

PREPARING YOUR BUSINESS FOR SALE

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As a business owner, chances are that at some point in your life, you will sit back in your chair, stare out your window and ask yourself “what else is there?” That’s the point, the epiphany, if you will, at which you realize that life is short and there is more to it than grinding it out day after day. This is true even if you love your business and have nurtured it through its ups and downs, the turmoil of the financial crisis and all the daily impediments that a business is bound to experience. Nevertheless, you yearn for something more. Maybe you want to work in the public sphere or for a charity where there is less pressure. Maybe you want to play 36 holes everyday. Maybe you want to travel and smell the roses. It all sounds good. Whatever you want, as a friend of mine says, “you should retire to something.”

Your advisors can help you deal with all the contradicting emotions you might be experiencing and help you to focus on your goals. You need to prepare yourself for the sale of your business. It takes a bit of self-analysis and a measure of work to prepare yourself for the sale of your business. Among other things, if you have not already done so, as soon as you contemplate selling your company, you need to talk to your estate tax lawyer so that the proceeds of the sale are distributed on the most tax-advantaged basis and to the parties you desire to receive the proceeds. In addition, you need to consult your wealth advisor. If you are like many business owners, the vast majority of your wealth has been locked up in the business and you have lived off the income it has provided. That stream of income will disappear and you need to replace it with another stream of income in line with your expectations. Your wealth advisor can assist you to “right size” your expectations and can come up with a program that should provide you with adequate income.

Correspondingly, you need to prepare your business for sale as well. Preparing your business for sale is nothing more than getting your house in order, or, better yet, making sure that all the tools and screws in your tool shed are in the right place. When they are, you know where to find what you need in an instant and everything runs smoothly. When they are not, let’s just say that leak on the roof does not get fixed in time. Oh boy!

Here’s the point. When a buyer proposes to buy your business he or she offers a price on the basis that everything in the business is in good working order. After you sign a letter of intent or a purchase agreement, which contains that price, the buyer is given a chance to investigate the business. And if the buyer is worth his salt, he won’t leave a stone unturned. If it turns out the business is not in good order, watch out! If the buyer finds problems that you did not disclose, he is going to lose trust in you and that might jeopardize the deal. In addition, if the buyer finds problems, he is going to insist that the original price be adjusted downward to account for the problems. He might even suspect that there are other problems that he cannot find and try to drive down the price to account for them. To say the least, it is not a happy day for a seller when a buyer delivers that message.

The best way to avoid this is to scrub your company clean as soon as you begin to think about your “next life.” Your allies in this project are your lawyers and accountant. What you need to do is pretend you are the person buying your business. Then you need to investigate your business to identify and solve any and all of its material problems. I put this into three buckets: 1) organization; 2) protection; and 3) correction. Let’s look at each of these briefly.

Organization

Some people are born organized. Then, there are the rest of us. Take a look in your closet. If it's a mess, there is a good chance your business records are too. Buyers hate that. So, the goal is to organize all of your records before the buyer starts his investigation. For example, all of your stock records should be complete and in good order. If not, don't panic. Your attorney has methods to clean things up. You should have separate files, whether hard copies or scanned copies for all the important documents in your business which are collated in a logical easy-to-access sequence, whether that be numerically by account number, chronologically, alphabetically, or a combination thereof. This applies to all your material documentation, including your corporate or other organizational records, including shareholder agreements, vendor contracts, customer contracts, employment contracts, property leases, deeds, surveys, title policies, equipment leases, health benefit contracts, stock option plans, retirement plans, union contracts, insurance claims (ordinarily for the last 5 years), lawsuits, claims, settlements, OSHA or EPA inquiries, tax and financial records. Sounds daunting? It isn't. Just like a farmer is never idle in the winter, doing his winter chores, you and your employees should be using every free moment to organize your office, if you have not done so already. Nothing warms the heart of a buyer more (other than getting a great price) than when everything that he wants to investigate is in good order.

Related to organization, if you have not already done so, and you only have compiled financial statements for your business, you should consider raising the level of your financial statements to at least reviewed financial statements. Among other things, a buyer is going to do a thorough financial analysis of the business and if you only have compiled financial statements, the buyer, correctly, is going to have less faith in their accuracy and in your grasp of the financial condition of your company. By going to the reviewed level, you involve your accountant in the formulation of your financial statement in a significant way to alleviate these concerns. The cost is worth it.

Protection

The next thing that every business owner needs to do is protect the business assets, for example, the intellectual property of the business. You need to make sure that you have registered trademarks for your trademarks and trade names. You should also have registered copyrights for your written materials and patents for your inventions. These need to be maintained and updated. It is best to have intellectual property counsel do this for you. They are born organizers. If you do not have any of these, you probably have trade secrets. This can be a recipe (e.g. the Coca Cola recipe), a formula, software code, or a customer list and customer requirements, among other things. Obviously, you need to protect these. First, trade secrets should be given only to your employees who have a need to know them. Second, every employee needs to sign appropriate confidentiality and non-competition agreements. This protects both your trade secrets and your customer base. If you have not done this already, do not worry. Continued employment is generally considered adequate consideration to the employee for his or her agreeing to sign these agreements now.

You also want to protect your contractual assets. If you have vendor or customer contracts on good terms, consider locking them in for a longer term when the contract expires. The same concept applies to leases. Also, make certain that all your contracts may be assigned

by your business to a successor business without the need to get the approval of the other party to the contract.

In addition, if you have key employees who would be important to your ongoing business, consider entering into an employment agreement with them. This is also an area where a covenant not to compete helps the company. There are various ways to incentivize employees to stay with the company.

Correction

The next area that you want to concentrate on is correction of any problems that the business has. Among other things, you need to address any litigation, shareholder claims, intellectual property problems and compliance requirements, OSHA problems and compliance, and any tax issues. Although you do not need to correct transactions with affiliates, you need to be prepared to shine a light on them. For example, often the business leases offices and warehouse space from a separate limited liability company owned by the business owner on terms other than market terms. Needless to say, not all problems can be corrected before you sell your business, but the buyer will be impressed if you have identified all the problems and have started to address them. Don't let the buyer discover the problem before you do.

Conclusion

Selling a business is a critical life changing event for the business owner. You want it to go as smoothly as possible. Like most everything else in life, you increase the chances of a smooth transaction if you have prepared for the same. As I have noted above, three important areas are organizing your documents, protecting your assets, and correcting your problems. If you do that, the buyer is more likely to believe the business is in good shape and have confidence in your team. Buyers like that. More importantly for you, your buyer will have less ability to drive down the price. Buyers hate that. Good luck.



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