

Selling A Company



**ATLANTIC MANAGEMENT COMPANY
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ATLANTIC MANAGEMENT COMPANY

Atlantic Management Company is a leading valuation and financial advisory firm that has been serving New England's business, legal and financial communities since 1968. We provide our clients with a broad range of specialized services that meet their valuation, merger and acquisition, ownership transition, and corporate finance needs.

Our client list is widely diversified and includes many of New England's largest and most successful companies in both the private and public sectors. We work with companies in virtually every industry from basic manufacturing to emerging high-tech disciplines, as well as retail, wholesale, and consumer and business services.

Atlantic's reputation for excellence reflects the technical capabilities of our professional staff. Individually, each is a results oriented specialist with outstanding academic and career credentials. Together, they comprise a team with backgrounds in the fields of finance, economics, banking, accounting, taxation, engineering and management. We invest in people to further develop our firm and insure that our clients' needs are met in a timely manner. And we continually broaden our research capacity and computer modeling capabilities to provide our professional staff with state of the art analytical tools and data resources.

In every engagement we undertake, one quality prevails: Judgment. The result of over 30 years experience, the judgment we bring to each assignment uniquely qualifies us to develop workable solutions to complex business and financial issues.

Introduction

For many business owners, selling their company happens only once in their lifetime while many corporate buyers acquire numerous companies. Therefore, the situation is often one where the owner is inexperienced in selling a company while the acquirer has completed numerous transactions, thus having the advantage. The purpose of this monograph is to highlight the various aspects of selling a company, to offer some guidance and to impress upon our readers the absolute importance of obtaining the “best” professional advice.

Motivation

Numerous surveys have been recorded as to what are the principal reasons owners sell their business. Surprisingly, financial reasons are rated number four! The major reasons in order of importance are as follows:

- Burnout
- Lack of growth capital
- Competitive pressures

Ideally, it takes 6 to 12 months to prepare a business for sale and then another 6 to 12 months to actually sell the business or 12 to 24 months to complete the process properly.

The message is not to wait until the owner “hits the wall” with burnout and makes the ill-advised decision to “unload” his or her life’s work (the business) as quickly as possible. Timing and preparation is very important, so the owner might consider selling out at age 59 instead of waiting until 65 years old. If the owner insists on leaving right after the company is sold, it could adversely affect the selling price of the business. Some years ago the Wall Street Journal estimated that if an owner was willing to “stay-around” after the sale that he or she could expect to receive up to a 20 percent higher price.

Concerns

The seller of a business naturally is concerned about confidentiality. What will happen if the sellers’ customers, vendors and employees hear that the company is for sale?

The seller is obviously concerned about what he or she can expect to receive for the business (sales price). Unfortunately many sellers do not take the time to figure-out what will be realized after all the considerations are deducted from the purchase price, e.g., debt repayment to the bank, taxes, all closing costs, severance or stay agreements with employees, etc.

Other concerns are how long is the selling process, how much will it cost, who are the most logical acquirers, will the buyer take care of the remaining employees, etc. These concerns accentuate the need for professional advice from merger and acquisition experts.

Valuation

There are different considerations in valuing a company depending whether the company is a manufacturer, a service operation or a distributor. Furthermore, value of the company is often in the “eyes of the beholder.” In other words, it depends on the buyer, particularly if the acquirer is strategic, financial, competitor, or a management buy-out. While not always certain, often a strategic buyer will pay more for a company than a financial buyer, which in turn will pay more than a competitor, which in turn will pay more than a management buy-out.

There are so many factors that influence value, both objective and subjective, that it is impossible to properly expound on all these in this discussion! Some of the obvious macro issues include the state of the economy and the industry, while some of the obvious micro issues include the historical record of the company and its growth rate both past and estimated future. In order to touch on some of the other valuation issues, listed below are major factors for consideration:

- Company size
- Access to capital/financial leverage
- Depth and breadth of products/services
- Quality of management
- Market share/customer base
- Overall profitability/cash flow
- Uniqueness and Intellectual property
- Adjustments to balance sheet and income statement

Value and Risk Drivers

In understanding the real value of a company, one should consider the value and risk drivers impacting the business. It is imperative to identify the value drivers of the selling company, substantiate them and if possible, position them so they are transferable to the buyer. The following two industry examples explains the rationale behind value drivers:

Retail: Superior locations and long and competitive renewable leases are deal drivers in the retail business above and beyond multiples of earnings or cash flow. A very desirable contract might be a ten year lease with interim escalators based on the consumer price index with the right to renew for

another ten years based on certain conditions. Now, the value driver in the retail business could be the attractiveness of the assumable lease(s).

Technology: Protection of engineering talent, intellectual property, proprietary information, etc., are paramount in the successful transfer of ownership in the hi-tech industry. Pre-and post-agreements with key employees are essential to have in place. The loss of assets previously mentioned would greatly diminish the value of the company. Conversely, the retention of the assets, both people and intellectual property, enhances the company's value. The validity of the confidentiality agreements depends on the ability of the company to enforce them.

Let's assume that Technology, Inc. has obtained confidentiality agreements down to the lowest employee level. In the case of the non-compete agreements, the company granted stock options as part of the contractual agreement. Further, Technology Inc.'s top ten management team members were willing to sign a three year employment contract with Newco to help assure continuity going forward. These agreements pre and post the sale of Technology Inc. are value drivers for selling the company.

Services Provided

In the engagement of Atlantic Management Company for selling a company, the following services are provided:

Preparing to Sell

As a seller, put yourself in the buyers' shoes for a moment. What would impress you and what would you expect to see from the seller.

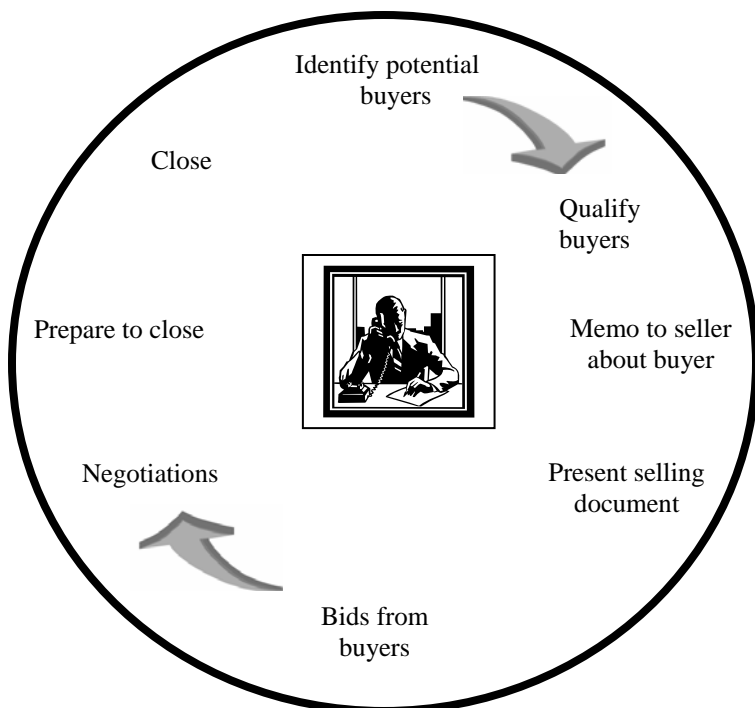
Initially, a buyer expects to receive a well-documented selling memorandum, which describes the industry, the business, the products/services, the competition, the management, the facilities, the financial information with adjustments, the company's competitive advantage, growth opportunities, and the company's shortcomings. Preferably the seller will prepare far enough in advance to have the financials audited. In spite of the added expense, audited financials give a buyer substantially more confidence in the figures, and therefore, a willingness to offer more money. The seller should thoroughly "scrub" the financials to write-off uncollectible receivables, convert owner's notes to equity, consolidate bank loans, settle disputed invoices, etc.

Secondly, the owner should take great effort to clean up the plant and/or offices so the facilities are organized and immaculate. On numerous occasions, prospective buyers have backed-off immediately from pursuing an acquisition based on the lack of cleanliness of a manufacturing plant because the implication is that a messy operation is disorganized, and also implies lack of workers' pride, inefficiency, waste, poor quality, etc.

Third, engage key employees in confidentiality and non-compete agreements if not already obtained. One of the worst aftermaths of a buyer's acquisition is to have the seller's sales manager or top technician leave the company and join a competitor right after the sale.

Fourth, create a war-room preferably off-site at your attorney's office. A war-room is really several file drawers of almost every conceivable document related to vital information regarding the selling company including:

- Financial Statements
- Leases
- Contracts
- Sales representative agreement
- Bank documents
- Tax Returns
- Employee compensation
- Stockholder records
- Past and present lawsuits
- Alliances and joint ventures



The potential buyer's due diligence team including attorneys and accountants will need to have all the records in one place to review. Not only does such a war room provide an efficient way to conduct business, but without it gives the impression that the seller is not organized, or even worse, trying to hide dubious facts about the company.

Costs Related to Selling a Company

Hiring the "best" professionals to help you sell a business is absolutely one of the most critical decisions in the selling process. The wrong advice on valuation, structuring, taxes, negotiation, etc. can cost the seller thousands or even millions of dollars. Within reason, the seller should get the best advice possible. Using a hypothetical company with a \$5 million transaction price, the approximate fees that might be incurred are as follows (not everyone will require all of these services):

Services	Fee Range
Valuation of Company	\$10K - \$20K
Valuation of Machinery/Equipment	\$3K - \$8K
Valuation of Real Estate	\$3K - \$10K
Intermediary	\$200K - \$300K
Accountants	\$5K - \$40K
Attorneys	<u>\$25K - \$70K</u>
	\$246K - \$448K

The range above represents closing costs of 4.9% to 8.9% of the \$5 million transaction price. Generally speaking, as the transaction price increases, the closing costs as a percentage of the transaction price decreases.

Selling the Deal

The old adage in the stock market is to "buy low and sell high." Selling companies is similar. One should sell a company when the operation is firing on all cylinders, the sales and profits are near their peak and new products and services are being introduced.

Since most and sometimes all of the potential synergies in the deal are created by the buyer, it is advisable for the seller and/or his advisors to show financially how the combination of the buyer and seller will create such synergies that 1+1=3. The obvious areas to show these synergies are with revenue enhancements, cost reductions and economies of sale.

Before entering into the discussion of price and/or negotiations, the seller should determine his or her minimum acceptable price. Anything lower than that price, there should be no discussion as it is probably a waste of time. Furthermore, the seller should also pre-determine before the negotiations begin what is the "cellar price and terms," e.g. \$5 million in which \$3 million is cash, \$1 million secured pay-out (note) and \$1 million unsecured contingency (non-compete, consulting and/or earnout).

Pearls of Wisdom

1. The decision to sell is not irreversible, but it should be firm.
2. Decide up front who is going to be the ultimate manager of the selling process so there is no ambiguity later on.
3. Set time frames on the selling process.
4. Partner with real professionals.
5. Target buyers, which would perceive your company to be the most valuable.
6. If a buyer indicates he or she will be submitting a letter of intent, tell them right up front what items you want to be included in the document.
7. Be willing to rent the real estate component of the business.
8. Understand the buyer's concerns.
9. Don't negotiate directly, but through an intermediary who can act as a buffer.
10. Don't delegate important aspects of the deal to underlings.
11. Complexity is a killer in deal making.
12. In approaching a negotiation, the first problem is determining who is the decision maker on the other side.
13. Once the decision maker has been identified, it is important to establish rapport with him or her.
14. Keep the momentum going.
15. As a seller, be prepared to accept lower valuation multiples for lack of management depth, reliance on a few customers, and regional versus national distribution.
16. In negotiations, start with the less confrontational issues first.
17. Don't negotiate with people that are not motivated to buy.
18. Businesses get stale after sitting on the shelf for a while.
19. Successful "sales" do not just happen. If you do not have a good dealmaker on your team, employ one, rent one, but get one.
20. "Always be prepared to negotiate, but never negotiate without being prepared".