How to effectively sell a business

MERRICK WEALTH

By Peter Merrick

Within the next 10 years 15 per cent of the workforce is planning to retire, according to Statistics Canada. Yet many successful business owners are wary of selling their companies. It is very difficult for an owner to see their identity separated from the business.

The most important reason cited by owners for selling their businesses is to create financial independence for their families. They also want to enjoy their lives, without the financial constraints of having the vast majority of their net worth tied up in a company.

According to Rudolph Dorner, president of M&A Inc. in Cambridge, Ont., which has brokered the sale of 74 corporations valued at between $2 million and $50 million over the last 20 years, there are five key indicators that a business owner is a candidate for selling their business:

• Age: They're 50 to 55 or they have been in the business over 20 years. At this stage the business owner is ready to do something else.

• Fatigue: The owner demonstrates a lack of daily enthusiasm for the business. The owner has traveled across North America building the business and has dealt with enough problems.

• Money: They want to take some or all of their equity (most of which is in the company) off the table. They want to secure their family financially.

• Future: The prospects of the business are not as bright as previously due to competition, currency exchange, technology or whatever.

• Partners: The long-term arrangement has finally hit a major snag. Think of the McCain and the Steinberg families.

The number one question that many successful business owners ask their advisors is, "when is the right time to sell?" Before considering selling one's business the vendor needs to know what his individual financial independence number is. This 'magic number' is the amount of capital that he will need to live on for the rest of his life.

The number is 'magic' because it can turn a business owner into a business seller. If it is determined by your client that he could net out his magic number, he is a prime candidate to sell.

If your client would not reach his magic number today by selling, he should consider developing new strategies to grow his business until the 'magic' day comes.

The second question asked by business owners who are contemplating selling is, "Who should I sell my business to?"

Generally speaking, there are three primary categories of potential purchasers:

• Family members (whether active or passive in the business);

• Key managers or senior employees of the business;

• A third party purchaser (which may be a strategic buyer, such as a competitor or key customer/supplier, or a private equity fund, merchant bank or investor).

I have found that selling to a third party is the best of the three options.

The advantages of selling to a third party over selling to family or key managers is that your client has a better probability of selling his business for cash, plus the odds are greater the vendor will get a premium and surpass their magic number. As well, if the negations fall apart your client will not have to worry about continuing a relationship with the third party. This cannot be said when dealing with family or key managers.

There are a number of major steps in selling a business. First it is essential to choose a reputable business broker. Forget the ads or mail solicitations. Ask around for a personal reference from someone who has sold their business.

Expect to pay about five per cent on the first $10 million and one per cent thereafter for the broker. Legal and accounting fees will cost 1.5 per cent of the selling price. The broker will value your client's business. Over the last 20 years in Ontario, good businesses have sold for an average of 3.54 times normalized EBITDA (earnings before interest, tax, depreciation and amortization – normalized for the owner's wages and non-recurring costs).

Once your client has decided to sell his business and has selected a business broker, the broker writes the offering memorandum describing your client's company in detail. It usually takes 2.5 days of the seller's time to supply the raw information.

What is helpful during this process is for the seller to provide a list of every potential buyer that he can think of to the broker. The broker will also solicit buyers, sign them to a non-disclosure agreement, screen out non-serious buyers, and present the company in its best light.

The seller will meet with the potential buyers to discuss company history, current and future operations, and any role the seller is willing to play in the business transition. The seller should expect to meet a maximum of five potential buyers. If more buyers are introduced, the broker is not screening carefully enough.

When a deal is in the offing the broker will provide a signed offer in the form of a letter of intent. He will review it with the seller, and point out any advantages or deficiencies. He should not advise the seller to accept or reject it. He should only advise if the deal is at, above or below market, and that is all. If the deal is acceptable, the broker will procure a deposit. A standard deposit on deals in this segment is $100,000.

The seller should have already sat down with his certified financial planner and public accountant and put in place solutions to generate and strip out excess cash.

Working with tax and financial planning specialists will go a long way to minimize the tax liability triggered by the sale.

The buyer will then do a 90-day due diligence investigation to determine if the facts presented about the business are true. It is important to note that this process will be intrusive and tedious.

Next is the share purchase agreement prepared by the buyer's lawyers. The terms will be strongly tilted to the buyer's advantage. The broker, working with the seller's lawyer or with his own specialist, will make sure balance is restored. The seller stays out of this process, letting the lawyers and his broker work. The vendor will formally review the final version.

Just prior to closing the broker will provide a projected balance sheet to the new owners, as well as a payout statement to the vendor showing all costs, projected taxes, and net funds receivable from the sale.

The day after closing the broker will usually hand-deliver the cheques and ensure the funds are deposited as per the tax plan.

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