The most frequent reason given by owners of a privately owned company for considering a sale includes a combination of the following:

- Retirement
- Health Reasons
- Partnership Disputes
- Divorce
- Loss of Key Customers or Suppliers
- Other Business Interests

However, starting a sale exercise is not something your business, irrespective of size, should undertake lightly, and every effort should be made to manage the sale process professionally, and to prepare, or 'groom' the business so to facilitate a successful outcome.

This guide has been prepared, based on our proven knowledge and practical experience, to guide owners through the complex phases involved in a business sale. While the content within this guide is comprehensive, we have also presented in a user-friendly style. We believe that this guide can play a significant role in helping business owners like you, deal with the critical issues that will come about during the business sale process.

Should you have any questions after reading this guide we would be more than pleased to discuss these with you. You will find our contact details at the end of the guide and we look forward to hearing from you!

Yours in Business,

Tom Gosche

Business Strategist

GLM Financial

4 Steps to Succession Planning

Step 1- Business Planning (Days 0-90/ Months 0-3)

- Understand the owner's personal, business and financial goals
  - Sale Readiness Assessment
- Collect data about the company
  - Company Information Questionnaire
- Prepare a detailed business valuation
  - GLM's Business Valuation Report
- Develop and action plan to Prepare the Business for Sale
  - Succession Planning Approach

Step 2- Pre-Market Preparation (Days 90-180/ Months 3-6)

- Conduct in-depth industry research
  - Reference USA
  - 2016 Business Reference Guide
- Prepare Generic Executive Summary and Marketing materials about company
  1. General Information Executive Summary (No Business Name or location)
  2. Buyer Nondisclosure Agreement
  3. Complete Executive Summary (Company name and Adjusted Financials)
  4. 3 Way Confidentiality Agreement (To be signed before seeing complete financials)
  5. Complete Company Description
- Develop marketing plan to sell company
  - Suggested Next Steps
- Identify prospective buyers
  - Reference USA Custom Lists

Step 3- Going to Market (Days 180-270/ Months 6-9)

- Market company on confidential basis
- Secure nondisclosure agreements from prospective buyers
- Schedule and conduct management presentations and site visits
- Secure Offer to Purchase- qualifying bids or indications of value from buyers

Step 4- Negotiation (Days 270+/ Months 9+)

- Analyze offers and terms to help client decide best option
- Manage key relationship with buyers
- Assist with negotiations of Letter of Intent
- Obtain final signed letter of intent
- Coordinate the due diligence process
- Assist with negotiations of purchase and sale agreement

Step 5- Closing (Days 270+/ Months 9+)

- Work with attorneys to draft the definitive purchase and sale agreement
- Help to resolve and open issues between parties
- Coordinate with seller and buyer on strategic planning issues
- Close the transaction

What Is Your Business Worth?

This question can only be answered by addressing other related questions, specifically: Who's asking and for what purpose?

From the perspective of the owner, prospective buyers, the IRS, lenders and divorce & bankruptcy courts, the value of a business for purposes of a sale, estate planning, orderly or forced liquidation, gifting, divorce, etc. can be vastly different.

Intrinsically tied to the various purposes of valuation are numerous definitions of "value." Here are a few examples:

Investment Value – The value an acquirer places on a business based on a future return on investment determined by assessing past and current performance, future prospects, and other opportunities and risk factors involving the business.

Liquidation Value – The value derived from the sale of the assets of a business that is closed or expected to be closed following the sale.

Book Value – Book value is the difference between the total assets and total liabilities as accounted for on the company's balance sheet.

Going Concern Value – Used to define the intangible value which may exist as a result of a business having such attributes as an established, trained and knowledgeable workforce, a loyal customer base, in-place operating systems, etc.

Fair Market Value – For the purpose of this article, the focus will be on transaction related valuations. Fair Market Value ("FMV") is the most relevant definition of "value" and is of the most interest to business owners. The more knowledge business owners and prospective buyers have about the valuation process, the more likely they will come to an agreement on a purchase price.

FMV is the measure of value most used by business appraisers, as well as the Internal Revenue Service (IRS) and the courts. FMV is essentially defined as "the value for which a business would sell assuming the buyer is under no compulsion to buy and the seller is under no compulsion to sell, and both parties are aware of all of the relevant facts of the transaction." IRS Revenue Rule 59-60 lists the following factors to consider in establishing estimates of FMV:

- The nature and history of the business.
- The general economic outlook and its relation to the specific industry of the business under review.
- The earnings capacity of the business.
- The financial condition of the business and the book value of the ownership interest.
- The ability of the business to distribute earnings to owners.
- Whether or not the business has goodwill and other intangible assets.
- Previous sales of ownership interests in the business and the size of ownership interests to be valued.

- The market price of ownership interests in similar businesses that are actively traded in a free and open market, either on an exchange or over-the-counter.

What is Goodwill?

An important element of value, when it exists, is goodwill. The IRS defines goodwill in its Revenue Rule 59-60, stating, “In the final analysis, goodwill is based upon earning capacity. The presence of goodwill and its value, therefore, rests upon the excess of net earnings over and above a fair return on the net tangible assets.”

While the element of goodwill may be based primarily on earnings, such factors as the prestige and renown of the business, the ownership of a trade or brand name, and a record of successful operation over a prolonged period in a particular locality, also may furnish support for the inclusion of intangible value.

In some instances, it may not be possible to make a separate appraisal of the tangible and intangible assets of the business. The enterprise has a value as an entity. Whatever intangible value there is, which is supportable by the facts, may be measured by the amount by which the appraised value for the tangible assets exceeds the net book value of such assets.”

Valuation Approaches and Methods

Exploring valuation techniques requires an understanding of the tools available. Which tools are utilized depends in part on the purpose of the valuation and the circumstances of the subject company. Generally, there are several approaches to valuing a business. Within these approaches, there are several different methods. Listed below are the three major approaches along with some examples of specific methods that fall under each category.

- Income Approach
- Discounted Cash Flow Method
- Single Period Capitalization of Earnings Method
- Market Approach
- Comparable Publicly Traded Company Analysis
- Comparable Merger & Acquisition Analysis
- Asset-Based Approach
- Adjusted Net Asset Method
- Excess Earnings Method

All of the above methods and approaches are frequently used business valuations tools.

Normalizing the Financial Statements

Before the approaches and methods above can be applied, it is necessary to analyze and normalize both the income statement and balance sheet of the business for the current and past periods selected to form the basis of the valuation.

Normalizing the Income Statement

Normalizing the Income Statement generally entails adding back to earnings certain personal expenses, non-recurring and non-cash items. Examples of these "add-backs" could include depreciation, amortization, auto, boat and airplane expenses, one-time extraordinary expenses and other excess expenses such as owner's salaries and family member's salaries that are above fair market value, travel and entertainment, bonuses, etc. Owners usually tend to use a laissez-faire basis when normalizing the income statement so they can bolster earnings, which can artificially inflate the business valuation. Each item must be carefully analyzed and scrutinized to ensure that the normalization process is credible.

Normalizing the Balance Sheet

Normalizing the Balance Sheet includes adjustments that eliminate non-operating assets and other assets and liabilities that are not included in the proposed transaction, and therefore not included in the valuation. The book value of the assets will be adjusted up or down to reflect their fair market value. Inter-company charges will also be eliminated. Inventory may be adjusted upward or downward based on prior accounting procedures and/or obsolescence. It can also be expected that accounts receivable may also require an adjustment based on an analysis of collectability.

Relevant Terminology:

EBIT - Earnings Before Interest and Taxes

EBITDA – Earnings Before Interest, Taxes, Depreciation and Amortization.

Capitalization Rate – Any divisor that is used to convert income into value. This is generally expressed as a percentage.

Discount Rate – The rate of return that is used to convert any future monetary gain into present value. (Note: when determining FMV, the earnings stream selected to be capitalized or discounted should be normalized.)

Summary

Even with all the terminology and definitions discussed above, the answer to the original question has not yet completely been answered: *What is the company worth?*

The value assessment driver of any business is the ability of the entity to generate future cash flow or earnings. Business appraisers will assign an appropriate capitalization rate (or multiple) to a selected earnings stream to derive an overall value for a business. The value of the net assets of a business is compared to the cash flow valuation and may be adjusted upward or downward. For example, if the earnings based valuation is less than the net asset value, an upward adjustment may be in order. Conversely, if the net assets are negligible, a downward adjustment is more likely to occur.

Many appraisers typically use a common range of multiples to arrive at a “ballpark” indication of value (for example, 4 to 6 times EBITDA). While this approach is commonplace it is not an accurate valuation and an in-depth valuation of the company will show the true position. There are too many intangible factors to consider relying solely on the capitalization of earnings. Of course, the ultimate value of a company will be determined by the marketplace. This will generally differ from a seller’s expectation, as well as the expectations of potential acquirers.

It is not uncommon for business owners to have an inflated sense of value of their company. This is due to a variety of factors including emotional attachment to the business, unwillingness to accept the impact of the risk factors facing the business, outside influence from previous market conditions, incorrect conclusion of normalized earnings, comparable transactions, etc. Conversely, acquirers often undervalue businesses. In their quest to “buy right” they often, end up paying a lower multiple for a company with serious negative factors, while passing up on higher multiple opportunities, which, due to the quality, are actually the best buys. A business valuation is a complex process. Owners and buyers will be in a better position if they rely on professional advisors such as their accountants, business appraisers, intermediaries or investment bankers.

Know As You Go

While valuing a company is not an exact science, it is also not a total mystery. Valuation is an art practiced by experienced financial professionals. Given the complexities of analyzing all the direct and indirect factors influencing a company’s value, it is often a good wise investment to have a third party valuation or appraisal by an accredited valuation analyst. Having this information prior to going to market drastically enhances your chances of selling at the best possible time and price.

Preparing for the Sale

For many people, this is a once-in-a-lifetime event. And there is no doubt that the process is going to be unfamiliar and perhaps a little uncomfortable. However, you did not get this far by avoiding the unknown. Now that you have a good idea about why you want to sell the business, the question you face is "How will I sell my business?"

Briefly, a typical sale process, if there is such a thing, can be broken down into four broad categories:

1. Preparing for sale
2. Marketing the company
3. Negotiating the deal
4. Closing the transaction

This may sound simple enough but here is some sound advice: Each phase is an important step towards giving you the strongest position at the bargaining table. Resist the urge to jump right to the marketing phase and you will reap the rewards!

Prepare To Succeed

It is often said that most successful entrepreneurs begin to prepare their companies for sale on the first day of business. While this comment should not be taken literally, it does highlight a key point that the characteristics, which will enhance your company's marketability, take time to develop. It takes more than a little touch-up or a coat of paint to sell your business at the price you feel it is worth. The presence of several of the following characteristics will significantly enhance your company's marketability and make it more likely that you will obtain a strong offer:

- Depth of management
- Clear top management succession
- History of audited financial statements
- Consistent reinvestment of earnings into operations
- Discipline of regular business plans / Projections

To the extent that selling your company is being planned for a future date, addressing the above attributes and incorporating them into your operations now will allow you meet your financial objectives when the time comes to sell.

Grooming Tips

You should make every effort to prepare or 'groom' your business so it is sold successfully at the first opportunity. While the financial advisors you appoint will work with you to address issues specific to your company, there are a number of general grooming points worth considering (even before you appoint advisors) to maximize the value of your business:

Sales & Profitability: Historically, you may have been setting your prices, and thus your profit margins, at levels designed to create barriers to entry for your competition. If you are planning for a business sale your focus is likely to be short term strategies. It will be time to re-examine your market and customer base to see if higher sales and turnover levels are achievable. If the proposed sale itself is a number of years away, you should consider performing a strategic review of the entire business.

Operating Costs: You should regularly review your operating expenses but this is especially so when preparing your business for sale. You need to identify avenues to reduce expenses without affecting the operational effectiveness of your business.

Profit Trends: Apart from current margins, a purchaser will be looking at profit trends. Buyers are looking to see stable and steady yearly profit trends. Therefore, risky projects should be avoided and longer-term contracts that may prove to be onerous should be fully considered before acceptance. Unprofitable contracts need to be reevaluated and, if appropriate, terminated, as it is quite possible they will be detrimental to the value of your business.

Management Team: The purchaser of your business will be looking to acquire a high caliber management team. It may be worth reviewing your corporate structure to ensure that job titles and role descriptions adequately reflect the contribution that your management team makes to your business. Any re-structure needs finalization well in advance of an anticipated sale. A purchaser may also want assurance that the management team is supportive of your decision to sell or at least that it is likely to stay with the business for a reasonable period post-transaction. You should consider talking to management - how cooperative will they be? You never know, they may be interested in buying the business themselves.

Asset Base: Are there any assets in the business that may be of little or no interest to potential purchasers- e.g. short-term investments, under-utilized property, equipment or perhaps surplus cash? Think about realizing and removing them from the business before the sale. It is also worthwhile having all your property assets valued individually.

Restructuring: If your business has more than one division, some thought should be given to restructuring it into a number of stand-alone entities and perhaps selling these separately. Any such reorganization will have potential tax implications and other complexities associated with it and it will be important to take professional advice before undertaking any such initiative.

Tax Planning: Details of the various tax factors that you need to consider are set out in section 4 of this guide. Initial points to address include making sure that all your Corporation Tax, PAYE and VAT returns and payments are up to date. In addition, any tax losses that your company may have built up over the years may now have a value to the extent that they are available for use by the potential purchaser. Personal tax planning opportunities should be discussed with your tax adviser.

Valuation Expectations: You must have realistic valuation expectations. Valuation is important but do not let it get in the way of securing the sale.

Timing: Deciding the best time to sell your business can be a difficult decision to make. Factors to be considered when making this decision include the level of corporate activity in your industry; the state of the economy; changes in sector relevant legislation; and available tax reliefs (e.g. do you have to be a certain age to avail of certain retirement reliefs or pension planning opportunities).

It is better to sell your business on historical trends and results - they are a proven record of accomplishment that you can pinpoint and will provide you with a strong platform to negotiate from. If you have forecast a growth level of 20% for the coming year and can point to 20% annual growth for the last two to three years you can be assured of being in a more credible position. If, however you forecast 20% growth and have to justify that this is achievable by selling off part of the business, assets, cost cutting or increasing profit margins, the natural questions of potential buyers will be - "Why haven't you done it already" and "Why should the purchaser share these potential post transaction gains with you?"

Put It In Writing

A major step in establishing your company for the sales market is the preparation of an Information Memorandum. This document can range in size and detail but it is the initial compilation of materials distributed to interested buyers. The key to successfully preparing this memorandum is to focus the intended purpose – marketing your business. Accurately describe the company, its history, products, markets, competition, personnel, facilities and financial performance (historical and projected) to highlight your organization's strengths and future potential.

When prospective buyers complete a review of the memorandum, they should clearly understand the company's unique investment merits, or 'growth potential'. Your company's investment strategy is detailed but most importantly, reinforced in the memorandum. The challenge is to develop a selling position that compels potential buyers to conclude that the opportunity to acquire your business is not just another investment, but is a chance to realize benefits and potential that cannot be otherwise achieved.

Target Potential Buyers

While the selling document is being prepared, you and your broker should be developing a targeted list of possible purchasers. During this process the advisor's knowledge of the mergers and acquisitions marketplace will be extremely valuable. Your advisor should have a feel for which buyers are actively pursuing investment opportunities and a good sense of the attractiveness of your particular industry segment to such investors. Potential buyers usually fall into one of the following categories:

1. Individual buyer

This is typically an individual with substantial financial resources, and with the type of background or experience necessary for leading a particular operation. The individual buyer usually seeks a business that is financially healthy, indicating a sound return on the investment of both money and time. The individual buyer will hit a strong bottom line when it comes to price. Therefore, these buyers will usually limit themselves to transactions involving less than $1 million cash.

2. Strategic buyer

This buyer is usually a company, having as its goal entering new markets, increasing market share, gaining new technology, or eliminating some element of competition. In essence, it is part of this buyer's “strategy” (hence the name) to acquire other businesses as part of a long-term plan. Strategic buyers can be either in the same business as the company under consideration, or a competitor.

3. Synergistic buyer

Synergy means that the joining of the two companies will produce more, or be worth more than just the sum of their parts. Example: A large real estate company purchases a mortgage company. It can now use its existing customers (those who buy homes) and offer them the mortgage funds to finance their purchases.

4. Industry buyer

This type is often a competitor or a highly similar operation. This buyer already knows the industry well and, therefore, does not want to pay for the expertise and knowledge of the seller. These buyers will pay for assets (but probably not what the seller thinks they are worth); they will not pay for goodwill, covenants not to compete, or consulting agreements with the seller.

5. Financial buyer

Financial buyers are generally influenced by a demonstrated return on investment, coupled with their ability to get financing on as large a portion of the purchase price as possible. Working on the theory that debt is the lowest cost of capital, these buyers purchase businesses with the sole purpose of making the maximum amount of money with the least amount of their capital invested.

Value Is In The Eye Of The Buyer

There are more buyers out there for your company than you might think. Ranking potential buyers from most to least logical requires an assessment of how each of the following characteristics applies to a particular buyer:

- Potential synergistic benefits of your business if they currently own a related business
- Capital / financing available to close the transaction
- Experience in completing acquisitions
- Previous knowledge of, or involvement with, the company / industry
- Geographical proximity

It is at this point that it is time to make the first critical decision. How broadly should you market your company? A wide offering distribution increases the probability of achieving the best price, but also increases the likelihood of damaging your company by releasing sensitive business information to a wide range of people. Your competitors may be the ‘best’ buyers, but they are also the ones who could inflict the most harm on your business if they are privy to confidential information. Because this decision sets the stage for the marketing process, we will address the advantages and disadvantages of narrow versus wide distribution in more detail in section 3 of this guide.

Maintain Your Momentum

Investing time in the preparation phase is likely to pay off by putting you at a distinct advantage during negotiations. Remember keep asking yourself, "What can I do now to avoid delays once the process is rolling?" For example:

- Ensure that your company's 'investment story' is clearly articulated and supported by your management team. Particularly those who will have regular contact with potential buyers.
- Anticipate the buyer's basic due diligence requirements and gather the appropriate information as early as possible.
- Adjust your corporate structure to eliminate certain asset classes that you may wish to retain. Once you have begun preparing your company for sale, your momentum will maximize the strength of your negotiating position. With few exceptions, the best prepared companies:
  1. Find the process to be the least disruptive to current operations
  2. Are able to identify and deal with the greatest number of potential bidders
  3. Command the highest price multiples

Marketing The Sale

Now that the preliminary stages have been completed you will be about to enter the uncharted waters of presenting your company to potential buyers.

Do not be alarmed if some of the waves muddying those waters come from you. It is natural at this critical phase to ask, “Why am I doing this?” or to feel the need to steer too much of the marketing process yourself. The key to smooth sailing is to trust your chosen advisors as they have the expert knowledge and skills needed.

How Broadly Should You Market?

In the last section, we briefly touched upon the decision of how broad the marketing phase should be to maximize success and minimize risk. There really are no set answers here. Each case must be analyzed individually as each one is markedly different from others. For example, companies with significant proprietary technology may find sharing company information with competitors devastating. These same competitors however, may be the only ‘buyers’ capable of satisfying the financial objectives of the sellers.

In contrast, a manufacturing operation whose success is based factors other than proprietary technology, such as strong management, personnel, or customer relationships, would have little to risk by sharing information with competitors. However, the challenge here is to convince a buyer of the value of these ‘human’ or intangible assets.

Other considerations affecting the decision on how broadly to market one’s company include:

- How quickly does the transaction need to be completed? Generally, with a shorter time line, you will identify a shorter the list of buyers.
- How complicated is the business or the expected structure of the transaction? If your company’s intrinsic value does not come across well in your memorandum, it is often best to focus on a few select niche buyers.
- How has the business been performing? If there is a lot of explaining to do for a buyer to grasp your company’s value, concentrate your efforts only on the most likely buyers.

The ‘A’ List

Usually, an ‘A’ list of potential buyers is identified in the first instance. These potential buyers will probably be contacted on a no names basis using your business broker as an intermediary. The group may average 5 to 10 potential acquirers, but could have as few as 3 or as many as 20.

‘B’ or ‘C’ buyer classifications serve as a backup only after the ‘A’ list is exhausted. Another option is to break your buying list into two groups: competitors and non-competitors. Competitors could receive a more generic memorandum than non-competitors, in order to manage the risk of information leaks. While this approach may be beneficial, it could also cause confusion because it creates two parallel processes that may be difficult to control.

Keep In Mind

The following points should receive the focus of your management team throughout the marketing phase:

- First and foremost, run your company as if you will always own it. You never know if the sale process will end with an unacceptable offer.
- Confidentiality agreements need execution with potential purchasers. However, don't rely on them completely. Information gets out. The key is to have as short a sale process as possible in order to limit the inevitable leaks.
- Plan carefully when and how you will tell your employees that the company is on the market. In many cases, a direct announcement with a system for regular updates is far less disruptive and damaging than the inevitable rumors. The approach adopted should suit both personal and business objectives and will vary from business to business.

Contacting Potential Buyers

One of the most frequently asked questions by owners contemplating the sale of their business is:

How Are You Going To Find Potential Buyers?

The first step is to match the business with the broker's internal database of pre-qualified buyers that make a good fit. Additionally, the broker will create a "blind" profile that will be advertised through several channels including internet Classified sites, broker networks, and industry and trade associations.

Prospective buyers will respond with an indication of interest to the broker. The response establishes that a potential buyer is interested in pursuing the acquisition in more detail. A good business broker will have requested the interested parties to include some or all of the following in the response:

- Non-Confirmation of their capability to finance the transaction
- Steps necessary to make a definitive offer
- Time required making a final decision
- Reasons for making the acquisition
- Description of plans for the company in the future
- Anything else to help verify the potential purchaser's interest

Site Visits

The objective and intention is to receive responses that are vetted to establish a qualified small group to move on to the next phase of the marketing process- usually management visits. While essential, plant and management visits hold the greatest potential to disrupt business operations and confidentiality. If your workforce knows little of your decision to sell the business, they will know after a number of pinstripe suits parade through your facilities in rapid succession.

Critical proprietary information such as plant operating systems, future plans and R&D programs can be expected to be discussed during site visits. On the other side, this face-to face interaction could be your one chance to convince the buyer that this investment opportunity is unique, built on a solid footing and full of potential.

The need to prepare for these visits cannot be overestimated. A good business broker will assist you in preparing a brief oral presentation on the company's history, its operations, and plans for the future. The presentation tone and style should reflect the culture of the company. If an acquirer appears uncomfortable with the content, it is more likely that he will feel uncomfortable with your company.

Selecting Visitors

Just as you and your advisors initially had to decide on how broadly to market the company, you must now decide how many buyers should visit. In practice, four to six visits are adequate and easily accommodated. More than this will not only make it difficult to keep the business operating smoothly, but will tend to delay progress without adding additional value. Once again, there is no fixed rule here. The number of visits should be as few as possible while still encouraging competition.

Managing Information Requests

Being patient until this point, you may feel that satisfying the entire prospective buyer requests for additional information is not very time consuming, and next too impossible. One effective way to limit the time input is to have your advisors help identify anticipated buyer information requests early in the process, and to begin to gather such data long before the company is marketed for sale.

One helpful hint is for you and your advisors to take all the requests by potential acquirers, short list them and supply all the bidders a similar supplemental package. Any additional information should be limited and handled verbally on an individual basis.

Offer to Purchase

After answering all the questions of the remaining bidders, your advisors should be steering the acquirers to present their formal offers, usually in the form of an Offer to Purchase (OTP). The OTP will usually spell out an indicative purchase price, how it will be paid (e.g. cash, shares), contingencies upon which the offer is based and most importantly the steps required to close.

Managing The Tax Issues Involved

It may be an assumption that the availability of a historically low rate capital gains tax should eliminate the need for any significant level of tax planning but, in reality, major efficiencies can be achieved at every stage in the sale process.

Preparing The Business For Sale

Many companies, particularly the traditional family business, will have diversified over the years into a range of business operations. Often it is the case that prospective purchasers will be interested in acquiring specific lines of the business rather than an amalgamation of businesses with no natural linkage. In these circumstances, the value of the enterprise will be enhanced by splitting the business into distinct units so that the founder or owner-manager, perhaps through an overall holding company structure, holds each separately.

Moving to a structure such as this can have significant tax implication, particularly through capital gains tax and stamp duties, unless the structures are planned and executed carefully. A tax efficient splitting of the component elements also presents the owner with an opportunity to retain an interest in some parts of the enterprise, for example, property assets, or to facilitate succession of part of the business by the next generation of the family.

In some scenarios, the best commercial results are achieved by consolidating different businesses that are currently held separately, and again, pre-sale re-structuring can be accommodated on an effective tax-free basis with appropriate advance planning. A prospective purchaser will generally require undertakings in the form of tax warranties and indemnities. Any issues that might emerge here need identification as early as possible in the planning stage of preparing your business for sale. These issues need be resolved in the most part before ‘going to market’ to avoid both the delays and costs that might otherwise occur later in the process.

Maintaining Momentum

Even before, you receive a specific offer for the business; it is important that you review all of the options for extracting value from the business you have grown over the years.

There are a number of strategies to consider including:

- Establishing arrangements to receive significant cash lump sums and / or pension income on a tax efficient basis.
- Facilities that will allow you to receive tax-free ex-gratia company payments.
- The extraction of dividends prior to negotiating a sale may produce after-tax benefits. In addition, the owner of a family owned company may secure savings by use of the generous retirement relief provisions and business property reliefs for transfers to family members.

Structuring A Sale Transaction Tax Effectively

From a tax perspective, the precise nature of a sale transaction can have a major impact on your after-tax position. The capital gains tax consequences in each scenario depend on individual circumstances and other historical factors. Remember that significant savings will be achieved depending on the route is taken.

Accommodating The Purchaser

Any prospective purchaser of a business will have certain preferences in terms of how the transaction is to be structured. Insofar as these preferences can be accommodated, you as the seller should be in a position to secure a premium price. Depending on the nature of the business, it may well be that the purchaser will want you to remain involved in the company as part of the management team and perhaps retain a shareholding in the short to medium term.

The earn-out, or similar arrangements to be put in place to reward you during the transition phase will have significant tax implications that require careful planning in order to ensure tax efficiency. In general, a business purchaser will have significant borrowings and will aim to secure full tax relief on the associated interest costs. Your cooperation will be required to accommodate such an arrangement and especially so in the context of management buyouts. In such a scenario, it is important to ensure that management secure their start up shareholdings on a tax efficient basis and that any proposed share option arrangements are in place from the outset.

The development of an effective tax strategy around the business sale is a subject that you need to address early in the planning phase. Being aware of the issues involved and the various options open to you improves your chances of structuring the sale of your business with minimal tax implications.

Offer To Purchase

After answering all the questions of the remaining bidders, your advisors should be steering the potential buyers to present their formal offers, usually in the form of an Offer to Purchase (OTP). The OTP will usually spell out an indicative purchase price, how it will be paid (e.g. cash, shares), contingencies upon which the offer is based and the steps necessary to close.

How To Negotiate Offer To Purchase

You feel a rush, and are ready to accept a big price in cash at closing, with no strings attached. Unfortunately, the potential buyer has made a preliminary proposal to buy your company at an average price, with some of the payments paid out over time, which is all contingent upon you remaining active in the business for a certain period. Do not panic - this is undoubtedly not, what the final deal will look like. You have just entered into the next phase of the process: the negotiation.

Getting Down To Basics

The basic principles are the same regardless of whether you have one or a number of potential buyers. The first tenet in the negotiation process is to allow your business broker to lead the way. No one says this is going to be easy for the average entrepreneur. Finely tuned sale negotiations are not unlike summit talks between two nations.

The leaders do not get together until the majority of the background work and negotiations are fleshed out. As the business owner has been a follower throughout this process, they must continue to allow the business broker to manage the proceedings, particularly as they move closer to a conclusion. Unless the stage is properly set for negotiations, a face-to-face, all-hands gathering could easily result in an explosive confrontation, causing irreparable damage.

Enhancing The Seller's Position

As lead negotiator, the business broker can significantly enhance the seller's position by:

- Acting as a buffer and protecting the amicable relationship between the buyer and seller, which may be critical if the seller is to remain for a transition period.
- Offering deal parameters to gauge the buyer's reactions. A typical comment could be, "I am not sure that my client will accept this, but what if we were to..."
- Protecting against the acceptance of a term or condition that is not in the best interests of the seller. By including a third party, an additional step is added before any responses are made on particular issues, buying time to reflect on its impact.
- Taking the role of fall guy, who can be blamed for problems that will invariably occur between the beginning of negotiations and the closing of the deal. The business broker can be the 'good guy' or 'bad guy' or whatever role is required to protect the seller's interest.
- Reducing the element of emotion, after all this is one of the leading causes of broken deals.

Offer To Purchase

Typically, a buyer and seller agree to general terms and conditions of a transaction in a document called an Offer to Purchase (OTP). The OTP is a non-binding document outlining issues relevant to the proposed sale and purchase agreement. The areas that the OTP generally cover include:

- Definition of parties and legal terms used
- Transaction structure - assets and liabilities being acquired
- Form and structure of the consideration being paid
- Assumptions made about specific assets (e.g. stock, debtors, cash, loans, intercompany balances, pensions, taxation etc.)
- Exclusivity
- Restrictive covenant preventing the business being sold within an agreed period
- Restrictive covenant preventing the owner from competing with the business for an agreed period
- Provisions relating to transaction costs
- Specific commercial arrangements and agreements, including ongoing role of management
- Business conduct between now and completion
- Confidentiality
- Completion timetable, arrangements, announcements (outline timetable)
- Subject to finance, due diligence, shareholder / board approval
- Any other important conditions to which the transaction remains subject, for example, regulatory clearance
- Subject to sale and purchase agreement

Beyond The Basics

Beyond these basic terms, a OTP should cover all the key points that the buyer or the seller feels are critical to resolve if a deal is to be completed. Such key points, so-called 'deal breakers' must be addressed as early in the process as possible.

The least expensive time to conclude that a deal won't be structured is at the beginning of the process. No responsible business broker would allow a seller to rush into the final phases of a transaction, such as due diligence or purchase and sale agreement, before knowing with some certainty that there is a high probability of closing.

Following the execution of an OTP, both sides will begin to incur significant expenses, including legal and accounting fees and expenses related to regulatory issues. Such expenses are needed to be paid regardless of whether a deal is consummated. In addition to the heavy economic costs of failing to complete a sale, the emotional toll on the management and its employees is significant and can be extremely damaging.

Legal Representation

If you have not already done so, now is the time to get serious about obtaining the most efficient legal representation. You will need commercial legal advisors with the depth of resources and experience to ensure a successful transaction. While there is usually a role for your existing counsel, in most cases, it is highly recommended that you retain legal advisors with significant corporate finance experience to handle this once-off business event.

These advisors will be particularly valuable in protecting your interests within the intricate language on indemnification, representations and warranties, default terminations and other areas primarily found in the purchase and sale agreement.

How Much to Include

There is a fine line between including too much in an OTP in anticipation of limiting all possible obstacles at the end, and including too little in order to speed up the process. It is at this point that the owner just, once again, rely on his advisors, both financial and legal.

If you and your business broker have worked together candidly, the key deal points should already be defined and specifically addressed in the OTP. A knowledgeable advisor will have already primed the buyer as to what you consider critical issues. Often, many of the critical factors are non-financial in nature; such as the future of certain employees; the role of the owner after the sale; and movement or closing of particular operations.

Attempting early on to negotiate every point in the OTP often comes at a high price. A buyer will be in a much better position to understand the hidden values in a business later, after completing due diligence. For example, a buyer may be unwilling to agree to the notion that inventory over a year old has any value if forced to make that decision too early in the process. However, once he has had the opportunity to study the market in more detail, and to review the stock first-hand, he should be more willing to accept your assessment of value.

A second point to remember about up-front negotiating is that the emotional and financial stakes are higher when the parties sense an acquisition is near to a successful close. If the closing of a deal is in sight, buyers and sellers alike will have a much greater tendency to concede particular points to protect the deal than at any other stage of the process. For the well-advised seller, a number of small but valuable adjustments to the deal have the best chance of procurement towards the end of the process. Of course, the buyer may adopt the same strategy.

Moving to the Close

Once the major deal points are hammered out, and the OTP is fully executed, everyone shifts into gear to move as quickly as possible to the closing. Expenses begin to mount, an announcement to your employees will most likely be necessary, and maintaining management's focus on the company's operations can become extremely difficult. Do not enter into an OTP lightly. Your mind-set should consistently be that once you sign the OTP, you expect the deal to happen, you will do whatever is necessary to make it happen, and overall, you can accept the terms and conditions of the deal, as is.

Despite all of this, you are now feeling something you may have never felt before- Lost. In many cases, the private business owner feels his first taste of finality of his decisions soon after signing an Offer To Purchase He or she may ask: “What have I done? What am I going to do when this is all over? What is going to happen to MY company?” The best relief from ‘the lost-owner blues’ is simple: stay focused on running your company.

The contemplated transaction is far from closed, and any hiccups in your company’s performance at this time will have a major impact on the ultimate terms of the deal. Unlike the mid 1980’s, when many financial buyers prided themselves on never having failed to sign a purchase and sale agreement or close a deal, where they had signed an Offer to Purchase. Today, it is more common for deals to break down during the final stages.

In today’s business environment, it takes more than agreement on basic terms and conditions to close a deal. The new reality is that the current fiscal environment for financing, our litigious society, and the heightened public concern over environmental issues have all introduced major points of contention often addressed in the purchase and sale agreement. Coupled with the inherent economic and emotional issues, these uncertainties make it imperative that your focus remains as strong as it was six months earlier, when all this began.

The Purchase Contract

More so now than any other time in the process now is the time for you to take the guidance of your advisors. Consequently, retaining advisors, legal and financial, with the requisite experience and wisdom not only to present your company to the market, but to lead it to a successful closing, is one of the most important decisions to be made.

What Is In A Purchase & Sale Agreement?

The purchase and sale agreement is the formal document that captures all contractual arrangements between buyer and seller. While there is no standard contract, as one might find for a house sale, a purchase and sale agreement usually includes the following:

- Detailed description of the price to be paid, in what form (cash, shares, future payments), and the assets and liabilities being acquired, both tangible and intangible, such as trade names, licenses, contacts, etc.
- Representations and warranties made by both buyer and seller to each other at closing and for the future.
- Copies of any other agreements between the two parties, including employment agreements, supply agreements, lease agreements, debt subordination agreements, and so forth.
- Any indemnities that may be granted or received between seller and buyer.
- Conditions to closing, which list all possible ways in which either party could terminate discussions, without being subject to legal action.
- Other schedules including detailed listings of all personnel, equipment, patents, notes payable, union agreements and much more.

Disclosure Letter

The disclosure letter includes a myriad of schedules disclosing all known information on various issues, such as outstanding litigation, corporate obligations to retired employees and other contingent liabilities.

Topics That Need To Be Addressed

While your advisors will be spearheading the drafting of the purchase and sale agreement, understanding some of what is addressed in the agreement will help you ask the right questions and get the appropriate answers. Below is a breakdown of topics usually found in various sections of the purchase and sale agreement:

Representations & Warranties. In this section, both buyer and seller acknowledge their legal rights to enter into such a transaction as contemplated by the purchase and sale agreement. The buyer will require the seller to acknowledge or represent a number of other critical factors.

This would include confirmation that the financial statements as provided are true, correct and follow generally accepted accounting principles; that all licenses and contracts are transferable and valid; that all legal proceedings against the company have been noted in a schedule; and that no other liabilities remain undisclosed. In addition, the buyer will ask the seller to agree, in writing, that certain schedules such as the list of employees and equipment are true, that receivables are collectible that the stock is saleable.

The complexity of representations and warranties should not be underestimated. For example, with trade debtors, the clause may only represent that the amount as stated on the financial statements is the current amount to debtors due for collection. Alternative language could read that at the time of recording all debtors in the financial records, such balances were deemed collectible - or at closing were deemed collectible - or that they are collectible and the seller will make good if someone does not pay. Obviously, the effect for the seller is very different in each case.

Conditions to Close. Even when you have agreed and signed the agreement, the buyer will have clearly defined conditions under which he or she could terminate the contract. Many of these will reiterate those listed in the Offer to Purchase, such as the ability to raise finance, completion of final due diligence, and receipt of a clean environmental audit.

The seller will also have his 'outs' such as board of directors' approval and acceptable terms of an employment agreement (which may not be completed). The important thing to remember is to limit conditions as much as possible without being unrealistic. If, for competitive reasons, you have not allowed the buyer to delve into your research and development as part of his due diligence, it may be unreasonable to expect the buyer to close still waiving this due diligence condition.

Indemnities. This section goes hand-in-hand with the representations and warranties section. It is here that most buyers will demand that the seller protect them from lawsuits and other litigation that might arise from the past practices of the company.

The most common and often the most difficult indemnification to negotiate is associated with tax or contingent liabilities. Again, a carefully worded sale agreement will be critical in protecting the interests of both parties, and, at the same time, to share the risks fairly.

Other types of indemnification include protection against misrepresentation or omission of critical information, particularly as it relates to a representation.

Indemnifications have a finite period during which they are in force. Some can expire as soon as the closing, while others remain in effect for as long as the legal statute of limitations stipulates. Just as with the Offer to Purchase, negotiations will ultimately end in a series of compromises that attempt to meet each party's key objectives, but at some cost. The trust you have in your advisors will be tested as they recommend unpopular positions.

The costs associated with terminating a prospective deal grow exponentially toward the end of the process. The sale agreement is an expensive document that should not be started if you have not made the leap of faith that the potential buyer sitting across the table from you is one to whom you are willing to sell your business.

A properly managed sale process should give you the comfort that you have chosen the right buyer and that the business reasons for the combination will outweigh any temporary obstacles that may arise.

Ten Pitfalls To Avoid

While this list is not exhaustive, just remembering these ten pitfalls will move you a long way toward achieving a successful transfer of ownership.

1. Not Minding The Store

More often than not in a sale scenario, the owner becomes preoccupied with the sale process and loses sight of the critical, day-to- day management issues. A sale can take anywhere from two months to two years. Hence, distraction from your business can be fatal to a deal - particularly during the latter stages. Late in the negotiation process, a buyer's adverse reaction to negative reports of even a relatively minor problem could undermine the entire transaction.

2. The Unfocused Effort

Significant unfocused problems are more likely to arise the longer a transaction takes to be completed. The sale process will usually take some unexpected twists and turns, but for most situations, a good team of advisors and management will have contingency plans. The key is to be well prepared, confident and decisive, and to have clearly defined objectives.

3. Standing Up On The Roller Coaster

Selling your company can be one of life's most stressful experiences. Besides dealing with the prospect of retirement, and with separation from a much-cared-for business, you must also face the inevitable scrutiny that your company and business activities will receive from every potential buyer. The key here is to keep your emotions in check. Being over-emotional is likely to lead to rash decisions, based on the heat of the moment, rather than on a rational agreement process.

4. 'But-Your-Man-Got-More' Syndrome

What another entrepreneur got for his company three years earlier, or what one large company paid for another, is irrelevant to your transaction. The market will dictate what your company is worth today. Ensure that your advisors do their homework to arrive at a preliminary valuation range, and then let the market do its work. Unrealistic price expectations are the quickest way to dampen buyer enthusiasm and ensure your disappointment. Inflated valuation expectations will impede you from recognizing reasonable bids.

5. Going With The Highest Bidder

When it comes to ownership transfer, the highest price bid may not be the best deal for you. A number of critical issues could override a decisive price difference among competing bids:

- Financial ability of the bidder to close the deal.
- Contingent liabilities that you must accept for some period after the sale, such as those related to environmental problems, pending litigation and the salability of stocks.
- Contingencies or 'outs' in the buyer's offer, such as due diligence, environmental audits, financing, board or parent company approvals.

- Employment agreements for the seller and key employees, including length and level of compensation.
- Form and timing of consideration to be paid if other than cash, such as loan notes, shares and earn-out.

6. Going Alone Syndrome

Below is a summary of some of the potential hazards of handling the sale of your own business:

- Limiting the buyer universe: An owner will tend to focus on only one or two possible types of buyers, usually direct competitors or customers. Unfortunately, such an approach could very likely leave out many potential buyers not readily known by management.
- Creating bad blood: Negotiations can be a very turbulent process, causing bad feelings and bruised egos. An advisor is able to act as a buffer between the buyer and seller, playing the 'bad guy' or being the scapegoat, if necessary.
- Being caught off-guard: By limiting the direct contact between you and the buyer, an advisor can protect you from the pressure to respond without proper consideration. Additionally, an advisor can offer a compromise during negotiations without being committed to it, to gauge the buyer's reaction. By negotiating directly, you would forego this advantage.
- Lacking credibility: The involvement of a business broker in managing a professional sale process sends a clear message to potential buyers that there will be competition; that delay, or similar tactics will be ineffective; and that pertinent information will be carefully prepared and presented.

7. Favoring The Fast Track

Letting one attractive buyer get on the 'fast track', far ahead of the buyer pack, will cause you to lose your greatest weapon: competition from other bidders. The key is to build competition, to force buyers along your schedule and not theirs. A good advisor will know when the time is right to sit down and hammer out a deal with the buyer.

8. Sparing The Bad News

No one likes to be the bearer of bad news – particularly when the news contains potentially damaging information about a company that is for sale, or reports about the company's key players. Unfortunately, the later bad news becomes public, the greater the threat of derailing the entire deal. By addressing bad news up front, you can establish a strong case and avoid potentially damaging innuendo. Negative reports can certainly influence overall valuation, but cover-ups or omissions, which will undoubtedly be discovered during buyer due diligence, could easily result in a broken deal that no price adjustment can repair.

9. Information Leaks

More than likely, you are not going to be able to keep the fact that you are selling the business a secret. It is best to avoid conflicts and protect your credibility by being direct with employees and key customers about the news, on your own terms.

10. Rushing To Market

If you are looking to maximize your company's value, overcome the disruptive effects of a sale, and cash-in when it is all over, don't expect it to happen as an overnight event. In addition, strong financial reporting systems and historical statements (preferably audited) are essential. They must support the financial data presented to potential buyers, and ensure that all the required documentation is available when it is required.

In Summary, selling your business is a difficult, complex and stressful process and not something you should undertake lightly. You should make every effort to prepare your business to ensure it is sold successfully the first time. Preparation and planning are the critical success factors in all business sales.