



Do you have realistic expectations about your company's value?

There are currently 5.6 million small to medium companies in the U.S., 70% of which are expected to try to change ownership by the year 2025. However for lower middle market companies, more than four in 10 transactions will fail, according to research from the Pepperdine Private Capital Markets Project.

The reasons are twofold:

1. As Baby Boomers increasingly look to sell their businesses, the number of younger entrepreneurs available and interested in buying those businesses won't keep pace.
2. There's often a large gap between a buyer and seller's expectation of a company's value.

Middle Market Inefficiency



That leaves 220,000 businesses worth \$1 trillion waiting for a shot at going to market.

Key takeaways

Value Opportunity Profile® helps maximize business value by:



Determining total capability and proficiency by evaluating eight functional business categories



Targeting and prioritizing potential risks to long-term growth and value



Providing the insight and tools necessary to both implement complex improvement initiatives and anticipate outcomes

At Key Family Wealth, we know that of the businesses that do succeed in changing hands, most will include seller concessions. This means the business purchase price will be reduced.



In order to build tangible value that can be sold at an optimal price, a business must generate profits in excess of its cost of capital. If your business' returns are not high enough or there is too much embedded risk, there is probably a gap in what you think the business is worth versus what the market thinks it's worth.

Profitability > Cost of Capital = Value Creation

If there's a value gap will this impact your ability to retire? When do you want to figure out if there is a gap? Will you pursue a strategy to increase or create value by chasing profits or focus on reducing intrinsic risk (a component of your cost of capital)?

If your business is the major asset funding your nest egg, you'll need a couple of years prior to retirement to close any value gaps. However, business owners who proactively quantify available resources along the way are more likely to avoid a shortfall and attain financial security upon retirement.

At Key Family Wealth, we help business owners analyze why they're experiencing gaps in value expectations and put a plan in place to close the gap before it comes time to retire.

The higher the risk rate, the lower the value

Business owners become desensitized to problems they overcome to make their business run "smoothly" and lose the ability to objectively assess the amount of risk within their business.



Statistics overwhelmingly indicate that most middle market business owners believe their companies are worth far more than they actually are. In fact, business owners assume their company should be valued or sold based on the "normal" or "industry standard" multiple, but this metric doesn't completely account for the company-specific risk that exists within a business.

When a business has a high company-specific risk rate, it increases a business' capitalization or discount rate and, consequently, depresses the business' value.

Key Family Wealth's Consulting Services Group employs a tool called Value Opportunity Profile® to help owners optimize their business' value.



Business Value Optimization, a service offered by Key Family Wealth's Consulting Services Group, is a road mapping process that utilizes a proprietary assessment tool called the Value Opportunity Profile (VOP®). The VOP helps a business maximize its value by:

1. Assessing a business' competency across eight functional categories: planning, leadership, sales, marketing, people, operations, finance and legal.
2. Identifying and prioritizing a business' company-specific risks that are depressing value and obstructing long-term sustainable growth.
3. Providing business owners visibility into outcomes and return on investment (ROI) for any contemplated initiatives, motivating the business owner to take action to implement specific improvement initiatives.

This process enables business owners to avoid a situation where at the 11th hour they realize that they're accepting an amount for their business that will not adequately fund their retirement or less than what they could have received by reducing the business' intrinsic risk before going to market.

Key Family Wealth's Business Value Optimization process enables business owners to close gaps before it's too late.



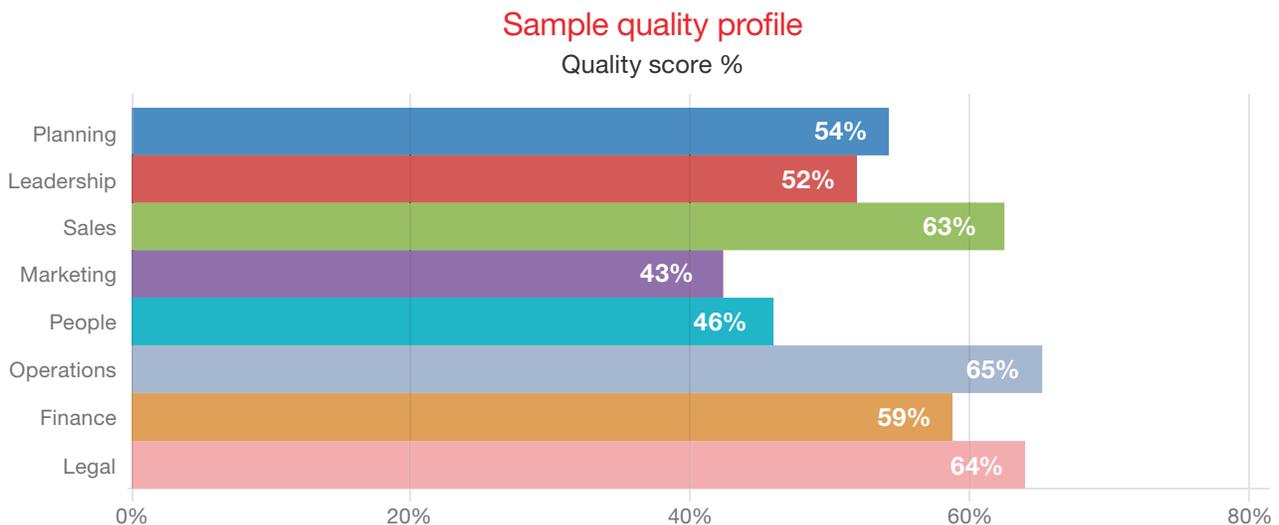
VOP gives owners and managers of private companies an opportunity to strengthen the overall quality and competency of their company in advance of any change in ownership, regardless of whether the prospective owner is a third party, family member(s) or group of employees.

Through a collaborative interview format, the VOP platform collects responses from a business' management team and assesses the entire enterprise, providing:

- Quality and risk ratings across 47 different categories
- A baseline estimate of the current business value
- A detailed roadmap of recommended initiatives to maximize future value
- A dashboard to conduct "What if?" analyses

A VOP advises:

1. An **Overall Quality Profile** that represents the level to which the overall company, or any particular area of the company, is fully developed and effectively functioning compared to a best-in-class company operating at 100% competency.



How it works: The quality scores are designed to compare a company's development against the standards of a high-performing company, measured across eight main categories: planning, leadership, sales, marketing, people, operations, finance and legal.

- **Follow the 80/20 rule:** Ideally, a company should achieve a minimum quality score in every category of at least 80 and should have a continuous improvement program in place to strive for even higher quality scores.

- **Go for gold:** A quality score between 60 and 80 indicates a need for improvement, and a score below 60 indicates that the company has substantial opportunity for improvement in that category.
- **Achieve equilibrium:** The company should maintain balance across the eight main categories.

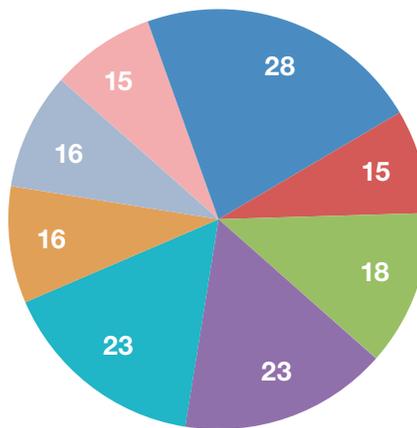
2. An **Overall Risk Profile** provides an assessment of how a potential investor or buyer might view the company from a risk standpoint. The risk score is intended to provide insight as to how a prospective lender, investor, or buyer would likely view the company at its present state of development.

How it works: All of the factors that flow into the quality scores also flow into the risk scores, but the risk score flows into the calculation of intrinsic value as a key determinant in the company's estimated value. This is important because it will directly impact whether the buyer would be willing to execute a transaction with the company, as well as the value that the outside party would place on the business.

- **High-risk:** Companies in the high-risk or highest-risk categories would dampen a buyer's enthusiasm and would be least likely to achieve any desired financing or exit transaction until the risk level is reduced.
- **Medium-risk:** Companies in medium-high or medium-risk categories are more likely to achieve desired transactions, but might still be subject to rather harsh valuations due to the risk level.
- **Low-risk:** Companies with low-risk profiles are most successful at achieving desired transactions at anticipated valuations.

Sample risk profile

Risk score points
Total VOP risk score: 154



The good news: Over a three- to five-year period, most private companies have an opportunity to double their values if they adopt a disciplined, methodical approach.

Whether contemplating a sale or transfer, or looking to operate your business in the most efficient, profitable and sustainable manner possible, contact any one of your Family Wealth advisors or email familywealth@keybank.com.

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