Sell-Side FAQs: Selling a Mid-Market Business

What is the definition of a Mid-Market Business?

The definition of mid-market can vary widely depending on the marketplace (i.e. Chicago versus Halifax) or whether the business is public or private.

W5 Business Group, providing M&A services throughout Atlantic Canada, defines the Mid-Market as businesses with enterprise valuations in the $2 million to $50 million range.

When is a good time to sell?

Without question, the best time to sell a business is following a period of 2-3 years of steady growth in revenues and net income. Additionally, business owners can maximize value by maintaining solid management and infrastructure that will continue to support the growth of current operations with little need for additional capital expenditure. Major financial milestones that positively impact value include:

- Recent wins – landing large sales contracts;
- Recent successful capital raising campaigns – capital to support growth;
- A well-developed strategic plan identifying growth opportunities.

Conversely, avoid going to market during times of major change whether it be regulatory or during periods of staffing shortages or labor unrest. Plan your “exit” well in advance so that you can go to market at the best possible time.

Why is EBITDA important?

Earnings before interest, taxes, depreciation and amortization (EBITDA) is a good indication of a business’s operating profitability. It does this by removing non-operational expenses (interest, taxes and depreciation expense etc.). Top line sales combined with EBITDA allows a prospective buyer to quickly gauge the magnitude of a business opportunity. Additionally, EBITDA provides an indication as to how much operational revenue could be available to cover additional long-term debt for growth or expansion.

What is Normalized EBITDA?

The process of “Normalizing EBITDA” is simply one of making appropriate adjustments to EBITDA for expenses incurred that are not necessarily “normal” to the business. These things may include inflated payments of salaries, rent or benefits to shareholders, family members or other related parties.

How do Mid-Market Businesses determine their value?

Business valuation methods generally fall within one of three categories:

1. Earnings Based Valuations

By far the most common valuation methods are based on income or earnings.

Capitalized Earnings Method

This method uses **past income** and a capitalization rate that is reflective of the weighted cost of capital plus an adjustment for risk. The weighted cost of capital would be the rate of interest paid for long term debt, the rate of return expected on invested equity capital plus an amount that reflects the increased risk over investing in guaranteed treasury bills or government bonds.

Discounted Cash Flow Method

A method relying on an average of **future expected earnings** and a discount rate that generally represent the minimum rate of return one would expect from invested capital.

2. Market Based Valuations

If there are recent relevant examples of similar businesses sold, this information can be used to support the value of a business. In the private marketplace and in smaller economic centers, such relevant comparable data is unlikely to be available.

Certain industries have unique and historically accepted methods of determining the value of the businesses operating within that sector. As an example, securities and investment brokers typically express their selling price as a multiple of recurring commission income. The fisheries industry is another good example. Businesses holding a fishing quota will have market values more tied to the fishing quota than its earnings and profits. Contact W5 to find out if more about the how this may be a factor in the valuation of your business.

3. Asset Based Valuation (for businesses that are a going concern)

This method creates a valuation by subtracting liabilities from the company’s asset. As book values of business assets are often depreciated, valuators tend to determine the market value of all of the assets. This will more adequately reflect the true value of the business’s assets. This method also is dependent on the valuation of certain intangibles such as exclusivity agreements, patents and goodwill.

By far, the most often discussed valuation indicator is the EBITDA Multiple Valuation. It is simply the Normalized EBITDA multiplied by an accepted multiple. For privately held business, the multiple commonly falls between three and six times EBITDA. Factors influencing the multiple include the size of the business and history of growth in earnings year over year.

Sometimes, several valuation methods are calculated and compared. The differences in valuation results are studied and the strengths/weakness of each method are considered. Ultimately, valuation is accurately determined by the marketplace provided there is a healthy presence of qualified buyers. W5's engagement process includes an important initial assessment of the availability of appropriate and suitable buyers before we commit to a client. Contact W5 to discuss the best approach to determine your businesses valuation.

How do you find buyers for my Mid-Market Businesses?

As with most M&A practices, W5 maintains a database of qualified buyers. We are regularly approached by business, investment bankers, hedge funds and other M&A practitioners who have growth or acquisition strategies to fulfil.

At W5, our "go to market strategy" begins with the development of a list of buyers who would derive strategic benefit from owning the business and would therefore recognize the full value the business represents.

Go to market strategies are greatly impacted by the degree of confidentiality an engagement requires. W5 places the protection of our client's identity and information above all else. The irony is that in order to sell a business, you must let the right people know it is available. Accordingly, W5 will develop a go to market strategy that may include a very controlled and discrete list of qualified buyers. Alternatively, if the circumstances allow, W5 will promote the business opportunity amongst its established directory of qualified buyers.

What are the major differences between a share sale and an asset sale?

Share sale:
In a share-sale transaction, the shareholders will have to pay capital gains tax on the sale of the shares. Tax rates on capital gains income is more favorable than tax on regular income. The vendor may be able to access the lifetime capital gains exemption to reduce or eliminate the tax payable. In 2016, the lifetime capital gains exemption amount was $824,176.

Asset sale:
Asset sales are often perceived as being more favorable for the purchaser of a business (which is not always the case). The new owner sets up the assets on their books at or close to the purchase price maximizing depreciation expense. Asset sales also are regarded as less risky as legal liabilities associated with the business does not transfer to the purchaser of the assets. From the vendor's perspective, the proceeds from the sale of company assets are paid into the company and then paid out to shareholders as regular or dividend income.

Wealth and tax planning strategies exist to enable both vendors and purchasers to mitigate the impact of tax whether the transaction be an asset or share sale. At W5, our clients benefit from having the necessary expertise within the Engagement Team to ensure these matters are managed properly.

How long does it take to sell a business?

Experience tells us that no two transactions are alike. In a favorable environment, it is not unreasonable for a transaction to complete within 9 months. It is best to account for unexpected delays and plan to engage your M&A advisor at least 12-18 months in advance of your targeted exit date.

Can you describe the W5 Divestiture Process?

W5 follows a three-phase process:

Phase I – Shareholder Wealth & Tax Planning | Vendor Due Diligence
Phase II – Development of Offering Documents | Go to Market
Phase III – Negotiate P&S | Close | Post Transaction Wealth Support

Each phase will take a minimum of 60-90 days.

Our Partners are committed to differentiating ourselves from traditional M&A service providers. Just one example is our focus on the shareholders and beneficial owners. Job one is to understand the collective needs of ownership and to develop a strategy that will be most appropriate for their individual situations.

W5's divestiture process has been designed intentionally to maintain control of the deal structuring process so that we can avoid unnecessary delays frequently created when multiple professional advisors become involved.

Is "M&A Readiness" part of Phase I of the divestiture process?

No. M&A readiness activities should be a component of a business's strategic planning process.

It is not uncommon for business owners to initiate M&A readiness discussions 2-3 years in advance so that optimum corporate and tax structures can be put in place. W5 has the expertise and experience to help you develop your M&A readiness plan.

Contact W5 to find out more about how we can help you prepare for the transition of your business' ownership.