

M&A Insights

Three Key Considerations for Owners Contemplating a Business Sale

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The sale of a business can be one of the most important transactions in an individual's life, particularly for founders and owners of closely held businesses. It is an event that requires careful consideration of many distinct factors, with varying degrees of complexity. Whether motivated by personal goals such as retirement, or by financial objectives like asset diversification, selling a company requires tangible goals, critical evaluation of the asset, and a strong team to successfully navigate a strenuous event.

For business owners who have resolved to sell, understanding the intricacies of a transaction can eliminate surprises, quell nerves, and create advantageous positioning during negotiations. This white paper explores three key considerations essential for business owners to study before pursuing the sale of their company: 1) Identifying your transaction goals, 2) Knowing your company's financials, and 3) Building your transaction team. These are all crucial factors in ensuring a successful mergers and acquisitions (M&A) process.

Consideration 1: Identify your Transaction Goals

Defining your transaction goals before exploring a sale is an essential step of the M&A process. Goals will set success parameters and guide expectations for all parties throughout the process. With clear objectives, your M&A team will be able to work towards an outcome which aligns with your personal and strategic objectives.

1. What are your goals surrounding employees, customers, and vendors? A transaction allows an owner to exit the business, take chips off the table, and secure their financial future. Since this is typically an owner's primary goal, it is easy to overlook how a sale could affect stakeholders such as employees, customers, and vendors. Charter advises that an owner takes meaningful time to contemplate how the business will unfold post-transaction, and how certain terms in the purchase agreement could affect company stakeholders following their exit. Selling a business can be an emotional process for many different participants, and reducing concerns about layoffs or ensuring an unchanged supply chain for a customer can go a long way in maintaining relationships.

2. What type of buyer fits your preferred dynamics?

There are many types of buyers that may be interested in purchasing your company. First, **strategic buyers** operate in the same industry and will be interested in growing their own operations. As a result, strategic buyers have a long-term hold period. Secondly, **financial sponsors** consist of private equity funds who raise funds and return capital to their investors, so hold periods are typically much shorter (3-8 years). Additionally, **hybrid buyers** are characterized as private equity-backed strategic companies seeking to grow through the addition of companies with similar capabilities. Hold periods for hybrids can be more akin to strategic buyers as the add-on will most likely remain as part of the platform. All in all, knowing your buyer options will help ensure that your values align with those of new ownership.

3. How do you view your transition period? Another critical component to consider is a transition period. Certain buyers will have different requirements for how long current ownership stays with the company. This depends on many variables such as current ownership's involvement in the operations of the business, but most groups will like the owner to delay departure for a smooth transition. If an owner is active in the business, Charter recommends considering a few different outcomes such as a 6 to 12-month consulting contract, or a 3-year employment agreement until a suitable replacement can be found. Clearly communicating your desired transition period at the start of the process is vital as it can have meaningful financial, valuation, and legal impacts at later stages of the transaction.

Consideration 2: Know your Numbers

Financial preparedness is foundational to a successful transaction. It is critical for business owners to understand which financial metrics are key, as they provide valuable insights into the financial well-being of the company. A few critical metrics to understand include:

1. EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization): EBITDA is a measure of a company's core operating performance. Removing items related to capital structure, like interest, taxes, depreciation, and amortization allows a third party to analyze the performance of a business free of noise. Adjustments to EBITDA are also considered to normalize income and expenses unrelated to regular business operations. Examples of these adjustments may consist of, but are not limited to, owner/founder personal expenses, non-operational income sources such as gains on asset sales, and market-rate rent normalization.

2. Forecasts/Backlog: Performance sustainability is vital to a successful transaction. Building top line goals enables management teams to plan operations, set budgets, and allocate resources appropriately to reach their targets. However, a full M&A process can take over 6 months, and the financial performance of the company will be closely tracked throughout this period. Providing future sales detail to buyers can set baseline performance expectations, and if a month or two are missed due to unforeseen events, such as supply chain issues, buyers may use this metric to ding value. In addition to setting realistic projections, maintaining a detailed sales backlog tracking purchase orders can be helpful in reaching goals, thus creating buyer comfort.

3. Working Capital: On the surface, working capital is a simple calculation – Current Assets minus Current Liabilities. However, there are many nuances involved within this financial metric including which balance sheet items are included, which items are excluded (deemed as "debt-like"), and determining an appropriate target amount that must be delivered at close. Since working capital can have implications on proceeds paid at close, it is crucial for business owners to have a firm grasp on their balance sheet and understand the nuances of net working capital.

4. Profitability: Generally, gross, operating, and net profit margins are standard metrics in determining company performance. In today's M&A market, buyers are seeking greater detail to identify the drivers of this profitability to understand sustainability, and to identify growth opportunities once the acquisition is complete. For example, buyers often look at profitability by customer, by product, and by end market. Additionally, buyers will dig into price versus volume trends to understand the impact of inflationary gains. Knowing these details of your business will allow you to get ahead of buyers and establish data-based growth targets and goals.

All in all, knowing your numbers is vital to data-driven decision making which can ultimately add material value during the M&A process. Having the right financial systems in place, and understanding how to process, analyze, and draw conclusions from this data can help stakeholders better evaluate trends within the company which can smooth the transaction process.

Consideration 3: Build your Team

The M&A process is arduous and complex. Having a strong sell-side transaction team is an essential part of getting a deal completed efficiently. Charter recommends engaging with capable and reputable firms who bring expertise to minimize stress and increase return on investment for a deal that is often the most important transaction in the seller's life.

1. Investment Banking: An investment bank provides expert guidance, strategic buyer negotiations, and optimized deal structures to help maximize a company's value in the marketplace while minimizing risks to ensure a successful transaction. The benefits of hiring an investment banker include creating a competitive market, providing access to unique buyers, leveraging knowledge to vet past behavior of buyers, and taking the burden off your management team, so that you can focus on operational performance. Most importantly, investment bankers are experts in the process of selling companies. Experience brings a wealth of knowledge that will be crucial in a successful closing with terms and deal structure that are the most favorable to you.

2. Legal: Engaging with a legal team that specializes in mergers and acquisitions is imperative for minimizing risks and creating superior outcomes. Addressing potential legal issues proactively minimizes the risk of disputes or litigation post-sale, so business owners must conduct a comprehensive review of contracts, licenses, permits, and intellectual property rights to identify any potential legal hurdles or liabilities. Managing these documents in addition to complexities of transaction documents, can be time consuming and complicated, and M&A legal counsel is essential in drafting and negotiating sale agreements, non-disclosure agreements, and other legal documents. With a strong legal team, post-transaction legal exposure can be mitigated, and excellent outcomes can be achieved.

3. Accounting/Tax/Wealth Management: As mentioned previously, knowing your numbers is crucial to a successful transaction. Charter may recommend engaging with a third-party accounting firm to perform a Quality of Earnings ("QoE") financial audit which can deliver clarity on the company's financial health. Additionally, a full QoE can provide support to help build compelling arguments for significant add-backs, where appropriate, which will help maximize the value of your company. Furthermore, proceeds resulting from the sale will inevitably create tax and estate implications. Proper wealth management and tax planning can help minimize liabilities and optimize the after-tax proceeds from the transaction. Business owners should consult with their wealth managers and tax advisors to explore different strategies, such as structuring a deal as an asset sale, or utilizing tax-deferred exchanges where applicable, in order to secure long-term financial stability.

4. Management Team: Aside from external advisors, it is important that a seller identifies and brings internal confidants into the fold as well. Since the existing management team will likely stay in place post-transaction with the new buyer, Charter recommends making a few members of the company's leadership available to assist with the transaction. Employees responsible for the strategic vision, financial controls, and human resources are often key to a successful deal. These employees will add value to the process by providing essential information and a wealth of company knowledge. Furthermore, bringing these team members into the circle sooner rather than later will give them an appropriate amount of time to adjust to the idea of the sale and a new owner.

Conclusion:

Selling a business is a multifaceted endeavor which requires careful planning, strategic foresight, and meticulous execution. By examining the critical considerations outlined in this white paper – identifying your goals, knowing your numbers, and building your team – business owners can navigate the complexities of the sale process and maximize value for themselves, and for their stakeholders. With proper preparation and guidance, the transaction process can become more transparent and lead to a successful sale for all parties involved.

About Charter

Founded in 1989, Charter Capital Partners is a premier investment banking firm headquartered in Grand Rapids, Michigan. We offer a comprehensive range of investment banking advisory services, including buy-side and sell-side M&A, succession planning, business valuation and capital raise.

About the Author



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Michael is an Associate in the Mergers and Acquisitions practice at Charter. His responsibilities include conducting financial deal analysis, executing industry and financial due diligence and managing client engagements. Michael has transaction experience across a variety of industries including the health and wellness, healthcare, and diversified industrials sectors.

In 2022, Michael earned his MBA from the University of Notre Dame where he concentrated in Finance and Investments, graduating with Honors. Prior to joining Charter, Michael worked in the healthcare industry and holds a B.S. in Biology from the University of San Francisco, as well as a Certificate from University of California Berkeley's Health Professions Program.

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