

HOW TO PREPARE YOUR BUSINESS FOR SALE



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PRESENTATION OUTLINE

- Introduction
- The Decision to Sell
- The Buyer(s)
- Valuation Methods
- Enhancing the Value of Your Business
- Financing Scenarios / Considerations

INTRODUCTION

DEFINATION OF A SMALL BUSINESS

The SBA considers small businesses to be:

Retail & Service Businesses	Up to \$13.5 million in sales
Construction Businesses	Up to \$17 million in sales
Agriculture Businesses	Up to \$3.5 million in sales
Wholesale Businesses	100 or less employees
Manufacturing Businesses	500 or less employees

EMPLOYEE / REVENUE BREAKDOWN

Business Size by Employees	Average Annual Revenues
1 to 4	\$321,000
5 to 9	\$792,000
10 to 19	\$1,600,000
20 to 99	\$5,701,000
100 to 499	\$27,056,000
500 TO 999	\$540,467,000

Source: US Census

NO. BUSINESS BY ANNUAL REVENUE

All Business Entities	# of Entities	Percentage
Less than \$25,000	13,973,000	57.9%
\$25,000 to \$100,000	4,765,000	19.8%
\$100,000 to \$500,000	3,491,700	14.5%
\$500,000 to \$1 million	804,800	3.3%
\$1 million or more	1,078,400	4.5%
Total	24,112,900	100%

THE DECISION TO SELL

THE DECISION TO SELL

Whatever the reason, a time will come when you will "sell" your business.

It's in your best interest for you to properly prepare now for that day to ensure a smooth transfer that reflects the true value of your business.

WHEN IT'S TIME TO SELL

The following are general signals which indicate the reason for selling is approaching or has arrived.

The first six are business related

and

the second six are personal in nature

BUSINESS REASONS

- **Superior Growth Rates Vis-à-Vis the Industry**. You can justify a higher price for a business when it is growing at a faster rate than the industry average.
- **Heavy Financial Requirements**. Continued growth requires maintaining debt levels which are higher than the owner's capacity or comfort level.
- **Cash Buildup**. A business is throwing off more cash than it can wisely use. Applying a multiple to this cash flow may maximize your net worth now.
- **Competition**. If a owner suspects that his or her competitors will adversely affect sales and profits, the sale of the business may produce more personal financial gain than continued ownership of the business.
- **Economic Conditions**. If future prospects are worrisome.
- **Continued Business Growth Demands Different Skills**. If the business might grow beyond the point which an owner can retain control.

PERSONAL INDICATORS

- **Age - 50 and Up**. One out of five men age 50 will not reach 65. A business sold by an estate usually nets less money than a business sold by an owner.
- **Health**. Many businesses will fall in value as an owner's health or stamina declines.
- **Loss of Interest**. The business has become a bore. It has lost its challenge. May want to go into new ventures, or reduce workload.
- **Family Situation**. Often the state of the spouse's health, marriage instability or lack of a family successor will prompt the sale of a business.
- **Employee Situation**. If the sale to employees is not possible, they would be better off under new ownership.
- **Entrepreneurial Hunch**. Most entrepreneurs have an intuitive sixth sense. If it is saying, "Now is the time to sell," be careful not to ignore it.

BEGIN PLANNING YOUR BUSINESS SALE

- The only time a business can be sold for a favorable price is when conditions surrounding the business are strong and the future looks good.
- The process of preparing your business for sale and completing the transaction can take a great deal of time, even years. Now is the time for you to begin planning your business sale.

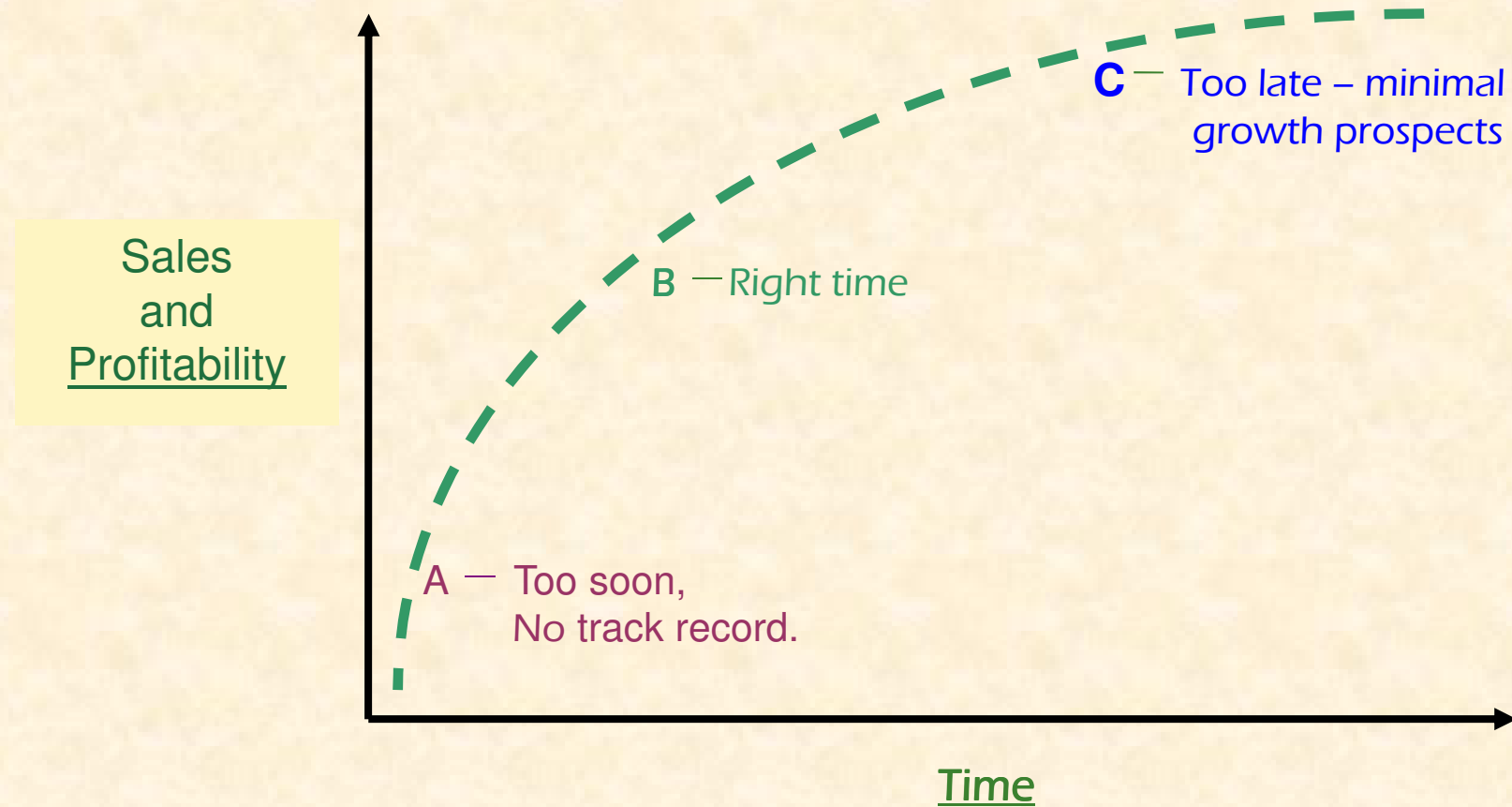
TIMING IS THE MOST IMPORTANT FACTOR

Sell When the Market is Ready!

...which may be different from when you are ready

Timing

When to Consider Selling



TIME REQUIRED TO SELL A BUSINESS

1 to 3 Months	6%
4 to 6 Months	34%
7 to 6 Months	37%
10 to 12 Months	15%
13 to 18 Months	7%

WHAT KIND OF BUSINESSES SELL

Service	24%
Food & Drink Related	18%
Manufacturing	14%
Retail	13%
Auto Related	10%
Distribution	9%
Professional Practices	7%
Other (coin laundry, routes, etc.)	5%

EXPLAIN THE PAST, SELL THE FUTURE

Buyers Buy a Documented Past,
and Believable Future...

The buyer rarely buys what the seller thinks he's selling."

Dr. Peter Drucker

THE BUYERS(S)

TYPES OF BUYERS

- Financial Buyers
- Strategic Buyers
- Family Buyers
- Partner, Shareholder, and Employee Buyers
- Industry Buyers

CHARACTERISTICS OF FINANCIAL BUYERS

- Individuals rather than companies
- Primarily motivated by profits and a return on their investment
- Wants to minimize their cash investment in the business & their risk
- Wants the seller to finance some portion of the purchase price
- Willing to pay for goodwill, if the investment justifies it
- By far the most common buyer for a business with a selling price less than \$1 million
- Usually undercapitalized

ADVANTAGES OF A SALE TO A FINANCIAL BUYER

- There are many potential buyers of small businesses in the market
- The transaction costs will be the least of any of the other methods of sale.
- The actual transaction will generally be the least complicated in terms of legal issues, and therefore faster to accomplish.
- There are many experienced professionals available to advise you in this form of business ownership transfer.

DISADVANTAGES OF A SALE TO A FINANCIAL BUYER

- May find it difficult to find the truly motivated buyer with the financial wherewithal to complete the transaction.
- Although the transaction costs are lower relative to most of the other methods of selling your business, a good business broker may take up to 10% of the total selling price of the business, plus you will also pay attorney and accountant fees.
- Many buyers may get "cold feet" during the sale process for no rational business reason. Many transactions never close because of this.
- You will most likely need to finance a significant portion of the business sale
- The more that your business is discussed with potential buyers, the greater the chance that it will become general knowledge that your business is on the market.

VALUATION METHODS

BUSINESS VALUATION METHODS

- Asset based valuation (liquidation value).
- Market comparison valuation.
- Present value of the businesses future earnings valuation.
- Capitalization of current net earnings valuation.

VALUATION METHODS VS. BUYER TYPE

-TYPES OF BUYERS-

<u>Valuation Methods</u>	<u>Financial</u>	<u>Strategic</u>	<u>Family</u>	<u>Employee</u>
<i>Capitalization</i>	X	X	X	X
<i>Present Value</i>	X	X		
<i>Asset Based</i>			X	
<i>Market Comparison</i>		X		

CAPITALIZATION RATES

Type 1: Very well-established businesses with good trade positions, good management, stable or increasing past earnings, and a reasonably predictable future: 6% to 10%.

Type 2: The same kind of business as *Type 1* except the company is in a more competitive industry: 11% to 15%.

Type 3: Businesses in highly-competitive industries, with low capital investment and mediocre management, but having a good historical earnings record: 16% to 20%.

Type 4: Relatively small businesses that depend on the skill and expertise of one or two people, or large companies in very cyclical industries with poor predictability relative to sales and earnings: 21% to 25%.

Type 5: Small, personal-service businesses with a single owner/manager upon which the business is dependent:
26% to 30% (or even higher in some high risk cases)

CALCULATING CAP RATE

Capitalized Value = Current Year Earnings divided by CAP Rate (as a decimal)
= \$100,000 / .345
= \$289,855

RECASTING THE INCOME & EXPENSE STATEMENT

- Recasting the earnings statement.
- Determining actual "free cash flow" in a business.
- Reconstituting the net operating income.
- Normalizing the earnings.

ENHANCING THE SALES VALUE OF YOUR BUSINESS

IMPROVING THE SALE PRICE

- Maximize Your Operating Profits
- Streamline Your Financial Operating Ratios
- Improve Business Income and Minimize Expenses
- Other Enhancements You Can Make
- Anticipate Buyer Concerns
- Give a Buyer a Good Reason to Buy
- Properly Organize your Company

MAXIMIZE YOUR OPERATING PROFITS

\$150,000

New operating profit

-100,000

Status quo net operating profit

\$ 50,000

Gain subject to additional taxes

 x 40%

Representative tax rate (federal, state, & local)

\$ 20,000

Increase in total taxes

\$ 50,000

Additional operating profit

- 20,000

Additional income taxes

\$ 30,000

Increased after-tax net income

MAXIMIZE YOUR OPERATING PROFITS, CON'T.

\$ 30,000
x 5
\$150,000
x 20%
\$ 30,000

Increased after-tax net income
Earnings multiplier (20% capitalization rate)
Increased business value
Representative tax rate (federal capital gains)
Increase in capital gains tax due for sale of
business

\$150,000
- 30,000
\$120,000
- 20,000
\$100,000

Increased business value
Increased capital gains income taxes
Net gain
Additional operating income tax
Additional net business value after taxes

STREAMLINE FINANCIAL OPERATING RATIOS

Is the business solvent?

Current Assets
Current Liabilities

The Current Ratio is a test for solvency. It provides a clue to the magnitude of the financial margin of safety for the business. The standard guideline is for a ratio of 2: 1 or higher.

Is the business liquid?

Cash & Accts Receivable
Current Liabilities

The Quick Ratio, also known as the Acid Test Ratio, is used to determine the company's general liquidity (its ability to pay its current debts). A general standard for this ratio is 1: 1 or higher.

Are the products selling?

Cost of Sales
Inventory

This ratio shows the number of times the inventory turns over.

FINANCIAL OPERATING RATIOS, CON'T..

How's management doing?

$\frac{\text{Net Profit}}{\text{Net Worth}}$ This ratio shows the return on invested capital.

Is the business earning a profit?

$\frac{\text{Net Profit}}{\text{Sales}}$ This ratio measures the profit margin of the business.

Are profits adequate?

$\frac{\text{Cost of Sales}}{\text{Sales}}$ This indicates how much money is available to pay expenses.

IMPROVE INCOME & MINIMIZE EXPENSES

- Evaluate Leased & Financed Assets for Conversion to Owned Assets
- Evaluate all Service & Material Contracts and Agreements
- Evaluate the Business's Physical Plant
- Evaluate Your Employee Costs
- Evaluate all Office Equipment & Computer Software
- Evaluate all Product-Related Equipment
- Evaluate all Owner-Specific "Perks" and Benefits
- Review all Products & Services

OTHER ENHANCEMENTS YOU CAN MAKE

- Consider using outside consultants to help increase the business' profitability.
- Clean up inventory to ensure that it's current.
- Modify all leases, mortgages, agreements, and contracts so that they are assignable to a new owner.
- Have your financial statements audited by a CPA.
- Bring the accounts receivable up to date.
- Settle all/any outstanding lawsuits, tax liens, and employee disputes.
- Resolve all/any partnership or shareholder disputes.
- Ensure that you have replacement corporate management.
- Do not take on any new debt.

OTHER ENHANCEMENTS YOU CAN MAKE, CON'T.

- Do not take on any new debt.
- Defer all major facility improvement or expansion programs.
- Separate the real estate from the business.
- Be prepared to stay with the business for a time, after the sale.
- Ensure that you have an impressive and active Board of Directors.
- Make sure that all of the company's product/service liability coverage is in place.
- Upgrade all of the company's sales & marketing literature.
- Ensure that all of your copyrights, trademarks, service marks, trade names, and patents are fully documented.

MISCELLANEOUS ENHANCEMENTS

- Clearly visible, modern, up-to-date signage.
- Company employee uniforms, if appropriate.
- Cleanliness and neatness of the premises.
- Well-stocked supply rooms.
- Prominently display vendor awards, community citations, etc.
- Membership in organizations such as Better Business Bureau and local Chamber of Commerce.
- Busy, cheerful employees when potential buyer visits/tours your company.
- Ample customer and employee parking.
- Public and private ground in good, visually inviting condition.

ANTICIPATE BUYER CONCERNS

Ask yourself:

“If I were a potential buyer for this company, what would I be most concerned about?”

GIVE A BUYER A GOOD REASON TO BUY

- Strong sales and earnings growth.
- Declining operating expenses.
- Potential new markets to be tapped.
- Upward trends in your industry segment.
- Excellent management and sales force.
- Well-maintained facilities with room for expansion.
- New products in development.

PROPERLY ORGANIZE YOUR COMPANY

- The complete corporate stock ownership status should be clear.
- If the company is a partnership, there should be a properly-executed partnership agreement in place.
- If the company is a sole proprietorship, there should be a record of ownership of the corporate assets, a properly executed agreement by the owner's spouse authorizing the sale of the business assets.
- The company debt structure should be clear and well documented.
- All retirement plan documentation should be up-to-date and fully described.
- All information regarding subsidiary operations, joint-venture agreements, and similar business arrangements should be fully documented.
- A comprehensive operations manual, including procedures for compliance with EEO, EPA, OSHA and other applicable government regulations.

FINANCING SCENARIOS/ CONSIDERATIONS

FINANCING SCENARIOS

- A business might be financed by a Bank or SBA if it is profitable and can produce Tax Returns,
A Buyer will...
 - ❑ Need 20-30% down payment on a business
 - ❑ Need 10-20% down on the property

- Without Tax returns, but with acceptable P&L's,
If Seller provides financing,
 - ❑ Buyer puts 30-50% down
 - ❑ Price is negotiable

- With poor quality financial records
 - ❑ Buyer may offer 70-75% of asking price.
 - ❑ Buyer may walk away

OTHER CONSIDERATIONS

- All Cash Buyer – Very rare over \$100k because buyers can leverage their money for a better deal.
- Owner Financing – A high percentage of transactions are financed by owners & require a down payment from the buyer of 30 - 40%. Tells the buyer that the seller is confident the business will service the debt.
- All Cash Deal – A seller who requires all cash is likely to receive only 70% of his original asking price.