



Column by **John Burley**

## **The Lifecycle of Selling a Small Business**

**From early valuations to closing the deal, selling a business is a complex process, but rewarding when it's done right.**

Welcome to the first in a series of articles examining the lifecycle of selling a small business. In this series, we'll discuss the merger and acquisition process -- from the point of preparing to sell, all the way through closing. It will focus on the process as a whole, with tips to guide business owners through the entire lifecycle of a deal. In subsequent columns, we'll dive deeper into the topics touched on here, covering everything from going to market, increasing value, valuing a small business, letters of intent, understanding earnouts, and the due diligence and closing process. For now, here's a quick overview of the process from start to finish.

### **Getting Started**

There are a number of things that business owners can do long before the point of deciding to sell that can enhance the value of their business, reduce the risk of the deal falling through, and otherwise make the process easier. The very first step is to learn about the mergers and acquisitions process and how businesses are valued. Knowing how to actually value a business is not required, but an understanding of what buyers will look at and how it impacts value is critical. For instance, many business owners assume the value of their company is based on revenue. In fact, cash flow and earnings before interest, taxes, depreciation and amortization, or EBITDA, are often the primary metrics for determining value.

Early on in the process it's also important to clean up your books and records. The tighter and cleaner they are, the better an advisor will be able to value the company. In addition, don't make any drastic personnel changes right before selling. Stability is important to buyers.

### **Setting the Terms**

With these building blocks in place, you can start looking at what to do when you're ready to sell. Most businesses start by hiring a business broker or an M&A advisor, in addition to a CPA and an attorney. A business broker will help locate a buyer, while an advisor will value your business, develop a book on the business, help negotiate the price and terms, and manage due diligence and closing.

Here are a few tips at this stage of the process:

- Be leery of so-called "back-of-the-envelope" valuations. Anyone can add the owner's salary to the net income on the tax return and multiply by three. But often this will leave money on the table or create an unrealistic price expectation.
- Hire your M&A advisor or business broker before getting an estimate. It's too easy for brokers to quote a value just to get you to sign up, and this usually leads to failed deals.
- Don't settle for a two-page profile. Be sure the book on your business (the confidential memorandum or information memorandum) offers a substantial presentation of your products and services, operations, management and senior staff, major accomplishments, significant risks, financial history, and future outlook.



## Going to Market

When you're ready to go to market, make sure your advisor markets your business confidentially, but effectively. They should have access to no less than ten market venues where buyers look, and should cooperate with other firms.

Here are a few more important considerations:

- Be flexible. A good advisor will provide you with several ways to structure the deal, each with a material affect on what a buyer will pay.
- Be willing to consider more complex structures, like recapitalizations, stock consideration, warrants, and the like. Each of these has risks, but if structured right, they can add a large upside potential.
- Have your M&A advisor work closely with your CPA and attorney from the start. A good advisor who works with the rest of your team will save you more in the end than it will cost in the beginning.
- Look beyond the purchase price. Money can be left on the table when everyone is too focused on the cash at closing. Ask yourself if this is the sale of the company's assets or stocks? Each has very different tax consequences and risk levels.

## Due Diligence

Once an offer to purchase your business is signed, the due diligence process begins. Here, the buyer will often examine financial information, contracts, employee-related issues, legal and regulatory issues, and so forth. This can take as short as two weeks, or as long as 90 days or more. For smaller businesses, about 30-45 days or so is typical. At this stage, be sure to disclose everything, while giving the buyer everything they ask for as quickly as possible. This will reduce the risk of the deal falling through, protect you legally, and get you to closing faster.

During due diligence, definitive agreements will be negotiated and drafted. These are the contracts that will be signed as part of the closing, and often include an asset or stock purchase agreement, non-compete agreements, indemnifications, representations and warranties, employment or consulting agreements, promissory notes and earnout agreements, and other ancillary agreements and exhibits.

## Closing the Deal

The closing process can be an event, often referred to a sign-n-close, or a process whereby a series of steps are taken leading to a final "close" in which, ultimately, funds are transferred to the seller.

In future columns, we will delve into each of the topics discussed above, including preparing to sell, increasing value, valuation, negotiating letters of intent, understanding earnouts, and the due diligence and closing process.

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