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Beyond Purchase Price: Other Important Considerations in Selling Your Business

by Terry Bressler

Overview

When discussing the sale of a business, one of the most frequently asked questions is “What was the company valuation?” or “What was paid for the business?”. The price for which the Company was sold is usually the most important detail that most individuals want to know. Even in cases where the seller says, “It isn’t just about the money,” it often is. Maximizing the amount of cash received by the seller at closing is usually the primary goal in selling a business and is often the preferred way to “boast” about the success of a company sale. However, there are other important factors that, unlike the price, cannot be easily expressed in a single dollar value. Often, these other factors can have a significant impact on the true value achieved in a Company sale. Business owners should have a thorough understanding of these non-price considerations before they start an M&A process because these factors may have an important impact on the overall success of the Company sale.

Planning: The Goals & Objectives

Most successful company sales begin with a thorough understanding of the seller's goals and objectives and a well-thought-out action plan. The seller's goals and objectives help to determine not only the type of sale transaction for the given circumstances, but also help define the other non-cash considerations and structure a sale process to satisfy the seller's objectives. It is better to review and analyze all the relevant variables before "taking the Company to market" so that necessary adjustments can be made to the M&A process without the added stress of "being in the market." Last-minute company sale process adjustments are generally difficult to make and usually have a negative effect on the outcome. Upfront planning is key.

Frequently, non-price factors will have a significant influence as to the type of transaction considered. Often, a careful discussion of the seller's goals and objectives and an understanding of the non-price considerations can take a Company sale in a completely different direction than originally contemplated, perhaps into another form of shareholder transition. As an example, a dividend recapitalization might make more sense to a seller than a sale to a strategic buyer if the seller only needs partial liquidity. If one of the objectives is to maintain the legacy of the business along with taking care of the employees, perhaps the sale to an Employee Stock Ownership Plan ("ESOP") is a more desirable alternative to a seller rather than maximizing price.

While maximizing the cash proceeds at closing is often the primary goal, there are other non-price factors that should be addressed in the business transition plan and Company sale process. These factors can be segmented into two broad areas: intangible deal considerations and tangible deal considerations. The intangible deal considerations are generally more "global" in nature and are derived from the desired outcome of the transaction. Successfully accommodating the intangible transaction factors can have a tremendous impact on how the seller feels about the transaction outcome. The intangible deal factors help specify the type of transaction segment to consider (e.g. ESOP versus Company sale) and what type of buyers to approach (e.g. strategic buyer versus financial buyer). The tangible deal considerations, on the other hand, include elements that might also have an effect on the type of buyers approached, but these factors could also have a negative impact on the cash received at closing. Typically, the tangible deal considerations can be addressed through the purchase agreement provisions to satisfy the seller's goals and objectives. It is important for the seller to have a general awareness of these potential tangible deal factors and the trade-offs they may present.

This white paper is not intended to present specific solutions or strategies to address the intangible and tangible deal factors. Instead, the intent is to highlight some of the major non-purchase price factors that should be considered when contemplating a company sale. The seller's advisory team should work with the business owner to review the specific options and approaches that can address these issues and design and execute a plan to meet the goals and objectives. As with any major decision, careful upfront analysis and the counsel of a good team of advisors can mean the difference between transaction success and failure.

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Intangible Deal Considerations

The intangible factors or considerations have perhaps the most significant effect on the psychic rewards of the Company sale and can determine the overall direction and type of transaction. As stated earlier, the first step in a company sale process is an honest assessment of the shareholder goals and objectives, including a review and understanding of the ramifications of the intangible deal factors. These intangible deal factors may include:

Legacy: Perhaps one of the greatest considerations in the sale or transition of a privately-owned business is the concept of business legacy. What will be remembered of the business and its owners? Will the company name be continued? Will the company facilities continue to be used? Will the employees remain? All of these are legacy issues. Legacy and maximum value are not always in conflict. However, maintaining the business legacy might result in a trade-off where a business owner accepts a lower price for the business to satisfy their legacy goals and objectives. There are many alternatives available to a seller to meet their desire to maintain the legacy of the business. As long as the advisory team knows the seller's legacy goals upfront, a plan can be developed to accommodate these objectives.

Corporate Culture: Similar to legacy, maintaining and continuing a corporate culture is often important to a seller. Many buyers are also interested in continuing a corporate culture, but some may want the business to be folded into their culture. If the maintenance of corporate culture is an important goal, the advisory team can approach buyers that place a high value on maintaining the existing corporate culture.

Reward or Protect the Management Team: Rewarding the management team with an opportunity to own the business is another popular exit alternative. Again, there is usually a trade-off between immediate cash value and selling to management. This objective can be achieved by looking at a leveraged buyout or a sale to private equity firm. Other ways of protecting the management team might include seller-funded special bonus or management retention payments. There are many deal-structuring tactics that can help achieve this goal.

Reward or Protect the Employees: Like providing management with the opportunity to own the business, some sellers want to reward all the employees for their contribution to the past business success. If this objective is known in advance, an ESOP transaction or some other employee reward structure can be employed to achieve this objective.

Tangible Deal Considerations

The tangible deal considerations should also be addressed in the Company sale planning. The business owner should understand each deal factor, the trade-offs and how these factors might ultimately affect the company sale outcome. Typical tangible deal considerations include:

Earn-Outs or Contingent Payments: Differences of opinion relating to the future performance and its effect on the valuation of the business are often resolved through earn-out provisions or other contingent payments. While these future payments will be made in cash, there is risk that they ultimately will not materialize. Because the seller is usually not involved in the future operations of the business the contingent future payments will be subject to the buyer's ability to execute the acquisition and continue to run the business successfully. When planning a M&A process, determine how these contingent payment provisions will be considered in evaluating the buyer options.

Seller Paper: Situations where the financing to acquire a company is difficult to find often use seller notes to fill the funding gap. These notes are obligations of the new owner and the Company and are also subject to the future performance of the business under the new ownership. As a result, like contingent payments, these notes have some risk as to future payment, and the seller should evaluate how these affect their decision on the buyer. On the other hand, in the current low interest rate environment, reinvestment of the company sale proceeds into investments with attractive returns is problematic. The use of seller notes might be an attractive option for the seller as they can earn a current return from an investment in the recently-sold company, the risk profile of which they already know.

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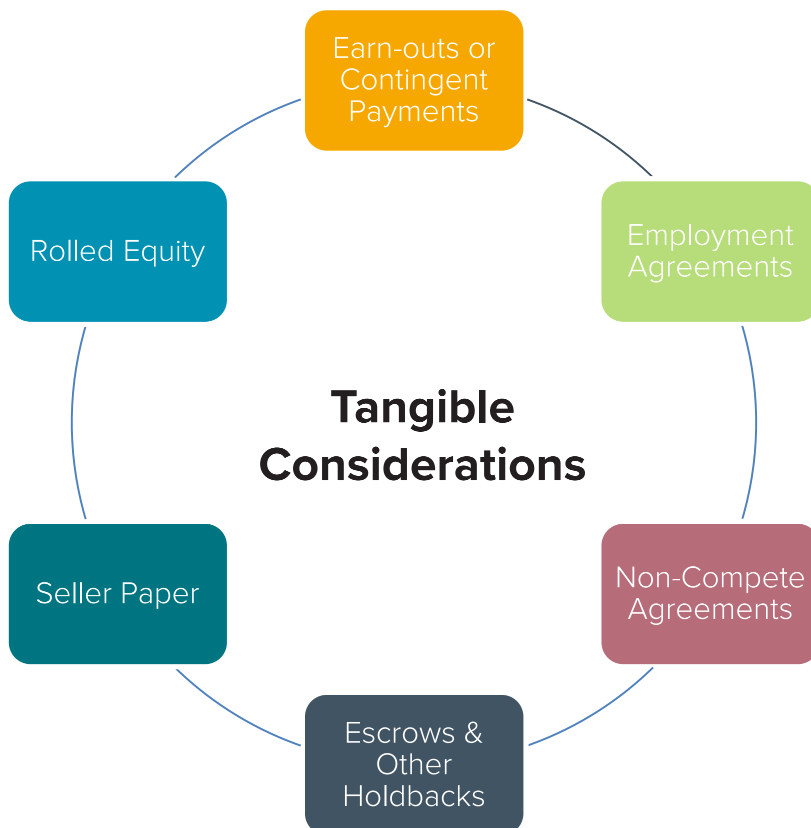

Rolled Equity: The prospect of the "second bite of the apple" is appealing and offered frequently by a financial buyer to a seller as a way to allow the seller to participate in the "new future" of the company. The rolled equity also has benefits for the buyer in that it reduces the amount of capital required to close a transaction and also keeps the seller's interests aligned with those of the buyer. The structure of rolled equity can have significant seller tax consequences. Further, depending on the structure of the rolled equity, there can be significant effects on the risk-return trade-offs for this rolled equity to the seller and ultimately if the seller will actually realize the returns. An understanding of these structuring implications and careful documentation can assure congruence with the transaction goals and objectives.

Escrows & Other Holdbacks: In a normal sale transaction, a portion of the purchase price will be placed in escrow to cover post-closing claims that may arise. Generally, the escrow is established to cover the representations and warranties made by the seller, including environmental, taxes and other liabilities and the working capital adjustment. The implied risk of certain elements of the sale transaction will have a bearing on the size and the provisions of the escrow. These holdbacks can be structured in ways to have the money released relatively quickly or sometimes eliminated by using deal insurance products. Again, a general awareness of the need for and structure of the escrow will be necessary to evaluate the buyers' offers.

Non-Compete Agreements: Most buyers will require the seller to agree to not compete with the business for a period of time after closing. On the surface, this is a reasonable request, but it could have future ramifications for the seller, particularly younger sellers with a long future career. An understanding of the future goals and objectives of the transitioning shareholder can affect the structure and nature of these non-compete agreements.

Employment Agreements: Also common in company sale transactions are transition employment agreements that obligate the seller, especially if the seller is heavily involved in the business, to assist the buyer in transitioning the business to their new management team. Typically, these agreements are from 12 to 36 months and require effort and time of the seller. Again, knowing the seller's flexibility and future plans will help address the provisions of the transition employment agreements.

Make Sure to Look Beyond the Purchase Price

There is more to a Company sale than just the purchase price. It is essential to carefully consider the seller's goals and objectives and develop a plan for the M&A sale process to satisfy the seller. It is also important for the seller to be aware of the non-price intangible and tangible deal factors as well as the trade-offs and options available to successfully address these issues. This advanced preparation will enable the seller's advisory team to build and refine a company sale process that can meet the transaction goals and objectives.

About Prairie Capital Advisors

Prairie Capital Advisors offers investment banking, ESOP advisory, valuation advisory and financial reporting valuations to support the growth and ownership transition strategies of middle-market companies. Headquartered in Oakbrook Terrace, Illinois, the company is a leading advisor to closely-held companies nationwide. For more information, call 630.413.5574 or visit www.prairiecap.com.

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