Selling A Business

Using An Experienced Advisor Pays For Itself

According to the Business Reference Guide, only one of every four potential transactions involving family owned businesses actually closes. This can be because of broad market conditions or the fact that the unlucky companies are simply not "saleable". More likely it is due to one or more of the following reasons:

- **Lack of preparation for the process**
- **Lack of management depth**
- **Revenues concentrated with one customer**
- **Poorly positioned to buyers**
- **Unorganized or incomplete information provided to buyers**
- **Contacted the wrong type of buyers**
- **Contacted too few buyers**

Business owners often wonder whether it's necessary to hire an intermediary in order to sell their business or to source capital for growth. Although there are a number of reasons for hiring an intermediary, the most compelling and quantifiable reason is dollars and cents—the amount of money that will be changing hands.

A good advisor can mitigate a number of issues by conducting a thorough, disciplined process that increases the likelihood of a transaction closing. The lead advisor serves as a "player/coach", making sure the process continues to move forward while handling many of the responsibilities personally. This also allows the management team to remain focused on their core competency of running the business day to day, and ensures that company performance does not falter, decreasing the chances of closing a deal.

The experience of selling all or part of a company can be very emotional and time consuming for an owner. In addition, the results of the process have lasting implications for the owner, his family and employees as well. Engaging an experienced reputable investment banking firm to facilitate the process generally produces positive outcomes and intangible benefits that more than cover the costs involved.

"I Know Who'll Buy My Company"

The most typical objection to hiring an intermediary is that the business owner thinks he or she knows who will ultimately buy their business---but that is rarely the case. During the initial phase of our process, we compile a list of potential acquirers (the Buyer List) from industry databases, our network of Private Equity Groups (PEGs), and inquiries a client has received over the years. We review the Buyer List with the client in order to rank potential acquirers and to eliminate those who, for various reasons, are not a fit. We often have conversations similar to the one below during the review process.

Business Owner: There sure are a lot of names on this list. Seems like a lot of work contacting all these people when I'm pretty sure I know who's going to buy us.

Advisor: Really? Who do you think is going to buy you and why?

Business Owner: ABC Inc. is going to be the buyer. I've been going to the National Widget Tradeshow for the past 20 years and every year, their CEO corners me in the hospitality suite and says, "Now you remember, if you ever want to sell your company, you give me a call, and ABC Inc. will be happy to buy you out."

Advisor: With all due respect, Mr. Business Owner, it is very unlikely that ABC, Inc. will end up actually buying your company.

Business Owner: How do you know?

Advisor: Because it rarely works that way.

The Value of a Competitive Process

Several case studies support the advisor's assessment in the conversation above. In a recent FourBridges Capital engagement, one of the most likely acquirers identified by the client submitted a bid of $18 million; the eventual buyer paid $33 million. If the business owner had called ABC, Inc. and struck a deal without running a process that fostered true competitive bidding, $15 million would have been left on the table. Most people would agree that $15 million is a life-changing sum of money for an owner, his family, and his future heirs.

Another transaction executed by a FourBridges partner yielded similar results. Although there was no likely buyer identified by the business owner in this case, the value of using an intermediary was underscored by the wide range of bids the owner received. Approximately 50 potential buyers were contacted—47 financial buyers (PEGs) and three strategic buyers. In this case, the bids ranged from $25 million to $48 million. Had the business owner not worked with an advisor to conduct a thorough process, he may have sold to the $25 million bidder.

The low bid came from a very reputable PEG who provided an analysis that supported its bid. The PEG's logic was not necessarily ***wrong***; the bid simply reflected its view of the industry and of the target company. The highest offer, which, on the other hand, was not necessarily ***right***, reflected the bidder's vision of how the FourBridges client might fit into his company and the ultimate returns the bidder felt could be generated by the acquisition. While $25 million would have made for a nice retirement, it would have been a tragedy to have missed out on another $23 million.

Positioning the Company and Passing the Smell Test

All businesses have strengths and weaknesses, and the right advisor will know how to present the company to interested parties in a favorable light. Weaknesses inevitably are discovered at some point, so it is prudent to acknowledge them up front and present them along with an explanation of how they may be mitigated. A credible, balanced Confidential Information Memorandum (CIM) can positively impact the bidding process by giving acquirers confidence that they are getting the full story on how the business operates and on its financial health. Buyers may also factor in the reputation of the advisor, recognizing that good firms only represent good clients. Having an advisor with relevant experience and the proper licensing (membership in FINRA, and Series 7 or 79 licenses from the Securities and Exchange Commission) also enhances credibility.

Analyzing and Comparing Offers

The objective of running a process is to generate multiple term sheets from credible buyers. Because each term sheet will contain different dollar amounts and deal structures and terms, each must be analyzed carefully. Term sheets are typically non-binding, but the seller agrees (1) not to disclose the terms of the offer and (2) not to continue marketing the company for a period of 60-90 days while the buyer is conducting due diligence and working to close the deal. At this point, the negotiating leverage favors the buyer, so it is extremely important that all aspects of the term sheets are vetted properly and that the possibility of miscommunication regarding an offer is minimized.

The advisor will evaluate not just the dollar value of an offer, but also the terms and conditions of the offer. A term sheet that includes contingent payments based upon a company's performance after the closing (an earnout) or that specifies an amount to be financed by the seller must be analyzed differently than an all-cash-at-closing offer with a lower dollar value.

Minimizing the Possibility of Surprises during Due Diligence and Closing

An advisor aims to avoid surprises during the closing process by identifying and discussing additional aspects of the transaction prior to signing the term sheet. In most cases, buyer and seller are honorable parties who wish to close the transaction in good faith. However the final purchase agreement contains certain provisions open to interpretation, and these provisions can materially impact the ultimate value of the transaction. If conditions are not discussed during term sheet negotiations, an owner can be a month into the closing process only to discover that the buyer is taking a different position than the owner was expecting. A prudent advisor will ask the bidder to outline its approach to dealing with factors, such as earnouts, representations and warranties, indemnification, and the closing working capital calculation. These considerations might seem inconsequential in relation to the top-line purchase price, but, depending upon how they are addressed, they can actually add up to hundreds of thousands or even millions of dollars.

Thinking Two Steps Ahead

While the benefits of enlisting an intermediary to conduct a process become apparent during the "indication of interest" phase (when contacted parties submit a non-binding indication of value based on information provided to date), the intermediary's value becomes even more evident when the winning bidder begins his due diligence review of the company's financial results and operations. Inevitably "things" come up during this review, and if they are not addressed early and properly, they can result in a reduction of the purchase price or in the potential buyer walking from the transaction altogether. If the intermediary and business owners have worked prudently and efficiently during the development phase, many of the "things" will have already been identified and addressed by corrective action or through disclosure in the CIM.

Playing Referee, Bad Guy and Emotional Supporter

Particularly during the closing process, an advisor keeps things on track while the owner continues to run the business, respond to due diligence questions, and deal with the emotions that such a transaction evokes. Typically, some type of sticking point arises during final negotiations or closing. By this time, it is usually apparent that both parties are interested in closing the deal and have agreed

to key terms; it is important that the things around the edges of the deal not cause either party to walk away.

As an example, a large company making an acquisition might have a policy that prohibits executives from receiving any type of auto allowance. If the target company executives have been accustomed to auto allowances, talk of losing that perk because of the transaction can result in a contentious discussion between the parties. The cumulative dollar amount of the allowance might be $20,000 annually, while the transaction itself is in the millions, so it makes sense to resolve the issue in a reasonable manner

In these situations, the advisor can act as a buffer between buyer and seller and between the buyer's attorney and the seller's attorney. This can be very beneficial when the owner is selling a portion of his equity but will be working in partnership with the buyer or when the owner is staying on in a managerial or transitional role.

The advisor can serve as a vigorous advocate for the owner on certain issues, knowing that if he pushes too hard, he will be seen as the bad guy, rather than allowing the owner to become embroiled in an argument with the seller that may have lasting negative repercussions. An experienced advisor understands what is "market" when it comes to key closing conditions. The intermediary recognizes when terms are onerous and require a push-back or when terms are standard and should be agreed to.

Particularly in cases where the owner will have a role in the company post-transaction, it is important to have an advisor who can call on his experience to evaluate the non-financial aspects of a transaction. In some cases, such as when the chemistry with the new owner is good or when the buyer and seller share a similar vision of the company's future, it may be in the interest of the owner to take a lower financial offer. As the closing date nears, it can be helpful to have an advisor who will provide comfort that the transaction will, in all likelihood, allow the owner to achieve both his financial and non-financial goals.

An Advisor's Role in a Limited Marketing Process

Experience indicates that sales prices are maximized by conducting a broad based marketing effort targeting a number of Private Equity Groups and Strategic (Corporate) acquirers. However, in some situations involving timing or other issues, an owner may be compelled to deal with only one or maybe a handful of interested parties. Even if an acquirer presents an unsolicited "table clearing" offer, an owner will realize value by having an advisor involved.

The advisor's presence lets the bidder know that the owner will be receiving objective advice relating to valuation, and the deal terms discussed previously. Bidders also know that with a third party involved, there is a possibility that the owner will be advised to "take the company to market" and they stand to lose the deal in a competitive process.

Using a Registered Investment Banker Vs. an Unlicensed Business Broker

Investment bankers are typically described as professionals who hold licenses issued by the Securities and Exchange Commission and whose firms are regulated by both the SEC and FINRA (Financial Industry Regulatory Authority). Business Brokers usually hold no governmental licenses and are not regulated by any governmental authority.

A number of "no action letters" issued by the SEC have established guidelines as to what an adviser can do or not do without being registered with the SEC. These letters indicate that unlicensed business brokers legally cannot be involved in transactions involving a sale of stock or any other form of security. This would arguably apply to notes being held as part of a seller financing structure or an earnout. Absent registration, advisors may be subject to potential fines and , disqualification for future registration. If an advisor is not properly registered, there may also be ramifications for seller, given that post transaction, a disgruntled buyer can ask for rescission. Unlicensed business brokers are also limited to transactions for companies that meet the Small Business Size Regulations issued by the Small Business Administration. A business broker is not allowed to advise clients as to whether or not they should issue securities as part of a proposed transaction.

Registered investment bankers have background information on file with FINRA. Business owners can use FINRA's Broker Check to review any issues or complaints involving an individual or the firm with whom they are affiliated.

Summary

Few, if any, business owners would consider remodeling their facility or purchasing new equipment without the benefit of professional guidance. They would seek advice from someone with a thorough understanding of what the business wanted to accomplish, its budget, and its expectations for the future. It follows, then, that owners would enlist the services of a qualified advisor when it comes time to sell the business they ran with such care. An experienced advisor can ensure that a business owner realizes full value for his company by properly positioning corporate strengths and weaknesses, conducting an extensive review of potential buyers, negotiating major and minor terms of the deal, and coordinating all aspects of the process.

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About FourBridges Capital Advisors

FourBridges Capital Advisors, a middle market investment banking firm based in Chattanooga, Tennessee, represents business owners in selling their companies, provides advisory services relating to acquisitions, sources debt or equity capital for growth, and provides restructuring services for lenders and corporate borrowers. The senior professionals have been corporate C-level executives (CEO or CFO) and enable the firm to provide ***"financial advisory services based on actual operating experience"***.

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