

SELLING YOUR BUSINESS

By James E. Hadley

Frequently we are asked to provide general advice regarding selling businesses. These discussions start with simple inquiries of “should I consider selling my business or not,” “when is a good time to sell,” “how do I place a value on the business,” “what should I do in preparation for a sale,” “how do I find a buyer,” “how long does the process take,” and “what should I do to protect my business while marketing it?” This is in addition to the technical legal issues of drafting the purchase and sale agreement, determining whether a sale of the entity holding the business or an asset sale is more advantageous (from a tax and operating standpoint), due diligence (gathering of important information to show prospective purchases), and preparing appropriate financing and conveyance documents.

To Sell or Not to Sell

The personal goals and objectives of the business owner are critical. The emphasis is on the word “personal” as some people thrive on what they do for a living and they would be lost without the intensity and fulfillment that comes from being in charge of “their” business. Others are primarily motivated by financial returns. They look to maximize their return on liquidating their business as a way of fulfilling the dreams they sacrificed while being consumed by their career. Germane are the age and financial situation of the Owner, family and generational wealth preservation issues, as well as concerns regarding key long-term employees, particularly those approaching retirement age. Being a counselor at law involves more than just working on legal documents, it involves *counseling* on business and life goals and developing a strategy to achieve personal objectives. This process involves not only the decision of whether or not to sell, but also to whom, on what terms, etc.

When to Sell

Market timing can make a huge difference in how long it will take to find a buyer, the consideration (\$\$) that can be received, and the terms of the deal. Cyclical businesses should time a sale near the peak of a business cycle. Selling a business requires planning. Considerations include an analysis of the market segment of the business. Are there relevant market segment consolidations, are there growth opportunities, who are business competitors, how aggressive are they, is there a chance competitors would welcome the opportunity to buy the company, etc. One should also consider unique personal relationships or intellectual property rights that give the business a competitive advantage. Business cycles, general market and financial conditions are important as impacts timing. Can a buyer obtain financing at reasonable interest rates? Is the economy up or down? Are buyers actively pursuing opportunities or sitting on the fence?

Establishing a Price for the Business

There are many ways to establish a sale price for a business. The most common approach is to focus on the income the business generates and has potential to generate into the future. Although actual earnings are important, also focus on what a prospective buyer might be able to do with the business and its value to him. Earnings formulas often use a multiple of EBITDA (earnings before interest, taxes and depreciation), along with projections for future earnings and free cash flow. Businesses where substantial growth is anticipated (tech companies for example) can have a much higher multiple than companies with flat earnings. When no earnings have been achieved, values can be based on a multiple of gross sales, customer headcount, market penetration, and other factors. Another approach is to focus on the value of the company's assets. Inventories, equipment, real estate, and intellectual property rights may have substantial value whether the company is profitable or not. A floor in determining a sale price for such a business is the amount the assets could be sold for if the company were shut down, which in some cases can yield a greater amount than continuing operations at a loss while looking for a prospective buyer. Book value is also a consideration, as are recent sales of comparable businesses. All of these factors should be considered and weighed in establishing a range of prices that may be acceptable. Each buyer typically determines the price it is willing to pay using its own unique methodology. Sellers should be cognizant of these differing valuation techniques to maximize an achievable sales price.

Grooming the Business

There are a number of things that can enhance the value of a business. These include limiting risk and uncertainty to the buyer. In anticipation of a buyer's due diligence, one should insure that trademarks, trade names, copyrights, patents and other intellectual property rights are perfected, employees have signed confidentiality and noncompetition agreements where appropriate, key employees have employment contracts, and insure facilities are under lease for a reasonable term (preferably with renewal options). Pertinent documents can be organized in advance and left with an attorney to facilitate prospective buyers due diligence while minimizing disruption to the company's operations. Another consideration is the current business owner's willingness and ability to assist the new buyer in transition. What steps are critical to insure the new owner is successful, and how can that be assured? Financial records are typically essential to the buyer's evaluation. Steps may be taken to recharacterize financial information through adjustments for add backs for owner compensation, unusual or nonrecurring expenses, etc. Also, unrealized potential for the business should be identified and quantified. Confidentiality agreements for prospective purchasers to sign at the inception of discussions are essential.

Locating a Buyer

Buyers have differing motivations in buying a business. These make a difference in timing, consideration and terms. There are strategic buyers who are looking to expand their business into your product line or geographic area, financial buyers who look to buy the company as a pure economic investment (frequently retaining key members of the existing management team as a condition of the sale), and individual buyers who look at the business as a source of wealth building and employment, and public companies looking for growth opportunities to increase their earnings and thus their stock price. Family members who understand the business and key employees or employee groups should be considered as possible purchasers, as should competitors in the industry. Sources of potential buyers include following up on unsolicited inquiries, use of brokers, trade journals, personal contacts,

etc. Some business brokers focus on a particular industry and have a good understanding of the market and potential purchasers, and can facilitate financing and other matters.

How We Can Help

Ryan, Swanson & Cleveland has a skilled mergers and acquisitions team that has closed numerous transactions in diverse industries and geographic locations. We are accustomed to dealing with counsel throughout the United States and abroad. We have experience in estate planning, succession planning and tax, regulatory, employment, bankruptcy, litigation, insurance, intellectual property, securities, and other disciplines which may pose issues during the due diligence, drafting and closing process. Please call for a list of representative transactions.