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SMARTER PERSPECTIVE: CORPORATE FINANCE

Should You Really Sell Your Company?

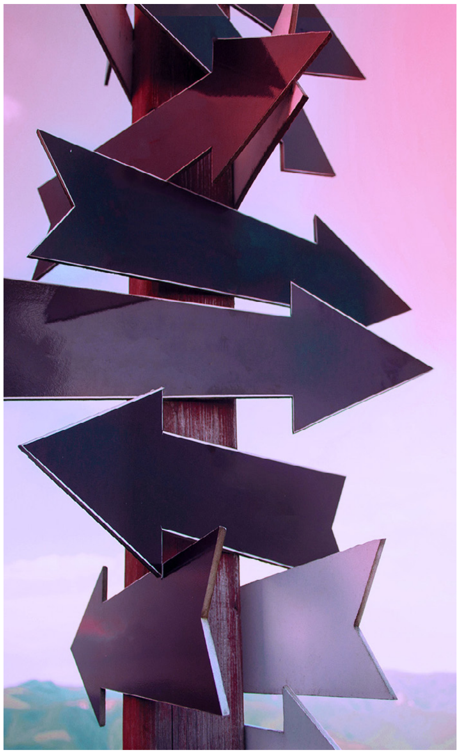
By Sheon Karol

In the business equivalent to the film *Groundhog Day*, every day I watch as successful business owners sell their businesses for less than they are worth. It is time that entrepreneurs learn a dirty little M&A secret: Very few middle market sellers are beneficiaries of the windfalls they expect. This is tragic as, according to the Exit Planning Institute, over 80% of entrepreneurs' wealth is tied up in their businesses.

THE INVESTMENT BANKER PLAYBOOK

If you ask most investment bankers whether you should sell your company, they will inform you that "this is a good time to sell" – no matter when "this" is. You will then ask them how much your company is worth. To show you how well they know your sector, they will multiply your EBITDA by a range of multiples in your sector and thereby calculate the value of your company. To clinch the deal, they will tell you a success story.

After you sign their engagement agreement, most will run a cookie-cutter process that includes sending out a teaser followed by a confidential information memorandum full of clichés such as "a scalable business" and other similar marketing boilerplate. As in the



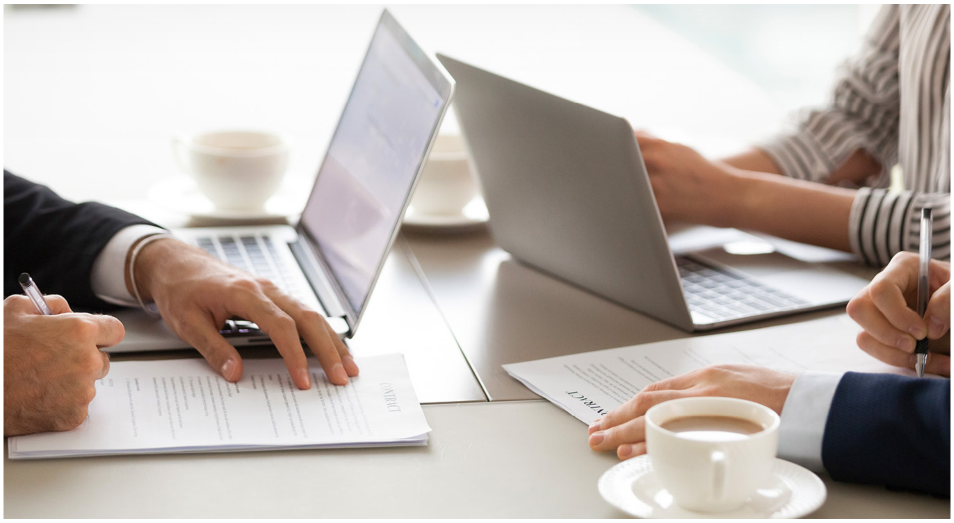
film *Casablanca*, they will round up the usual suspects for potential buyers. After formalized management meetings with interested bidders, the investment bankers will engage in what passes for negotiation, while moving as quickly as possible to close a deal so they can collect a success fee. ***Whether you realize it or not, you have just been hustled.***

Let's take a look at each step of the process and consider the alternatives.

THERE MAY BE A BETTER ALTERNATIVE THAN A SALE

Uncommitted capital, often referred to as Private Equity's "dry powder," has grown globally to $1.81 trillion worldwide in January 2022, a nearly 17% annual growth rate since 2015. Pitchbook reports that approximately half of this capital originates from 2019 or later but, in private communication, reveals that uncommitted capital has begun to decline as deployment is exceeding fundraising. This abundance of capital – accompanied by a recent decline, the uncertainty introduced by inflation, the war in Ukraine and the Federal Reserve raising interest rates – requires consideration of all options.

Instead of selling your business, it might be more advantageous, for example, to obtain additional capital to weather the economic hurricane predicted by J.P. Morgan's Jamie Dimon last June: Buy a competitor, enter into a joint venture, sell in part, or enter into a performance improvement engagement. If you have selected an advisor who provides only one service, it is almost certain that you will be encouraged to



buy that service even if there is a more attractive alternative. This is particularly problematic if the advice coincides with your preconceptions.

For unbiased advice and greater optionality, ***seek an advisor who has a broad focus, wide contacts and, best of all, can provide a spectrum of services. You need an investment banker who can assess and unlock value.*** That value, for example, may lie in your company's real estate or intellectual property. I increasingly find that clients want our real estate or intellectual property colleagues to assess, formally or informally, such assets. They realize they may be leaving money on the table if these assets are not analyzed and monetized. For example, a substantial amount of IP value is not recorded on balance sheets but can be marketed in ways that significantly enhance outcomes. This is especially true with brands and patents, as well as more esoteric intangibles such as internet protocol addresses and other digital assets.

Look for investment bankers who also provide (as needed):

- Pre-acquisition services to enhance your company's value
- Assessment or "early look" of the value of specialized assets
- In-house operational expertise to tweak or restructure shortcomings in the business that would deter a buyer
- The capability to invest its own funds if needed

In short, middle market companies need, and should seek, the investment banking expertise and optionality that bulge-bracket firms make available to megacompanies.

VALUE IS NOT OBJECTIVE

If you do decide to sell, make sure the sale process maximizes the value of your business. According to surveys by the Exit Planning Institute, most sale processes are failures. Some of the reasons for this include:

- A paucity of professional talent serving the middle market
- Most sellers have little M&A experience
- Business owners generally neglect to prepare their businesses for sale
- Some investment bankers and lawyers are more dedicated to being part of a "club" (the players in a sector) than serving their clients

While all of these are valid factors associated with failure, I have found that the key reason is that businesses are usually sold as commodities. Determining the company's value by a mechanical formula – EBITDA x EBITDA multiple – is, in essence, a psychological straight jacket that puts an upper limit on the sales price.

Selling a company mechanically is fundamentally flawed because a business is not a commodity. Ludwig von Mises, the great economist and sociologist, explained that it is a fallacy to assert "that things and services exchanged are of equal value." Value is not objective. It is, as he observed, "merely … the expression of various people's eagerness to acquire them."

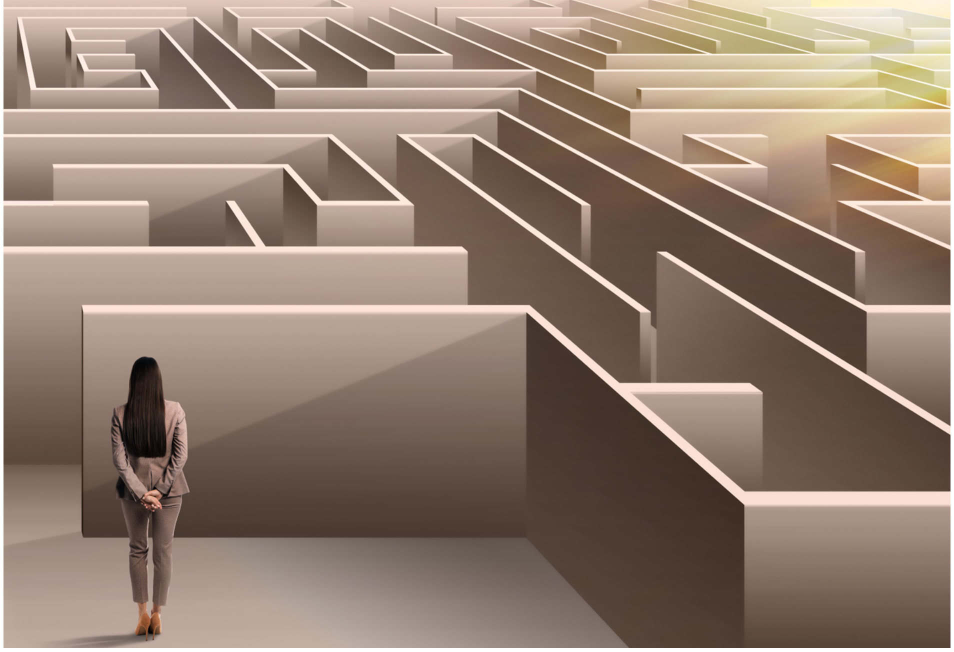
The essence of M&A is selling a business to the buyer for whom it has the greatest value. ***A company is not a multiple of EBITDA – it is worth what someone will pay for it.***

SELL YOUR COMPANY AS A UNIQUE LIVING ORGANISM

Every business has a life. A successful business has a soul. To borrow Socrates' words from Plato's Republic, it is "the soul writ large." Sellers do not always realize that their company is special.

Recently I closed a transaction that began inauspiciously. When I first met with the owner, he insisted that although it was highly profitable, there was nothing special about the company. I questioned him repeatedly to no avail. Eventually, in desperation, I ended the formal meeting and invited the owner to sit with me in a casual setting. We chatted about our dogs, joked, and then I asked him to tell me how he founded the company. It transpired that he had developed a workaround to a technical issue. He thought the methodology was just common sense but it was such a brilliant solution that we had to explain it repeatedly to bidders. The eventual buyer paid a pretty penny for the enterprise.

You know your business better than anyone else. With your assistance, your advisors should position the company, encapsulate the distinctive quality of the



business, articulate the value proposition to buyers, and find the buyer for whom this business has value beyond a mechanical EBITDA calculation.

The right buyer will appreciate the company's current legacy and most importantly see in his mind's eye the next stage of the company's life. The right buyer will be prepared to pay commensurately – maybe even more than the seller expected.

DON'T GET LOST IN THE MAZE

Ramchal, a renowned 18th-century Italian Jewish philosopher once compared life to the mazes that the nobility used to build. Some people find their way through the maze, while others get lost. Those who are wise, he advised, select guides who have the experience to lead them to their goals. As an entrepreneur, you must seek advisors who can create alternative paths. There are more out there today than you may realize, and if you decide to sell, the right professionals will not only guide you but also lead the buyer through the maze to you.

A successful sale process occurs when a seller and buyer converge in a transaction that has greater value to them than to anyone else. You have a choice. You can follow someone else's playbook and sell your company as a commodity. The more profitable alternative, however, is to explore your options. And if you do decide to sell, find the path through the maze on which you and the buyer converge.

Hilco Corporate Finance, a boutique investment banking advisor affiliated with Hilco Global, provides unmatched creativity and relentless support to our clients.

We work closely with leading experts in asset valuation, monetization, business advisory and capital solutions from across the Hilco platform of companies to re-imagine the comprehensive advisory services we provide to private & public companies, private equity groups, family offices, and entrepreneurs.

Our senior professionals have successfully completed hundreds of value maximizing corporate finance transactions across a broad range of industries – particularly diversified industrials/manufacturing, automotive, aerospace, metals, plastics, building products, packaging, retail/consumer, technology, business services, telecom/media, and energy. Our professionals actively maintain relationships with capital providers and counter-parties in each of these sectors.

SHEON KAROL IS A MANAGING DIRECTOR AT HILCO CORPORATE FINANCE

Sheon joined Hilco in early 2022 and has a unique hybrid skill set as a nationally prominent investment banker.

Sheon has successfully executed numerous strategic transactions – M&A advisory, capital raise, and restructurings – for healthy and distressed businesses and their stakeholders. His combination of executive, turnaround, legal and finance experience covers every facet of the middle market M&A transaction process and has resulted in multiple award-winning deals.

Winner of the "Boutique Investment Banker of the Year" Atlas Award (2018), Sheon has an enviable track record of success in assisting corporations of all sizes as lead financial advisor and in senior leadership roles such as CRO and SVP. He has held executive leadership positions at prominent investment banking and restructuring firms and possesses notable expertise spanning several industries, including manufacturing, biotech, pharma, for-profit education, medical research, agriculture, consumer goods, food & grocery, sports, and technology.

As a recognized middle market thought-leader, Sheon writes and lectures widely on topics such as entrepreneurship, auction theory, sale processes, the middle market and foreign buyers. He received his JD from Yale Law School and his BA from Yeshiva University. Contact Sheon at 646.391.6913 or skarol@hilcocf.com

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