How To Sell Your Company When No One Is Buying

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OVERVIEW: The option to sell your company through the traditional avenue of a normal acquisition has been severely limited due to the economic downturn.

Back in the late 1990's, some 300+ domestic acquisitions a year were consummated. This was aided by creative approaches such as roll-ups, where smaller staffing firms were consolidated to achieve critical mass and higher valuations. This technique has fallen out of favor in the last few years however. The number of deals has averaged 125 from 2003 - 2007, and this has fallen further in 2008 with the fourth quarter coming in at just nine.

So what is the owner of a small to medium sized staffing company who wants to sell now to do? The answer comes in the form of another financial tool that attracted a lot of attention many years ago. It is a modified form of the leveraged buy-out or LBO, a transaction where the buyer acquires a significant percent of the purchase price via external financing (leveraging), with the assets of the company used as collateral.

In today's severely restrictive financing environment, a special form of the LBO known as the MBO or "management buy-out" or bootstrapping can work. Here, the company's management team buys the company with a small down payment and the residual purchase price is generated from future cash flows.

We have structured several deals of this type over the years as part of our management consulting services. Although the details are different for each transaction, the basic concept is similar. Here is an illustrative example.

EXAMPLE: ABC Staffing is a commercial temp company organized as an S Corporation. It is owned by John Palin and has been in business for 10 years and has grown to $10 million in sales, with adjusted earnings (EBITDA) of $1 million. It is viable and has been growing about 5% per year with about 30% of its business with one major client. In normal times, John should have been able to sell his company for some 3.5 times EBITDA, or $3.5 million and a brokerage fee, which if the deal could be done would cost some $200K, and John would recover $1.0 million in cash and net receivables for a total of $4.3 before taxes.

Given his high customer concentration, unattractive line of business and the current economic climate, John has been unable to develop any serious interest in a sale even if he did an earnout. He does have two key employees with a combined compensation of $350K/year. Joe is in charge of sales and Barack is responsible for recruiting. Both have been with him for many years and have become very interested in buying the company after John explored the MBO concept with them. Given the realities of the market and their ability to perpetuate the company, he would be happy if he could net $3.75 million from them over the next three years.

Joe and Barack have a nest egg of $300,000 in savings that they can pay John day one for the company. They estimate that their free cash flow (profits, less the increase in the net assets less liabilities will average $1 million per year over the next three years. In addition to that, they would reduce their compensation and associated payroll taxes by $200K per year during this period adjusting this value to $3.6 million. This, plus their $300K down, brings their total payable to John to $3.9 million, exceeding John's target of $3.5 million. From Joe and Barack's standpoint, in three years they are free and clear owners and expect to be doing $11.5 million in sales with an EBITDA of $1.2 million. The company should be worth $4.2 million to them at that time. Then after paying off John, with better economic times ahead, they should grow 10% a year, move into IT where Barack has experience to get a higher multiple, reinvesting their free cash flow, sales should reach $18.5 million in five more years and be worth some $7.5-8.0 million.

SUMMARY: The parties recognize that the sale is not finalized until the purchase price is paid in full and clearly a lot of legal, operational and financial details have to be worked out, but the basics of a transaction are there. Nevertheless the MBO offers an alternative exit strategy which may be very attractive during these economic times. ■

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