British Business Brokers

Guide to

Successfully Selling a Business

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Contents

Chapter 1

Introduction – The Importance of the Business Sale

Selling a business is likely to be the most important transaction in a business owner's life. Most famous entrepreneurs have made their breakthrough by building up and selling a business.

A business might easily sell for the equivalent of many years profit. For the owner that is like getting a bonus equivalent to many years salary.

So if you have got a business to sell, getting it right can make a massive difference to your life. And the whole purpose of this book is to help you get it right.

Consider Jess, 35 years old, the owner of a chain of six dance clubs, she is already making £100,000 a year before tax. But she is a 40% taxpayer, and has been investing heavily in the business; she has never had much more than £20,000 per year to live on. Going forward she has the option to build up to 12 dance clubs over the next 5 years and expects to be making £200,000 per year by the end of that period. However even with high levels of borrowing her take home will rise only slowly to £40,000 by the end of the 5 years. Her advisers have suggested an alternative strategy. They have found her a national leisure business prepared to pay £400,000 for 80% of the equity. They will invest in the new clubs and retain Jess as divisional managing director. [Note, £400,000 less 10% Capital Gains Tax net of Entrepreneurs Relief is £360,000 net. This is equivalent to 18 years net income].

Or consider Bill who is 64 and runs a small Wholefood Shop. Bill's shop has made a steady £40,000 profit for many years and Bill has about £30,000 to live on. Bill is thinking of retiring and closing the Shop next year. He goes to see his accountant to discuss the best way of doing this. His accountants find him a sales agent, who finds several interested parties and eventually achieves a sale at £65,000, net of £10,000 agent's fees. After entrepreneur's relief Bill has £60,000 net of tax to spend. [2 years extra pay, and no problems with redundancies, long leases, stock write-down etc….]

Never underestimate the importance of taxation. At the time I am writing, if the owner of a business is earning £40,000 per year he is paying tax at 20% (self-employed) or 21% (incorporated, and receiving dividends) but he is likely to pay only 10% Capital Gains Tax on any proceeds after Entrepreneurs Relief. An individual earning over £150,000 per year is paying tax at 45% but will still be entitled to Entrepreneurs Relief on up to £5,000,000 of proceeds, and thus pay tax at only 10% on sale of the business.

The other important thing about this book is that this book is *mainly* for the owners of small businesses.

Chapter 2

Preparing the Business for Sale

2.1 Timing

How many times have I had guys in their 70's decide it is about time to think about selling their business?

This is too Late….. Much too late…..

Virtually every business decision you ever take should be evaluated against the simple question "What outcome will do most to enhance the value of this business?"

Business ownership changes more often than you would think. Partners leave and new partners join; shareholdings in family companies are inherited as well as bought and sold.

If you want to maximise the value for the existing partners or shareholders, you should constantly be tweaking the business to maximise value.

Even if you are a sole trader or sole shareholder, you never know when health, death or other circumstance will make the value that you have built into your business critical to the financial comfort and security of yourself or your dependants…

2.2 Business Valuation

Chapter 5 is devoted to the topic of business valuation (there are many substantial books devoted to this topic too). But the point that we need to make here is that once we know what factors boost the value of a business, then we can work to maximise those factors.

- In theory, all business valuation is based on expectation of future profits. But the most important factor influencing expectations of future profit are the **profits of the current period** and recent past. It is not just Accountants that like consistent profitability, Sales Agents, Bankers (providing funding to buyers), and more experienced business people will also be looking for this first and foremost.
- To generate that consistent profitability the most sophisticated buyers will be looking for **business systems** (an organised, documented, way of working; that produces consistent quality and profitability). Some valuation techniques put quite a bit of emphasis on business systems.
- Whilst buyers are attracted by a consistent history of solid profitability, they are hugely deterred by anything perceived as **risk**. So to maximise the business value proprietors should sort out; complexity, uncertainty, conflict, and unpredictability generally.
- Last but not least buyers are very attracted to **assets**. Now these might be traditional assets, particularly land and buildings, but in many industries it is intangible assets such as customer lists that are particularly valued.

Now that we have considered where value (and disvalue) lie, we can concentrate on the real issues of what to do to maximise that value.

2.3 Maximise Profit

As your business value is going to be some multiple of your business profitability it follows that if you increase your adjusted profit by 20% you will increase your business value by 20%.

Let us imagine Jo's engineering products business. The business agent is pretty confident he can find a buyer at 5 times adjusted profit. Jo has booked turnover of about £100,000 and (adjusted) profits of about £25,000 for the last three years. He is keen to sell the business sometime in the next couple of years. After consulting with Hornbeam Accountancy Services Ltd, Jo agrees that he is so busy that he can raise his profit to £30,000 per year (or more), simply by raising his sales prices by 5%. He delays selling his business and shows £30,000 profit for each of the next two years. This raises his expected proceeds from the sale of the business from £125,000 to £150,000. A whacking £25,000 increase (equivalent to one year's income) taxed at only 10% in the UK at the time of writing).

Obviously if Jo can raise his prices by 10% without losing output, he could increase the business value to £175,000.

Whilst we are convinced that clients should be straining every sinew to maximise the profit from their hard work throughout the life of the business, the closer the owner gets to a business sale the more important it is to maximise day to day profit. In the run up to a planned sale of the business:

- Loss making products and activities should be ceased ruthlessly (or prices raised if possible, but fear of losing the customer or sales should not come into the equation).
- Prices should be pushed up tentatively to the limit of market resistance.
- Wherever possible higher priced, higher margin options should be introduced (in parallel with conventionally priced offerings).

The first chapter of the booklet "***The Hornbeam Guide to Successfully Managing Your Small Business"*** is devoted to the topic of ***"Selling for More"***.

We are not suggesting that you exploit current customers to the point of losing future income, but far too many clients fail to recognise the market signals when they are undercharging (The order book is bulging, there is not enough time to do the job properly). But when you are about to sell the business the equation changes subtly, every extra £1 of profit now may well bring in a further £5 through the business sale!

Profitability can also be maximised by driving down costs.

If handled intelligently, systematic downward pressure on supplier prices, by obtaining quotations and moving suppliers if necessary, can cut the cost base to an astonishing degree.

Even more effective is systematic review of demand for cost items – the first question to ask is "can the business manage without this cost entirely?" Our experience is that most businesses are carrying substantial "optional" costs, that have seemed like a good idea at some time in the past.

Subscriptions, Advertising and Marketing costs are good places to look for easy wins in ending "optional" costs. Advertising in particular needs to be carefully appraised in fattening a business for sale. If the business is already running flat out with demand from existing customers and referrals, what is the purpose of the advertising spend exactly?

Some businesses get a good return from advertising,

- they grow the business, adding to the capital value,
- or they obtain premium prices by making the product highly desirable,
- or they may depend on advertising for a steady stream of one-off customers.

But many businesses get very little return from substantial advertising budgets.

At any time you should review your spend honestly, perhaps with a trusted adviser who is not trying to persuade you to buy advertising! In the run up to a known sale only advertising needed to maintain the business should be incurred.

The most difficult thing to do is to drive down costs by increasing accuracy, and quality, and thus reducing waste. But the mindset of driving out error and waste is the cornerstone of a successful business.

Are there any projects which are for the long term benefit but which will harm short term profitability such as; product development costs, own labour used in capital projects, major maintenance projects? If so can these be delayed until after the business sale?

In summary, to maximise the value of your business you must maximise profitability. There are two types of action to take (1) those actions you should be taking at any stage of the business cycle (2) those actions to take in anticipation of the business sale. Make your own action plan. I have summarised a few key matters to consider below.

Key matters to consider to maximise profits	
At any stage in the business cycle	**In the two years prior to sale**
Prices should be increased to the limit of market resistance. Loss making products or services should be dropped.	Even “Loss Leaders” should be dropped
Input prices should be driven down by obtaining quotes, switching suppliers.	
The need for particular costs should be challenged and wherever possible cut altogether.	Costs taken on to expand the business, particularly those related to marketing, but also product development, capital projects, maintenance, rebranding etc etc can be cut entirely or deferred until after the sale
Improved production techniques and quality control can reduce all kinds of costs by reducing wastage and reworking, management effort should be focused on driving our error and wastage.	

2.4 Improve Business Systems

Best Practice and Exceptional Business Systems through each stage of the business cycle should be your aim.

Here are some quick wins for making your business more saleable:

- Formalise sales contracts if trading relationships are currently informal.
- Ensure there is a strong management structure, and document it. It is hard to overstate how important this is. The business will be most valuable if it can continue to churn out profits after you have sold it and retired. It will be ideal if you can demonstrate that it is already doing this. Do something else; give management a chance to prove itself.
- Make sure all employment contracts are up to date.
- Make sure software contracts are up to date.
- Make sure that compliance with legislation and best practice (health and safety, employment, environmental, consumer credit, money laundering, data protection, public liability) is taken seriously and that compliance is properly documented.
- Make sure that assessment of business risk is taken seriously and properly documented and that appropriate insurance cover exists.

When you come to sell your business the lawyers for the buyer will ask you for all these things.

However business systems are much more than this, you should record how you:

- Identify desirable customers
- Obtain leads
- Reject undesirable customers
- Prepare quotations
- Chase and secure sales.
- Document sales contract terms
- Programme service delivery.
- Order from suppliers
- Record time or other costs
- Control quality and efficiency of production operations
- Control stock levels
- Monitor supplier compliance and control payment.
- Trigger and prepare sales invoices
- Chase and collect debts
- Maintain accounting records

Of course not all businesses will need systems for all these parts of the business cycle. For example retailers have little need to obtain leads, reject undesirable customers, prepare quotations, document sales contract terms, or chase and collect debts, but systems to chase and secure sales, control stock levels, order from suppliers, and monitor supplier compliance and control payment are likely to be crucial.

If you have these systems in place and documented, and you monitor and record internal compliance, then your business will be more easily saleable, and more valuable.

2.5 Keep it Simple

Buyers do not want to buy problems, complexity, or risk. So you should aim to keep things as simple as possible for them. This may involve some unpalatable actions but we suggest that if necessary:

- Review your accounting policies with your accountant, if your policies deviate from the industry norm then the buyer will be reluctant to trust your accounts. Income recognition and depreciation policies are the first to review.
- Get the family hobbies out of the business (motor racing sponsorship, horse riding costs, boats, caravans, shooting equipment, sponsorship of sports clubs should not be hidden up as business expenses) they may save tax if undiscovered – but they will certainly make selling the business harder.
- There are other family costs, fuel, phones, laptops, gardeners, handy man, groceries, which you may be tempted to try to put through the business, just like the hobby costs they will make the apparent profit lower and the business harder to sell. Anyway the buyer will not want to take on the risk of paying taxes on your private expenditure.
- Not only should personal cars, caravans and boats come out of the business, but in a few cases properties used by the proprietors are bound up in the business too. These must be unwound as soon as practical, although tax implications should be considered.
- Only borrowings appropriate to the business should be left in the business. The charges on personal credit cards (put through the business because the cards were used for business expenditure) can be penal, and can significantly suppress profitability.
- Buyers will not be impressed by a history of none or late payment of taxes. Make sure that VAT, PAYE, Corporation tax, are all filed on time and paid on time.
- If the business is a company make sure all statutory filings are up to date.
- Settle any disputes as quickly, amicably, and informally as you can – buyers will not like disputes, past or ongoing.

2.6 That Certain Something

Some businesses seem to be able to create a demand for their products that far exceeds that of their rivals.

Consider that café with a queue out of the doors whilst nearby rivals are more than half empty.

Consider the way a £40,000 car has a 6 month waiting list whilst a similar vehicle is available for £20,000 straight out of the showroom.

Consider the way a clean attractive house that smells of newly cooked bread sells in a week, whilst a larger run down property for less money remains blighted for years.

Well, the same sort of thing applies to a business sale. We see big businesses buying into technology companies at extraordinary prices. We see niche businesses being bought by enthusiasts at prices that no economic model can justify. We see well funded consolidators buying up small businesses in insurance, healthcare, and professional services for prices three or four times that bid by the management team.

Now a lot of this is about luck, about being in the right industry at the right time. But there is much that can be done:

- Read Chapter 6 about finding a buyer.
- Consider what your likely buyers will be looking for, what will excite them.
- Set about creating that ideal business to sell.

Whatever industry you are in there are certain things that will make the business attractive above and beyond its financial results:

- Possession of cutting edge technology
- Quality customers
- A happy highly skilled and highly motivated workforce (and especially second tier management)
- Attractive well located premises
- Brands or reputation
- New or niche products and services
- Superb business systems

2.7 Assets

Buyers like assets and the more you have to sell the more you are likely to get for your business.

Many, many people have done extremely well following the logic that:

> *"If I can buy a building for the same monthly outgoing that I would pay to rent the building, then I can't go wrong… In a few years rents will have gone up, the price of the building will have gone up, and the outstanding mortgage will have come down"*

That is okay as long as building values and rents are rising not falling and (most critically) interest rates do not go up. I am not against buying property, I just caution clients to properly evaluate the risks.

Plant and machinery is another problematic area. Often substantial assets of say an engineering or wholesaling business are fully depreciated over 4 or 5 years but are in use for twenty or more years. It may be difficult to get a realistic price from the buyer, who will focus on the accounts price, and point out (quite rightly) that the assets would not be valuable in an auction. The only thing that you can do about this is to adopt a more realist depreciation policy as soon as possible, and to focus on the replacement cost value.

Jon has a warehousing business, the racking and materials handling equipment was bought ten years ago for £100,000 and was fully depreciated over 5 years. The equipment would probably get no more than £5,000 at auction, but would cost £150,000 to replace. Jon is convinced that the equipment whilst not "as good as new" will continue to be fully functional for at least another ten years.

It will not make any difference to tax so, as Jon is planning to sell his business in three years we advice him to revalue the equipment (to half it's original cost) and depreciate the revalued equipment over its expected useful life. At least the starting point will be £35,000 when Jon comes to sell not £0.

Rather interestingly small cafés and restaurants often sell for around £50,000 even though they provide a modest living and require long hours from the proprietor. The real explanation may be complex but this price is probably underpinned by the fact that it costs about this much to kit out a similar enterprise from scratch.

Inevitably, I like best those assets that are created by the business from scratch. These are particularly:

- Lists of customers where there is repeat business (accountancy, copier maintenance)
- Physical assets such as moulds or dies, paintshops
- Intellectual property, such as copyright for books, training manuals, software.
- Brands (although not often held by small businesses)

There is a lot you can do to maximise the value of these type of assets:

- For example many customer lists maintained by many kinds of retailer will tend to have value and will enhance the value of the business. So if you are a retailer in a niche market ask you customers if they would like to go on your mailing list for future promotions (record name and address, email, date added to list/last responded). This will be a useful marketing tool for you and will be valued highly by many buyers.
- It is all very well having intellectual property such as a patent, or a software licence, but it will really start to gain value once potential buyers can see customers starting to pay royalties or licence fees.

2.8 Cultivating Potential Buyers

(See also chapter 6)

Having maximised the value of the business, the next most important thing to do is to cultivate potential buyers. You won't be able to do very much about the general pool of buyers, but you will be able to influence the internal options.

Most businesses are sold to people known to the proprietor. So it makes sense to cultivate an internal option. This will involve employing, training and giving a wide range of experience and responsibilities to those individuals who are likely to want to buy into the business. In many cases these managers will be family members, but the same principles for cultivating an internal option apply to family members as apply to other employees.

Many businesses will receive letters through the post from potential buyers. These should be treasured and kept safe. When the time comes to sell, the file of interested parties provides at least one list of people to write to who may well still be interested in buying the business.

Chapter 3

When to Sell

If you think about it, your planned retirement age is unlikely to be the best time to sell your business. For example during the 1990's valuations of internet and technology businesses reached dizzying heights. In early 2000 the value of most technology companies fell 90% and more, some were destroyed. Many of those technology entrepreneurs who sold out in the late 1990s received payments that they could never have obtained in any period before or since, and quite small businesses were sold for sums that set up their owners for life.

I use this story quite a lot to explain why business valuation is an art form rather than a science. But the story has a second moral. There are many factors, some outside the control of the business owner, that can influence when is a good time to sell a business.

Here are some factors worthy of consideration:

- Most businesses are quite difficult to sell, so an approach from a potential buyer should always be treated seriously and courteously. I would suggest that if you receive such an approach you could discuss the business valuation with a sales agent or two, and then see what the potential buyer is offering.
- If you have senior managers or family members who want to buy into the business, you should consider their personal timetables as well as your own. It is always possible to lose a key man who has been locked out for too long. Worse still, that key man may set up in competition, to the detriment of your business.
- The business may benefit, growing faster and enjoying greater profitability, if key employees are brought into the business as partners.
- You may consider diluted ownership to be an unmitigated evil, and determine to control 100% of the business until the day you leave.
- Taxation may be a consideration. You may wish to take advantage of the annual exemption. You may consider that Capital Gains Tax rates for small scale business sales are very low and never likely to be lower. You may be intending to emigrate and wish to leave the sale until after you are ready to leave the country.
- You may think that the business is about to grow rapidly, and increase in value accordingly, thus deterring you from an early sale, or
- You may think that the future is going to be very difficult for your business, so you might as well sell it whilst it is doing well.
- You may want to do something else with your life, or
- You may have nothing else to do and no other source of income.
- It may be very difficult to obtain the same return on capital if you sell the business.

Overall then, my advice is that to sell a business for a good price is rarely easy, so consider your options rationally and keep a look out for opportunities.

Chapter 4

What to Sell

4.1 Asset Classes

You will need to consider what to sell whether you are a sole trader or a partner or a shareholder.

In selling a business you have to consider what exactly you are selling. So first let us consider the various asset classes. These can be conveniently grouped as:

- Property
- Equipment
- Goodwill
- Stock
- Debtors
- Money

The business will also have liabilities, typically:

- Trade Creditors
- Financial Liabilities such as Loans, Overdrafts, Hire Purchase Contracts, and Finance Leases

4.2 Property

Property often plays an incredibly important part in a business sale. On the one hand the buyer may be particularly interested in the property:

- Because it is a readily saleable asset which helps to underpin his confidence in the business and
- Because it can be remortgaged to help him finance the purchase.

But on the other extreme, the property may be withheld from a sale:

- To provide a rental income as a safe retirement income for the owner
- So that the business can be sold for a price more readily achieved by, for example, a young manager or family member.

When you are selling your business you must get the freehold valued, by a qualified independent valuer, and make sure you get a valuation of the market rent. This is important information in structuring the best deal for yourself. Taxation is also important, tax reliefs may be lost if a building is stripped out of the business, and tax charges may be triggered. Take advice.

4.3 Equipment

Equipment will almost always be sold with the business, it will almost always be needed for the business to continue.

In my experience not enough attention is paid to equipment. Because it has been heavily depreciated, because asset maintenance and even some asset creation (such as use of own labour) have never even been recognised as assets, the value in the books is often very low. And indeed if those assets came up for auction they would be unlikely to achieve anything but low value.

However, if a new entrant to the business were to try to create those assets from scratch the cost would be very considerable indeed.

It is easy to think of situations where this applies:

- To kit out an office for 20 people, buying new desks, chairs, phones, computers, staplers, punches, etc might easily cost £50,000, but all that equipment, all up and running and operating, is probably in the books of an existing business for a tenth of this amount, or less.
- A manufacturing business probably has moulds, benches, spray booths, that would cost tens of thousands of pounds to buy or create, that are not even in the books.
- A café will have kitchen equipment, tables, chairs, décor, cutlery and crockery that would cost tens of thousands of pounds to buy. It rarely has any value in the books.

It is one of the reasons that buyers will pay for an existing business, is because starting from scratch is probably more expensive. As the seller you should miss no excuse to remind the buyer and the sales agent how much it would cost to replace your equipment (but don't expect the buyer to pay this amount, you aren't selling him new equipment).

4.4 Goodwill

It is the "goodwill" that makes a business sale.

Goodwill is notoriously difficult to explain.

Although defined by the financial community as the excess of the business value over the fair value of the individual assets, this definition fails to explain why purchasers are willing to pay more for a business than the value of the underlying assets.

I will approach this from a variety of angles. Firstly, most business people when they acquire a business, look upon the purchase as an investment. Like any investment the business is valued on the basis of the income and capital growth it can generate in the future. Thus a business with £50,000 of net assets that can generate £25,000 of pure profits each year (growing with inflation) is more likely to be valued at £250,000 (ten times earnings) than at £50,000 (net asset value).

What factors allow businesses to earn the consistently high profits that underpin goodwill?

- Loyal Customers
- Reputation
- People
- Intellectual Property
- Systems

Loyal customers and the repeat business that they bring are so central to many business sales that it can be that the "customer list" is sold and all other factors are peripheral. If you are selling a copier maintenance business or an accountancy business it is likely that potential buyers will mainly be interested in your customer list.

Make the best of your customer list, play up:
- Long standing customers
- A wide spread of customers
- Good quality of customers

You are going to be asked for this by the buyer so you might as well prepare this information. Usually you will disguise names and contact details until the sale is settled.

You should offer to help the buyers to secure the goodwill by introducing them to key customers, and by remaining available to existing customers for a period of time.

Reputation, or "brand name" as it is also known, can be very valuable. Although typically associated with large businesses such as Sony or Toyota, small businesses can also have valuable brands, in the form of an established local reputation for expertise, customer service, quality, reliability. A niche retailer may have a reputation for always having what you want in stock. A maintenance firm may have a reputation for always turning out. An engineer may have the reputation of always being able to fix a broken widget. A restaurant may always serve superb meals. Any firm may have a reputation for being courteous and helpful. If you have this reputation, make sure you have plenty of commendations to show to potential buyers.

People are the main asset of any firm. It is the team who know and operate the systems that generate consistent profits. Make sure your HR systems are up to date; all employees have signed contracts, records are kept of regular staff appraisals, etc. In the financial sector (as in many others) it is the expertise of the team that enables the business to make profits.
If possible:
- Make sure the team are tied in (by deferred bonuses, share holdings, or whatever).
- Make sure the team buy in to the sale (put part of the proceeds aside for the team, defer payment).

Intellectual Property can take many forms: for example, patents, copyrights, niche technologies, expertise, systems manuals. All of these should be recorded properly and protected. Physical protection, incentives and legal protection should all play a part:
- Copyrights and patents are legal forms, but they could not be more different, patents are registered, complex and expensive. Copyright simply has to be asserted, but can be difficult to enforce.
- Technologies (recipes, design drawings), expertise and operating systems must be carefully recorded, and copies kept safely off site. But they must also be secured, in particular contracts of employment must prevent leavers from exploiting company intellectual property to the fullest extent of the law. But don't overdo it, employees can always sell their personal expertise, the law will not countenance a restriction. But employees can be tied in by
    - Certain legal restrictions
    - Deferred bonuses
    - Repayable training bursaries
    - Shareholdings and options (that lapse if they leave).

Systems must always be created that enable a business to repeat error free, profitable ways of working. These systems must be documented, but most of all they must be reinforced by training, and by the culture of the business.

These systems will earn the business the reputation for reliability, punctuality, courtesy, that underpin the value of the goodwill. These systems give the business the ability to earn profits consistently from year to year. These systems ensure that the strength of the business will continue after the owner sells it and leaves.

4.5 Stock

For the owners of many small businesses it is realising a decent value for the stock that a business sale is all about. Many wholesalers and retailers (of niche products, engineering or manufactured goods) will have stocks equivalent to one or more years sales. Often these stocks will have taken considerable effort to compile. The problem can be that they may be worth three times as much as they cost if sold through the business, but might only fetch a quarter of the value if sold at auction. So a machinery maintenance business might have £40,000 of parts, that would sell for £120,000 to customers (over time), but would fetch only £10,000 if sold in auction.

This business might have only £80,000 of turnover and £30,000 of profits.
The parts perhaps underpin the business. The success or not of the business sale depends overwhelmingly on finding some way of obtaining a full value for the transfer of the stocks. The vendor needs, at the very least to get back the money he has spent.

It would not be a particularly unusual deal for the vendor to sell the business for a small sum, with the buyer obliged to buy the stock, as he draws it down, and perhaps required to buy at least £1,000 per month for 40 months.

4.6 Debtors and liabilities

It is not usual for a sole trader to sell the debtors and liabilities. The buyer is taking on a lot of commercial risk anyway, he really doesn't want the risk of your:

- Potential bad debts
- Unrecorded liabilities
- Disputes with the HMRC or other authorities.

Remember that the buyer doesn't know anything like as much about the business as you do, and the unknown always breeds fears, so it will probably make the sale easier if you can take the debtors and liabilities out of the equation, and handle them yourself.

Buyers will generally seek to buy the equipment and goodwill, and perhaps the stock and/or freehold, but leave you with the debtors and the liabilities.

Sometimes buyers will seek to buy just “the trade” even out of a limited company.

In any case I have rarely seen a buyer pay more than £1 per £ for current assets, so unless there is a very good tax reason (see below) then what you have to weigh up are:

- Keeping the buyer happy
- Avoiding cost and hassle of due diligence and negotiation over the debtors and liabilities

Against:

- The hassle of collecting the debtors and paying off the liabilities yourself

4.7 Money

It just doesn’t happen for a sole trader to sell money, there is simply no point.

However, money may well come to be valued, almost always at £ for £ in selling of a partnership share or, for example when the shareholding of a limited company is sold.

If you are the owner of a limited company you may well have to pay 25% higher rate tax if you strip cash out of a business. If on the other hand the value of that cash is added to the sale value of the shares, you are likely to pay only 10% capital gains tax after entrepreneur’s relief (per the rules in the UK in 2010).

4.7 Limited Companies

If the business you own is constituted as a Limited company it will almost always be easiest and tax efficient for you to sell the shares.

Jo has a business for sale. One buyer has offered £500,000 for the shares; another buyer has offered £520,000 for the business (£320,000 for net assets at book value and £200,000 for the goodwill).

If Jo sells the shares he will pay £50,000 Capital Gains Tax (assuming annual allowance already used), leaving him with £450,000 to spend.

If the company sells the business then it will have at least £40,000 of corporation tax to pay on the sale of the goodwill. When Jo takes the remaining £480,000 out of the business he will have at least £110,000 of higher rate tax to pay, if he pays dividends in one go. This leaves Jo with just £370,000 of the £520,000 to spend.

It may be possible for Jo to extract the capital payment from the business under Extra Statutory Concession C16, in which case he will pay the 10% rate of Capital Gains Tax as he winds up the old business. This will be £48,000 of £480,000, leaving Jo with £432,000 of the £520,000 to spend.

There are two alternative routes which are used in well advised deals:

In the first route Jo sells the shares to a brand new holding company owned by the buyer. The buyer transfers the trade and net assets of the business up to the holding company (this transaction should be free of tax) pretty much straight away, and either closes down or holds dormant the original company. Jo gets his £450,000 and the buyer gets the business pretty much free of any historical baggage.

By the second route Jo applies for clearance under ESC C16 and sells the business to himself. He has to pay 10% Capital Gains Tax on the value of the business (the value is not in dispute as he makes an arms length disposal a few days later). There will be no further gain as Jo has established a base cost equivalent to the sales tax. This is a bit more difficult to organise but could conceivably result in Jo having £468,000 (£520,000 less 10%) to spend if the higher price can be secured!

Chapter 5

Valuing Your Business

5.1 Why Business Valuations Fluctuate Wildly

As I have mentioned above business valuations are subject to wild fluctuations, even when the world's most sophisticated stock markets are the valuers. The evidence for this is the collapse of the dot com shares in 2000. But wide fluctuations are pretty much the norm for most stock markets.

There is at least one good theoretical explanation for this.

This is that, as current value is always a function (the discounted value) of expected future earnings, then quite small changes in expectations cause massive fluctuations in value. This is easy to replicate on a spreadsheet…

Imagine a business paying £10,000 of profits for its absentee owner. If interest rates are low and discounting of future profits is quite low, say 5% per year so that from year 20 onwards we ignore the profits however high. And if profit growth is quite high at 20% per year, the value of this business will be astronomical, at £416,000 or 41 times current earnings (ie a dotcom or bubble value)

But if expectations change and the market (or the business buyer) expects no real growth, the value falls to £95,000 or 9 times current earnings (still a good value)

If growth is maintained but interest rates rise, the time value of money will decline, it may easily switch from a 5% per year discount to a 10% per year discount and then the valuation falls from £416,000 to £80,000.

If the two factors come together, falling profit expectations and tightening time value of money, then the value can quite easily fall from 41 times earnings to 4 times earnings in quite a short period.

You can take my word for it, but if you like spreadsheets, try it yourself!

Accountants are taught how to calculate the current value of a business by discounting future cash flow. However, I am profoundly sceptical of this pseudo scientific approach, precisely because business growth more than a few years ahead is simply not knowable, and the discount rate is both arbitrary and subject to unknowable fluctuations over the life of the project.

5.2 The Conventional Business Valuation Technique

My preferred valuation technique is one usually called the conventional valuation technique.

Firstly, we must establish recent profits as a guide to the future. Typically we calculate the weighted average of the adjusted profit. This is in two stages.

For each of the past three years we calculated the "adjusted" profit. The adjustment involves:

- Putting in a fair salary for the proprietors work.
- Taking out all the excess salary, private expenditure, benefits, sponsorship, payments to family members, excess travel etc.

Secondly, we apply the weighting by:

- Multiplying the most recent result by three
- The middle year by two
- The oldest year by one

Then we add together the three results and divide by the total of the weighting factors (6), to get the "weighted average adjusted profit"

For example, Bills Widgets has declared profits before tax and dividends of £35,000 last year, £30,000 in the previous year and £45,000 two years ago. Investigations find that whilst Bill has been paid a reasonable salary, private expenditure within the business amounted to 15,000 last year, £10,000 in the previous year and £5,000 two years ago.

The calculation is as follows:

	Accounts Profit	**Adjustment**	**Adjusted Profit**	**Weighting**	**Weighted Profit**
Last year	35,000	15,000	50,000	3	150,000
Previous yr.	30,000	10,000	40,000	2	80,000
Two yrs ago.	45,000	5,000	50,000	1	50,000
Total				6	£280,000

Weighted Average Profit = £280,000 / 6 = **£46,667**

Having calculated the weighted Average Profit**, the difficult bit is to apply the right multiple to value the business**. This is more art than science; however there is a logical procedure to follow.

We typically start with a multiple of 5. There is a sound logic to this. Although interest rates vary a great deal the rate required by a lender funding a business deal will typically be around 10% - the buyer needs to fund this interest and have plenty left over to pay taxes, to repay loans and hopefully to earn a profit.

A buyer who is not borrowing, is forgoing investment income and taking a (higher) level of risk with his capital and will typically want a similar level of return to that needed by the buyer who is borrowing, and will start from a multiple of 5.

Now we must adjust the multiple. There are many factors to consider

- Future prospects are critical. If growth prospects are considerable the multiple may increase, considerably. As I showed at the start of this article, expectations of 20% per annum growth could increase the multiple to 40 (although how anyone can see 20 years ahead I have no idea). Businesses that are seen to be in mature, high risk or, declining industries can be difficult to sell for multiples of much more than one.
- Transferability of goodwill may be crucial. If a business is seen as being dependent upon the skills, contracts, or other personal qualities of the owner it may be nearly impossible to sell, and the multiple will be reduced accordingly.

- On the other hand, good systems, a well trained workforce, and a proven, committed, and incentivised management will increase the multiple (because of the perception of reduced risk).
- Restrictions must be considered. If the business sold is a Limited Company or a partnership there may be restrictions in the articles, co-shareholder agreement or partnership agreement as to how the business is to be valued or how ownership may be transferred.

There may be many other factors but they all come back to how they influence our perception of the probability of future profits and cash flows.

Considering again Bills Widgets,

There is no evidence of growth in profitability of the business, with a relatively low level of profitability it is perhaps rather dependent upon the proprietor and has few formal systems.

A multiple of 3 might be applied; indicating a reasonable target value of £140,000

5.3 Adapting the Conventional Valuation Technique – Early Stages of the Business Cycle

Some businesses may not yet have established profitability. In this case it is not impossible to use the conventional valuation technique:

1. Firstly, a business plan and a set of projections are prepared
2. The valuation is then prepared as though the projections were achieved profits
3. This will then have to be discounted for risk of not being achieved

This technique can also be adopted to check a valuation where high growth rates, and therefore a high valuation multiple have been used in a conventional valuation.

5.4 Adapting the Conventional Valuation Technique – Consideration of Assets and Liabilities.

It is important to consider how the valuation of a business as above relates to the value of particular business assets.

Consider business premises. If Bills Widgets sale includes a workshop independently valued at £100,000 how does this influence the business value?

In my view there are two ways of viewing this:

Firstly, if there is no rent or depreciation in the accounts then the business value as calculated should include the building. Some accounts will include depreciation of buildings – because the rules to which qualified accountants work require this. The valuation can be adjusted by adding back this depreciation (increasing weighted average profit).

Some valuers will start from the EBITA, Earnings Before Interest, Tax and Amortization, in which case the depreciation is automatically excluded.

If the value of the building is greater than the value of the business, then what we are saying is that there is no value of business goodwill. This might happen particularly when the premises themselves carry the value because of their excellent location. In this case the value of the business will be the value of the premises and visa versa.

The second way of viewing it is to adjust the value of the business by putting a commercial rent into the adjustment of the weighted average adjusted profit.

So for example a commercial rent of £10,000 per annum would reduce the weighted average profit of Bills Widgets to £36,667. Applying the multiple of 3 suggests a value of £110,000 for the goodwill (and current assets) plus £100,000 for the property. This value of £210,000 is considerably more than the £140,000 attributed to the business at first attempt. This demonstrates the danger of leaving a property in a valuation with a low multiple.

In general then property should be independently valued, and weighted average adjusted profit should be adjusted by taking out any property depreciation and adding in a notional market rent.

Secondly we should consider **other equipment**. In general profit will be after depreciation of equipment, if the buyer is buying the equipment this depreciation is added back in calculating the weighted average adjusted profit and thus increases the value of the business. The value should not really be brought in separately.

The valuer should also consider whether any assets have been created in-house during the accounting period, if they have then they should be added back in the profit adjustment. Many businesses do this creating their own moulds and dies, spray shops, retail displays, carrying out R and D, etc. All this tends to slip through the P and L and thus undervalue the business when it comes to calculating a value.

Where equipment values are significant, especially the replacement cost, there may well be a case for considering them separately in a sale. For example a low profitability business such as a Café may have most of its value in the value of the equipment.

Consider Joes Café

Mick has been looking at opening a similar Café nearby and is somewhat deterred by the costing of fitting out and equipping the café at about £100,000. Joe wishes to retire and asks his accountant to value the business. The accountant considers the accounts which show a consistent £24,000 profit before adjusting for a salary. Jo often works 60 hours per week, so his accountant finds it hard to put any value on the business (who wants to pay for the right to work a 60 hour week in order to make a living?).

But Jo persists and asks a sales agent if the business is saleable. The agent is pretty sure that the business will sell for £50,000. Of course this is very attractive to Mick who can buy an established business and start earning from day one for half the cost of setting up from scratch.

As I have already mentioned **stock** can be a significant factor in valuing a business. This will be particularly true for certain niche retailers and wholesalers.

Many sellers and their agents will try to establish a value for goodwill, then add stock as a separate item. This can be a clever negotiating ploy and you should certainly consider using it to maximise the value you get for your business sale.

Whereas notional rent for buildings can be adjusted in the goodwill valuation there is no equivalent Profit and Loss charge to adjust for stock.

Consider Jill's Hobby Shoppe
Jill makes £12,000 per year working 30 hours per week in her Hobby Shoppe. The Accountant cannot justify a goodwill valuation. It is the stock that is the underpinning to this business. Jill's business has £80,000 of stock in the accounts, this would sell for £240,000 to customers (over time), but would fetch only £20,000 if sold in auction. The negotiation over stock value is critical; probably Jill will have to accept cost (or something close to it) spread over a period of time.

Goodwill (again). Although the conventional business valuation is a valuation of Goodwill, in some cases Goodwill might be valued by other techniques.

For example, Customer lists are often sold at a multiple of turnover or recurring fees. Royalties and cash flow from Patent Licences might also be independently valued (at net present value of estimated future income).

5.5 Sale of less than 100% of the business

Having valued the underlying business and assets the valuer has to consider what is being sold.

If a whole business is being sold by a sole trader or husband and wife partnership this is quite straightforward. However, at the other extreme is the sale of a minority holding in a private limited company.

Many Limited companies restrict the right of shareholders to dispose of their shares. In any event, few independent investors will want to buy a minority stake (with no management control) in a family company. For this reason minority stakes are traditionally valued at significantly below their pro rata value, sometimes only 20% of their pro rata value.

There is no firm and fast rule and it is quite possible for a 10% stake to be worth well over its pro rata value to two warring parties each with 45%.

Similarly, a buyer might prefer to buy 80% of a business, knowing that the vendor is retaining a 20% interest, than 100%. Buyers' attitudes will vary widely.

If it is shares being sold the valuer will also have regard to any dividend history. If for example the shareholdings are widely spread and the company rewards its owners through regular dividend payments. A multiple of weighted average dividends will be calculated similarly to that for weighted average profits. To this a multiple will be applied that will tend to be higher than the multiple for the underlying business.

Ultimately guidance for valuation multiples might come from similar businesses with quoted shares, although private businesses will have lower multiples because of the higher risk and greater difficulty in selling the shares.

5.6 Other Valuation Techniques – Discounted Cash Flow

One of the most sophisticated valuation techniques is the discounted cash flow.

The business is modelled and the profitability is projected for a number of years. This future cash flow is then discounted back to a net current value.

It is a sophisticated and complex technique, which comes up with a single current value, but it is rotten with opportunities for error. Discount rates (like our profit multiple) are a matter of choice, and the choice is super critical to the result. Similarly, future income will be dependent upon all kinds of variables, in the economy and in the business, and projections will never be better than a reasonable possibility. I said at the start of this chapter I am not a fan of discounted cash flow. If you have to do a discounted cash flow, or if your buyer has prepared a discounted cash flow remember that as seller, the higher the growth rate, and the lower the discount rate built into the model, the higher the current value that the model will produce. So this is what you and your advisers should be arguing for!

5.6 Other Valuation Techniques – Business Plan

As the military say *"a plan rarely survives first contact with reality".*

Non-the-less the buyer of a business should always create an economic model of the business he is buying. He should use this model to predict future profits and evaluate current value.

As the seller of the business, you should do this exercise, highlight future opportunities, anticipate how problems are to be overcome, maximise value.

Many businesses carry most of their value in the future opportunities. Sellers are selling because they do not themselves have the resources (capital, marketing clout, expertise) to maximise these opportunities alone.

Pretty much all the entrants to Dragons Den will fall into this category.

Whilst, a valuation can be created by applying a discount rate to future income, the discount will be very high to reflect the uncertainty of future income.

5.8 Market Value

A professional valuer can come up with one of two things:

- An independent view of the inherent value of the business (this is what most of the preceding paragraphs of this chapter have been about)
- A view of what the business might sell for on the open market.

Of course, inherent value is an important factor in deciding market value, but not necessarily the most important factor.

Instead **Demand** is perhaps the most important factor in deciding market value.

Let us consider the extremes first:

- If enough people think that a particular internet business is going to be a great success then, they will start to bid up the price of the shares. As buyers bid the share price up, this tells potential buyers that (i) the share price is rising so they had better get in now before the price is even higher (ii) if they buy shares there is a ready market to sell them again even if the fundamentals don't seem to justify the price. This is the classic operation of herd instinct, and is how a financial bubble forms.
- On the other hand everyone knows that engineering is a declining industry in the West. So no one wants to buy an engineering business. Everyone knows that no one else wants to buy an engineering business, so even if they themselves like the fundamentals of a particular business, they might well be put off from buying in, because they know it will be so hard to sell out…

Demand for quoted businesses is easy to assess from stock markets, where yield and price earnings ratios are published (but even these fluctuate daily). Demand for unquoted businesses is notoriously more difficult to assess. For example, prices achieved in recent sales will not be in the public domain, and whilst experienced sales agents will have some knowledge of the local market:

- The market is very narrow and so buyers may no longer be in the market
- New buyers may have appeared
- Businesses for sale are not commodities and all will have individual characteristics which drastically effect value.
- Bank lending policies can fluctuate wildly, which effect price
- The presence or absence of an individual buyer can make all the difference.

Open Market Value is thus an informed guess, and really can only be ascertained by putting the business on the market and skilfully negotiating the price.

Chapter 6

Finding Potential Buyers

No other factor will have a bigger impact on the price that you get for your business, than your success in finding the right buyer.

Finding a buyer can be approached systematically, as can most business processes. The first thing to do is to understand and maximize the different categories of potential buyer. These can be summarised as follows:

- Internal candidates (family, management, others)
- Horizontal contacts (competitors/related businesses)
- Vertical contacts (customers and suppliers)
- Other buyers
- Investors

6.2 Internal Candidates

The first category of internal candidates is the one that the business owner is most able to influence and cultivate. It is also the most likely source of potential buyers.

Professional corporate finance literature and journalism is full of references to management buy outs (MBOs), Management Buy Ins (MBIs) and the like. But for smaller unreported deals sales to internal candidates are even more common.

There are a lot of advantages with selling to someone you know, particularly if you have a good relationship. Trust and like-mindedness make a deal much easier.

The advantages of selling to someone you know and trust can be summarised as follows;

- The buyer will know the business and will not need to do due diligence.
- The parties know each other so negotiation to iron out small differences should be easier.
- The seller may be happier with deferred payment, if he knows and trusts the buyer.

Typical disadvantages can be summarised as follows;

- Buyers are unlikely to be well financed.
- If provoked by unrealistic expectations of the value of the business or other forms of seller insensitivity, the buyer may decide to leave the company and set up in competition.

Ricky and Robert owned a substantial metal fabrication business. Both were approaching retirement age, so they were delighted to get an approach from a consolidator. They easily agreed a deal with the management of the consolidator, but after six weeks of haggling between solicitors lost faith in the ability of the purchasing team to deliver the deal. At this stage, a different deal was struck with a couple of young members of the in-house management team. Although the price was similar, the new deal inevitably involved mostly deferred payment. Because of difficult economic conditions, it took six years rather than the three years originally envisaged to complete the deal. But all parties worked together and remained on good terms.

Dean owned a small car hire business which was operated by Peter in the office and Jim in the workshop. The business had become peripheral to Dean's main interests so he offered it for sale to Peter and Jim. We valued the business at between forty and sixty thousand pounds and recommended that Dean offer it to the in-house managers at a discount, because in our view, the managers controlled most of the goodwill, anyway. Dean asked for seventy-five thousand pounds and after six weeks of negotiation, Peter and Jim left the business and set up in competition.

These two examples demonstrate perfectly the advantages and dangers of selling to a management team.

If younger members of the family are working in the business, there may be an understandable desire by the business owners to pass on the business within the family. Whilst fraught with the difficulties of family politics, this may be a perfectly sensible route for the business owner to pass the baton. Here are a few of the extra matters which need to be considered:

- The owners may wish to gift all or part of the business to their children.
- The owners may need an income from the business for their own retirement.
- The owners have to work out how to be fair between children involved in the business and children not involved, or children competent to manage the business and children not competent.
- Family members need the same commitment of training, and a wide range of responsibility and experience, that other in-house buyers need.

In spite of these difficulties, amongst my clients many of the best family run businesses are in the third or fourth generation ownership!

Whether the internal candidates are family or not they should be cultivated by:

- Recruiting the strongest managers you can find.
- Involving them in ALL aspects of the business.
- Ensuring that they get the best possible training and mentoring.
- Giving them responsibility.
- Bringing them into the business in a structured manner.

Most managers will know stories of mates who have been promised the earth, but it never happens. Everyone hates this. So if you make a promise, give it in writing, perhaps from a lawyer. This way the internal candidate knows you are serious and intend to keep your promise.

Consider giving or selling minority stakes to internal candidates, relatively early on, this helps them to buy in, helps them to know you are serious.

If you do sell to an internal candidate you may well have to help them by structuring the deal over several years or helping the buyer to raise finance.

6.3 Horizontal Contacts

The competitor or nearby trader in a related business, is the classic buyer. He is the trade buyer who wants to expand his business

Selling to a trade buyer has a number of advantages:

- He already knows the industry.
- There may added value from the advantages of synergy

It is important to understand about synergies:

- If one party has an under utilised property, then it may be possible to consolidate both businesses onto that property and reduce rent and rates or even raise cash by selling the other property.
- Various other cost duplications may be reduced; typically the labour force, advertising, accountancy.
- A well managed business will compare various business systems and adopt the best in each case, the same may be well be true of managers, if two managers compete for the same role the best can be promoted.
- The customers of each business may provide a ready market for the products of the other. The salesmen of each business may be able to sell the products of the other.
- Local competition may be reduced or eliminated.

Although synergies can be hard to achieve in practice, buyers are often overly optimistic about what synergies can be achieved. You as seller should encourage this optimism, talking up the possibilities of cross selling, of cost reduction and of choosing the best systems.

It is possible to cultivate potential buyers in a number of ways:

- Keep “fishing” letters from potential trade buyers.
- Develop co-operative agreements with nearby firms (sharing equipment or expertise, helping each other through difficult contracts etc). Apart from being good business practice, this enables you to develop relationships with potential buyers or investors.
- Discuss your retirement plans with your local contacts. You might flush out an interested party.

6.4 Vertical Contacts - Customers

There is always a chance that suppliers may wish to secure an important customer or that a customer may wish to secure an important supplier. This type of acquisition is called vertical integration, and it is important in some industries, but irrelevant in others. However, as a potential seller you should never ignore the possibility that a buyer may come from a vertical contact, and not always in the obvious manner.

Veronica owned a small shop selling craft products to a very specialist market. Customers regularly travelled up to a hundred miles to visit the shop. Many customers commented that it was their idea of heaven to run the shop, many offered to work for free. Veronica took to keeping a book of people who expressed an interest, a valuable marketing tool for many years, this list eventually proved invaluable when a growing family forced Veronica to sell. Eight contacts from the list took the prospectus, four followed up and one eventually bought the business.

For most of his working life John worried about his dependency on one sizable engineering firm for 90% of his turnover. However when it came to considering retirement it quickly became obvious that the customer was equally concerned by the prospect of losing John's business, which they considered an integral part of their operations. The Customer quickly offered to buy Johns business to integrate it into their own operation.

6.5 Vertical Contacts – Suppliers

Suppliers may have a strong incentive to consider buying businesses that are important customers. It will not often be the case but, if you are a sales agent or wholesaler, a supplier or potential supplier may be prepared to invest in your business to protect their position or obtain a new outlet by investing in your business.

Alternatively a supplier may be willing to help you find a buyer and to support that buyer in order to retain your custom.

When Sam wanted to retire from his bakery business, his local wholesaler helped him to find a young baker from a nearby national chain. Unusually the wholesaler lent the buyer a substantial part of the purchase price. This loan was repaid with interest and the bakery remains a loyal customer of the wholesaler twelve years later.

In the past, petrol wholesalers have been prepared to help garages, grocery wholesalers have been prepared to help grocers, insurers have been willing to help insurance brokers, and breweries have been willing to help pubs by finding and even funding buyers, in order to retain the loyalty of the outlet. If you have a business to sell which has a substantial relationship with a powerful supplier, it will always be worth asking the area manager if they can help you find a buyer for the business.

6.6 Other Potential Buyers

Although the contacts discussed above:

- Have the highest probability of yielding a buyer
- Are the easiest to contact

Out there is a huge reservoir of Other Potential Buyers who might be interested in buying your business. The problem is finding them and communicating with them.

I may get into trouble for stereotyping, but there is a fact that there is a large pool of retired teachers looking for an attractive tea shoppe to run and an even larger pool of Asians looking for a grocery shop to run.

There is also a huge pool of employees of large firms looking for a small related business to run. Employees of Insurance companies looking for Insurance Brokerages to run, managers of engineering businesses looking for an engineering workshops to run, employees of giant Architectural practices looking for a local Architects practice to run. Etcetera.

There are thousands, perhaps hundreds of thousands of established businesses looking for potential businesses to bolt on.

Finally, there are thousands perhaps hundreds of thousands of investors looking to buy businesses that are capable of running themselves.

Accessing this pool is difficult, in my experience advertising, web based agencies and similar passive means of accessing this pool have limited success. Whilst there is little to be lost in paying a small fee to advertise on a business sales website, beware of those websites posing as business sales agencies.

Overall the pool of *“Other Potential Buyers”* is possibly best accessed by employing a proper sales agent.

Chapter 7

Some Thoughts about Sales Agents

As set out below a good sales agent will help you:

- Organise your sales campaign
- Find those "other buyers" that are so elusive to us ordinary mortals
- Value your business
- Prepare your sales prospectus
- Obtain confidentiality agreements
- Choose the right "preferred bidder(s)"
- Negotiate the deal
- Document the "Heads of Agreement"
- Deal with solicitors
- Secure the deal.

And in return he will probably charge you quite a high percentage of the sales proceeds for doing so.

On the other hand a bad sales agent will:

- Promise the earth (including a high business value)
- Require you to pay a substantial up front fee
- Sign you up on an exclusive sales agreement
- Put you on one or more internet sales sites
- Offer to sell you further services

And probably nothing else!

So the selection of a good sales agent is critical. **Only choose an agent that is recommended by someone you know. Your accountant, your (commercial) solicitor, or your professional association, may be able to recommend someone.**

On the other hand be very sceptical of national organisations whose sales technique to you is high pressure face to face, but whose technique for finding buyers relies on internet advertising, they will also almost certainly require an up from fee and expect you to give them a sole agency.

My view of sales agents is as follows:

- They should be remunerated by commission, possibly a flat rate percentage, but a sliding scale is even better.
- It is fair that if you pull out of the deal you should have to remunerate the agent's costs.
- Be careful how the commission works if your payment is deferred or an earn-out is agreed.
- But most of all it is better to have a highly motivated agent and to receive 90% of £500,000 than 95% of £450,000 or 99% of nothing.
- You need the right agent for your business, some agents will not accept instructions from smaller businesses or if they do will not give you the time and resources needed to manage the sales process properly. Some agents specialise in certain industries, it will help if you can find an agent with expertise in your industry.

Alan put his coatings business on the books of a large nation firm of sales agents. They valued his business at £600,000, took a £2,000 deposit and put his details on the database. In eighteen months they received one enquiry. Disillusioned with sales agents and in declining health Alan asked Hornbeam to help. We prepared a prospectus, then prepared a target list of possible buyers composed of:

- Firms who had once expressed an interest
- Business partners
- Customers
- (there were no internal options)

This list failed to flush out any seriously interested parties, so we persuaded Alan to meet a local sales agent (agent of an international group). This sales agent found three interested potential buyers from his database of contacts and eventually sold the business to one of those contacts, for a price not far short of £600,000.

Besides knowledge of the market and the technical processes of a business sale, a sales agent also needs to be a salesman. He needs to know how to counter all the negotiating ploys that skilled buyers will use to drive down the sales price of your business. Like all salesmen he needs to be thick skinned and persistent. He needs to be diplomatic and a support to you, his customer, because the sales process is almost always stressful.

Chapter 8

Conducting a Sale

Firstly, I would like to review where we have got to:

- You have spent 5 years making the business as saleable as possible, simple, profitable, low risk, with superb systems
- You have built up a management team, who have interest in buying in
- You have built up a file of people who have expressed interest in the business
- You have seen off high pressure salesmen who have tried to tie you in to inappropriate sole agency agreements

So what do you do next? How is a sale conducted?

In practice what happens next is almost always messy, but I would suggest that you will probably need to carry out the following:

- Set yourself some price objectives
- Advertise the business for sale
- Obtain the prospective purchaser's agreement to maintain confidentiality of information supplied
- Supply outline information to interested parties – the Prospectus
- Screen interested parties – Evidence of Financial Capability.
- Control of the sales process and the timetable.
- Supply more detailed information
- Sell the business
- Negotiate terms
- Strike a deal and document the deal

I hope you will understand my view, as set out in the previous chapter that a good sales agent is invaluable to help you through these processes. But the remainder of this booklet is to help you to understand and make the best of each stage.

8.1 Price objectives

Although I have devoted the whole of Chapter 5 to valuing a business, I have also stressed, and would like to stress again that you are not conducting an academic exercise; you are trying to get the best price that you can.

In general it is an established truth that it is much harder to negotiate a price up than to start with a higher price and negotiate down. But choosing a starting point is fraught with difficulties:

- Choose a price that is too high and you may put off potential buyers (the potential buyer)
- Choose a price that is too low and you may miss out on money that a buyer is willing to pay

Sellers deal with this conundrum in a variety of ways. Many businesses are offered without a price, potential buyers are asked to bid. Other businesses are offered for a price set as "Offers in the region of".

There is no correct answer to this conundrum and I have certainly seen sellers lose deals, including having management teams leave the business, because they have held out for unrealistic values. I have also seen sellers lose out on huge sums of money because they have set the price too low, have accepted lowball offers, or have negotiated badly.

I would suggest:

- Find out as much as you can about similar businesses that have been sold
- Talk to competitors, suppliers, accountants, bankers and sales agents
- Set a price towards the upper limit of what you think is achievable
- Ask for offers. Use the "OITRO" formula. Tell prospects that you would rather have an insulting offer than no offer at all

Of course if you are selling to family or protégés then the object may well be to set a fair price, rather than to obtain a maximum price.

8.2 Advertise the business for sale

I set out in chapter 6 the categories of people who may buy your business.

The way that you approach these categories warrants some careful thought.

Many potential sellers are massively reluctant to share knowledge of the business with potential purchasers. All that I can say is that you have to overcome this reluctance if you are to sell your business properly. Information is restricted in the initial advertisement and sales prospectus, but after the potential buyer signs a confidentiality agreement, they will expect answers to questions about every aspect of the business.

Information is thus let out in 3 stages:

1 Advertisement
2 Information Pack or Prospectus (post confidentiality agreement)
3 Answers to a constant stream of enquiries from the buyer and his professional advisers.

At each stage you must set a desire to retain confidentiality and confidence (of staff and customers), against a need to maximise interest from potential buyers.

In my view the best way to retain confidence is to present your story to staff, customers and suppliers at an early stage. You can thus put your spin on the story:

- "To maintain continuity of the business we have commenced a search for…"
- "It is our intention to consult with staff at every stage."
- "I hope to be able to remain to oversee a smooth transfer."

Don't forget that employees, customers and suppliers include the best categories of potential buyers. So if you have a good reason for selling make sure that you include that in your communication. In my advice to buyers of businesses I always advise them to look closely at the seller's reason for selling. If the reason is health or retirement, then there is a much better chance of completing a successful deal than if there is no obvious reason. So if you have a good reason, stress it and if you don't have a good reason (from the buyer's point of view), keep quiet about it.

Even before this though, you have a tricky decision to make. Do you approach potential buyers amongst your staff, customers, suppliers, and neighbours,

- Yourself?
- Through an existing advisor such as your accountant?
- Through a sales agent?

Only you can make this assessment. If you are a confident salesman and negotiator, you have the time available, and you have no worries in showing your hand, then you certainly can mastermind the sales campaign yourself.

If you want to retain confidentiality but don't want to bring in an outsider then certainly your accountant can write to customers and suppliers, and businesses that have previously expressed an interest to find out who is interested. But remember that most advisors such as accountants or lawyers are not skilled as salesmen and have little time available to focus on the sale of your business. Some larger firms of accountants will have corporate finance departments that employ sales agents internally.

You will have to employ a sales agent if you want to approach "the market" as well as those contacts that you have already made at the same time. It is also my view that an approach by an experienced salesman (by advertisement or in person) is more likely to unearth a potential buyer than an approach by an amateur!

Anyway once this decision is made you can design your first advertisement. By convention business sales advertisements are teasers rather than detailed documents. They will provide:

- Industry or business description in as few words as possible
- Location or "Location fully transferable"
- Turnover
- Possibly Profit Before Tax, Gross Profit, or EBITA (industry conventions vary and whilst you might prefer to keep quiet about high net profits they will certainly attract the attention of potential buyers)
- Possibly OITRO
- Possibly a selection of key selling features such as:
  - Prime High Street Location,
  - Prime Location on Busy Main Road
  - Ill Health Forces Sale,
  - Order Book in Excess of 6 Months

There follow a couple of actual adverts copied off an email received onto the authors laptop whilst writing this paragraph

Niche audio visual equipment

UK. Wholesale and distribution. Experienced second tier management. Own branded products division. Further growth potential. Turnover £16M Net Profit £1M

Snack foods business

Staffordshire. Sales over the last 3 financial years have been in the range from £3M to £3.4M producing an adjusted EBITDA of between £227k and £324k for 2009/10

Whilst adverts can be posted onto the internet, and in local papers, they can also become the basis for trawling letters sent out to known prospective purchasers.

8.3 Obtain the prospective purchaser's agreement to maintain confidentiality of information supplied

There now comes a slight impasse. Prospective purchasers will want somewhat more information before committing serious resources. You want some assurance of confidentiality before releasing further information.

The best procedure is to ask for a confidentiality agreement immediately, and if you have employed a sales agent or accountant this is probably what they will do.
Don't be shy in doing this. It shows that you are serious and professional about selling the business

Chapter 9 gives a couple of sample confidentiality agreements.

8.4 Supply outline information to prospective purchasers

It is usual to prepare a prospectus for prospective purchasers.

Sales Agents views vary as to what should go into a prospectus. But there are some obvious guidelines, and my advice follows.

Firstly, you are trying to sell this business, so sell it. Put in as many sales plugs as you can, and omit concerns, worries or other negatives which do not have to be included.

Guided by these parameters, my advice would be to prepare a Sales Prospectus that contains enough detail to be useful, enough to enable prospective purchasers to make a realistic assessment of your business. But not so much as to swamp the reader and only so much as you are comfortable in releasing at this stage.

I would suggest that a prospectus should be constituted as follows:

- The Executive Summary. – An outline description of the business for sale, its customer profile, products, location, workforce, turnover, profitability, technology, mode of operation – A fair view of the businesses prospects – A description of what is for sale, and why it is for sale, guidance on the asking price. – Any special factors that make the business more valuable.

- Background Information – Start with business contacts, who is handling the sale and how they can be contacted. – It is a good idea to outline how you intend to manage the sales process. – Now put in more detail about the things in the executive summary, analysis of customers by number, location, purchases in the last 12 months (largest 3, average, smallest), etc. Number of employees by function, length of service, pay grade etc. Detais of technology. Etc - Put copies of technical literature, patents, maps etc into the appendices.
- Market Data. – Any buyer worth his salt will want to know about your market, and this warrants its own section, home in gradually from worldwide market, market structure, your market, your approach to market, how you win new business, what proportion of leads you convert, your USPs (unique selling points) - Put copies of sales literature, commendations etc into the appendices.
- Financial Data – Summarise financial data, prospects, risks, etc into this section. Discussion of special assets, land, equipment, stock, or other can either be handled in this section or given their own section. Relegate Accounts, business projections etc to the appendices.
- Systems – If you have strong business systems or technologies they may be set out in the section on Background Information or promoted their own section as here.

An example Sales Prospectus is set out in Appendix 1.

8.5 Screen interested parties

You are selling the business and this next stage is perhaps the most important.

What you are ideally looking for are two or more interested parties. Two or more prospective buyers who are:
- Fired up about the business.
- Have the resources to carry through the sale.

So whilst trying to ensure that each and every prospect, are fed lines about
- Unique products
- Growing Markets
- What a fun and exciting business this is.

You should also be shrewdly looking out for:
- Timewasters
- Buyers who do not appear to have the financial capability
- Buyers who do not appear to have the management capability to carry through the acquisition
- Apparent buyers who are seeking customer lists, IP, staff details, with wholly improper intentions – ie to approach customers or staff or to steal IP without payment

Ideally you want one or more prospective buyers that:
- You trust
- That have sufficient funds
- That either have a successful track record in completing acquisitions, or are convincing in their ability to carry through the acquisition for other reasons.

It is common practice for the seller to ask their prospective buyer to supply evidence of sufficient funds (a bank statement, letter from a bank, or similar).

It is also perfectly reasonable to ask the prospective buyer if they have any previous acquired businesses that are evidence of their seriousness and capability. Ask for the contact details of the people who were bought out as referees for the acquirer. Good acquirers will be pleased to supply these if they have them, after all it helps their cause and they will no this. I the acquirer is not prepared to offer references, this puts you on enquiry and if you can you should try to track down the past owners of recently acquired businesses. This might save you a lot of grief.

8.6 Control the sales process

It is fair to all parties to spell out a proposed “Sales Process and Time Table”.

For Example

Dear Prospective Purchaser

Sale of the business of A Bloggs Ltd

To try to keep this fair to all parties it is our intention to follow the procedure and timetable:

- By 30 September Prospective Buyers must have submitted (i) their outline bid (subject to due diligence etc), (ii) evidence of financial capacity, (iii) details of recent experience in carrying out acquisitions.

- By 14 October we will select a Prospective Buyer for Exclusive Negotiation Status.

- By 31 October we will have agreed a heads of agreement with the Buyer selected for Exclusive negotiation or we will reopen the bidding. We will inform all prospective Buyers.

- It is our intention to complete due diligence by 30 November and have the Sale completed by 31 December 2010.

You will have lots of chances to appraise potential buyers as they come back to you for further information, and as they try to get a step ahead over price in the period to 30 September. This is your chance to persuade buyers to bid the price up, you might even elect to move to a formal Auction, although this is rare. But it is also your chance to assess the buyers, to turn down anyone who you suspect will pay the deposit but not the follow up tranches, or indeed anyone whom you do not wish to inherit the business for whatever reason.

8.7 Supply of more detailed information

The Sales Process gets more stressful and more time consuming from now onwards.

All the prospective buyers will want more information before making a bid, in fact you will probably find yourself bombarded with requests for more information. Prospective buyers will probably also be tardy about supplying evidence of their financial capability; but perfectly serious buyers may well be having to put together a proposal to their bankers to fund the bid for your business. So this is all in real time and their may be genuine difficulties even for your best bidder.

Once you have agreed sole negotiating rights the Prospective Buyer will still want more information whilst a Heads of Agreement is negotiated.

The **Heads of Agreement** is the outline of the sale agreement and usually contains at least the following:

- Seller
- Buyer
- Details of what is bought and sold
- Time table
- Consideration / Price
- Obligations of the seller
- Structure of Payment (see chapter 11)
- That the Agreement is subject to due diligence / successful acquisition of funding.

Once a Heads of Agreement is signed the Buyer will usually want to carry out a process of "Due Diligence". Usually this is a kind of super audit carried out by the Buyer's Accountants. They will want to look at proof of turnover and costs, at past projections if available, at current projections, at assets and liabilities if included in the sale, they will want proof of ownership of assets involved in the sale, and in particular they will want to ferret out any liabilities, or risks not disclosed in the accounts or sales prospectus.

The objective of the due diligence is to give the buyer a kind of Doomsday Book of what they are buying.

Most prospective buyers will simply walk away if you do not co-operate with the "Due Diligence" process.

Finally when a Heads of Agreement is handed to the buyer's solicitor to raise a "Sale Agreement" in my experience the first thing the lawyer does is run off a 50 page "Legal Due Diligence" on their word processor.

This is extremely difficult to control. In my experience relatively small sales are best conducted without the involvement of Lawyers (see the Hornbeam *Guide "To Successfully Expanding Your Business By Acquisition"*). However you cannot tell a prospective purchaser that he must not employ a solicitor. You might ask prospective purchasers whether they are prepared to proceed to sale without involving a solicitor (several categories of buyer are, for example some experienced acquisition teams, and some Buyers for whom the acquisition is small beer). You might inform all Prospective buyers that you will not answer legal due diligence amounting to more than 5 pages or unless the Buyers solicitor has already been through the document with the buyer and removed all the questions that have already been answered.

But in my experience solicitors love trading reams of largely irrelevant documentation, and charging their clients for the privilege, and there is little that you can do about it, other than grit your teeth and provide the information requested. Although, answers such as “See Prospectus”, “already provided to Buyers / Buyers Accountants”, Not Applicable, and “Not as Far as the seller is aware”, will get you through swathes of word processed questions.

It is of course perfectly possible to skip the Heads of Agreement, the Accountants Due Diligence, and the Lawyer altogether and proceed straight to a sales agreement between the parties, although this is not common unless both parties have some experience of business sales and acquisitions, the values are quite small and both the business itself and the structure of the deal are quite straightforward.

8.8 Selling the business

It is important not to lose site of this objective.

It is important not to miss any opportunity to sell the business.

Firstly, if your business has lots of attractive features, do not miss every opportunity, every advert, every document, every meeting to play these up:

- Good reason for selling
- Valuable customer list
- Skilled and Experienced Workforce
- Cutting Edge Technology or IP.
- New products or services

Of course if the business has low levels of profitability you need to have your explanations ready. Most buyers will want to believe that they are better businessmen than you are so it is a good ploy to play up to this. Tell prospective buyers about the things that you were not very good at:

- Pricing and Quotations
- Charging for Extras
- Managing the workforce
- Laying-off staff when work is slack
- Negotiating supplier prices

They are likely to be calculating the extra profit that they can make by correcting your mistakes.

On the other hand you should NEVER explain to a buyer why you think problems:

- Downward pressure on sales prices
- Difficulty of obtaining payment for extras
- Bolshy workforce
- Industry Practices
- Rising supplier prices

If you have solutions to problems in the pipeline, you can, of course, share these with the prospective buyers, just as you would inform them of new products, services or markets.

Like any good salesman you should try to find the buyers hopes and aspirations and then show him how buying your business will fulfil them.

Like any good salesman you should try to identify the buyers concerns and show how these can be overcome.

Most of all, like any good salesman you should not be afraid of asking the prospective buyer to commit. Ask them to make a bid. Flatter them; tell them that you would really like them to bid.

After you have bids, after you have granted sole negotiation rights, continue to look for ways to resolve the buyers fears, continue to build their confidence.

8.9 Negotiate the Deal

Top negotiators often make fools of themselves.

I have seen top negotiators lose deals, in fact destroy businesses, holding out for more money than the buyers could possibly justify or afford.

I have seen top negotiators overpay (by my calculation) more than triple what a business is worth and more than double what the proprietor would have accepted.

I have seen businesses with considerable intrinsic value, closed down rather than sold, and I have seen businesses sold for half the amount the buyer would have been prepared to pay.

Negotiating is never easy, but it is relatively easy to avoid the worst mistakes.

The first thing to do is to prepare:

- There are books available on negotiating – consider reading one (they will all tell you about the importance of preparation!)
- Find out as much as you can about recent sales in your industry – what are the basics of valuation in your industry
- Set goals before you enter into negotiations, for example minimum price at which you will open negotiations, minimum price for which you can sell
- Identify areas where you can afford to be flexible, for example sale with or without property, with or without your involvement, maybe accepting some form of deferred payment

When you have a buyer or buyers lined up you need to do some research about them:

- You can find out where their funding is coming from and therefore perhaps the limits to their funding, and whether they have a budget
- You can try to asset their trustworthiness. Get them talking about their past deals, if these involve ripping off previous sellers then you would be unwise to sell to them for anything other than cash on the nail
- You can ask them about their concerns, and perhaps throw in some extra assurances to allay those concerns… for example offering to stay with the business, or to offer part of the sales price related to outcomes

Now you must organise the negotiation process to favour your skills. If you are good at blagging then try to nail a deal face to face. But do not be deterred if this is not your skill. Ask for time to consider an offer and to respond in writing, by email perhaps. For most of us, making decisions in the heat of the moment is a case of "Act in haste, repent at leisure".

So take your time and perhaps talk things through with a trusted confidant before committing yourself.

But negotiations can be skewed to favour one party or another.

For example, if you can line up two or more keen prospective buyers, rather than one, the buyers know that they cannot drop the price (at the last moment) or make unreasonable additional demands. Also you know that buyers have put in their best offers or risked losing the deal to a competitor. So you have extracted maximum value from these prospective buyers (which is not otherwise always easy to do).

Another part of the sale process which can favour the seller is the structure of costs. You will be paying your broker or sales agent a proportion of the proceeds – no sale no fee. The buyer will be running up costs especially once they instruct an accountant to carry out due diligence, as well as committing a considerable amount of their own time. If the buyer pulls out these costs are taken as a hit. You, on the other hand, have a second and a third buyer lined up and are now well up the learning curve when it comes to providing information.

Canny buyers will try to work themselves into the position where they are the only buyer in the field, perhaps because you have left the sale too late and are committed to retiring, or starting a new job or whatever. If they get this upper hand many buyers may simply drop their offer price, knowing that you have little option but to accept.

So beside finding more than one prospective buyer you should

- Give yourself plenty of time to let a deal fall through and negotiate a second deal.
- Give yourself other options, perhaps letting managers buy a minority share in the business and enjoy the income instead of selling out altogether.

8.10 Documenting the deal

As set out above, you the seller, or your agent, or your accountant will first try to document the deal in a semi formal way when they set out the "Heads of Agreement".

This document usually runs for 2 to 5 pages and sets out the meat of the deal:

- Seller
- Buyer
- Details of what is bought and sold
- Time table
- Consideration / Price
- Obligations of the seller
- Structure of Payment (see chapter 11)
- That the Agreement is subject to due diligence / successful acquisition of funding.

For smaller or less complex deals the heads of agreement can be reformed into a sales document. In my experience this will usually contain all the critical elements of the transaction.

However most business sales involve lawyers, and lawyer's standard forms often run up to 100 pages.

What are all these extra pages about?

Well in my experience, after you have negotiated the deal then you start to hear from the Buyers Lawyer about many "Warranties" and "Disclosures". There are two ways of looking at these:

- They are just spelling out and codifying what was implied and presumed in the Heads of Agreement.
- They are introducing a whole new aspect to the deal which completely changes the risk / reward balance in favour of the buyer!

You will also find that in converting the Heads of Agreement (written in Business English) to the language of the legal contract, crucial elements of the deal (seem to) get lost or subverted. The toing and froing between you, your solicitor, the buyer's solicitor, and the buyer, is boring, confusing, and time consuming.

It is very hard to control this process, this is how Lawyers conduct deals, and if employed this is what they will do.

It is also critically important.

The buyer's solicitors will insert or omit clauses to subvert your interests, if you ignore them you will lose out. It is critical that:

- You stand up for yourself; don't let the lawyers subvert your deal
- You employ an experienced, robust lawyer who will protect your interests

Make it clear from the start in writing to the buyer, your solicitor and your buyers solicitor, that you will not sign a legal contract that differs in any significant way from the heads of agreement, and before you sign (and throughout the haggling process) keep checking the sale document to the heads of agreement and referring to your perfectly reasonable letter, inform the buyer of the clauses, lack of clauses, or subversion of agreement, that will make it impossible for you to sign.

I have known sellers walk away when the buyer's lawyers cannot be made to stick to the original agreement! But hopefully, a contract can eventually be agreed, and signed and the business sold.

Chapter 9

The Issues of Confidentiality

If you employ a competent sales agent or business broker they will require any potential purchasers to sign a confidentiality agreement before releasing any additional information. The following pages are a template of just such an agreement, in use by one of the biggest business brokers in the market.

It will be seen that this broker will not release any information, even the name of the business for sale until the confidentiality agreement is signed.

It can also be seen in this letter that the Broker states that they will seek “evidence of financial ability” before releasing the name of the business for sale. As I have said in the previous chapter, this might be good practice, but is not always practical or achievable in reality.

The letter seeks to extend the confidentiality net to the buyer’s advisers, whilst the buyer himself remains liable for costs arising from any breach.

This letter contains exclusion of liability and hold harmless clauses for the agent!

Example 9.1

A Business Broker's Confidentiality and Non - Disclosure Agreement

(The Broker)'s agreement with our sellers ("the Sellers") requires us to obtain a Confidentiality & Non - Disclosure Agreement and evidence of financial ability of proposed purchasers before we disclose the name and location of the business. In return, information which you disclose to us will be kept confidential by *(The Broker)* unless and until such time as an offer is made by you on any business represented by *(The Broker)*.

In consideration for information on businesses offered for sale by *(The Broker)*,
I,………………………………………………………………………………………………
understand and agree as follows:-

1. I acknowledge that Information (as defined herein) provided by *(The Broker)* in respect of businesses for sale is sensitive and confidential and its disclosure to others would be damaging to the businesses and to the Broker's relationship with the Seller.
2. I will not disclose any Information regarding these businesses to any other person who has not also entered into this Agreement except to my professional advisor, in which case I agree to obtain their consent to maintain such confidentiality. "Information" shall include the fact that the business is for sale together with other related data. Information does not include any information that is, or becomes, generally available to the public or is already in my possession or information which I am required to disclose by law. All Information provided to me will be returned to *(The Broker)* without retaining copies, summaries, analyses or extracts thereof in the event that I do not proceed with the purchase of the business.
3. I will be responsible for any breach of any of the terms of this letter by myself or by any of my professional advisers. I will indemnify and keep indemnified in full the Seller and the Broker from and against all costs, expenses, losses or damages (including but not limited to legal expenses) which may arise directly or indirectly from the unauthorised disclosure or use of Information or from any other breach of the terms of this Agreement.
4. I will not contact the Seller, employees, suppliers, or customers except through *(The Broker)*. I will not use the Information to establish a competitive advantage over Seller.
5. I acknowledge that all Information is provided by the Seller and is not verified in any way by *(The Broker)*. *(The Broker)* will rely on the Seller for the accuracy and completeness of the Information, has no knowledge of the accuracy of said information and makes no warranty, representation or undertaking, express or implied, as to the Information. Prior to finalising an agreement to purchase a business, it is my responsibility to make an independent verification of all Information. I agree that *(The Broker)* is not responsible for the accuracy of any Information I receive and I agree to indemnify and hold *(The Broker)* harmless from any claims or damages resulting from its use. I will look only to the Seller and to my own investigation for all information regarding any business offered by *(The Broker)* on behalf of a Seller.
6. I acknowledge that *(The Broker)* does not give tax, accounting, legal or financial advice.
7. Should I enter into an agreement to purchase a business *(The Broker)* offers for sale, I grant to the Seller the right to obtain through standard reporting agencies, financial and credit information concerning me or the companies or other parties I represent and understand that this information will be held confidential by the Seller and *(The Broker)* and will only be used for the purpose of confirming my ability to pay the consideration for such business and the Seller extending credit to me should an agreement to do so arise.
8. I confirm that I shall promptly provide sufficient evidence of identity and proof of sufficient funds to *(The Broker)* upon request.
9. All correspondence, inquiries, offers to purchase, and negotiations relating to the purchase or lease of any business presented to me, or companies, which I represent, will be conducted exclusively through *(The Broker)*.
10. By providing the information set out below (and any further information relating to the purchase of a Business) to *(The Broker)*, I expressly consent to the dissemination of such information to any Seller, any employee, director, consultant or advisor of *(The Broker)* or a Seller or any agent, assign or successor in title of *(The Broker)*. I acknowledge that *(The Broker)* may, without my consent, at any time novate or transfer any rights or obligations arising under this Agreement to another *(The Broker)* Advisor by giving me written notice of such novation or transfer.
11. This Agreement will be governed by and interpreted in accordance with the law of England and Wales.
12. This Agreement is enforceable by the Sellers but otherwise only the parties to this Agreement may enforce any of the terms of this Agreement pursuant to the Contracts (Rights of Third Parties) Act 1999. This Agreement may however be varied without the consent of the Sellers.

Agreed and accepted this _____ day of _____________________, 20___

Print Name(s): ________________________________ , _____________________________

Buyer's Signature(s): _______________________ , _____________________________________
Address ____
____
____
Postcode ________________

Phone _____________________________ Mobile ____
Fax ______________________________ Email Address ____

If you choose not to appoint a business sales agent, you will still need to get a confidentiality letter signed, before releasing much information. In general the prospective buyer will already know the name of the business, unless you are using a friend or advisor to retain confidentiality. So the following example 9.2 assumes the buyer already knows the business. If this is not the case a reference or codename can be inserted.

Example 9.2 contains an exclusivity clause 4(c) that would not be appropriate at such an early stage in most cases and should therefore usually be deleted in its entirety. This clause might be appropriate if you were giving a management team the option to organise an MBO without putting the business to the wider market for example.

Example 9.2

Private Confidentiality Letter

To: *(Potential Investor/Acquirer)* Limited

Dear Sirs

We understand that you wish to investigate the business of *(Name of Company or confidential reference)* (the "Company") [and of its subsidiaries (together the "Group")] [in connection with *(Nature of Transaction)* (the "Permitted Purpose")] and that you, your directors and employees, other potential syndicate members or other providers of finance and your financial and professional advisers in relation to the Permitted Purpose, (together referred to as the "Disclosees"), will need access to certain information relating to the Group (the "Confidential Information").

1. In consideration of our agreeing to supply, and so supplying, the Confidential Information to you and agreeing to enter into discussions with you, you hereby undertake and agree as follows:

   (a) to hold the Confidential Information in confidence and not to disclose or permit it to be made available to any person, firm or company (except to other Disclosees) without our prior written consent;

   (b) only to use the Confidential Information for the Permitted Purpose;

   (c) to ensure that each person to whom disclosure of Confidential Information is made by you is fully aware in advance of your obligations under this letter and that, in the case of other potential syndicate members, each such person gives an undertaking in respect of the Confidential Information, in the terms of this letter;

   (d) upon written demand from us either to return the Confidential Information and any copies of it or to confirm to us in writing that, save a required by law or regulation, it has been destroyed. You shall not be required to return reports, notes or other material prepared by you o other Disclosees or on your or their behalf which incorporate Confidential Information (Secondary Information) provided that the Secondar Information is kept confidential;

   (e) to keep confidential and not reveal to any person, firm or company (other than Disclosees) the fact of your investigations into the Group that discussions or negotiations are taking place or have taken place between us in connection with the proposed transaction or that poten investors/acquirers are being sought for the Company;

   (f) that no person gives any warranty or makes any representation as to the accuracy or otherwise of the Confidential Information, save as r subsequently be agreed.

2. This paragraph 1 does not exclude liability for, or any remedy in respect of, fraudulent misrepresentation.

3. Nothing in paragraph 1(a) to (f) of this letter shall apply to any information or Confidential Information:

(a) which at the time of its disclosure is in the public domain;
(b) which after disclosure comes into the public domain for any reason except your failure, or failure on the part of any Disclosee, to comply with the terms of this letter;
(c) which is disclosed by us or the Company, its directors, employees or advisers on a non-confidential basis;
(d) which was lawfully in your possession prior to such disclosure;
(e) which is subsequently received by you from a third party without obligations of confidentiality (and, for the avoidance of doubt, you shall not be required to enquire whether there is a duty of confidentiality); or
(f) which you or a Disclosee are required to disclose, retain or maintain by law or any regulatory or government authority.

4. In consideration of the representation and undertakings given by you in this letter, we undertake and agree:

(a) to disclose Confidential Information to you;
(b) to keep confidential and not to reveal to any person, firm or company (other than persons within our group who need to know, our bankers and professional advisers) the fact of your investigation into the Group or that discussions or negotiations are taking place or have taken place between us; (and
(c) that we will not prior to [insert date], directly or indirectly enter into negotiations or have discussions of any kind with any other potential investors which relate to the Permitted Purpose without your prior written consent and we recognise that in reliance on this undertaking you and other Disclosees may incur substantial costs.) [This relates to exclusivity and is a matter for negotiation.] and
(d) Confirm that any personal information contained or referred to in any of the Confidential Information, has been obtained, maintained and handled and all relevant licences, authorities and consents have been obtained in accordance with all applicable date protection laws, rules and regulations.

No term, condition or provision of this letter shall be enforceable under the Contracts (Right of Third Parties) Act 1999 by a person who is not a party to it.

(a) This letter shall be governed by and construed in accordance with English law [and the parties irrevocably submit to the non-exclusive jurisdiction of the Courts of England and Wales in respect of any claim, dispute or difference arising out of or in connection with this letter.]
(b) The obligations in this letter will terminate on [insert expiry date].

Please indicate your acceptance of the above by signing and returning the enclosed copy of this letter as soon as possible.

Yours faithfully

We have read and agree to the terms of the above letter.

Signed by ______________________________________

for and on behalf of *(Potential investor/acquirer)* Limited

Date: ___________________

Chapter 10

Negotiation

I am unapologetic that most of this slim chapter repeats what was said in section 8 of Chapter 8.

Top negotiators often make fools of themselves….

I have seen top negotiators lose deals, in fact destroy businesses, holding out for more money than the buyers could possibly justify or afford.

Twice actually, clients of mine; successful businessmen and tough salesmen, have ended up losing their management teams when trying to ring too much out of potential management buyouts. In both cases the teams have set up in competition, and the businesses have been damaged, unprofitable and unsellable for years afterwards.

Also I have a clear recollection of the chief executive of a sports association saying on Radio 4 that the TV station that had asked for a reduction in the agreed fees must think he was a fool. The TV station went bust hours later.

I have seen top negotiators overpay (by my calculation) more than triple what a business is worth and more than double what the proprietor would have accepted.

I am pretty amused to see one of our top dealmakers claiming in the US courts that he was duped by his merchant bank advisers into overpaying over £1billion for EMI, because they told him there was another buyer in the frame!

I have seen businesses with considerable intrinsic value, closed down rather than sold, and I have seen businesses sold for half the amount the buyer would have been prepared to pay.

I was thrown out of a meeting when my buying team asked for an additional department of the target business, rather than reduce our price. This business was closed down a few months later.

Negotiating is never easy, but it is relatively easy to avoid the worst mistakes.

The first thing to do is to prepare

- There are books available on negotiating – consider reading one (they will all tell you about the importance of preparation!).
- Find out as much as you can about recent sales in your industry – what are the basics of valuation in your industry.
- Set goals before you enter into negotiations, for example minimum price at which you will open negotiations, minimum price for which you can sell.
- Identify areas where you can afford to be flexible, for example sale with or without property, with or without your involvement, maybe accepting some form of deferred payment.

When you have a buyer or buyers lined up you need to do some research about them.

- You can find out where their funding is coming from and therefore perhaps the limits to their funding, and whether they have a budget.
- You can try to asset their trustworthiness. Get them talking about their past deals, if these involve ripping off previous sellers then you would be unwise to sell to them for anything other than cash on the nail.
- You can ask them about their concerns, and perhaps throw in some extra assurances to allay those concerns… for example offering to stay with the business, or to offer part of the sales price related to outcomes…

Now you must organise the negotiation process to favour your skills. If you are good at blagging then try to nail a deal face to face. But do not be deterred if this is not your skill. Ask for time to consider an offer and to respond in writing, by email perhaps. For most of us, making decisions in the heat of the moment is a case of “Act in haste, repent at leisure”.

So take your time and perhaps talk things through with a trusted confidant before committing yourself…

But negotiations can be skewed to favour one party or another.

For example, if you can line up two or more keen prospective buyers, rather than one, the buyers know that they cannot drop the price (at the last moment) or make unreasonable additional demands. Also you know that buyers have put in their best offers or risked losing the deal to a competitor. So you have extracted maximum value from these prospective buyers (which is not otherwise always easy to do).

Another part of the sale process which can favour the seller is the structure of costs. You will be paying your broker or sales agent a proportion of the proceeds – no sale no fee. The buyer will be running up costs especially once they instruct an accountant to carry out due diligence, as well as committing a considerable amount of their own time. If the buyer pulls out these costs are taken as a hit. You, on the other hand, have a second and a third buyer lined up and are now well up the learning curve when it comes to providing information….

Canny buyers will try to work themselves into the position where they are the only buyer in the field, perhaps because you have left the sale too late and are committed to retiring, or starting a new job or whatever. If they get this upper hand many buyers may simply drop their offer price, knowing that you have little option but to accept.

So besides finding more than one prospective buyer you should

- Give yourself plenty of time to let a deal fall through and negotiate a second deal.
- Give yourself other options, perhaps letting managers buy a minority share in the business and enjoy the income instead of selling out altogether.

Chapter 11

Structuring a Deal

Although this is my last chapter, it is in many ways one of the most important.

In my experience sellers give much thought to the price that they might get for their business, but little thought to how the sale might be structured.

Be under no illusion, virtually no buyers offer you payment in one lump upon exchange of contract. Only if the deal is really small and really straightforward have you much chance of getting payment on exchange.

Of course you should always tell buyers that you are looking for payment on exchange and then be prepared to concede deferral of part of the payment.

11.1 Deferred Payment
Deferral can have a number of different elements.

1. Straight forward deferral of part of the payment. This has several advantages to the buyer,
    a. It gives them more time to raise the money, including profits from your business.
    b. It gives them a fund to raid if they have any claims against you. Whatever the contract says it is unlikely that the buyer would sue you, much more likely that they would deduct a claim from the deferred payment due.

Equally, straight forward deferral has several costs to you.

a. Time value of money – deferring part of the payment is tantamount to reducing the price.
b. But this pales to insignificance compared to increased risk. There are many reasons why a buyer might not pay; he might have a genuine claim, things might go badly and he convinces himself he has a claim, he might be or become crooked and have no intention of paying, he might have no money, he might die or disappear.

This doesn't have to be a deal breaker, if you concede some deferral then you are effectively giving a discount and can reasonably ask for some concessions in your favour, more money perhaps!

Of course if you know or trust the buyer then deferral can be much less of an issue.

2. Part of the payment is linked to future performance of the business. This is often termed an "earn out". Besides all the risks highlighted in 1 above the earn out adds a few more risks for the seller.
    a. If the economy or business sector turns down, the performance may bomb, and the effective sales price with it.
    b. If the new owner proves to be an incompetent manager the performance may decline and the effective sales price with it.

None the less, earn-outs are quite common. By sharing the risk the seller may be able to command (and the buyer afford) a higher price. So the earn out will be reasonably attractive where

- The seller has considerable confidence in the business (because of the order book for example) and
- The seller has confidence in the buyer's honesty and management ability.
- And quite often the seller will be staying on to help and advise for much of the earn out period.

11.2 Deferred Transfer

One way you as seller can counter the disadvantages of deferred payment is to offer deferred transfer of ownership.

For example you may have two offers for the shares in your limited company. One bidder has offered £500,000 now with just 10% deferred for 18 month. The second buyer has offered £600,000 with £200,000 now, £200,000 in twelve months and £200,000 twelve months after that.

You can accept the higher figure but, you sell only 1/3 of the shares now, 1/3 in 12 months and 1/3 in 2 years. This is quite complicated from a tax perspective in the UK, but on the positive side you keep control of the company until you receive the second tranche of payment, and you retain a sizeable minority stake until you are fully bought out. If dividends are being paid, you will be entitled to a share. Until the second tranche of shares is sold you effectively control the management of the company.

This is a specific example, but the principle can be adapted to many circumstances. Watch the tax though, under current UK law as it stands you could end up liable for Capital Gains Tax based on the entire £600,000 proceeds on exchange of contract.

11.3 Partial Sales

There is no fixed rule that says that you have to sell 100% of the business, you can release some capital by bringing in

- A business partner
- A financial Investor
- A Trade Investor

in any proportion that you agree between you. And don't forget that shares can be created with different terms (voting rights, dividend rights, and restrictions on sale etc).

In my view this is a completely valid way to plan for retirement and succession. You bring in a business partner perhaps with 40% or 50% of the business initially. You document an "understanding" that you will retire out of the business, selling the remaining stake for an agreed amount (or according to an agreed formulae) at some defined point in the future.

It is very important when you set up a business with a partner, or when you make a promise to an employee, that you document this properly. The co shareholder agreement between business partners operating through a limited company, or the partnership agreement between unincorporated business partners, should set out a procedure for winding up the arrangement should one of the partners wish to leave. This would normally include rules for

- Offering shares to the other shareholders
- Establishing a fair value for those shares
- Rules for the remaining shareholders to accept the offer to sell and perhaps to defer payment
- An option for the leaver to offer shares to outsiders if the remaining shareholders do not wish too buy.

As neither party knows whether they will be buyer or seller at this stage, this is the time to establish an agreement fair to all parties.

If you make an offer to employees or members of the management team, make it in writing. All employees seem to know somebody who has been spun meaningless promises in lieu of money. If you make a verbal promise they will have a suspicion that your offer falls into this category. So make the offer in writing. Then they know that you are serious.

11.4 Your Future Involvement.

This is often an important aspect of a deal.

My advice is to be flexible.

If the buyer offers you a lot of money, up front, and wants you to leave on day one; I would recommend acceptance.

If the buyer wants you to stay to help smooth the transfer, then all else being equal that is sensible.

If you are being asked to agree to an earn-out then it makes sense to stay on if you can; To keep and eye on things and to try to ensure the success of the earn-out.

I would be more nervous about agreeing to leave on day one if there is an ear-out or any large element of deferral.

Whether and what you get paid is also an interesting aspect of the deal. If the staying on is for a limited period and the sale price is generous then it may be acceptable to provide your time as part of the overall sale deal.

If the period is likely to stretch and perhaps the deal is less generous than you would have liked then perhaps payment for your time through the payroll is appropriate.

11.5 Property.

Sometimes a deal can be structured around property. From your point of view property is a nice secure asset to hold on to. Rent is a good form of income, not subject to NI if you are below retirement age and a welcome enhancement to any pension in old age.

But the tax position can be complicated; property assets are not always entitled to entrepreneurs relief from Capital Gains Tax or Business Asset relief from Inheritance Tax so seek advice if you are planning hold onto the property when you make the sale.

The point of holding onto the property is that it allows you to accept a lower price for the goodwill and other business assets, which may bring the business within the ability of management or family to afford.

On the other side of the coin a buyer might require the property for a number of reasons, for example:

- As security for borrowings
- Because the business is location based

Again the more flexible you can be the more likely you are to be able to obtain a good price and to secure payment if the buyer wants to defer.

Appendix 1
Example Prospectus

A B Engineering Limited

Prospectus

A B Engineering Ltd
Content

A B Engineering Ltd
Chapter 1
Executive Summary

A B Engineering Ltd is a small engineering workshop with

- 17 multi-skilled operatives,
- Specialising in small volume jobs for
- The Aerospace, Marine, Automotive and, particularly, the Rail Industry.
- Capabilities are strongest in painting, coating, and phenolic (fire proof glass fibre) moulding.

The business operates from a 7,500 square foot premises in Small Town, Norfolk. It is offered for sale

- With or without the premises
- The proprietor is happy to help with the handover or to go on day one as required.
- The terms and mechanics of the deal are open to negotiation.

The business is offered for sale because the proprietor (Andrew Blogg) is 68 years of age and needs to retire for health reasons. Andrew is committed to retiring abroad as soon as the future of the business can be secured.

The business has been managed, if not as a lifestyle business, then at the very least, not for immediate profit maximisation. The owner takes the view that he would rather quote what he considers a fair price, rather than the best price he can get for the job. Whilst there are some very nice profitable, repeat business, jobs, the niche for this kind of small business is inevitably small volume, one off and prototype jobs. Inevitably problems with drawings, and variations to drawings are endemic with this work. In the authors view there is considerable scope for tightening up on contract terms, procedural discipline (not carrying out work without a signed contract or variation order), recording of costs and billing of variations.

None-the-less the success of the company in manufacturing niche products for new and refurbished railway carriages has given the company a significant boost in terms of turnover and profitability. This is just starting to come through in the figures and is the reason why the business projections are included as a key part of this sales documentation.

Offers for the business are invited at or around £500,000 plus £250,000 for the premises.

A B Engineering Ltd
Chapter 2
Background Information

Expressions of interest and or requests for further information should be addressed in the first instance to Phil Needham, at

British Business Brokers
8 Street Farm Cottages
The Street
Brampton
Norwich NR10 5AA

Tel 0333 3580050
Email phil@britishbusinesbrokers.co.uk

The proprietor of the business is Andrew Bloggs

The business for sale is

A B Engineering Ltd
Mill Road
Smalltown
Norfolk
NR20 1BC

Tel 01603 123456
Email andrew@abengineering.co.uk

Company number 01234567

Directors Mr A J Bloggs and Mrs S Bloggs

Shareholders	Mr A Bloggs	500
	Mrs S Bloggs	500

A B Engineering Ltd
Chapter 3
Sales and Marketing Information

Recent actual customers include

RAIL

- ABC
- Abtranz
- Alston
- Axion
- Bombadier
- Chiltern Wail
- Wailcare
- Seemens
- Floodgate Engineering
- Sailalawa
- TRS
- Bexcel
- Wastec

AIRCRAFT

- BZ Aerospace
- Swisfair
- De Havilling
- South Australian Airways

MARINE

- FBM Wicholson Interiors
- RNLI

AUTOMOTIVE

- Group Locus
- Pumarsport
- Mitsubashi
- Saat
- Verboden

MOTOR RACING

- Team Locus
- Formula Redault

The company does not have a sales department or undertake any marketing. Its niche status is such that customers approach it for low volume and development projects. For example the successful manufacture of the niche product pod has led to approaches from all of the three UK train refurbishment businesses and one overseas company.

All quotations are currently prepared by Andrew Bloggs

Refurbishment of the London underground and expansion of the rail industry in the UK and overseas, mean that the company's markets are very strong at present and are expected to remain expansive for the foreseeable future.

A B Engineering Ltd
Chapter 4
Description of the Financial Model

The financial model is driven by three job types:

- Niche Product Modules
- Standard Product Modules
- Other Work

The Standard Product Modules
Are taken out by the train refurbishment companies, and returned to A B Engineering Ltd. Decayed wood and man made components are removed and replaced; the module is brought into compliance with today's regulations and is generally upgraded and refreshed as required, then sent back to the refurbisher.

The Niche Product Modules
Are designed and built to fit into a standard UK passenger train carriage. By law every sixth rail carriage should now provide, a niche product. This means that both manufacturers of new carriages and firms refurbishing existing carriages need niche product pods, at the rate of one for every 6 carriages. Enquiries have been received from all major UK refurbishment companies and from UK and overseas carriage manufacturers.

There is a much bigger materials component to the manufacture of these modules than to most of the work carried out by A B Engineering Ltd.

Other Work
The Company does a massive variety of small painting and fabrication jobs. A typical job is painting the aluminium window surrounds for the driver emergency escape windows installed in GV trains. Each aluminium surround has to be rubbed down to bright aluminium and painted within 4 hours. The company has a contract to do a set of these every month for just over £1,000 per set.

The company also has a contract to respray a series of luggage holders, manufactured in Italy and destined for Derby, the original painting (in Italy) was not to exact colour or gloss specifications.

The other specialism is creating and manufacturing phenolic (fireproof glass fibre) mouldings. These are used in aeroplanes and ships, but at present virtually all the orders are coming out of the railway industry. Mouldings are being manufactured for carriages and station refurbishments, for mainline and underground railways.

For the painting and Phenolic work it usually works out that materials are around 20% of costs, labour at charge out is 80% of cost, labour at cost is about 30% of cost. Some jobs are for about £1,000 (like the TGV windows, but some jobs can be for up to £100,000 over a period of time)

The drivers and calculations are found on a separate sheet.

It is interesting that the total of the costed labour on the jobs is significantly less than the actual labour force of Arthur Birchall Coatings. The difference is modelled as “Inefficiency” but the author of this Prospectus considers that such levels of “inefficiency” are endemic to small jobbing workshops. Turnaround time, set up time, quality control inevitably erode the efficiency of any workshop handling small production runs. In practice many of the items manufactured by A B Engineering Ltd are from inadequate drawings and the business is regularly at the bottom of the learning curve (as yet another new product is taken up and sorted out)

Overheads are taken from the actual costs in recent periods.

It is clear that the new products, and the high levels of demand from the rail industry have created a situation where the business IS enjoying high levels of profitability and positive cash-flow.

Glossary

Adjusted Profit: The booked profit adjusted for reasonable proprietors salary (if missing) less private costs going through the business (if present).
Consolidator: A business seeking to become a big player in a particular industry by buying up numerous smaller competitors.
Corporate Finance: The profession dedicated to buying and selling businesses and financing business deals.
Earn Out: All or part of the payment for a business that is linked to future performance of the business.
EBITA: Earnings before interest, taxation, and Amortisation (Amortisation is a posh word for Depreciation).
Goodwill: The value of the business that cannot be attributed to tangible assets.
Intangible Assets: Assets that you can't kick (customer lists, Intellectual Property, Systems).
MBO: Management Buy-out.
OITRO: Offers in the region of.
Tangible Assets: Assets that you can kick (buildings, equipment, stocks).

The Author

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British Business Brokers

Offer the following services:

- Developing a **Business Strategy**
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-

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