Preparing Your Company for Sale

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If you have been sitting on the sidelines contemplating the sale of your business and you are now ready to get in the game, your company should first undergo some pre-season conditioning. You don't want to be on the playing field if you are not in shape.

Unlike most articles on this subject, I am not going to suggest that you change your strategy or how you operate your business. If there is a better way to run your company to generate superior results, you should already be doing it. However, there are a number of action items to be considered before you begin the process of selling your company that will lead to a greater probability of success and a higher price:

1. Lock in your key employees. For some reason, most business owners fear that if they sell their company, the new owner will fire all the key employees who have made the company successful. Nothing could be farther from the truth. Without assurances that the key employees plan to remain under the new ownership, a prospective buyer will severely discount the price of the company, if they make an offer at all. Some owners attempt to sell the company without informing any of their employees of their intent. In rare circumstances this can work.

However, in most cases, the best course of action is to be honest with key executives about your plans to sell and offer them economic incentives to remain with the company for some designated time frame after the closing of a deal. The benefits far outweigh the cost. Most buyers want to meet key employees and make sure that there is a competent team in place, as well as a cultural fit, before they will make an offer.

The outcome of these meetings will influence the buyer's appetite for the deal and the price they are willing to pay. To assure this process goes smoothly, you want those key employees to help put the best face on the company.

2. Don't make long-term commitments. Although you want to be able to deliver your management team to a new owner intact, you don't want to limit the buyer's flexibility

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in making operational changes. As an example, don't sign a three-year renewal on a lease for office space right before you plan to sell the company. The new owner may want to move locations, consolidate operations into a larger site or house certain functions in disparate places. If they don't want to occupy the space you committed to for three years, you might be eating the cost of the lease, either directly (they don't assume it) or in the form of a discount to the purchase price. I have one client who bought his office building just before hiring us to put his company on the market. Hopefully, the buyer we find won't want to relocate.

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3. Review your contracts. The contracts that are in effect when you sell your business will have to be assumed by a new owner. Make sure there aren't any surprises buried in your contracts that might become deal breakers.

In a recent deal I did, after we had entered into a letter of intent and the buyer's counsel was reviewing the contracts as part of their due diligence, the owner discovered that his COO had signed a letter several years prior giving a competitor of the buyer the first right of refusal to purchase the company if it was ever sold. The owner's deceased partner was aware of the agreement, but he wasn't. Needless to say, managing our way out of this dilemma resulted in some stressful moments.

4. Clean up your balance sheet. If you have old inventory or receivables on your balance sheet, you should try to sell the inventory or collect the receivables before selling the company. A buyer will typically write off accounts receivable that are more than 90 days old, or possibly less, depending on industry norms.

Likewise, the new owner may not have the same appreciation you do for that two-year-old inventory that you are certain can be sold some day. If you aren't going to be paid for these assets, you may as well try your best to realize as much cash as possible before the due diligence process begins.

5. Clean up any off-balance sheet liabilities. Similarly, if you have sexual harassment lawsuits, environmental disputes or other liabilities that may or may not be resolved on your balance sheet, it is best to resolve them before the buyer discovers them and you have to explain the details. Human nature dictates that when you don't know the facts, you assume the worst.

Buyers will typically force you to retain these liabilities or they will apply a significant discount to the purchase price to accommodate them. Moreover, it is always best not to give the buyer a chance to re-negotiate a deal during the due diligence period, after the letter of intent is signed (at which point the company is taken off the market) and before a legally binding purchase agreement is executed. Any undisclosed liabilities can result in an opening for the purchaser to re-cut the deal.

6. Produce reasonable projections. Consistent with the theme of minimizing windows of opportunity for a buyer to re-cut the deal once due diligence begins, you don't want to work toward a closing while you are failing to meet your projections. The sale of a company is a lengthy process. It often takes six to 12 months from when you first contact prospective buyers until cash changes hands at the closing table. When you initiate the process, you have to produce projections for at least the current year.

Many owners provide the proverbial hockey stick projections that show the current year being much better than previous years, with the hopes that they will get a better price for their company. This strategy often backfires. First, most astute buyers completely discount projected results that are inconsistent with historical trends.

Secondly, the really smart ones don't tell you that. Then, once you have agreed on a price, if your monthly results prior to the closing trail your optimistic projections, the buyer has a valid basis to come back to you and demand a price reduction.

Your projections should be your "best guess" numbers. Don't low-ball the numbers, or it will cost you in price. But it is just as damaging to be overly aggressive. Use the same approach as guessing the number of jelly beans in a jar — the closer you come to the real number, the better.

7. Diligently document legitimate add-backs. When a buyer values your business, they will consider expenses you have run through the company that are not true business expenses as add-backs to your profits. The more add-backs you identify and document, the higher the value you will receive.

Because you are most likely going to be paid a multiple of cash flow or profits, in the final analysis, you should invest the time to sift through your historical expenses carefully. Compensation you pay yourself above what would be paid to a non-shareholder to perform the same responsibilities at the same level is called "excess compensation" and it should be added back to profits. So should the salary of your spouse who only shows up at the annual picnic, part of the pay for the yard man who keeps your lawn at home as well as the company's grounds but only receives one check, your daughter's wedding, the lease on the beach house and the retainer fee paid to your investment banker when you hired him or her to sell your company.

Attention to these details can greatly increase the likelihood of a successful outcome and have a meaningful impact on the purchase price you receive.

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