# Good Advice from your investment banker if you are thinking of selling your company

Selling your business or merging it with another entity is a high stakes proposition. You need a team to do this. The team requires a high level of expertise in multiple disciplines...experience in managing the sale process in a confidential manner, top flight M&A legal counsel, accounting and tax advice. As a business owner, you generally are going to do this once, so it's got to be absolutely right the first time. You need the A team and the investment banker is the quarterback, the coordinator, of all these specialized services.

I've had the wonderful opportunity of working for two Fortune 20's and owning several small manufacturing companies. What I have learned from many years' experiences as a mid-market investment banker regarding planning for a liquidity event include the following:

- **If you are planning a liquidity event, do not lock-on to one potential acquirer / investor. So many owners get convinced that the first party across the transom is the best acquirer of their business. It may be a company you've know for 20 years. It maybe a well known competitor. It maybe even a family member. It is really important to create a competitive environment for your business to determine the highest market value and the best fit for your business; where the #1 prospect always believes he is in second place. So many business owners believe that the single suitor they have started talking to will bring the highest valuation and most favorable terms. They won't if they think they are the only party you are talking to. Competition always results in acquirers sharpening their pencils. Run a competitive, professionally managed, confidential process. It will be worth the cost.**

- Audited statements will enhance your company's value by minimizing risk to the acquirer....make the investment. Understand how to prepare your business for sale, including the value of audited statements.

- Strategic investors *may* provide the greatest value for your business; but cast a wide net...for years the financial investors have accumulated substantial dry powder to put to use, especially those that know your business or industry or already have a platform investment in your space. We have at times seen financial investor's proposals that have trumped those from strategics.



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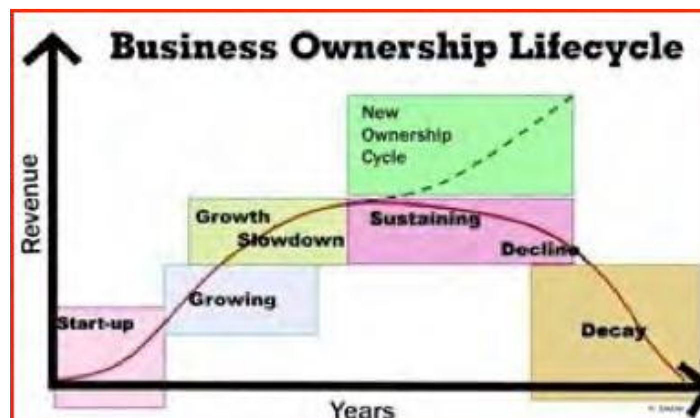
- Strategic acquirers will take a lot longer to do a deal than the financial acquirer....manage a process that tries to get them both to the table at the same time. You'll be surprised how acquirers will sharpen their pencils once they know that a licensed financial intermediary is involved.

- When asked to roll part of your equity with the acquirer, think and evaluate what "second bite of the apple" means. Do your own due diligence on the acquiring company and its management team. Recognize that the honeymoon with your company's new owner can be shorter than you plan.

- Know the life cycle of your business and how you stack up in the industry. Assess when it's best to pull the trigger.




- Before you start any process, understand the after tax cash to you....perform a "**cash-in-pocket**" evaluation with advice from your tax adviser. We have lost investment banking assignments, and rightfully so, when the owners realize up front that their after tax proceeds from the sale will not support the level of their pre-sale life styles. An example of such an analysis is shown below.

- Do an annual strategic / financial plan out 3 years. This task shows the mark of professional business owners. Your investment banker will focus the acquirer to on where you are going, rather than where you've been.

- Put a plan in place now and share it with key advisers / family members...you may get hit by a bus tomorrow. If you're not there, what do you want your spouse / children to do to maximize the value of what you have built? Such a plan should include who is your team: investment banker, tax and legal counsel.



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- **Keep everything confidential**. No one needs to know, unless they have a real need to know. If employees know you are selling, resumes tend to get updated. Customers will become skittish with the possible loss of a vendor and seek others. Vendors may consider changing the terms of their products or service. Both customers and vendors absolutely do not need to know your plans.

- Keep good records every year of the add-backs: those owner expenses run through the business and all non-recurring expenses. Adjusted / recasted EBITDA will be your newest best friend. See a sample of those **adjustments** below.

- Do whatever you can to minimize customer concentration. Financial investors are most concerned with this; strategics less so.

- If the buyer wants to keep you on, remember that the honeymoon generally doesn't last more than 12-18 months. Your chemistry with the new owner is often more important than the numbers.

- Consider acquirers from global sources. Many have the capital as well as government incentives to do outbound M&A transactions.

- Don't change horses in mid-stream. If you have a set of trusted advisers, don't make changes if you have started the process of selling or even acquiring another business. These advisers know your business and where the bodies are buried.

- Business owners generally are too close to the grindstone to recognize it might be time to take some chips off the table...you might want to assess if any of the following are present to make you think it's time to orchestrate a liquidity event:

    - fatigue and burnout...you've lost fire in the belly
    - stress and your health
    - market dynamics…..have you lost your core competencies?
    - competition
    - economic uncertainty
    - things beyond your control: regulations have changed, taxes, limited debt financing available
    - You shouldn't do this yourself: surround yourself with a great team of advisers, particularly to assist in negotiations. They are worth the investment since this is a full-time, generally a once-in-a-business life exercise.



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| **Company X** | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Post-Closing, net after tax cash to shareholders..."cash-in-pocket" analysis template | | | | | | | | | | |
| | | | | | | | | | | |
| Consideration | | | | | | | | | | |
| Cash | | | | | | | | | | |
| Seller note | | | | | | | | | | |
| **Total Consideration** | | 10 million low | | | 12 million probable | | | 15 million high | | |
| | | Federal | California | Total | Federal | California | Total | Federal | California | Total |
| **Asset Sale Structure Transaction** | | | | | | | | | | |
| Selling Price | | | | | | | | | | |
| Closing costs (IB/legal) | | | | | | | | | | |
| Net Selling Price | | | | | | | | | | |
| | | | | | | | | | | |
| Liabilities Assumed | | | | | | | | | | |
| Total Selling Price | | | | | | | | | | |
| | | | | | | | | | | |
| Assets Sold | | | | | | | | | | |
| | | | | | | | | | | |
| Gain on Sale of Assets | | | | | | | | | | |
| Basis of Assets | | | | | | | | | | |
| Gain on Sale of Assets | | | | | | | | | | |
| | | | | | | | | | | |
| Long Term Capital Gain | | | | | | | | | | |
| Taxes | | | | | | | | | | |
| Cash in Pocket after taxes and debt repayment | | | | | | | | | | |
| | | | | | | | | | | |
| **Stock Sale Structure Transaction** | | | | | | | | | | |
| Selling Price | | | | | | | | | | |
| Closing costs (IB/legal) | | | | | | | | | | |
| Net Selling Price | | | | | | | | | | |
| | | | | | | | | | | |
| Liabilities Assumed | | | | | | | | | | |
| Total Selling Price | | | | | | | | | | |
| | | | | | | | | | | |
| Gain on Sale of stock | | | | | | | | | | |
| Basis of stock | | | | | | | | | | |
| Gain on Sale of stock | | | | | | | | | | |
| | | | | | | | | | | |
| Long Term Capital Gain | | | | | | | | | | |
| Taxes | | | | | | | | | | |
| Cash in Pocket after taxes and debt repayment | | | | | | | | | | |
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| Possible sources of addbacks to determine adjusted EBITDA | |
|---|---|
| uninsured losses | legal expenses that are one-time in nature |
| "excess" owner compensation....this may be a "negative" addback if under-market, what would a general manager vs. owner get for running Graphic Electric? | life and health insurance for owners, family meembers |
| "excess" rent expense , this may be a negative addback if rent is less than FMV | non-business expenses of the owners run through the company.... for example, travel not really business related, others |
| financing expenses family properties | payments to or expenses incurred by family members not related to the company ...for example, health insurance and other expenses,<br>family members on the payroll, but not working at the company |
| CAPEX for new/existing real estate that was expensed (added back) vs. capitalized | consultant expenses that are one-time in nature |
| discretionary bonuses and contributions to 401K plan | expenses for personal vehicles, boats, planes, vacation homes |
| discretionary donations | theft losses |
| Revenue or Expenses Generated by Redundant Assets<br>Redundant assets are not used to run the business. Imagine that your business owns a lake cottage that is occasionally used for company functions or as an incentive for good performance among your employees. The cottage isn't really needed to run the business - it would be redundant to a buyer. Therefore, if the expenses related to this cottage have been paid for by the company, these expenses would be added back for adjusted EBITDA. | Start-Up Costs<br>If a new business line has been launched during the period when the historical results are being analyzed, the associated start-up costs should be added back to EBITDA. This is because the costs are sunk and will not be incurred going forward. |
| Medical expenses of owners and family members if they are exiting the business. | Non-Arms-Length Revenue or Expenses<br>This refers to a company that enters into transactions with related parties at a price that is lower or higher than market rates. An example would be if your operating company buys supplies from another company owned by a major shareholder at prices higher than market value. When your operating company goes up for sale, you would normalize EBITDA to reflect the fair market value of these supplies. |
| One Time Professional Fees<br>Look out for expenses incurred that relate to matters that do not recur in the future. An example is legal fees a business may incur in settling a legal dispute. Not only would you add the settlement expense back to EBITDA, but you would also add back the related legal expenses. The same applies for accounting fees on special transactions or marketing costs if you did a one-time marketing campaign. Your newly incurred invesment banking fees and other costs of selling should be added back to current adjusted EBITDA. | Repairs and Maintenance<br>One of the most overlooked categories to review is repairs and maintenance. Often, private business owners will aggressively categorize capital expenses as repairs in order to minimize taxes. While this practice may reduce annual taxes, it will hurt the valuation when the business is sold by reducing historical EBITDA. Therefore, an adequate review to separate and add any of these capital items back to EBITDA is a must. |
| Other Income and Expenses<br>This financial statement category is usually loaded with items that may be added back to EBITDA. It is also sometimes the dumping ground for expenses that cannot be coded elsewhere. Pay careful attention to these accounts, and make sure that anything that is not recurring gets added back. For example, some companies record one-time employee bonuses or special donation expenses in this category. These should definitely be added back to EBITDA. | Inventories<br>If your company provides services using equipment, there is usually parts inventory on hand. Often, private business owners will carry a general allowance of parts inventory throughout the year (say $25,000 for a small warehouse). Like capital purchases, parts acquired during the year are also expensed to minimize income for tax purposes. If there is more inventory than the general allowance being carried, it would be smart to count and value this inventory as close to the time the business is sold as possible. Any excess over the carried allowance of $25,000 would be added back to EBITDA in order to account for the actual inventory value carried. |

## Finally, Selling your business is not a "do it yourself" project!

Do-it-yourself mergers and acquisitions (DIY M&A) has become a symptom of many failed privately held company sale transactions. In these situations, company owners and managers have attempted to manage their own sale process without assistance from a lead sell-side financial advisor and with limited assistance from their other deal professionals.

In a typical situation, the business owner is approached by a potential buyer and believes that he or she can navigate and negotiate a sale process with accounting, tax and legal advice. Unfortunately, a large number of these one-to-one negotiations, which business owners mistakenly believe will save time and money, are ending without a closing, resulting in a very frustrated and discouraged seller.

### *Reasons for DIY M&A failures*

- Lack of negotiating leverage with a single buyer who is very much aware that there are no other competing offers
- It will be relatively easy for the single buyer to re-trade of transaction value and terms, happens frequently
- Single buyers will have no incentive to expedite due diligence; without a seasoned team running the process, both sides will find issues that will delay the transaction
- The seller will develop deal fatigue and stress as the seller attempts to balance managing a sale process while operating their business.

### *Remedies for success*

- Retain a lead sell-side advisory team including investment banking, legal, accounting and tax professionals
- Work with your advisers to determine the potential range of enterprise value (the headline sale price), pre-tax and post-tax equity proceeds (the net amount of money for the seller) and the desired key transaction terms
- Assess the benefits and costs of running a sell-side process that includes a number of strategic and financial buyers. Generally, the seasoned banker will cast a wide, confidential net to attract the best prospects.
- Run a sale process with multiple bidders with a focus on:
    - Maximizing value
    - Optimizing transaction terms and deal structure
    - Minimizing closing risk
- In many instances, a seller can benefit from working with an investment banker who can lead a well-controlled and time-efficient sale process, which could include:
    - Developing sophisticated marketing materials (i.e., teaser, confidentiality agreement, confidential information memorandum and management presentation)



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- Contacting strategic and financial buyers, distributing marketing materials and gathering and vetting indications of interest
- Preparing the management team for meetings with potential buyers and coordinating the due diligence process and data room for both the seller's and buyer's deal advisors
- Assisting the seller in negotiations of transaction documents with the seller's legal counsel
- In nearly all instances, the additional enterprise value and enhanced transaction terms driven through the investment banker-led process will more than offset the advisory fees paid for the successful transaction.

**Grand Avenue Capital Partners** is a FINRA licensed broker/dealer authorized to manage security transactions and merger/acquisitions. Our firm's bio is attached which includes the backgrounds of our team and advisers.

Our firm focuses on sell- and buy-side investment banking assignments for domestic North American client companies with revenues $10-200 million which are typically profitable and established. We are prepared to serve clients globally; approximately 25% of our practice is in Asia where we have been involved in substantially larger transactions with world-scale companies and investors. We have been engaged by private companies in China with up to $2.6 billion in revenue, seeking growth capital private equity placements. We have managed investment banking assignments in Europe, Mexico and Asia and understand the complexities of cross border transactions.

Our principals and advisers have owned and operated companies of the type we seek as clients. We have manufactured and sold products, managed extensive work forces and as owners, generated profits and cash flows. Accordingly, we have great affinity with the business owners and entrepreneurs we work for.

We maintain a proprietary data base of institutional investors (over 1,300 such groups worldwide) wherein we have cataloged their investment/acquisition criteria. Matching these criteria with clients' needs is a routine activity for us in making a market for private companies. Our particular expertise is to similarly cultivate strategic investors/acquirers developing the specific operating synergies that match our clients' parameters.

We welcome your input and referrals regarding companies wishing to grow through acquisition, companies whose owners are interested in selling their businesses, and divestitures of divisions of public companies. We also welcome the opportunity to review business plans that would require capital via equity or debt placements. Currently, all our active engagements came from referrals.

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