

FOR EXECUTIVES SEEKING TO BUY, SELL, OR RECAPITALIZE BUSINESSES

2011: Exit Planning For The Year Ahead

We start 2011 with a sobering fact that the much anticipated economic growth in 2010 did not materialize. While pundits continue to say that the worst is behind us, the reality is the growth in the recent past has been anemic. Widespread economic growth may occur in 2011 but the overall growth levels are likely to be modest.

For business owners planning to retire or cash out of their business for other reasons, this is a harsh reality. Businesses are valued based on the potential future cash flows and acquirers use past earnings as one of the key measures of how a business is likely to perform in the future. For many business owners, it may take several years to rebuild their businesses to their past glory.

In 2010, business was soft, credit continued to be hard to come by, and liquidity levels continued to be low. All of these translated into a very negative environment for deal making especially in the housing, construction and retail industries. Business owners who had their businesses on the market saw less than stellar business valuations and, in vast majority of cases, found that their deals did not close as planned. Several other business owners who were planning on exiting held back - unwilling to face a reduced valuation and hoping things would be a bit better in the not so distant future.

Business owners evaluating the consequences of these environmental factors on the business sale/recapitalization process, need to keep in mind that the business sale/recapitalization process for a mid market business can take about 12 months. Most acquirers/investors look carefully at business performance as they navigate through the deal process and positive trends along the way can be helpful in closing a deal and in getting the terms sought by the shareholders. On the other hand, negative trends can kill a deal or substantially decrease the deal valuation.

Here are some key factors business owners need to take into account while planning exit/recapitalization strategies this year:

- **Economy:** While widespread growth is not imminent, several segments of the market are starting to pick up. Most construction related businesses continue to be in the doldrums, but the prognosis for several other business categories is getting positive. It seems likely that most businesses will see a better 2011 than what they saw in 2010. This positive trend can be beneficial to companies and shareholders with near term plans to exit or to recapitalize their businesses.

- **Interest Rates and Liquidity:** Long term interest rates are at historic lows and credit markets will likely improve as the year progresses. Lower interest rates not only improve liquidity, but also have an effect of making valuations higher. Acquirers are likely to find a higher valuation more acceptable in a lower interest rate regime when they can finance the deal and still meet the cash flow metrics needed. Lower interest rates, coupled with improved liquidity, make the chances of putting together winning deals a lot more likely.
- **Taxes:** Unfortunately, selling a business with a gain means that a business owner has to pay capital gains tax or ordinary income tax on the gain. Since capital gains are taxed at a lower rate than ordinary income, a competent business M&A specialist attempts to structure much of the gains from the sale of the business as capital gains. In the last few years, business owners have been beneficiaries of a historically low 15% Federal Capital Gains Tax Rate. Most tax experts believe that the low 15% Capital Gains Tax rate is unlikely to stay at that level and there is a substantial risk of the rate being changed to something higher. The prospect of increased Capital Gains Tax should be carefully thought through in the context of the business exit/recapitalization process.
- **Deal Making Opportunities:** Acquirers are a lot more likely to buy a business in a flat to upwards trending market than in a downward trending market. Deal making opportunities should become more abundant as the economic trends improve through the year. Deal making opportunities are also likely to be aplenty if the business is in a growth oriented segment, or if the business is of a type that can be desirable to foreign companies. With the US Dollar being relatively weak, foreign entities are actively looking to make synergistic acquisitions. It is unclear how long the weak dollar will last but the prognosis is for the dollar to continue to be weak for the near term.

All things considered, 2011 would be a good time for business owners to review their exit or recapitalization strategies and determine how to approach the business sale/capitalization process for optimum financial return.

Chak Reddy is a Mergers and Acquisitions Advisor with Elite Mergers & Acquisitions, Inc. [Elite Mergers & Acquisitions](#) specializes in selling California Central Valley businesses with revenues between \$1 million and \$100 million - Businesses too large for business brokers to adequately handle but too small for the national M&A firms. Mr. Reddy is a business M&A and Marketing expert, and is the chief deal maker at Elite. You can reach Mr. Reddy at 916-220-3052 or by email at creddy@elitemanda.com .

For assistance with selling or recapitalizing your mid market company, contact:

Chakradher (Chak) Reddy

Elite Mergers & Acquisitions

creddy@EliteMandA.com

www.EliteMandA.com

11707 Fair Oaks Blvd, Suite 201, Fair Oaks, CA 95628

Ph: 800-335-3068; Fax: 888-502-3817

Disclaimer: This document is for informational purpose only and should not be construed as tax or legal advice. Please contact your CPA/attorney for advice on your specific situation.