

LEGAL ADVICE

## Minimizing the stress of selling a business

**T**he market for selling and buying businesses is heating up again. After a steady decline in the number of sales from its peak in 1999 and 2000, the market has increased every year since 2003, with 2005 looking to be a record year.

Prices are also increasing. Strategic buyers are feeling stronger and looking for expansion opportunities, and private equity groups and lenders have abundant capital and are looking for places to use it.

If you are the owner of a small- or medium-sized business, there are some things you should do before you get involved in this process. Chances are you have not been involved in a process like this before. Most business owners are involved in only one or possibly two business sales in their lifetime. The process is complex and the details can be overwhelming. There is a lot to be gained by focusing on some key things very early in the process. Here are some things to think about:

**Set your price.** What is your business worth? It is worth what someone will pay for it. However, you need to get a handle on pricing before getting involved in the sale process. How do you do that? There are several approaches.

Many industries have developed “rules of thumb” that essentially are multiples of various financial metrics of the business — such as a multiple of book value, or assets, or net income. Trade associations are good sources for this information.

There are also several sources for national or regional data on pricing multiples based on earnings, the most common one being multiples of EBITDA (earnings before interest, taxes, depreciation and amortization). EBITDA multiples are increasing and, for transactions that are less than \$25 million, the data show that

multiples have increased from an average range of 4.5 to 5 in 2004 to about 5.5 to 6 today. Multiples for larger businesses are even higher.

However, be very careful using these estimates and multiples.



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They can give some insight into value and they are worth looking at, but they are simply averages and do not take into account the specifics of your business — both positive and negative. The key is to get guidance from valuation professionals early on in the process. Some accounting firms provide valuation services, and there are also independent valuation firms. Potential buyers will look closely at valuation and you need to be prepared to defend your price.

**Get ready to sell.** As with most transactions, timing is very important. As noted above, we are entering into a seller’s market, which is leading to higher prices. If you are contemplating selling in the next few years, now would be good time for you to take a couple of steps to get ready.

First, you should clean up your balance sheet. By that I mean get rid of assets that are not really assets of the business — the farm, the ranch, the hunting land, the car collection, the expensive yacht, the sideline business/hobby.

Many small businesses have these assets on their books, and a buyer will just look at them as problems they will have to deal with. Sell them or dividend them out, but get it done right away.

Second, assemble a team to help you. You need people with proven

expertise: your financial and tax advisers, a valuation expert, your lawyer and, if appropriate, a business broker or investment banker. Get them involved early, because once a deal is struck on the main terms, there are often (always in my experience) disagreements about some of the many details that can have a large impact on the transaction and the value you will ultimately receive.

Understand the main issues. It is important for you to understand the main issues before you get into the middle of negotiations. If there is a particular financial or other issue that is very important to you, you need to get it on the table early.

In the typical deal, these are the main issues: price; structure (asset sale or stock sale, taxable or tax-free); payment terms (cash up front, holdbacks or escrows for contingent items such as uncollectible accounts, promissory notes and collateral for them); people issues (what happens to employees, management and directors); non-competition agreements after the closing (what are you willing to agree to); contingencies; due-diligence timing and access to records, employees and customers (when and how); indemnification provisions setting forth your liability if what you have told the buyer about your business turns out to be incorrect (maximums based on time or dollar amount are often extensively negotiated); and personal guarantees by the owners of the buyer.

The devil is in the details on these issues, but it is very helpful to have a good understanding of these issues and when, how and why they come up. And, most importantly, how they can be resolved.

Selling a business is a stressful process. Going into it prepared is the best way to deal with it. ■