Exit Scenarios for Owners of Wire Harness Manufacturers

As featured in the
September/October 2012 issue

Serving the Electric Wire and Cable Processor
WIRING HARNESS NEWS®
Voice of the industry
P.O. Box 527 • RICHMOND, ILLINOIS 60071

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By Loren M. Smith

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I'm very happy to be writing a regular column for *Wiring Harness News*. As a participant in the wire harness industry for over 30 years, I've had exposure to a considerable number of harness manufacturers. In these columns I will share observations based on this experience, hopefully providing readers with practical and useful information.

In the late 70's I moved my family to rural Iowa to acquire a small (under $1M) wire harness manufacturer (MWC). After growing revenue to $23M, I sold the majority of my company to an investment firm, and stayed on to execute my acquisition strategy, growing revenue to $85M. After MWC was sold, I started Blue Valley Capital, an M&A Firm focused on mid market ($2M-$50M) manufacturing companies. I was a founder of WHMA (Wire Harness Manufacturers Association) in the 80's, and continue to be an active member while serving on several boards.

This column will cover "Exit scenarios for owners of Wire Harness Manufacturers." In the November/December edition of *Wiring Harness News*, my column will be "How has the Wire Harness Industry changed (or not changed) over the past 4 decades."

The highly fragmented wire harness industry is made up of well over 1,500 small manufacturers serving niche markets. Since many of these businesses are owned by founding entrepreneurs, estate planning, succession planning, and ownership changes are subjects that effect a large number of owners of these companies today. Solutions can range from an outright sale and retirement to a partial sale that enables owners to keep running their business or performing another function of their choice while achieving liquidity (getting their money out.)

To begin with, it's a fact that most owners do not engage proactively in a process that provides them with liquidity or that gets them on a path toward retirement. Factors that keep owners from taking pro active steps to deal with these issues include; 1. confidentiality concerns, 2. fear that net after tax proceeds will not be sufficient to maintain an equivalent life style, and, most commonly, 3. we all tend to delay change until a life event forces us to do so.

The issue of confidentiality is always a paramount concern. Before any buyers learn the name of our seller, we take 3 steps; First, we vet all prospective buyers for motivation and financial capability. Second, all prospective buyers must sign our legally binding Confidiality Agreement. Third, our seller can, for any reason, ask us not to include a particular buyer in our process.

The 2 scenarios that I will cover today are an outright sale, followed by retirement (usually with a 6 to 12 month transition), and a sale that enables an owner to stay in place, with a plan for his eventual retirement.

Outright sale: Many owners believe they are "locked in" to continued ownership, because in the event of a sale they believe their after tax proceeds will be insufficient. This is often the case with companies whose revenue is less than $10M and who have heavy customer concentration (80% of revenue from 2 or 3 customers). While there is no "magic" solution to this quandary, there is a solution. First, it's necessary to see this as a process, rather than an event. Since some portion of the value of a business is the business's future performance, in these instances a portion of the proceeds from a sale, must come in the future. I'm not referring to a "seller note," which is just a way of deferring payment based on value at closing. There a variety of ways to "un lock" this future value when owners believe they are locked in, but they all require getting over a very substantial hurdle.

Once you sell more that 51% of your business. the new owners can do whatever they want. Why would you ever agree to future performance based payments when you have no control over how the business is run? The answer is you must see evidence that the party you are selling to has a track record that provides you with confidence they will listen to you (you'll have to stay on for a transition) and that they have experience that gives you confidence that they know what they're doing. You must do as much due diligence on them, as they will do on you and your business.

Once you get over this hurdle, there are a variety of ways you can unlock future value. It can be done based on revenue. For example, if you're selling a company with historic revenue of $6M, a deal can be structured that gives you x% of revenue over $5.5M for x years. This provides the new owner with confidence that you will maintain the 2 or 3 customers who comprise 80% of your revenue.

Another approach is to pay you x% of EBITDA for a period of x yrs. Both of these approaches reduce a buyer's risk that your business will go the wrong way post sale because of the loss of one of your major customers. It's scary for a seller to go down this road, but I've seen it work many times.

Another option is a partial sale, one that keeps an owner in place either running the business, or in another capacity that an owner might chose. The reasons an owner might chose this option are liquidity, risk avoidance, capital to grow, expertise to grow, and burn out. Many wire harness companies see opportunities to grow within their niche, but lack the capital to finance growth. In this case, a sale to a buyer who wants to create value by helping you grow can work. Often these situations include expertise in addition to capital. Usually owners have their entire net worth tied up in his or her business, and a sale transaction like this can provide an owner with liquidity; i.e. they can convert the value of their business to cash. While most owners love what they do, most if not all of the risk and much of the responsibility rests squarely on their shoulders, resulting in stress. The right buyer, the right transaction, will relieve an owners sleepless nights the day of closing.

Post sale, owners can opt stay on in a variety of roles. Owners find a sale that allows them to continue in the job they like, while shedding the stress and potential liability of ownership, very attractive. He or she can keep running the business, be a sales manager, engineering manager, manufacturing manager, salesman, or rep; I've seen all variations of these scenarios work well. The driver in this decision is for an owner to pick a role under new ownership that fits how he or she choses to spend their time.

Prospective buyers include other wire harness companies, contract assemblers, connector manufacturers, printed circuit board manufacturers, electrical/ electronic distributors, private equity firms, and angel investors. The cliche "timing in everything" is absolutely true when it comes to the M&A (merger and acquisition) business. The best deal is always driven by a buyer's appetite for a particular transaction at a precise point in time. Because this is true, the only way to sell a company, is to initially give it the widest initial exposure possible, and of course to do this without revealing the name or location of the selling company.

Finally, as someone who has been the shoes of an owner, I understand how emotional this process can be. During the sale process, most of my time is spent with a seller, explaining and ranking his or her options, and contemplating the repercussions of the decision to sell. For me, It's a great honor to be given this responsibility.

The sale process can result in the next chapter in an owners life. The comment I most frequently hear post sale, is "Why didn't I do this sooner?"

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