

Value *focus*



**BALDWIN & CLARKE CORPORATE
FINANCE, INC.**

Maximizing Value in the Sale of Your Company

Proper business and family-wealth planning requires consideration of alternative business transition strategies well in advance of the date that you would like to complete a transaction, whether with third-parties or family members. A sale of your business, if done properly, will take at least eight to twelve months from the time that you decide to sell until you close. The cyclical nature of the economy periodically causes major disruptions in the merger and acquisition marketplace that could affect the sales price of your company.

There may be other factors affecting business or the marketplace that will cause you to delay the start of the sale process to avoid selling the business at unfavorable price. Advanced planning should be flexible enough to allow sales process to start when the market expected to be more receptive to acquisitions of companies like yours. **Therefore, the earlier that you start the planning process, and the more clearly that you define your objectives, the likely that you will be able to successful transaction that meets your expectations.**

Various investment bankers and business brokers may tell you that the sale of your company must be a win-lose situation in order for you to maximize value, and that buyers are out to steal your company. However, a properly managed negotiation and sale process, designed to provide potential purchasers with the information needed to justify maximum sale value, will help ensure that you receive maximum value in a sale. Maximum sale value is obtained when buyers are informed of pertinent issues affecting cash flow and risks and when they understand how to increase cash flow while minimizing risk.



Buyers will pay maximum value to a seller when they are comfortable that:

- ▶ they understand the pertinent issues affecting cash flow;
- ▶ opportunities for growth or increased cash flow are present;
- ▶ transactional, business and financial risks are minimized; and
- ▶ a transaction will close in a timely manner in an orderly process.

Working with an independent, knowledgeable and experienced negotiator will help you achieve maximum sale value. Investment bankers bring an understanding of the business sale process; the skills to properly manage the transaction; the patience to work through barriers; and allow you to continue focusing your efforts on running your business. Your ability to concentrate your efforts on running the business is an important benefit of working with an independent negotiator. Finally, an experienced negotiator will help you maintain a high level of confidentiality during your sales process.

It is true that buyers are interested in acquiring your company for the lowest price possible. You will receive less than maximum value only if you allow a buyer to pay you less than you deserve. Buyers have many ways of attempting to persuade you that you should take less than maximum value. Some of these methods include:

- ▶ showing you that they are interested in acquiring your company through a “friendly” deal by offering you a few “extra incentives”;
- ▶ offering you large amounts of contingent payments or asking you to take large amounts of seller paper;
- ▶ taking unreasonable positions during the course of the negotiations; and
- ▶ designing the negotiation and due diligence process to cause or permit the seller to take price reductions during the due diligence period.

The remainder of this paper will provide you a basic understanding of the steps that you should consider as part of your sale process. Sound planning before you enter the sale process and your ability to modify your planning during the sales process are two of the most important characteristics of a successful sales process. A successful sale of your company is also dependent on the quality of the negotiation process. William Ury of the Harvard Law School’s Program on Negotiation illustrates this when he pointed out that

“The secret of effective negotiation is that simple: prepare, prepare, prepare.”¹

The Sale Process

An auction format is often the most effective approach to ensure a seller that they will receive maximum value. In this process, multiple potential acquirers (“Buyer(s)”) are invited into the sale process with each Buyer being negotiated with individually. This process works best when two to three very interested buyers end up participating in the process.

The auction format process includes the following steps:

- ▶ valuation analysis and review;
- ▶ identification of Buyers;
- ▶ development of Information Memorandum (disclosure and sale document);
- ▶ beginning the sale process;
- ▶ negotiating the letter of intent (“LOI”);
- ▶ selecting the final buyer and finalizing the LOI;
- ▶ developing the Purchase and Sale Agreement (“P&S”);
- ▶ managing due diligence; and
- ▶ closing the deal.

Although these steps are numbered sequentially, several of the steps overlap or are intertwined with other steps. For example, identification of Buyers generally begins prior to beginning the sale process and is sometimes completed during the negotiations of the LOI.

SMARTER INVESTING: Experience vs. Discipline



A properly managed negotiation and sale process, designed to provide potential purchasers with the information needed to justify maximum sale value, will help ensure that you receive maximum value in a sale.

Before the sales process begins, you should assemble your business sale team.

Your sale team should include a select group of key managers or employees, a reputable law firm with experience in merger and acquisitions, your independent accountant, an investment banker and you. It is important for the entire business sale team to meet prior to beginning the sale process and regularly throughout the process. The amount of stress that you will face during the process, the total cost of the transaction, and the outcome of your deal, will all hinge on how efficiently and effectively your business sale team functions.

¹ William Ury, *Getting Past No*, (New York: Bantam Books, 1993), p. 16.



Getting the most from our investment banking experience

Remember, the final agreements that you sign will govern all of your rights and obligations following the completion of the sale.



1-Valuation Analysis and Review

The valuation process is an extremely important part of preparation. To determine whether or not you should consider a sale will depend on the state of your company and the industry, and the value that you should expect to receive in a sale. There are times when it is more advantageous to consider a sale. If you go to market now, do you run the risk of leaving value behind because your company is not properly prepared or because industry expectations are lower than normal? Does the valuation leave you feeling dissatisfied by the potential sale price? If so, you should consider delaying a sale of your company until changes occur that make the answers to these questions more positive.

A valuation is not simply a “number crunching” exercise. The valuation process should identify:

- ▶ key business drivers affecting the valuation;
- ▶ company weaknesses and opportunities for improvement;
- ▶ strengths or weaknesses in the marketplace including the status of Buyers’ appetites; and
- ▶ what type of Buyer will be most likely interested in your company, i.e., what makes your company particularly attractive to potential buyers and any other adjustments to valuation that are necessary.

The valuation report should include enough detail for you to have a good understanding of how value was derived, what type of buyer is likely to be interested in your company and whether or not the conclusion makes sense to you. Remember that much of value is determined by perceptions of those valuing the company or making offers for your company. **You should have a clear understanding of how Buyers will view your company and what their perceptions are likely to be.** You should make a conscious decision as to whether your company is ready to go to market or whether there are issues present in the marketplace or changes that you should implement before going to market.

2-Identification of Potential Acquirers (“Buyers”)

The process of identifying Buyers should begin early in your Sale Process and may continue while you are in the negotiating phase. Buyers should be grouped into the following classes:

- synergistic
- strategic
- conglomerate
- financial
- individuals

The expected sale price for your business will generally be lower as you move down the list from one class of Buyers to another. For example, a synergistic player, such as a larger competitor can leverage purchasing power efficiencies, sales and marketing efforts or be able to eliminate costs in redundant functions and can therefore justify paying more for an acquisition of your company. An individual buyer on the other hand will bring none of these benefits, may have more difficulty understanding your company’s value and have significant capital constraints.

If you have developed a long list of Buyers you should consider reducing the list to a manageable size before going to market.

3- Development of Information Memorandum

Once you have developed an initial list of Buyers you need to begin the development of your sale documentation. This documentation, normally referred to as an Information Memorandum, provides Buyers with the information that they will need in developing a Letter of Intent (“LOI”). The Information Memorandum will disclose information about the strengths of your company, its opportunities for future growth and will identify your company’s “warts”. Your ‘warts’, if presented properly, can provide a road map to opportunity for Buyers.



4- Beginning the Sale Process

Once you have completed the Information Memorandum you are ready to begin marketing your company. You should create a set of rules governing the sale process, develop nondisclosure agreements and select the method for initially contacting Buyers. You should be as discrete as possible during the initial Buyer contacts to avoid identifying yourself to someone that ultimately may have no interest in acquiring your company. Conversely, you may determine that it is best for you or your negotiator, to contact Buyers directly to invite them into the process. This allows a personal touch in the process and will demonstrate your respect for these companies, especially if you are planning to work with a small group of Buyers who: 1) are likely to have a high degree of interest in acquiring you; 2) you have a relatively high degree of trust in; and 3) will have little trouble in identifying your company from relatively few facts.

5- Negotiating the Letter of Intent (“LOI”)

Your negotiator should speak with Buyers on a regular basis immediately after sending them the Information Memorandum to ensure that your deal is their highest priority. This can be accomplished when they receive answers to their questions in a timely fashion and when they know that you are keeping the pressure on them to continue moving the process along.

The objective of this process is to provide each Buyer with the information they need to provide you with an initial LOI. Discussion with a Buyer is important to clarify items addressed in their LOI and for the negotiating process to begin. You will want to understand the methods of how they arrived at their offer and begin to provide them with additional issues to consider so that they can get comfortable in making a better offer. The negotiator’s job at this point is to act as an educator, communicator and sometimes as a prod to keep each Buyer’s level of interest high.

6- Selecting the Final Buyer and Finalizing the LOI

It will become clear at a certain point during the negotiation process that you are closing in on the best combination of price and terms that you are going to be able to attain. It is at this point where you must decide what the final LOI needs to look like for you to accept an LOI and with whom you would like to sell your business. The terms of an offer and the underlying deal structure can be as important, or more so, to your decision as the price of the deal. The selection of the final offer should come only after you have reviewed its terms with all of your advisors. You are ready to sign an LOI once you are comfortable with all of the offeror’s terms including deal structure and the value of the offer.

Defining the timeframe to closing is one of the most important terms in the LOI. The greatest risk that you have as a seller will be during the due diligence period.

7-Developing the Purchase and Sale Agreement (“P&S”) and Managing Due Diligence

Developing the Purchase and Sale Agreement and managing due diligence are discussed together since these two steps of the process are intertwined. What the buyer finds during due diligence will be directly reflected in the terms that they are willing to agree to in the P&S. Surprises found in due diligence will have a large negative effect on either the final price or on the severity of the underlying terms. It is important that you have provided Buyers with a clear understanding of issues within your business so that the ultimate purchaser is not surprised by a significant issue when they get to due diligence. The “warts” discussed earlier can become Buyer opportunities, justifying a higher multiple in determining your company’s sale price, if identified during the process of negotiating the LOI, but will become a significant cost to you if identified by the Buyer during due diligence.

You can commit to a tight time frame for these parts of the transaction if you have prepared properly. While the ultimate buyer is reviewing due diligence related items, your attorney should be negotiating the terms of the P&S. Language in the P&S that starts off in the buyer’s favor should soften as the buyer gains comfort through the findings of due diligence. Your LOI negotiator should remain active in this process by managing the due diligence process and providing your attorney with feedback and insights in each draft of the P&S.



8- Closing the Deal

Once you have reached a final agreement with the Buyer and are ready to sell your business, you need to make sure that you understand all of the provisions of the P&S and that you are comfortable with each. Remember, the final agreements that you sign will govern all of your rights and obligations following the completion of the sale.

You, as a business owner, devoted your life to building a business that you take great pride in. You need to approach the business sale planning process diligently to ensure that your years of hard work will be well reflected in the value that you ultimately receive.

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