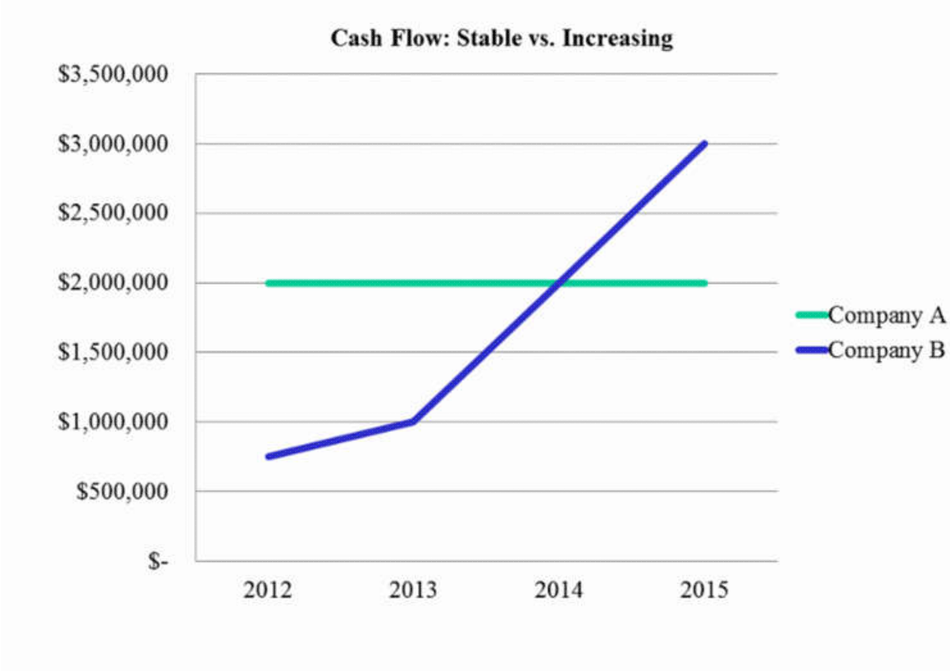
Value Drivers in Action: Ike's Story, Part Six

Ike was the owner of a small, Midwest company; a Tier I supplier of proprietary parts to several U.S. heavy truck manufacturers. Ike decided he wanted to significantly ramp up the value of his business before his eventual exit. Ike wanted us to help him devise and execute a plan to grow the value of his company and then help find a buyer. This multi-part article is his actual story.

Good and Improving Cash Flow (Value Driver #6)

Ultimately, all the value drivers contribute to a stable and predictable cash flow. While sales and net income are great metrics, it's cash flow that should be the most valued metric for a business owner. Buyers purchase future cash flow - and they pay top dollar for cash flow that they expect to increase after they buy the company. Think like a buyer.



Ike had been a salesman his entire business career, and so revenue growth had been his primary motivation. He figured out that the revenue growth rate was attractive to a buyer, but it was the rate of annual cash flow growth that commanded premium prices. The rate of growth in revenue was of little value without an equal, or even greater, increase in the rate of cash flow growth.

Notice that the total cash flow for each company represented in the chart is the same, $6 million over the last three years. Yet, company B has a better story to tell because its immediate past and present cash flow have improved and continue to improve. Think like a buyer. Which company would you like to buy?

So, while Ike's sales forecasting process was rock solid, he modified the process to add a cash flow element. He realized that adding his product to more "Big 3" automotive platforms would greatly accelerate revenue growth. But, buyers at the "Big 3" would pressure for lower prices, which could decrease Ike's gross profit percentage. Ike focused on manufacturing efficiencies and worked with suppliers to reduce costs. But it all came down to cash flow, and Ike's product pricing decisions ensured that the percentage increase in revenue from new sources had a corresponding "equal or greater than" percentage increase in cash flow.

On a side note, Ike did not use his business as his personal pocketbook and did not "play games" for tax purposes. This is a critical step for owners planning to sell in the next two to three years. Many owners seize the opportunity to use the business to pay for all kinds of hidden perks and excessive manipulate the balance sheet to defer income. While expenses for owner perks and a "true up" of the balance sheet can be factored back into the sale price via recasting earnings, fewer of those is better than many.

So Ike set his salary at a market rate of compensation, and provided himself with a company vehicle. He avoided salaries for inactive family members, recreational vehicles, airplanes (he was a pilot), and above market rental payments for assets owned and leased to the company. Accounts receivable and inventory were reported on both the financial statements and income tax returns without manipulation.

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