PRIVATELY HELD COMPANY

the report on transaction issues

CK BUSINESS CONSULTANTS, INC.

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Do Financials Tell the Whole Story?

Many experts would answer the question in the title with a resounding no! They would agree that at least half of a valuation should certainly be based on the strength of the financials. However, they would be very quick to add that the remainder should be based on non-financial/subjective analysis. For example:

The Industry: A company has more value if the company's industry is growing, and the industry does not have too much foreign competition, on-going price wars, etc.

Geographic Location: The value of a company can be influenced by its location. For example, does the state in which the company is located have a solid work force and/or favorable tax structure?

Management: A company with a solid management team can be a strong plus.

Facilities: Up-to-date fixtures and equipment plus a long-term lease with a reasonable rent structure will increase a company's value.

Customers: A large and varied customer base as opposed to a few large customers is a huge plus. This, along with recurring revenue from long-time customers, can definitely increase a company's worth.

Competition: One expert said that a business is worth more if it doesn't have to battle with a Microsoft or Costco.

Products or Services: A company is worth more if its products or services are proprietary or a known brand.

Suppliers: Value increases when a company is not dependent on just one or two major suppliers.

Working with M&A Intermediaries

Professional M&A intermediaries can be a big help in selling a company. However, they do need a willing seller who will work with them in the following areas:

1. **Provide access to key employees.** Sellers can be so concerned about confidentiality that they fail to even tell their top management about a potential sell. This may prevent the M&A intermediary from gathering necessary data and information.

2. **Communicate**. It is vital that the seller return calls and emails from the intermediary on a timely basis. The intermediary is generally the conduit between the buyer and seller.

3. **Provide complete information.** The preparation of the offering document needs to be completed as quickly as possible so the selling process can begin. When a seller does not have the necessary information readily available, the process cannot begin. Some areas that sellers commonly fail to have at the ready are: financial projections, competitive information, growth strategies, equipment lists, analysis of sales, competitive advantages, etc.

4. **Let the M&A intermediary do his or her job.** One aspect of the intermediary's job is to identify all of the potential buyers. One thing the seller can do to assist with this is to inform the intermediary of all of the possible candidates he or she can come up with.

5. **Include the M&A intermediary in all meetings and discussions pertaining to the selling process.** It is critical that the seller include all of his or her business transaction team -- including attorneys, accountants and the M&A intermediary -- in all meetings concerning the selling process.

Sample Outline of an Offering Memorandum

The Company:

- History
- Products or Services
- Management
- Customers
- Market
- Competition
- Management
- Equipment
- Real Estate or Lease

Financials

Summary

Supporting Documents

6. **Do not assume the intermediary's job is done when a buyer is located.** Sellers are inclined to stop including the intermediary in meetings after a suitable buyer is found. Sellers should remember that the intermediary found the buyer and is probably on excellent terms with him or her. This relationship may smooth over any problems that might develop. The intermediary may also be able to provide another buyer if the first deal falls through. Keep your M&A intermediary involved.

Deal Breakers

You are ready to go to market to sell your business but, you should be aware of the eight most common deal breakers.

- An undisclosed material fact surfaces at the due diligence stage or just prior to closing. This could include a variety of issues such as the loss of some major accounts, a product recall and, of course, environmental problems.
- The seller, a C Corporation, figures out the amount of the double capital gains taxes in an “asset sale” and tries unsuccessfully, at the last moment, to convince the buyer to do a “stock sale,” which would be a single capital gains tax.

Seller’s remorse happens more often that one might expect.

- At the purchase and sale agreement stage, the buyer wants his note uncollateralized and wants a hefty escrow account or an over-bearing list of “reps and warranties.”
- The chemistry between the buyer and seller was never really established, so when the deal runs into road blocks for a number of reasons, including the egos of the advisors, there is no personal relationship to bridge the differences nor to get the deal back on track.
- The buyer is undercapitalized and, just before closing, the buyer is unable to raise the necessary cash to do the deal.
- Seller’s remorse happens more often than one might expect. It is like a bride backing out the day before the wedding. In the case of seller’s remorse, the seller realizes that his life’s work, the company, is too important and he cannot part with it.
- The deal lags and either buyer or seller loses patience and walks away from the deal.
- The seller loses control of the deal either to the buyer or to one of the advisors. The seller is not accustomed to the selling process and succumbs to the other players. Out of resentment, the seller picks up his marbles and goes home.

Considering Selling? Some Things to Consider

- **Know what your business is worth.** Don’t even think about selling until you know what your business should sell for. Are you prepared to lower your price if necessary?
- **Prepare now.** There is an often-quoted statement in the business world: “The time to prepare your business to sell is the day you buy it or start it.” Easy to say, but very seldom adhered to. Now really is the time to think about the day you will sell and to prepare for that day.
- **Sell when business is good.** The old quote: “The time to sell your business is when it is doing well” should also be adhered to. It very seldom is – most sellers wait until things are not going well.
- **Know the tax implications.** Ask your accountant about the tax impact of selling your business. Do this on an annual basis just in case. However, the tax impact is only one area to consider and a sale should not be predicated on this issue alone.
- **Keep up the business.** Continuing to manage the business is a full-time job. Retaining the best outside professionals is almost a must. Utilizing a professional business intermediary will allow you to spend most of your time running your business.
- Finally, in the words of many sage experts, **“Keep it simple.”** Don’t let what looks like a complicated deal go by the boards. Have your outside professionals ready at hand to see if it is really as complicated as it may look.

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Tell the Buyer What You Would Like in the Letter of Intent

Following is a list of items that should be included in a letter of intent. You will want to communicate to the buyer that each of these items needs to be both included and clearly defined.

- **The price**

- **The form of purchase**
  - Will the purchase be a stock or asset sale?
  - What is the assumption of what the assets and liabilities are?
  - Exactly what is being purchased and what is not?

- **The structure of the sale**
  - Cash?
  - Notes?
  - Stock?
  - Non-compete and/or consulting agreements?
  - Contingencies?

- **Management contracts**
  - For whom?
  - What duration?
  - What incentives?

- **Closing costs and responsibilities of buyer and seller**
  - Include items such as environmental due diligence or title searches.

- **Brokerage fees**
  - Who pays and how much?

- **Timing for completion**
  - What is the drop-dead date for due diligence?
  - What is the drop-dead date for financing?
  - What is the time frame before the exchange of money?
  - What is the time frame for the final closing?

- **Statement that this is a non-binding agreement subject to satisfactory due diligence by both parties**

- **Stipulation of confidentiality from the buyer**
  - This includes a promise from the buyer that he or she will not disclose information about the business or the seller to outsiders.
  - This also includes a promise that the buyer will not disclose that negotiations are underway.
  - It needs to be clear that a breach could cause the seller to sue the buyer.

Eliminate as many surprises as early in the sale as possible.

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