Selling your Business?*

You have decided to cash in – what's next?

1. What are the most attractive buyers for my business?

It all depends on the business and the transaction volume. Most privately held businesses with revenues under $50 million are sold to strategic investors such as entrepreneurs and other businesses. On the other hand, if you own a business that generates higher revenues, you might also consider selling to financial investors such as private equity firms. However, you have to be aware that deals with private equity buyers are generally more complex than those done with strategic buyers due to the level of debt added to your company and financial engineering.

2. What are the first steps to sell my business?

Most businesses with revenues under $10 million work with business brokers rather than investment banks to locate and screen out prospective buyers. In order to prepare your business for prospective purchasers, make sure that your corporate books, financial statements, agreements with suppliers, customers, franchisors and landlords are in good order. If possible, try to sell all assets clear of encumbrances. Many purchasers will shy away from buying a business that appears to have been managed in a sloppy manner with regard to internal book keeping.

Make sure to talk to an experienced accountant and an experienced M&A attorney to prepare your business for a prospective sale. The next step is to have your business valued in order to determine the best purchase price.

3. How do I pick the best purchaser if I have several offers?

If several prospective buyers are interested in your business, you may have an auction during which they will have to compete on price and terms. Make sure that other factors such as a cap on your potential liability and termination fees are discussed in an early stage. Your business broker, investment banker and attorney will assist you during this phase of the sale process.

4. What agreements are required to document the deal?

The first agreements are generally a non-disclosure agreement followed by a Letter of Intent ("LOI") and/or a term sheet. The LOI will reflect all essential terms of the deal such as purchase price, liability and timeframe. After the due diligence, a number of agreements will be signed such the purchase agreement, the affidavit of no creditors, the bill of sales, promissory notes, security agreements and side letters. Moreover, ancillary agreements with third parties such as customers, suppliers, landlords, franchisors and commercial banks have to be amended.

5. Stock or asset deal – what's better?

Most acquisitions can be consummated either as an asset or stock transaction. Factors such as the size and the nature of the business, the number of existing customers, existing intellectual property rights as well as security law issues will play a role in making a final determination with which route to pursue. For example, if you are selling a technology business, a buyer will only be interested in your company if it can use related intellectual property rights after the deal has been consummated. Often, re-registering patents and trademarks is lengthy and costly therefore a stock deal makes more sense. On the other hand, if the buyer is only interested in certain assets of the seller which can be easily transferred, an asset deal might be the way to go.

As a general rule, the entrepreneur should sell equity for mainly two reasons: (i) potential tax savings if the target is a "C" corporation due to the fact that a stock deal may permit the sale to be treated as a tax-free reorganization (ii) to pass the target's liabilities, disclosed and undisclosed, onto the buyer. However, for the very same reasons, many prospective buyers of closely held businesses prefer asset deals.

To make a final determination, tax and legal advisors on both sides will be involved during the whole process.

6. What do I have to watch out for during the due diligence process?

Generally, due diligence will be more vital to the purchaser because he knows much less about the business than the seller and needs to be put in a position to evaluate the opportunities and risks of the acquisition.

However, sellers need to be aware that the sale process itself can have an adverse effect on his business, regardless if the acquisition is completed or not. If the sale process is unsuccessful, the seller will have to continue operating a diminished business. Even if the acquisition is completed, the sale process may have diminished the value of the business.

This is caused by the general disruption to the business and operations during the sale process with regard to employees, customers, leases and other third parties. Often, employees begin scouting for new jobs if they learn the news that a sale is pending in

order to have options in case the purchaser plans payroll cuts or changes. In addition, sensitive information might leak out which diminishes the market position of the seller.

Often, contracts with third parties require obtaining the consent of selling the business due to change of control provisions in agreements. Generally, third parties and employees do not like the idea of change. Even if the sale is not successful, it will often leave a bitter taste with them.

We therefore stress to our clients each time they plan to sell their business to keep the planned sale as confidential as possible and use confidentiality and non-disclosure agreements to a maximum. Nothing is worse than trying to sell a business without success and destroying the business in the process.

7. What clauses should I use to protect myself?

(a) Basket Provision: The seller should insert a basket term in the acquisition agreement dealing with indemnity obligations which means that only certain types of claims or those exceeding a specified dollar amount are said to "fill" the basket. This aggregate amount can range between .5 to 1 per cent of the purchase price. This way, the buyer would only be permitted to recover for its aggregate amount of damages in excess of the amount of the basket. Sellers should also include a mini-basket for individual claims which means that individual and unrelated claims under a specific dollar amount are excluded. For example, unless the buyer's damages exceed $10,000 with respect to a particular claim, it does not get counted toward the basket.

(b) Non-Reliance Provision: This provision requires the purchaser to acknowledge that it is buying the business based solely on the seller's representations and warranties in the acquisition agreement and its own due diligence investigation. Indeed, such a provision is intended to prevent the buyer from suing the seller based on any oral statements, writings, projections, etc. outside the four corners of the acquisition agreement.

(c) Liability Cap: Sellers should push for a maximum cap of ten per cent of the purchase price while trying to minimize any buyer carve-outs. The seller's message to the buyer should be that, absent fraud, once the business is sold, the purchaser should only be able to recover a limited amount of the sale proceeds. This provision is important and should be part of the first LOI.

8. What can I do to prevent the buyer from calling the deal off?

It happens from time to time. The seller and prospective buyer spent time and money leading up to closing and the buyer calls the deal off in the last minute. In order to minimize this risk, the selling entrepreneur should require the buyer to pay a break-up fee in the form of liquidated damages if the acquisition agreement is terminated through no fault of the seller (e.g., if the purchaser is unable to satisfy a financing condition); the liquidated damages can range from the amount of seller's transaction expenses to over ten per cent of the purchase price.

9. How long will the whole process take?

Typically, the process from the decision of the owner(s) to sell the business to the successful closing of the transaction can take up to six months depending on the size and nature of the business. Due to the large number of service providers involved, correct timing is important to avoid unnecessary details. In the beginning, accountants, business brokers or investment banks will determine the purchase price and find a suitable purchaser. Later on the transaction will be structured by attorneys on both sides who will negotiate the transaction documents and ancillary agreements with third parties such as customers, landlords and commercial banks.

10. What are the costs for selling my business?

Selling a business comes at a high price due to the complexity of the process and the fact that many different service providers are involved. While investment banks and business brokers charge fees pursuant to the value of the transaction, accountants, business appraisers and attorneys charge hourly fees most of the time. In addition, banks and landlords typically charge processing fees for amending contracts. Therefore, total costs on both sides of the transaction can amount to twenty per cent of the transaction volume.

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