Study



We were working with Client "B", a business services client. The company had been in business for 25 years and they had one large customer for the life of the company who represented 25% of revenue.

The seller stated that the customer was very happy, and secure, since they were working together for so long.

During the due diligence phase of the deal, the long-standing customer had an issue that was not handled properly by the staff. The customer took their business to a competitor.

The loss of this large customer had a significant financial impact on the company's future revenue projections and this resulted in a dramatically lowered transaction price offered by the buyer. The lower offer was unworkable for the seller and the deal died.

Achilles Heel #3

Compliance: Inaccurate Reporting Activity

- Financial/Operational reporting
 - Financial statements
 - Operational reports:
 - Sales
 - Production
 - A/R and A/P
 - Inventory
 - Tax filings and reports
- Human Resources
 - Hiring/training
 - Safety
 - Compensation
 - Benefit and Retirement Plans
- Regulatory
 - Department of Transportation (DOT)
 - Occupational Safety & Health Association (OSHA)
 - Environmental Protection Agency (EPA)
 - Internal Revenue Service (IRS)



Achilles Heel #3

Compliance – The Solution: Reports & Documentation

- Audited financials
 - Shows you are serious about selling your company
 - Ensures “proper” accounting for accruals and expenses
 - Auditor becomes your partner during due diligence
- Regulatory procedures and filings
 - Sales, payroll, business taxes
 - Department of Labor – overtime, exempt/non-exempt, diversity
 - DOT, EPA, OSHA
- Use third party professionals for “best practices” and credibility
 - Safety training
 - Benefits review
 - Environmental monitoring, reporting and remediation
- Robust compliance reduces risk in the transaction since the business reports and documents its activities.

Achilles Heel #3

Compliance – A Case Study

Client “C” was a closely held manufacturing company with 150 employees. The owner did not want to spend money for annual financial audits. The Director of Finance was very good but was also understaffed.

During due diligence, the buyer identified an error in the accounting for “paid time off” that resulted in an overstatement of annual earnings by \$300k.

The initial offer to buy company was at a 7x earning multiple. This “mistake” cost the sellers \$2.1M in reduced transaction value far outweighing the cost of annual audits.

The buyer was then even more careful in analyzing the business and they uncovered other issues that reduced the final transaction value even further.

Three Areas that Trap Value OR --- Three Achilles Heels of Deals

1. Owner dependence
 - Build a proven and transferable management team.
 - Create a Board of Advisors.
 - Limit family members.
2. Business concentration
 - Add new customers, products, geography.
 - Explore mergers and acquisitions.
3. Compliance
 - Develop processes for creating audited financial statements
 - Submit regulatory filings on time
 - Hire third-party expert support for:
 - Human Resources
 - EPA, OSHA, DOT
 - IRS and other tax entities.

Make your “value traps” gold mines --- not pot holes!

Three Areas That Trap Value And How to Manage Them

	Value Trap	Best Way to Manage
1	Owner Dependence	<ul style="list-style-type: none">• Build a proven and transferrable management team.• Create a board of advisors.• Limit family members.
2	Business Concentration	<ul style="list-style-type: none">• Add new customers, products or geographies.• Explore mergers & acquisitions.
3	Compliance	<ul style="list-style-type: none">• Develop processes for creating audited financial statements.• Submit regulatory filings on time.• Hire third-party expert support for:<ul style="list-style-type: none">• Human Resources• EPA, OSHA, DOT• IRS and other tax entities.

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