Getting your business ready for sale

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General Company Sale Advice

When it is time to sell, a business' "last job" is usually to ensure a well-developed exit strategy and possibly a comfortable retirement. Just like many house sellers greatly benefit from staging their property (think of "Designed to Sell" on HGTV), most businesses can only be sold for their maximum value if prepared/staged properly. This usually involves the concerted efforts of the owner, business broker, lawyer and accountant and can take between 4 weeks and 3 years.

Every business sale is unique. What works for one may be wrong for another, even for companies in the same industry. Factors like company size, overall market conditions, reason for selling, recent financial performance of the company, motivation of the buyer, number of bidders etc., all play a role. However there are some general "rules" that apply to most situations:

Most Businesses are not Worth What the Seller Expects

Just like parents are usually not objective when judging their children, most business owners cannot objectively evaluate their company. Their emotional bond to the business often makes them blind to its true value on the market. The biggest misconceptions are that buyers will pay you for your sweat equity or that you will definitely get all the money back that you pumped into it. The truth is that the amount of sweat equity and money you have put into a business is rather irrelevant to its value. The value of a business is mostly based on recent financials, strength of customer base, product uniqueness, etc. Any acquisition ultimately has to be more financially rewarding to a buyer than an investment into the stock market.

At minimum, a business usually has to generate enough profit to cover the buyer's debt payment, the buyer's taxes and the buyer's salary. The "debt payment ability" of a business is therefore often used to determine an estimate for its value. A buyer can expect that the ratio between asking price and annual profit allows him to pay back a loan to finance the acquisition, within 5 years.

The Mergers &Acquisitions market fluctuates like the stock market; paid multiple of profit can go up and down within a few months. Millions of Baby Boomers are starting to retire and the number of US businesses annually for sale are expected to double from 250 000 to 500 000 in the near future. The number of buyers is expected to remain stable. The resulting "buyers' market" will decrease the average paid multiples of annual profit. Anyone thinking about selling their business within the next 5 years should therefore seriously consider speeding up the process.

Keep Your Eye on the Rabbit

Finding the right buyer is an extremely time consuming process that will probably take longer than the seller anticipates: 12 months +/- 3 months are average. Developing an Offering Memorandum (15-20 pages document that contains all relevant and confidential information about the business), identifying and qualifying potential buyers, negotiating terms, discussions with lawyers and accountants, etc. can realistically take hundreds of hours. That is too much time diverted from your core business responsibilities to keep "the ship on course". A drop in business results due to a lack of attention to everyday business responsibilities can drastically affect the sale price. Buyers are like wild horses, they tend to react violently to unexpected events (like a sudden drop in financials). A Business Broker will shoulder most of the above mentioned hours and allow the seller to concentrate on the business.

Housecleaning and Staging

Housecleaning

A buyer expects that you have all important business documents in proper order. Receipts and documents in a shoe box will not do. Also, most buyers will expect that you have important information like financial data available in electronic format (QuickBooks etc.), and not relying on IRS individual tax returns. Public companies will require audited financials whereas most privately held ones will accept financials that have been reviewed by your Accountant/CPA.

You should try to bring your accounts receivable and accounts payable in order and attempt to reduce your long-term debt. Buyers often will not assume large amounts of debt.

Reduce employee count to an appropriate level by letting go (if possible) family members who will not continue in their job once the business has been sold or those employees that are known troublemakers. Proper documentation of the reasons for employee reductions is important. Contact an HR professional if you are unsure about the proper/legal way to letting employees go.

Clean up any pending law suits, HR problems, insurance issues, leases, permits, etc. Trying to hide unpleasant facts like pending law suits is not at all advisable: any proper due diligence of the buyer will most likely unearth them anyways.

If you own the real estate where the company is located: most buyers prefer the real estate to be legally separate from the business, allowing them to choose whether they will acquire the real estate or not (keeping the real estate will provide the seller with a great long-term income via a lease that is negotiated during the acquisition process).

Businesses are often sold on a multiple of EBITDA (Earnings Before Interest, Tax, Depreciation and Amortization). As a rule of thumb, the higher the EBITDA, the higher the selling price. However, most small businesses try to limit their tax exposure by "artificially" lowering the EBITDA they report to the IRS by adding so called life-style expenses. Examples are cars and salaries for family members that do not really work in the business. It is difficult to get money for income that the IRS is "unaware of". Restating your financials so that they reflect the true profit is therefore advisable (discuss this with your Accountant/CPA).

The following additional adjustments to financial statements are common:

- **Comparability Adjustments.** These adjustments are intended to eliminate differences between the way that published industry data is presented and the way that the subject company's data is presented in its financial statements.
- **Non-operating Adjustments.** It is reasonable for the seller to retain any assets which were not related to the production of earnings or price those non-operating assets separately. For this reason, non-operating assets (such as excess cash) are usually eliminated from the balance sheet.
- **Non-recurring Adjustments.** Non-recurring items such as the purchase or sale of assets, a lawsuit etc., are usually adjusted on the Balance Sheet
- **Discretionary Adjustments.** In order to determine fair market value, the owner's compensation, benefits, etc. must be adjusted to industry standards. Similarly, the rent paid by the subject business for the use of property owned by the company's owners individually may be scrutinized.

Staging the Business

Selling a business can be similar to selling a house: limited investments can increase the sales price.

First of all, nobody wants to buy a mess: you should literally "clean house"! Be sure your business is as presentable as possible.

An expertly crafted Offering Memorandum will attract buyers. However, it should only be distributed to those who have signed a Non-Disclosure Agreement (consult your Business Broker and/or Attorney). The following information should be included (at minimum):

- Company and product/service description (what makes you unique?)
- Market/industry summary
- What are the key business drivers for your company
- Key customer overview
- Description of key employees and their qualifications
- Description of potential growth initiatives (start them, if possible)
- Financials of the last 5 years and realistic projections for the next 3
- Asking Price
- Reason for selling
- Industry benchmarks (if available)

Employee incentives are critical to ensure strong "management presentations" to the buyer (why should they enthusiastically help you to sell your business if they do not benefit from it?). Inappropriate or critical comments from key employees to the buyer will weigh heavily in his or her decision to buy your company or not and for which price! Be sure to properly brief all employees who will be involved in the selling process. Many sellers choose to keep the pending sale confidential because they fear an exodus of good employees. However, keep in mind that retention bonuses can be an effective way to keep key employees from leaving during the selling process.

Most transactions involve some kind of debt financing such as bank loans or "seller financing" (agreement where the seller provides the financing for a purchase) so make sure that you/the business have good lines of credit and a good credit score. It might be advisable to take out a sizable loan a couple of years before you intend to sell and pay it back to demonstrate to a bank that the business can afford the loan payments.