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MID-MARKET BUSINESS

Fifth in a Series of Seven: A Joint Venture with Roynat Capital

Ensuring transfer of knowledge is critical for sellers and buyers

When Brad Suter, District Manager for Roynat Capital in St. Johns, arranged to meet a prospective client, he knew the man would be busy. Throughout the meeting, the client's phone range with calls that could not be ignored. They involved several aspects of the business – sales, deliveries, transactions – and in almost every case a decision was required by the owner. Sounds like good news, right? The owner was a busy man, making things happen, continuously moving the business.

In fact, the owner's relentless schedule could be cause for concern. Suter provides innovative capital solutions to mid market businesses and often finances intangible assets, such as goodwill associated with successful businesses.

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associated with successful businesses.

The owner was so integral to the daily operations that if he sold and exited the business, it might not have been able to carry on in the same manner. The goodwill would be lost.

Debra Feltham, Managing Partner at Feltham Attwood Certified General Accountants has helped many business owners and buyers perform due diligence for the sale or purchase of a business - a state of the sale of the sale of a business - a state of the sale of the sale of a business - a state of the sale of the sale

with the company's goodwill realized.

"Recently we are assisting clients more and more with leveraged buy outs," said Feltham." And there's often a goodwill component to the business and that's the intangible asset. So if they have an

the business and thats the intangible asset. So if they have an established business with a good customer base, we value the business to be higher, using a multiplier of future earnings of the company."

A leveraged buyout is simply the acquisition of a business where cash flows or assets of the company are used to secure and repay the debt. In other words, the financial institution or lender agrees that the business itself can be used as collaterable. al. When the business does not have property and equipment to secure the full value of financing, the lender has to have a great deal of confidence in the business' ability to generate cash flow.

"You are going to pay for more than the book value of the hard assets if it's a successful company," Feltham added.

Suter says that when providing financing beyond the value of a company's fixed

Suter says that when providing financing beyond the value of a company's fixed assets, he takes many different factors into account.

"We take a look at many aspects of the business such as a solid management team, reputation, and business plan", said Suter. "We look to see there is an ability to generate cash flow on a sustainable basis. We're talking about the systems, processes, and decision-making- the things that make a business a living, breathing thing. It's almost the ecosystem of that business. The question is can it sustain itself into the future?

"An owner has to ask, 'if I leave the business is the phone going to stop ringing?" added Suter. "If the answer is 'yes' then you must take the necessary steps to build a solid foundation and management team that can support the business through a transition"

Feltham agrees with Suter that business owners must do their homework and extricate themselves from the day-to-day operation of business. That process often takes years, she said.

"If the company's success is restricted to one person's brain power or ability, they



have to be able to show that the business can carry on," she said. "We often see an arrangement where an owner will stay on for a period of one to five years. There has to be an overlap for transfer

of knowledge.

That knowledge transfer includes preparing client and customers as well as staff, she said. Lenders and buyers want assurances that the culture of the company will be seamlessly passed on

Suter adds the longer the transition time, the easier it is to do the appropriate transfer and development. "It's important to take the time to give the new owners broad exposure to aspects of the business they might not otherwise see, such as financing, banking. ousness they might not onerwise see, such as mancing, banking, human resources and compensation decisions. In addition, it's often a good idea for owners to take occasional extended leaves to allow management to get used to running the company before the final transition."

In addition to planning for a successful transfer of knowledge,

Feltham notes sellers must also take steps to ensure employees and clients remain with the business. Sound employment contracts for staff are critical, she said. Businesses must have contracts in place that ensure employees won't suddenly start their own business and take the company's clients with them. At the same time, employ ment contracts cannot be so onerous that they break established principles of labour

Then there's the business valuation itself. A review of five years of financial state-ments is typical, Feltham said, including a review of the owner's personal financial sit-

"We look at the company's ability to service debt, debt ratios; we look at trends of ousiness, what's happening in that industry, Feltham said. "We would look at thistory of cash flow – has the company had this type of excess cash each year? Because that would indicate most likely what the future would be."

Feltham adds the valuation is only a starting point, like the asking price on the sale of a home. And as with the sale of a home, there are always conditions to be worked

Determining those conditions and sale terms can be key to a successful transition.

In the sale of small and medium sized businesses, sometimes the vendor provides portion of the financing, holding on to a stake in the business until they have

a portion of the linancing, noticing on to a stake in the business with they have nearwell the transfer of knowledge to the new owner.

Suter notes that "whether the business has hard assets or is leveraging intangibles, they are the surface of the state of the right balance. Many even structure financing in stages to alleviate the burden on new owners to come up with everything at once." "When the transaction is done properly, it really is a win-win situation for buyer the stages of the stage of the s

and seller," adds Suter, "The seller realizes value for that intangible goodwill he or she has built into the business and the buyer gets the momentum of a profitable, sustain

