A PRIMER

FOR SELLING

THE

CLOSELY - HELD

BUSINESS

This document is intended for business owners.

It is designed and written to help owners understand what is involved when a sale of their business is contemplated. This document is not intended to replace expert advice from accountants, lawyers, business brokers and other professionals who have expertise in the mergers and acquisitions business. The content is considered basic information about business valuation and the process of selling a closely-held business.

Professional advice is encouraged.

INTRODUCTION

The decision to sell your business is not easy; usually it involves part emotion and part economics. After all, it's your business, perhaps your creation, in a way, it defines who you are.

Selling may be inevitable for most owners; the only questions are to whom, for how much, and when. Selling the business as a going concern is normally a far more viable option than closing the doors and liquidating; <u>you will make more money selling.</u> Hopefully, for you, the sale will be carefully planned, and value will be maximized. However, we know that often this is not the case. We hope, in perhaps a small way, our report will help.

"To whom" will be determined by a number of factors; perhaps your offspring, or your employees will eventually buy. Other than an "heir apparent," "to whom" will be determined by the effective marketing of the business to get the best possible price, and terms.

"How much" is explained in this report. Price or value is, in part, the result of negotiation, but you have to have a value known to you <u>before</u> you enter "the market."

"When" is up to you. Obviously, <u>to maximize value, it's best to sell when the business is doing well</u>. But, the decision also has to take into account other factors, like when you are ready.

We know the decision is tough; we also know mistakes in this process can be disastrous, both in economic and emotional terms. Fortunately, there are places and people to turn to for good advice. In fact, Opportunities in Business is one of them; we've been valuing and selling businesses since 1981.

There is a difference between
SELLING OUT AND SELLING SMART.

WHY PEOPLE SELL THEIR BUSINESS

We have been directly involved in thousands of sales, and our experience supports the research done on this question. **"Burnout"** is the most common reason cited for selling a business. However, we know that it is the things that cause burnout and the results of burnout that really often times create the desire to sell:

- Increased competition;
- The loss of a key customer or employee;
- Undercapitalization;
- Recession, inflation, other economic factors;
- A changing labor market and;
- Inability to manage the business.

Other than burnout, the most common reasons for selling are what you might expect:

- Retirement;
- Failing health;
- To buy or start another business and;
- Partnership/family problems.

WHY PEOPLE BUY A BUSINESS

The reasons people buy are almost as varied and plentiful as why people sell. However, two primary reasons are most common:

- Individuals buy to "be their own boss," partake in the "Great American Dream," to "control their own destiny;"
- Companies buy to grow through acquiring more assets, more profits, more customers or to diversify.

Often, business owners instinctively figure that a competitor is the best buying prospect; we've found that often times, **competitors will pay the least for a business and goodwill**, and that <u>the "best" buyer is from outside the particular industry the business is in</u> because they will pay the most for goodwill or the intangible assets of the business.

The market today is relatively strong; buyers are plentiful and money is relatively inexpensive and available. The economy is growing but middle and upper management professionals are being displaced ("down sizing") in record numbers producing more individual buyers. <u>It is a good time to sell.</u>

THE BUSINESS VALUE

A reality of Business Valuation is that it is as much art as science. Knowledge of the market is critical, and to be knowledgeable, you have to be in the market every day. We know what businesses sell for, because that's what we do - every day. Unfortunately, there are plenty of myths and misinformation about "appraising" a business' value.

First, it's important to understand what "a buyer" wants when they consider buying a business.

- The individual is primarily looking for an income stream i.e. the money the owner can take from a business (whether its net profit or owners' compensation is irrelevant).

- Companies who buy essentially want the same things and, in addition, want to see some synergy with their existing business or diversification from it.

If there is goodwill, evidenced by earnings, you should be paid for it, and it should be calculated into the price of your business.

Valuation of a business is, in one sense, somewhat complex and, in another sense, fairly simple. It's all about money, return on investment, and the things you would want <u>if you</u> were buying.

First, a few very important principles one should understand:

Principle 1 What a "reasonable buyer" will pay a "reasonable seller".

The term "reasonable" in this context is used in the economic sense. The buyer and seller are each assumed to be comparing alternative investments and when the economic incentive to purchase is equal to the economic incentive to sell, a sale is made.

Principle 2 For evaluation purposes, a business is defined as a organized method of producing revenues routinely over a period of time.

The worth of a business is divided into two (2) parts:

1. The asset value represents the value of machinery, equipment, buildings and land, patents, saleable inventory and other legal rights.

2. The business value or "goodwill value" of a business represents the premium value a buyer will pay the seller for organization and historically recorded cash flows.

Additionally, when comparing alternative investments, there is no economic incentive to invest monies in a business which has not, or is realistically not capable, of producing a net income in excess of the operator's salary plus a reasonable return on investment.

Principle 3 Accuracy depends upon the standard use of terms, methods and <u>disclosure of</u>

information.

The valuation is based on documents and other materials. The existence of source materials for any valuation will have many effects:

Transfer liability from personal opinion to fact
Add credibility to the results
Ensure accuracy of data
Ensure a source of future reference

Principle 4 All estimated values are limited by time.

Any sale price is subject to change as the market conditions change; therefore, the suggested price is only valid for a short time relative to the size and scale of a given business in a given industry.

Invariably, all buyers, buying a big business or a small business, want to know how much money they will make, and will judge history as a key predictor of future earnings. Second, they will calculate their income after debt service is created in buying the business, whether seller financed or not.

The price must allow for a reasonable economic return on the investment to buy and the risks associated with buying. Any pricing method must account for these factors.

There are various methods to estimate the value of a business, which all take into account the value of assets being sold and the historically recorded earnings of a business.

Your business is probably your most important asset; if you really want to know what it's worth, get a professional to tell you. Your accountant is not your best choice to perform this function; nor is your lawyer. While neither may appreciate that statement, the fact is:

- They are not in the business of selling businesses; they don't know the market;
- They may not want you to sell; they lose a client;
- They invariably will overstate value to protect you; the problem is that if the business will not sell because of an owner's inflated sense of value, they are not accomplishing anything for you.

Furthermore, forget "Rules of Thumb" or any other "quick and dirty" method you may have heard of to value a business; they will not work for you.
Bottom Line: Hire a pro. It's too important. We value businesses every day; we're members of the International Business Broker's Association and the Institute of Business Appraisers. We know the market - what businesses sell for. We are considered and used as experts in State District Court and U.S. District Court.

You require an **objective** opinion; not one that is only meant to make you feel good for a day.

Finally, it's very important for an owner to understand these realities:

1. Small businesses can sell for all cash; however seller financing can play a part in financing of the purchase/sale.

2. Terms are as important (such as security) as price, and the buyer's character and solvency are important as well.

3. The sale has to work for the seller and the buyer, or it will not close. No seller should give their business away and no buyer should expect to "steal" a business.

PACKAGING AND MARKETING THE BUSINESS

Whether you use a professional broker or not, there are some things you will have to do to sell your business.

1. Clean it up! Make it look nice, fix the sign, throw away the junk, dump the obsolete inventory.

2. Clean up the financial statements as well. The easier they are to understand and to identify the money for the owner, the better.

3. If you lease your premises, know if your landlord will do a lease with the buyer.

A buyer will ask for three to five years' (at least) financial history, a copy of the lease, information concerning employees, customers, suppliers, etc. Be prepared to show them "a package" when it is appropriate (see below).

Marketing a business for sale has to be done intelligently and discreetly. It's not broadcast material. If not done correctly, the business will be damaged!

There may be lots of folks who may express interest in buying your business. As we know, "money talks and .... " - well, you know the rest.

<u>Prospective purchasers must be qualified, i.e., they must demonstrate interest and the ability to buy, if they so choose. They must promise - in writing - confidentiality and discretion.</u>

<u>Again, intermediaries help with this; they can ask for buyer financial statements, credit reports, etc., and screen candidates without offending - and know when to ask. They also know when to ask for the offer. When the offer is made, things get really interesting.</u>

NEGOTIATIONS

We can't give a short course here on the art of negotiating any more than we can completely instruct you on business appraisal techniques. We can, however, give you some important principles:

1. Even though you may pride yourself as an able negotiator, you will find it difficult to negotiate the sale of your own company; your **ego** will get in the way.

2. Value is an economic term.

3. Business sales (that are completed) are "win-win" negotiations. The sale has to make sense for both sides.

4. Terms make (or break) the sale.

5. Each side must "see" the other side's perspective to understand it and to respond to it.

6. You have to be ready to walk, and be prepared for the toughest negotiations you ever experienced and to "hang in there".

USE YOUR ADVISORS

We feel that the best selling “team” is the owner, his/her attorney and accountant, and a competent, experienced broker. Each has a role and while they can overlap, each has to respect the other’s expertise. The seller always retains “top dog” status and makes the final decisions. If your regular attorney or accountant are unfamiliar with the process - for the sale only, hire another one to help you.

IN CLOSING

We sell businesses every day and have since 1981. We know the process and the market. We know it's a difficult (and scary, sometimes) process for both buyer and seller, and we know how important it is for everyone involved.

This report is designed to help you understand "the basics." Most of it is common sense - just like most things are. We've found, however, at times, common sense is forgotten by some people under stressful conditions - like when you sell or buy a business.

<u>Selling a business is one of the most important events in an owner's life; it's important that it be done right</u>. Entrepreneurs naturally at least think about doing things themselves. They always have. However, good sense and an appreciation for what is at stake prevent some of us from wiring our own home, doing our own plumbing or providing medical treatment to ourselves or our loved ones.

We encourage you to become educated, that is what this report is supposed to do. We also encourage you to seek competent, professional advice <u>when it's time.</u>

Opportunities In Business has sold thousands of businesses since 1981, of all kinds, of all sizes. We're specialists in Business Brokerage. Our Brokers have "been there." We appreciate the importance of your business to you, and your decision to sell. If we can be of service, call us. There is no cost or obligation until we are successful in selling your business, and all of our discussions are deemed confidential.