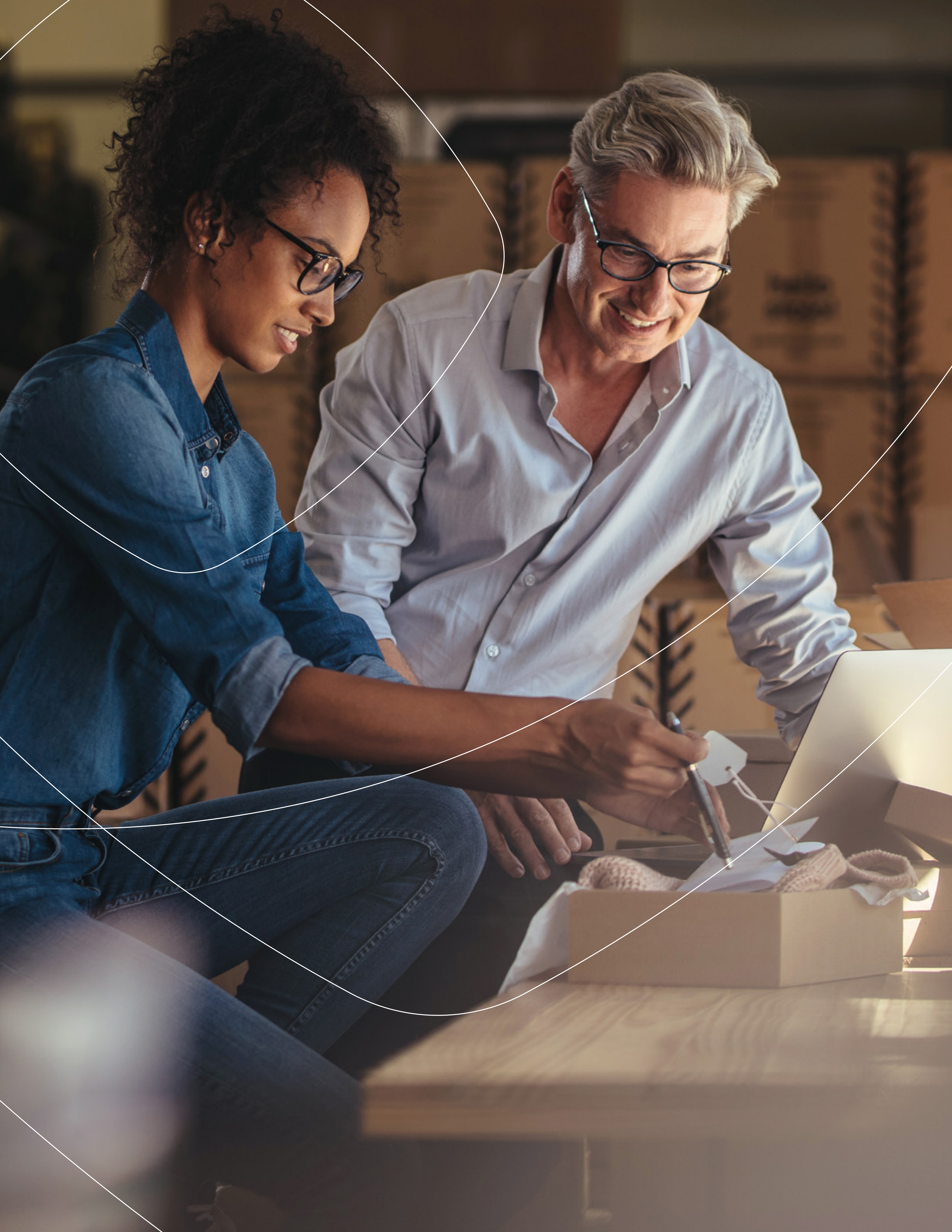
Doane Grant Thornton

Exiting your business: A guide to finding a buyer



Alongside the decision to start a business, the decision to exit is among the most consequential that ownership and management will ever make. Whether through a sale, merger, public offering, or winding the company down, an exit demands careful consideration to deliver the best outcome for all stakeholders. To do so, decision makers must ensure that they have a solid grasp of each component of the selling process from preparation to engaging the market to completing the transaction.

This guide, the third in our ‘Exiting your business’ series, will help key stakeholders understand how to approach finding the right buyer, including determining your core objectives, understanding the different types of buyers and what motivates them, and preparing the business for potential sale.

While looking at the universe of potential buyers *has to* happen before you sell a business, it *can* happen at any time as part of your strategic planning. Understanding who might be interested in your business can give you insights into potential markets for expansion, opportunities for new financing, and the way your organization is structured.

Standard sale process

Phase 1
Planning and prepartion

- Understand your objectives
- Review tax planning and tax implications
- Review of alternatives (benefits and risks)
- Research potential buyers
- Determine a go-to-market strategy
- Prepare marketing documents: teaser and Confidential Information Memorandum (CIM)
- Prepare vendor due diligence, as required

Phase 2
Execution

- Conduct introductory phone calls with potential buyers
- Execute NDAs
- Provide information documents (CIM)
- Arrange on-site meetings with buyers and management
- Draft and support management presentations
- Solicit indicative offers
- Assist in negotiating/selecting offer

Phase 3
Closing

- Support the due diligence process
- Negotiate key aspects of the proposed transaction
- Ensure the proposed transaction is completed in a tax efficient manner
- Work with legal cousel on final terms of the purchase and sale agreement, and any other key agreements (e.g., employment/consulting agreements, non-competition agreements)

Typically spans 6 to 8 months

Setting your objectives

The first step is to understand why you're selling. While this guide is generally focused on owners looking to completely exit a business, there are many other reasons to sell all or a portion of a business, including to increase liquidity, raise growth capital, position the business for the future, or for strategic purposes.

Once you understand why you're selling, you need to define what you need to get out of a deal for it to make sense to you. When asked what they want out of an exit, many, if not most, owners will give a simple answer—a good price. However, once you begin to dig into the details of what a potential deal could look like, that simple answer begins looking a lot more complicated. While getting the highest price possible will always be an important objective, there are often other considerations at play, including preserving your legacy, protecting employees, and the impact it will have on key business relationships (e.g., customers, vendors).

Even if you limit your analysis to selling price, the different options available will add complexity to the decisions that need to be made. Do you want cash or will you accept shares? Are you open to an earnout agreement in exchange for a higher valuation? The most fundamental step in finding a buyer is understanding what you can and can't accept in a deal. That will set the boundaries for engagement and eliminate a host of potential buyers that simply can't meet your requirements.

Common forms of consideration

- **Cash:** An immediate cash deal will see the seller receive payment upon transfer of ownership. Cash may sometimes be held in escrow at close until certain conditions are met, for example, there is commonly a cash holdback for a period until the final balance sheet figures are confirmed.
- **Shares:** In exchange for their business, the seller received an ownership stake in the purchasing company in the form of shares.
- **Vendor takeback:** A portion of the sale price is converted into a debt held by the seller. The terms of the debt (e.g., term, interest rate) are negotiated as part of the sale.
- **Earnout:** A base price is paid to the seller with additional payouts to be delivered as negotiated financial milestones are met.

Finally, it's important to determine an ideal time horizon that includes your nearest and farthest closing deadlines. A potential buyer that will be ready in ten years when you plan to retire in three isn't going to be a good fit. Conversely, there may be ideal buyers that aren't in a position to purchase today but may be down the line. In that case, a longer time horizon may produce a better deal in the end.

Value drivers

Our guide to valuations offers a comprehensive overview of how to determine the fair market value of your business. However, potential buyers will all value different elements according to their own needs. Below is an overview of how different elements of value can impact a buyer's perception of your business.

- **Enhancing management depth:** The deeper a company's management bench, the easier a transition for a buyer becomes, and the more flexibility available for sellers looking to step away from the business.

- **Diversifying customers and suppliers:** Over-reliance on a single customer or supplier adds risk to a deal for a buyer since the loss of that business relationship post-acquisition can severely impact the business' performance. A diverse customer and supplier network makes a company more attractive to potential buyers and can increase perceived value.

- **Protecting intellectual property (IP):** Key IP is often a source of competitive advantage for a company and the ability to protect and/or transfer that IP can drive higher price multiples.

- **Assuring the quality and accuracy of financial information:** The ability to quickly provide accurate, organized data gives buyers confidence in the business' operations, which can speed up the due diligence process and improve certainty around the execution and completion of the deal.

- **Securing key contracts:** The more certainty surrounding future operations you can provide to a buyer, the lower the risk to them and the higher the potential price you can secure. Being able to demonstrate that you've secured good contracts (e.g., leases, supply agreements, financial arrangements, customer orders) with key business partners will give buyers significantly more confidence in the future of the business.

- **Addressing asset condition:** Well-maintained assets reduce future maintenance costs and the need for replacements in the future. Buyers will consider future asset expenditures when evaluating the business and the likelihood of significant outflows will decrease the price they are willing to pay.

- **Identifying and mitigating business risks:** Having a well-considered plan to assess and manage challenges to the business and/or industry can mitigate pricing impacts from real or perceived risks to the business.

- **Detailing your growth strategy:** The price of a business is largely driven by the expectation of future cash flows; the more growth potential in those cash flows, the more a buyer may be willing to pay.

- **Demonstrating your financial forecasting:** A company's ability to accurately forecast performance lends confidence to buyers around the future performance of the business they want to acquire.

- **Dealing with minority or inactive shareholders:** A complex corporate structure can create challenges in the transaction process, especially regarding the drafting of definitive legal agreements. A clean structure can smooth a process and accelerate the time to close.

The buyer's universe

Just as sellers may have different motivations for exiting their business, so too do potential buyers. At a very high level, buyers can be categorized as one of two types: financial or strategic.

Financial buyers are simply looking for returns on their investment realized either through cash flow or by taking steps to increase the company's valuation and then selling once their goals for a return are met. When considering a purchase these buyers will be looking primarily at a company's financial history and growth opportunities, and will base their offer on multiples of your earnings/profit. As a potential seller, you can maximize your value to financial buyers by enhancing your key value drivers, de-risking your business, and positioning it for growth. You can refer to *Exiting your business: A guide to valuation* for more details on key value drivers and how they affect a company's value.

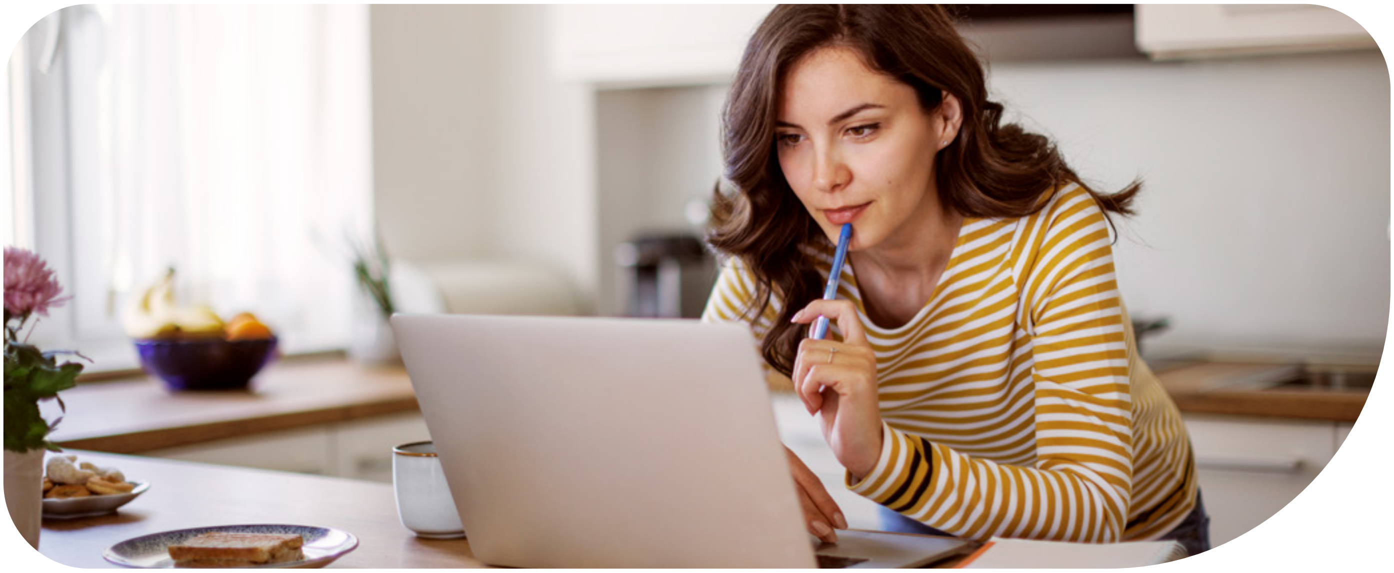
Strategic buyers are looking to acquire operations that either complement or augment their own. This could include a competitor seeking to bolster their share of the market, a vendor or customer looking to vertically integrate, or a buyer in a cyclical industry looking for a counterweight. These buyers will be looking for information that demonstrates how this purchase could enhance their strategic position.

Strategic acquirers frequently operate in similar industries to the company being sold and, as a result, may be familiar with the company. Since the negotiation and buying process often involves the sharing of confidential and commercially sensitive information, working with strategic acquirers requires extra care to protect your business' information. This can include:

- Use of project names to anonymize the company prior to execution of confidentiality agreements.

- Execution of non-disclosure and confidentiality agreements to establish legal requirements with respect to shared information.

- Managing the timing of document sharing with more sensitive information shared only when deal execution is more certain.



Research

Once you've clearly set out your objectives and understand the current state of your business in terms of value drivers, you can begin to identify organizations that match your objectives and assemble a 'buyers list'. This is a research-driven list of companies that will help you focus your efforts on the most suitable buyers and maximize your chances of success. To assemble this list, you'll need access to different sources of information, each of which will help to develop a more complete picture of the buyers pool in which you'll be fishing.

- **Internal sources:** Over the years, you may have pulled together information on potential buyers as part of strategy discussions, project plans, and market research efforts. That information is an excellent starting point for your buyers list and can be enhanced with additional information as it's gathered. You can also make use of personal networks and industry connections to gather information.
- **Advisor sources:** If you've already brought advisors into the process, they'll be able to impart their knowledge from previous deals and work they've performed in adjacent industries to bolster your buyers list. They'll also leverage their business relationships to gather relevant information. Finally, advisors will have access to comprehensive research databases that supply important information such as precedent transaction information, industry screening, and sector sources.

  If you don't yet have advisors in place, there is a section below on building the best team.
- **External sources:** Membership in trade/industry groups may include access to information on the industry that can help you identify key industry players. If you're part of an accredited or regulated industry, accrediting bodies and government organizations may offer listings of industry operators that include basic company information.

Sale process

To drive the best outcomes, the sale of a business is often conducted via a competitive process. This engages multiple potential acquirers in a structured process that provides potential acquirers with the information they need to provide an offer. The process is designed to create competitive tension to help the seller drive the best value, terms, and deal certainty.

A critical point in the process is going exclusive, in which one buyer and one seller commit to work together to complete a transaction. It's important to achieve as much deal certainty as possible before going exclusive because it places limits and/or costs on the involved parties. On the one hand, exclusivity removes the competitive tension, which means there will be less pressure driving up price or favourable terms. On the other hand, the potential acquirer will begin investing significant resources on legal agreements and due diligence to complete the transaction.

Alternative sale methods

While a broad competitive process is the most common method of finding a buyer, each situation is unique. Sometimes a process is less structured and focused on a single party who is the most likely buyer or to protect confidentiality by concentrating on one party.

- A *targeted auction* involves selecting a short, targeted list of high-probability buyers and allowing them to make bids.
- A *sole-source* process involves finding a single, highly logical buyer and approaching them directly to negotiate a potential sale.

Preparing to sell

Due diligence

Sell-side due diligence is an analysis of the company's financial position and operations to gain a clear picture of what a potential buyer will see—and take the steps to adjust any issues that could derail a deal. This can include reviewing historical financial data, testing forecasting assumptions, examining the company's tax exposure and compliance, and reviewing accounting policies and controls across the organization.

Conducting due diligence early in the process can give you time to eliminate major red flags, enhance your value, and build trust by being transparent.

Securing key management

The value of your business isn't found solely in the equipment you use or the land you own—much of it is the knowledge your key employees have built from the experience of running your business. In preparing for a sale, you'll want to identify those people who are central to your company's operations and ensure that they're open to staying on in a new environment. Losing key players before a sale can lower your value or even sink a deal altogether. Once key management positions are identified, you can make use of retention bonuses to incentivise key employees to stick around through a transaction process. Additionally, buyers will often look to sign new employment contracts (including non-competition agreements) with important team members during the due diligence phase to further incentivise these employees to stay with the company after closing.

Optimizing your business

Buyers evaluate companies on both their historical and anticipated future performance. Establishing a multi-year track record of improvement increases a buyer's perception of the company. Even if you aren't planning on selling for a number of years, the best time to start incorporating optimization strategies is now.

Some considerations for your business today are:

- **How imperative are you, as the owner, to the business?** Do you have a management team in place that would let you walk away today? If not, consider how you might begin to offload some of your responsibilities, and build a team around you that you - and a future buyer - can trust to run the business.
- **Is your client base diversified enough?** If you feel you are too reliant on an individual customer, think about how you might be able to diversify operations and generate sales from other sources.
- **How strong are your financial reporting and budgeting functions?** Ensuring your company's back office is well organized and regimented will improve the quality of your financial information, easing both due diligence and the business transition. Alongside this, the development of a disciplined budgeting process can add confidence to buyers in your company's ability to forecast results and drive higher valuations.
- **How well is your organization structured?** Have you done the right planning to ensure you will be able to minimize taxes on a sale? Can you simplify or streamline your organizational structure?
- **Do you have strong contracts in place?** These might include supplier, customer, or employees. A legal review of existing contracts might help to identify any shortcomings that exist in your current contracts.

Advisors

Having the right advisors will ensure that the process is as smooth as possible and that when an issue inevitably arises it can be managed. Your team of advisors will provide the expertise your management team may not have and ensure that all the minutiae of a sale is covered. Your core advisory team should include:

- **Finance:** Your financial advisor will help ensure that you're able to secure a deal that matches your value. As part of due diligence and the valuation process, they can also identify levers you can pull to enhance your potential value to buyers.
- **Legal:** Your lawyer will ensure that you're in compliance with laws and regulations that apply to your business and can also flag any potential changes on the horizon. They'll also be critical in structuring the sale and drafting the buy-sell agreement and other terms and conditions for the deal.
- **Tax:** Good tax advice can result in significant savings when selling your business. Working with a tax advisor early to ensure you're taking advantage of all possible tax planning strategies is key to ensuring you're minimizing what could potentially be a large tax bill on the sale of your business.

Summary

Finding the right buyer for your business is imperative to ensuring that you're able to maximize your value from the transaction and protect the legacy that you've built. It's a complex process, but Doane Grant Thornton can help—contact your local advisor or reach out to us here.

You can also check out our series of guides on exiting your business, which help to explain other critical elements of the exit process.

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