The Power of Projections

Budgeting process becomes a huge tug-of-war because there is a lot at stake in terms of resources, bonuses, and pride. Unfortunately, many companies give it little effort or they forgo the process entirely. However, **budgets and projections are very important**, especially in the world of M&A.

When selling a business**, projections are important for several reasons**. These include:

- **Business valuations** are mostly based on future cash flows. Everything else, such as customers, products, technology, employees, and equipment is important, but in the end boils down to projected future cash flows.
- **Solid projections** show that ownership/management has a good grasp on the business and customers. Buyers would like to know if the owners and managers really understand their business. If not, it will require more investment and time to bring the business up to speed. It also adds risk.
- **Projections provide a basis for earnout calculations.** Earnouts are a part of many deals, and they are usually based on the company's own projections. If projections are too high, the business will be missing forecasts during the sale process, which is not good. It seems like a seller gets dinged $2 for every $1 missed vs. the forecast, but only gets $0.50 in extra credit for every $1 that it beats the forecast. If the forecast is way too low, the owner may look like they were "sandbagging" or that they do not really understand their business. It is best to be a little conservative yet realistic.
- **Buyers want to know the company's plans for CapEx,** working capital, inventory, hiring, training, taxes, technology roadmaps, and other milestones. Projections and budgets help the company determine those needs and are an essential tool for business. How can you possibly know how many pencils to buy next quarter if the company does not have a predictable budget? People have been making projections and budgets ever since the first goat farmer in 10,000 B.C., predicted how many kids would survive the spring.
- Projections help management react proactively and quickly to issues that come up. **Issues will definitely arise**, both during the sale process and in the future. Showing how the company reacts to issues helps buyers determine how the company can react in the future. It is better to have at least a decent handle on the business than to be constantly playing whack-a-mole when issues come up. For example, perhaps the business has some seasonality that is predictable. Many business owners seemed surprised that there were three payroll periods, fewer workdays, year-end bonuses, and that customers pushed out orders in December when, in fact, it happens every year.

In general, **the more predictable the business**, the higher price and better terms the business will receive on the market. For example, in the past few years, there have been many M&A deals in the landscaping and HVAC services markets. These sectors are not traditionally very popular with buyers, such as private equity firms because the new owners are working to convert customers to annual/seasonal contracts or monthly service agreements, which makes their revenues more predictable. Many of us have been offered these contracts at home by our long-tenured HVAC guy—who we didn't even know had been acquired. This move toward predictability will allow the new owners to sell at a higher valuation in the future if it all works out.

But to turn a PCB shop into a predictable business with more than 80% annual recurring revenue? Well, that might not be possible, but the goal should be to become a little more predictable every month and to be able to spot issues as soon as possible.
At least, if the owner can provide TTM (trailing 12 months) and FTM (forward 12 months) monthly adjusted EBITDA figures on a spreadsheet, with notes to explain any large variations, we will be in great shape.
In addition, be ready to produce those figures by the 10th of every month.
It is not possible to go **from HIIK** ("Hell if I know") forecasts **to monthly rolling forecasts overnight,** so the earlier the owners get on that path, the better.
It will pay dividends for the business as well as help the owner get a better valuation and terms when the deal goes to market.

*Thanks to our US-Partner **Tom Kastner** – he generously allowed us to publish his article.*

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