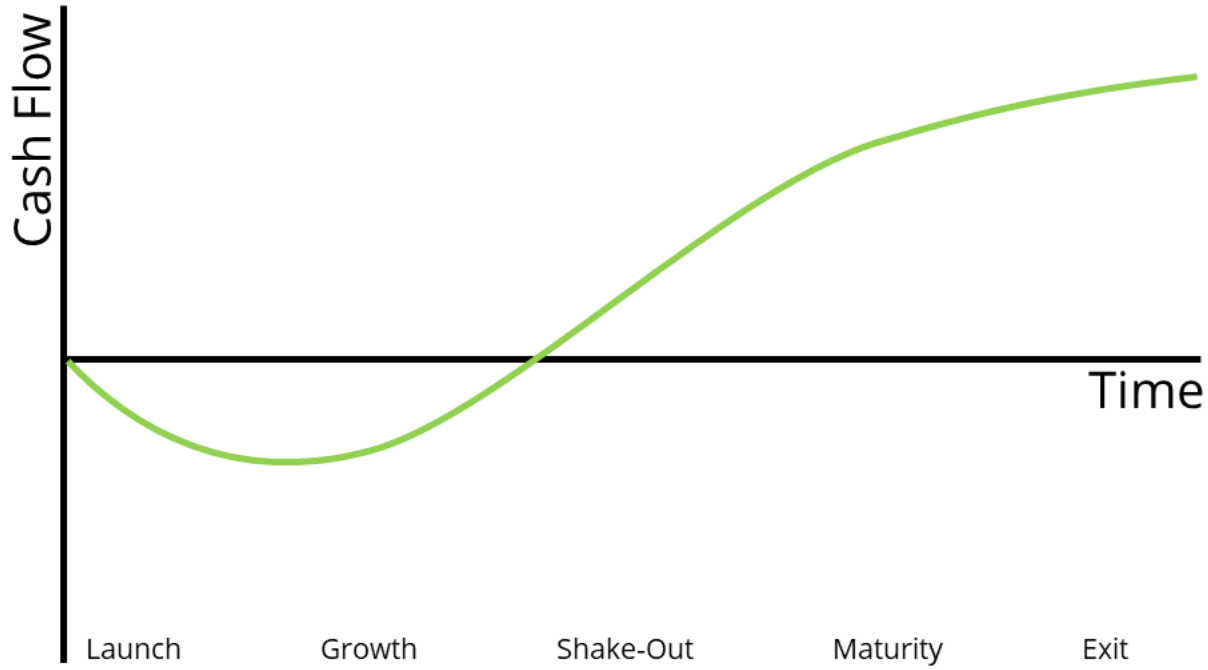
VALUESCOPE
Measure | Defend | Create

Maximizing Value Throughout the Business Life Cycle

Most business owners think about valuing their business and how to get the best deal when it's time to sell. While some owners consider their company's value from inception, too frequently owners give no consideration to value creation until much later, often when it's too late to affect value. In fact, value is created from the design of the business plan all the way through the close of the final business sale.

This paper explores value creation and how valuation-centric analysis throughout the business life cycle not only maximizes value but compounds the effects of accelerating value.

The graph below depicts the business life cycle and when cash flows are typically achieved.



Value is ultimately derived from the timing, amount, and risk of a business's cash flows. If an owner is able to shift the above graph, the rate of value creation is enhanced, improving and compounding the owners' wealth both during and after the business is ultimately sold.

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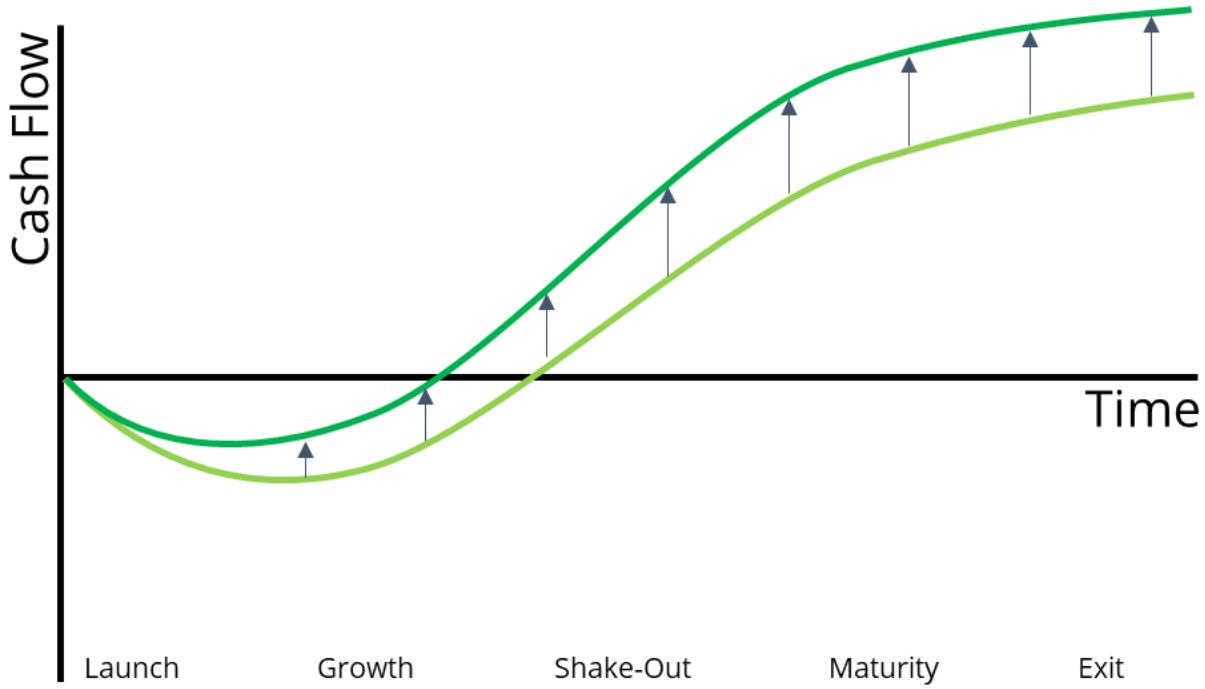

LAUNCH

I have seen untold business plans; some well thought out, some with massive holes, but few with good financial planning and modeling. At the launch phase, valuations necessarily incorporate detailed projections of unit sales, pricing, cost, and infrastructure components. This analysis helps answer many questions fundamental to a successful launch. It also helps the owners understand the level of capital required, its likely sources, costs and possible dilution, and the timing and number of tranches that may be necessary. A competent valuation will help attract capital, and at the lowest cost, in addition to "cleaning up" the plan and focusing Management on the most value-maximizing strategies.

Mistakes at this stage are costly, as restarting or re-engineering leaves investors and lenders with little confidence and ability to fund further. The track record of the owner is negatively affected and often difficult to recover from.

Additionally, getting the capital structure right is critical at the start; there are no second chances here. Options, warrants, preferred equity, and debt with privileges and features all have values and associated costs. There is no way to understand the economic ramifications of these decisions without sophisticated modeling as component parts of the financial forecasts and expected ultimate sale.

GROWTH

Execution is critical during the growth phase as this is when a business model is perfected affecting many future years of financial performance. The value drivers of the business start to come to light and modeling the effects of those drivers helps optimize strategies and the allocation of finite resources. Scenario and sensitivity analysis aids in understanding the cash flow and value impact of dollar or percentage changes in investment and performance. Anything short of detailed and creative modeling is guess work. While intuition has its place, financial modeling offers a more consistent framework on which to build and understand value.

Strategic and growth planning is a dynamic process. Marketing econometrics that lead to better and optimal strategies at this stage often have the highest return. Additional capital raises may be required or desired. Management planning, incentives and compensation analysis are often helpful during this phase. Understanding the market price of these decisions is important to maximizing value.

Growth can be achieved many ways, but there are only two basic paths: organic and acquisitive. Both need to be examined as the "build versus buy" decision is almost always in play. While investing and building operations is always a viable option, so is acquiring other companies that could accelerate growth or play a strategic role. Valuation analysis is multifaceted here. Value creation needs to be assessed based on the tradeoffs of the build versus buy decision. By growing organically, an owner might take less risk, and better control growth and operations. By acquiring, an owner hastens the growth of the company, creating business synergies and often bolstering investor returns. The acquisition method, though, is somewhat riskier as each acquisition must have a strategic fit and be acquired at the right price. Sometimes a single poor-acquisition can leave a young firm struggling not only to grow, but to survive.

SHAKE-OUT

This phase is often characterized by the entrance of new competitors, and while sales may be increasing, margins are sometimes squeezed. As investments decline, cash flow may improve, and the owners may enjoy enhanced distributions.

The goals of valuation analysis in this phase are to tweak the business model, help in the planning process, and provide ongoing visibility via better decision-making tools.

This can be accomplished through updated valuations (typically yearly), capital structure optimization, and business optimization that often involves detailed data analysis of operations, pricing elasticity studies, or other metrics that can improve cash flow.

Additionally, financial planning and analysis (FP&A) tools and support are very useful in helping Management budget, plan, and make informed daily decisions. The visibility gained by using this "dashboard" model has been quite instrumental in lowering risk and managing cash flow for many companies.

MATURITY

This life cycle phase may be the most relaxing but the least rewarding. Too many competitors, too little growth, and declining profits often accompany this phase. Cash flow is often flat as major investments are in the rear-view mirror. Not a bad place to be unless you're the type who needs to reinvent yourself, which sometimes happens. Even so, valuation modeling can help extend the life cycle through better planning.

There may be transactions during this period with managers, outsiders (maybe taking a few chips off the table) or family, such as with children working in the business. Valuations are needed for all these circumstances, and the IRS is keenly aware of "gifts" to children based on undervalued stock.

The maturity phase is also a good time for succession planning; predominately to understand the alternatives and the wealth ramifications of different strategies. These strategies include leveraged recapitalizations, private equity investments, management buy-outs, and ESOPs. No matter which strategy is selected, an analysis of exit-timing is instrumental to generating the greatest sale price for the business.

EXIT

Few owners want to think about the exit because it triggers negative thoughts, not the least of which is one's own mortality. That said, leaving a legacy to its stakeholders is usually important. But self-interest also dictates that owners receive the maximum benefits for their decades of hard work. Performing analysis of value and understanding strategic value to acquirors may be the most important valuation undertaking over the life cycle. Often, it's the last chance to get it right.

Understanding strategic value is best accomplished through detailed valuation and synergy analysis, presentation decks, and effective financial and legal representation throughout the sale process. Adjunct analysis can be informative as it includes an understanding of the after- tax wealth differences between various deal structures. Hopefully, some of the measures during the earlier phases have been completed making the exit more effective and rewarding. The sooner owners understand the drivers of value and how to promote those assets most efficiently, the greater the value seen at exit.

Hopefully, this paper has highlighted that valuation is far more than appraisal. It's about value creation and its many forms. Utilizing these tools over the business life cycle can accelerate and improve the business, while creating additional wealth to its owners and stakeholders.

Questions and comments may be directed to Martin Hanan, CFA at 817-481-4900 or mhanan@valuescopeinc.com.

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