

The Top Ten Questions to Consider When Selling a Fire Protection Business

By Robert F. Coleman

The fire protection industry is going through consolidation, and many private owners of fire protection businesses are considering their options and the future of their businesses. Certainly issues like management succession plans, estate planning, the future competitive landscape of the industry, and other more personal matters will be given a lot of thought by these owners.

In the last year there were over 180 closed or announced M & A (mergers and acquisitions) transactions in the fire safety and security industry worldwide. The industry is still very fragmented. According to ThomasNet.com, an online database that specializes in logging information on privately held and publicly traded business, in the United States and Canada there are over 4,000 companies listed under fire protection systems and over 2,500 listed under fire protection products.

There are currently several large public companies participating in the fire protection industry; to name a few: United Technologies, Tyco International, Cintas, and Honeywell. For these large publicly traded companies to sustain their stock market positions they are required to generate growth. This growth will be both organic and through acquisitions. Many of these acquisitions will be through consolidating privately held businesses in both manufacturing and distribution channels. This article will highlight the top ten things for a private owner to know about selling a fire protection business, and it applies to both manufacturers and distributors.

1. How does your business revenue split between recurring and non-recurring



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revenue? Buyers of fire businesses put premium value on sources of recurring revenue, such as inspections and servicing. This is due to the unique aspect of this type of business that essentially guarantees a future cash flow. Project or product sales are valuable, but there is a greater risk that the cash flow will fluctuate. Buyers, although very happy to acquire this type of business, will offer only fair value. Getting a premium value requires more negotiation skills.

2. What are the potential growth opportunities for your business? When evalu-

ating your business, although you must be realistic, you can still be opportunistic. Buyers are looking for growth potential and how they can take your business to the next level in terms of sales, profits, and cash flow. It is important to know how your business could grow quickly if you had much bigger cash flow to invest. You should consider existing product-line expansions, geographic expansions, entry into new offerings related to the fire industry, etc. For example, if you are a fire equipment distributor consider expanding into fire suppression systems, fire-fighting equipment, or SCBA.

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3. How do you determine a realistic and achievable fair market value for your business? In the fire protection industry there are many factors to consider in valuing your business. We have already touched on the recurring versus non-recurring revenue split. You also need to determine your gross margin prior to overhead costs. A higher gross margin on sales is more attractive to a buyer as overhead cost is often easier to manage by a new owner. What are the company brand, customer list, intellectual property, and other intangible assets really worth?

The most common way to determine the fair market value of your business is to review what prices have been paid for other companies similar to yours. This is an area where professional assistance will be valuable. Professional M & A firms will do the research on industry-comparable transactions and can be more objective in determining the value of your business. Many private owners will let their years of hard work building the business and their emotional attachment influence the determination of value. An independent valuation by a professional will not only give you, the business owner, an objective view but will also allow for a much more informed negotiation with potential buyers.

4. What is your "Adjusted EBITDA"? The key measurement of a company's cash flow is often described as Earnings Before Interest, Taxes, Depreciation and Amortization, or EBITDA. In privately owned business, getting at an EBITDA number may not accurately reflect the true cash flow of the business compared

to if it had been in a typical public corporation. Private owners typically take additional compensation, bonuses, and other deductions. These impact profitability of the business but would not be typical costs for a publicly owned company. Often, particularly with fire protection businesses, there are one-time costs that will not repeat, such as insurance claims or settlements, or equipment upgrades that were expensed. These may be EBITDA adjustments.

Once the EBITDA is determined and adjusted to reflect a more standard public company format then you can better present your business to a potential buyer. This is another area where professional help can make a difference. M & A professionals will typically know how to look for the EBITDA adjustments and, most importantly, know how to document and present the adjustments to potential buyers so that they don't become contentious items in your price negotiations.

5. How much debt does your business have? Many companies have normal debt related to ongoing operations of the business. Debt such as service van loans, accounts payables, and other expenses are normal. Most buyers expect to absorb this debt as part of any deal. If a business has long-term loans from banks, shareholders, or others, then the buyer will often not accept these debts and will assume that you as the seller will settle these debts as part of any sale. Therefore, the amount of debt has a direct impact on the net amount of cash a seller may get from the sale of their business.

6. What is the tax impact of the sale of your business? The tax issue is a huge consideration and requires professional assistance and guidance. How a sale transaction is structured very much determines how much tax you will pay on any gain from the sale. Some transactions may be structured in a manner where you are selling the assets of the business, while other transactions may be structured as a sale of the stock shares you own in your company. There are other considerations depending on what type of corporate entity you have established. This is an area where you want the tax questions addressed very early in any sale process so that you or your advisor can negotiate the right structure to maximize the amount of cash you will get from any sale transaction.

7. Is your fire protection business dependent on any one supplier? Whether you are a distributor representing a key manufacturer's brand or a manufacturer closely tied to a particular material supplier, the contractual arrangements that are in place need to be reviewed. Many contracts have change-of-control clauses which allow the supplier to review the situation after there has been a change in the control of your business. This does not automatically mean that the supplier will cease doing business with your company; they have the right to decide what they want to do. A buyer will want to look at these key supply arrangements to determine what products are being supplied. The buyer will look at how easy is it to replace the supplier in the event of the supplier terminating the business arrangement.

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Buyers and sellers need to ask questions such as: Will pricing change? Will supply availability change? Are there limits on use of brands under the new ownership? The answers to these and other questions directly impact how much a buyer is willing to pay for a business. For example, if a buyer already has products in their existing portfolio and can replace a competitor's product easily then the buyer can get incremental profit margin from the replacement process and will therefore be willing to pay a higher price. Conversely, if the product is not easily replaced and the supplier pulls the product line, then the future profitability of the business could be affected and thus the valuation will be lower to reflect this risk.

8. How stable and skilled is your senior management team? Many fire protection businesses are privately owned, with the owner being the senior executive managing the business. Buyers will many times look for the owner to stay with the business after the acquisition, if not long term then at least for some transition period. One of the big questions a buyer considers when valuing a business is: How much does the business depend on the owner? Their concern is that if the owner were to leave the business, the business would be adversely affected and thus the return on their investment would be put at risk. Buyers very often are looking for a good second-level management team to run the day-to-day operations of the business in order to reduce the dependence on any one individual.

9. What type of equipment do you have in your business and how well is it maintained? Potential buyers don't want to be surprised by finding out that the equipment is in poor condition and they need to invest significant funds to update the assets. This will almost always influence the price you can get for your business. Additionally, it is important to make sure

that you have assets within the business to sustain the customer base. For example, if your business has a significant amount of portable extinguisher business then having a properly equipped dry chemical fill operation is important. Equally, if you are in the engineered fire suppression systems business then having recharge systems for the agents being used is a key consideration.

10. Are you ready for management presentations and business site tours? Before the real negotiation begins with any buyer, they are going to want you to present the business and allow them to visit. Many deals will either terminate or experience a decrease in the price offer at this stage. It is important for owners to approach this process as if they were trying to get the biggest customer ever. Having the senior managers present in professional attire is important. This doesn't necessarily mean "business suits" but should mean things like clean uniforms, clean offices, etc. Your senior managers must also be fully up-to-date on their functions within the business; this is necessary so that they can answer any question that may be asked.

It is also important that the operations area of your business is presented well. You should consider actions like cleaning out the trash before any visits, emptying dumpsters before the visit, touching up painting, and organizing inventory. This is much like selling a house; you want to present your business in the best light. It is worth the

time, effort, and cost. It does impact how a buyer determines a price offer as the offer will be lower if the buyer thinks that they need to spend time cleaning up the business or changing out managers immediately after the acquisition. Often a very well organized slide presentation about the business followed by a clean site tour will leave the buyer with the impression that this is a business they want to own.

The Business Sale Process

These are the top ten considerations in selling a fire protection business but there are many others. Most transactions involving the sale of a business follow the processes listed below:

- Determine the value of your business.
- Prepare a detailed, descriptive offering document on your business, financial statements, confidentiality agreements and other key transaction documents.
- Determine who the likely buyers are and qualify these buyers by their ability to pay the value you are seeking.
- Due Diligence reviews are almost always required by buyers and the key is to have no surprises in this review. Surprises complicate negotiations and lower values.
- Negotiate from an informed and objective position and then close the deal.

The full process takes time, must be detailed, and requires knowledge of the process to be completed. Short cuts, lack of detail and emotions can cost real money in getting a good value for your business. It is typically well worth the investment to engage a professional investment banking firm with experience in the fire protection industry to manage your transaction process so you can remain focused on running your business and maintain the good value you are seeking to present to potential buyers. ♦

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