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business sales and acquisitions for entrepreneurs

A GUIDE TO SELLING YOUR CONSUMER PRODUCTS BUSINESS

Frequently Asked Questions

Deciding how and when to sell your business is an important and complex process. At Hughes Klaiber, we guide our clients through every step of selling a business, from initial planning to a successful exit.

In the pages that follow, we've assembled many questions entrepreneurs ask as they begin to consider a potential sale in today's environment.

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Selling a business can be time-consuming and stressful. However, with a clear understanding of how the process works, you'll be better prepared to make decisions and handle a sale.

WHO MIGHT BUY MY COMPANY?

Generally there are two types of buyers who purchase most consumer products companies:

- Strategic buyers are companies already involved in consumer products, who want to further develop their own businesses via acquisition. Many companies find that buying another company is easier and quicker than building business organically by finding new clients. You've heard of acquisitions by leaders like SC Johnson, Unilever, Johnson & Johnson, and The Estee Lauder Companies; but there are many mid-sized companies with less name recognition who are also interested in acquiring consumer products brands.
- Financial buyers include private equity firms or other investment groups that have raised capital and may be interested in helping you or another management team expand the company for a future sale or other liquidity event. Financial buyers are usually looking for companies with strong current and projected growth. Just like the strategic buyers, financial buyers range in size and acquisition criteria, from Castanea Partners and TSG Consumer Partners, who are generally interested in larger deals; down to three- or four-person private equity funds with a focus on acquiring small brands or those in a turn-around situation.

We're currently seeing an increase in buyers who are a hybrid of the two types. They include private equity firms looking to make a purchase to complement an existing platform company; and more recently, platform buyers interested in businesses with distribution on Amazon and other DTC channels.

Entrepreneurs often ask us whether strategic or financial buyers pay the most for a business. Historically, strategic buyers have historically had the reputation for paying the best prices to acquire a company, but in today's market with excess private capital funds available, strategic buyers may be outbid by private equity buyers.

But the buyer that pays the most for your business is likely to be the one that sees the best fit and upside potential for your business, no matter the category of buyer.

It's important to consider a wide range of buyers, and careful planning and execution of the sales process helps bring the best buyers to the table.

HOW MUCH IS MY BUSINESS WORTH?

The most common way to value a privately held business is as a multiple of the last 12 months' earnings before interest, taxes, depreciation, and amortization (EBITDA), adjusted to exclude some one-time, non-recurring revenues or expenses and to normalize owner's compensation.

If you hear someone use a term like a "seven times multiple," it generally refers to a valuation that is seven times the company's trailing 12-month adjusted EBITDA. The appropriate multiple used to value your company is derived from recent sales of comparable companies in your industry, but can also vary up or down, based on a wide range of factors specific to your company, including, for example, your growth prospects, track record, brand, client base, margins, inventory, intellectual property, and a host of other factors specific to your company.

In addition to using the multiple of EBITDA approach, some buyers value companies using a multiple of revenue approach. This is more typical for high-growth companies. Both of these approaches are based on historical financials, with the assumption that past performance will reflect the future performance of the business. Sophisticated buyers and private equity firms will also likely build a discounted cash flow model, which projects the future income of the business over multiple years, and then uses a discount rate to calculate their perception of value.

While valuations for consumer products companies are generally strong compared to other categories, the valuation of your company will depend on many factors, including your branding, product differentiation, margins, distribution channels, retail relationships, and financial performance.

Bear in mind that the value of your business as stated on paper is a hypothetical amount. The true value of the business is how much one or more buyers will pay for it. No two buyers put the exact same value on a company, and buyers' perceptions of value are also driven by their ability to build future income.

It's easy to fixate on a price for the business, but the terms associated with the transaction are just as important as the price. A transaction that is paid all cash at closing may be significantly more attractive than a higher valuation that includes some form of delayed or contingent payment. The way in which the transaction is structured can also significantly impact how much you pay in taxes. Working capital adjustments, escrow, your compensation post-closing, your non-compete terms, and many other issues can also each play a major part in the real value and attractiveness of a transaction.

Finally, the way in which you market and position the business, and find and manage potential buyers is also an important driver in obtaining value for your business. An effective sales process, that includes compelling marketing materials, organized financials, and a credible road-map to grow the company can all help increase value.

WHEN IS THE BEST TIME TO SELL MY BUSINESS?

There are typically three main factors to consider and balance regarding timing a sale: your personal goals, the growth trajectory and financial performance of your business, and the current economic conditions and prevailing valuation multiples.

In an ideal world, to obtain the best value in an exit, your personal desire to sell comes at a time when the company is growing quickly, and when strong macro-economic conditions are driving attractive valuations. This can definitely simplify your decision-making regarding timing!

But like many other aspects of life, these three factors may not all conveniently align at the same time. Often, an entrepreneur's personal desire to sell is greatest when the company has hit a plateau in growth, when additional investment is required to spur more growth, or when the business needs more experienced leadership than the founder can provide. Conversely, it's not so tempting to sell when the business is growing and the future looks bright.

2021 was a very strong year for mergers and acquisitions activity in the consumer products sector. Deal volume and valuations were at all-time highs. As of mid-year 2022, the M&A market continues to be strong for successful smaller consumer products companies. Private equity firms and strategic buyers are actively looking for acquisition opportunities.

If (as many experts are predicting) the economy slows over the next few months, we will likely see the M&A environment slowing in 2023, with buyers evaluating how each potential business will perform as consumer spending changes. However, barring a major recession, we expect that strong businesses will still command attractive valuations, and well-funded buyers will continue to pursue acquisitions. We do expect increased buyer focus on seeking businesses that are performing well, and that are in growing categories. Some buyers who were unable to find opportunities or who were constantly out-bid in the very strong post-COVID M&A boom are also actively planning to look for acquisitions.

One development, which was amplified due to COVID and which we expect to continue in 2022 and into 2023, is increased interest in smaller acquisitions by larger businesses. A smaller transaction is an ideal way for a big buyer to make acquisitions while limiting risk. Private equity is also focusing on "add-on" opportunities which are smaller companies that complement their existing portfolio holdings.

If you are evaluating timing, we can help you work through these complex issues, and help provide you with information to develop a solution that strikes the right balance between your financial and personal goals.

WHAT IF MY BUSINESS HAS DEBT OR EXISTING INVESTORS?

For consumer products companies that are bootstrapped, it's not uncommon for the business to also have a significant amount of debt, including a line of credit, factoring, or a business loan. Most businesses are sold on a "cash free, debt free" basis, which means you have to pay the debt back out of the proceeds of the sale, but you keep any cash in the bank accounts. For example, if your company valuation is $8 million, but you have $500,000 in debt, you will net $7.5 million after the debt is paid off at closing. In some cases, a buyer may assume the debt, but this is the exception, not the norm.

If you already have investors, the proceeds from the sale will be split between all shareholders according to your cap table (unless you have "preferred" investors who may get paid first.) You will need to ensure your investors are all on board with a sale (unless you have "drag along rights" which means you may be able to "drag" them along, even if they don't agree.)

HOW LONG DOES IT TAKE TO SELL A BUSINESS?

Historically, the average time to sell a company is nine to 12 months, from the time you hire a mergers and acquisitions advisor to a successful closing. However, this varies from company to company and can also be faster in a strong economy, and slower in a challenging environment.

WHEN SHOULD I TELL EMPLOYEES ABOUT A POTENTIAL SALE?

Most entrepreneurs choose to keep a potential sale confidential, to ensure that employees do not become concerned about the company's future prospects. It's not unusual to let employees know that the company has been sold after the transaction is complete. Confidentiality is also important to ensure that clients or vendors don't hear of a potential sale. In some very limited circumstances, it may make sense to let key employees or other important stakeholders know about your plans. For example, if you are in a precarious financial situation, it may help to reassure your employees that you are looking for a way to continue.

DOES THE FOUNDER NEED TO STAY ON AFTER THE SALE?

Most buyers require the founder to help with transition issues. Whether the founder stays on in a management role after the initial transition generally depends on the goals of both the buyer and seller. A strategic buyer may have their own existing team, and may not need you to stay, whereas a private equity buyer will often want the founder to remain committed to the business, retain some equity and continue to run the business. Sometimes a founder will agree to stay with the business in a key role such as product development, or to continue to act as the face of the brand, while relinquishing the day-to-day management headaches.

WHAT STEPS ARE INVOLVED IN SELLING THE BUSINESS?

There are three key phases to successfully sell a consumer products company:

1. **Preparing the business for sale**. Careful preparation for sale is the critical first step towards a successful outcome and maximizing value in a sale. We work closely with clients to understand and evaluate the business, identify a likely valuation range, and develop sophisticated, professional marketing materials to highlight the unique characteristics and growth opportunity of your company. Sometimes you might hear these materials referred to as a "CIM" (short for confidential information memorandum) or a "book." Proper preparation helps ensure the later due diligence process moves smoothly, resulting in a higher potential selling price, and increased likelihood of a sale.
   An equally important component of preparing for a sale is developing a list of qualified prospective buyers, who have the ability to continue to run your business, and the financial wherewithal to acquire it from you. While there are sometimes valid reasons to limit the number of prospective buyers, reaching a broad section of qualified buyers can generally increase the likelihood of success, and increase the attractiveness of the valuation or deal terms. Over time, we have built a large database of buyers looking to acquire consumer products companies.

2. **Buyer conversations**. Once your marketing materials and buyer lists are complete, we start to reach out to buyers. The time and effort spent preparing the business for sale and developing professional marketing materials pays dividends in ensuring buyers are able to understand your business, and quickly decide whether to move forward. Of course, all buyers sign a non-disclosure and confidentiality agreement before they receive any confidential information on your business.

   As buyers express interest in your business, you will meet with them to answer their questions, and have an opportunity to ask them your questions. We help you navigate these meetings, helping you put your best foot forward, and highlighting the benefits of your business that will appeal to each buyer.

3. **Finalizing the transaction**. This last and very crucial step in successfully selling your business includes moving from a buyer's initial interest to obtaining and negotiating one or more strong letters of intent ("LOIs"), that outline all the proposed terms associated with the acquisition. Once a final buyer is selected and acceptable letter of intent signed, your buyer will likely want to conduct additional due diligence, to confirm that all information provided during the earlier stages is accurate. We manage this process, and help you provide the required documentation.

   In conjunction with the due diligence phase, the buyer's legal counsel will generally prepare asset or stock purchase documents, based on the terms agreed in the letter of intent. Your legal counsel will generally finalize the terms in these agreements, and prepare detailed closing documents, which can vary based on the type of transaction. Your final steps in the process are to review and sign the closing documents, receive payment (usually by wire transfer into your bank account), and assist the buyer with the transition to new ownership.

WHO SHOULD I HIRE TO HELP SELL MY BUSINESS?

Selling a business can be a time-consuming and challenging process, and most entrepreneurs decide to hire an advisor or investment banker with experience selling companies to provide advice and guidance on valuation, prepare marketing materials, introduce buyers, and manage the overall process to get to a successful sale.

Our experienced advisors at Hughes Klaiber can help you manage the entire process. We typically focus on working with consumer products companies with annual revenues of at least $4 million. Set up a confidential conversation to discuss how we can assist you here.

Other equally important members of your deal team are your CPA and your lawyer. The legal aspects and pitfalls in a transaction can be complex, and your lawyer should ideally have experience buying or selling companies similar to yours.

WHERE DO I START?

Please contact us to schedule a free, no-obligation, confidential conversation to discuss your business and your goals, and to answer your specific questions about selling your business.

You can reach out via email, call us, or schedule a confidential consultation here:

https://calendly.com/sallyannehughes

ABOUT HUGHES KLAIBER LLC

At Hughes Klaiber we guide clients through every step of selling a business, from initial planning to a successful exit. We combine transactional experience with a thoughtful approach, and an unwavering commitment to help our clients achieve their goals.

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