PREPARING A PRIVATELY HELD BUSINESS FOR SALE

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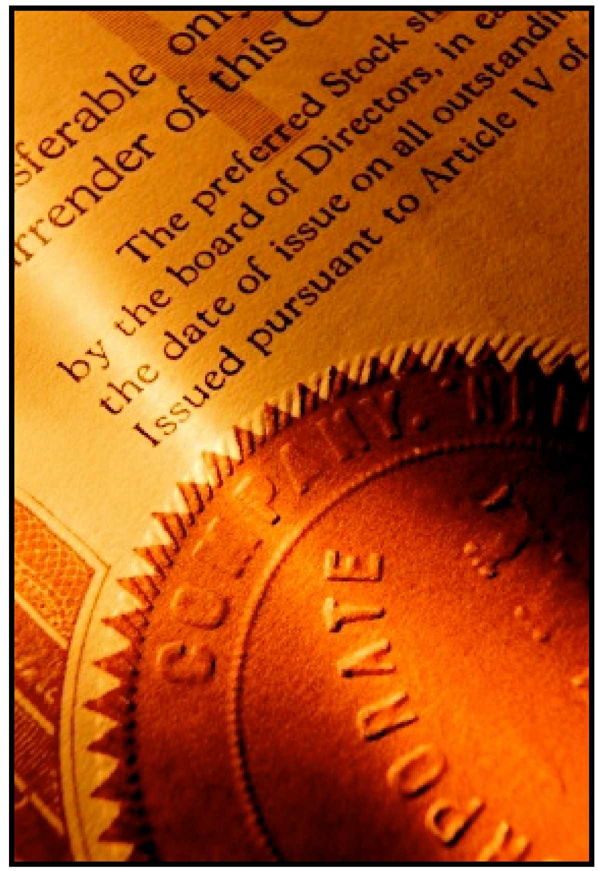
What are the key things a business owner should do to prepare a business for sale?
By Patrick Harkins | President, Anchor Business Advisors, Inc.

A business owner recently asked me to succinctly define what a privately held company and owner must do in order to prepare the business for sale. I segmented my response into major categories as follows:

Financial



Since all business sales are based upon a multiple of the cash flow (either EBITDA or Discretionary Cash Flow), the owner must have all of the financial records segregated and in good order. At a minimum, we would suggest having three years of financial statements and tax returns. If there are substantial differences between taxable income and book income (e.g. cash basis vs. accrual), those must be identified and explained. Culling out all significant discretionary expenditures along with isolating any unusual and non-recurring expenditures and losses will be important.

Operations

The Seller will want to identify all products and services provided by his (her) company and the specific markets served. In this review, it will be important to define the strategic advantages enjoyed by the company in their respective niche as well as comparative gross profit margins for each product and service.

Growth Opportunities

While buyers will purchase a business at a price predicated on current and historical cash flows, the main impetus for the purchase will be the ability of the buyer to grow the business at a rate that exceeds the norm for similar opportunities. It is important for the Seller to visualize those growth possibilities and define them tangibly in terms of product extensions to current lines, existing products to new markets, better market penetration, wider geographical distribution and etc.

Management Structure

In addition to transitioning the current customer base in an acquisition, the buyer will have concerns about the depth, breadth and ability of the current management team and their willingness to stay on board after the deal is consummated. The Seller should have an Organization Chart which defines the direct reports to the CEO along with their titles and responsibilities. Ideally, you would have a management profile available that gives a brief resume of each manager along with his salary history and longevity with the firm.

Deal Structure

The preponderance of transactions in the sale of privately held companies are handled as an asset sale (versus sale of stock). This type of sale will result in the buyer receiving a stepped up basis in the assets purchased (which generates future tax deductions) while concurrently avoiding unwanted contingent liabilities that result from a stock sale. The owner must sit down with his CPA and/or attorney and understand the tax implications of this transaction under each scenario so that he will not be surprised at closing or worse yet, when preparing his individual and corporate tax return. Remember, it's not what you get but what you keep that counts!

Available Financing

Most owners would prefer to be cashed out of the transaction at closing and do as little owner financing as possible. To a large degree, this will be dependent upon the basic cash flow add backs including net income, depreciation, interest and owner compensation. Most lending institutions whether SBA or conventional, will typically shun discretionary add backs falling outside these parameters. In aggregating these cash flow components, the financing companies will consider: required compensation of new owner, debt amortization period, debt coverage ratios and available collateral to determine the extent of financing offered.

As you can well see, there are plethora of items that must be addressed in the sale of any existing business. The more time spent in developing comprehensive answers to these questions and issues upfront will pay dividends in the end with an easier due diligence period as well as a smoother close.

Jeff Snell is the founder and Principal Broker of Enlign Business Brokers, a member of the International Business Brokers Association [IBBA] and a Certified Business Intermediary [CBI], the American Business Brokers Association [ABBA] and an Accredited Business Intermediary [ABI]. He can be reached at (919) 341-1100 or jsnell@enlign.com.

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