



Selling Your Company

Introduction

Business owners are confronted with a number of decisions each day that impact their business, the sum of which in the long-run, will have a significant impact on their lives. Over time, a privately-held business is likely to become the major asset of its owner. Given the tremendous financial, labor, and time investments that the owners make in their business, no decision is more important than developing a strategy for achieving personal liquidity through the merger or acquisition of their company. This is an issue that many privately-held business owners are reluctant to discuss, or even consider at first, due to their emotional attachment to the businesses they have struggled to build over the years. Many find it difficult to imagine not owning and running their company and initially refuse to recognize the importance of planning ahead for a potential liquidity event. However, this issue should become a major concern for those privately-held business owners, particularly those who are nearing retirement age, and/or seeking to achieve personal liquidity via a transaction.

The Process

The process of selling a privately-held business is generally more complex than most owners initially imagine. Just as Rome was not built in a day, the merger or acquisition of a privately-held business is not accomplished overnight and requires significant efforts by the owners, their advisors, and their transaction advisor. To be successful in achieving maximum personal liquidity through a transaction, privately-held business owners should be cognizant of the many dynamic stages and issues associated with selling their business. These stages and issues include the following:

- **Determining the Need to Sell the Company**—Typically, there is a wide range of reasons that a privately-held business owner may have for selling the company, including retirement, family succession issues, illness, unforeseen circumstances, loss of interest, financial distress, other investment options, etc. Whatever may motivate the owners of a privately-held business to pursue a sale of their company, the results of such a transaction generally include increased

personal liquidity, diversification of their portfolio, and a reduction in the overall risk of their personal portfolio.

- **Preparing the Company for the Sale**—Once the decision is made to sell the business, the owners of a privately-held business are typically unprepared for the process of selling their company; they usually are not sure where to start. While this clearly is a self-serving statement, we strongly believe, that to adequately prepare the privately-held company for sale, the owners must retain a competent transaction advisor to guide the process from start to finish. In addition, the owners must ensure that preliminary legal work is in order and that the company's most recent annual and interim financial statements are prepared (audited, if available) by their accounting firm. In preparing the company for the sale, the owners must also adopt the appropriate mindset that provides a level of commitment to the process that is conducive to a successful and optimal transaction.
- **Understanding the Value of the Company**—Most owners of a privately-held business have preconceived notions regarding the value of their business. The valuation process is crucial in estimating the fair market value of a privately-held company and in establishing a minimum price expectation for the owners of the company and its team of advisors. The valuation process involves extensive analysis of specific company factors that impact the value estimate. Under the income, market, and asset approaches to valuing a privately-held business, there are numerous methods for estimating the fair market value. Once the fair market value has been estimated, the transaction advisor then attempts to secure the highest price during negotiations in order to maximize value for the owners of the business.
- **Marketing the Company to Various Types of Potential Buyers**—Once the valuation of the company is complete, the privately-held company's transaction advisors typically begin marketing the company to potential acquirers via a non-confidential (and anonymized) one- or two-page summary of the company. This summary is sent to potential buyers via fax or email. Those potential acquirers who express and interest are then required to execute a Non-Disclosure Agreement (NDA). Once the NDA is satisfactorily executed, the prospective buyer receives the confidential selling memorandum – an in-depth overview of the company and its merits, which has been prepared by the transaction advisor. The transaction advisors utilize a variety of resources to identify and contact potential buyers who are categorized into three categories—financial, strategic, and individual buyers. Once the prospective acquirer receives and reviews the confidential selling memorandum, if there is further interest, the transaction advisor has more in-depth with them, to further qualify their level of seriousness and ability to do a deal. Should all indications be positive, the transaction advisor coordinates a site visit(s) with the owners, respecting the confidentiality of the situation and their desire to spend time only with 'qualified' potential acquirers.

- **Preliminary Due Diligence**—Prior to providing a Letter of Intent (LOI), a potential acquirer (already under NDA), typically will want to perform “preliminary due diligence”, which is a “lite” form of the very extensive due diligence that most companies will perform after the execution of an LOI. Preliminary due diligence is a basic analysis of the company, its financial position, etc. to whatever extent permitted by time and the willingness of the owners to divulge information at this stage. Typical basic issues considered/analyzed during preliminary due diligence include:
 - Capitalization table, detailing current ownership of company;
 - Most current three to five years of GAAP financial statements, audited if possible, as well as up-to-date interim statements;
 - Revenue breakdown and profitability by region, product line, customer, etc. to the extent tracked and based on management’s willingness to divulge – can of course be a very sensitive area;
 - Any industry and market analysis seller is willing/able to make available, in order to help the prospective buyer understand the potential for growth and profitability of the business
 - Discussions with senior management who are privy to the idea of a potential sale – conversations may be brief or extensive, based on the wished/willingness of the owners;
 - Others as appropriate.

- **Letter of Intent (LOI)**—After the site visit(s), the transaction advisor continues discussions with the prospective buyer and facilitates further conversations with the owners and answers to questions, as reasonable and appropriate. Should the potential buyer wish to proceed further, it is typically at this stage that they are expected to provide an LOI, explicitly stating their intent to proceed toward a possible transaction, and under what basic terms. LOI’s typically are non-binding, but may include a “no-shop” clause, which does not allow the owners to “shop” for other buyers during a specific period of time. It is therefore important that the owners consider the basics of the LOI to be reasonable before counter-signing it, particularly if there is a “no-shop” clause, as they will be effectively locked up from proceeding further with other prospective acquirers. The typical LOI will address some or all of the following issues:
 - Stock purchase or asset purchase and amount/form of consideration;
 - Employment and other agreements that will need to be executed before closing;
 - Expected closing date;
 - Refundable deposit or “good faith money”;
 - Agreement of seller to grant full access to company records, data, and employees for due diligence process;
 - No material changes in operation of business;
 - No-shop provision;

- Finder's fee or advisors fee, if any – specifies which party will be responsible to pay;
 - Confidentiality – further iterates expectations for confidentiality as the process proceeds;
 - Break-up fee, if any, should the deal not be consummated;
 - Others as necessary.
- **Negotiating the Deal**—It is rare that the owners of a closely-held business will accept the first offer and the conditions set forth in the initial LOI. Rather, this is a starting point for further negotiations centered on the price, terms, closing date, etc. The transaction advisor will discuss the initial LOI with the client and make recommendations regarding the future course of action based on the specifics set forth in the LOI. Typically, at this point, the transaction advisor will discuss with the client their expectations and desire to continue discussions with the potential acquirer based on the terms and conditions in the LOI. The range in which the amount of consideration will largely be established now, with the lower limit the amount offered in the LOI and the upper bound being the owners' previously established expectations.

It is not unusual for the owners' to become very emotionally charged once the initial LOI is received and has been reviewed. After all, the entire process of selling the business is very emotional for the owners. Adding an offer that the owners may feel is insulting only compounds the emotional aspect of this process. Therefore, a seasoned transaction advisor will help the client understand that the price and terms of the LOI are in no way meant as an insult and that this is merely a part of the strategy of the acquirer. It is unlikely, after all, that the terms and conditions set forth in the initial LOI represent the absolute best offer of the acquirer.

Based on the discussions with the client, the transaction advisor may suggest a counter offer be presented to the potential acquirer. If the owners are in agreement, the transaction advisor, as middleman, delivers the next iteration of the potential transaction to the issuer of the LOI. This process typically continues back and forth until the potential acquirer either agrees to revised terms and issues a new LOI or withdraws from the negotiations. This phase of the process is one of the most crucial for the transaction advisor and is where the transaction advisor utilizes skill and judgment in guiding the negotiations to a conclusion that serves the best interests of the client by maximizing the ultimate return for the client.

- **Due Diligence**—Once an agreement has been reached on price and terms, the acquirer then issues a revised LOI delineating the new terms. At this point, recall, the potential acquirer has had limited access to the target company's financial information, operations, legal documents, management, etc. The due diligence phase is where the acquirer delves deeply into the financial information of the company and other aspects to ensure that the information presented thus

far correctly and fairly represents the actual financial, competitive, and operational position of the company. After all, the acquirer's decision to issue the LOI has been based only on the information provided by the owners and transaction advisor. To consummate a deal without further verification would be irresponsible on the part of the acquirer.

During the due diligence phase, it is typical to have an audit performed to ensure the financial position is accurately represented by the company's financial statements. In addition, the acquirer will likely examine the corporate legal documents to ensure there are no restrictions or irregularities. Only if the acquirer determines that the company and all relevant information can withstand the intense scrutiny under due diligence will the acquisition process proceed. In this phase, the transaction advisor remains as the middleman in coordinating access to information with the client such as for an audit, oversees the collection and delivery of the requested information in a timely manner, and attempts to continue moving the process forward at a reasonable pace.

- **Purchase Agreement**—Once the acquirer has completed the due diligence phase, they will usually provide a purchase agreement (assuming the target company withstands due diligence). The purchase agreement incorporates the terms and conditions provided in the previous LOI with any changes or modifications stemming from matters arising in due diligence. The purchase agreement is divided into two main sections—structuring the deal and representations & warranties. Structuring the deal addresses issues such as total consideration to be paid for the company, including cash, shares, debt assumption, earnouts or consulting agreements, whether the deal will be structured as an asset sale or a stock sale, timing of any compensation payments, real estate issues including any purchases, leases assumed or leasebacks, and other legal matters related to structuring the deal. The representations and warranties outline the specific guarantees that the owners of the closely-held company make regarding the financials, operations, products, services, and business conditions. The section also details the specific ramifications the acquirer has in the event that a representation is inaccurate.

The transaction advisor in this phase will typically review the purchase agreement and consult with the client's accountants and attorneys to ensure that the purchase agreement is structured in accordance with the interests of the client. Any recommended changes are conveyed to the acquirer by the transaction advisor and the client's attorney. Once the final purchase agreement has met the satisfaction of all parties, the final closing date is scheduled for the signing of the appropriate documents and disbursement of the necessary funds.

- **Post-closing Issues**—Once the final purchase has been signed, signifying the final consummation of the deal in a process that may have taken a few months to as long as two years, the owners of the privately-held business may confront many post-closing issues. A good transaction advisor will maintain contact with

the client even after the closing and their fee has been paid in order to be true to the relationship that has been fostered throughout the transaction process. The transaction advisor will likely offer advice, guidance and assistance on post-closing issues such as tax issues for the client (this is usually in conjunction with the client's accountants and investment advisors), issues that arise from consulting agreements between the client and the new parent company, and some psychological issues arising from the clients finding themselves with a new or changed lifestyle.

The transaction process is a complex and often difficult progression of clearly-defined events that seek to ultimately enable the owners of the privately-held company to achieve personal liquidity. The process may take as little as a few months from start to finish up to several years, depending on the size of the companies involved, the acquirer's desire to consummate the transaction in a particular timeframe, obstacles arising from negotiating problems or differences, and the extent of the owners' cooperation in seeing the process through from beginning to end. A typical timeframe for the transaction process is illustrated in the following chart.

Phase of Transaction Process	Estimated Timeframe
Preparing the Company for Sale	2-4 months
Marketing the Company to Potential Buyers	2-8 months
Preliminary Due Diligence	1-2 months
Letter of Intent & Negotiating a Deal	2-5 months
Due Diligence	1-3 months
Closing	1-2 months
Total Estimated Transaction Process Length	9-24 months

Conclusion

The process of selling a company via a merger or acquisition is often more complex than business owners realize. From the decision to sell the company to closing and transition, the path is often fraught with potential pitfalls that may derail the deal or create unnecessary and unwanted disruptions, which only serve to place additional stress on the company's owners. From the list above, the privately-held business owner should be able to recognize the need for a strong team of advisors in order to successfully achieve the desired results throughout the merger or acquisition. As such, privately-held business owners should carefully select qualified, competent advisors who will guide them through the difficult process of selling the company.