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BUSINESS TRANSITIONS

TODAY'S TRANSACTION PREPARATION FOR OWNERS



Today's business owners are becoming more and more aware that preparing their companies for a sale has a lot of benefit to them and their businesses. In fact, with the growing marketplace of 'exit planners' – professional advisors who help business owners prepare for a future transition of their business – the number of owners who are doing this form of planning is growing every day. Being prepared for a transaction is more favorable to simply relying on faith that a buyer will be interested in your business, as is, without improvements. And, this type of preparation is being recognized as not only producing a higher value for a business but also increasing the likelihood of getting to a closing as well as having more control of the process. This newsletter is written to help owners see the types of things that will help prepare their business for a successful transaction.

The Concept of "Exit Planning"

The concept of planning for an exit is new to the marketplace. In the past, owners simply viewed the selling of their business similar to the manner in which they might view selling their home . . . they would fix up a few things before listing the business and buyers would come to make their offers. However, as markets mature and more and more baby boomer owners are thinking about an exit, more and more owners are seeing the value in being prepared for a future transition of the business to someone else. And, of course, this makes logical sense because being prepared for any endeavor generally leads to a better result when it is time to execute – this is particularly true for a large financial and emotional transaction such as selling a company.

General Preparation for a Sale

In general, owners who are preparing for a sale transaction are well served by considering the concerns of the next owner / buyer. Typical areas where owners will look to improve their companies include:

People: having a more complete leadership team with employment and non-compete agreements, compensation aligned with growth initiatives, retention programs to keep key people with the company, as well as competitive benefits plans.

Strategy: Having a strategic plan along with a financial forecast that demonstrates how the company is expected to perform in the future, as well as any historical trends of how the company has performed against prior goals.

Financials: Helping to assure that the financials are 'clean' and can be relied upon. What this means is that the accounting and financial statements can be explained without many surprises. Personal add-backs of the owners can be identified and explained, particularly those that will not continue post-transaction.

Risks in the Business: These can be identified and explained so that the buyer can see their potential liabilities.

Another way of putting this is that sellers want to anticipate and address concerns of buyers long before the selling process begins. An old saying is that 'if the truth will kill a deal, there is no deal to be had'. Sellers should assume that buyers will find all of the issues in due diligence and, to the extent that these issues were not disclosed or addressed, it will create a sense of dis-trust, potentially derailing a transaction.

Today's Trends in Preparing to Engage with Buyers

In addition to all of the general guidance provided above, there are two (2) trends that are emerging in today's marketplace that owners are well served knowing about and considering implementing. They are (1) preparing a sell-side quality of earnings report, and (2) researching and offering the buyer representations and warranties insurance.

(1) Sell-Side Quality of Earnings Reports.

More and more of today's owners are investing time and money,

before they go to market, to have a 3rd party, independent source, review and verify the financial records of the business. Historically it has been the job of the buyers to engage professionals to verify financials before acquiring a business. Larger accounting firms typically provide this 3rd party validation. The trend in the markets today is towards having selling business owners spend the time and money to complete these reports and then handing these 3rd party report to the buyers. There are two (2) clear messages to buyers when they see a seller who has prepared a sell-side quality of earnings report – first, that the owner stands behind the accounting and numbers being presented, which is a large concern of any buyer. And next, the buyers can see how serious the owner is in getting to a successful transaction closing. Both of these elements raise the level of interest that buyers have in a selling owner's company.

(2) Sourcing Representations and Warranty Insurance

When a business sells, the owner needs to make certain representations and warranties about the state of the business. These are items that go beyond the due diligence process that buyers want to know are secure. To protect

themselves, buyers will place a certain amount of money into an escrow account and, if there are any representations that prove to be false, then the buyers can access the money in escrow in order to protect against the damage done by the misrepresentation.

A recent trend in the marketplace is for sellers to assume the responsibility of shopping for representations and warranty insurance and letting the buyers know that the policies are available to give them the protection that they seek with less (or no) escrow. What this says to the buyer is “we understand that you have concerns over how we represent the business, but we’ve already had an underwriter look at those concerns and they have priced the R&W insurance and are ready to underwrite the deal.” Similar to the sell-side quality of earnings report, this type of action signals to a buyer that the owner is serious about getting to a closing and makes the buyer more comfortable that the risks that they see in the business are addressed. Also, this tends to reduce or eliminate escrows for sellers, allowing them to walk away from the deal with more cash in their pockets.

Concluding Thoughts

Selling a business is a complex process but being prepared for a transaction tends to lead to better results. By knowing what trends are happening in the marketplace today, sellers can be better prepared for lies ahead. And, for sellers who are counting on the proceeds of the sale to meet their financial goal, investing time and money into addressing the concerns of buyers is a thoughtful way to approach the market and set yourself up for a higher likelihood of success.



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Clarity for Your Exit. Confidence for Your Future.

If you have questions or would like to explore these ideas further, we'd be happy to connect. Reach out to Ed at Edbarone@kintrawealth.com

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