The ABCs of Selling Your Business

You’re the owner of a company. You thought at one time you’d hold on to it forever. But for one reason or another, you know that now is the time to sell. Where do you begin?

While the process of selling your business may seem straightforward – you get your accountant to crunch the numbers and put a price tag on your company, you find a buyer, and they acquire your business – it’s really anything but. As you well know, conducting business oftentimes is not linear. Selling a business is no different. It’s a process littered with challenges and oftentimes the seller is left feeling like they’re on an emotional roller coaster.

That’s why, before you move forward, it’s vitally important to ensure you do in fact want to sell your business. At this moment, you may be thinking: Of course I do! But consider this statistic: Over 15% of the companies that “truly” claimed to be for sale were not sold due to non-price issues. In other words, you can bring an owner to the altar, but in many cases he or she walks away even though price and conditions are met. And if you’re one of the owners who reconsiders and backs out, then you’ve wasted significant time and resources for all parties involved.

Once you are confident you are ready to sell, what does the process look like? Just like any other sales transaction, it can be broken down into the following core elements and stages:

**Stage #1: Connecting With the Right Adviser**

Selling a business is a major undertaking. It’s a long and complex process that typically takes 15 months. So unless you have sold a business in the past, trying to do it yourself can have dire implications for your return on the sale.

While turning to your accountant might seem like a logical step, you instead need a sell-side mergers and acquisitions (M&A) adviser who not only understands your business, but also knows how to add tangible value to it while the sale process is progressing.

*Such a professional will focus on the following key elements:*

- Timing
- Appearance of the Company
- Executives and Employees
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- Documentation
- The Balance Sheet

They will also ask critical questions that will enable you to position your company in the best light possible to a potential buyer. For example, they will inquire about back taxes and debt. One or both of these issues could put you in a weak position when negotiating and it’s therefore important to take advantage of cost cutting opportunities before selling.

In addition, when considering the sale of a business, there are a wide variety of transaction options an M&A adviser can educate you on. These options must be understood and evaluated by all involved – including the CEO, owner, and/or board.

A seasoned M&A adviser will also work with you to understand the selling requirements, the range of valuation expectations, and strategic goals. This includes defining exit strategy options; thinking through the most appropriate types of buyers and the timing of the sale; identifying and minimizing tax consequences; and discussing your desire for future involvement with the company (or lack thereof).

Stage #2: Determining a Valuation Range For The Company

Determining a reasonable valuation range is a critical next step in the process. Valuation techniques range from the highly academic and analytical methods of discounted cash flow and dividend discount models (DCF and DDM) to the more pragmatic comparable company valuation methodologies.

Unfortunately, none of them is a replacement for the actual process of engaging with high quality, highly relevant buyers. Analysis and number crunching is necessary; but it will only take you so far. In the end, price is determined in the market by the buyers and the quality of your engagement with them.

If the M&A adviser proposes a valuation range that is not acceptable to you, the process should stop at this step. Too many deals are derailed by sellers and buyers with completely different expectations about business value. While it’s the job of the adviser to close that gap through negotiation, enormous ones simply cannot be bridged.

Stage #3: Implementing Pre-Marketing Value Enhancements

Oftentimes, advisory firms will review a company’s strategic and financial condition and make suggestions for how the company, over a six to 12 month period, can implement changes that will make it more desirable. These should not be massive, which take too long and are too risky. Instead, they should be valuable changes that make the business more attractive and can be put into place in a reasonably short period.

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Sometimes a trigger-happy CEO just wants to sell the company. However, a few minor adjustments might add significant value before going to market. Again, working with a knowledgeable M&A adviser or informed board members with relevant industry and business strategy experience can prove invaluable in these situations.

**Stage #4: Gathering, Collecting, and Presenting Data**

Spending the time to properly aggregate, interpret, and present a company’s financial and business history and future projections is a crucial element of the sales process. This requires trust between a business owner and his M&A adviser. The engagement letter should reflect the confidentiality that an advisory firm commits to before they have access to any sensitive information.

Business owners typically prepare their financial statements for tax purposes, not for business sale purposes. But using tax statements for a business sale presentation is a major mistake, as it usually obscures the earnings capability of a business. Taking the time to properly present a company's earnings power can have a big impact on how the buyers view the opportunity.

**Stage #5: Preparing Marketing Materials**

When potential buyers evaluate a company, they expect the records and facts to be properly organized and documented. Disorganized or poorly collated material delays the process, appears sloppy, and badly reflects on the seller. It’s another area where many sellers can be pennywise and pound foolish; as a result, they pay a terrible price in the form of lost opportunity.

However, a well-packaged and presented business summary will serve to increase a buyer’s confidence and comfort level, as well as increase the likelihood of a successful sale. A business owner spends years establishing name recognition, market niche, vendor relationships, operation and production systems, management, personnel, distribution channels, customer loyalty and numerous other intangibles. This is a story that needs to be properly told to educate potential buyers.

**Stage #6: Conducting Buyer Research and Strategizing Buyer Outreach**

While large multi-billion dollar companies often have only a handful of relevant and sufficiently capitalized potential buyers, lower middle market companies (businesses whose values typically range between $10M and $250M) often have an enormous number of potential buyers. Some of these potential buyers are known to the business owner; others are not.
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This means that the adviser and the business owner must have the right tools and resources to access the largest and most qualified data set of relevant buyers. This research process should be exhaustive, not rushed. The adviser should review competitors, customers, strategic buyers, private equity firms with relevant expertise, and other sources of highly suitable capital and partnership. This is one of the most time-intensive elements of the process, but it often determines overall success. After all, if you don’t approach the best buyers, how can you get the best outcome?

Stage #7: Qualifying Potential Buyers

Many potential buyers who express interest in a business will not be qualified to purchase the company. These companies are referred to as “tire-kickers.” A good M&A adviser will know the right questions and have enough market intelligence and expertise to filter these buyers out and pre-qualify the right ones, saving you and your team significant time and attention. This isn’t a particularly complex step. However, when not done right, you can waste valuable efforts and resources dealing with unqualified buyers. This also increases your risk of a breach in confidentiality.

Stage #8: Negotiating

There are many schools of thought on how to run the negotiation and buyer engagement process. Some advisory firms suggest a process with only one highly targeted buyer. This strategy has tremendously high risk, but can be extremely expedient if it works out.

In general, sellers are more likely to achieve a stronger outcome when negotiating with multiple qualified buyers, rather than just one. This can, of course, be taken too far as well, where every buyer feels like they are part of a huge auction and walk away for fear of overpaying. Competition in the sale process does typically drive up purchase price and quickens the pace. But it must also be handled carefully, respectfully, and professionally.

Stage #9: Structuring the Transaction

The sale of a business has many financial and professional considerations for you and your management team. The purchase price is only one component of the overall result. Other decisions and considerations to be made include: stock sale versus asset sale; earn-out; financing terms and interest rate; liabilities assumed by the buyer; employment contracts; non-compete agreements; current assets retained by the seller; stock ownership and equity options packages; relocation; and employee preservation versus redundancy layoffs.

Stage #10: Preparing IOIs, LOIs, and the Purchase Agreements and Closing

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Typically, buyers express interest in a company through three documents: the indication of interest (IOI), the letters of intent (LOI) and the purchase agreement.

- The IOI is non-binding and provides the proposed terms, valuation and structure for a transaction. The owner will review this with their adviser and make a determination as to whether or not to invite the buyer to learn more about the company and become more serious.

- LOIs are a more serious signal of interest by the buyer. Once they are jointly executed, the seller is typically under exclusivity with that buyer, such that they are not able to meet with other buyers during a stated period of time. Meanwhile, that buyer is beginning to conduct heavy due diligence on the business with the intent of acquiring it. During the exclusivity period, the buyer must move quickly to determine if they want to proceed.

- If they do, the purchase agreement must be drafted to define all the details of the transaction: legal, financial, representations, warranties, etc. The purchase agreement is the definitive document outlining the terms of the sale.

**Stage #11: Handling Post-Closing Issues and the Business Transition**

The transition period typically involves a period of cooperation during which the seller will assist the buyer in transition. There are instances in which the seller is specifically not interested in doing this; however, a lack of willingness to ease the transition typically leads to a lower valuation and can even derail the deal process entirely.

Sellers should proceed with extreme caution if they elect to have no post-closing commitment. These commitments often include transferring customer relationships, and explaining key management or market dynamics, as well as other proprietary information and trade secrets needed to operate the business optimally.

The bottom line? While selling a business may be a predominantly financial decision, it’s not as easy as putting a price tag on your company and finding a buyer. Many non-financial factors contribute to a successful outcome, including the timing of the close and the terms of your exit. But when you work with the right M&A adviser – who takes the best approach, you can navigate your way through the sales process and achieve your goals, financial and otherwise.