3 Ways to Maximize Value in the Sale of your Business

Tips to Help Sellers Avoid Common Pitfalls in a Transaction


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In today's market, buyers of businesses are increasingly savvy and aggressive. Many public companies have turned to serial M&A as a primary mechanism for driving growth, and private equity buyers and other professional investors continue to deploy massive amounts of capital in search of value. Although competition among buyers has pushed purchase price multiples to high-water marks since the 2008 recession, sellers of businesses need to remain diligent to avoid pitfalls and maximize the value of their company. Although each sale transaction is a unique experience that presents its own set of challenges, this article will highlight a few common themes that are frequently seen in the context of a business sale.

Take a Closer Look at your Company

A potential seller that thoroughly understands his or her company's financial and legal position can identify and highlight potential issues for buyers, which is a distinct advantage at the outset of a sale process. For example, problematic customer contract provisions (such as restrictions on competition, most-favored-nation (MFN) pricing clauses and exclusive dealing provisions) can be red flags for buyers. Also, non-GAAP revenue recognition and other non-GAAP accounting policies can result in different viewpoints between a buyer and a seller as to a company's actual financial performance. Are your key employees bound by noncompetition and non-disclosure agreements? Are there any unresolved disputes with key customers and vendors? Identifying these types of issues at an early stage allows a seller to proactively address them on the seller's terms, rather than reacting to a buyer's discoveries at a later stage of due diligence.

Take the Lead on Working Capital

Often, a letter of intent for a buyout transaction will specify a proposed sale price for a company, but with only a vague description of how much working capital a seller will be required to deliver at closing. Ultimately, after negotiations, the parties will agree on a working capital target as closing approaches. Every $1.00 increase in the working capital target that the buyer extracts from the seller will reduce the sale proceeds in the seller's pocket by $1.00. A seller that can take the early lead in these negotiations might have a stronger position in arguing for a lower target. The key is to develop a thorough understanding of the company's working capital position throughout the year. Will a 12-month rolling average give an accurate picture of working capital at any given time of the year? Do seasonal business fluctuations suggest that a higher or lower target might be appropriate at certain times? If so, do changes during the year in the company's line of credit balance track the company's working capital levels, which may suggest that a higher target might not be appropriate at certain times? Framing these issues early in the sale process can be an effective strategy to protect the headline purchase price.

Plan Early and Often to Minimize Taxes

Will Rogers once said, "The only difference between death and taxes is that death doesn't get worse every time Congress meets." Income taxes, which are often the seller's single largest expense, have gone up and become more complicated in recent years. The good news is that sellers can minimize taxes through careful planning and negotiation. Here are some key tips:

- Start planning before you market your business. Analyze your corporate structure and tax positions to put yourself in the best position to maximize after tax proceeds.
- Focus on the optimum deal structure, including a possible "win-win" asset sale scenario, to maximize after-tax proceeds. The structure of the transaction is often critical to determining after tax proceeds. A seller can often maximize the sale price and minimize taxes in asset sale structures. Buyers will often pay a higher price in an asset sale because such structures can reduce the buyer's taxes after the closing. On the other hand, an asset sale may trigger substantially higher taxes for some sellers. Understanding this issue at the beginning can help manage expectations and set the framework for a productive negotiation.
- Address key tax points at the letter of intent stage. Frequently, critical tax items are deferred until late in the process, when buyers tend to have more negotiation leverage. Sellers can often achieve a better result by addressing key tax issues, such as purchase price allocation, in the letter of intent.
- Structure management incentives to maximize tax benefits for sellers and avoid tax penalties. A company can create tremendous incentives for management to generate value and maximize sale proceeds for owners by adopting a well-designed compensation plan. However, the tax code has significant penalties for poorly-structured incentive compensation plans. Careful design and implementation of these plans can avoid tax sanctions while at the same time maximizing tax benefits for the owners when the compensation is ultimately distributed.

Don't Get Caught off Guard

Selling a business is a complicated process with pitfalls at every turn for those caught off guard. Although current purchase price multiples reflect a seller's market, the deal process gives buyers many opportunities to claw back value from unprepared sellers. Sellers should consult qualified legal advisors before undertaking a potential sale process to help maximize their sale proceeds.