Goldin Peiser & Peiser, LLP

SELLING YOUR BUSINESS

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OUTLINE

- Exit Strategy
- Initial Considerations
- Pre-transaction Individual Tax Planning
- Pre-transaction Business Tax Planning
- The Legal Process
- Key Takeaways

EXIT STRATEGY

BUSINESS OWNERS

In our experience:

- Many business owners do not really know what their business is worth.
- A large percentage of business owners' net worth is tied up in their business.
- Most business owners have no clear exit strategy.

EXIT STRATEGY

Today we are going to focus on one exit strategy

THE SALE OF A BUSINESS TO A THIRD PARTY.

- Selling your business is a process, not an event.
- Preparing now will smooth the sale process and gives you the greatest chance of realizing the highest return.

INITIAL CONSIDERATIONS

MAKING THE EXIT DECISION

- What, exactly, do you want out of this transaction?
- Begin with the end in mind.
- Map it out - formulate a comprehensive financial plan.

DEFINE YOUR

- All cash with a full exit?
    - Are you willing to finance all or part of the price?
    - Do you envision a future role in the business after the sale?
    - What is your number?

Knowing your priorities ahead of time and the relative importance of each priority will go a long way towards crafting a deal you can live with.

THE IMPORTANCE OF FINANCIAL PLANNING

- Income Projections
- Cash Flow/Budgeting
- Capital
- Family Security
- Investment Planning
- Standard of Living
- Financial Understanding
- Assets vs. Liabilities
- Savings
- Ongoing/Continuous Process

TELLING THE STORY

- Are you……..a taxi service in the greater Dallas area?
- Or are you…?
- The smartest way to get around. One tap and a car comes directly to you. Your driver knows exactly where to go. And payment is completely cashless. (Uber's value statement)
- A buyer will <u>pay a premium</u> for a company's unique market position.

TIMING THE SALE

- When do I sell?
- How long will it take?
- Can you time the sale in an imperfect world?

A better strategy is to prepare early for an eventual sale so that you are able to take advantage of better conditions, and drive internal factors that will maximize the value of your business.

PRE-TRANSACTION INDIVIDUAL TAX PLANNING

BUSINESS OWNER GOALS

- Evaluate financial situation, personal needs, and goals.

- Consider tax implications of transferring "excess" financial resources.

PRE-TRANSACTION BUSINESS TAX PLANNING

DEAL STRUCTURE

- **Stock** versus **Asset** sale
- LLC (partnership) or Corporation (S or C Corp)
- Purchase Price Allocation
- Net Working Capital Adjustment
- Adjusted EBITDA (and how to arrive at)

WHAT ARE YOU SELLING?

- **Stock** versus **Asset** sale:
  - Seller's want to sell Stock (capital gains).
  - Buyer's want to buy Assets (stepped up tax basis).

- LLC (partnership) or Corporation (S or C Corp):
  - Partnership interest sale is effectively an Asset sale.
  - Hot assets
  - IRC 338(h)(10) election – S Corp

PURCHASE PRICE ALLOCATION

Considerations:

- Capital assets generate capital gains.
- Depreciable assets can generate ordinary income (recapture).
- Goodwill generates capital gain.
- Hot assets (A/R, Inventory, other)
- Employment agreements
- Consulting agreements
- Covenants not to compete

PURCHASE PRICE ALLOCATION

(buyer)

Asset (1) Hot Asset	Price Allocated	Tax Life	Year 1 Tax Deduction	Future Years Tax Deductions
Example 1:				
Inventory (1)	500,000	1 year	500,000	-
Equipment	500,000	5 years	100,000	400,000
Goodwill	500,000	15 years	33,333	466,667
Totals			633,333	866,667
Tax Benefit (40%)			253,333	346,667
Example 2:				
Inventory (1)	800,000	1 year	800,000	-
Equipment	600,000	5 years	120,000	480,000
Goodwill	100,000	15 years	6,667	93,333
Totals			926,667	573,333
Tax Benefit (40%)			370,667	229,333

PURCHASE PRICE ALLOCATION

(seller)

Asset (1) Hot Asset	Price Allocated	Tax Impact	Tax Rate	Future Years Tax Deductions
Example 1:				
Inventory (1)	500,000	Ordinary	40%	200,000
Equipment	500,000	ST/LT & Recapture	30% (estimated)	150,000
Goodwill	500,000	LT Capital Gain	20%	100,000
Totals			Tax	450,000
Example 2:				
Inventory (1)	800,000	Ordinary	40%	320,000
Equipment	600,000	ST/LT & Recapture	30% (estimated)	180,000
Goodwill	100,000	LT Capital Gain	20%	20,000
Totals			Tax	520,000
			Increase in Tax	**70,000**

ADJUSTED EBITDA

- EBITDA – earnings before interest taxes depreciation and amortization.
- Many deal values are multiples of adjusted EBITDA.
- It’s critical to understand what this is and how to arrive at it.
- What is an acceptable adjustment to financial statement EBITDA?
- Every dollar increase in this number could yield 8x or more in transaction price.

ADJUSTED EBITDA

(example)

	12/31/2016	12/31/2015	Average
EBITDA	850,000	725,000	787,500
X 4 (sale multiple)	3,400,000	2,900,000	3,150,000 (a)
Adjustments:			
Owner salary	450,000	450,000	
Owner car costs	30,000	25,000	
Owner travel/entertainment	25,000	30,000	Harder to justify
New COO salary	-250,000	-250,000	
Adjusted EBITDA	**1,105,000**	**980,000**	**1,042,500**
X 4 (sale multiple)	4,420,000	3,920,000	4,170,000 (b)
Sale price increase			**2,040,000 (b – a)**

ADDITIONAL CONSIDERATIONS

- Timing of payments:
  - Lump sum versus installment sale.

- Earn-outs:
  - Terms and conditions of earn-out and effect on installment sale.

- State tax issues:
  - Are there operations in different states?

THE LEGAL PROCESS

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1. Confidentiality or Non-Disclosure Agreement
2. Letter of Intent/Term Sheet or Indication of Interest
3. Negotiations
4. Due Diligence

THE LEGAL PROCESS (cont.)

5. Definitive Agreements
    - Purchase Agreement
        - Indemnification
        - Survival of Representations and Warranties
        - Baskets and Caps
    - Consulting/Employment Agreements
    - Financing and Rollover Agreements

NON-DISCLOSURE AGREEMENT

- Legally enforceable contract that creates a confidential relationship between a seller and a buyer
  - Protects sensitive information.
  - In the case of new product or concept development, it can help the inventor keep patent rights.
  - Expressly outlines what information is private and what's fair game.

LETTER OF INTENT

- Prepare letters of intent once the broad terms of the transaction have been hammered out.
  - Letters of intent usually cover the broad deal terms, as well as due diligence, confidentiality, and "no shop" clauses.
  - Typically non-binding, except provisions relating to clauses and confidentiality.
  - Depending on the transaction, may call for buyer to make an "earnest money" deposit.
  - The process of drafting and agreeing to broad terms is a valuable step to guiding the parties in drafting definitive agreements.
  - Counsel must strike a balance between getting broad terms hammered out, and dealing with the minutiae of terms. Experience is essential.
  - Exclusivity period and break-up clause

DUE DILIGENCE

- Usually for a specified period following the letter of intent. During this period, the buyer has access to your financial and other records to investigate prior to the deal. Most buyers will present the seller with due diligence requests.
- Physical "data rooms" vs. online "virtual data rooms."
- Do your own due diligence on yourself – see your business through the eyes of a buyer to avoid delays and future expense. Never try to hide anything – smart buyers will usually find it.
- Do your own due diligence on the buyer.

BUSINESS PURCHASE AGREEMENT

- The devil is often in the details, and usually purchase agreements are the subject of intense negotiation.
- Buyer's counsel will usually insist on drafting the agreement.
- Major components of a purchase agreement:
  - Provisions on transfer and sale of assets/stock.
  - Seller representations and warranties.
  - Pre-closing covenants of buyer and seller.
  - Conditions to closing.
  - Indemnification and remedies.
  - Disclosure schedules

THE DEAL CLOSING

- In a well-run deal, often the anti-climax.
- Be prepared to deal with last minute issues.
- Face-to-face closings vs. email and fax.

THE DEAL CLOSING (cont.)

- Cash sweep
- Debt payoff
- Working capital
- Funds flow
- Earn-out
- Estate/Financial Planning

ADDITIONAL CONSIDERATIONS

PREPARING EARLY

- Make sure records are formalized and all transactions are clearly documented. Consider documenting company policies and procedures.
- Examine supplier and customer contracts.
- Review real estate leases and make sure they will not expire or require renegotiation within the time frame of your sale.
- Determine whether material contracts can be assumed by a buyer.
- Inspect your corporate "vehicle."
- Review your arrangements with any business partners.
- Conduct an intellectual property audit or financial audit, if necessary.
- Ensure that you are in compliance with all laws and regulations.
- Lock-in key employees and consultants.

BUILDING THE TEAM

- Lawyer - preferably one with significant transactional experience.
- Accountant – with M&A tax experience.
- Investment Banker/Business Broker – provides critical advice on strategic alternatives, positioning the company, identifying potential buyers, and acting as an intermediary.
- Financial Planner – works to quantify potential options and map out life after the sale of your business.

NET WORKING CAPITAL

- What is Net Working Capital? Otherwise known as the PEG.

- Defined as current assets less current liabilities, net working capital is the short term liquidity needed to run your business.

- A buyer will likely require you to leave behind a healthy company that can make next weeks payroll (for instance).

NET WORKING CAPITAL (cont.)

- The Net Working Capital Peg is typically calculated using the average working capital over the preceding 3 to 6 months period prior to the sale date.
- Seasonal businesses would require other special (normalizing) adjustments.
- The PEG amount is expected to be left behind on the date of the sale.

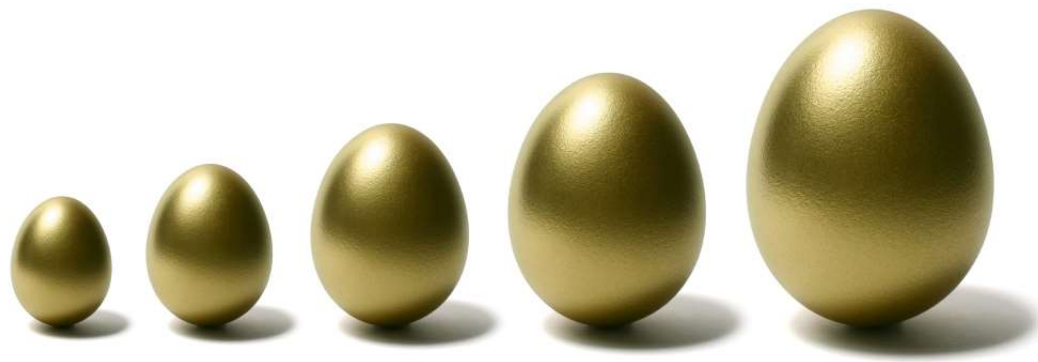
KEY TAKEAWAYS

KEY TAKEAWAYS

- Begin with the end in mind.
- Clearly define your goals and objectives.
- Prepare early to enhance value.
- Build your professional team.
- Understand your transaction options.
- Don’t let emotion drive the negotiations.
- Be prepared for deal fatigue.
- And remember…..

KEY TAKEAWAYS (cont.)

The more prepared you are, the more value you create and the more value you actually transfer to the buyer……..and to YOURSELF!



If you have any questions, please feel free to contact us at:

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Thank you