

PRIVATELY HELD

C O M P A N Y

the report on transaction issues

FIRST BUSINESS RESOURCES, INC.

is a full service business advisory firm providing professional acquisition, divestiture and consulting services to private middle market corporations. We competently counsel our clients in the areas of disposition, acquisition, and exit strategy development.

To receive the latest edition of The Privately Held Company newsletter via e-mail, register at www.first-biz.com (In The News).



Why Business Owners Decide to Sell

#1. The Tank Comes Up Empty!

Burnout is the most common reason businesses are put up for sale, according to merger and acquisition experts. Often in as few as five years, business owners are worn out from living and breathing their corporate creations. Boredom and frustration also take their toll, leaving owners disinterested or resentful of the business routine. At a certain point, walking away from something they started appears the lesser of two evils, and is often an act of survival.

Other Common Reasons

While burnout is the most likely reason why an owner would give up a business, the following are other common reasons cited by merger and acquisition experts:

- ◆ Business has grown too big to handle alone
- ◆ A desire to relocate
- ◆ Retirement
- ◆ Partnership dispute
- ◆ Death of one of the partners
- ◆ Employee problems
- ◆ Customer or supplier problems
- ◆ The need for estate planning

**Burnout
is the most
common
reason
businesses
are put up
for sale.**

IN THIS ISSUE

- **Why Business Owners Decide to Sell**
- **Important Points in Selling a Business**
- **The Prepared Seller**
- **Recognizing Deal Breakers**
- **Be Prepared to Ask and Answer Critical Questions**

Continued on next page

Why Business Owners Decide to Sell (continued from cover)

Other Reasons

Finally, other reasons for selling may include one or more of the following:

- ◆ Insufficient capital
- ◆ There is no heir apparent
- ◆ Divorce or illness in the family
- ◆ Liquidity is running low
- ◆ Competitive pressure is building
- ◆ Adversity is too hard to overcome
- ◆ Outside investors become factors
- ◆ An unsolicited offer is placed on the table

Important Points in Selling a Business

- ◆ Make a firm decision about selling the company.
- ◆ Decide up front who is in charge of the sale.
- ◆ Present pristine financials.
- ◆ Communicate succinctly.
- ◆ Set time frames and milestones.
- ◆ Partner with professionals.
- ◆ Communicate with your bank.
- ◆ Target companies that would perceive yours as valuable.
- ◆ Openly recognize off-balance-sheet items.
- ◆ Negotiate stay agreements with management.
- ◆ Set up a war room.
- ◆ Tell the acquirer what you would like in the letter of intent.
- ◆ Be prepared to ask and answer critical questions. (See back page for more on this.)
- ◆ Recognize deal breakers.
- ◆ Be prepared to deal with due diligence.
- ◆ No mulligans allowed. (A mulligan is a golf term for granting a second shot without a penalty.)

The Prepared Seller

There are plenty of reasons why businesses change hands, some unexpected, others that can be foreseen. Given how often it happens, however, it is surprising how unprepared business owners can be. Based on a survey of business owners of small private companies conducted by a leading CPA firm some years ago, 85 percent of the owners have no exit strategy. Many companies are acquired serendipitously - by acquirers who happen to be in the right place at the right time.

An Old but Great Story

Traditionally speaking, a seller should be rather coy and not too revealing of his or her ultimate intentions. Cary Reich, author of *The Life of Nelson Rockefeller*, offers a good example:

“The modest unassuming and subservient John D. Rockefeller, Jr. was overly burdened with his father’s obligations, but he surprised all as an astute negotiator. When the indomitable J.P. Morgan was seeking the Rockefeller’s Mesabi iron ore properties to complete his assemblage of what was to become U.S. Steel, it was Junior who went head-to-head with the financier. ‘Well, what’s your price?’ Morgan demanded, to which Junior coolly replied, ‘I think there must be some mistake. I did not come here to sell. I understand you wished to buy.’ Morgan ended up with the properties, but at a steep cost.”



Recognizing Deal Breakers

Most people in the merger and acquisition business recognize that when a seller reaches the letter of intent stage, the chance of closing is only about 50 percent. Recognizing the various deal breakers will help sellers anticipate hurdles to overcome. The following items are merely a few potential deal breakers.

- ◆ Undisclosed material facts surfacing in due diligence, such as loss of a major account, customer concentration, product recall, environmental problems, and missed sales/earnings projections
- ◆ Higher than anticipated taxes, which may be due to an asset sale for a C corporation
- ◆ Unacceptable details of Purchase and Sale Agreement for either the acquirer or seller (collateralization of note, the insistence of escrow account, or the rigidity of the “reps and warranty” agreement)
- ◆ Lack of chemistry between the principals of the acquirer and seller
- ◆ Undercapitalized acquirer who cannot provide the necessary financing
- ◆ Remorseful seller who becomes discouraged when the deal lags and ultimately walks away

Deal breakers can sometimes be short-circuited if most of the potential problems are addressed early on in the buyer-seller relationship and if both parties are willing to consider alternative solutions.

Part of the problem is not recognizing a deal breaker until it is too late to resolve it. To overcome this pitfall, it is useful to have several people on each side during the various meetings to improve the overall communications. Another way to recognize deal breakers is to bluntly ask the acquirer to express concerns. The expectation is that concerns can be addressed if uncovered, but if concerns do not surface, then it is unlikely they will be resolved.

Part of the problem is not recognizing a deal breaker until it is too late to resolve it.

Numerous deals fail because of sellers' greed. Instead of accepting a slightly lower price from a well-financed buyer, some sellers will go with acquirers who offer a slightly higher price, only to find they cannot finance the deal.

One of the most important factors for a seller is to not let up on increasing sales and earnings.

The best way to close is to offer all cash at closing with few contingencies. Conversely, complicated deal structures with numerous contingencies have a less likely chance of closing.

Many deals are aborted because the actual financial results for the recent quarter are substantially lower than the projections. Consequently, the acquirer gets cold feet and withdraws, often without a counteroffer. One of the most important factors for a seller is to not let up on increasing sales and earnings, as the acquirer will be carefully scrutinizing each quarter, each month, and maybe each week to measure any weakness in the seller's performance.

Look Deep into Their Crystal Ball

In addition to checking out the acquirer's credit and management history, see what he or she plans for the company's future. This is especially important if the owner will be maintaining some involvement with the company as a consultant or employee, or if a portion of the purchase price will be deferred.

Even if the owner will be making a clean break from the business, he or she should be reasonably confident that the acquirer is capable of running the enterprise successfully. Otherwise, the owner runs the risk of being sued for fraudulently misrepresenting the business's financial state, assets, or products if the new owner fails miserably.

Be Prepared to Ask and Answer Critical Questions

There are three crucial questions business owners need to ask themselves when preparing to sell:

1. What is the bottom price based on net after-tax and net after-closing costs?
2. What are the most lenient terms I am willing to offer as the seller?
3. What will be the severance packages for key employees?

Once owners have decided on these items, they should have a dress rehearsal with their advisors regarding negotiation strategy and tactics. Owners should decide which one person among the seller's group will be the lead negotiator, how to rationalize the higher price, and what items are not negotiable. Negotiations require various skills including careful listening, knowing when to caucus separately with the team, knowing how to make concessions slowly, and when to counter with requests. Above all, the seller must predetermine the bottom price and the most lenient terms before the negotiations begin.

When Senator Ted Kennedy ran for president of the United States, he was being interviewed on national television by David Frost. Frost asked Kennedy, "Why do you want to become president of the United States?" Kennedy stuttered and stammered his way through the response in a very unconvincing way. His response was so lackluster that the campaign virtually ended there. The moral of this story? A seller should be prepared to answer such critical questions, as:

- ◆ Why do you want to sell the business?
- ◆ How would a new owner grow the business?
- ◆ What is the company's competitive advantage?

Selling your business is in many ways you, as the owner, selling yourself. An owner can't be overly anxious and should be able to articulate how the acquirer can grow the company.

The owner should be able to paint a bright picture of the company's future, but in doing so, also be careful not to dominate the conversation. Anticipate the questions that will be asked by the acquirers, particularly the critical questions.

**The owner should also
be able to paint a
bright picture
of the company's
future.**

This newsletter is not intended to render accounting, legal, or other professional service; the publisher and sponsors assume no liability for a reader's use of the information herein.



**FIRST BUSINESS
RESOURCES, INC.**

**First Business Resources, Inc.
8117 Preston Road, Suite 300
Dallas, Texas 75225
This firm is not a CPA firm.**

**Phone: 214-363-7774
Fax: 214-378-6899
Email: info@first-biz.com
Website: www.first-biz.com**

Treasury Circular 230 Disclosure – To comply with requirements imposed by the Internal Revenue Service, we inform you that any statements contained herein are not intended or written to be used, and nothing contained herein can be used by you or any other person, for the purpose of (1) avoiding penalties that may be imposed under Federal Tax Law, or (2) promoting, marketing or recommending to another party any tax-related transaction or matter addressed herein.