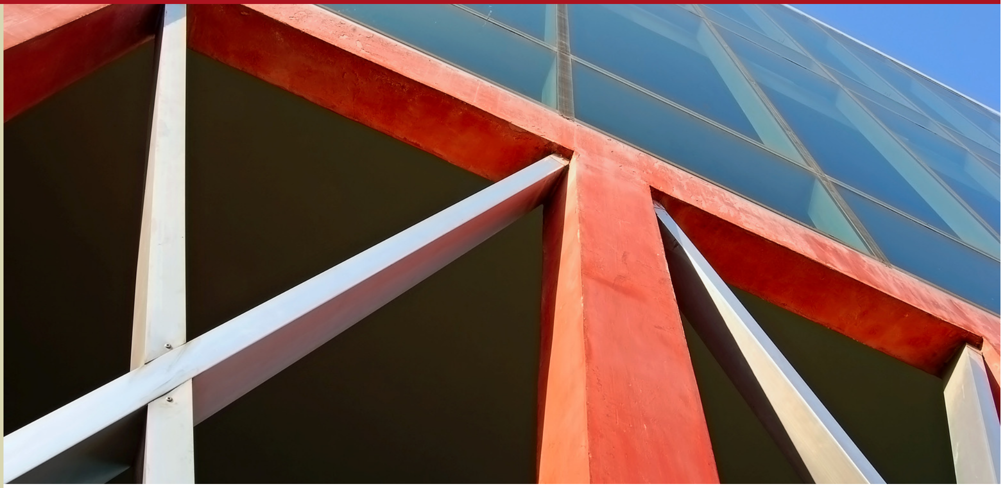
PRIVATELY HELD COMPANY

the report on transaction issues

IN THIS ISSUE



An Acquirer's Disclosure Questionnaire

As part of the acquirer's due diligence, a questionnaire will most likely be submitted requesting responses from the seller. Following are some of the questions that might be asked of the seller. Note that a "yes" response will require an explanation from the seller. There may also be a need for disclosures regarding regulations and/or legal issues as requested by the purchaser.

1. Is the business in default on any of its financial or contractual obligations?
2. Are there any revenues or expenses that are not clearly reflected in the financial statements?
3. Has the business or any of its owners been the subject of any bankruptcy filing, assignment for benefit of creditors, or insolvency proceedings of any kind during the past five years, or has the business or any of its owners consulted with any attorney or advisor concerning such proceedings?
4. Are there any individual customers or clients who account for more than 10 percent of annual gross sales? If yes, list each by name and indicate the approximate percentage of annual gross sales and the relationship of the client to the business or its owners, if any.
5. Are there any commitments to employees or independent contractors regarding future compensation increases?
6. Are there suppliers who have a personal or special relationship with the business or any of the owners? If yes, list each such supplier, the nature of the relationship, and the approximate amount of annual purchases.

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A Buyer's Disclosure Questionnaire (continued from cover)

7. Are any of the employees or independent contractors related to any of the owners of the business, or to one another? If yes, list them by name and describe their relationship.
8. If any of the business's premises are leased, are there any disputes between the parties and is either party out of full compliance with the terms of the lease or leases?
9. Have there been any deaths, violent crimes or other criminal activity on the premises within the past three years?
10. Are there any substances, materials, or products on or near the premises which may be an environmental hazard such as, but not limited to, asbestos, formaldehyde, radon, paint solvents, fuel, medical waste, surface or underground storage tanks or contaminated soil or water?
11. Is there any equipment used in the business that is not owned by the business, is not in good operable condition, or on which maintenance has been deferred?
12. Does the business have a franchise, distributorship or licensing agreement? If yes, provide a copy of each.

As intimidating as a due diligence questionnaire can be, honest disclosure is critical to avoid legal repercussions later on.

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Valuation after the Calculators, Computers and Formulas

After all of the discount rates, EBITDA and/or EBIT multiples, projections, etc., a buyer has to also look at a business under consideration for acquisition from the non-financial side. Here are some questions that should be answered prior to settling on an offering price.

Market:

Are there any significant competitive threats?

Is there large market potential?

Does the company have a reasonable market position?

Are there broad-based distribution channels?

Is there a wide customer or client base?

What's the company's competitive base?

Operations:

Are there significant alternative technologies?

Is there product/services diversity?

Are there multiple suppliers?

Is there pricing elasticity?

What's proprietary?

What's the company's competitive advantage?

What's the status of employment agreements and non-competes?

Post-Acquisition

Are there cost savings after purchase?

Are there significant capital expenditures pending?

Is there synergy with the buyer?

Is it perceived the integration will go smoothly?

Are there substantial cross-selling possibilities?

Will the cultures blend?

Is there synergy with the buyer?

The Pitfalls of Too High a Price

Many sellers dream about the value of their company based on what they perceive as their "sweat equity" or Wall Street comparisons. The merger and acquisition marketplace is fairly efficient. However, it is not formalized like the real estate marketplace in which almost all sales are public knowledge and practically all properties have assessed values.

Sellers almost always have a figure in mind that they would like to get, but pricing a business too high can be a mistake. If the company does not sell in a reasonable amount of time, the business can be shopworn and tarnished. There is also a greater risk of confidentiality being breached the longer the business is on the market.

A higher price often can require a buyer to use greater leverage, thus possibly jeopardizing the debt payments or the seller's notes. For a variety of reasons, it is usually best for the seller to arrive at a win-win arrangement with the buyer.

There are ways to avoid putting too high a price on the business. One is to have a formal valuation on the business. This is not inexpensive. Another is to have a qualified business intermediary provide an informal valuation or what might be called a most probable selling price. These valuations are not provided to the buyer initially, but can be used in the negotiation process. About fifty percent of owners seem to have an unrealistically high selling price and the other fifty percent seem to price it too low. Without a professional opinion for reference, owners cannot begin to discuss or justify a selling price that makes sense.

There are a number of choices if the owner determines that he or she has set too high of a price based on the offers received from potential buyers. One is to lower the price or become more generous on the terms. Alternatively, the owner can take the company off of the market until the company's earnings have improved and then go back to market.

Growing Your Company

There is the old adage that a company never stands still for very long. It either grows or declines. There are several options business owners have for growing their companies. The basic ones are:

- Take business away from the competition and expand into their markets.
- Expand into these existing markets by getting a share of the new business growth.
- Expand into new product and service lines that are compatible with your existing lines or services.
- Expand into new geographical markets.
- Expand into unrelated business products and services.

One of the most successful methods for growth is through acquisition of existing, compatible companies.

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Tips for a Better Sale

1. **Make sure all agree.**
   The decision to sell is not irreversible, but it should be firm. In a family business, it is important that not just the majority owner or CEO but all of the family members who have some ownership, or who work in the business, are brought into the selling process. Hopefully, they all agree with the decision. For non-family private businesses, all stockholders should be made aware of the situation.

2. **Select a head.**
   Decide up front who is going to be the ultimate manager of the selling process so there is no ambiguity later on. Decide whether it should be the majority owner, the CEO, the intermediary, or some other appropriate person.

3. **Keep it moving.**
   Set time frames on the selling process in order to have milestones: when to complete selling memorandum, contact buyers, sign Letter of Intent, close the deal, etc. Deals that drag don't close!

4. **Partner with professionals.**
   Improper advice can cost the owner tenfold later on. In retaining legal advice, the seller should be sure the selected legal counsel is a "transaction" attorney, not a trust attorney. To properly screen and qualify potential buyers, an intermediary should be brought on.

5. **Communicate with the banker about what is happening.**
   Bankers not only hate surprises, but if they are surprised, they may not be cooperative when the seller needs them most.

What Sellers Should Expect From an Intermediary

- Assistance in arriving at a fair price and help in the proper structure of the deal itself.
- Assistance in gathering the necessary information and preparing it in a format convenient for a prospective purchaser.
- Development of a market strategy.
- Screening of the possible buyer candidates with an emphasis on maintaining confidentiality.
- Arrangement of buyer visits to the selling company and meetings with company officials.
- Communication of preliminary information to buyer candidates.
- Negotiation of the sale price and deal structure.
- Interaction with all of the outside advisors in order to follow the sale to a satisfactory conclusion.

Negotiation of the sale price and the deal structure.

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This latest issue of the Private Market Report is compliments of Gary Papay, CBI, M&AMI. Gary is president of CK Business Consultants, Inc. and is an active member of the M&A Source. Gary has been involved in the sale and acquisition of businesses since 1976, and is available to handle all of your merger, acquisition or divestiture needs.