

How to Sell Your Company

Presented by:

**Small Business Development Center
of Hampton Roads**

Sponsored by:

**Sajomach Business Services, Inc.
Resource Bank
Paul M. Harris, CPA
Kaufman & Canoles
The Lucky Star Restaurant**

Thank you
Reception



Housekeeping

- Schedule
- Breaks
- Cell phones and pagers
- Questions?



Today's Topics

- Why sell your business?
- Planning to sell
- Complexity of the selling process
- Tax, legal, and financial consequences
- How buyers see value
- The marketing process
- What buyers want
- Financing the deal
- Offer to purchase
- Due diligence
- Closing



Educate Yourself First

- "If you don't know where you're going, any road will take you there."
– *Chinese Proverb*
- "We're lost, but we're making good time."
– *Billy Crystal - City Slickers - 1991*
- **Most business owners put all their energy and expertise into running their business. Now it's time to develop an understanding of how best to exit it profitably.**



Why Businesses Are Sold

- Retirement/semi-retirement
- Health issues
- Burn-out
- Personal diversification
- Death
- Divorce/partner disputes
- Business growing too fast
- Second generation not up to the task
- Loss of market share



Exit Scenarios

1. Close the business
2. Accident, illness, or death
3. Succession
4. Sale of business



1. Close the Business

- Fire sale of assets
- Greatest potential for financial loss
- Reputation harmed
- Self-esteem degraded
- Does not maximize value

2. Accident, Illness, or Death

- Loss of competent management (whatever reason)
- Dependence on management loyalty and trust
- Relies on existing infrastructure and business processes
- Does not maximize value

3. Succession

- Successor(s) identified, qualified, selected and accepted
- Successor(s) adequately trained; relies on existing infrastructure and business processes
- Make rational choices; emotional choices do not maximize value

4. Sale of Business

- Planned sale allows for owner's goals, objectives, and timetable
- Have to identify potential buyers
- Create an attractive acquisition candidate
- Understand why they buy. Do you know what counts?
- Realize the worth: use sale for retirement planning

Timing Considerations

- Is the Time Right?
 - State of the business
 - State of the market/economy
 - Current lending environment / interest rates
 - When buyers abound?
 - Is the business in the most salable condition possible??

Don't dig your well when you're thirsty..."

Stages of Planning

- Long-term planning *3–10 years*
- Intermediate planning *6 months–3 years*
- Short-term planning *Up to 6 months*

Checklist for Selling



- Be confident
- Be credible
- Have a firm selling strategy
- Plan your marketing
- Seek professional advice
- Pre-qualify your business for lending
- Address internal issues
- Prepare for buyer's due diligence
- Anticipate buyer's questions
- Use professional intermediary to market and negotiate for the highest value

Financial Records Housekeeping



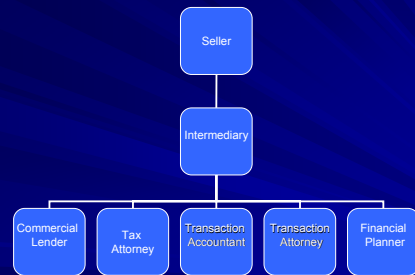
- Record all sales and expenses
- Eliminate co-mingling assets
- Do your own due diligence
- Eliminate marginal "perks"
- Compliance with taxing authorities
- Clean the balance sheet and income statement
- Organize and make records available

Difficulties Sellers Encounter

Issues sellers encounter when trying to sell their own business:

- Value
- Confidentiality
- Marketing
- Employees
- Deal structure
- Financing
- Experience
- Competitors
- Documents
- Negotiating
- Timing
- Difficult buyer
- Communication
- Emotional attachment

Selling Team



Professional Representation

Benefits of using a business broker/intermediary:

- Maintains confidentiality
- Coordinates the key participants
- Interfaces with professionals: attorneys, accountants
- Keeps players focused
- Maintains deal momentum
- Negotiates the broad strokes
- Meters frustration levels
- Finds the pool of potentially qualified buyers
- Chases the buyer

Business Structure Issues

- There are many issues stemming from the legal structure of the business:
 - Depreciation recapture vs. capital gains
 - Sales Tax and other taxation issues
 - Hidden corporate liabilities - holdbacks.
 - Nature and transferability of contracts and obligations
 - Shareholder/co-owner consent.

A majority of small business transactions are structured as Asset Sales. Tax law generally pits Buyer against Seller. Proper tax and legal advice and preparation is vital!

Understanding Buyers

- Buyers come in 3 basic flavors...
 - **Individual** (Most common - 70 - 80% of mid-market transactions.)
 - **Corporate** - Strategic or consolidation
 - **Investment Consortia** - Financial buyers.
- Current buying climate is hot:
 - Many former senior corporate executives
 - Much industry consolidation
 - Interest rates at record lows

What Is the Value of Your Business?

Fair Market Value

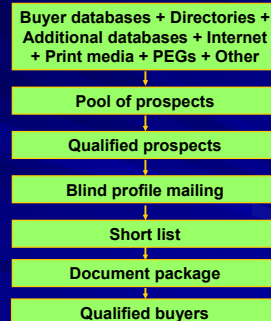
- The hypothetical price at which a transaction occurs between a:
 - Willing buyer
 - Willing seller
- Both reasonably informed
- Neither acting under any compulsion
- Both of whom have the financial capacity to engage in the transaction

Considerations in Determining Value

- Seller's discretionary earnings/cash flow
- Value of tangible assets
- Value of intangible assets (reputation, goodwill, copyright, etc.)
- Comparable sales
- Replacement value
- Marketability factor
- Market segment
- Territory rights
- You know how buyers value a business
- You can help uncover this value

Marketing for Buyers

The Prospecting Process



All About Buyers

Who will buy your company?

- | | |
|---------------------------------------------|------------------------------------------|
| Best prospects: | “Beware and take care” prospects: |
| ■ Qualified individual | ■ Local competitors |
| ■ Private firms – domestic/international | ■ Company's customers |
| ■ Private investment groups/portfolio firms | ■ Company's suppliers |
| | ■ Employees – the worst |

Why Do Buyers Buy?

A buyer will buy* your business not for what it has been, but for what it can be, and to:

- Acquire new products/technology/markets
- Achieve growth more rapidly
- Acquire established presence in market (area)
- Avoid risks of start-ups or expansion
- Strengthen position in particular markets
- Acquire undervalued facilities
- Acquire undervalued businesses

*Buy ≠ Pay

What Is the Value of Your Business to Buyers?

Value Drivers:

- Earnings stability
- Gross profit percentage
- Reputation/image
- Customer loyalty/continuing customers
- Customer diversity vs. concentration
- Personnel retention/management depth
- Historical and projected growth rates
- Market size and penetration rate
- Key locations

"Growth Potential"?

- Buyers will not **pay** money for "growth potential"
- They will **pay** only for current and past performance of the seller's business



What Buyers Look For

- Provable books and records
- Reasonable price
- Leverage and terms
- Living wage
- FF&E (current FMV, not overstated)
- Appearance
- Lease (reasonable term and cost)
- Training (by seller for 1–6 months)
- Covenant not to compete
- Good reason for sale
- Time is of the essence
- No last-minute surprises

Prepare to Share With the Buyer

Provide the following for past and present *only after the buyer signs a Confidentiality Agreement* :

- Historical financial statements
- Tax returns
- Employee lists
- Accounts receivable aging
- Facility and equipment leases
- Environmental reports
- Pension, profit-sharing, and all other benefits
- Union contracts or organization activity
- Pending or threatened litigation
- Customer lists
- Other important agreements



Time kills deals. Keep the momentum going!

How to Finance the Purchase

- Family, friends, partners
- Commercial banks
- Home equity, pension funds, insurance cash value
- Government agencies
- Strategic partners
- Leasing companies

Additional acquisition elements:

- Buyer's cash
- Seller financing
- Institutional financing

Components of an Offer to Purchase

An offer to purchase specifies price, terms, and payment:

- Cash due at closing
- Assumption of debt (if any)
- Seller financing: term, interest, security
- Non-compete compensation
- Consulting income or earn-outs

Continued...

Components of an Offer to Purchase

The offer to purchase is usually subject to certain contingencies that are satisfied prior to closing:

- Due diligence (confidential information not disclosed by seller that buyer needs to review)
- Confirmation of financials, books, and records
- Financing arrangements
- Lease assignment or negotiations of new lease
- EPA compliance
- Licensing requirements
- Franchise approval

Continued...



Components of an Offer to Purchase

Other issues that are addressed in the Offer to Purchase agreement:

- Earnest money
- Buyer and seller warranties
- Training
- Covenant not to compete
- Allocation of purchase price
- Desired closing date
- Date by which seller must respond



Due Diligence

- Legal and Tax Issues
 - Litigation
 - IRS audits
- Accounting
 - Accurate picture of financial position
 - Accounting method used (cash vs. accrual)
 - Inventory valuation
- State Regulations
 - Environmental



Selling Documents

- Business summary/blind profile
- Confidentiality agreement
- Letters of intent or purchase and sale
- Confidential business review
- Definitive purchase agreement
- Other agreements



How Long From Start to Finish?

Task < \$2 Million

Valuation Process	Approx. 15–25 days
Develop Prospectus (CBR)	Approx. 15–25 days
Buyer Search Databases	Approx. 20–30 days
Blind Profile Mailing	Approx. 20–30 days
Preliminary Response	Approx. 30–60 days
Business Profile/CBR Distribution	Approx. 30–60 days
Negotiations and Sale	Approx. 6–12 mos.

Approximate total labor hours = 450–550

CLOSING (Seller's payday) = USUALLY ONE DAY



The Many Steps

PLANNING	SEARCH	DEAL MAKING	CLOSING
Explain Selling Process	Activate Buyer Search Plan	Buyer Visit First Meeting	Coordinate Due Diligence
Data Gathering/Owner Interview	Present 1-Page Business Summary	Tour Business	Loan Request Package
Recast Financial Statements	Qualify Buyer	Probe Buyer Interest	Lender Introductions
Prepare Valuations Report	Determine Buyer Interest	Motivate Buyer to Act – Offer to Purchase	Assist in Resolving All Issues
Obtain Listing Agreement	Nondisclosure Agreement	Facilitate Negotiations	Definitive Purchase Agreement
Prepare CBR /Data Package	Present CBR /Data Package	LOI or offer to purchase	Review Final Documents
			Close!

Paul M. Harris CPA

Tax Considerations in the Selling Transaction

Stock vs. asset sale:

- Capital gains vs. ordinary income
- Depreciation/amortization basis
- Deferred recognition of gains
- Tax “savings” ideas:
 - Write down inventory at year end
 - Prepay expenses at year end
 - Personal expenses paid out of business



Plan Ahead

- 2 to 3 years
- Consult with your accountant to make adjustments
- Organize records

Tax Entity Pros and Cons

- C-Corp
- S-Corp
- Partnership
- LLC, LLP
- Sole proprietorship

Nichole H. Duke, Esq. Kaufman & Canoles

Legal Due Diligence *Get You House in Order*

- Buyer will ask for a lot of information
- Be Prepared
- Use the professionals that you are paying

Categories of Due Diligence

- Corporate Records
- Contracts
- Real Property
- Intellectual Property
- Equipment and Fixtures
- Tax Matters
- Customers and Suppliers

Categories of Due Diligence

- Insurance
- Labor Matters
- Benefit Plans/ERISA/COBRA
- Litigation
- Environmental
- Debt
- Financial Statements
- Material Changes

Importance of Contracts

- Often a determining factor in the type of deal – asset or stock, merger or purchase
- Is consent to assign/transfer required?
- Real property leases

Dealing with Shareholders or Members

- Shareholder/member concerns
- Consent

Michael Austin Resource Bank

Financing

Introduction

- Background
- Years in Banking
- Number of Business ownership changes

Financing Options

- Seller Financing
- Equity Financing
- Bank Financing
- Combination Financing

Bank Financing

What to Expect?

- General Qualities of Borrower
 - Industry or Business Experience
 - Acceptable Personal Credit
 - Sufficient Equity (15-20%)
 - Clear Secondary Repayment Source

The next step –
a well-developed business plan

Information Required from Seller

- Historical Financial Results (tax returns for 3 years and interim current year results)
- Profit and Loss, Balance Sheet
 - Establishes basis for value
 - Confirms cash flow to repay proposed debt
- What is being sold – Buy/Sell Agreement
- Type of Sale (asset or stock)
- Need Clean Financial Statements !

Information Required from Seller

- Proprietary assets being sold
- Transition of Owners
- Compensation for Transition
- Compensation in lieu or in addition to “base” sales price
- Seller Financing – How Banks View
- Seller Financing with intention of getting loan at later dates - caveats

Business Valuations

- Financing intangibles vs. tangible assets
- Business Valuations/Appraisals
 - Appraisals of “fixed or tangible assets” and a valuation of intangibles and business as “going concern”*
- Established Values

Loan Underwriting Process

- Risk of Failure Concern
- “Mitigate” potential losses
- SBA guarantees
- Advantages of SBA 7A loan
 - Longer term
 - Financing intangibles
 - Lower equity requirements
 - Focus on cash flow

Loan Underwriting Process

Independent valuation required for larger deals

Disadvantages:

higher cost for guarantee fee (3%)
takes longer to complete

Lender Concerns with Seller

- “Funky Stuff”
- Co-Mingling business and personal assets
- Declining Ratios, Revenues, Profits
- Excessive Discretionary Adjustments
- 2 Sets of Books
- Environmentally Tainted Business

Lender Concerns with Seller

- Non-transferability of knowledge
- Withholding of key information

What Do You as a Seller Do?

- Request “ Pre-Screening of Buyer”
 - An experienced lender can review qualifications of the applicant/buyer and based on that information give at least a preliminary “nod” based on additional information/documentation

Time Required

- Preliminary Idea – 2 to 4 days of receiving the package
- Typical credit approval, even with the SBA (under PLP) around 2 weeks
- Closing process takes an average of 3-5 weeks

Panel Questions and Answers

Lucky Star Restaurant

- *Please join us for some hor duerves and mini-desserts*
- *Relax and mingle with some professionals in business brokerage, banking, law, and tax planning*
- *But mostly just enjoy yourself!*



Thanks for your attention!

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