



Volume 1 Issue 1

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**The Value of an Exit Strategy**

When an investor or venture capitalist places money in a company, they want to know when and how they will get their money back. Business owners have the most invested in their businesses, but very often have never thought of an exit strategy for themselves. Here's a fact – every privately held business will change hands someday. Shouldn't you be prepared?

You may say to yourself, "I plan on operating this company for another twenty years! Why should I worry about an exit strategy now?"

There are a couple of reasons that every business owner should always have an exit strategy. First of all, no one has a crystal ball. External circumstances may dictate the sale of your business. Death or disability of a business owner can cause serious harm to the business and the heirs of the business. Having a roadmap that is well conceived can eliminate doubt and loss of action on the part of the estate.

Second, sometimes an exit from the company isn't on your timetable. You may not be thinking of selling, but what if someone else is thinking of buying? With an exit strategy in place, you already know what cards you are holding. This can provide you with a crucial strategic advantage, especially in the case of an unsolicited buyout offer.

Many businesses operate on tactical mode, making decisions that extend the life of the company but do not build ongoing value. Short-term thinking and decision-making can actually destroy value in a company. By having a long-term plan tactical decisions are based upon strategic objectives. Value built over a period of time creates a stronger company, one that is worth much more when you eventually do decide to sell.

Many business owners are not aware of what they have built until the day they decide to sell their company. When they receive a valuation, many owners are disappointed. They look back over the life of the company and realize that just a few different decisions could have made a huge difference. Place yourself twenty years into the future, looking back at your business. What could you have done to build the company value? By having a goal set now for five, ten, or twenty years down the road you are building an image of where you want to be. Decisions will be made to reinforce that image and make it a reality. It's never too early (or too late!) to begin developing that image through a sound exit strategy. If you have any questions about exit strategies or options available, please don't hesitate to call us at **(925) 609-1440** ext. 13 (Karen Mindt Howell)

## **The Sunny Side of the Street**

Reading the papers, listening to the news and watching television, you would think that we have reached financial Armageddon. However, in the market segment The Bentley Companies operates in, things are bright and looking brighter!

The mid-cap market in Northern California has shrugged off most of the blues that surround many of the larger cap companies. In fact, 2001 was the second best year ever for our company, and the first quarter of this year was our best ever.

Granted, some buyers pulled in their horns after 9/11, and deal flow dropped a bit, but demand for good quality companies has remained strong for the most part. In fact, we have over one thousand high net worth individuals looking for buying opportunities.

For business owners looking to sell, now might be an ideal time. If you have a strong company that has demonstrated a good track record, many buyers are willing to overlook one bad year considering the circumstances.

Many companies have seen earnings drop, resulting in lower valuations, causing them to drop out of the market, thereby reducing supply and creating a stronger market for the companies that are available.

Aggressive buyers can find good opportunities in the market now, as some companies can't withdraw from the market and must sell now at the lower valuations. This is leading to some buyers finding very attractive deals in today's market.

One factor to be aware of is that lenders are very wary and financing is tight. This is leading to buyers bringing more equity into the deals or a higher participation by the sellers. A continued upward movement in the economy may lead to a less restrictive financing atmosphere later in the year.

The main strategic reasons for acquisitions remain vertical and horizontal integration, with companies looking to expand their technology base, their product or service offerings, their customer base or their geographic reach.

The bottom line is, if you are a seller with a strong company and proven value, this is a good time to be placing your company on the market. If you are a buyer looking for bargains, this could be a great time to be finding a deal. In either case, The Bentley Companies will be happy to assist you.

## **Build Company Value Through Cash Flow Planning**

When it is time to measure and improve the value of a company as a financial asset, it is all about cash flow. Generally speaking, cash flow is – by far - the best measure of a company's true ability to generate profits - and hence its long-term future. Indeed, risk-adjusted cash flow projections remain the most popular measure of a company's value.

Cash flow statements are used because they look behind the accounting techniques that can obscure true net income; they are regarded by many as the key to both a company's ability to pay its current bills AND make reinvestments for tomorrow's growth. You should watch your cash flow carefully over time to spot early warnings of problems and to ensure you have the resources to remain competitive. Investors do.

Cash flow is usually calculated by adding depreciation and any other non-cash charges to operating profit. As a fundamental measure of company health, many pundits focus on the ratio of revenue to cash flow, and would expect to see healthy cash flow at 10% of the trailing twelve months (TTM) of revenue.

Cash flow is especially useful in assessing firms in capital intensive industries -- heavy manufacturing, for instance -- in which huge depreciation adjustments can hide unhealthy profits.

Particularly in these industries, some analysts focus on 'free cash flow.' This is cash flow from operations minus capital expenditures minus cash dividends paid. The premise behind backing out capital expenditures and dividends is that these are not optional and therefore should be set aside to see how much money a company is really making.

Similarly, individual buyers and investors interested in small and midcap companies will look at *adjusted* cash flow. Under the assumption that there are no dividends to pay or major recurring capital expenditures, this is operating profit with discretionary deductions, such as perquisites, added back to expenses to determine true cash generating capabilities. The purpose is to essentially 'normalize' earnings to understand a company's true profit potential and to make valid comparisons with alternative investment options.

Take a look at your cash flow to revenue ration. If your cash flow percentages over time are falling off, this is costing your money. Fortunately, we have some tips.

√ Turn to your balance sheet. Look at your '*quick ratio*.' - defined as: (current assets - inventory) / current liabilities. A quick ratio of 1.0 is normally considered prudent. If your quick ratio is less than 1.0 (meaning relatively speaking you are carrying too much in current liabilities), you have some options.

√ Check your *days sales outstanding* (DSO = revenue / accounts payable). Is it greater than 45 days? Is the ratio climbing? If so, look at your aged receivables statement, and find out who owes you the most money beyond 30 days - you should not be lending cash to them for free. Start collecting what is owed, and either invest that money in solid instruments or invest it in your company's growth.

√ Check your *inventory turns* over time (cost of goods sold / inventory) and see if your stock is moving more slowly than usual. If so, idle inventory is costing you cash flow. In such a case you could either develop sales programs or discontinue weak product lines.

	Year 1	Year 2	Year 3
Cost of Goods Sold	\$945,000	\$1,060,540	\$1,134,341
Average Inventory	\$412,000	\$489,777	\$605,487
Inventory Turnover	2.3	2.2	1.9

**Table 1**  
Troublesome Inventory  
Turnover Ratio Going Down

At The BENTLEY Companies, we use cutting edge diagnostic tools that can help determine where possible problems lie. Give us a call at **(925) 609-1440 ext. 13** (Karen Mindt Howell) or [click here](#) to send us an email. We'll be happy to make an appointment to discuss your company's overall financial health and improving your cash flow.

## Growing Your Company Through Acquisitions

Your company is doing well -- so well, in fact, that you are considering expansion. Which way should you grow your company, internally or through acquisitions? Let's take a look at some of the pros and cons of each.

Expanding internally can make sense when you occupy a niche market that has little competition. Maybe there simply aren't any companies worth acquiring! You then build on your current expertise and expand through hiring additional staff and building out additional facilities.

Internal expansion can also make sense if there is no geographic issue to face. If you can build your business without opening new physical locations, adding to your existing plant can keep costs low.

External factors may make an internal expansion more favorable as well. If you are looking to acquire businesses through a stock transaction, a poorly performing stock market can make the price you pay very costly.

Corporate culture assimilation can be a very tricky proposition. When uniting two different companies, there will always be a give and take. When you grow the company through internal expansion, the culture and values the company was built on remain ingrained in your work force.

Acquiring companies as a growth strategy can make sense for a number of reasons. If the target company has a product or service that is complimentary to yours, many times you can save yourself the pain of "reinventing the wheel". You can expand your service offerings and strengthen your value proposition to customers by acquiring these services or technologies.

In many cases you may simply be looking at picking up a valuable customer base. We are seeing this time and again in the technology sector, as companies that are on strong footing are finding it easier to get new customers by acquiring competitors than trying to go out and sell a company on a new vendor. With market caps low, there have been some bargains to be had.

Gaining geographic expansion is another key to a sound acquisition strategy. You will find this particularly important when looking to expand outside of the U.S. By acquiring a local company in another country you can instantly gain credibility and market knowledge in the local area.

Finally, there is always the obvious reason to acquire a company: eliminating competition. A thorn in the side can often be removed more easily by simply bringing it into the fold. Let's face it, if the competition is giving you trouble, then they must be doing something right! Ultimately, the choice you make should be the one that provides the best value at the end of the day.

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