8 Things To Know (or Do) Before The "For Sale" Shingle Goes Up

A thoughtful approach to the sales process can pay dividends. These 8 tips can help owners make the most of the financial opportunity for their company.

1. Understand the reason for the sale

Sounds obvious, but owners sometimes need help recognizing their true motivation and how much they want to stay involved with the business after the transaction closes. After all, there are different types of sales – recapitalizations, transitions, and exits. Each requires a different way of preparing and positioning the company, ideally several years in advance. Which direction to pursue may depend on such factors as:

- the role the owner wants to play in the company going forward;
- how much the owner wants to participate in the ongoing growth of the business;
- how much money he/she needs, and when;
- what the company's future looks like; and
- the landscape for the industry the company inhabits.

Sometimes owners think they want to sell the whole business or choose not to sell at all. They may not realize there is another option – a partial sale, which allows them to share business risk with an outside partner, continue to run their company, and own a meaningful part of it. (For more information about recapitalizations, see *How A Recapitalization Can Help Boost The Business* in the April, 2015, issue of *INSIGHTS*.)

It is also important to understand the time involved. A complete sales process can take six months to a year.

2. Get good advisors

The seller should have experienced and trusted advisors to help the team navigate the sales process. These advisors could include a qualified business intermediary, an accountant, and an attorney who specializes in mergers and acquisitions.

"This can be an overwhelming process, especially for first-time sellers," explains Prospect Partners' Maneesh Chawla. "The best advisors are those with significant experience representing sellers in M&A transactions. They will understand private equity terms and be highly knowledgeable about how corporate sales work."

In addition to being sounding boards, good advisors offer a range of skills that clarify and speed the process. For

example, they can help set realistic expectations, explain important issues and steps along the way, remain focused on the right points, advocate for the seller, assist with due diligence, and close the transaction.

What's more, in a market with many potential buyers, intermediaries can help identify the best 'fit' for the seller and his or her vision for the company.

"It can be hard to distinguish among private equity firms," Chawla says. "Advisors can help the seller ask the important questions to narrow the field to the most appropriate buyers based on the client's specific criteria (see box on page 3)."

On the legal side, an experienced M&A attorney is key. "M&A transactions are very different from other legal transactions," Chawla explains. "Sellers may be tempted to hire their long-time lawyer. That won't be to anyone's advantage if the advisor isn't well-versed in the sales process, or is not familiar with standard terms needed in an M&A deal."

He adds, "It's important to choose a lawyer who understands, and can represent, what the seller wants out of the transaction. For example, for a seller seeking to recapitalize his business, a good lawyer will recognize the importance of maintaining an ongoing collaborative partnership with the buyer that will extend beyond the sale process."

3. Analyze financials

Private equity firms typically review a company's books for at least the preceding three years.

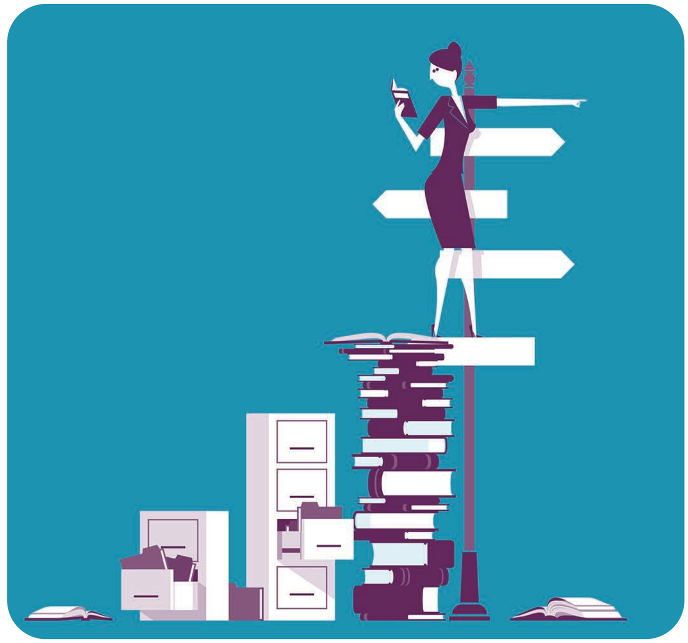
If the company does not have a CFO or has never had an audit, owners a few years from a sale might consider hiring a reputable accountant to review two years of balance sheets, recommends Prospect Partners' Erik Maurer. That's because analyzing financials in advance can uncover issues a buyer will find during due diligence.

"Investing in an audit or a review can lead to a smoother sales process because it puts the owner in the driver's seat, giving him the ability to decide – *before* putting the company up for sale – whether any business adjustments need to be made and, if so, how to manage them," Maurer says.

Maurer adds: "Too many times we have seen owners scramble to respond to a big issue – like customer concentration or changes in profitability – that came up during due diligence and could easily have been caught and addressed had the company engaged in any front-end work. Newly discovered issues can be costly, adding time to the process or affecting our view of the company's worth."

Sellers with shorter lead times – say, a year or so – may instead consider asking the accountant for a "Q of E," or a quality-of-earnings report, which can be similarly helpful. The study reviews the components of the company's revenue and expenses to verify earnings and assesses the quality of earnings going forward.

The accountant also can align the company's financial statements with GAAP (Generally Accepted Accounting Principles), the language spoken by private equity firms and lenders.



4. Get the story and key documentation in order

Private equity buyers will ask sellers many questions as they get to know the business.

"We are impressed by owners who can present the company well, who articulate compelling reasons why we should back the team and its vision, and who make available key information that helps us understand the business overall," Chawla says.

Looking at the business through the investor's mindset is one helpful way to prepare the company story. Toward this end, sellers should be able to speak to:

- **The company, industry, and market opportunity.** How well-positioned is the business for growth?
- **The competition.** Who are the main competitors? How does the company stack up against them? Why do customers choose the company over its competitors?
- **Team roles and responsibilities.** Is this the right team to lead and execute on the growth strategy? Are there management gaps?
- **Company's financial picture.** For example, what are its cash flows, capital expenditure needs, and working capital trends?
- **Customers and suppliers.** Any customer concentration? Do demands spike and ebb or do they recur? What are market dynamics – for example, are customers being acquired? "Develop an understanding about what drives customers, what they are buying each year, and their profitability," Chawla suggests.
- **Information technology.** What systems are in place? Are they scalable? Are capital investments needed?
- **Employment and labor practices.** What is the employee base? Are there any one-time or ongoing issues that affect the cost structure of the business?
- **Legal disclosures.** Does any potential litigation lurk?

- **Potential risks (and mitigating factors).** Are potential business problems offset by market or other dynamics? For example, a possible risk like significant customer concentration might be diminished if that big account is spread among 20 facilities.

Sellers should keep available:
- **Business plan** (see #6) **and budget**. Often sellers don't have either. Yet being able to articulate a purposeful direction for the business, establish goals, and identify business needs will help the buyer better understand the risks and opportunities for the company. For example, how much of new projected growth requires new assets, new people, new products, or new customers?
- **Key customer contracts.** Do assignment provisions exist? If so, what is required?
- **Building documentation** such as a lease agreement.
- **Basic governance materials.** These include company incorporation documents, bylaws, and Board minutes.

5. Involve the management team

Clarifying the "why" for the sale is important for another reason: It makes clear whom to involve. Proactive communication and incentive-building help get company leaders on board and ready for the process and their future roles. Whether due to fear of the unknown or nervousness about starting a rumor mill, owners sometimes keep a sale decision close to their vest for too long.

"We have traveled to companies thinking we will meet the senior team, and end up visiting only with the owner, who did not invite anyone else to the meeting," says Prospect Partners' Brad O'Dell. "This has happened even in situations where the owner wants to transition out over several years and says he has people in place to succeed him. Both sides then miss the opportunity to get to know and become comfortable with each other and ask questions."

Making sure top executives are present provides an opportunity for the owner to display the team's strength, as private equity firms like to see strong teams built around the owner, not a one-person show. It also signals the company takes the potential sale seriously.

Adds O'Dell, "We're happy to be patient and approach the conversation with leadership in phases. Management usually is pretty tuned into what's going on anyway."

6. Develop a strategic business plan

Owners with well-articulated business plans signal they have carefully considered the business opportunity.

Yes, private equity firms like to hear growth stories. These need to be reasonable and genuine. "We receive lots of books that say the prospect is pursuing international growth," Maurer notes. "Cross-border initiatives are not low-hanging fruit for most small companies, which often do not have the infrastructure or experience to successfully execute on them."

Owners should pinpoint inherent growth engines, identify initiatives to jumpstart them, and be able to describe what the company is doing – or what it wants to do, with a buyer's help. Perhaps an owner has found an exciting new distribution channel opportunity, but needs guidance selling into it.

Ideally, an owner can speak to a 90-day, one-year, and five-year plan for the business, and the building blocks of each.

"We like when a company has identified realistic growth initiatives and has started to invest in some of them," Maurer says.

He adds, "Even if a new product launch or geographic expansion hasn't worked out perfectly, private equity firms

Choosing the right buyer

Every business is unique. Deciding which prospective buyers to invite to the table is often part art and part science. Upfront research and "gut checks" may include the following assessments:
- **Website review.** As a starting point, buyer websites can provide information on the firm's background, experience, portfolio, industries of interest, and investment approach. All can help determine whether the company is a natural investment "fit."
- **Personality match.** Do the seller and buyer like each other? Do interactions feel genuine?
- **Cultural mesh.** Do they share a similar work ethic? Communication style?
- **Investment period.** Do buyer and seller share an understanding of how long the buyer plans to hold the business, the variables that drive that decision, and what the future exit plan looks like?
- **Partnership sensibility.** Do both sides have a true sense of how they will work together, and who really runs the business, after the deal closes?
- **Past support.** Has the buyer seen, and supported, similar businesses or situations in the past? What were the outcomes of that involvement?
- **Available capital.** Does the buyer have the funds to close the deal? What resources are available to support the growth plan after the transaction closes?

Ultimately, the decision may come down to talking to business owners who have sold their companies to the prospective buyer and can provide feedback on experiences from years of working together.

"Checking references with past or current business-owner partners is the best way for sellers to truly understand the buyer across many dimensions," Chawla says. "Sellers should ask every possible question about what it was like working with an outside partner, and the buyer should welcome those conversations."

appreciate management teams with clear, logical plans. We also like it when management has taken proactive strategic actions to build their business."

7. Feed the business

As selling time nears, some owners stop investing in the company because they don't want to affect short-term profitability.

"Owners may worry that big recent expenditures will hurt valuation, or think they can save money by waiting to let the new investors step in and make the needed investments," Chawla says. "The opposite can hold true. Addressing immediate business needs – like adding capacity or key team members – and demonstrating their positive impact can actually result in a higher valuation."

Higher valuation multiples need to be supported by growth, which typically requires continued investment back into the business. Toward that end, buyers also like to see that companies are working to improve their systems, processes, and infrastructure.

"From the buyers' view, sellers who have been making investments take some risk off the table," Chawla notes.

8. Maintain solid support

Selling a business is a time-consuming process, especially during the due diligence stage. Owners who plan ahead – by working with good advisors (see #2), by anticipating buyer needs, by shoring up management support, and by making sure company fundamentals remain strong – can help ensure the business runs smoothly during this important time, thus setting the stage for a timely and successful sale.

About Prospect Partners

Prospect Partners is a leading private equity firm that invests in smaller lower-middle-market companies, focusing exclusively on management-led leveraged recapitalizations and acquisitions of niche market leaders with revenues typically under $75 million. Since 1998, Prospect Partners has invested opportunistically nationwide in more than 120 unique companies in a broad range of niche manufacturing, distribution, and specialty service markets.

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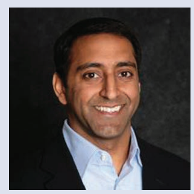

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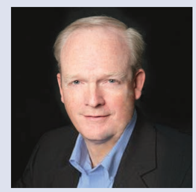

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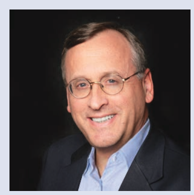

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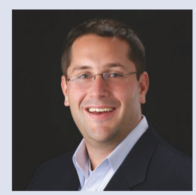

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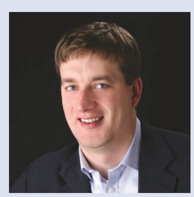

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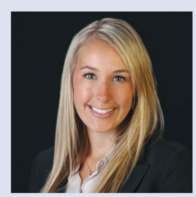

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