SAYINGS FOR SELLERS

Considering a sale? Keep in mind these words of wisdom

BY STUART ROSE

As an investment banker for middle market companies, my job is to do three things: sell businesses for owners who wish to exit or have a "liquidity event"; assist companies or private equity groups buy businesses; and raise capital, either equity or debt, for growing companies.

My experience has taught me a few things about the deal business. Some of the lessons have been hard, some profitable, but all well learned. What do sellers need to know? These eight sayings do a good job summing it up.

1. **"Sell the sizzle" is the first lesson of a potential exit.** Companies are typically sold for the promise of future earnings. To maximize the selling price, your company needs to have a story of growth and excitement. While the history and current business performance is important, it is only the foundation for the future.

When there is no sizzle, the prices businesses fetch tend to be drab. You can realize fuller multiples when your company has a good story to tell.

For example, I know of one catalog company with three stores. The merchant sold the notion of a 30-store retail rollout with locations based on where the catalog buyers were located. A complete and detailed story of growth—the sizzle—brought this multichannel retailer an enormous multiple.

2. **It is best to "resolve deal breakers before going to market."** Every company has warts that need to be dealt with, but the big warts need to be addressed before going to market.

For example, is a particular division a burden on the company? Is the firm's ownership in dispute? Are there material lawsuits pending? These are often deal breakers. Passing the problem off to a buyer not only increases the risk and uncertainty, it complicates the transaction and lowers the price significantly.

3. **One reason for a seller to hire an investment banker is to help "keep your eye on the ball."** The CEO must continue to run the company on all eight cylinders. An investment bank can help take most of the burden of communication, correspondence, and negotiation off the shoulders of the CEO.

Working as a team, the investment banker (knowledgeable about the intricacies of the company and industry) is selling the future and using the present as a foundation, while the CEO manages the day-to-day affairs of the business. A seller doesn't want cracks in his proposition to start appearing at any point in the process.

4. **A business owner should "always be prepared to negotiate, but never negotiate without being prepared."** Business owners know their company, but they also need to know the buyer's business. First, you must prepare the business for sale. Put the house in order by preparing straightforward documents and getting ready for negotiation. That means understanding motivations—your own and your counterpart's.

Setting realistic expectations will help in negotiations. Play out scenarios of what counter proposals you would expect. All of these exercises will help you in consummating a successful transaction.

5. **Sellers should know that "one buyer is no buyer."** While many transactions occur when there is a single bidder, this is not desirable.

For one, multiple bidders create an auction of sorts, greatly enhancing the price paid and the terms received for the business being sold. Have you ever seen the auctions at Sotheby's? Imagine what would happen if there was only one bid.

Second, a seller's options are limited if there is only a single bidder. If the one buyer walks away—for whatever reason—there may not be a back-up plan.

Finally, the power in the negotiation is shifted to the buyer in these cases. The buyer knows that the seller wants to sell and can use that as leverage. Since power in a negotiation is accrued to the party most willing to walk away, in most instances that's the buyer. To the buyer, "there is always another bus around the corner." To the seller, it can be now or never.

6. **The deal is not done once a buyer and seller agree on the price.** The saying "I'll let you dictate the price, if I can dictate the terms" reminds us that the terms of a deal are as important as the price paid.

Of course, there is the old example of someone paying $1,000 for a $100 bill. The buyer will just pay $1 a year for a thousand years. This happens!

Deferred payments, earn outs, indemnifications, and escrow payments all influence whether the deal is a good one for the seller. While price is important, it needs to be evaluated within the framework of the terms offered and the prevailing market conditions. Even when terms are complete, the deal is not done.

7. **Sellers should know that "the bigger the company, the easier the deal."** Small deals can be hard to finance because there aren't as many assets to leverage, and because cash flows are considered riskier. A 20% drop in profits at a company with $1 million in profits can hurt the owner of a company more than a similar size drop at a company with $10 million in earnings.

Also, in today's age of private equity and consolidation, acquirers want their cash deployed in fewer but larger transactions. If the buyers have $100 million to invest, they prefer five deals at $20 million each compared to 20 deals at $5 million each.

A billion-dollar strategic company does not want to bother with a $5 million add-on division as it will not affect the bottom line. Furthermore, larger companies generally have better systems and record keeping than smaller companies.

8. **The lack of systems and controls is only one reason why "a small deal takes as much time and work as a large deal."** Transaction costs for small deals tend to be relatively high. The transaction fee for an investment bank can be as high as 10% for small deals and as low as 1% for large deals. Lawyers, accountants, and due diligence experts all take their cut.

Further, negotiations and due diligence can take as long with a small deal as with a large one, adding to the cost and attention needed. Due diligence costs are less for small deals, but contracts still need to be reviewed, evaluated and assigned. Purchase and sale documents must be negotiated and drafted. All of this takes considerable time.

Of course, the process of selling a company is more complex and detailed than what's covered in these expressions. Perhaps important: The selling CEO must surround him/herself with an experienced transaction team.

Who should be on this team? A corporate attorney, an accountant and, yes, an investment banker who is familiar with current market conditions and the prices being paid for businesses of comparable size and type.

A clear understanding of each person's role and a well-coordinated focus on the owner's objectives are also critical for a smooth transaction. As Donald Trump might say, that's the art of the deal. ■

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