SELLING YOUR BUSINESS: TEN STEPS AND EIGHT RULES FOR GETTING THE BEST POSSIBLE DEAL

Selling Your Business Is A Process, Not An Event

Selling your business for its highest and best value requires time, teamwork, research, planning, strategy, preparation, networking and commitment.

This article is all about process. The process suggested here is meant to maximize your chances of multiple, interested buyers who bring multiple offers to the table.

However, the rules, principles and processes set out here are just as applicable if you only have one interested buyer, or know in advance who your buyer is likely to be.

In all cases, this process will help you manage everyone's expectations, including your own, and will channel energy into its most productive path.

Working through this process in a diligent and conscientious manner can have an immediate, positive impact on your business, which could become increasingly meaningful the longer it takes you to find a buyer, or if you postpone your timetable for selling out.

The Eight Rules

There are eight rules and ten steps suggested in this article. Some rules apply to more than one step. The eight rules you need to consider are:

Rule #1: Do not try to sell your business yourself.

Rule #2: Have a clear understanding of why you are selling your business.

Rule #3: Have a realistic understanding of what it is you have to sell and how valuable it really is.

Rule #4: Have a good understanding of why someone would want to buy your business.

Rule #5: Get your house in order.

Rule #6: Plan to sell a business opportunity, not a pile of assets or a set of financial statements.

Rule #7: Plan to have multiple, enthusiastic buyers for your business.

Rule #8: Do not get attached to a particular price for your business; plan to let the market give you the best idea of what your business is worth.

Step 1 - Assemble a Team and Define Your Basic Needs

Start the process by implementing Rule #1:

Rule #1: Do not try to sell your business yourself.

Assemble on an advisory team, including an accountant, a transactions lawyer and your closest personal advisors. Make sure they can give you objective advice and look out for your best interests. Do not select people who will simply tell you want you want to hear. Get people who have done this before.

Make sure they have access to solid income tax advice.

Make sure they have access to experienced business valuation advice – an experienced business valuator or business broker is often a very good idea.

Once the team is together, implement Rule #2:

Rule #2: Have a clear understanding of why you are selling your business.

Develop a clear and simple statement of why you are selling the business, and what you want to achieve from the transaction. Remember there is lot more to making a good deal than getting a good price. Reduce your statement to writing and hang on to it. You will need this touchstone as you work through the rest of the process.

Step 2 - Research, Analyze and Understand The Business Opportunity You Have to Sell

Step 2 in the process results from implementing Rules #3 and #4:

Rule #3: Have a realistic understanding of what it is you have to sell and how valuable it really is.

Rule #4: Have a good understanding of why someone would want to buy your business.

Research and analyze your industry. Figure out where it's been and where it's going. Consider the competitive environment, barriers to entry, threats from new products or services, and the bargaining power of suppliers and customers. Have a realistic view of the attractiveness of your industry to a buyer.

Research and analyze your business within your industry. Do you have a true sustainable competitive advantage or a strategy to build or maintain one? Is this strategy clearly articulated? Look at the position and power of your business in the industry, especially in terms of bargaining power with suppliers and customers and the ability to anticipate and ward off competition. Look at your company's financial performance compared to industry standards. Have a realistic view of the attractiveness of your business within the industry.

Research and understand how businesses like yours are valued and appraised and what you can do to increase the value of your business.

There are two very important principles to keep in mind at this stage in your process:

The largest impediment to selling a business is usually the seller's price expectation.

The buyer's excitement for the future of the business determines how much he or she is willing to pay for it.

Get some idea of what the other side is likely to be told if it brings in an expert to value your business. Use this information to develop a strategy for maximizing a buyer's perception of the opportunities associated with your business, while minimizing the buyer's perceptions of risk.

Prepare a comparative recast statement of sustainable and normalized profit and loss for the past two to five years and projected ahead two to five years:

- Interest, taxes, depreciation and amortization should be identified and added back in;
- Owner and management compensation and expenses should be adjusted to take out any extraordinary items like owners' personal expenses or management bonuses; and
- One-time or extraordinary income or expenses should be identified and adjusted.

The buyer should be left with a clearer sense of what the business really produces in terms of profit and cash flow before owner financing, taxation and compensation. Prepare a comparative balance sheet for the company for the last three to five years and project ahead two to five years, based upon adjusted book value:

- Adjusted to reflect current market values;
- Goodwill and other intangibles can be left off as they are difficult to measure must be resolved through negotiation;
- Inter-company receivables and similar items that would not be purchased or benefit buyers should be removed;
- Redundant assets which are not necessary for the successful operation of the business should be identified, and perhaps removed from the statement; and
- Assets or liabilities that should be removed from the company to make it attractive to potential buyers should be dealt with.

Prepare your own assessment of the value of your business. Remember that there are a range of potential values for any asset. Set a range for yourself after researching how similar businesses typically valued. Use all that you have learned, including your recast financial statements.

Objectively assess the risks associated with your business from a buyer's perspective. Consider how they impact your valuation, and have a strategy for dealing with them.

Define the characteristics of an ideal buyer, so that you can measure candidates against some basic reference point. Consider intangibles and tangibles. If you are like most owner-manager-sellers, you don't want to sell your business to just anyone.

Step 3 – Look Into Basic Housekeeping Matters

Rule #5: Get your house in order.

Give your company a fresh and objective review. Obtain and review a typical buyer's due diligence request list. This will not only prepare you for the due diligence process, but also will help you consider your business from a buyer's perspective. Polish up the things they will value, and deal with any potential problems.

Some of the things to do include:

- Research basic legal, tax and financial issues, such as whether you are better off selling shares or assets.
- Get some basic tax planning and implement any changes that are required.

- Review your insurance programs, company health and pension plans, and other insurance matters and make sure everything is current and up to date.
- Review your human resource policies and make sure they are current and up to date.
- Refresh your sales and marketing materials, and make sure they are contemporary and accurate.
- Look into your operating procedures and manuals, and get them current as well.
- Review how your company is financed, and optimize the financing and capitalization of your business.
- Identify redundant assets and develop a plan to get them out of the company, whether they are old and obsolete or simply unnecessary for current company operations.
- Get the company minute books, corporate records and financial information in good order.
- Make sure all tax or government returns are completed and filed up to date.
- Identify outstanding legal, tax, banking or financial issues that would slow down or complicate completing a deal.
- Consider basic operating issues including key contracts and suppliers, key employees and employment contracts, customers, competitors, product development and cash flow issues that could be strengths or weaknesses. Fix what needs fixing and be ready to deal with other issues as they are disclosed to or uncovered by a buyer in the due diligence process.

You would not sell your house without taking care of all those things you have learned to "live with". You should do the same thing before you take your business to market.

Step 4 – Prepare An Opportunity Plan For Your Business

Rule #6: Plan to sell a business opportunity, not a pile of assets or a set of financial statements.

Identify areas in your business that need improvement, and get to work on them. Find ways that to add to the value of your business, and try to implement them.

Revisit your industry and valuation research results from Step 2.

Research potential buyers for your business. Look at competitors, suppliers, customers, investors and others who have a proven interest in your industry, or who should consider buying your business because of the potential synergies they could unlock. Decide who can make the most out of your business opportunity, and quantify what they could accomplish. Make sure that you concentrate on people that can afford to pay a reasonable price for your business.

Document all that you have learned in an "Opportunity Plan" that you will use in marketing your business for sale, including:

- A five to fifteen page strategic summary of the business. There is no set formula you need to follow, but typical headings can include the following:
    - Industry Background: Markets & Opportunities
    - Company Background
    - Company Offering: Products and Services

  - Company Markets and Customers
  - Company Management and Personnel
  - Company Plant and Facilities
  - Company Finances – Past, Present and Projected;
- Opportunity Summary – a short narrative of the future for your company, including opportunities still to be exploited, potential investments and the impact they could have, and the upside for a potential buyer;
- Your recast financial statements from your valuation; and
- Other information and documentation that supports your vision and plan, especially if it is empirical and objective.

The point is to make a summary that is accurate, compelling and persuasive. You want to generate excitement and buzz around your company. However, keep in mind that unrealistic projections and overstatement backfire. People who have done this before understand that quality beats quantity. Be positive, realistic and honest. It will get you a better deal in the long run.

Step 5 – Prepare a Marketing Plan for Your Business

Rule #7: Plan to have multiple, enthusiastic buyers for your business.

Rule #8: Do not get attached to a particular price for your business; plan to let the market give you the best idea of what your business is worth.

Prepare a brief confidential outline of what kind of deal you are looking for, without setting an asking price:

- Decide if you want to sell shares or assets, or what you will need in either case in order to get where you want to be after taxes.
- Consider how available you will for the transition post-closing, and what sort of contract it would take for you to hang around for a while.
- Consider if you are open to providing vendor take-back financing, and if you are, on what terms, to what kind of buyer, and how that will affect the purchase price.
- Consider what kind of non-competition, non-solicitation or other restrictive covenants you are willing to provide.
- Decide if you are willing to tie a higher purchase price to post-closings sales or earnings, and what would work for you in such a scenario.
- Consider any other major deal component that your advisors think could come up in negotiations.

The point is to have a good idea of what you want and are willing accept before you get into the market. The more prepared you are, the more likely that you will be able to know a good deal when you see it, and move quickly if the right buyer comes along.

Prepare a marketing strategy for the sale of the business, which will bring multiple buyers to the table.

Decide whether you will use a broker or an intermediary.

Consider whether you will approach a handful of people directly, or expose the business to the broadest possible market.

Review your list of potential buyers. Decide who you will approach, how you will approach them, when you will approach them, and how to integrate them into your marketing plan.

Plan around the "rumour mill" issue.

Plan a way to "qualify" interested parties. You do not want to give out confidential information to parties who do not meet your target buyer profile.

Develop a plan that can be rolled out in stages. For example, you may start by approaching the obvious buyers directly, or networking with a few key business associates, and then engaging a broker or intermediary if that does not bring the success you are looking for.

Document your plan and share it with your advisory team. Refer back to it from time to time to keep yourself on track.

If you find you are having trouble getting the buyer or deal you want, revisit the plan and change it as necessary.

Step 6 - Prepare and Distribute Preliminary Disclosure Documentation

Remember Rules 7 and 8:

Rule #7: Plan to have multiple, enthusiastic buyers for your business.

Rule #8: Do not get attached to a particular price for your business; plan to let the market give you the best idea of what your business is worth.

With input from your advisors, prepare a basic set of initial disclosure information, including:

- A one or two page, anonymous term sheet that can be widely distributed to potential buyers, including cold calls, requesting an initial expression of interest;
- A confidentiality/non-disclosure document for interested buyers to execute before you give them too much information;
- A ten to twenty page opportunity summary which provides more information to a prospective buyer, identifies your business, develops enthusiasm for your business; and
- A preliminary due diligence package, which can be used as the basis for negotiating the price and terms of a proposed transaction.

Distribute this information at the right time to the right people in accordance with your marketing plan.

Qualify parties who respond in accordance with your qualification criteria.

Obtain signed confidentiality agreements from interested parties.

Distribute the opportunity summary to qualified parties, and solicit a written expression of interest which should include background on the buyer, why they are interested in the opportunity, and their preliminary assessments of value. Set a timeline for their response and let them know there are other interested parties. Also let them know that a short list of interested parties will be invited for a detailed follow-up meeting, including a site visit.

Step 7 – Follow Up With The Most Promising Interested Parties: Site Visits

Remember Rules 7 and 8:

Rule #7: Plan to have multiple, enthusiastic buyers for your business.

Rule #8: Do not get attached to a particular price for your business; plan to let the market give you the best idea of what your business is worth.

Assemble all the expressions of interest and review them with your team.

Identify the most promising interested parties, using your characteristics of the ideal buyer and the expressions of interest. The most promising parties may not be those indicating the highest valuation. Knowledgeable buyers will entice you into discussions with a value they have no intention of maintaining.

Do not give anyone an exclusive option at this point, even though most buyers will tell you they do not want to participate in an "auction". Serious buyers will stay in the hunt for your business even if you tell them there are other interested buyers.

Arrange a series of introduction meetings with the most promising interested parties, including site visits to your business and more detailed presentations on your business opportunity. Ask them to present their business background, financing capability and overall intentions.

Ask the selected parties to submit non-binding term sheets or letters of intent by a fixed deadline, assuming they are interested in proceeding to the next step. Offer to sign a "lock up" provision with them if their preliminary offer is your first choice to negotiate and finalize.

Even at this stage, you do not have set an asking price for your business. Let the market give you a better idea of what your business is worth.

When people ask you want you want for your business, tell them you want a fair purchase price and good deal overall, you know there is more to a good deal than price, and you are as interested in finding the right buyer as in getting the right price. Let them know you have ideas of value, which you will happily share with them if you get to the negotiation stage, but that you want your buyers to take the first crack at putting something down on paper.

Be willing to discuss all deal factors in general terms, including all the matters you considered in Step 5, but be let it be known that you have an open mind and that everything is up for discussion to get the best deal overall with the right buyer.

Step 8 - The Letter of Intent, Deal Memo or Term Sheet

By this stage your suitors should be providing you with letters of intent, deal memos or terms sheets. Review them with your whole team. Prioritize your interest in each potential buyer.

Select your first choice suitor; let them know they have been chosen; arrange to put your two teams together to begin negotiating the details and planning the due diligence. Commit to exclusivity at this point. Tell them you will have written feedback on their proposal before the meeting.

Tell the remaining suitors you have committed to try to make a deal with the person who presented the best overall offer. Do not turn them off. Promise to come back to them if you cannot get a deal done with the first suitor.

Prepare your counterproposal, including specific details, arguments and supporting material. Provide it in a short written form to the potential buyer in time for them to review it before your team meeting. This may be the first time you set a price for your business, and may not happen until after you have a very good indication of what the market is already thinking. With any luck, you will have multiple potential buyers at the table.

Have your suitor present their proposal to you and your complete team at meeting where the key members of both teams are present (including professional advisors). Present your counterproposal at the team meeting. Having everyone from each side assess the other side's presentation will allow for better communication, less risk of misunderstanding, and a more co-operative and creative effort to find solutions to problems.

If the decision is made to proceed, commence serious negotiations to hammer out the price and all the main business points. Be prepared to use all your most convincing arguments to increase the price to something you can live with. Be prepared to deal with tangibles and intangibles. Remember, you are <u>selling</u> a business opportunity, and now is the time that you actually sell. All your briefing books can now come into play.

When it works, the final letter of intent, deal memo or term sheet becomes the agenda for all future dealings. The structure and basic principles should not change dramatically, even though the definitive legal agreement will go into much greater detail and will handle the thornier problems.

Make sure price, closing date, buyer conditions and collateral agreements are addressed.

As an expression of your sincerity, commitment and good faith, you should agree not to engage in discussions with other potential buyers during the due diligence and pre-closing period. In return, the buyer may put up a deposit, a portion of which may be non-refundable if the deal fails to close because the buyer backs out through no fault of the seller.

It should take no more than a few days to a week to finalize a letter of intent. If you can't get past price and the principal business issues in that period of time, you should seriously consider disengaging and picking up where you left off and either go back to the market or go to your second suitor.

Beware of the buyer who insists on detailed due diligence before getting the letter of intent or deal memo in place. You should be prepared to give them enough information to document their key assumptions, and agree in general terms to a deal based on those assumptions. They will get time to verify their assumptions later. Handing out details like customer lists, employee lists, supplier contracts and similar items can come back to haunt you if the buyer is simply trying to pick your pocket or replicate your business model, and is only using the negotiations to gather information.

In particular, do not count on the confidentiality agreement to protect you. Confidentiality agreements are not easy to enforce in practise. It is never easy to discover and prove that information was misused, and you have to spend the money on litigation to make your point. Contracts are like locks on your front door – they are easily bypassed by the unscrupulous or dishonest.

The best protection at this stage is not give away anything that can come back to haunt you until after you have a solid deal in place with another layer of confidentiality protection built-in to your letter of intent or deal memo by your legal team.

Step 9 - Due Diligence and Negotiation of Legal Agreements

Assuming the letter of intent or deal memo hammers out all the main business points, the buyer should now prepare and deliver a detailed list of required disclosure documents. Depending on the deal, this can be an extensive and intimidating document. However, if the seller has truly prepared the business for sale, the seller should have considered, anticipated and been prepared to produce the disclosure the buyer will be looking for.

Sometimes a disclosure room is established. This is often off-site, to maintain the confidentiality of the deal and not interfere with the operations of the business. The buyer's due diligence team will assemble at the required time and place, review the disclosure documents, and prepare a list of follow-up items to be looked into.

The question of third party consents will be considered, as will key contracts. The buyer will finalize its list of conditions, and begin working on satisfying them.

There needs to be an agreement and a plan in regards to pre-closing and post-closing announcements and introductions.

Assuming the parties still wish to proceed, the buyer's lawyer will prepare an agreement of purchase sale based upon the letter of intent and subject to verification of the latest information provided. This document is a complete and comprehensive agreement that is binding on both parties. It will include an extensive list of seller representations and warranties that act as checklist, assist with full disclosure and knowledge transfer, challenge the seller to stand behind what they said about the business, and assign the risk of most pre-closing issues and problems to the seller. The lawyers for the parties usually negotiate the agreement, with lots of input from their clients and due diligence teams. In most deals, this agreement is signed at the same time as the deal closes.

The buyer's lawyer will also prepare a draft closing agenda, which details all documents required to complete the contemplated transaction. The lawyers will then start working together to draft and negotiate the relevant closing documents. At the same time the parties will work together to obtain any third party consents that are required.

As part of this process, the seller and his advisor will usually have responsibility for preparing all the schedules to the agreement of buyer and sale. The schedules can be quite detailed and lengthy. However, they are usually based upon the disclosure documents, and therefore much of the work in preparing schedules will be completed once disclosure and due diligence is completed.

It should take no more than three to eight weeks to complete due diligence and hammer out a detailed agreement of purchase and sale and all other closing documents. The length of time depends on the size of the deal, the complexity of the business in question, and the nature and type of financing the buyer is putting together to make the deal happen.

A Note on Professional Fees

All professional fees should be discussed in advance, as they can get quite large.

Most business sales are not done on a pure hourly rate basis. For example, the rule of thumb for real estate and business brokers is 5% to 10% of the purchase price. For lawyers, the starting point is generally 1.0% to 5.0% of the purchase price, adjusted up or down depending on the complexity of the deal, the amount of time and resources that will be required, the amount of money involved, whether the lawyer has brought the buyer to the table, whether the law firm is losing the company as an ongoing client, and the role of the lawyer in negotiating the deal (especially obtaining favourable price and terms). Accountants typically work on a similar basis. Valuators usually work on a combination of fixed fee and hourly rate.

As always, the goal is to motivate your team to get the best possible result while giving you a sense of satisfaction from knowing that what you are paying for professional services is fair and reasonable in the circumstances.

A Note on the Deal "Low Point"

Most deals have a "low point". Many deals start on a high with the signing of a letter of intent. Emotions tend to fall gradually throughout the due diligence and documentation stage, hit a sometimes-unexpected low, and then rise back up to the original high (or higher) on closing.

Be prepared for the "low". It happens on many deals. It can be characterized by an unexpected delay, something found in due diligence, or difficulty with the final wording of key documents.

If it is unanticipated or poorly managed, a good deal can fall apart for the wrong reasons.

If you know it is likely to happen, then be ready for it, and be ready to get involved. When it does happen, you may want to take the discussions away from the professional advisors and talk directly to the number one person from the buyer's camp. These issues are often resolved CEO to CEO. Leaving it one hundred per cent with the lawyers or accountants can be a mistake.

Step 10 - Closing

If all goes well, closing can be anti-climactic. It usually takes place at a lawyer's office, with the each lawyer walking his or her clients around a closing table helping them sign documents.

The fun part for both sides comes when the cheques are handed out.

Bring a camera or lucky pen. Even consider buying an expensive pen just for the occasion and give it to the other side when everything is signed up.

Some deals have an escrow period, where the lawyers are holding everything under lock and key until some final detail falls into place.

However, eventually the deal will close and there will be handshakes all around.

Unfortunately for the buyer, that is usually when real work begins!

You Can't Lose If You Follow This Process

Even if you cannot or do not get an offer you are willing to take, you will be better off if you implement this process.

You will know your industry, your company and yourself better than you ever have before.

You will have a plan to move forward that is objective and realistic.

You will end up doing things that you should have done already, including things you knew you should have been doing before.

You may even get so excited about your business opportunity that you stay with the business and become your own buyer!