

The PRIVATELY HELD Company

The Report on Transaction Issues



IN THIS ISSUE

- Should You Be Selling Your Company...Now?
- Deal Structure: Thinking Outside the Box
- Sellers Take Notice - What Serious Buyers Look For
- Over and Above the Numbers
- How Does Your Business Compare?

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Should You Be Selling Your Company...Now?

It all depends! There are all sorts of studies, surveys and the like suggesting that with the "baby-boomers" reaching retirement age, the market will be flooded with companies for sale. The consensus is that with these privately-held company owners nearing retirement age, the time to sell is now. In one survey, 57 percent of business owners said that their age was the motivating factor for exiting their business. In another one, 75 percent of owners with revenues between \$1 million and \$150 million stated that they looked to sell within the next three years. Reading all of this information, one gets the feeling that over the next few years almost every privately-held business will be on the market.

While there are always going to be those who feel that Armageddon is coming, or that all of these companies are going to be on the market on the day that baby-boomer owners hit 65, there are some compelling reasons to sell your business now – and some reasons that may compel you to hold off. First, we'll address the reasons to sell now. Under the Bush administration, the capital gains tax rate was reduced from 29 percent to 15 percent – almost cut in half. That is a pretty significant reduction. However, there is the distinct possibility that a new administration in 2009 will see fit to change this, and an increase is a real possibility. The tax issue is an important reason to consider packing it in now. Another good reason is that it just may be time to "smell the roses," as they say. After running the business for so many years, "burn-out" is a very valid reason for selling. Many business owners may have, without actually realizing it, let their business slide a bit. You lose a customer or client here and there and don't make the effort to replace them. Or, you don't make the effort to check back with the supplier who has promised to give you a better price on an important product or service. It's too easy to stick with the one you have been dealing with for years, even though you know the price is

probably too high.

On the flip side, it is also easy to convince yourself that business is down a bit this year, mostly due to the current economy, likely reducing the value of the company. Maybe waiting until things pick up a bit and values increase would be a good idea. Too many business owners feel this way, but unfortunately no one can predict the future. New competitors may enter your market. Foreign competition may move in. You may not have the energy or that “fire-in-the-belly” you once had, so the business may slide even further.

You could also point your finger to the tightening of credit and ask, “How is a buyer going to finance the business?” Despite very low interest rates, borrowing money has become more difficult. People seem to be pulling back a bit, so maybe no one will want to buy the business. Thirty-five percent of business owners, in another survey, said they were going to hold off selling because they felt their business would continue to grow and therefore, hopefully, also increase in value.

There is an old saying that the time to plan your exit strategy is the day you start running the business. Business owners can’t outgrow interest rates, capital gains or aging. The time to sell is when you are ready to sell. There is truly no right time, but understanding the tax implications now should play a very important role in this decision if you are considering a sale in the next two or three years. The mere fact that you have read this far may be a sign that now is the time to sell. To learn more about current market trends, what your business might sell for, and what your next step might be, call a professional intermediary.

[return to top](#)

Deal Structure: Thinking Outside the Box

The price gap between buyer and seller can often prevent a deal from closing. However, if the principals really want the deal to work, and their advisors really want to help, the following ideas might get the juices flowing so that all of the parties involved can think outside the box in order to make the deal work for everyone.

If the seller owns the real estate, let him or her lease it to the buyer, thus reducing the price. Another idea is to have the seller lease the premises to the buyer at a higher rent, thereby reducing the goodwill factor. The seller could also lease the machinery and equipment, again reducing the overall price.

If it is a fast-growing business with a possible big upside, let the seller share in the growth through an override or royalty over a set sales dollar amount. Or, place a fast-growing portion of the business in a separate subsidiary with the seller owning a part of it – and giving the buyer an option to buy that portion.

Let the buyer buy 70 percent, for example, of the business and the right to purchase 10 percent more each year on a set formula, thus reducing the price.

When all else fails, one good way to solve major issues between a buyer and a seller is for them to meet for dinner, just the two of them, so they can talk about how to make the deal work. We also suggest that you always consult with a professional intermediary as experienced intermediaries can offer helpful ideas and suggestions as to what could work for both the buyer and the seller.

[return to top](#)

Sellers, Take Notice - What Serious Buyers Look For

Obviously, serious buyers want to carefully look at the financials of a company under consideration and all of the other major aspects of the company. However, there are a few other areas that the serious buyer will investigate that sellers may overlook.

The Industry – The buyer will want to take a serious look at the industry itself, the customers, the suppliers, the competition, etc. This investigation will cover the strengths, weaknesses, threats from competition, and opportunities of the potential acquisition. With the growth of the “big box” retailers, much power has shifted from the manufacturer to the retailer. A manufacturer may want to increase prices, but if Wal-Mart says no, it’s a very powerful no.

Discretionary Costs – Some sellers will reduce their expenses in discretionary areas such as advertising, public relations, research and development, thus making for a higher bottom line. However, these cuts will hurt the future bottom line, and smart buyers will take notice of this.

Obsolete Inventory – This is another area that buyers take a serious look at and that can impact the purchase price. No one wants to pay for inventory that is unusable, antiquated or unsalable.

Wages and Salaries – A company may be paying minimum wages, or offering few or low-cost benefits, a limited retirement program, etc. These cost-saving devices will make the bottom line look good, but employee turnover may create expensive problems later on. If the target company is to be absorbed by another, compensation issues could be critical.

Capital Expenditures – The serious buyer will take a very close look at machinery and equipment to make sure they are up to date and on a par with, or superior to, that of the competition. Replacing outdated equipment can modify projections and may affect an offering price.

Cash Flow – Serious buyers will take a long look at the cash flow statements and the areas that affect them. The buyer wants to know that the business will continue to generate positive cash flow after the acquisition (i.e.: after servicing the debt and after paying a reasonable salary to the owner or general manager).

Other areas that sellers overlook, but that the serious buyer does not are: internal controls/systems, financial agreements with lenders, governmental controls, anti-trust issues, legal matters and environmental concerns.

[return to top](#)

Over and Above the Numbers

A close review of the financial statements is always in order when considering the acquisition or merger of a company. However, that is only part of what a buyer is acquiring. Other important assets are:

- Repeat customers or clients
- Patented product, government approvals, profitable copyrights

- Broad customer or client base (diverse & growing)
- Long-term contracts
- Recognizable brand or product name
- Experienced management team and trained work force
- Valuable intellectual property
- Proprietary products
- Profitable alliances
- Contracts/non-competes with valuable employees

The Letter of Intent

Once a buyer has determined to make an offer, he or she typically presents this in the form of a Letter of Intent which outlines the terms of a possible transaction. The buyer prepares the Letter of Intent, but the seller should provide his or her thoughts on what should be covered.

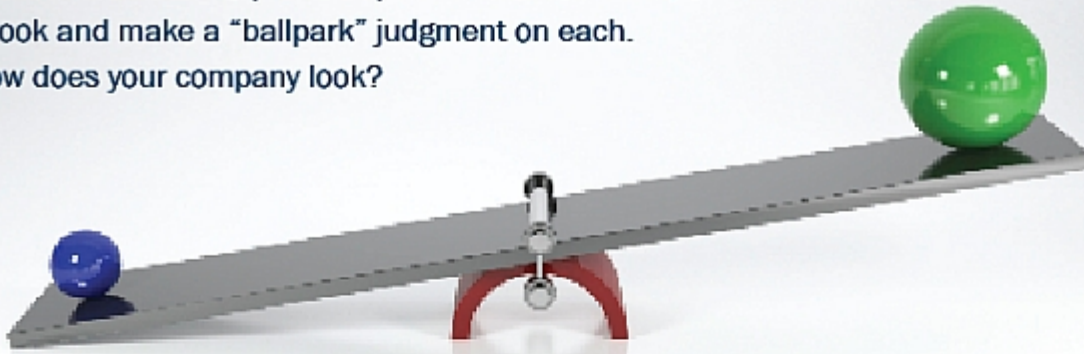
Here are some of the items that are generally covered:

- The assets and liabilities to be included.
- Assumption of contracts and warranties.
- Lease or sale of property.
- Employee contracts or severances.
- Time schedules of due diligence and closing.
- Price and terms.

[return to top](#)

How Does Your Business Compare?

When considering the value of your company, there are basic value drivers. While it is difficult to place a specific value on them, one can take a look and make a “ballpark” judgment on each. How does your company look?



Value Driver	Low	Medium	High
Business Type	Little Demand	Some Demand	High Demand
Business Growth	Low	Steady	High & Steady
Market Share	Small	Steady Growth	Large & Growing
Profits	Unsteady	Consistent	Good & Steady
Management	Under Staffed	Okay	Above Average
Financials	Compiled	Reviewed	Audited
Customer Base	Not Steady	Fairly Steady	Wide & Growing
Litigation	Some	Occasionally	None in Years
Sales	No Growth	Some Growth	Good Growth
Industry Trend	Okay	Some Growth	Good Growth

The possible value drivers are almost endless, but a close look at the ones above should give you some idea of where your business stands. Don't just compare against businesses in general, but specifically consider the competition.

As part of your overall exit strategy, what can you do to improve your company?

Improving Your Prospects for Selling

According to a Price Waterhouse Coopers survey of more than 300 privately held U.S. businesses that have been sold or transferred, the most common steps companies take to improve their prospects for a sale, prior to taking the company to market, include:

- Improving profitability by cutting costs
- Restructuring debt
- Limiting owners' compensation
- Fully funding the company pension plan

- Seeking the advice of a consultant or intermediary
- Improving the management team
- Upgrading computer systems/processes

[return to top](#)

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