Quantive

How to Sell Your **Business**

What to expect, steps to take, **and more.**

No matter what the reason for your exit, you need a plan.

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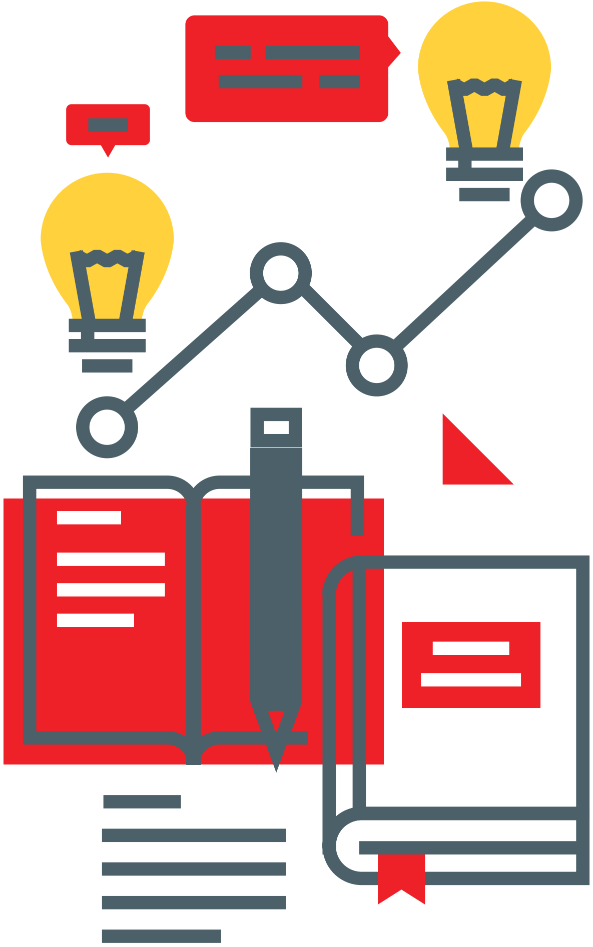
The Definitive Guide to BUSINESS VALUATIONS

HOW MUCH IS YOUR BUSINESS WORTH?

Quantive

2022



Value Growth Playbook

Using Value Drivers to increase **Corporate Value**

What really moves the dial when it comes to value?

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Introduction

SO. YOU'RE THINKING ABOUT SELLING YOUR BUSINESS?

At Quantive we've worked with hundreds of business owners who are thinking about a sale. All those practice reps have helped us understand the issues most likely to derail your plans. We've distilled our lessons down into this handy guide.

We'll teach you about:

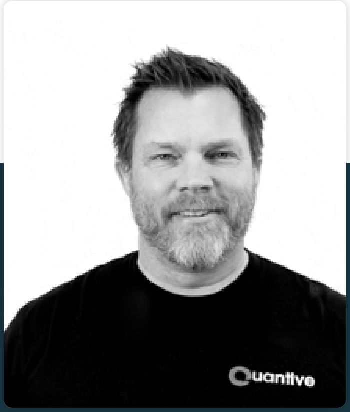
- How to prepare for the sale
- Critical valuation issues
- Pre-diligence (how to keep your buyer from leaving you at the altar)
- Deal structuring (it's not always an "all cash offer")

It's not enough to simply "list" a business for sale. Selling a business is hard work, and a business is not saleable without establishing a process to do so. Business owners who are truly successful in achieving an exit — and maximizing the value of their business — are proactive about exit planning and deal structuring.

We often use the term "exit planning" when we talk about selling a business, and you'll see it here and there within this guide. Whether you're exiting the business to retire, or to pursue other ventures, you need a plan.

LET'S GET STARTED.

> “SELLING A BUSINESS IS HARD WORK. YOU NEED A PLAN.



About the Author

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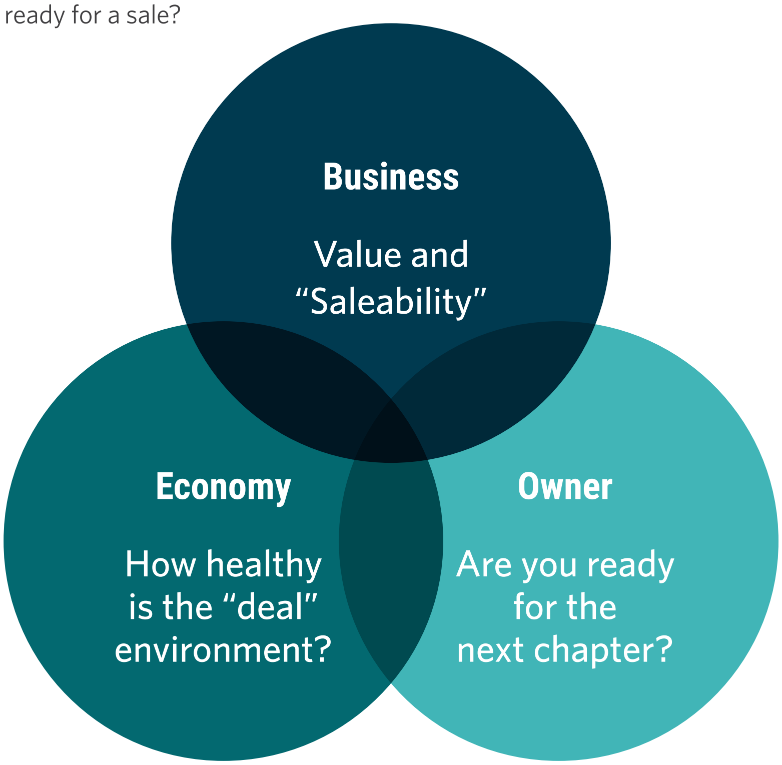
Overview

ALIGN THE "THREE VARIABLES"

Successful M&A deals usually have three variables that are aligned:

- **Business Health.** The business is well positioned for a sale (more on this later)
- **Owner Sentiment.** The owner has to be ready to exit. We've seen too many deals fall apart at the alter when seller's get cold feet.
- **State of the Economy.** Ideally we want to exit in a strong market. Right now - going in to 2022 - we have an incredibly strong M&A market.

Bottom line, as an owner you can control 2 of the 3 items above. We know we are in a great market to exit right now and probably for the next 12-24 months. Are you and the business ready for a sale?


Business
Value and "Saleability"
Economy
How healthy is the "deal" environment?
Owner
Are you ready for the next chapter?

IF ONE OF THE VARIABLES IS OFF...
Expect some "uphill sledding"

PART A: START BUILDING AN "EXIT PLAN"

"Exit planning" is all about understanding and addressing the ramifications that stem from the sale of a privately held company. The Exit Planning Institute defines it like this:

> *Exit planning is the creation of a comprehensive road map to allow a business owner to successfully exit a privately held business. An exit plan asks and answers all of the business, personal, financial, legal, and tax questions involved in selling a privately owned business.*

That's a pretty holistic approach. Most professionals will tell you an exit plan should be:

- A formal, written document
- Consider all critical aspects in your exit
- Address deficiencies to improve prospects for a successful exit
- Ideally start 3-5 years prior to the planned exit

A 3-5 year process? Maybe. But let's go back to the economic cycle: what do you have to gain by waiting? If we were earlier in the cycle or just departing a recession then 3 years or more would make sense. But consider this: valuation multiples drop during a recession, often taking 5-8 years to recover. Are you thinking about waiting 12 months so you can increase your earnings? If the economy swings, the gains you just made will likely evaporate as multiples decline.

Regardless, you absolutely should clean up everything possible as fast as possible! (In fact, that's one of our specialties consider talking to one of our professionals regarding help getting "sale ready."

2022 IS THE YEAR OF THE DEAL.
If you aren't ready soon...
the next window might be 2027.

PART B:
BUILD YOUR EXIT PLANNING TEAM

WHO'S ON YOUR EXIT PLANNING TEAM?

So, just who are the folks on your exit planning team? Do you really need them? And what do they do? The exit planning team traditionally includes six professionals:

- Valuation Expert: Engage your valuation expert to start the process. Your business is your biggest asset. Start there.
- Fractional CFO: Consider bringing in outside help to take it to the next level. Clean up those books!
- Financial Planner / Wealth Manager: How does your business fit into your estate? Is the value high enough to exit? Understand this early.
- Value Growth Advisor: Need a higher value? Don't go it alone. Hire an expert help to ensure a successful exit.
- Business Broker / M&A Intermediary: Find the right help for the sale. This isn't an easy job – find the right pro to get this deal done!
- Transaction Attorney: Getting the legal piece of the deal right is critical. Hire an experienced attorney who won't kill the deal, but will keep you protected.

Getting the team right is often every bit as important as developing a formal exit plan. Like most things in life success is in execution, and the right team is there to help you success in the execution portion of your formal exit plan.

DON'T CUT CORNERS.
This is the team that's going to help you monetize your largest asset, right?

WHAT'S THE CORRELATION BETWEEN VALUE AND "SALE-ABILITY?"

One of the challenges that we often face is correlating value to "salability"—meaning, how desirable it will be to the right buyer. In many cases a business has value to the owner, but there may be a very limited market for the company. (In fact, this notion is the basis of the concept of a Discount for Marketability.) For example, a small three-person company with a single working owner may generate significant value for the owner. But that same business might not have significant conveyable value to a buyer.

We know – you're like us and crave data. Consider this: BizBuySell.com recently released their annual survey of businesses sold, totaling 7056 completed deals. Can you guess how many businesses were listed on the site? 45,000. So 15.7% sold. Clearly there is an issue of salability here.

Many sellers think a long history, a well known name, and their "blood, sweat, and tears" should be factored into value. And they will be – all based on how the business performs, but not by adding "extra" value for the buyer.

So, what is a business owner to do?

1. Understand (and mitigate) risk.

So how does a smart business owner mitigate risk? This is actually a critical area where your business valuation expert can help you. By identifying and mitigating risk factors early you can help increase your buyer's confidence in the transaction.

2. Plan for a smooth transition.

Hand in hand with the buyer's risk perception is their lack of clarity on what happens post-closing. What's going to happen when you hand over the keys? Who's in charge? Who opens the building? Where are sales coming from?

As a seller you can mitigate these concerns by:

- Replacing yourself as a critical piece of the business
- Providing a lengthy, well considered transition. A seller should consider hiring a replacement to take some of the workload off them. Not only does this improve your quality of life, but also lessens the business's dependence on you personally. Further, by working at the company post-closing you can help maintain a level of continuity.

3. Structure the deal.

Did you know most deals aren't all cash at closing? In fact, a recent study suggested well over half of deals have some portion of purchase price paid post-closing and contingent on future performance. (These structures are often referred to as "earnouts.") So why should you be smart about deal structure?

Simple:

- **Get the deal done.** You want to sell the company, right? Being inflexible on structure is the perfect recipe for killing a deal.
- **Get paid more.** Want an all cash deal? Expect the buyer to price in risk and pay less. Much less. But if you want to get paid for future growth and performance.... well an earn out is just the ticket.

With all of that in mind, now it's time to get to work...

BUYERS HATE RISK.

To be successful, you have to mitigate as much perceived risk as possible.

CLEAN UP YOUR FINANCIAL STATEMENTS

What is one of the biggest mistakes a seller can make in selling a business? We see this time and again – the buyer (understandably) requests financials from the seller. After executing an NDA the seller then sends along the most recent statements. A few days later the buyer sends back what is considered a "low ball offer" and the deal falls apart. Dreams of sailing in the Caribbean are put back on hold.

WHAT'S WRONG WITH THIS PICTURE?

Typically the most important step in understanding and assessing a company's value is interpreting both past financial performance and its future prospects. The company's financial statements are the key source of such data. The income statement (aka P&L) offers insights on performance over a period of time, and the balance sheet provides a snapshot of the company's position at a single point in time.

At issue, however, is that financial statements are often misleading:

- Statements contain non-recurring income/ expenses
- Outdated asset values
- Many other factors that distort the company's performance and condition

Perhaps most importantly, many business owners actively try to manage their tax bill down by showing the least amount of profit possible

By sending the buyer financial statements that have not been properly prepared, reviewed, adjusted, and footnoted, the seller is giving the buyer an incomplete and inaccurate view on the company's performance and condition. No wonder they received a low-ball offer.

OUR M&A ADVISORY SERVICES

Learn more at GoQuantive.com/services/M-A-advisory/

Using Your Valuation for Financing / Loans

CHAPTER 5

UNDERSTAND YOUR STARTING POINT.

For a deal to work, a buyer and seller have to agree on pricing. And for you (the seller) that price likely has to support a retirement. Unless you have accumulated enough wealth to retire without the sale of the business and if you have, kudos then you need to get this right. You need an accurate number to plan. Your financial advisor needs an accurate number to model your retirement. And you need an accurate number to help defend your position when you do go to market.

MOST OWNERS ARE WRONG.

We've worked with thousands of business owners, and one resounding theme appears time and time again: business owners tend to overvalue their business.

Why? Here are a few common reasons:

- Perceived Risk Profile: Owners don't perceive company risk the same way external buyers do
- Perspective Bias: you've built a great asset through years of hard work- there's an expectation that it correlates to market value
- Lack of Experience: Most owners go through one deal and aren't active M&A participants

WHY IT MATTERS.

Ok, so what? Ultimately the market will price the deal, right? Right... but if the market's numbers don't work you will have wasted precious time and resources. It's far more expensive to run a failed M&A process than engage in a formal valuation.

Get the facts early and use them to craft a value growth action

OUR VALUATION SERVICE
Learn more at GoQuantive.com/Valuation

plan prior to hitting the market.

WHAT IS THE IMPACT OF VALUATION ADJUSTMENTS?

By not properly working through adjustments, a seller is potentially leaving significant money on the table. Depending on the nature of the unadjusted financial statements the impact could be two times or more in purchase price.

By working with a professional to identify, understand, and detail these adjustments the seller puts himself or herself in a position to significantly increase the purchase price.

When you retain a business valuation professional, one of the first steps they will take is to work with you to identify, detail, and document all of the required adjustments to both your profit and loss statement and balance sheet.

These might include:

- Excess Compensation
- Non-working compensation
- Unusual or one time expenses
- Expenses that might be better adjusted to industry norms
- Excess working capital/working capital deficits

An experienced professional can quickly identify the proper adjustments to make and help the seller substantiate a more accurate valuation for their company.

We've spent a lot of time covering what TO do when you are considering the sale of a company. However, it's just as important to be aware of what NOT to do, AKA deal killers. We've compiled a list of the 12 most frequent issues, myths and misunderstandings that can kill what might have been a great deal.

BUYERS HATE RISK.

To be successful, you have to mitigate as much perceived risk as possible.

Valuation Process

1. Reliance On Rules Of Thumb

> *"I know how much my business is worth. All X companies sell for ____(insert rule of thumb)___."*

No, they don't. Some may, some may not. Rules of thumb are great for back of the napkin discussions, but they are distinctly NOT great when you want someone to write a check for what is likely your largest asset. Corporate buyers don't rely on rules of thumb. Private equity groups do not rely on rules of thumb. Lenders certainly do not rely on rules of thumb. So if the three groups most likely to influence the amount of the actual check written don't rely on rules of thumb, why would you?

Tip: Understand the actual factors that DRIVE value, and consider hiring a valuation expert early in the process. Become familiar with accepted valuation techniques. Most industries seem to have perceived techniques for valuing businesses. Many of these, however, are not accepted by the valuation/lending industry. Owners should avoid listening to uninformed sources for determining value, even if those sources are in the seller's industry. Owners who have sold a similar business are unlikely to be informed sources, in that they tend to not understand all of the intakes that went into making their own sale.

2. Listening To Prices From Other Sellers

First, comps are often not easy to find for private transactions. Beyond that, cocktail hour talk from peers who have sold often exclude very pertinent deal attributes: what was included in their sale? Full balance sheet or carve outs? Seller financing? Earn out? How difficult are the hurdle rates? How was debt handled? What about indemnities? Reps and warranties?

Without getting a grasp of the above, it's really hard to get a true picture of the value conveyed.

3. Poor Record-Keeping/Financials

We all know business owners try to "tax manage" their financial statements. Some do this by timing AR/AP or inventory. Others take this to the extreme and use the business as their piggy bank. While we can work with these items to some extent, the more "adjustments" you have in the pro forma statement presented to buyers, the more risk they perceive. (And you can bet that EVERY adjustment will be checked to the last penny during diligence).

Beyond the issue of adjustments, having clean and orderly records gives a buyer a sense that the business is solid, the owner has a firm understanding of performance, and that they are more likely to get the asset that they THINK they are buying. All these points tend to increase "saleability".

Tip: Consider a "pre-diligence" exam of your books and records BEFORE you actually start marketing the business.

4. Poor Attitude

The sale of a company is a massive undertaking. It is likely going to take the better part of a year to complete, and is bound to involve a good amount of stress. Business owners who have not fully bought into the process, or worse are just "kicking tires," face an exceptionally high likelihood of failure.

It's important to remember the principle of substitution: the buyer does not have to buy YOUR business. In nearly every case they can simply go find a similar business and still accomplish their goals.

Having a positive attitude, fully committing to running a sale process, and negotiating in "good faith" are all elements likely to increase your potential for sale.

5. Questionable Or Completely Undocumented "Owner Perks"

One thing we frequently see is questionable or aggressive "owner perks." This can range from padding the travel budget to paying for Suzie's college out of business funds to not reporting cash receipts.

In some cases we can make adjustments to re-class these items to profit, BUT the business owner must be able to document the adjustments ideally, to the last penny.

One thing that is for all intents impossible to re-class to profit (and hence take into account for valuation/pricing purposes) is unreported cash. In fact, unreported cash is such a Deal Killer that we typically will not take on an assignment if un-reported cash is a meaningful component of profit.

6. Year-end "Tax Planning" Adjustments

In terms of "tax managing" a business, owners will typically make year-end adjustments to AR/AP/inventory. These adjustments often present challenges when buyers are trying to understand the true cash flow and working capital requirements of a business.

7. Inexperienced transaction counsel

We push our clients on this point on every single transaction: the importance of having an experienced transaction attorney cannot be overstated. The buyer will in all likelihood have an experienced attorney. Having a general practitioner, the attorney that handled your last real estate deal or worse, a family friend, handle the transaction can be downright foolish. Experienced transaction attorneys can help facilitate the deal while protecting your interest, rather than using your deal as a learning process and being an impediment to closing.

8. Uninformed spouse

This is probably just common sense, but a spouse is often a "silent partner" in a privately held business. Having their buy-in to proceed with a transaction is often critical. Smart sellers get the topic on the table early in order to prevent problems later.

9. Neglecting Curb appeal

You'd be surprised by some of the comments we've heard from buyers when looking at a messy business. And by messy, we mean papers everywhere, disorganized work areas, etc. While a business is priced based on performance, it's often some of the intangibles that get it sold. Just like dressing up a house before you sell it, you must do the same for a company. When a buyer walks into a messy and disorganized business you can bet they are wondering if it's even worth their time. This is an easy step to improve "saleability."

10. Taking your foot off the gas

Sellers sometimes get so focused on a sale that they ease up on running the business. Buyers want to see growth, and even a slight downturn during negotiations is going to cause a buyer to ask, "What do they know that I don't? Why are they REALLY selling?" The lesson here is the work hard to achieve consistent results until the check is in hand.

Tip: One of the key reasons for working with an intermediary is so you don't have to spend all your time on a sale.

11. The Magic Number

One of our big concerns is always how much thought a seller has put into the post-transaction needs of their estate. The market is going to pay what the market pays for your company. But is it enough? It's imperative to speak with a skilled financial advisor prior to getting deep into a deal.

Tip: Your CPA is the wrong tool for the task. Spend the time, find a top flight wealth manager, and work through an estate plan early.

BONUS DEAL KILLER:
Not thinking like a deal-maker

Avoid drawing lines in the sand early in the sale. Many business owners have a predetermined idea of the value of their business explore a sale process, and have already determined that they will not sell at below that figure. Like any major sale, selling a business is a process of give and take, and refusing to budge will usually set a barrier to going forward. Failure to keep an open mind is a sure way to kill a deal.

Choosing a Valuation Firm

So, if you've made it this far without breaking into a cold sweat, chances are you may be ready to get serious about selling your business, especially if you're hoping to be out within 3-5 years (yes, we really meant that...3-5 years).

Whether you're ready to take the leap, or just want to dip your toe in the water, it might be time to get a valuation on your business. A solid business valuation allows you to:

Play Offense.

A business valuation enables you to gain an understanding of the most likely value of your business, which will place you at an advantage when you sit down at the proverbial negotiations table. Consider this – would you start negotiating the price on a house or a car without an understanding of likely value? Probably not. Working with a certified valuation professional arms you with the information and data to both establish value as well as back it up.

Demonstrate Value.

One of the things we do when we value a company is to try to ascertain how to value a particular business relative to its peers. Let's assume a Widget Manufacturer should sell for 1x earnings. That's the average widget manufacturer. Is your company just average? Absolutely not. To get to a more accurate value, we work through a process to dig in and understand why your business is more or less valuable than the market average.

Increase Value.

Regardless of the valuation method used, the number one concern for a buyer is their ability to generate profit. Period. The most reliable indicator of this is your past performance. A valuation professional will help you clean up your books (see Chapter 3), which will have a direct, significant impact on increasing both actual and perceived value.

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About Quantive

Quantive is a veteran owned and operated financial services firm. We work in three areas:

- **Valuation Services** — Full service valuation practice providing transaction, litigation, underwriting, and tax support to both business owners and advisors.
- **Value Growth Advisory** — We help companies grow and entrepreneurs meet their retirement goals either through Fractional CFO or Certified Exit Planning support.
- **M&A Advisory** — We help clients exit their companies

Get in touch — we'd be delighted to discuss how we might be a fit on your particular project.

LEARN MORE:

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