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Ten Steps to Prepare Your Business for Sale Later

A full text version of [Ten Steps to Prepare Your Business for Sale Later Handout] is also available in a PDF / print friendly version for your convenience.

Don't let predictable events, such as your pending retirement, dictate the terms of your exit. Instead, view exit planning as an ongoing process that you should initiate now, regardless of your targeted exit date. Remember, having a well-designed and executed exit strategy will increase your chances of achieving desired results by encouraging multiple competitive offers and maximizing financial proceeds when the time comes to transition or sell your business.

Step One:

Take the time to learn and understand valuation principles, as they provide the framework for all of the other steps.

- Cash flow is the key metric, and consistency and sustainability are paramount.
- Your task will be to convince potential buyers that your historical performance will be sustainable and will increase in the future.
- Understand that "country club talk" and EBITDA multiples may have limited application to your business.
- Be realistic. "Because that's the price I need" is not persuasive.
- Consider "multiple arbitrage" value of having real estate owned outside of the company, i.e., the valuation multiple of real estate cash flow is often higher than the tenant-business's cash flow multiple.

Step Two:

Understand the tax implications of various types of sales transactions and take steps to minimize tax on sale.

- Buyers prefer and are often willing to pay up for an asset purchase that allows them to limit their exposure to legacy liabilities and to step–up the value of the assets for tax purposes.
- Consider making an S–election if you are a C–corporation to minimize or eliminate double tax on sale.

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- Consider forming a separate LLC to conduct new operations with significant growth potential.

Step Three:

Understand working capital (inventory + accounts receivable + prepaids −accounts payable − accrued expenses) and work to minimize the "normalized level" that is required to operate your business.

- This will be the target that a buyer will require you to deliver at closing.
- Each dollar of reduction is a dollar in your pocket.
- Try to document non-recurring reasons for elevated levels, such as a particularly slow paying former customer.
- Minimizing working capital levels is simply a good business practice, regardless of a pending exit.

Step Four:

Make yourself and your salary redundant—this will have the added benefit of allowing you to take time off or devote your time to more strategic issues.

- Begin letting go. A buyer wants to purchase a business that is not reliant upon the exiting seller (consider an outside board if you don't have one).
- Develop and empower your management team so that you become redundant.
- Consider long-term incentive plans that align management's interest with yours.
- Review and/or implement noncompetes, work-for-hire and confidentiality agreements/procedures with employees.

Step Five:

Understand the types of potential buyers. Know which most closely align to your goals (or do not) and tailor your plan accordingly. Realize that this need not be an "all or nothing" approach and that rolling over some equity may generate a "second exit" more profitable than the first.

- Strategic Buyer
- Management Buyer
- Private Equity
- Individual Buyer

- Family Member
- ESOP

Step Six:

Enhance your financial and administrative processes and controls.

- While "close enough" may be good enough for you, it will not be good enough for a buyer.
- "Our financial statements are fine…." Right!
- Understand what drives profitability in your business and develop processes to timely monitor and react to these key performance indicators.
- Timely financial reports and being able to articulate to potential buyers the reasons for changes in profitability, both upward and downward, will increase your credibility and be a positive influence on a buyer's decision.
- Implement procedures to identify and capture one-time, non-recurring, or unusual expenses for purposes of normalizing EBITDA.
- Consider stepping up to an independent review or audit by your CPA firm (which, with the increasing use of representation and warranty insurance, may allow you to acquire greater levels of insurance coverage, including "multiple of earnings" damage coverage).
- Develop and implement a capital expenditure policy that is designed to lower capital expenditure requirements.
- Review contracts with customers and suppliers.
- Protect and secure the company's intellectual property rights, including third-party software.

Step Seven:

Reduce customer (and supplier) concentration, which increases the risk of sustainable cash flow.

- A company with a lower EBITDA but diverse customer base may be more valuable than one with higher EBITDA but with dependency on a small number of customers.
- Long–term contracts with key customers help to mitigate the risk.

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Step Eight:

Run it like a business and not a tax shelter or a family trust.

- Saving 45% in taxes each year for each dollar of personal expenses run through the company may cost you four to eight times the actual amount of such expenses (based upon a multiple of EBITDA) at the time of sale.
- While earning can be “normalized” to add back non-operating or non-recurring expenses, such amounts may be difficult to substantiate after the fact and, more importantly, may impact your credibility.
- The goal is to credibly show a buyer what it will take from an expense standpoint to run the business after closing.
- Clean up your balance sheet by removing, or at least identifying, assets not necessary for the operation of the business and the costs incurred with respect to those assets.

Step Nine:

Provide potential buyers with a credible plan and ideas to grow the business, and present a reasonable and defensible forecast that shows the potential value.

- Identify organic opportunities, such as enhanced efficiencies through additional capital expenditures or credible means to replace lower margin sales with higher margin sales.
- Identify potential synergies that a strategic buyer could unlock, such as elimination of redundant costs, efficiencies of sale, increased pricing opportunities and reduction of material costs.
- The fact that growing the business may not fit your current risk profile (or energy level!) does not mean you shouldn’t think about the ways of doing so and articulate your vision to potential buyers.

Step Ten:

Assembling a team of trusted advisors and functional experts should pay for itself by unlocking savings and adding value.

Potential members:

- You

- Your key employees
- Accountant
- Tax specialists
- M&A attorney
- IT specialists
- Banker
- Wealth manager
- Insurance advisor
- Investment banker
- Most would welcome the opportunity for an “off the clock” discussion with you as you initiate the process.
- Understand that the actual sale process is an incredibly time consuming and often frustrating process that will leave you and your key personnel distracted.
- Your goal should be to get ahead of the issues and present a well-prepared business that enhances interest from buyers and minimizes their ability to raise questions regarding its assets or operations that would inevitably result in a lower price.