THE GUIDE TO BUYING OR SELLING YOUR BUSINESS SUCCESSFULLY

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Introduction

Many business owners will only find themselves faced with the decision to sell their business once in a lifetime. With this lack of previous experience it can be a difficult, complicated and stressful process. It can also be easy to miss opportunities in taxation, pensions and other areas of financial planning. The actual process of selling the business needs careful consideration with special attention to marketing and presenting the Company correctly, to ensure that the message reaches as many potential investors as possible. The price and terms for the sale need to be skilfully negotiated, whilst trying to keep all options open with other potential investors, should the deal fall through.

The purpose of this guide is to highlight some of the important issues which may need to be addressed for business owners who are thinking of selling or buying. The guide also highlights some of the advantages of employing a "Business Transfer Agent" or broker to help with the process, whilst pointing out some of the areas to consider, before taking action.

This guide cannot cover every subject or eventuality but is simply intended to make the subject matter easier to understand.

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Note about the author: Roger Smith has been a Director since 1982 and has been successfully selling businesses since 1999. From his own experience, he understands both what it is like to run a business and what needs to be done when it is time to sell.

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1. Successful Sales

What do you need for a successful sale?

Selling a business can be a long drawn out process but it need not be this way if care is taken before the sale process gets underway. Although there is a reliance on the buyer to help reach a successful conclusion, delays can be minimised if the seller or "Vendor" takes the following action:-

- Plan ahead first as part of an overall business plan
- Develop strategies to maximise profits 2 years prior to sale
- Review level of provisions to maximise balance sheet value
- Ensure major Shareholders/family members are in agreement
- Demonstrate current year and future profit growth
- Understand what the business is likely to be worth (at least on paper) before negotiating the price – seek an independent valuation first
- Clarify exactly what is included and what is not included in the sale
- Seek tax advice on whether the sale should be an "Asset Sale" or a "Share Sale"
- Ensure that Statutory Accounts and Management Accounts are up to date
- Ensure that Contracts of Employment are up to date and issued to all staff
- Ensure that all tax queries are resolved and that Corporation Tax, VAT is up to date etc
- Ensure that all legal issues have been resolved
- Ensure that your business complies with all Health & Safety legislation
- Ensure that all documents/records are up to date especially with those covering employees, customers and suppliers.
- Seek personal tax advice
- Record unsolicited approaches, from potential buyers
- Consider professional help to develop the business should the sale form part of a longer term plan

2. Planning a Business Sale

Business Planning & Exit Strategies

Ideally, a business sale should be planned in advance, as part of the overall "Grand Strategy" within the business plan. Business plans typically look ahead for 3 years and should be updated each year to ensure that the business remains "on track" with its action plans to work through the strategies in order to achieve the various objectives. The following may provide a useful reminder of the essential key elements of a business plan:-

Grand Strategy: The owner's ultimate ambition for the business
Mission: The purpose of the business
SWOT Analysis: The strengths, weaknesses, opportunities & threats
Objectives: Exactly what needs to be achieved
Strategies: Exactly how the objectives are going to be achieved
Action Plans: Exactly who is going to do what and when

An exit strategy should consider various issues which could affect the actual sale. At worst, the issues will prevent the buyer from proceeding with the deal if there are unnecessary delays, legal complications etc because insufficient planning has been carried out in advance. Items that may need consideration include:-

- Pension and/or taxation advice for the owner(s)
- Effective management of data
- Outstanding issues with tax/payroll/expense claims/NIC's & PAYE
- Outstanding disputes to be settled
- Trading relationships between Customers and/or Suppliers
- Future for family members
- Future for key employees
- Management expertise and training
- Staff Contracts of Employment
- Status/funding of Company pension scheme
- Health & Safety issues

3. Business Valuations
How are businesses valued?

There are five main methods for valuing businesses which are:-

- **Multiples of earnings and sales -** The "multiple earnings" approach uses established market based Price/Earnings (P/E) Ratios and is suitable for those businesses with a record of profit generation. It involves multiplying adjusted after tax profit by an industry sector related multiplier. The "sales or fees multiple" approach is often used in valuing businesses that include consultancies, professional businesses, brokerages, agencies etc. This approach will involve applying an established industry multiplier to the adjusted annual sales or fee income.
- **Asset based valuations** – for those businesses that are well established and have substantial tangible assets but possibly low earnings, eg. property companies and investment companies, but not excluding some manufacturing businesses. This approach will include calculating the net realisable value of all the assets held by the business and deducting the liabilities.
- **Entry Cost –** values a business as if starting from scratch
- **Discounted Cash Flow –** this valuation approach is suitable for those businesses that have been established for many years, have invested heavily and with a stable earnings record.
- **Industry Rules of Thumb –** use of an established standard formula for a particular sector

With the exception of Entry Cost, where the valuation of a business determined by one or more of the above methods exceeds the market value placed upon the business's adjusted net assets, the difference will be "goodwill". Goodwill is an intangible asset as it invariably does not have a value in the balance sheet and as such is notoriously ambiguous to value unless recognised valuation procedures have been adopted as outlined above. It will usually involve two valuation methods being employed. The practice of valuing goodwill will be determined from negotiations between the buyer and seller and will usually come down to what a willing buyer is prepared to pay and what a willing seller is prepared to accept.

4. Exit Routes

What are the exit routes?

Many small to medium sized businesses are successfully sold as "trade sales" where the shares or assets, name and goodwill are sold to another business or individual. However, other types of sale are possible, which include Management Buy-Out's (MBO's) or Management Buy-In's (MBI's).

MBO's and MBI's may use the existing management team with or without outsiders to take over the ownership of the business, either by pooling the equity themselves or by using external finance, such as a Venture Capitalist to "Buy-In". Existing assets may also be used to help raise finance.

Potential trade buyers will not normally wish to compete against the prospect of an MBO or MBI sale and it might be difficult to actually match an offer that could be realised from a trade buyer. There is also a real need to be wary of a demotivated key manager or management team, should an MBO sale fail and the whole process could lead to a distraction from the day to day management of the business – owners need to be extremely careful! A summary of the different types of sale are as follows:-

Trade Sale:	Business purchased by another Company or individual(s)
MBO:	Management buy out
MBI:	Management buy in
IBO:	Institutional buy out
Floatation:	Stockmarket listing
Merger:	Joint venture through shareholding

5. Types of Business Sale

What are the different type of sale?

For a Limited Company, there are two basic types of Sale – "Asset Sale" and "Share Sale". An asset sale includes just some or all of the assets, plus the name and goodwill. The liabilities will then need to be settled by the Vendor and then the remains of the Company wound up unless the business is to continue in another form. A share sale will normally include the Company as a whole, including both the assets and the liabilities. There are tax implications on either type of sale, so tax advice is essential before deciding which type of sale to go for.

Advantages of an Asset Sale

- Less potential liabilities for a purchaser as only buying the assets, name and goodwill
- Less legal work for both parties for the Sale Agreement document, which is normally produced by the Vendor's Solicitor
- Normally tax advantageous for the Purchaser.

Disadvantages of an Asset Sale

- Vendor has to settle outstanding liabilities
- Remains of the business has to be wound up or to become dormant if no longer trading

Advantages of a Share Sale

- Vendor sells the complete business with all assets and liabilities (unless specific items excluded from the sale).
- Purchaser can take advantage of any previous tax losses.
- Normally tax advantageous for the Vendor.

Disadvantages of a Share Sale

- Increased legal fees with a more complex Sale Agreement document which is normally prepared by the Purchaser's Solicitor.
- Large potential number of warranties for the Vendor which need careful consideration against a disclosure letter to mitigate potential future claims.

6. Structuring a Deal

Types of deal

It is not always possible to structure a deal where the final price is paid in full on legal Completion; especially so for larger transactions, often due to the large amount of funding required. In these cases, payments are often spread over an agreed timescale, known as "Deferred payments".

An alternative method used is an "Earn out" where part (or even all) of the sale of the business is paid for from future profits, assuming that the Vendor and buyer can agree the basis for future profit calculations. This method can be used to realise a greater overall purchase price for the Vendor, particularly if the purchaser is likely to achieve a higher level of profitability than the current owners.

Whatever the deal, the Solicitors will need to look at the legal aspects very closely, so it makes sense to choose a Solicitor with the relevant experience in commercial law.

Points to consider include:-

- Level of security from the buyer for Deferred payments
- How profit is to be calculated on Earn-out deals
- Level of risk for the Vendor, should the new business owners fail

7. The Business Sale Process

The process of selling

The process of selling a business can be lengthy with possibly up to 6 months to find a buyer and up to 6 months to sell the business before legal completion. The basic process involves the production of a “sale memorandum” document which will provide the basic particulars of the business for sale, for potential prospects. A prospective buyer will only be found through constant advertising and following up leads and each prospect should sign a “confidentiality agreement” or “non-disclosure agreement” (NDA) before handing out sales particulars or other confidential information.

Once a prospect is in a position to make an offer, this is usually submitted in writing as an “indicative offer” from which negotiations can take place. Obviously, the Vendor is in a much better negotiating position when there is more than one interested party – the aim should be to get a short list of six serious buyers from the outset, as offers could be double that of others. Once an indicative offer has been accepted, the next stage is to progress to Heads of Terms, which sets out exactly what the two parties have agreed between them and also grants an exclusivity period (legally binding) to the Purchaser.

Following the signing of Heads of Terms, the sale process is subject to the Purchasers “due diligence” exercise, to make sure that the business “is what it appears to be” both from a legal and an accounting point of view. The sale process is also handed over to Solicitors, acting for each party. Before appointing a Solicitor, it is as well to make sure that they have experience of handling business sales; that they can operate within the agreed timeframe and can work to an agreed budget.

Remember, even if the deal falls through, the Solicitors will still want to be paid!

8. Role of a Business Transfer Agent

Why use a Business Transfer Agent?

Business owners often use a Business Transfer Agent, (also known as a Business Transfer Specialist or Broker) to help sell their businesses. There are several advantages for this, including:-

- Skills to gather up knowledge of the business to prepare a Sale Memorandum document
- Knowledge of where to advertise the business for sale, in order to generate enquiries
- A network of potential investors who could become prospects
- The ability to secure confidentiality agreements
- The handling of enquiries enabling the business owner to carry on the day to day running of the business
- The ability to negotiate on the Vendor's behalf
- The ability to help the prospective buyer with contacts for raising finance
- A network of specialists to support the sale process such as Accountants for due diligence, Solicitors for legal work and Financial Advisors for equity funding, pension advice etc.

Before appointing a Business Transfer Agent, it is worthwhile taking the following action:-

- Meet at least two or three brokers to compare terms of business
- Read the "small print" to understand the penalties for cancellation
- Be wary of very high "up front" fees or exorbitant commission
- Find out exactly what service is being offered for the fees
- Find out who will actually be doing the work on your behalf
- Find out the standard, for the Sale Memorandum document

If in doubt, please contact Stirling - Business Transfer Specialists

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