

Preparing a Business for Sale Before Selling It

by

Daniel R. Siburg, CPA, CVA
The Siburg Company
6347 E. Windstone Trail
Cave Creek, AZ 85331
(480) 502-2800

Dan.Siburg@thesiburgcompany.com
www.thesiburgcompany.com

by

James P. O'Sullivan, Esq.
Tiffany & Bosco
Esplanade II, Third Floor
2525 E. Camelback Road
Phoenix, AZ 85016-4237
(602) 255-6017
jpo@tblaw.com
www.tblaw.com

Learning Objectives

- Reasons why a business owner decides to sell
- Time frame for preparing a business for sale
- Legal tasks to consider before selling the business
- Increasing the business's value by maintaining equity
- What information buyers will want to see
- Preparing a team committed to seeing the sale of the business all the way through

A business that is for sale –
Is a business that is in transition

Why a Business Owner Decides to Sell

Commonly referred to as the “D List”

- Death
- Disease
- Divorce
- Dissolution
- Disenchantment
- Disenfranchisement
- Disagreement

Time Frame for Preparing a Business for Sale

- It depends on the business's infrastructure
- Seller may need to consider a period of 90 days to 2 years to prepare the business for sale
- Businesses generally take 6 to 18 months to sell under normal market conditions

AVOIDING COMMON LEGAL MISTAKES

- Involve the CPA and Other Advisors
Early.

AVOIDING COMMON LEGAL MISTAKES

- Plan Early for Exit.
- Gifting of Ownership or Other Estate Planning Opportunities Available?

AVOIDING COMMON LEGAL MISTAKES

- Address Confidentiality Procedures at the Outset.
 - Non-disclosure agreement?
 - Employees: Who needs to know?
 - Data room?

AVOIDING COMMON LEGAL MISTAKES

- Address Confidentiality Procedures at the Outset.
 - “Staged” disclosure of key customers or other vital information.
 - Include non-compete restriction?
 - Require return of information, including extracts/analyses prepared by buyer.

AVOIDING COMMON LEGAL MISTAKES

- Identify and Address Likely Transaction Obstacles.
 - Litigation threats.
 - Tax compliance problems.
 - Faulty financial accounting records.

AVOIDING COMMON LEGAL MISTAKES

- The Accounting Records Will Be One of the First Items a Buyer Will Request for Review.
- Has the CPA Had Sufficient Time to Review Tax and Accounting Compliance?

QUALIFYING THE BUYER

- Has the Buyer Been Properly Qualified?
- Don't Be Shy About Due Diligence on the Buyer!
- Insist on Comparable Disclosure to Qualify Potential Buyer!

QUALIFYING THE BUYER

- “Carryback” Financing Should Be Viewed as a Loan to Buyer. Probably Will Be Subordinated Debt.

QUALIFYING THE BUYER

- CPA Should Analyze Financial Records Provided by Buyer
- CPA Can Provide Critical Suggestions Regarding a System of Ongoing Financial Reporting by Buyer, Including Right to Audit Buyer's Compliance with Carryback Payment Terms.

PREPARING FOR DUE DILIGENCE

- Review Client Legal Records.

REVIEW CLIENT LEGAL RECORDS

- Confirm Entity Status with the Arizona Corporation Commission (or Similar Agency in Other State):

<http://starpas.azcc.gov/scripts/cgiip.exe/WService=wsbroker1/connect.p?app=names-report.p>

REVIEW CLIENT LEGAL RECORDS

- Order Certificate of Good Standing.
 - Available online from the Arizona Corporation Commission or comparable agency in other states.

REVIEW CLIENT LEGAL RECORDS

- Confirm Accuracy of Information Listed on the Public Records of the Arizona Corporation Commission or Comparable State Agencies:
 - Owners;
 - Management;
 - Statutory Agent; and
 - Prior amendments to public record.

REVIEW CLIENT LEGAL RECORDS

- Analyze Governing Documents:
 - Articles of Organization/Incorporation;
 - Bylaws;
 - Shareholder Agreement; or
 - Operating Agreement.
- Voting, Proxy, or Control Agreements?

REVIEW CLIENT LEGAL RECORDS

- Essential Company Actions Documented?
- Meeting Minutes/Resolutions Current?

REVIEW CLIENT LEGAL RECORDS

- Analyze Status of Key Governmental Permits and Licenses.
 - Transferable? “Grandfather” issues?
 - Time frames?

REVIEW CLIENT LEGAL RECORDS

- Analyze Essential Contract Rights (e.g., Franchises, Distributor Agreements, Leases, etc.).
 - Any breaches or waiver of breaches?
 - Transferable?
 - Time frames?

REVIEW CLIENT LEGAL RECORDS

- Review Pending Liens and Encumbrances (Consider Engaging Professional Public Records Search Service).
- Are Financing Obligations in Compliance?
- Right of Lenders to Accelerate Debt upon Sale?
- Personal Guarantee Issues?

IDENTIFY THIRD-PARTY CONSENTS REQUIRED

- Identify Approval Requirements for Company.
 - Fiduciary duties of management to approve or reject possible sale. Conflicts of interest?
 - Timing of obtaining approvals (i.e., notices of meetings)?
 - Tag-along/drag-along rights?
 - Dealing with dissident owners/dissenters' rights.

IDENTIFY THIRD-PARTY CONSENTS REQUIRED

- Governmental Authorities.
- Consider Public Record/Confidentiality Issues.

IDENTIFY THIRD-PARTY CONSENTS REQUIRED

- Related Party or Other Non-Arm's Length Agreements?
- Any Improperly Documented “Promises” that Could Complicate Sale?
- Unfriendly Former (or Soon to Be Former) Spouse with Claim to Ownership?

IDENTIFY THIRD-PARTY CONSENTS REQUIRED

- Vendors.
- Customers.

REVIEW CLIENT LEGAL RECORDS

- Status of Intellectual Property Rights:
 - Patents;
 - Copyrights;
 - Trademarks; and
 - “Freeware” or unlicensed/unauthorized use of software code.

REVIEW CLIENT LEGAL RECORDS

- Environmental Compliance Audit.
 - Consider cost and timing.

REVIEW CLIENT LEGAL RECORDS

- Pending or Threatened Litigation?
- Again, Consider Engaging Professional Service to Search for Litigation Filed, But Not Yet Served.

REVIEW CLIENT LEGAL RECORDS

- Tax Compliance Concerns – Discuss with CPA.

REVIEW CLIENT LEGAL RECORDS

- Analyze with CPA:
 - Stock or asset sale after tax comparison.
 - Need for “S” election or similar preparatory tax strategies?
 - Note new tax law created special 5-year window for “S” elections to address built-in gains tax in corporate asset sale.

EMPLOYEE RETENTION/RESTRICTIVE COVENANT INCENTIVES

- Stay Bonuses.
- Continuation of Stock Options.
- Revisions to Employment Agreements.
- Revised Equity Participation Plans.
- Acceleration of Vesting if Remain Through Closing.
- Non-competition/Trade Secret Restrictions.

Maintain Equity in the Business

- Avoid the trap of normalizing entries to increase the value of the business:
 - Buyers compute their value on the actual financial information (tax returns, internal financials)
- Buyers understand high salaries and owner's draws when a business is profitable

Remove Personal Expenses

- Stop paying owner's bills through the business and start paying them personally
- Remove non-working family members from corporate payroll

Paying taxes on the business's profits will increase the business's value versus making normalizing entries

Buyers Will Want to See

- 5 years of financial information
- The business's tax returns
- Employee tax filings
- Additional information requests by interested buyers should be made in writing

The Offering Memorandum

- An Offering Memorandum (OM) serves to provide information about the business to interested buyers
- Avoid disclosing too much information about the business in the OM
- The OM and other information provided to interested buyers needs to be tracked
- If an interested buyer declines to offer make sure to get the OM and other information provided returned

Run the business as if it was for sale every day,
because it is!

Introduction and History

- Company founder and history
- Current direction of company
- Prior sales transactions of company stock, or asset sales
- Description of top products or business lines

Business Operations

- Business focus
- Operational business plans
- Organization chart and management bios
- Description of key management
- Positive and negative reviews related to the company's products or operations

Sales Information

- Sales by year, by product, or business lines
- List of top-selling products or business lines
- Sales by their various channels
- Pricing policies and programs
- Description of any customer concentration

Marketing Information

- Conferences and trade shows history
- Advertising and marketing plan
- Brochures and marketing literature
- Competitor research

A majority of privately-held businesses are acquired using an asset purchase agreement

Financial Information

- Financial statements, audited preferred
- Financial forecasts for company
- Corporate income tax returns
- Fixed asset and depreciation schedules
- Inventory analysis and inventory locations

Payroll Information

- Payroll tax returns
- Pension plan information
- Employee compensation agreements
- Employee benefit plans
- Other employee benefit obligations

General Business Items

- Describe any scope limitations related to information that the seller is unable to provide to the buyer
- Long-term leases, purchasing commitments, and customer contracts
- Facility/building lease
- Licensing or distribution agreements

A business may have very limited value when it is too closely tied to the owner!

Preparing The Team

- Selling a business requires the development of both an internal and external team of people
 - The internal team should include only the people in the company who absolutely need to know the business is for sale
 - The external team should comprise people who will support the sale of the business with technical expertise

Internal Team

- Owners and shareholders
- CEO/President
- Chief financial/accounting officer
- Chief operating officer
- Head of sales and marketing

Employee Retention and Incentives

- Stay bonuses
- Severance plans
- Equity participation

External Team

- Advisory services firm
- Law firm experienced in business transactions and tax advice
- An estate planner, for a closely-held business
- CPA firm that has audited the business
- Tax accountant who was responsible for preparing the business's tax return

When selling a business -

Have the right team

Have realistic expectation of the value

Be both financially and operationally prepared

Questions
and
Answers

Contact Information

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