PRIVATELY HELD COMPANY

the report on transaction issues

Twelve Steps to Assure a Successful Sale

By Valerio L. Giannini

The basic error made by most private companies is not beginning early enough to prepare for an eventual sale. The result can be a lot of dollars left on the table, or worse, transactions never consummated.

The steps described in this article won't prevent the pitfalls that plague the process of actually finding buyers or negotiating a deal. Rather, the steps described are ones that can and should be taken long before the process begins.

The seeds of a successful sale – or for that matter a private financing or IPO – are planted years in advance. Although a sale is a distinctly different transaction from a financing or IPO, people signing the checks ultimately all need to see the same basic things in or about a company, regardless of the type of transaction.

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The following are steps that don't cost a lot, but can make a huge difference.

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1. Clean up the balance sheet.
2. Do tax and estate planning now.
3. Have auditable financials.
4. Manage the income statement.
5. Fill gaps in management.
6. Add outside directors.
7. Raise the company's public profile.
8. Position the company for the right comparisons.
9. Document the competition.
10. Examine your company as buyers would.
11. Understand buyer needs.
12. Be prepared for the unsolicited approach.

Check List for Valuation

1. Start with the Business

- *Value Drivers:*
  Size
  Growth rate
  Management
  Niche
  History
- *Value Detractors:*
  Customer concentration
  Poor financials
  Outdated M&E
  Few assets
  Lack of agreements with employees, customers, suppliers
  Poor exit possibilities
  Small market
  Potential technology changes
  Product or service very price sensitive

2. Financial Analysis:

- Market Value - comparables
- Multiple of Earnings - based on rate of return desired

3. Structure and Terms:

- 100% cash at closing could reduce price 20%.

4. Second Opinion:

- Even professionals need a sounding board.

5. Indications of High Value

- High sustainable cash flow
- Expected industry growth
- Good market share
- Competitive advantage - location/exclusive product line
- Undervalued assets - land/equipment
- Healthy working capital
- Low failure rate in industry
- Modern

6. Indications of Low Value

- Poor outlook for industry:
  foreign competition
  price cutting
  regulations
  taxes
  material costs
- Distressed circumstances
- History of problems:
  employees
  customers
  suppliers
  litigation
- Heavy debt load

Conclusion

The above information is helpful in determining what multiple of earnings or what discounted cash flow rate to incorporate; however, it doesn't determine the actual number.

Much of the information above will influence the person's perception of value. Valuation is often in the eyes of the beholder, regardless of whether the price is rational.

Six Ways to Sell – It Depends on the Objective

1. Top Price at All Costs

The objective is clear, just like the submarine commander who said, "Damn the torpedoes, full steam ahead." Whether it is a public company divesting a subsidiary or a private owner, regardless if the plant is moved and the employees are dismissed, the top price is paramount. Of course, the directors of a public company will be challenged by the stockholders unless they accept the best price and/or best terms. On the other hand, the private owner has full discretion over such a decision, assuming he or she has the proper voting rights. The open auction process may be the best way to ratchet the price upward.

2. High Price but Other Considerations

The seller wants a very full price which means normally the company should be sold to a strategic buyer. However, one strategic buyer that offers $30 million and plans to move the business and replace management is less desirable than a $27 million offer in which everything is left in place.

3. Good Price but Some Risk

The seller may be in an adverse situation in which there is extreme customer concentration, weak or retiring management and/or other mitigating circumstances. In this case, strategic buyers will often "back off," but a large competitor will be less concerned with these matters when rolled into the total package. However, trying to sell to a competitor is fraught with risk. The obvious risk is that the acquirer will renege on the initial offer and walk away with a lot of competitive information.

4. Responsible Buyer but Lower Price

A financial buyer traditionally does not pay the top price, but usually improves the company's profitability by making some changes including the replacement of some management. While the status quo is more or less the same, the financial buyer's modus operandi is usually to resell the company (often times to a strategic buyer) in five to seven years.

5. Management Buy-Out (MBO)

A management buy-out is probably the most considerate transfer of ownership with the least monetary reward to the owner. Viewed differently, if the company has significant customer concentration or acute technology dependence on management, then the best alternative might be an MBO. Because existing management usually is underfinanced, it is common for the seller to take back paper as a majority of the purchase price.

6. Sellers Must Stick Around After the Sale

The only way some owners are going to get a premium for their companies may be to stay there for a while and make sure everything goes well. Many prospective sellers want to cash out and walk. Some buyers will not acquire a company unless the owner has a substantial stake in the company's performance for at least two years.

Owners should consider what their objective is for selling to help them select the best way to sell.

What to Expect from an Intermediary

There are certain basic items that are considered rudimentary for intermediaries to provide to any buyer. An intermediary should provide the following information:

- ownership breakdown
- product brochures
- company specific information such as M&E and real estate appraisals
- financials for past five years
- line item list of add-backs
- unique factors such as financing arrangements, contracts, family employees, patents, and environmental problems. Other unique factors would be factoring of receivables or capital leases.

In addition, a buyer should expect the following from a sell-side intermediary:

- Communicate the seller's goal upfront to save a lot of time such as whether the seller is flexible on the terms or whether the transaction must be an all cash deal or whether it must be a stock versus an assets transaction.
- Provide an overview of the company, preferably a well-organized and well-documented selling memorandum.
- Educate the owner on the sale process.
- Be helpful and pleasant.

Finally, a buyer should expect the following from a buy-side intermediary:

- Be knowledgeable about the buyer.
- Communicate the buyer's goal.
- Gather information.
- Facilitate meetings between buyer and seller.
- Be respectful.

Summary

When looking for an intermediary, you want to find one who will stay focused on the positives; listen and learn and take notes; provide solutions that match your goal; facilitate the transaction; and manage your expectations.

It is also important to find an intermediary you are comfortable working with and communicating with. Following are some questions to ask yourself when considering an intermediary:

- Will you be able to honestly share information with him or her including your goals and expectations, financial information, questions and concerns?
- Do you feel like the intermediary hears and understands you?
- Is the intermediary someone you trust?

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