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mergers and acquisitions for entrepreneurs

The Entrepreneur's Guide To Selling Your Business

Practical Answers to Frequently Asked Questions

Selling a business is an important and complex transaction. At Hughes Klaiber we guide our clients through every step of the process, from initial planning to a successful exit.

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

Choosing when and how to sell a business can be a complicated decision, with important personal and financial implications. With a clear understanding of how the process works, you'll be better prepared to handle a sale.

Who might buy my company?

Generally, there are three types of buyers who purchase companies:

- **Strategic buyers** are already active in your industry or an adjacent industry. They range in size from large publicly held companies to smaller direct competitors, and make acquisitions on the hypothesis that an acquisition will help drive their own growth.

- **Financial buyers** include private equity firms, family offices or other investment groups interested in helping you or a management team expand the company for a future liquidity event. Financial buyers are usually looking for companies with strong projected growth. These buyers also range in size and acquisition criteria, from global private equity firms down to three- or four-person private equity funds with a focus on acquiring small companies.

- **Individual buyers** also buy many smaller companies, often with the use of SBA financing which is relatively easily available up to $5 million.

Many buyers are a hybrid of these three types, such as private equity firms looking to make a purchase to complement an existing platform company via an "add-on" acquisition.

Entrepreneurs often ask us whether strategic or financial buyers pay the most for a business. Historically, strategic buyers have paid the best prices to acquire a company. However, in today's environment, strategic buyers are increasingly outbid by private equity buyers with significant capital to deploy.

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?

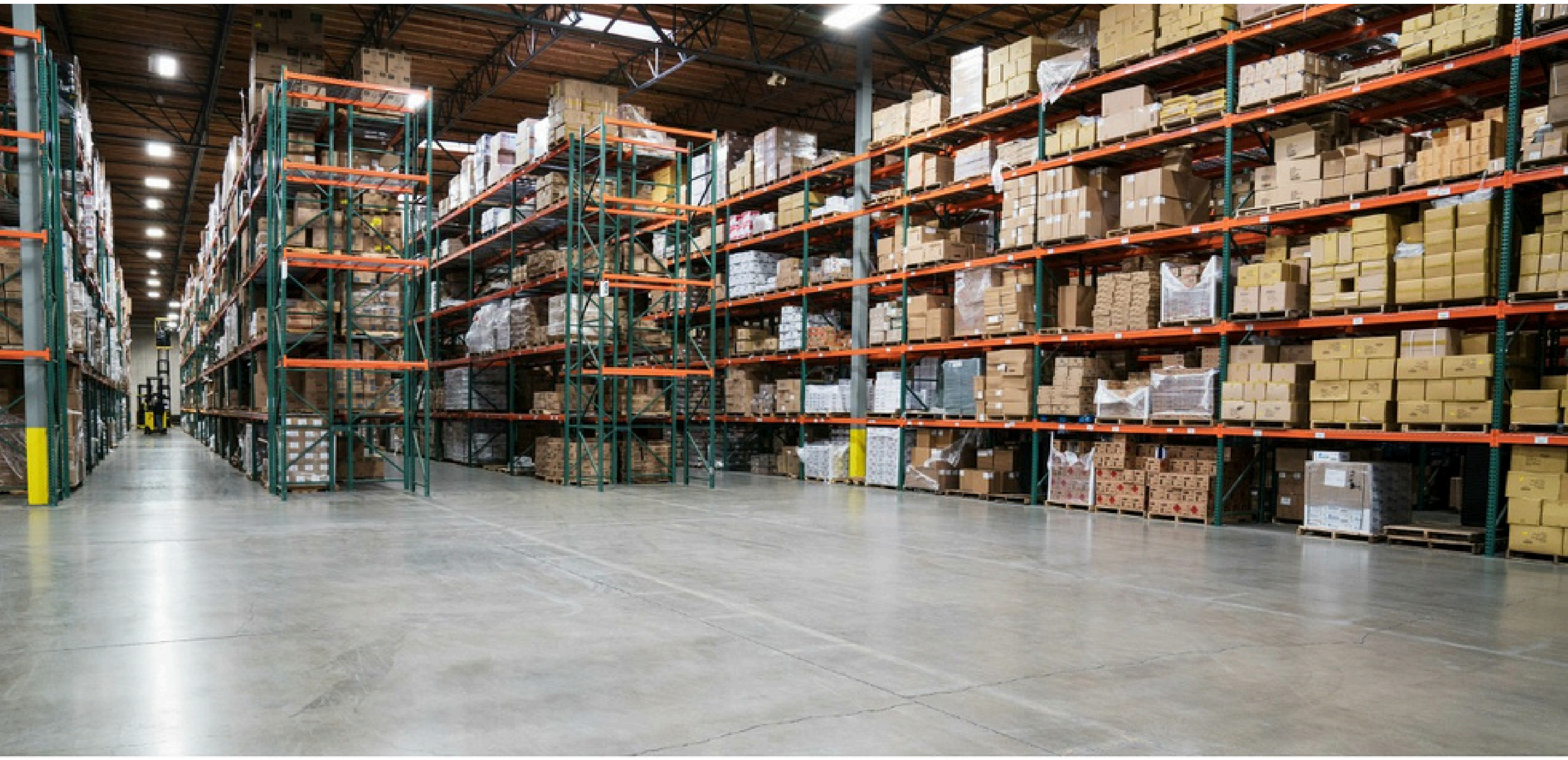
The most common way to value a privately held business is as a multiple of the last 12 months' earnings before interest, taxes, depreciation, and amortization (EBITDA), adjusted to exclude one-time, non-recurring revenues or expenses and to normalize owner's compensation. Some buyers use a weighted average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

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 the same industry, but will also vary up or down based on factors specific to your company, including, for example, your growth potential, gross and net margins, track record, brand, client base, inventory, distribution channels, management team, product differentiation, intellectual property, customer relationships, and a host of other factors.

In addition to the multiple of EBITDA approach, some buyers value companies using a multiple of revenue. This is more typical for high-growth companies. Both 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 an appropriate discount rate to calculate the present value of the company.



Some of the criteria which will likely improve a company's valuation multiple include:

- Strong historical growth and opportunities to continue the growth trajectory.
- Above-average gross and net margins.
- Recurring revenue, long-term customer relationships, or contractual revenue.
- Strong supplier relationships and diversified supply chain
- Ability to expand geographically with minimal incremental cost.
- Strong management team with limited dependency on any one key employee.
- Broad or diversified customer base (i.e. low customer concentration).
- Strong branding and positioning.
- Competitive differentiation.

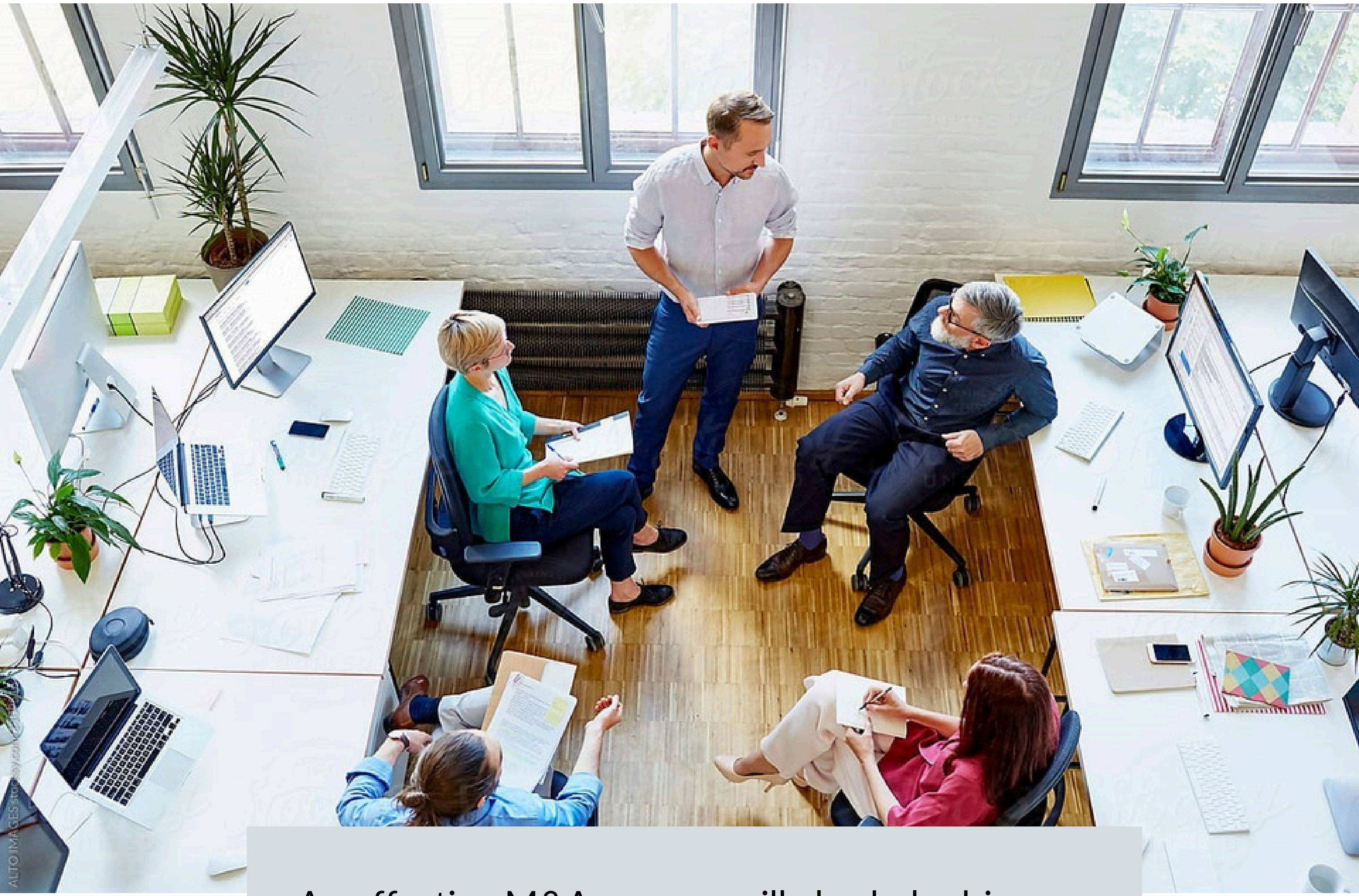
Of course, characteristics opposite of the above will negatively affect valuation.

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.

The way 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 roadmap to grow the company, will all help increase value.



An effective M&A process will also help drive an increase your valuation, and significantly increase the certainty of closing the transaction.

A strong process includes providing qualified, motivated buyers with compelling marketing materials, organized financials, and a credible road map to grow the company.

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

When is the best time to sell my business?

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 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, or when the business needs more experienced leadership.

Conversely, it's not so tempting to sell when the business is growing and the future looks bright. However, companies that are performing well and growing receive higher valuations.

If you are evaluating timing, it's important to develop solution that strikes the right balance between all three factors. We spend a significant amount of time working with entrepreneurs to identify the best time to exit their business.

What if my business has debt on the balance sheet?

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 a line of credit, 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.

What about existing investors?

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.)

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. However, in some limited circumstances, it may make sense to let key employees or other stakeholders know about your plans. For example, if you are more than ready to retire, it may help to reassure your employees that you are looking for a new owner. In some cases, a buyer may want to interview key employees, which has to be carefully handled.

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.

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Does the founder need to stay on after the sale?

Most buyers require the selling owner to help with transition issues. **Whether the founder stays on in a longer term management role 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.

What steps are involved in selling the business?

There are three key phases to successfully sell most businesses:

Phase One: Preparing the business for sale.

Careful preparation for sale is the critical first step towards a successful outcome and maximizing value.

We work closely with clients to understand 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 confidential information memorandum or "book."

Proper preparation helps attract qualified buyers and ensures the later due diligence process moves smoothly, all resulting in a higher potential selling price, and greater certainty of closing the transaction.

An equally important component of preparing for a sale is developing a list of qualified prospective buyers. 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.

Properly preparing the business for sale is a critical step to ensure a successful transaction.

Phase Two: Working with buyers.

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 the opportunity in your business, and quickly decide whether to move forward.** 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.

Phase Three: Finalizing the transaction.

This last step in successfully selling your business starts with moving from buyer interest to negotiating one or more strong letters of intent ("LOIs"), which should outline all of the proposed terms of the transaction.

Once a final buyer is selected and acceptable LOI is signed, your buyer will conduct additional due diligence, to confirm that all information provided during the earlier stages is accurate, and that there are no additional issues.

In conjunction with the due diligence phase, the buyer's lawyer will generally prepare purchase documents, based on the LOI. Your legal counsel will help 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 by wire transfer into your bank account, and assist the buyer with the transition to new ownership.**

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Who should I hire to help sell my business?

Selling a business can be a challenging process, and experienced advisors can add significant value. Most entrepreneurs decide to hire an investment banker or M&A advisor.

Our experienced investment bankers at Hughes Klaiber can guide you through the entire process. We have helped many entrepreneurs successfully exit their businesses, selling to strategic, private equity and individual buyers.

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 have significant M&A experience.

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 questions about selling your business.

Contact us via email at info@hughesklaiber.com, or schedule a confidential consultation here: *https://calendly.com/sallyannehughes*.

About Hughes Klaiber LLC

We bring over 18 years of experience helping a wide range of entrepreneurs successfully sell their businesses.

Please contact us to schedule a confidential conversation to discuss your goals and business.

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