BUYING OR SELLING A BUSINESS: A CHECKLIST FOR SUCCESSFULLY NEGOTIATING PRICE

A COMMON GOAL AND COMMON UNDERSTANDINGS

- ❑ Agreed: Our common goal is to make the best possible deal for both parties based upon a fair assessment of the business opportunity in question.
- ❑ Agreed: you do not buy or sell a business, you buy or sell a business opportunity.
- ❑ Agreed: the seller's reasons for selling and the buyer's reasons for buying probably have nothing to do with each other.
- ❑ Agreed: fair market value and a fair price are not the same thing.
- ❑ Agreed: It does not matter how you get to the same price, as long as you get there.
- ❑ Agreed: the best deal for both parties rarely means either party gets their best deal on price.
- ❑ Agreed: There is no "right price" for a business, only a range of reasonable prices.
- ❑ Agreed: We will disclose our calculations and the reasons behind our assumptions, but will not emotionally debate those assumptions again and again.
- ❑ Agreed: There is more to a good deal than price.
- ❑ Agreed: Price depends on structure.
- ❑ Disclosed: the seller's reasons for selling.
- ❑ Disclosed: the buyer's reasons for buying.

RECASTING THE COMPANY BALANCE SHEET – ADJUSTED BOOK VALUE and REDUNDANT ASSETS

- ❑ Receivables
- ❑ Inventory

- ❑ Capital assets
- ❑ Intercompany receivables or other which the seller does not wish to sell or the buyer does not wish to buy with the company
- ❑ Redundant assets or assets which are not important to company operations
- ❑ Removing any goodwill figures (which will be negotiated separately – see below)
- ❑ Liabilities which have been under or over stated
- ❑ Liabilities which the buyer does not want to assume
- ❑ Unusual items related to the seller's tax planning
- ❑ Identified, quantified and discussed: controversial items from recast balance sheet items
- ❑ Identified, quantified and discussed: controversial items from redundant asset discussion
- ❑ Identified, quantified and resolved: non-controversial items from redundant asset discussion.

RECASTING THE INCOME STATEMENT: NORMALIZED SUSTAINABLE EARNINGS (aka EBITDA)

- ❑ after tax profits from financial statements
- ❑ *plus* taxes, interest expense, depreciation and amortization, all owner compensation (salaries, bonuses, cars, spouses, management fees, etc.), all owner perqs (club memberships, toys), charitable donations, and non-recurring or unusual one-time expenses
- ❑ *less* the cost of hiring independent management to perform the owner's functions in the business
- ❑ *less* capital expenditures required to maintain normal earnings, and non-recurring or unusual one-time revenues
- ❑ and *other adjustments as required* (e.g. to normalize rents or other costs related to common ownership real estate or other assets) (could be plus or minus).
- ❑ Identified, quantified and discussed: controversial items from historical earnings.

❑ Identified and discussed: controversial items with respect to projected earnings.

ASSESSING THE BUYER'S RISK: MULTIPLES AND CAPITALIZATION RATES

❑ Discussed, and quantified and agreed to where possible: key risk factors in business opportunity.

❑ Identified and discussed, and quantified where possible: controversial items with respect to buyer's perception of key risk factors in business opportunity

Higher Risk/Lower Multiple/Higher Capitalization Rate/Lower Price	Lower Risk/Higher Multiple/Lower Capitalization Rate/Higher Price
new business or short time frame upon which to base normalized sustainable future earnings	established business and reliable, historical basis for normalized sustainable future earnings
weak balance sheet	healthy balance sheet
questionable growth trend	good growth trend
weak position in weak industry	strong position in strong industry
few barriers to entry for competition	significant barriers to entry for competition
company competes heavily on price, or provides commodity product or service	company sales not price dependant
customer loyalty, sales, company management strongly tied to personal goodwill of departing owner	company performance not tied to personal goodwill of departing owner
share purchase	asset purchase
deal structure means absence of healthy future depreciation and amortization opportunity to shelter cash flow	deal structure favours healthy future depreciation and amortization opportunity to shelter cash flow
no vendor take back financing	vendor take back financing with good terms
purchase price not tied to post-closing performance, no "earn-out"	purchase price tied to post-closing performance, and vendor sharing in post-closing risks
vendor providing excellent management but not staying on	vendor providing excellent management and staying on for extended period of time

Higher Risk/Lower Multiple/Higher Capitalization Rate/Lower Price	**Lower Risk/Higher Multiple/Lower Capitalization Rate/Higher Price**
lack of proprietary assets or sustainable competitive advantage	lots of valuable intellectual property and sustainable competitive advantage
business poorly managed or poorly positioned, buyer providing the “sustainability”	well managed and well positioned business, seller providing “sustainability”
significant personal goodwill with seller; risk of loss of key customers, suppliers and employees	minimal personal goodwill with seller; lots of corporate goodwill with customers, suppliers and employees
minimal synergy for buyer	lots of synergy with buyer’s other enterprises
negative trends in margins	good margin trends
questionable or negative trends re: key suppliers or raw materials	strong bargaining position on supply side, including favourable contracts for future supply
questionable or volatile labour trends in near future, including increasing costs, labour strife, shortage of supply, lack of predictability, layoffs required	solid trends in reasonably priced labour
significant currency risks	minimal currency risks
buyer inexperienced in the industry	buyer well established and familiar with the industry
economy or industry in or headed into a downturn	economy or industry coming out of downturn, or appears to be on track for strong future in the foreseeable future
no, questionable, poor or uncertain prospects or contracts for future sales	good prospects or contracts in place for future sales
buyer does not “need” to do a deal	buyer “needs” to do a deal
vendor “needs” to do a deal	vendor does not “need” to do a deal
buyer not afraid of competitor making the acquisition	buyer wants to eliminate or acquire a competitor, or to deny a competitor the opportunity to acquire the business

Higher Risk/Lower Multiple/Higher Capitalization Rate/Lower Price	**Lower Risk/Higher Multiple/Lower Capitalization Rate/Higher Price**
tax situation favours seller at buyer's expense (e.g. none of purchase price allocated to post-closing management fees or depreciable assets)	tax situation favours buyer at seller's expense (e.g. lots of purchase price allocated to management fees or other taxable income to seller)
acquisition or business hard to finance at low rates	good opportunity for buyer to finance business or acquisition at very competitive rates
assets over valued on balance sheet	assets undervalued on balance sheet
No opportunity for post-closing breakup of business assets	good opportunity for post-closing breakup value
Significant capital investment required in near future	no significant capital investment needed in near future
Buyer accepted normalized sustainable earnings at the high end of the range	seller accepted normalized sustainable earnings at the low end of the range

RECASTING COMPANY PERFORMANCE RATIOS

❑ Discussed, and agreed to where possible: key company performance ratios.

❑ Discussed, and calculated where possible: controversial items with respect to buyer's perception of adjusted key performance factors.

Annual Break Even = Fixed Expenses ÷ (Gross Profit ÷ Net Sales)
Annual Break Even (Months) = Fixed Expenses ÷ (Gross Profit ÷ Net Sales) ÷ Net Sales X 12
Margin of Safety (As Percentage) = (Net Sales – Annual Break Even) ÷ Net Sales X 100
Operating Leverage = (Net Sales – Variable Costs) ÷ Pre-Tax Profits *Operating Leverage X % Change in Sales = % Change in Profits*
Working Capital = Current Assets – Current Liabilities
Current Ratio = Current Assets ÷ Current Liabilities
Age of Inventory = Closing Inventory ÷ (Cost of Goods Sold ÷ # of Months)
Age of Accounts Receivable = Accounts Receivable ÷ (Net Sales ÷ # of Months)
Age of Accounts Payable = Accounts Payable ÷ (Credit Based Purchases ÷ # of Months)
Debt to Equity Ratio = Total Debt ÷ Total Equity
Debt Service Coverage = (Pre-tax profits + Depreciation + Interest Expense) ÷ (All Annual Current Loan Payment Requirements for Principal and Interest)
Interest Coverage = (Pre-Tax Profits + Interest Expense) ÷ Interest Expense
Return on Assets = Pre-Tax Profits ÷ Operating Assets

Return on Shareholders' Equity = Pre-Tax Profits ÷ (Adjusted Book Value + Shareholders' Loans).

USE OF COMPARABLES

- ❑ List of useful comparable sales identified, compared and shared
- ❑ Relevance of comparables discussed

BRIDGING THE GAP: SHARING THE RISK - PRICE ADJUSTMENT FORMULAS, EARNOUTS, VTB FINANCING

- ❑ Discussed, and quantified where possible: potential for price adjustment mechanisms.
- ❑ Discussed, and quantified where possible: potential for earnout or seller risk participation.
- ❑ Discussed, and quantified where possible: potential for price deferral through escrow funds, VTB security, etc.

BRIDGING THE GAP: SHARING THE BURDEN

- ❑ Seller contributing to certain buyer expenses
- ❑ Buyer contributing to certain seller expenses
- ❑ Paying part of the purchase price by consulting fees or non-competition payments or other ways which are more favourable to the buyer from a tax perspective than to the seller
- ❑ Seller providing financial support by deferring payments, holding a VTB with no or low interest rates, holding on to key assets and leasing them back to the buyer
- ❑ Seller keeping certain assets for itself, reducing the price to the buyer but leaving the seller with the opportunity to liquidate those assets at a later date to the benefit of the seller

BRIDGING THE GAP: SHARING THE TAX SHIELD

- ❑ Discussed, and quantified where possible: tax shield to buyer based on buyer's preferred price range and deal structure.
- ❑ Discussed, and quantified where possible: tax shield to seller based on seller's preferred price range and deal structure.
- ❑ Discussed, and quantified where possible: potential to bridge the price gap through sharing the tax shield.

BRIDGING THE GAP: INTANGIBLES

- ❑ Discussed: intangible reasons for bridging the gap, including:

  - how badly each party "needs" to do the deal
  - how badly each party "wants" to do the deal
  - how badly the parties want to do business with each other
  - what synergies the buyer thinks it can bring to the table to drive normalized sustainable future earnings to higher levels, thereby effectively reducing the buyer's multiple
  - how the buyer is financing the deal, and whether that financing package ultimately reduces his risk to an acceptable level
  - how the deal is structured, including vendor take back financing, price adjustment clauses, post-closing support, etc.
  - how the deal is structured for after tax cash flow to each party.