X-pert files

Setting sale

After the appeal of being one's own boss wears off, the aim of many who have started their own agency is to sell up and retire, or grow bigger with a new partner, or simply make a tidy profit. But how should an agency owner prepare his baby for the market? Results International's Imad Kublawi says the first thing to do is find out how much money you can get

Once you have decided to sell your agency, you will first want to know what it is worth. There are at least four methods of evaluating a business. Two of them are very common in the marketing and communications industry: price/earnings multiple and revenue multiple. (The other two are return on investment and discounted cash flow.)

The money you will get from a company that buys you out (or partially buys you out, with an earn-out or earn-in factored in) will be worked out as a multiple of your agency's normalized profits before tax, so one of the most important questions you, as the owner of an agency, want to answer is, "What multiple should we apply?"

This is not an exact science, and there is a whole range of discount and premium factors that will influence the level of the multiplier. I will explain, at the risk of oversimplification, how these factors apply to a realistic assessment of your company's value, based on experience from more than 220 transactions Results International Group has been involved in over the years.

Let's begin with discounts. Significant discounts are often demanded to offset increased risk for the purchaser. At your agency, are profits less than 10 percent of the revenue? Is there a lack of succession management, of well-trained and motivated people below you? Is there an exclusive reliance on one principal client? (This is often viewed as a hugely unattractive risk and may result in a heavy discount.) Does your agency have a weak strategy? And, finally, is it poorly positioned? Some of these may not matter as much as others, but they are still likely to be reflected in the multiplier and value to some degree.

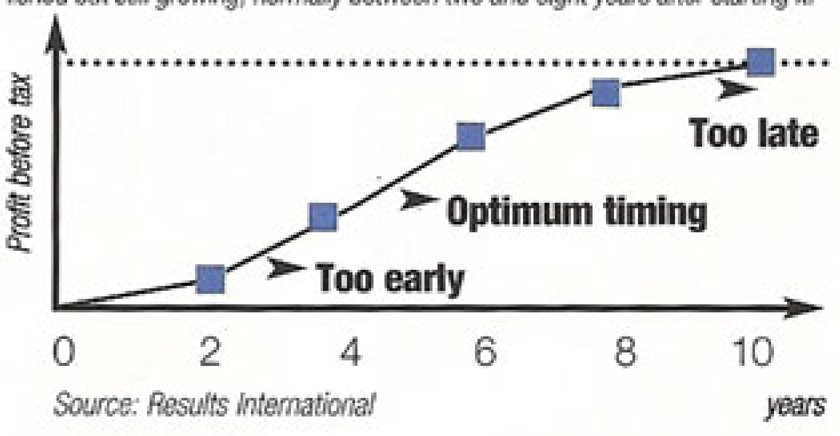
On the other hand, of course, there are premiums you can seek for your agency to counter these discount factors. A premium can arise from scarcity. If your agency has particular qualities that have special value for certain buyers – such as reputation, specific clients, intellectual property rights, lock-in products and proprietary tools, proven management, long-term contracts, or distinctive niche positioning – the premium could ultimately add up to 50 percent of the value of a comparable agency that doesn't have any of these characteristics.

Goodwill can also lead to a premium. Has your agency built up clear momentum over the years, such that, in a sense, it has a life of its own – regardless of who actually does the work? Longevity of client relationships, and management and key staff retention are other elements of goodwill. They contribute to confidence about the sustainable profitability of your agency, hence enhancing the multiplier and its value.

Good timing can even be grounds for a premium. As shown in the graph (below), selling when your agency is still getting established will not create much value, as there will be no real track record or reputation. Potential buyers will consider this highly risky. Similarly, selling your agency at the top of its growth cycle may reflect poor judgment and not be lucrative because the business is at risk of going into ex-growth (when significant growth stops), which will severely limit the buyer's view of the multiple.

IT'S ALL IN THE TIMING

With most agencies, the optimum time to sell is when the company is established but still growing; normally between two and eight years after starting it.



Source: Results International

The last thing to keep in mind when assessing premiums is scale. Profits that swell consistently above $500,000 – and particularly beyond $1 million – can lead to a higher multiple. With a healthy profit, your agency will be perceived as less risky and therefore more attractive to buyers. It also makes more economic sense for buyers to spend management time and shareholders' money on a business that will bring in more revenue for them.

Having said all this, one of the biggest stumbling blocks to successfully selling an agency is the understandable lack of experience among first-time vendors. Buyers will quickly realize whether they are dealing with someone who is reasonable, well-advised and knowledgeable. If it becomes apparent early on in the proceedings that you have unreasonable value expectations or a limited understanding of the process, they are likely to lose interest.

For this reason, you might find it wise to involve an independent company specializing in finance and marketing communications – such as Results International. Such a consultancy can coordinate and assume responsibility for the sale process.

Additionally, it will carry out a number of functions including assisting in the creation of a shortlist of candidates and making discreet approaches, preparing an appropriate "no name" summary for use in those initial approaches, advising and assisting in negotiations, proposing deal structures, and recommending whether the price and terms of received offers are acceptable under current market circumstances.

Which brings us to the ongoing financial downturn, which will certainly change the way mergers and acquisitions are conducted and concluded.

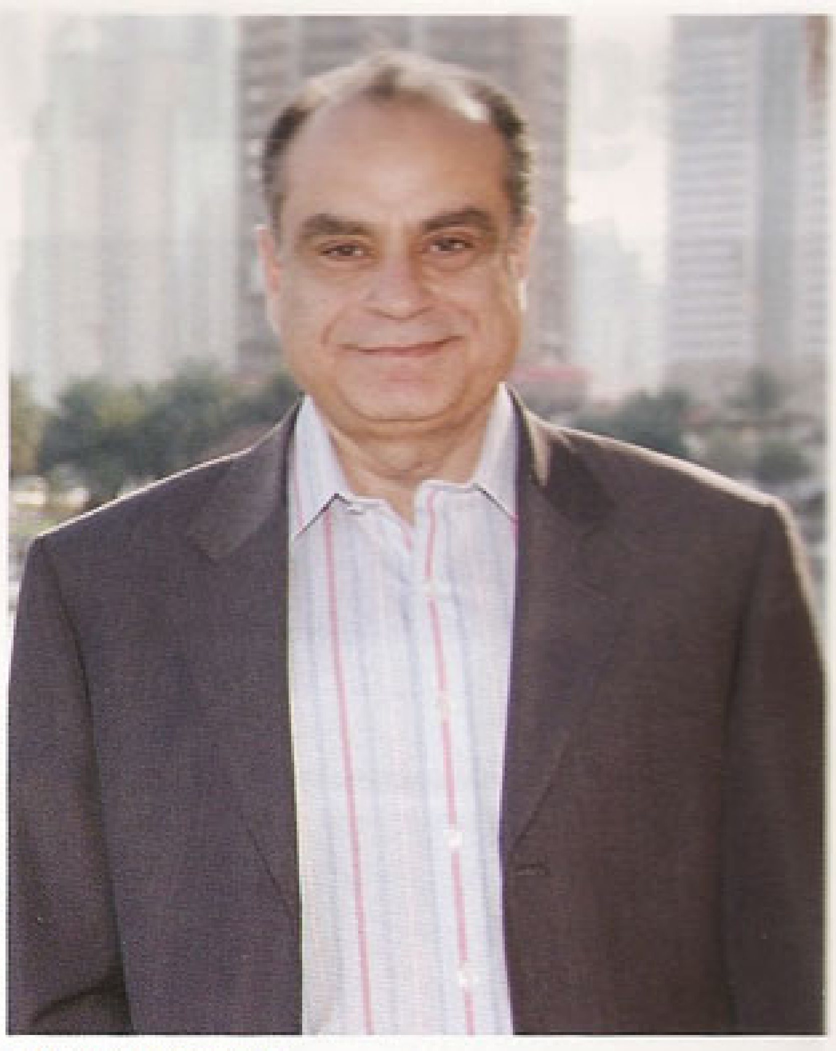
Recession will lead some companies to divest businesses they own. These businesses will become targets for other companies to acquire, and we may see more distress sales, when companies sell their businesses at discount prices to raise cash.

Generally, acquisition in difficult times is more strategic, and more successful for buyers. Since buyers target more selectively when finance is thin on the ground, we should expect the recession to weed out weak companies and strengthen the good ones.

With corporate buyers on the prowl for strong companies, they will be looking towards emerging markets like the Middle East, which can still provide growth in a recession.

Under these circumstances, our advice to independent agencies is to simply work on getting their shop in order so that when the buyers come browsing, attractive firms are not left on the shelf. ■

– Imad Kublawi is the founder of IK Consult Ltd. and regional partner of Results International Group (www.resultsig.com).



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