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Succession Planning for the RTO Industry

By Michael Helton, CPA and Rene J. Zarate, CPA•ABV

Succession planning should address the day-to-day internal management of operations as well as the leadership or ownership of the company.

What is succession planning? It has been defined as organizing a business in a manner to transfer key management roles between employees, whereas the business does not suffer from an interruption. Additionally, it would include preparation of a business for ownership to transfer its stake in the company to others – either internal or external parties.

The rent-to-own (RTO) industry has historically been populated by owner-operators who manage one or two stores, although, this has been changing in recent years. With the typical RTO owner employing a limited number of employees, the planning process likely will be critical for an exit. What are some reasons that owner may desire such an exit?

- Retirement
- Economic uncertainty, perhaps caused by regulations
- Burnout or lost interest in industry
- Competition
- Receipt of attractive unsolicited offer

What do we know about the timing of the company planning? Primarily, it will depend on the reason from the list above. Like most processes, a longer planning cycle typically leads to a better result. Some would say that the planning should begin when you first go into business.

Planning for addressing the day-to-day management of operations can be enhanced by creating detailed policies and procedures of all the key company business functions. Cross-training employees by utilizing the procedures once in place ensures that someone else can step in. In general, limiting reliance on any one employee or small number of employees provides a more comfortable level of security that the business will function without certain team members.

Most people think of succession of ownership when they hear about succession planning. Let's take a look at some important components of ownership succession.

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Ownership Succession Structure Points:

- An **asset sale** where a buyer buys specific assets and perhaps defined liabilities, limiting their risk.
- An **equity (stock/membership interest) sale** where a buyer takes on ownership of the entity operating the business, the good and the bad. Likely limited to family, key employees, or current partners who are familiar enough with the business to mitigate risk.
- A business combination or **merger** with another company, typically in the RTO business.
- Conversion to a **franchise** model, thereby spreading out risk to others.
- **Dissolution** through an orderly liquidation or court-supervised liquidation such as bankruptcy or state assignment for the benefit of creditors.

Financial Matters for Consideration:

- What is the company worth? The value in an open market fluctuates, based on the "eyes of the beholder." But how does that value correlate with the owner's perceived value? Can the two be reconciled?
- The industry has historically utilized various rules of thumb to assess value based on average recurring revenue, where the transactions marketplace generally utilizes multiples of EBITDA (earnings before interest, taxes, depreciation, and amortization).
- Establish a value to the owner based on historical monetary benefits. Can the business support that "lifestyle" in someone else's hands?
- Terms required such as cash at closing vs. seller financing. Seller financing exposes the owner to similar business risks, but those? are now navigated by the buyer.
- Tax consequences.

Getting ready for considering an exit takes serious planning. What are some operational challenges the owner needs to address in advance?

- How effective is the overall technology and POS in place – Is correct and efficient information generated?
- Are business processes documented?
- Does the RTO store(s) have an online presence?
- Do you have a handle on cash flows generated/needed? Do you know your margins?
- Do you have reliable financial statements, presented on a recognizable basis to investors?
- Are leases and other key agreements transferrable/assignable to a buyer?
- Have you explored seeking a mentor with RTO exit experience?

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The concepts leading to ascertaining a reasonable value or price for one's company is beyond the scope of this article. However, there are several things that can be done related to the financial operations of the company, that when coupled with the advance planning above, would place an owner in an advanced state of preparation for the day of succession. These include:

- Budgeting cash flow, to include monthly rental revenues at a reasonable collectability rate, providing for club and fee income.
- Knowing how much of the cash flow is needed for inventory, and how that amount was derived.
- Knowing what your breakeven fixed cost is.
- Understanding what other key performance indicators are important, such as units, customer agreements, deliveries, collections %, growth, and gross margin, and having historical metrics for these KPIs
- A comparison of your results to benchmarks in the industry.

The RTO industry has its uniqueness that is well established. But ultimately, an owner has to determine when and how they are winding down. The reasons and the roads traveled are many, but the way to the promised land starts with planning – succession planning.

Rivero, Gordimer & Company, P.A. has a unique edge for RTO business owners looking for succession planning. In addition to consulting services as needed for your business, our firm's Valuation and Advisory department is able to provide services such as Quality of Earnings, cash flow analysis, valuation, and due diligence using personnel who understand the RTO industry and its transactions.

About the Authors:

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