SALE OF A BUSINESS – TEN WAYS TO MAXIMIZE VALUE

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For most business owners the sale of their business will represent the single largest financial transaction in their lifetime. Extracting maximum value from the sale transaction will be essential to ensure adequate funding for a secure retirement and to provide financial security for the owner's children and future generations.

At Geneva Canada, we have been providing M&A services to mid-market business owners on sale of their business since 1998 and have identified a number of factors that together can make a major difference in the resulting value on sale. Following are the top 10 ideas we apply in working with our clients to maximize value on sale of a sale transaction:

1. KNOW THE VALUE OF YOUR BUSINESS

Many sellers enter the sale arena with little or no real idea of the market value of their business. Sellers should understand value from a buyer's perspective and the importance of intangibles such as: customer base, distribution channels, employee know-how and product development. Valuations prepared by the owner's accountants often look primarily at historical results whereas the buyer is interested in, and will pay for, the future performance of the business. A proper understanding of the value of the business to the buyer will be fundamental to extracting full market value in the M&A process.

2. PRE-SALE PLANNING POINTS

As the most important financial event in the lives of most business owners, the sale of their business must be planned well ahead of the date for entering the market. This planning will be the subject of extensive discussion with the owner's M&A advisor and will include the following list of Pre-Sale Planning Points:

a. Consider how the business will appear to prospective buyers and make immediate improvements that will make it more appealing to a buyer, whether cosmetic such as freshening up the décor or more important changes such as filling key positions that have been recently vacated

b. Ensure you will be able to devote full time to running the business during the sale process so there will be no erosion of operating results at or near the intended time of sale
c. Consider the role you desire for yourself and any family members in the organization post-transaction and the length of the transition period you desire
d. Assess the importance of keeping other key personnel employed in the business after sale and the requirement to select purchasers that will likely accommodate those employee-related issues
e. Consider whether any key employees should be brought into the loop regarding the proposed sale and the ideal timing for such disclosure
f. Devote some serious time to planning how you will spend your time post-transaction, taking into account the fact that a non-compete will likely prevent you from re-entering this sector for a number of years

3. SELECT THE BEST TIMING FOR THE SALE

Too often, sellers let their own situation dictate the time for going to market. Factors such as personal health, financial strength of the business (or lack thereof) and competitive issues may force the sale of a business into a weak market at resulting low value. The advice we give our clients is – Sell when the market is ready. Sellers reap much higher value by timing the sale of their business when it is performing reasonably well and the M&A market is very active.

We know from extensive experience that the M&A market follows a fairly well-defined cycle and when it cools off pricing will weaken across the board. Rather than wait for circumstances to force a sale into a weak market we advise clients to look ahead a few years. If they can envision selling within the next 3 to 4 years and the M&A market is strong, they should seriously consider going to market in the near future before the market starts to turn down and prices start to weaken. Keeping in mind that it generally takes the better part of a year to complete a transaction properly, the owners may be wise to sell a couple of years earlier than they ideally would have planned in order to ensure they do not have to wait until the window opens again, which may be several years into the future.

4. PACKAGING AND PRESENTATION

The expression “beauty is in the eye of the beholder” takes on significant meaning when applied to the sale of a business. Many buyers today are highly sophisticated and have a very clear idea of what they are looking for in a business. They are also inundated with opportunities that come across their desk daily in times of an active M&A market. If an opportunity is properly packaged, the strengths of the business and its growth potential will be captured and highlighted in a manner that catches the attention of even the busiest executives on the buy-side. The information package prepared for buyers will focus on what makes this business unique and will anticipate which features will attract the best buyers in the current marketplace.

The presentation of the opportunity to specific buyers will be key to setting the stage for maximizing the transaction value. The objectives of a successful presentation are two-fold: (1) to illustrate the strengths and future growth potential of the business and (2) to demonstrate the confidence of the owner / managers in the future direction of the business. It will be necessary to identify which features of a seller's business are most attractive to a particular buyer and, more importantly, to demonstrate to the buyer that seller is aware of the value of these features, in order to extract full value from the buyer. This awareness of the strategic fit between buyer and seller must be communicated from the initial contact with the buyer and is reinforced with proper packaging and a well-planned presentation of the opportunity.

5. NEVER DISCLOSE AN ASKING PRICE

Some sellers compare the sale of their business to a sale of a house. While there are some similarities, there are also major differences. One difference is that the value of a house will generally not vary much among different buyers whereas a business will often have significantly different values from one buyer to the next. When sellers disclose a price to a prospective buyer, that price automatically becomes the "ceiling", no matter how much value the business may have to a particular buyer. A recommended approach is to never state a price for a business but insist that the buyer propose a price based on what the business is worth to him. With the knowledge that there are, or may be, other parties with a serious interest in acquiring the business, the buyer will be motivated to respond with a price that recognizes the value to his organization which in many cases will exceed the seller's initial target price for the business.

6. UNDERSTAND THE BUYER MARKET

In order to attract the strongest buyers to an opportunity it is necessary to understand what buyers are currently looking for and which buyers are the best match for this opportunity. In recent years, for example, the community of financial buyers such as Private Equity Groups has been very active in the M&A market with competitive pricing and flexibility in deal terms.

In addition to knowing how and where to source the best buyers it is equally important to understand particular buyers and how they would benefit from ownership of the seller's business. There will often be fairly obvious cost-saving or synergies for a number of purchasers which may include elimination of duplicate personnel functions, rationalization of space and other common overhead expenses. What will be more difficult to identify are the business expansion benefits that may be available to a purchaser. For example, a particular buyer may be able to sell additional product through the seller's distribution channel. Another buyer may be able to combine the seller's product line into their own and increase sales of both lines. Yet another buyer may want access to employee know-how for further development of their own products. Understanding how the seller's business would fit with the buyer's business and the financial benefits that may accrue to a particular buyer will be crucial in identifying the buyer that stands to gain the most from the acquisition and extracting full value from that buyer.

7. NEGOTIATE WITH MULTIPLE BUYERS

Likely the most serious mistake a seller can make is to enter into negotiations with one buyer without having other buyers as a comparable. As a one-buyer deal progresses, the buyer will have diminishing incentive to offer the best price and terms to the seller. The single buyer will view attempts to improve the deal terms as "negotiating against myself". In the absence of other buyers a single buyer may intentionally slow down the process in order to put pressure on the seller and the deal terms. As the seller becomes increasingly invested in the deal in terms of time, costs and, most important, emotion, the single buyer will have no incentive to move the deal along quickly and the seller will have little or no leverage to force a proper deal pace. Having other buyers at the table, or even the ability to quickly bring those other buyers to the table, is in our view the best assurance that the deal will move on a proper track and that the best price and terms will be extracted for the seller.

8. EXPLAIN THE PAST, SELL THE FUTURE

In the modern day of M&A most purchasers place top priority on the amount of cash flow that an acquisition will generate for them post-acquisition. They will often build their own cash flow model of the business with assumptions as to how the business will be structured and managed under their ownership. Many of the assumptions will involve changes that the buyer plans to make in the business; for example, the addition of new product lines or investment in new equipment and personnel. The base case that they start with, however, will be the business as it would have appeared under the current ownership. Proper presentation of the current business and a "buy in" to the future plan will ensure that proper value is attributed to that inherent future growth in the overall purchase price. Conversely, a buyer may see opportunities for the business under his ownership but if he perceives that the business will not grow, and may even fail, under current ownership, the resulting lower perceived value will be reflected in the proposed purchase price.

9. OPTIMIZE THE TAX PLAN FOR THE SALE

In nearly every sale, the income tax cost to the seller will be a significant portion of the selling price. The time to begin consideration of ways to minimize the tax cost is at or prior to the time of entering into formal negotiations with a purchaser – generally at the

"Letter of Intent" stage. We advise our clients, at a minimum, to add a clause to the LOI that allows them to change the structure of the deal if necessary to provide for an improved tax result. This is rarely a problem for purchasers, provided they are not adversely affected by such tax planning.

There is a wide variety of tax plans available to minimize the tax cost on sale of a business. These range from straightforward plans such as maximizing the use of the Capital Gains Exemption, benefits of share or asset sale structure and "safe income" dividends prior to sale to more advanced planning that may involve change of residence prior to the end of the year of sale and use of family trusts. The seller should select tax advisors who will provide the full range of tax plans and will ensure that the final tax plan is properly matched to the seller's appetite for whatever level of risk that may be involved.

10. CHOOSE THE BEST ADVISORS

Most owners recognize the need for professional outside assistance in order to properly complete the sale of their business. Regardless of the size of the transaction there is a clear requirement for assistance from outside advisors such as accounts and lawyers for analysis of past financial activity, tax planning and review and preparation of legal documents. For advice related to M&A and the planning and execution of the transaction most owners look to an experienced M&A advisor.

The completion of a sale transaction is much more complex today than it was even 10 or 15 years ago and purchasers are much more sophisticated and financially astute than in the past. Sellers often face a wide and complicated array of choices in the way a transaction is structured, type of consideration to be received, preferred timing for the sale and relationship with the purchaser post-transaction. The advice of a professional and experienced M&A advisor can add value to the overall deal that often more than offsets the fees involved and will provide assurance that the deal is absolutely the best it can be for the client.

CONCLUSION

Each deal is unique and each will present its own opportunity for the seller to improve the end result whether by higher value, improved terms and conditions, better tax results or other means. Deals are not negotiated in a vacuum and obviously there are purchaser issues that have to be carefully considered in order to come to agreement and successfully complete a transaction. We find from many years of experience advising business owners on sale transactions that the more informed each party to the transaction is on the best practices and up-to-date deal ideas, the more likely the transaction will conclude successfully for all.