Preparing a business for sale

RSM Ireland

Selling your Business

It is tough to start and grow a business, however successfully exiting one can often be more difficult. Selling a business is one of the most important decisions a business owner will make. Having invested a significant amount of time, money, and energy into their business; realising the maximum return on this investment is of prime importance.

A significant challenge faced by owners selling their business is laying the right groundwork for a disposal. It is challenging to balance the time and effort required by a sales process while continuing to run day-to-day operations effectively. Furthermore, as there is no one-size-fits-all solution to help owners manage this challenge careful preparation for an sale is vital. To achieve a successful exit, minimise completion risk and maximise shareholders value, owners should start preparations early.

A process should be planned carefully, executed with precision and the owner should be prepared to address a host of financial, operational, technology, and human resource issues during the transaction.

Stages of selling

There are four stages to selling a business:

1. Preparing for sale;
2. Identifying the right potential buyer pool;
3. Negotiating the deal; and
4. Closing the transaction.

Owners of mid-market companies face numerous challenges during these stages so it is important to be aware of these and well prepared to ensure a smooth exit; as the incremental value implications can be considerable. Early preparations for exit and implementing good business practices and discipline in advance of a sale will not only make the sale process smoother, but will enhance the value and reduce risks for the exiting shareholders.

Preparing for Sale

Typically, the priority goal when selling a business is to capture the highest value possible for shareholders. While there are several factors that drive deal valuation (such as company performance, competitive landscape, economic conditions, deal structure and tax considerations), a well-prepared business will be better positioned to meet the challenges posed by potential buyers during the process.

Objective of sale

It is important to sell the business for the right reason. The objective of owners in turn drives the direction of the sale process. Such objectives could include;

- Maximising value/ cash received on closing of the deal;
- Supporting strategic growth initiatives;
- Achieving financial security/ minimisation of investment risk;
- Pursuing a new venture; or
- Retirement.

It is important to take some time to think through the actual objectives of business sale and define them at the outset of the process.

Management succession

Indispensable owners are a red flag for most buyers evaluating an acquisition opportunity. Having a credible second-tier management team in place who can continue to drive success when the owners have exited will make the business more attractive to a buyer. It is important to evaluate the second-tier management team and ensure that they have the required skills and potential to drive the growth story of the business on the exit of owners.

Employee retention

Retention of key employees and filling any outstanding positions is also important. Employee relationships should be formalised through appropriate employment contracts and supplemented by formal employment policies and practices (frequently in the form of an employee manual/ handbook).

Any decision to disclose a potential sales process to staff should be carefully considered, both with respect to timing and those to be informed. In certain instances it may be prudent to agree certain incentives with key staff, which serve to align motivations with those of the shareholders. For example, transaction bonuses.

Third party relationships

Customer and supplier relationships represent another area of focus. Trading terms impact both the margins and cashflow profile of a business and buyers will want to ensure they fully understand these dynamics. Certain businesses are prone to having informal/ verbal agreements over the terms of trade. Where possible (and appropriate) it is preferable to formalise agreements and thereby provide some comfort that trading relationships are likely to continue post deal. Where contracts are not appropriate, an ability to demonstrate the tenure and likely ongoing recurrence of the relationship will enhance value.

Other considerations include trying to avoid a potential concentration on a small number of customers and ensuring that all key stakeholder relationships are not seen to require the existing shareholders input (or that a credible plan to migrate such relationships to the remaining management team can be actioned).

Business controls

The key processes and controls should be documented and reviewed periodically to ensure their adequacy. In advance of due diligence, a review of financial controls and processes may merit consideration to ensure any shortcomings are rectified ahead of process.

There should be an appropriate formal finance function in place, commensurate with the scale of operations of the company. As part of the finance function, periodical reviews i.e., monthly/ quarterly should be undertaken including the preparation of the necessary board/ management packs. The finance function should be headed by qualified personnel.

Financial information

As part of any acquisition, financial due diligence with be central to a buyers analysis. Being able to provide up to date financial statements and quality financial reports not only accelerates the process but also improves the perception of the target company. On the other hand, poor quality financial information portrays a negative image and makes reliance on this information more difficult. This can result in delays or potential chips to indicative offer pricing .

Owners should ensure that there is a detailed business plan in place with a supporting financial model and mid-term financial projections. The assumptions supporting the financial model should be credible.

If there are past instances whereby the company's performance has not been in line with expectation, owners should consider an explanation for these periods of reduced performance and document a rationale along with any changes made to how business is conducted in order to safeguard against this in the future.

Business controls and processes

In addition to the business plan and financial model, the following represent core documents that will be required in financial due diligence. Ensuring the following is readily available in a clear and consistent form will allow advisors to drive timelines and maintain strong momentum.

- Audited/ reviewed annual financial statements for the last three years;
- Detailed monthly/ quarterly management accounts supporting the financial statements with clear links to the trial balance as obtained from the accounting software;
- Board/ management packs with detailed commentary on the performance of the business including any relevant KPI's;
- Detailed schedules on;
    - Sales pipeline;
    - Breakdown of revenue by product lines and customers, and costs by suppliers;
    - Any one-off, non-operating income/ expense;
    - Owner costs charged to the P&L (i.e., salary, pension, perquisites, personal expenses, family salary and personal expenses and interest on loans) and its replacement cost; and
    - Debt-like items.
- Working capital trends by month/ quarter reflecting the seasonality traits associated with the working capital requirements of the business; and
- A list of accounting policies adopted.

A business is normally acquired on a "debt-free/ cash-free" basis with a normal level of working capital being retained in the business on transfer. By understanding the working capital cycle and being able to drive efficiencies in working capital, management can unlock meaningful additional value. Tight working capital management in the months preceding a process will deliver incremental cash value to shareholders, by virtue of a likely reduction in the targeted working capital peg.

Further, cash is added to the headline value with debt and debt like items such as corporation tax liabilities being deducted from the price. Optimising the debt structure, having detailed justification for inclusion of any item which could be considered debt like in nature as working capital and keeping the cash position at the time of sale close to the operating levels can also drive incremental value at the time of sale.

Housekeeping and risk management

Ensuring that all legal and regulatory compliance requirements are in order is clearly important. From a legal perspective, The availability of up-to-date corporate documents such as incorporation documents, share certificates, lease deeds, title deeds, IP rights and contracts will facilitate a smooth start to legal due diligence.

Buyers will also want to understand potential liabilities and careful consideration should be given to the disclosure and messaging concerning same.

Lastly, identifying and mitigating the key commercial and transaction risks in addition to potential deal breakers at the outset should help enhance value at the time of sale.

Tax implications

Tax structuring associated with the transaction stems from the buyers and the seller's goals, legal form of the business and evolving tax laws. The success of the approach adopted depends on anticipating the transaction, establishing clear vendor objectives, and evaluating tax risks. Tax planning in advance of any transaction is vital and optimum structuring can vary greatly from deal to deal. Taking early advice will almost always reduce potential tax leakage on sale.

Corporate image

In advance of a sales process, it is prudent to review the company's public image and refresh or update where required, including;

- Gathering positive customer/ supplier testimonials;
- Documenting any public relations initiatives which the company has undertaken to build reputation; and
- Reviewing the online and social media presence of the business to ensure that it portrays the intended corporate image, is up to date and supportive of the investment case outlined in marketing documentation.

Marketing documents

Selling a business is about creating a compelling investment case to attract the right potential buyers, maintain competitive tension and drive a premium valuation. The story should accurately outline the history i.e., timeline, growth trajectory, core competencies, strategic advantages, market position and the vision of the business. The forward looking story will ideally strike a balance between being ambitious and compelling, yet credible. Careful preparation of key marketing documents is a precursor to any successful process;

- **Teaser:** A teaser is a short, high-level and potentially anonymous document containing the details of the investment prospect which would allow the potential buyers to decide whether they want to learn more about it and pursue the opportunity further; and
- **Information Memorandum:** The Information Memorandum (''IM''), no longer anonymous, pitches the compelling story crafted for the sale of business and would normally include the history of the company, products and services, geographical coverage, market description, market position, strategy and vision and the financial statements of the company. Interested parties will be required to sign an NDA prior to receipt of the IM.

Lastly, creating a targeted buyers universe based on attributes such as acquisition appetite, funding capacity and transaction history allows channelling of marketing efforts in the right direction.

Valuation and due diligence

A trading business is normally valued based on a multiple of maintainable earnings and potentially sense checked to a discounted cash flow methodology. The valuation of the business is driven by several factors such as track record, growth, profit margins, competition, net assets, and property values. Listed peer company ratings and recent deals in the same sector provide an indication of the price range buyers may be willing to pay. Understanding the buyer's philosophy and attitude towards value can also help provide an indication of the price they may offer.

Strategic buyers may be willing to pay more if potential synergies are significant. Thus, capturing these synergies such as benefits and costs of integration, potential opportunities, inherent sales and distribution channel synergies, purchasing power increases, production and administrative efficiencies and working capital improvement can help achieve an enhanced valuation. Maintaining competitive tension is key to potentially extracting additional synergy derived value.

Financial buyers (Private Equity) typically look for investment opportunities where leverage can be deployed to improve returns, support the business financially as it pays off debt and grows and then exit in short to medium term. For these buyers an investment opportunity with predictable cash flows, strong management teams, growing markets, lower working capital and capex requirements will likely command a premium valuation.

Lastly, the option of sell side due diligence can help the owners identify areas that have deal and value implications and enable mitigants to be put in place early. Typically, this would include understanding;

- Quality of historical earnings;
- Historical and projected trading performance;
- Key customer and supplier relationships;
- Working capital trends and capex requirements;
- Debt structure of the business (including debt like items);
- Strength of the management team;
- Potential synergies;
- Potential/ outstanding litigations and claims;
- Technological and IP assets/ challenges; and
- Any contingent liabilities.

A sell side due diligence may facilitate anticipating buyer's questions and help management prepare concise and tailored responses. Sell side due diligence will also expedite the sale process and could avoid lengthy negotiations and any disputes post closure.

In a Nutshell

An exit represents a once in a lifetime opportunity. Exiting owners can significantly impact the price achieved on exit by carefully planning and preparing for their exit. Expert professional advice from experienced corporate finance and tax professionals who have worked with similar owner managed businesses is key to realising a successful deal.

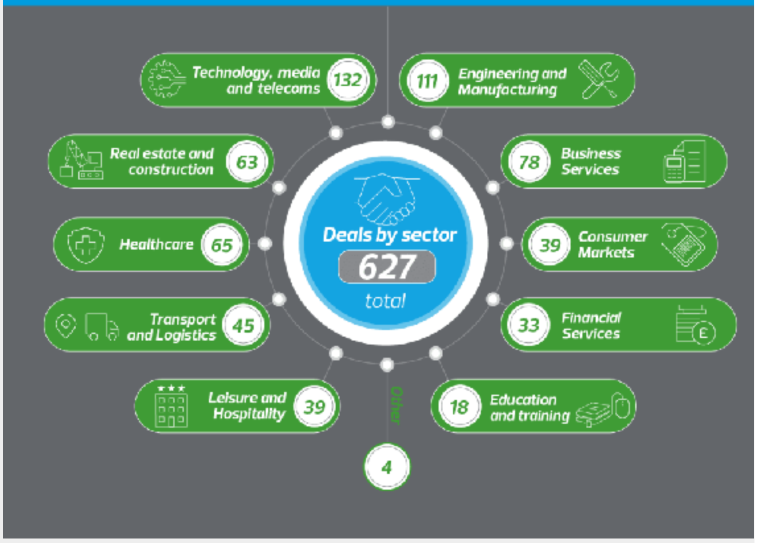
RSM Corporate Finance

RSM Corporate Finance is an established, full suite provider of deal advisory services to the SME and mid-market. This includes M&A, equity fundraising, debt advisory, due diligence, valuations and general strategic advice. During 2022 RSM's Corporate Finance teams supported 627 successful transactions in Europe alone. Key service lines are outlined below.

Mergers and acquisitions

RSM can assist you in selling your business and locating buyers who have the strategic rationale and capability to undertake a transaction. We will project manage what can be a complicated process, provide commercial input into required legal agreements and ultimately deliver premium, value-add outcomes for our clients.

The total number of European completed deals RSM advised on in 2022



Due Diligence

RSM complete high quality due diligence reports for buy and sell side M&A processes – or when otherwise required for taxation, IT or HR purposes.

Financial modelling

Financial modelling plays a crucial role in supporting effective analysis and corporate decision making. RSM assists clients by developing detailed decision support tools or by providing independent comfort over such models.

Capital raising and debt refinancing

RSM can assist in evaluating your capital structure, existing loan agreements, lending arrangements and covenant packages. Thereafter, we can identify and approach debt/ equity providers while simultaneously advising and developing marketing materials to present a compelling support case.

Valuations

RSM have highly skilled valuations specialists who can complete a full range of valuation exercises. Typical reasons for a valuation can include an exiting shareholder, M&A process, taxation or litigation purposes.

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