

Special Edition

How to Sell Your Company in a Down Market - Part 2

Last week, I discussed the conditions of the economy and I also indicated that the market is still brisk to sell a company; it's simply how you structure the deal. It's important to understand that;

- 60% - 70% of trucking company sales today is asset sales.
- The reason they're asset sale is; the Buyer can take depreciated assets and re-cast them on his balance sheet.
- It has nothing to do with any liability going forward as most "experts" seem to state, however;
- If you demand a stock sale, and;
- If you're convinced that a stock sale is the only way to sell your business, then don't bother to market it because you're eliminating 60% - 70% of the marketplace.

Despite the myth that selling company stock eliminates liability exposures – it does not;

- Even if a transportation Buyer was to buy the stock of a company;
- There would be a "basket deductible" in the purchase agreement, and;
- Regardless of the due diligence process, if there were additional exposures that were not uncovered during the due diligence period, the Buyer could still come back to the Seller for those liabilities.

With that stated, how does an asset sale work?

- A Seller keeps cash, receivables, and any life insurance policies.
- If there are pre-paid deposits that can be utilized by the Buyer, the Buyer will provide credit (as used) to purchase those pre-paid deposits.
- Furniture and fixtures, in most instances, are at "book or depreciated" value.

In some instances, a Buyer may pay you "book or depreciated value" for those assets and in other instances, they will tell you to sell those items yourself.

In reference to software and computer hardware;

- They normally do not bring any value to a Buyer.
- Unless you have a software program that's "state of the art".
- Unless it can be utilized as an integral part of the overall purchasing company infrastructure;
- It offers no value to the Buyer.

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Ahern & Associates, Ltd.

Accredited Member
National Bureau of Certified
Consultants Inc.

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Certain logistics companies do have “intrinsic” value in their software program, but for the most part, it’s simply a depreciated asset and there will be little, if any, value paid.

For companies that have a substantial amount of “rolling stock” such as:

- a) Tractors, and;
- b) Trailers.
- **9 out of 10 times you will be paid orderly liquidation on the equipment – if the Buyer decides to purchase the equipment. However;**
- Today, many Buyers are refusing to purchase any equipment due to the capital constraints on their working capital lines.
- Equipment values are in the proverbial toilet.
- Some Buyers will pay for trailers but they will not purchase tractors, and;
- Some trucking Buyers may offer orderly liquidation as they will take your equipment to auction – they don’t want it.

With that stated, how can you sell your company if:

- Orderly liquidation values won’t provide equity in your equipment? And/or;
- You’re “upside” down in your equipment?

Some Buyers will allow you to become a “fleet” owner;

- By becoming a fleet owner, you will be paid a percentage of revenue between 73% - 78% of the revenue for the operation of the truck, the trailer and the driver.
- They will purchase your customers;
- **They will lease the equipment, and allow you to build equity in your equipment and then sell it off over time, and;**
- As you sell the equipment off, they will replace it with their equipment as most larger carriers want to standardize their fleets.

Goodwill of a selling company is predicated on the customer base. In the old days, longevity of drivers was vital to the value of a company but it’s not today;

- Today, because of the fact that freight is at an all time low;
- Transportation Buyers are more interested in a customer base, and;
- The quality of the customer base than the drivers.

It’s also important to recognize that:

- Trucking Buyers are looking for companies that have no more than 10% - 15% concentration with any one customer.
- You need to have adequate rates.
- Adequate fuel surcharge, and;
- **If those two components are not part of your customer base, then you have very little, if any, value for the goodwill of your company.**

Also, it's important that you're able to define how much broker freight you utilize to cover your back hauls;

- In most instances, you should have no more than 10% - 15% of your back haul in brokered freight.
- If you have a higher percentage, such as 30% - 50%, that indicates to a Buyer that your customer base is not that strong.
- You're "shot gunning" revenue to fill trucks, and;
- That has very little value to a strategic Buyer.

Assuming that;

- You have a strong customer base;
- You have customers that have been with you a substantial amount of time, then;
- A customer base has a value predicated upon earnings.

It is important to understand that; you can not expect a Buyer to pay you based upon an economy at scale. In other words;

- If you feel that the Buyer will be able to eliminate 20% - 25% of your overhead.
- **You can not factor that cost into the purchase price for your company;**
- That's what's supposed to happen.

Say, for example; you're a \$20MM carrier and you're at a 98% operating ratio;

- You can expect to receive 2% of your revenue for 12 – 24 months plus assets less liability (as previously defined).

However, if you have extraordinary earnings and you can document those extraordinary earnings through;

- a) Add backs.
- b) Extensive expense accounts, and;
- c) Family members that are not on the payroll – those can be added to the overall projected income.

In most instances;

- A Buyer will review the projected income over a 3 year period.
- Based upon his review, the Buyer will make a determination of whether the company has more value than 4%.

If a company is consistently operating at 5% - 6% operating margins;

- A Seller can expect to receive 1 – 2 times average earnings plus assets less debt.

If you're a logistics company and you have a strong EBITDA (earnings before interest, taxes, depreciation and amortization).

- **EBITDA projections (today) average 3 – 4 times average EBITDA.**
- **Maximum, (today), is 5 times.**

How do you strengthen your position based upon the above numbers? You can do it through an earn out;

- If you're thoroughly convinced that you can increase your customer base/earnings.
- If you're thoroughly convinced that if you become part of a larger company with their economy of scale, you will improve earnings, then;

- **You can structure a deal in such a way that some of the pay out is based upon:**

- a) Increase in revenue/growth.
- b) Increase in profitability.

A third indicator for increasing the value of a customer base is if there are dedicated freight contracts. By dedicated freight contracts, I refer to;

- **Written contracts that pay for all miles, and;**
- Have proper fuel surcharges.

For companies that have written contracts, then those create additional value. That value is defined by a number of variables that I will discuss in the next several articles. **However, it's important to understand that for the basic structure for the sale of your company today, it's going to be predicated on the following:**

- a) An asset sale.
- b) Specific assets being purchased.
- c) Specific liabilities being retained by the Seller.
- d) "Goodwill" value predicated on variables as outlined in the above, and;
- e) Assets being structured in such a way that it does not affect the balance sheet of the Buyer.

Next week, I will discuss a purchase agreement and an employment agreement and how they're intertwined.

QUOTE OF THE WEEK:

"Wise men understand that every day is a day of reckoning".