



MidMarketCapital, Inc.

THE TEN COMMANDMENTS OF SELLING MY BUSINESS

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1. Thou shall not wait too long. Have you ever heard, “I sold my business to early?” Compare that with the number of times you’ve heard somebody say, “I should have sold my business two years ago.” Unfortunately, waiting too long is probably the single biggest factor in reducing the proceeds from the sale of a privately held business. The erosion in business value typically is most pronounced in that last year before exiting. The decision to sell is often times a reactive decision rather than a proactive decision. An individual who spends 20 years running their business and controlling their outcomes often behaves differently in the exit from his business. The primary reasons for selling are events such as a serious health issue, owner burnout, the death of a principal, general industry decline, or the loss of a major customer. Exit your business from a position of strength, not from the necessity of weakness. Don’t let that next big deal delay your sale. You can reward yourself for that transaction you project to close with an intelligently written sale agreement containing contingent payments in the future if that event occurs.
2. Thou shall to be prepared personally. We all create business plans both formally and informally. We all plan for vacations. We plan our parties. We need to plan for the most important financial event of our lives, the sale of our business. Typically a privately held business represents greater than 80% of the owner’s net worth. Start out with your plans of how you want to enjoy the rewards of your labor. Where do you want to travel? What hobbies have you been meaning to start? What volunteer work have you meant to do? Where do you want to live? What job would you do if money were not in issue? You need to mentally establish an identity for yourself outside of your business.
3. Thou shall prepare my business for sale. Now that you are all excited about the fun things you’ll do once you exit your business, it’s now time to focus on the things that you can do to maximize the value of your business upon sale. This topic is enough content for an entire article, however, we will briefly touch upon a couple of important points. First, engage a professional CPA firm to do your books. Buyers fear risk. Audited or reviewed financial statements from a reputable accounting firm reduced the perception of risk. Do not expect the buyer to give you credit for something that does not appear in your books. If you find that a large percentage of your business comes from a very few customers, embark on a program immediately to reduced customer concentration. Buyers fear that when the owner exits the major customers are at risk of leaving as well. Start to delegate management activities immediately and identify successors internally. If you have no one that fits that description and you have enough time, seek out, hire and train that individual that would stay on for the transition and beyond. Buyers want to keep key people that can continue the momentum of the business. Analyze and identify the growth opportunities that are available to your business. What new products could I introduced to our existing customer base? What new markets could utilize our products? What strategic alliances would help grow my business? Capture that in a document and identify the resources required to pursue this plan. Buyers will have their own plans, but you’ll increase their perception of the value of your business through your grasp of the growth opportunities.
4. Thou shall keep my eye on the ball. A major mistake business owners make in exiting their business is to focus their time and attention on selling the business as opposed to running the business. This occurs in large publicly traded companies with deep management teams as well as in private companies where management is largely in the hands of a single individual. Many large companies that are in the throws of being acquired are guilty of losing focus on the day-to-day operations. In case after case these businesses suffer a significant competitive downturn. If the acquisition does not materialize, their business has suffered significant erosion in value. For a



privately held business the impact is even more acute. There simply is not enough time for the owner to wear the many hats of operating his business while embarking on a full-time job of selling his business. The owner wants the impending sale to be totally confidential until the very last minute. If the owner attempts to sell the business himself, by default he has identified that his business is for sale. Competitors would love to have this information. Bankers get nervous. Employees get nervous. Customers get nervous. Suppliers get nervous. The owner has inadvertently created risk, a potential drop in business and a corresponding drop in the sale price of his business.

5. Thou shall get multiple buyers interested in my business. The “typical” business sale transaction for a privately held business begins with either an unsolicited approach by a competitor or with a decision on the part of the owner to exit. If a competitor initiates the process, he typically isn’t interested in over paying for your business. In fact, just the opposite is true. He is trying to buy your business at a discount. Outside of yourself there is no one in a better position to understand the value of your business more than a major competitor. He will try to keep the sales process limited to a negotiation of one. In our mergers and acquisitions practice the owner often approaches us after an unsolicited offer. What we have found is generally that unsolicited buyer is not the ultimate purchaser, or if he is, the final purchase price is, on average 20% higher than the original offer. If the owner decides to exit and initiates the process, it usually begins with a communication with a trusted advisor – accountant, lawyer, banker, or financial advisor. Let’s say that the owner is considering selling his business and he tells his banker. The well-meaning banker says, “One of my other customers is also in your industry. Why don’t I provide you an introduction?” If the introduction results in a negotiation of one, it is unlikely that you will get the highest and best the market has to offer.
6. Thou shall hire a Mergers and Acquisitions firm to sell my business. You improve your odds of maximizing your proceeds while reducing the risk of business erosion by hiring a firm that specializes in selling businesses. A large public company would not even consider an M&A transaction without representation from a Merrill Lynch, Goldman Sachs, Solomon Brothers or other high profile investment banking firm. Why? With so much at stake, they know they will do better by paying the experts. Companies in the \$3 Million to \$50 Million range fall below their radar, but there are mid market M&A firms that can provide similar services and process. Generally when you sell your business, it is the one time in your life that you go through that experience. The buyer of the last company we represented for sale had previously purchased 25 companies. The sellers were good business people, knew their stuff, but this was their first and probably last business sale. Who had the advantage in this transaction? By engaging a professional M&A firm they helped balance the M&A experience scales.
7. Thou shall engage other professionals that have experience in business sale transactions. You may have a great outside accountant that has done your books for years. If he has not been involved in multiple business sales transactions, you should consider engaging a CPA firm that has the experience to advise you on important tax and accounting issues that can literally result in swings of hundreds of thousands of dollars. What are the tax implications of a stock purchase versus an asset purchase? A lower offer on a stock purchase may be far superior to a higher offer on an asset purchase after the impact of taxes on your realized proceeds. Is the accountant that does your books qualified to advise you on that issue? Would your accountant know the best way to allocate the purchase price on an asset sale between hard assets, good will, employment agreements and non-compete agreements? A deal attorney is very different from the attorney you engage for every day business law issues. Remember, each element of deal structure that is favorable to the seller for tax or risk purposes is generally correspondingly unfavorable to the buyer, and vice versa. Therefore the experienced team for the buyer is under instructions to make



an offer with the most favorable tax and reps and warranties consequences for their client. You need a professional team that can match the buyer's team's level of experience with deal structure, legal, and tax issues.

8. Thou shall be reasonable in my expectations on sales price and terms. The days of irrational exuberance are over. Strategic buyers, private equity groups, corporate buyers, and other buyers are either very smart or do not last very long as buyers. I hate rules of thumb, but generally there is a range of sales prices for similar businesses with similar growth profiles and similar financial performance. That being said, however, there is still a range of selling prices. So, for example, let's say that the sales price for a business in the XYZ industry is a multiple of between 4 and 5.5 times EBITDA. Your objective and the objective of a good M&A advisor is to sell your business at the top end of the range under favorable terms. In order for you to sell your business outside of that range you must have a very compelling competitive advantage, collection of intellectual property, unusual growth prospects, or significant barriers to entry that would justify a premium purchase price. If you think about the process of detailing your car before you offer it for sale, a good M&A advisor will assist you in that process for your business. Let's say, for example, that 4 to 5.5 multiple from above was the metric in your industry and you had an EBITDA for the last fiscal year of \$2.5 million. Your gross transaction proceeds could range from \$10 million to \$13.75 million. A skilled M&A firm with a proven process can move you to the top of your industry's range. The impact of hitting the top of the sales price range vs. the bottom more than justifies the success fee you pay to your M&A professionals.
9. Thou shall disclose, disclose, disclose, and do it early. A seemingly insignificant minor negative revealed early in the process is an inconvenience, a hurdle, or a point to negotiate around. That same negative revealed during negotiations, or worse yet, during due diligence, becomes, at best, a catalyst for reexamining the validity of every piece of data to, at worse, a deal breaker. No contract in the world can cover every eventuality if there is not a fundamental meeting of the minds and a trust between the two parties. Unless you are lucky enough to get an all cash offer without any reps and warranties, you are going to be partnered with your buyer for some period in the future. Buyers try to keep you on the hook with reps and warranties that last for a few years, employment contracts, or non-competes that last, escrow funds, seller notes, etc. These all serve a dual role to reduce the risk of future surprises. If future material surprises occur, buyers tend to be punitive in their resolution with the seller. Volunteer to reveal your company's warts early in the process. That will build trust and credibility and will ensure you get to keep all of the proceeds from your sale.
10. Thou shall be flexible and open to creative deal structure. Everything is a negotiation. You may have in mind that you want a gross purchase price of \$13 million and all cash at close. Maybe the market does not support both targets. You may be able to get creative in order to reach that purchase price target by agreeing to carry a seller note. If the sale process produces multiple bids and the best one is \$11.3 million cash at close. You may counter with a 7-year seller balloon note at 8% for \$3 million with \$10 million cash at close. If the buyer is a solid company, that may be a superior outcome than your original target because the best interest return you can currently get on your investments is 4%. Be flexible, be creative, and use your team to negotiate the hard parts and preserve your relationship with the buyer.

You may have spent your life's work building your business to provide you the income, wealth creation, and legacy that you had planned and hoped for. You prepared and were competitive and tireless in your approach. You have one final act in your business. Make that your final business success. Exit on purpose and do it from a position of strength and receive the highest and best deal the market has to offer.



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