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Preparation to Sell a Business

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I am often asked, what should I do to prepare my business for sale? Recently, a publication geared to business owners asked me the following questions:

Q: As a seller, what should I do to prepare my business before listing it for sale?

A: The most important thing a seller can and should do is have high quality financial statements prepared for the prior three to five years of operations. What I mean by high quality financial statements is statements that clearly show the assets and liabilities, income and expenses of the business. They do not need to be audited or even reviewed CPA prepared statements. Compilation statements prepared by a good CPA with explanatory notes will give a buyer and his or her advisors sufficient information to be able to analyze your business operations and to determine what it is worth to them. One of the biggest problems encountered in the sale of a business is "hidden" income or expenses; i.e. revenue received, but not declared or personal expenses run through a business as actual business expenses. A buyer and his or her advisors is not going to want to hear that "the books show only ___ in net income, but it really made two or three times that." A Seller has "already been paid" for any business value that might be attributed to revenue not declared or personal expenses run through a business. The second most important thing a seller can do is to have the business facility or facilities looking a presentable as possible. Clean up any messes, paint what needs to be painted, seal the parking lot, etc. The facility does not need to be new, but it should look as good as it can. The third most important thing a seller can do is to prepare a business plan or similar document, usually with a business broker, CPA, appraiser, or other professional's help, that clearly outlines what it is that the business does, talks about the employees, etc. This can be used to prepare a marketing brochure for the Company.

Q: I own a business, some machinery and equipment used in the business, and the land it is on. How will each of these play a role in the appraisal? Do they need to be appraised separately?

A: Typically equipment actually necessary to the operations of the business are included in the purchase price and may not need to be actually valued separately. If the business owns the land and building in which it operates, the real property needs to be valued by a real estate appraiser, the market rent factor determined and that amount used as a rent expense when valuing the operating business. The value of the operating business and the real property together would then represent the sales price for the business. Real property and operating businesses have different risks associated with them – accordingly, valuing the business without pulling out the real property and substituting a market rent factor will result in an incorrect entity value. Likewise, any excess equipment or other assets, such as an owner's toy included in the business must be pulled out and valued separately.

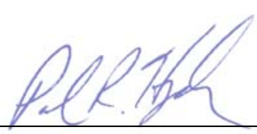
Q: Will I have to finance the sale of my business? How will it affect my sale if I decide I do not want to finance the business?

A: The nature of financing that is available to fund a purchase depends on the nature of the business, the industry in which it operates, the type of assets used in the business, and the quality of the financial statements. Some business sales can be financed by Banks or other conventional lenders; more often than not with a Small Business Administration (SBA) loan guarantee. If an SBA loan is needed, it is wise to make sure that the Buyer goes to a lender that does a lot of SBA loans rather than a lender that claims it can do them. The process of getting an SBA loan approved is not simple – a lender that does a lot of them knows how to do it and is more likely to tell you up front if it looks possible or not. Getting an SBA loan takes some time; the package required is very detailed and an experienced loan officer is critical. Seller financing is quite common in private business sales. Getting a good down payment so that the Buyer is motivated to make it work is important. Also, if you as a seller are willing to carry financing, make sure that you get good competent help from a good CPA and a good attorney that each have a great deal of experience in such sales. Unfortunately, some accountants and some attorneys are willing to take on any job for money whether or not they really know what they are doing. Carrying financing yourself involves some risk – make sure you get good collateral to support your position and that you are willing to step back into the business again if the buyer fails to make it work. If you get a good down payment and have good collateral, you should not be hurt if you need to step back in; if you cannot get a good position where you feel reasonably comfortable, then don't carry the financing. On the other hand, a buyer may get real nervous about a Seller that is unwilling to carry any financing on the sale of the business – it makes it look like there must be something wrong with the business that is not being disclosed. If the business is a great business and the price and terms are reasonable, why not carry the financing?

Q: Do you have any other tips of advice for anyone buying, selling or appraising a business?

A: A critical thing a seller needs to decide is whether to sell equity in the Company or the assets owned by the Company. Most accountants are going to encourage the Seller to sell the equity in the Company, i.e. a stock sale. This results in much more favorable income tax treatment to the Seller, however, most professional advisors for the Buyer are going to encourage an asset sale as this results in much more favorable situation to the Buyer. When the Seller sells as an Asset sale typically the Seller retains the cash and often the accounts receivable and pays off all liabilities. In an asset sale, the Seller typically recovers depreciation taken on the equipment as ordinary income – this can create a real tax problem. It is critical to get good professional tax advice so that the Seller knows what will happen income tax wise as a result of the sale. It is also very important to have a competent business attorney draw up the papers for a sale. There are many issues that need to be addressed. If a stock sale is actually agreed to, there are many more issues that need to be dealt with. In a stock sale, lots of unforeseen liabilities associated with the business could come back and bite an unsuspecting buyer, i.e. a sexual harassment suit, product liability issue, etc. could come out and the business very likely could be stuck with a huge liability. In an asset sale, it is important to have the attorney arrange to have the prior corporate name changed to a new name so that the "new" business entity formed for the buyer can be formed with the business name known to the public. All of the employees are typically terminated and "rehired" by the new entity and so forth so that the new entity with the old name "starts over" and does not carry forward any past liabilities associated with the prior entity. Also any past tax liabilities of virtually any kind should not be charged to the new entity, but rather would go to the old entity and the Seller.

Valuations play a part in all strategic transactions, tax, and many litigation matters. For additional information or advice on a current situation, please do not hesitate to call. **We value real estate, businesses, and personal property including livestock and machinery & equipment.**



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Enrolled to Practice Before the IRS (Enrolled Agent)
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