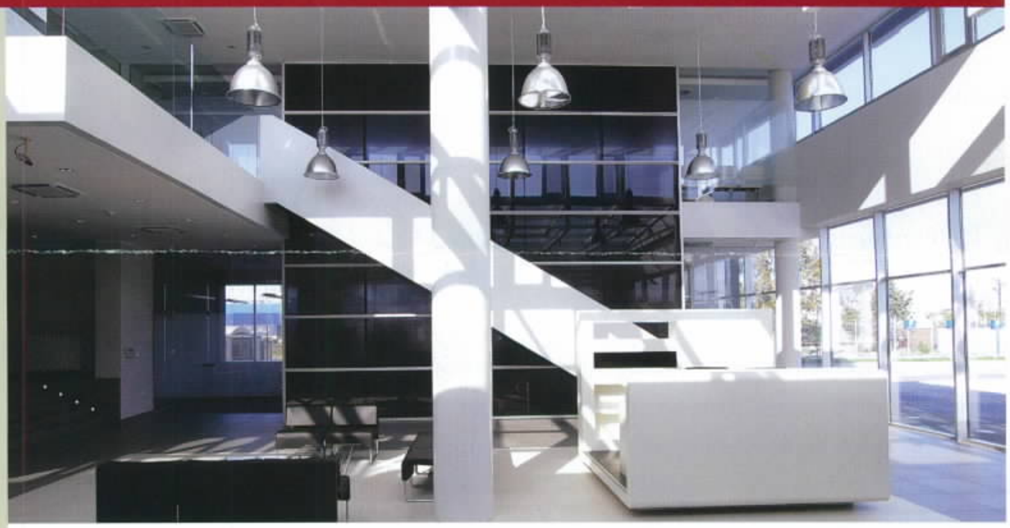
PRIVATELY HELD COMPANY

the report on transaction issues



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Beginning with the End in Mind

There is an old adage that says the time to begin planning the sale of your business is the day you buy or start it. That really doesn't make much sense. The excitement and enthusiasm in that first day of business should not be ruined by thoughts about your last day of business, right?

The truth is, starting from the very beginning to run your business with its future sale in mind and to maintain the information that a future buyer would expect can be just plain good business.

Whether it's your first day of business or closer to your last day, the time to start planning the sale of your business is now. Following, you will find some suggestions to get you started.

Take a Look at the Balance Sheet

Prospective buyers will want to take a hard look at the company's balance sheet. Further, a buyer will be very concerned if there are drastic changes in it from initial inspection to due diligence. A prospective seller should go through the balance sheet with his or her accountant prior to taking the business to market.

For example, there may be a surplus of assets that have built up on the balance sheet over the years. Such items could include surplus cash, automobiles, real estate, stocks and bonds, life insurance policies, etc. What about accounts receivables or loans due from officers? Has a reserve been set up for past-due receivables due from customers or clients?

Continued on Inside

Beginning with the End in Mind (continued from cover)

What About the Management Team

Many owners started their business from scratch and continue to function as a "one-man band." A chief financial officer, a vice-president of sales, and a head of manufacturing are all wrapped up in one person – the owner. A prospective buyer will want a management team commensurate with the size of the company. This should be addressed before putting the business on the market.

Review Long-Term Agreements

Favorable agreements should be extended, if possible, prior to beginning the selling process. Unfavorable agreements, litigation, or possible problems should be resolved prior to going to market.

Tax Issues

The time to be concerned with tax planning is prior to going to market. Changing the sale from one of assets to a sale of the stock of the corporation right in the middle of the business transaction process is not good tax planning. Get your tax issues, legal issues, etc. resolved prior to putting the company on the market.

Get a Business Valuation before Selling

Find out what your business is worth prior to selling. Paying for a professional valuation will more than pay for itself. You may discover that the business is not worth what you thought it was and elect to continue building the business, to cut costs or to make an acquisition to increase profits.

It is also quite possible that you will be surprised with the value of your hard work. However, keep in mind that the business is only worth what the market will actually pay. Keep in mind, also, that the terms and structure can be just as important as the price.

The Transaction Team

Probably the most important ingredient in selling a company is for the owner to be surrounded by the best transaction team possible. This means hiring the best transaction attorney possible (the buyer certainly will), hiring a very competent transaction accountant and hiring an experienced transaction intermediary.

Cleaning Up Your Balance Sheets

Whether it is a "stock" sale or an "asset" sale, a crucial reason for cleaning up the balance sheet is that the buyer will want to peg the purchase price to the selling company's book value or working capital.

As an example, let's say that the buyer and seller agree on a price of $5 million for the company on July 1, with a closing date of September 1. A lot can happen in sixty days, good or bad. If the book value was $2.5 million on July 1, then the purchase price is two times book value. If by September 1 the book value is only $2.3 million, then the purchase price is readjusted to $4.6 million.

Conversely, if the book value is higher, the purchase price is higher as well. If the buyer is not assuming 100 percent of the balance sheet, then both parties have to agree on a pro forma balance sheet that will address the adjustments at closing.

Cleaning up the balance sheet will ultimately help the seller because the deal to sell a company often unravels when either the quality of assets or the quality of earnings are not verifiable.

Selling: It Starts with a Selling Memorandum

A good selling memorandum addresses the functional areas of marketing, operations and finances. It should show a potential acquirer the business in the best possible light. A well-done selling memorandum will also separate the interested acquirers from the "lookers."

A good selling memorandum should answer many of the questions a possible purchaser would want answered and allow the buyer and seller to deal with the important issues. It should also point out company weaknesses so they don't turn out to be issues later. These issues can be explained in a positive way, but explained in such a way that the seller can use them as bargaining chips during negotiations.

The memorandum should also address the industry and marketplace. It should cover the company's customer base and the company's competitive advantages. It should also cover the highlights of the financial statements, include projections for the future of the business, and point out how the business can grow.

Table of Contents for Sample Selling Memorandum

Below is a sample outline for a selling memorandum. It shows what should or can be included.

1. Conditions of Acceptance
2. The Proposed Transaction
3. Executive Summary/Company Profile
4. The Company
   a. History
   b. Market
   c. Products
   d. Competition
   e. Distribution
   f. Plant
   g. Management
5. Financials
6. Growth Strategies
7. Conclusion
8. Appendices
   Balance Sheet (July 31, 2011)
   Balance Sheets (2009 – 2011)
   Statement of Operations (July 31, 2011)
   Statements of Operations (2008 – 2010)
   Business Plan – Projected Income (2009 – 2011)
   Organization Chart
   Equipment List
   Product Flyer

What Is Your Company Really Worth?

The first thing a prospective seller should do is to find out what the business may be worth in the market place. Business valuation is more of an art than a science, but if done properly, it can provide a good starting point. There are three factors that a buyer will usually consider: 1. quality of earnings, 2. sustainability of earnings post acquisition and 3. the verification of the information.

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1. Quality of Earnings

"Add-backs" are the bane of valuations. They are selected by the appraiser and can include a non-recurring item, for example, the sale of real estate, which is not a reflection of the earning power of the business. Such expenses as the cost of a big law suit, a write-down of inventory or just painting the office building are just a few examples of what may be considered as add-backs because they are one-time-only items. But middle market businesses almost always have such one-time-only items, so adding them back to income is unrealistic. Buyers will not pay for unrealistic add-backs which create unrealistic earnings.

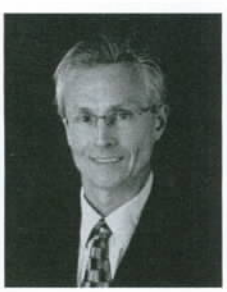
2. Sustainability of Earnings after Acquisition

The all-important question for a buyer is if the company's earnings are on the increase or if they are at their peak. Also, if earnings are increasing, will they continue to grow at the same rate?

3. Verification of Information

Is the information presented up-to-date, accurate and unbiased? Is there something missing such as uncollectable receivables, etc? Most importantly, are there any skeletons in the closet and is the seller playing it straight?

Prospective sellers should make sure that the valuation of their business is current and based on current data and information. An annual valuation is usually a good business move.



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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.