How to ... sell your business

A guide for business owners & managers

*connectedthinking

PricewaterhouseCoopers

Introduction

The most frequent reason given by shareholders in a privately owned company for considering a sale, or part-sale, is the desire to release capital, for either financial security or new projects.

In reality, it is rarely for one reason alone but often for a combination of the following:

- To release capital or funds invested in the business
- To find a larger partner to grow the business
- To reward a loyal management team by allowing it to participate in the ownership
- The business has reached a size where the existing owner is unable or unwilling to manage it
- Where there is significant conflict between the shareholders or owner-managers
- Retirement may be looming
- In the case of a family business, there may be a lack of interest from the next generation

However, starting a sale exercise is not something your business, irrespective of size, should undertake lightly, and every effort should be made to manage the sale process professionally and to prepare or 'groom' your business to facilitate a successful result.

This booklet has been prepared, based on our knowledge and practical experience, to guide owner-managed or family businesses through the various stages involved in the sale of a business. While the contents of this guide are comprehensive, they are also presented in a user-friendly fashion. We believe that this guide can make a significant contribution to the small and mid-size business sector by helping owner-managers and family businesses deal with the critical issues which arise when selling a business.

We would be pleased to answer any questions that you may have arising from this guide. The contact details for our offices are set out on the back cover of this document.

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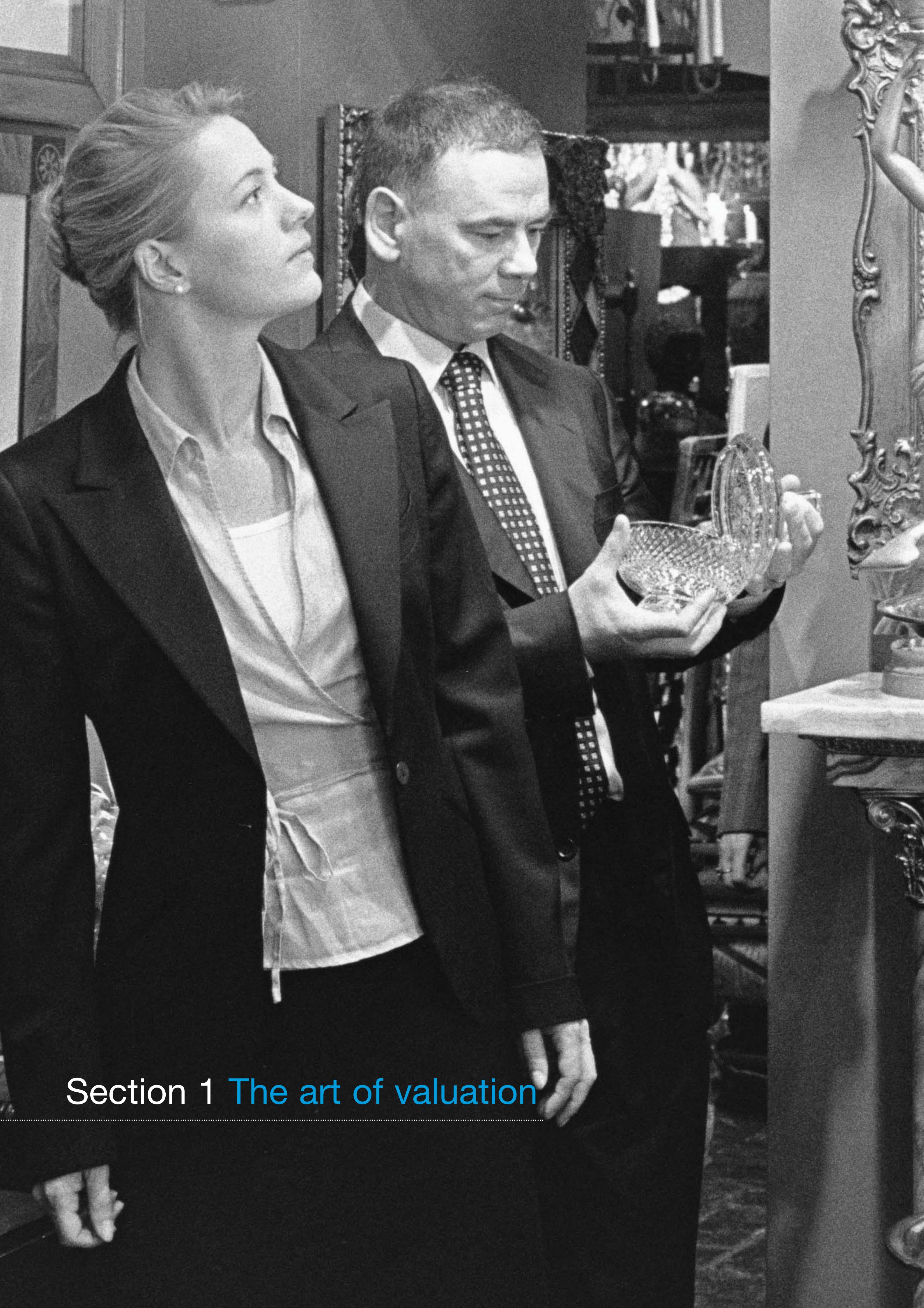


Section 1 The art of valuation

Most, if not all, owner-managers have at one time or another considered the question: "How much is my company worth?" Value is, of course, a subjective concept. At its best, valuation is an art. It is influenced by institutional, macroeconomic and personal factors.

What may be valuable to one person may actually be considered detrimental to another. For example, an in-house design department may be considered by one owner to be a significant attribute because it can provide proprietary designs quickly and efficiently, while another owner may perceive it as a detriment because of its high fixed costs and limited flexibility.

Given the subjective nature of calculating an accurate valuation range, it is tempting to avoid the exercise. However, if you are thinking about selling your business, raising new capital or, in the case of a family business, planning the succession process, this type of analysis may be critical to protecting your personal interests. The financial community relies on several quantitative techniques to arrive at an estimation of market value for operating businesses, and subsequently refines the estimate to take qualitative or subjective factors into account. These qualitative factors constitute the art of valuation.

Valuation basics

While no one technique should be relied upon exclusively, a realistic range of market values can be determined by employing several methodologies. The four most common valuation techniques are:

- Comparable Company Analysis - an attempt to measure value by employing the market values of public companies possessing attributes similar to your business, as benchmarks
- Comparable Transaction Analysis - similar to the previous technique except companies used as models are those companies that have been recently bought or sold
- Discounted Cash Flow - based on one simple premise; the worth of a company is based on the total amount of after-tax cash it can generate for the benefit of its shareholders
- Liquidation Analysis - valuing a company by determining what proceeds can be derived from selling off assets, less the cost of satisfying liabilities

Other value influencers

Many qualitative factors are not captured in rigid quantitative methods despite their obvious impact on value. Some of these factors may influence value in the eyes of many, while others may be important only to a few. This is where matching the right seller

seller to the right buyer can make all the difference in obtaining the greatest value for your business.

The significant emphasis placed by potential purchasers on subjective characteristics cannot be discounted and must not be overlooked. Below is a sample of factors that can impact on the value of your business but which are not directly taken into account with traditional quantitative approaches:

- Dominant market share
- Company size and critical mass
- Union-management relations
- Strength of competition
- Technological capability and expertise
- Size of backlog
- Location of operations
- Strength of customer / supplier relationships
- Competence of management
- Tax considerations
- Intangible assets (eg mailing lists and key supply contracts)
- Surplus / non-core assets

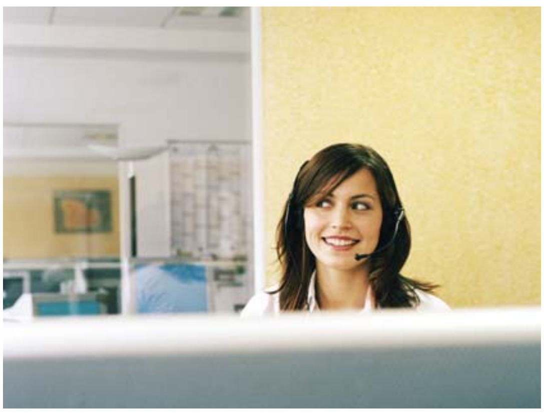
The market matters

The current market environment must also be taken into account when assessing market value. If your company is in a 'hot' industry segment in terms of merger and acquisition activity, a significant premium may be offered by potential buyers. On the other hand, a profitable business in an industry which is not the subject of much corporate activity may actually carry a market value lower than that of an unprofitable company in a highly popular market. Other market factors that can influence value include:

- Availability of finance
- Interest by foreign companies
- General economic conditions
- Positioning of company in a sale process

Why be in the dark?

Even if you are not currently interested in selling your company, going through the exercise of determining its market value has many advantages. It can identify competitive weaknesses in your operations, highlight misallocation of resources and bring to light new opportunities for growth or other value-enhancing ideas. In addition, determining that the value of the company is greater to you than



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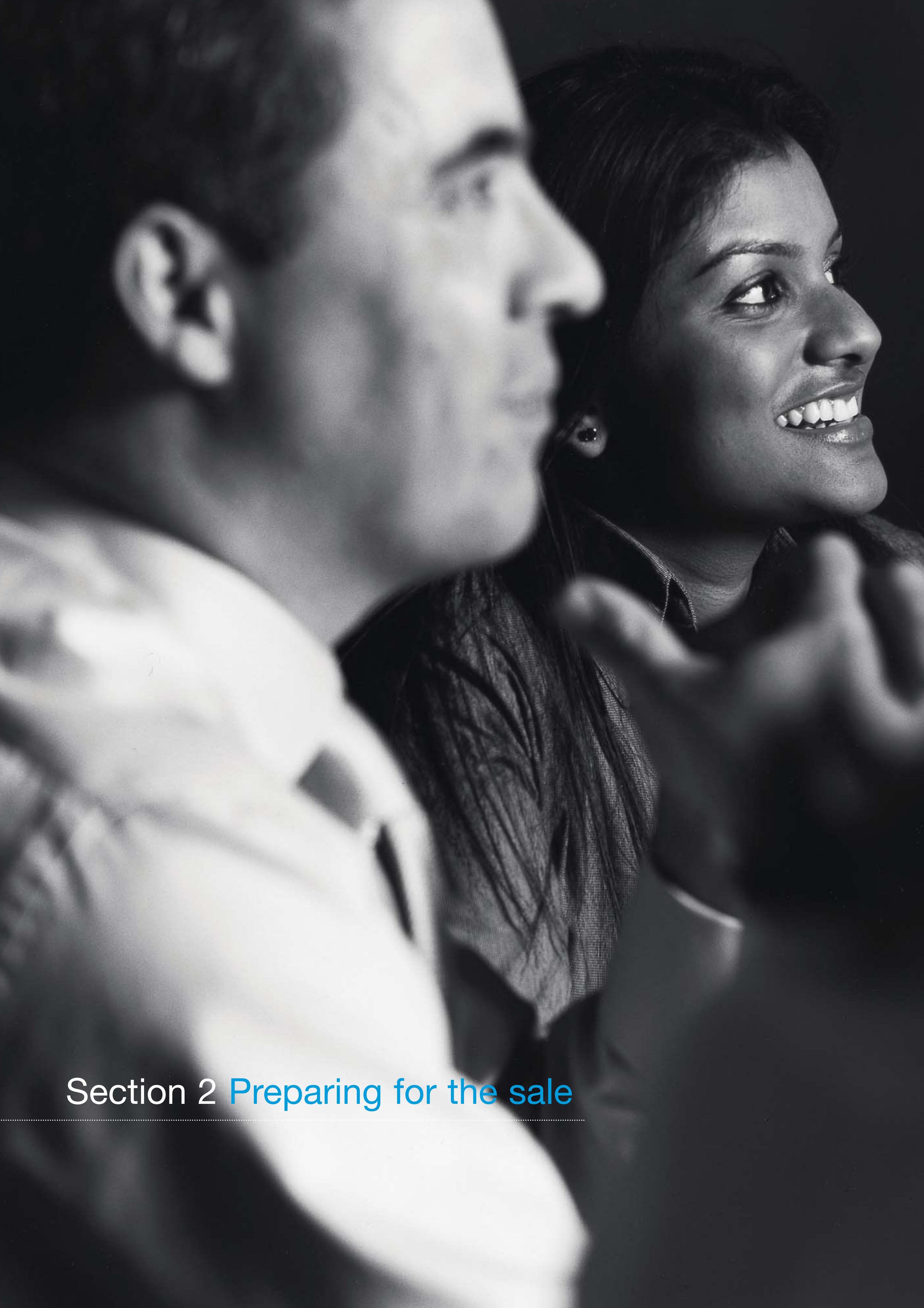
to someone else provides encouragement to forge ahead under your current structure. However, if it transpires that the market is valuing your business at a level you find surprising it may be time to cash out, in whole or in part.

Know as you go

While valuing a company is not an exact science, it is also not a total mystery. Valuation is an art practised by experienced financial professionals. Given the complexities of analysing all the direct and indirect factors influencing a company's value, it is often a good practice to meet with a financial advisor such as PricewaterhouseCoopers as early as possible. We can be just as valuable to you in quantifying a realistic valuation range as in preparing your company for sale. Additionally, as the dynamics of the market change, a trusted, informed advisor can quickly re-evaluate your company's worth, thereby enhancing your chances of selling at the best possible time and price.



Section 2 Preparing for the sale

After careful thought, and probably a few sleepless nights, you have determined that it is time to sell the business. The preliminary valuation work pointed to a range of acceptable estimated market values and, hopefully, you have engaged the services of a financial advisor to spearhead the effort.

For many, this is a once-in-a-lifetime event. As with most such events, the process is likely to be unfamiliar and perhaps a little uncomfortable. But you didn't get this far by avoiding the unknown. Now that you have a good idea about why you want to sell the business, the question is: "How?"

In a nutshell

A typical sale process, if there is such a thing, can be broken down into four broad phases:

(1) Preparing for sale

(2) Marketing the company

(3) Negotiating the deal

(4) Closing the transaction

Though it sounds simple, here's some advice: Each phase is an important step towards giving you the strongest position at the bargaining table. Resist the urge to jump right to the marketing phase and you'll reap the rewards!

Prepare to succeed

It has often been said that successful entrepreneurs begin to prepare their companies for sale the first day that their businesses are established. While this may not be meant to be taken literally, it does highlight a key point: most characteristics that enhance your company's marketability take time to develop. It takes more than a little touch-up or a coat of paint to sell your business at the price you feel it is worth. The presence of several of the following characteristics will significantly enhance your company's marketability and make it more likely that you will obtain a strong offer:

- Depth of management
- Clear top management succession
- History of audited financial statements
- Consistent reinvestment of earnings into operations
- Discipline of regular business plans / projections

To the extent that selling your company is planned for some time in the future, addressing the above attributes and incorporating them into your operations now will go a long way to ensure that you meet your financial objectives when the time is right to sell.

Grooming tips

Every effort should be made to prepare or 'groom' your business to ensure it is sold successfully first time. While the financial advisors you appoint will work with you to address issues specific to your company, there are a number of general grooming points worth considering (even before you appoint advisors) to maximise the value of your business:

- Sales & Profitability: In the past you may have been setting your prices, and thus your profit margins, at levels designed to create barriers to entry for your competition. If you are planning a business sale your focus is likely to be less long-term in nature and it may be worth re-examining your market and customer base to see if higher selling prices and margins could be achieved. If the proposed sale itself is a number of years away you may want to consider performing a strategic review of the entire business.
- Operating Costs: You should regularly review your operating costs but especially so when preparing your business for sale. Are there any costs that could be reduced, or removed altogether, without affecting the operational effectiveness of your business?
- Profit Trends: Apart from current margins, a purchaser will be looking at profit trends. They will be hoping to see stable and steady growth in the years leading up to a sale. So, risky projects should be avoided and longer-term contracts that may prove to be onerous should be fully considered before acceptance. Needless to say, unprofitable contracts should be re-evaluated and, if appropriate, terminated if they are likely to impact adversely on the value of your business.
- Management Team: The purchaser of your business will be hoping to acquire a quality management team. It may be worth reviewing your corporate structure to ensure that job titles and role descriptions adequately reflect the contribution that your management team makes to your business. Any re-structuring required should be performed well in advance of a sale. A purchaser may also want assurance that the management team is supportive of your decision to sell or at least that it is likely to stay with the business for a reasonable period post-transaction. You should consider talking to management - how co-operative will they be? Indeed, they may be interested in buying the business themselves.
- Asset Base: Are there any assets in the

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business that may be of little or no interest or use to a potential purchaser - eg short-term investments, under-utilised property, equipment or perhaps surplus cash? Think about realising and removing them from the business before the sale. It is also worthwhile having all your property assets valued separately.

- Restructuring: If your business has more than one division some thought should be given to restructuring it into a number of stand-alone entities and perhaps selling these separately. Any such reorganisation will have potentially significant tax implications and other complexities associated with it and it will be important to take professional advice before undertaking any such initiative.
- Tax Planning: Details of the various tax factors which you need to consider are set out in section 4 of this guide. Initial points to address include making sure that all your Corporation Tax, PAYE and VAT returns and payments are up to date. In addition, any tax losses that your company may have built up over the years may now have a value to the extent that they are available for use by the potential purchaser. Personal tax planning opportunities should also be discussed with your tax adviser.
- Valuation Expectations: You must have realistic valuation expectations. Valuation is important but do not let it get in the way of securing the sale.
- Timing: Deciding the best time to sell your business can be a difficult call to make. Factors to be considered when making this decision include: the level of corporate activity in your industry; the state of the economy; changes in legislation impacting on your sector; and available tax reliefs (eg do you have to be a certain age to avail of certain retirement reliefs or pension planning opportunities).

It is better to sell your business on historical trends and results - they are a proven track record to which you can point and will provide a strong negotiation platform. If you forecast growth of 20% for the coming year and can point to 20% annual growth for the last two to three years your forecast will have more credibility. If however you forecast 20% growth and have to justify that this is achievable by selling off part of the business, some of the assets, cutting costs and increasing profit margins, the natural questions that will arise are - "Why haven't you done it already" and "Why should the purchaser share these potential post-transaction gains with you?".

Put it in writing

A major step in readying your company for market is the preparation of an Information Memorandum. This document can range from 10 to 200 pages and is an initial compilation of materials that will be distributed to interested buyers. The key to preparing this memorandum is to focus on its intended purpose - marketing your business. Accurately describe the company, its history, products, markets, competition, personnel, facilities and financial performance (historical and projected) in a way that highlights your organisation's strengths and potential. When prospective buyers complete a review of the memorandum, they should clearly understand the company's unique investment merits, or 'growth potential'. Your company's investment story is introduced, supported and reinforced in the memorandum.

The challenge is to design a selling document that compels potential buyers to conclude that the opportunity to acquire your business is not just another investment, but is a chance to realise benefits and potential that cannot be otherwise achieved.

From the time you and your advisor begin an analysis of your company, preparing this Information Memorandum should take four to six weeks.

Target potential buyers

While the selling document is being prepared, you and your advisor should be developing a list of possible purchasers to target. It is during this process that the advisor's knowledge of the mergers and acquisitions marketplace will be extremely valuable. Your advisor should have a feel for which buyers are actively pursuing investment opportunities and a good sense of the attractiveness of your particular industry segment to such investors. Potential buyers usually fall into one of the following categories:

- Direct competitors
- Companies serving the same end-user
- Customers looking to capture channels of distribution
- Suppliers
- Companies using similar technology
- Companies with countercyclical products
- Investment companies

Value is in the eye of the buyer

There are more buyers out there for your company than you might think. PricewaterhouseCoopers professionals advised on the sale of a significant regional newspaper publishing group. The sale process was extremely competitive, attracting a wide spectrum of buyers, each with its own specific interest in the company.

Some buyers were interested in the client's steady earnings stream, while others saw great potential in generating additional revenue via new distribution channels. Others wanted to acquire the target because it was a geographical fit to their existing titles or provided access to the Irish regional newspaper market and the exposure to the Irish economy which this entailed. The point is: the range of potential buyers will often far exceed expectations.

The initial list of potential buyers should be as broad as possible, both domestic and international. It is easier to start from here and carefully reduce the numbers (usually through a system of setting priorities) than it is trying to add to a short list later in the selling process. Ranking potential acquirers from most to least logical requires an assessment of how each of the following characteristics applies to a particular buyer:

- Potential synergistic benefits of your business with their existing operations
- Capital / financing available to close the transaction
- Experience in completing acquisitions
- Previous knowledge of, or involvement with, the company / industry
- Geographical proximity
- Announced intentions to grow through acquisition.

It is at this point that the first critical decision must be made: how broadly should you market your company?

A wide distribution of the Information Memorandum increases the probability of achieving the best price, but also increases the likelihood of damaging your company by sharing sensitive information with too many people. Your competitors may be the 'best' buyers, but they are also the ones who could inflict the most harm on your business if they are privy to confidential marketing and manufacturing information. Because this decision sets the stage for the marketing process, we will address the advantages and disadvantages of narrow versus wide distribution in more detail in section 3 of this guide.

Maintain your momentum

Investing time in the preparation phase is likely to pay off by putting you at a distinct advantage during negotiations. Remember, keep asking yourself: "What can I do now to avoid delays once the process is rolling?". For example:

- Complete the memorandum so that it can be distributed immediately when a strong prospect is identified
- Ensure that your company's 'investment story' is clearly understood and supported by senior management, particularly those who will have regular contact with potential buyers
- Anticipate the buyer's basic due diligence requirements and gather the appropriate information as early as possible
- Adjust your corporate structure to eliminate certain asset classes that you may wish to retain

Once you have begun preparing your company for sale, your momentum will maximise the strength of your bargaining position. With few exceptions, the best prepared companies:

(1) find the process to be the least disruptive to current operations

(2) are able to identify and deal with the greatest number of potential bidders

(3) command the highest price multiples

Section 3 Marketing your company

At times it seemed like it would never happen: your advisors, lawyers, shareholders and other informed parties have finally approved what feels like the 1,000th draft of the memorandum that presents your company's 'investment story'.

All the preliminary stages have been completed and you are about to enter the uncharted waters of presenting your company to potential buyers. Don't be alarmed if some of the waves muddying those waters come from you. It is natural at this critical phase to ask: "Why am I doing this?" or to feel the need to steer too much of the marketing process yourself. The key to smooth sailing is to trust your chosen advisors who have navigated this course many times before.

How broadly to market?

In the last chapter, we touched on the decision of how broad the marketing phase should be to maximise success and minimise risk. There are no set answers here. Each case must be analysed individually. For example, companies with significant proprietary technology may find sharing company information with competitors devastating. These same competitors however, may be the only 'buyers' capable of satisfying the financial objectives of the sellers.

In contrast, a manufacturing operation whose success is not based on proprietary technology, but on strong management, personnel, or customer relationships, would have little to risk by sharing information with competitors. However, the challenge here is to convince a buyer of the value of these 'human' or intangible assets.

Other considerations affecting the decision on how broadly to market one's company include:

- How quickly must a transaction be completed? In general, the shorter your time horizon, the shorter the list of buyers
- How complicated is the business or the expected structure of the transaction? If your company's intrinsic value does not come across well in your memorandum, it is often best to focus on a few select buyers
- How has the business been performing? If much explaining is necessary for a buyer to grasp your company's value, concentrate your efforts only on the most likely buyers

The 'A' list

In most cases, a compromise is reached on the above issues. Usually, an 'A' list of potential buyers is identified in the first instance. These will probably be contacted on a no names basis using your financial advisor as an intermediary. The group may average 5 to 10 potential acquirers, but could have as few as 3 or as many as 20. 'B' or 'C' buyer classifications serve as a backup only if the 'A' list has been exhausted. Another option is to break your buying list into two groups: competitors and non-competitors. Competitors could receive a more generic memorandum than non-competitors in order to minimise the risk of information leaks. While this approach may work, it can cause confusion because it creates two parallel processes that may be difficult to control.

Keep in mind

The following points should receive management focus throughout the marketing phase:

- First and foremost, run your company as if you will always own it. You never know if the sale process will end with an unacceptable offer
- Confidentiality agreements should always be executed with potential purchasers. However, don't rely on them completely. Information gets out. The key is to have as short a sale process as possible in order to limit the inevitable leaks
- Plan carefully when and how you will tell your employees that the company is being sold. In many cases a direct announcement with a system for regular updates is far less disruptive and damaging than the inevitable rumours. The approach adopted should be designed to suit both personal and business objectives and as such will vary from business to business

Contacting potential buyers

One of the questions asked most often by owners contemplating the sale of their business is: How are you going to contact potential buyers? Some intermediaries will prepare an introductory letter, mail it to potential acquirers and follow up with calls.

In general, it is most effective to make the first contact directly by telephone. A call will allow your advisor to position the opportunity in the most favourable light, gauge the first reaction of the potential acquirer (which is critical and often the most telling) and set the stage for any follow up.

In the majority of cases companies are sold through a combination of auctions and negotiated sales. Most financial advisors today

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attempt to run something akin to an auction in the early stages, to reduce the buyer group to three or four bidders and then seek to negotiate the best offer from there.

A common first auction step is to request that all parties who receive an information memorandum respond with an indication of interest within a set time. The response establishes that a potential buyer is interested in pursuing the acquisition in more detail. A good advisor will have requested the interested parties to include some or all of the following in the response:

- Non-binding preliminary valuation range
- Confirmation of their capability to finance the transaction
- Steps necessary to make a definitive offer
- Time required to make a final decision
- Reasons for making the acquisition
- Description of plans for the company in the future
- Anything else to help verify the potential purchaser's interest

Site visits

The hope is to receive a number of responses from which a small group will be chosen to move on to the next phase of the marketing process - usually management visits.

While essential, plant and management visits hold the greatest potential to disrupt business operations and confidentiality. If your workforce has not been informed of your decision to sell the business, they surely will know after a number of pinstripe suits parade through your facilities in rapid succession.

Critical proprietary information such as plant operating systems, future plans and R&D programmes are regular points of discussion during site visits. On the flip side, this face-to-face interaction could be your one chance to convince the buyer that this investment opportunity is unique, built on a solid footing and full of potential.

The need to prepare for these visits cannot be overestimated. Your financial advisors should assist you in preparing a brief oral presentation on the company's history, its operations, and its plans. The presentation tone and style should reflect the culture of the company. If an acquirer appears uncomfortable with the content, it is more likely that he will feel uncomfortable with your company.

Selecting visitors

Just as you and your advisors initially had to decide on how broadly to market the company, you must now decide how many buyers should visit. In practice, four to six visits are adequate and can usually be accommodated. More than this will not only make it very difficult to keep the business operating smoothly, but will tend to delay progress without adding much additional value. Once again, there is no hard-and-fast rule here. The number of visits should be as few as possible while still encouraging competition.

Managing information requests

Patient until this point, you may feel that satisfying all the prospective buyer requests for additional information is not only too time consuming, but impossible. One effective way to limit the time input is to have your advisors help identify the most common buyer information requests as early as possible in the process, and to begin to gather such data long before the company is marketed.

One helpful hint is for you and your advisors to take all the requests by potential acquirers, reduce them to a reasonable list and supply all the bidders with the same supplemental package. Any additional information should be limited and can be handled verbally or on an individual basis.

Heads of agreement

After answering all the questions of the remaining bidders, your advisors should be steering the acquirers to present their formal offers, usually in the form of a Heads of Agreement (HOA). The HOA will usually spell out an indicative purchase price, how it will be paid (eg cash, shares), contingencies upon which the offer is based and the steps necessary to close.

Maintain the momentum

A successful marketing campaign maintains a steady pace. Keeping the momentum going, whereby potential acquirers move through the marketing phase on close schedules, enables a seller to benefit from the perceived competition. Your best chance for achieving this is a carefully orchestrated, tightly-managed process. Why run the risk of being forced to decide on an early and barely adequate offer before other more lucrative offers materialise? The phrase "one in the hand is worth two in the bush" is no comfort when so much is at stake in your transaction.

Remember, steps taken in each phase, up until the final negotiation, from valuation to tightly-controlled marketing - can strengthen your negotiating position and ultimately increase the selling price.

Section 4 Managing the tax issues involved

If you are to receive the best return from your business, it is essential that all the taxation issues, both pitfalls and opportunities, are taken into account as part of the sales process.

It might be assumed that the availability of a historically low rate of capital gains tax of 20% should eliminate the need for any significant level of tax planning but, in reality, major efficiencies can be achieved at every stage in the sale process.

Preparing the business for sale

Many companies, particularly traditional family businesses, will have diversified over the years into a range of business operations. It is very often the case that prospective purchasers will be interested in acquiring specific lines of business rather than an amalgamation of businesses, many of which have no natural linkage. In such circumstances, the value of the enterprise can be enhanced by splitting the business into distinct units so that each is held separately by the founder or owner-manager, perhaps through an overall holding company structure.

Moving to such a structure can have significant tax costs, particularly capital gains tax and stamp duties, unless carefully planned and executed. A tax efficient splitting of the component elements of a business also presents the owner with an opportunity to retain an interest in some parts of the enterprise, for example, property assets, or to facilitate succession to part of the business by the next generation of the family.

In some scenarios the best commercial result can be achieved by consolidating different businesses which are currently held separately, and again, pre-sale re-structuring can be accommodated on an effective tax-free basis with appropriate advance planning.

A prospective purchaser will generally require undertakings in the form of tax warranties and indemnities. Any issues which might emerge here should be identified as early as possible in the planning stage of preparing your business for sale. These issues should, as far as possible, be resolved before ‘going to market’ as this will avoid both the delays and costs which might otherwise occur later in the process.

Achieving the maximum net of tax return

Even before a specific offer for the business is received, it is important that you review all of the options for extracting value from the business you have grown over the years. A number of routes can be considered here. These include:

- The establishment or enhancement of pension scheme arrangements so that you can be provided with significant cash lump sums and / or pension income on a tax efficient basis
- The facility to receive tax-free ex-gratia payments from the company
- The extraction of dividends prior to negotiating a sale may produce after-tax benefits

Also, the owner of a family owned company may secure savings by use of the generous retirement relief provisions and business property reliefs for transfers to family members.

Structuring a sale transaction tax effectively

From a tax perspective, the precise nature of a sale transaction can have a major impact on your after-tax position. For example, a business may be carried on within a subsidiary company of a principal holding company. Disposal options in these circumstances would include:

(1) Selling the holding company,

(2) Selling the trading subsidiary, or

(3) Selling the business undertaking out of the trading subsidiary.

The capital gains tax consequences in each scenario will depend on individual circumstances and other historical factors but significant savings can be achieved depending on which route is taken. For example if the relevant conditions are met, a holding company could dispose its shares in a trading subsidiary without incurring a tax liability on the gain. Furthermore, the rate of stamp duty payable on the sale of a business could be up to 9% whereas that on share transactions will not exceed 1%.

Immediate tax exposures can be avoided where you decide to effect a disposal through a 'share-for-share' arrangement if there is no immediate requirement for cash. Apart from postponing the date on which tax is payable, such an approach may provide a seller with a further opportunity to manage the tax exposures. For example, an individual intending to emigrate may ultimately avoid any tax exposure by selling the replacement shares after relocating abroad.

Accommodating the purchaser

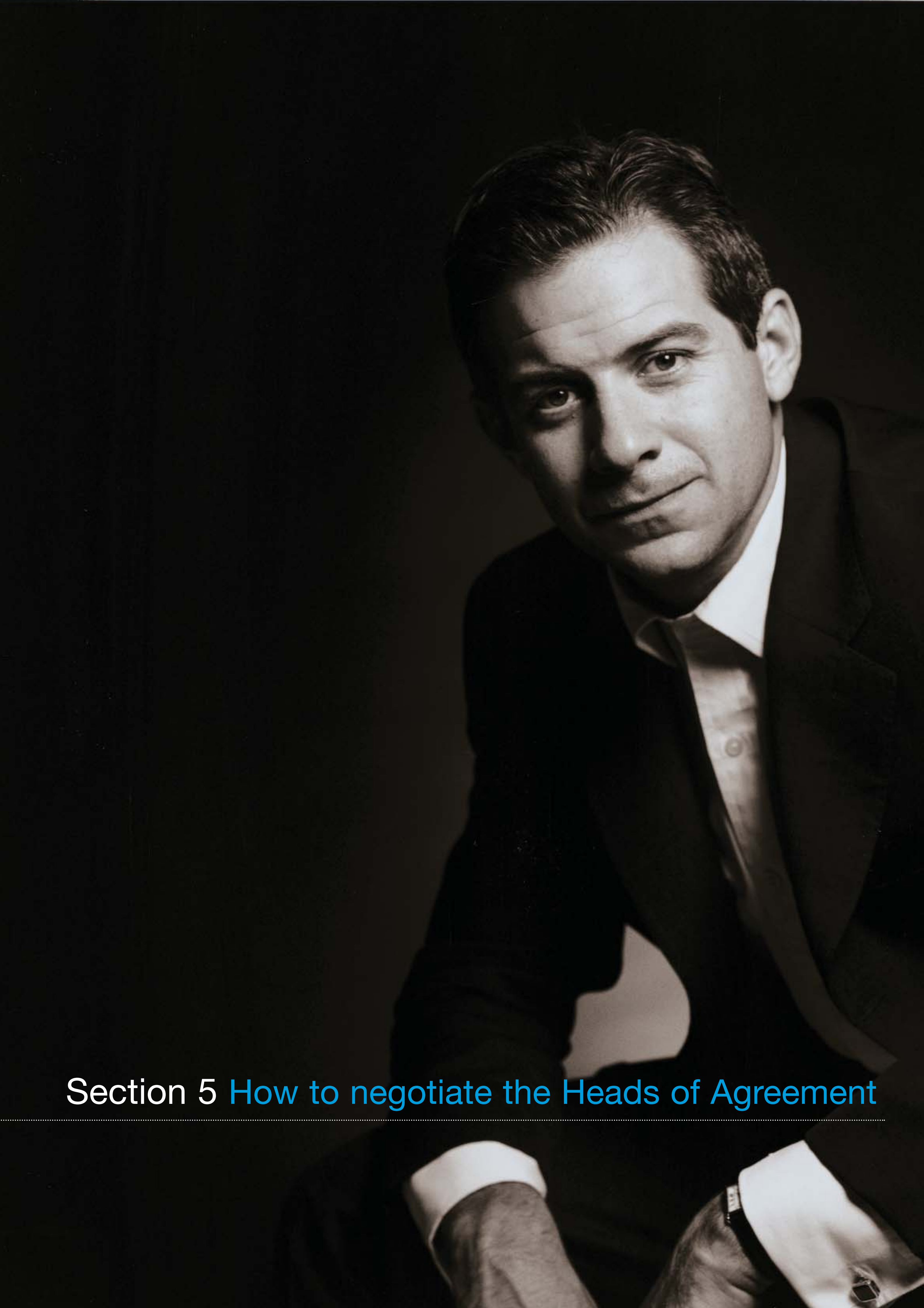
Any prospective purchaser of a business will have certain preferences in terms of how the transaction is to be structured. Insofar as these preferences can be accommodated, you as the seller should be in a position to secure a

Developing an effective tax strategy around the sale of your business is an issue that you should address as early as possible...

premium price. Depending on the nature of the business, it may well be that the purchaser will want you to remain involved in the company as part of the management team and perhaps retain a shareholding in the short to medium term. The earn-out, or similar arrangements to be put in place to reward you during the transition phase will have significant tax implications that require careful planning in order to ensure tax efficiency.

In general, a business purchaser will have significant borrowings and will aim to secure full tax relief on the associated interest costs. Your cooperation will be required to accommodate such an arrangement and especially so in the context of management buyouts. In such a scenario, it is important to ensure that management secure their start up shareholdings on a tax efficient basis and that any proposed share option arrangements are in place from the outset.

Developing an effective tax strategy around the sale of your business is an issue that you should address as early as possible in the planning phase. Being aware of the issues involved and the various options open to you improves your chances of structuring the sale of your business in as tax efficient a manner as possible.



Section 5 How to negotiate the Heads of Agreement

Just as you start to feel that you cannot make it through one more potential buyer's management visit, your financial advisor calls with the news: a potential buyer wants to pursue the acquisition of your company.

You feel a rush, and are ready to accept a big price in cash at closing, with no strings attached.

Unfortunately, the potential buyer has made a preliminary proposal to buy your company at an average price, with some of the payments paid out over time, which is all contingent upon you remaining active in the business for some period of time. Do not panic - this is undoubtedly not what the final deal will look like. You have just entered into the next phase of the process: the negotiation.

Getting down to basics

The basic principles will be the same whether you have one or many bidders. The first tenet in any negotiation is to allow your financial advisor to lead the effort. No one says this is going to be easy for the typical entrepreneur. Finely tuned sale negotiations are very similar to summit talks between two nations. The leaders do not get together until much of the background work and negotiations have already been debated. As the business owner has been a follower throughout this process, so must he or she continue to allow the financial advisor to manage the proceedings, particularly as they move closer to a conclusion. Unless the stage is properly set for negotiations, a face-to-face, all-hands gathering could easily result in an explosive confrontation, causing irreparable damage.

Enhancing the seller's position

As lead negotiator, the financial advisor can significantly enhance the seller's position by:

- Acting as a buffer to protect the amicable relationship between the buyer and seller, which may be critical if the seller is to remain for a transition period.
- Offering up potential deal parameters to gauge the reaction of the seller without having to live by them. A typical comment could be, "I am not sure that my client will accept this, but what if we were to.."
- Protecting against the acceptance of a term or condition which, on closer inspection, would not be in the best interests of the seller. By including a third party, an additional step is added before any responses can be made on particular issues, buying time to reflect on its impact.
- Taking the role of fall guy, who can be blamed for problems that will invariably occur between the beginning of

negotiations and the closing of the deal. The financial advisor can be the ‘good guy’ or ‘bad guy’ or whatever role is required to protect the seller's interest.

- Reducing the element of emotion, which is one of the leading causes of broken deals in transactions involving owner-managed and family companies.

Heads of Agreement

Typically, a buyer and seller agree to general terms and conditions of a transaction in a document called a Heads of Agreement (HOA). The HOA is a non-binding document outlining issues relevant to the proposed sale and purchase agreement.

The areas that the HOA generally cover include:

- Definition of parties and legal terms used
- Transaction structure - shares or assets and liabilities being acquired
- Form and structure of the consideration being paid
- Whether completion accounts are being prepared (price adjustments mechanisms)
- Balance sheet date used as basis
- Assumptions made about specific assets (eg stock, debtors, cash, loans, intercompany balances, pensions, taxation etc)
- Exclusivity
- Restrictive covenant preventing the business being sold within an agreed period - 'non embarrassment clause'
- Restrictive covenant preventing the vendor from competing with the business for an agreed period of time
- Principal warranties and indemnities to be given to the vendor (and, occasionally, the de minimis limits to apply)
- Provisions relating to bearing of transaction costs
- Specific commercial arrangements and agreements, including ongoing role of management
- Business conducted in ordinary course between now and completion
- Confidentiality
- Completion timetable, arrangements, announcements (outline timetable)
- Subject to finance, due diligence, shareholder / board approval
- Any other important conditions to which the transaction remains subject, for example, regulatory clearance

You will need legal advisors with the depth of resources and experience to ensure a successful merger or acquisition transaction.

- Subject to sale and purchase agreement
- Explicit statement to effect HOA non-binding other than exclusivity / confidentiality clause and that parties signing in good faith with a view to reaching final agreement on proposed transaction within the period of exclusivity

Beyond the basics

Beyond these basic terms, a HOA should cover all the key points that the buyer or the seller feels are critical to resolve if a deal is to be completed. Such key points, so-called 'deal breakers' must be addressed as early in the process as possible.

The least expensive time to conclude that a deal cannot be structured is at the beginning of the process. No responsible financial advisor would allow a seller to rush into the final phases of a transaction, such as due diligence or purchase and sale agreement, before knowing with some certainty that there is a high probability of closing.

Following the execution of a HOA, both sides will begin to incur significant expenses, including legal and accounting fees and expenses related to regulatory issues. Such expenses must be paid whether or not a deal is consummated. In addition to the heavy economic costs of failing to complete a sale, the emotional toll on the management and its employees is significant and can be extremely damaging.

Legal representation

If you have not already done so, now is the time to get serious about obtaining the most capable legal representation. You will need legal advisors with the depth of resources and experience to ensure a successful merger or acquisition transaction. While there is usually a role for your existing solicitor, in most cases, it is highly recommended that you retain legal advisors with significant corporate finance experience to handle this once-off business event.

These advisors will be particularly valuable in protecting your interests within the intricate language on indemnification, representations and warranties, default terminations and other areas primarily found in the purchase and sale agreement.

How far to go?

There is a fine line between including too much in a HOA in the hope of limiting all possible stumbling blocks at the end, and including too little in order to speed up the process. It is at this point that the entrepreneur must, once again, rely on his advisors, both financial and legal.

If you and your financial advisor have worked together forthrightly, the key deal points should already be defined and specifically addressed in the HOA. A knowledgeable advisor, particularly one experienced in selling owner-managed and family companies, will have already primed the buyer as to what you consider critical issues.

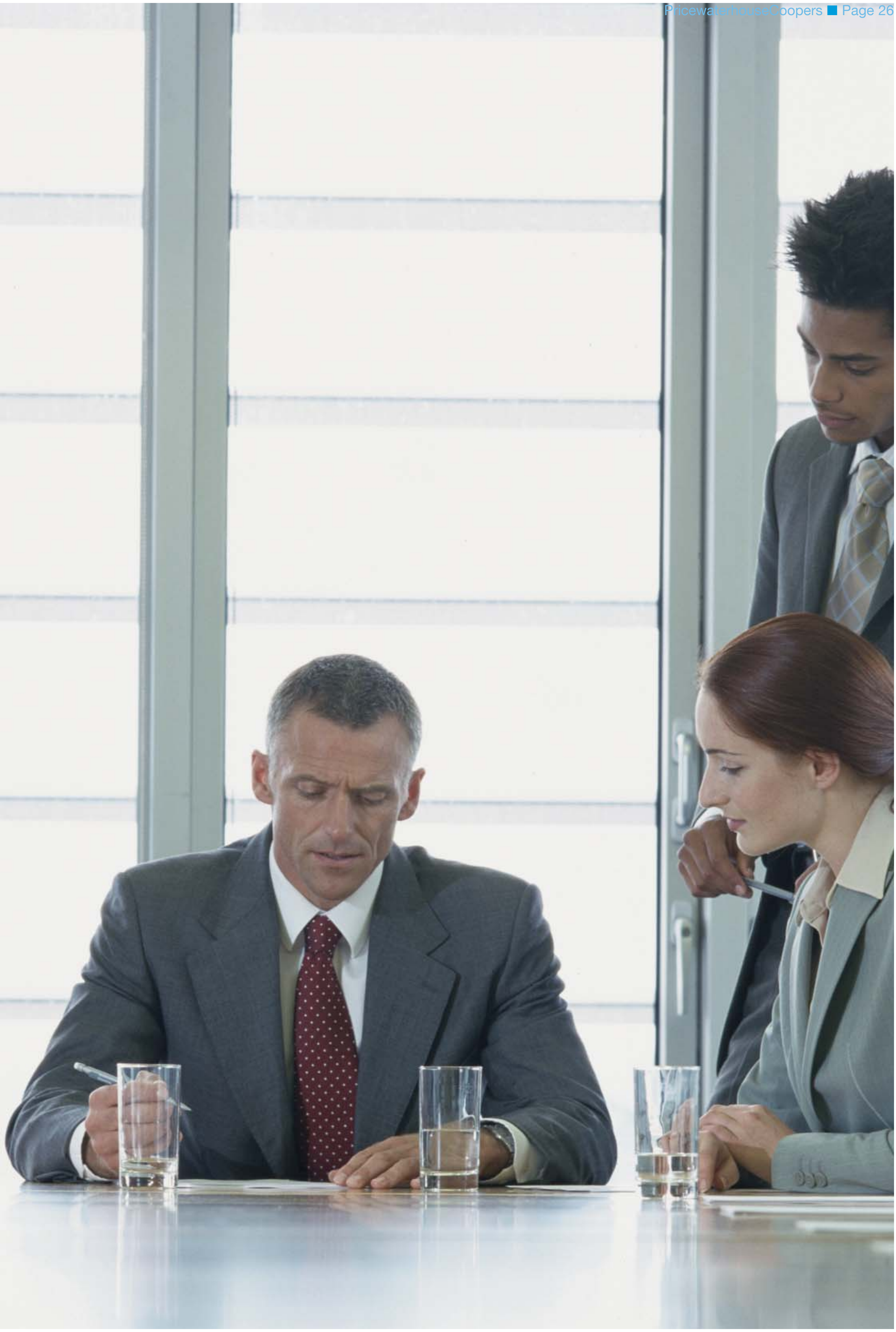
Often, many of the more critical factors are non-financial in nature; such as the future of certain employees; the role of the owner after the sale; and movement or closing of particular operations.

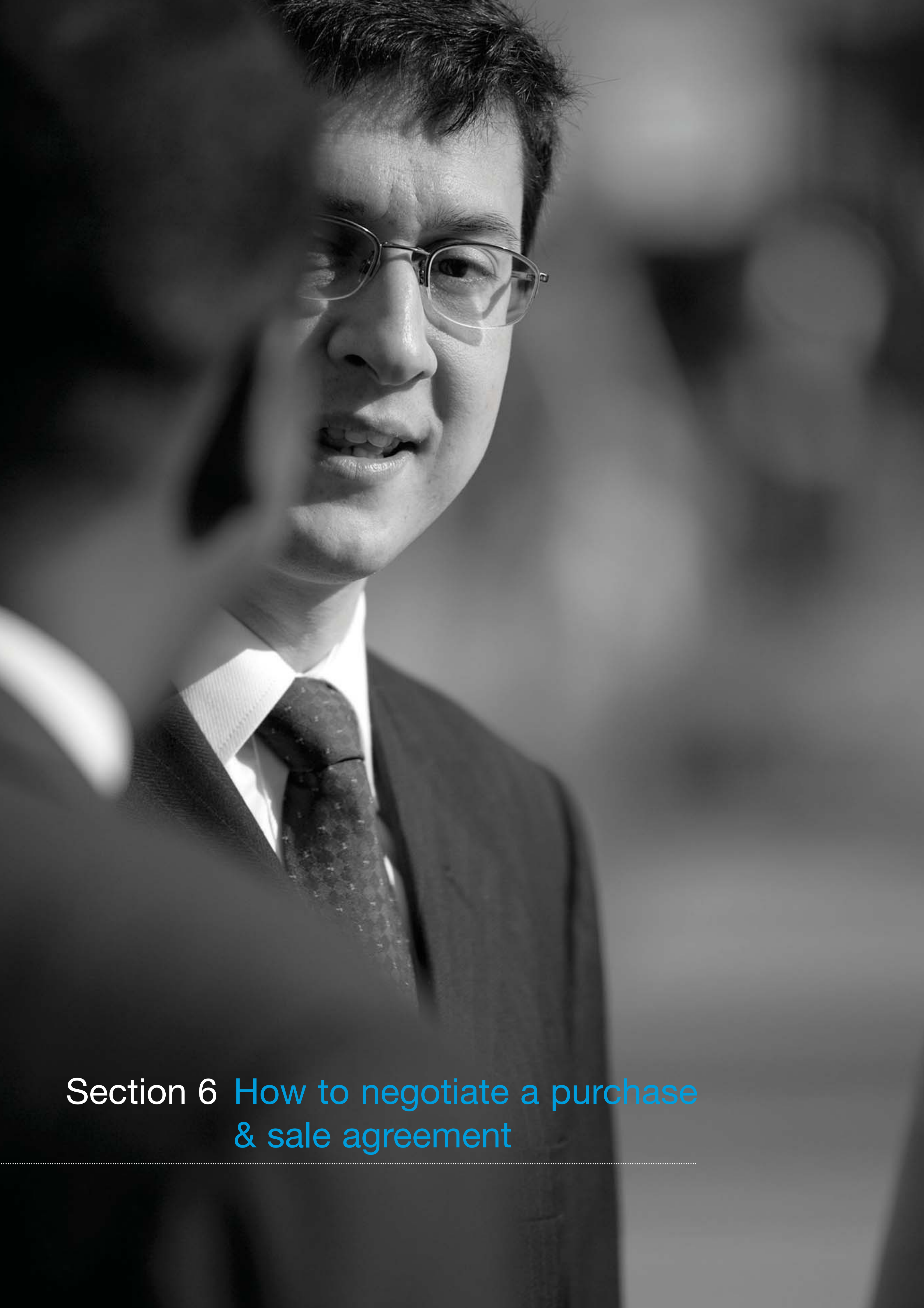
Attempting early-on to negotiate every point in the HOA often comes at a high price. A buyer will be in a much better position to understand the hidden values in a business later, after completing due diligence. For example, a buyer may be unwilling to agree to the notion that stock over a year old has any value if he is forced to make that decision too early in the process. However, once he has had the opportunity to study the market in more detail, and to review the stock first-hand, he may be more willing to accept your assessment of value.

A second point to remember about upfront negotiating is that the emotional and financial stakes are higher when the parties sense an acquisition is near to a successful close. If the closing of a deal is in sight, buyers and sellers alike will have a much greater tendency to concede particular points to protect the deal than at any other stage of the process. For the well-advised seller, a number of small but valuable adjustments to the deal have the best chance of being procured near the end of the process. Of course, the buyer may adopt the same strategy.

Moving to the close

Once the major deal points have been hammered out, and the HOA has been executed by both sides, everyone shifts into high gear to move as quickly as possible to closing. Expenses begin to mount, an announcement to your employees will most likely be necessary, and maintaining management's focus on the company's operations can become extremely difficult. Do not enter into a HOA lightly. Your mindset should be: once you sign the HOA, you expect the deal to happen, you will do whatever is necessary to make it happen, and overall, you can accept the terms and conditions of the deal, as is.





Section 6 How to negotiate a purchase & sale agreement

You have reached the stage where you finally have something to celebrate. The arduous journey to sell your company has led you to a suitable buyer. With a signed Heads of Agreement in hand, it seems that you have met many of the objectives you set out to achieve some six months ago.

Despite all of this, you are now feeling something you may have never felt before: lost. In many cases, the private business owner feels his first taste of finality of his decisions soon after signing a Heads of Agreement. He or she may ask: "What have I done? What am I going to do when this is all over? What is going to happen to **MY** company?".

The best relief from 'the lost-owner blues' is simple: stay focused on running your company. The contemplated transaction is far from being closed, and any hiccups in your company's performance at this time will have a major impact on the ultimate terms of the deal. In the mid 1980s, many financial buyers prided themselves on never having failed to sign a purchase and sale agreement or close a deal on which they had signed a Heads of Agreement. Today, it can be routine for deals to break down during the final stages.

Now, it takes more than agreement on basic terms and conditions to close a deal. The new reality is that the current environment for financing, our litigious society, and the heightened public concern over environmental issues have introduced major points of contention often addressed in the purchase and sale agreement. Coupled with the inherent economic and emotional issues, these uncertainties make it imperative that your focus remains as strong as it was six months earlier, when all this began.

Heed your advisors

More than at any other time in the process, now is the time for you to take the counsel of your advisors. Consequently, retaining advisors, legal and financial, with the requisite experience and wisdom not only to present your company to the market, but to lead it to a successful closing, is one of the most important decisions to be made.

What's in a purchase & sale agreement?

The purchase and sale agreement is the formal document that captures all contractual arrangements between buyer and seller. While there is no standard contract, as one might find for a house sale, a purchase and sale agreement usually includes the following:

- Detailed description of the price to be paid, in what form (cash, shares, future payments), and the assets and liabilities being acquired, both tangible and intangible, such as trade names, licences, contacts, etc

- Representations and warranties made by both buyer and seller to each other at closing and for the future
- Copies of any other agreements between the two parties, including employment agreements, supply agreements, lease agreements, debt subordination agreements, and so forth
- Any indemnities that might be granted or received between seller and buyer
- Conditions to closing, which list all possible ways in which either party could terminate discussions, without being subject to legal action
- Other schedules including detailed listings of all personnel, equipment, patents, notes payable, union agreements and more

Disclosure letter

The disclosure letter includes a myriad of schedules disclosing all known information on various issues, such as outstanding litigation, corporate obligations to retired employees and other contingent liabilities.

Topics to be addressed

While your advisors will be spearheading the drafting of the purchase and sale agreement, understanding some of what will be addressed in the agreement will help you ask the right questions and get the appropriate answers. Below is a breakdown of the topics usually found in various sections of the purchase and sale agreement:

- Representations & Warranties. In this section, both buyer and seller acknowledge their legal rights to enter into such a transaction as contemplated by the purchase and sale agreement. The buyer will require the seller to acknowledge or represent a number of other critical factors. This would include confirmation that the financial statements as provided are true, correct and follow generally accepted accounting principles; that all licences and contracts are transferable and valid; that all legal proceedings against the company have been noted in a schedule; and that no other liabilities remain undisclosed. In addition, the buyer will ask the seller to agree, in writing, that certain schedules such as the list of employees and equipment are true, that receivables are collectible that the stock is saleable.

  The complexity of representations and

warranties should not be underestimated. For example, with trade debtors, the clause may only represent that the amount as stated on the financial statements is the current amount of debtors due for collection. Alternative language could read that at the time of recording all debtors in the financial records, such balances were deemed collectible - or at closing were deemed collectible - or that they are collectible and the seller will make good if someone does not pay. Obviously, the effect for the seller is very different in each case.

- Conditions to Close. Even when you have agreed and signed the agreement, the buyer will have clearly defined conditions under which he or she could terminate the contract. Many of these will reiterate those listed in the Heads of Agreement, such as the ability to raise finance, completion of final due diligence, and receipt of a clean environmental audit.

  The seller will also have his 'outs' such as board of directors' approval and acceptable terms of an employment agreement (which may not be completed). The important thing to remember is to limit conditions as much as possible without being unrealistic.

  If, for competitive reasons, you have not allowed the buyer to delve into your research and development as part of his due diligence, it may be unreasonable to expect the buyer to close still waiving this due-diligence condition.

- Indemnities. This section goes hand-in-hand with the representations and warranties section. It is here that most buyers will demand that the seller protect them from lawsuits and other litigation that might arise from the past practices of the company.

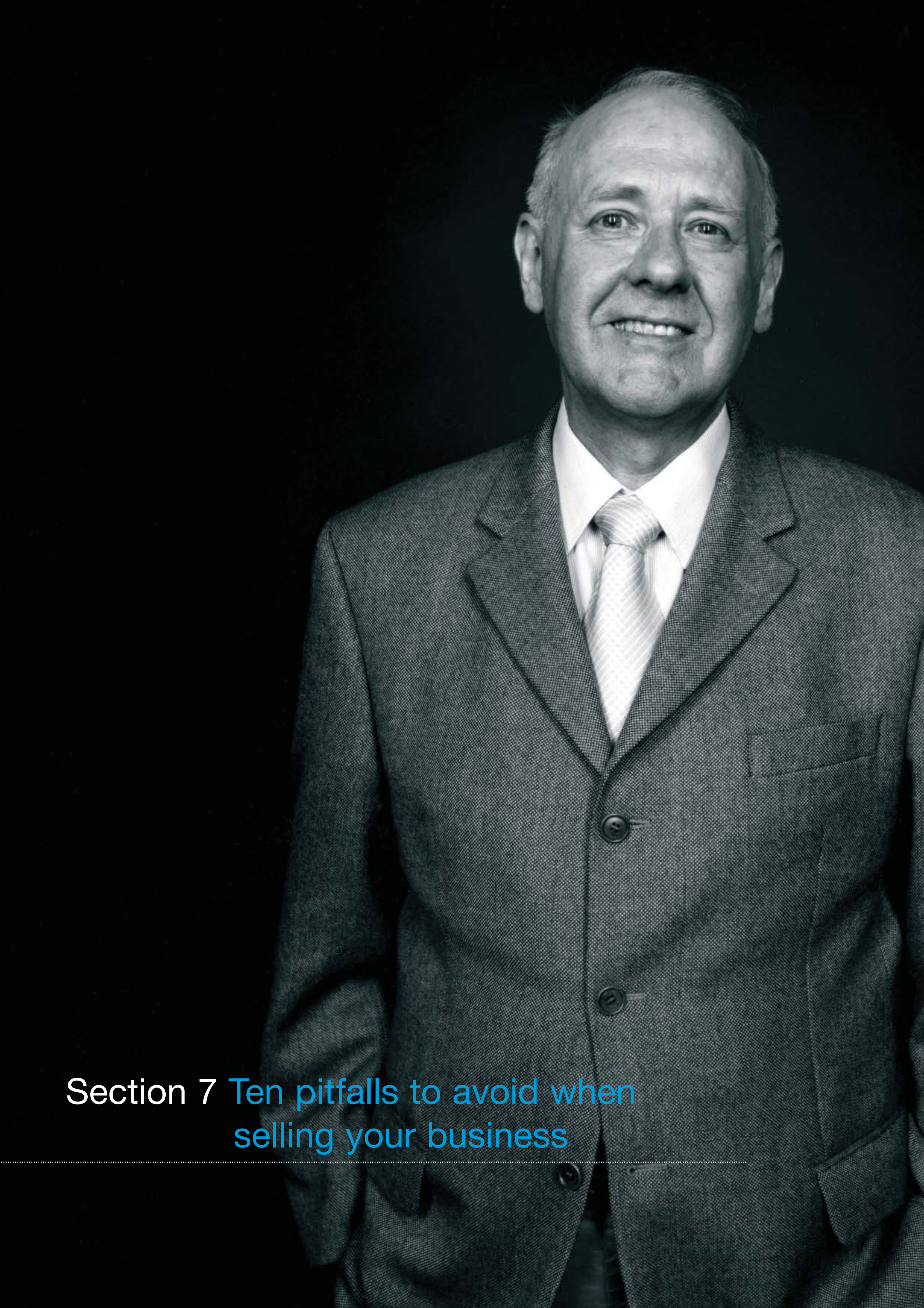
  The most common and often the most difficult indemnification to negotiate is associated with tax or contingent liabilities. Again, a carefully worded sale agreement will be critical in protecting the interests of both parties, and, at the same time, to share the risks fairly.

Other types of indemnification include protection against misrepresentation or omission of critical information, particularly as it relates to a representation. Indemnifications have a finite period during which they are in force. Some can expire as soon as the closing, while others remain in effect for as long as the legal statute of limitations stipulates.

Just as with the Heads of Agreement, negotiations will ultimately end in a series of compromises that attempt to meet each party's key objectives, but at some cost. The trust you have in your advisors will be tested as they recommend unpopular positions.

The costs associated with terminating a prospective deal grow exponentially toward the end of the process. The sale agreement is an expensive document that should not be started if you have not made the leap of faith that the potential buyer sitting across the table from you is one to whom you are willing to sell your business.

A properly managed sale process should give you the comfort that you have chosen the right buyer and that the business reasons for the combination will outweigh any temporary stumbling blocks that may arise.



Section 7 Ten pitfalls to avoid when selling your business

The previous chapters in this publication have described many of the 'nuts and bolts' involved in selling your company. Although each focused on a specific topic, several cautionary themes emerge.

While this list is not exhaustive, just remembering these ten pitfalls will move you a long way toward achieving a successful transfer of ownership.

1. Not minding the store

More often than not in a sale scenario, the owner becomes preoccupied with the sale process and loses sight of the critical, day-to-day management issues. A sale can take anywhere from five to nine months. Hence, distraction from your business can be fatal to a deal - particularly during the latter stages. Late in the negotiation process, a buyer's adverse reaction to negative reports of even a relatively minor problem could undermine the entire transaction.

2. The unfocused effort

Significant unfocused problems are more likely to arise the longer a transaction takes to be completed. The sale process will usually take some unexpected twists and turns, but for most situations, a good team of advisors and management will have contingency plans. The key is to be well prepared, confident and decisive, and to have clearly defined objectives.

3. Standing up on the roller coaster

Selling your company can be one of life's most stressful experiences. Besides dealing with the prospect of retirement, and with separation from a much-cared-for business, you must also face the inevitable scrutiny that your company and business activities will receive from every potential buyer. The key here is to keep your emotions in check. Being over-emotional is likely to lead to rash decisions, based on the heat of the moment, rather than on a rational agreement process.

4. 'But-your-man-got-more' syndrome

What another entrepreneur got for his company three years earlier, or what one large company paid for another, is irrelevant to your transaction. The market will determine what your company is worth today. Have your advisors do their homework to arrive at a preliminary valuation range, and then let the market do its work. Unrealistic price expectations are the quickest way to dampen buyer enthusiasm and ensure your disappointment. Inflated valuation expectations will impede you from recognising reasonable bids.

5. Going with the highest bidder

When it comes to ownership transfer, the highest price bid may not be the best deal for you. A number of critical issues could override a decisive price difference among competing bids:

- Financial ability of the bidder to close the deal
- Contingent liabilities that you must accept for some period of time after the sale, such as those related to: environmental problems, pending litigation and the saleability of stocks
- Contingencies or 'outs' in the buyer's offer, such as due diligence, environmental audits, financing, board or parent company approvals
- Employment agreements for the seller and key employees, including length and level of compensation
- Form and timing of consideration to be paid if other than cash, such as loan notes, shares and earn-out

6. Going alone syndrome

Below is a summary of some of the potential hazards of handling the sale of your own business:

- Limiting the buyer universe: An owner will tend to focus on only one or two possible types of buyers, usually direct competitors or customers. Unfortunately, such an approach could very likely leave out many potential buyers not readily known by management.
- Creating bad blood: Negotiations can be a very turbulent process, causing bad feelings and bruised egos. An advisor is able to act as a buffer between the buyer and seller, playing the 'bad guy' or being the scapegoat, if necessary.
- Being caught off-guard: By limiting the direct contact between you and the buyer, an advisor can protect you from the pressure to respond without proper consideration. Additionally, an advisor can offer a compromise during negotiations without being committed to it, to gauge the buyer's reaction. By negotiating directly you would forego this advantage.
- Lacking credibility: The involvement of a financial advisor in managing a professional sale process sends a clear message to

potential buyers that there will be competition; that delay, or similar tactics will be ineffective; and that pertinent information will be carefully prepared and presented.

7. Favouring the fast track

Letting one attractive buyer get on the 'fast track', far ahead of the buyer pack, will cause you to lose your greatest weapon: competition from other bidders. The key is to build competition, to force buyers along your schedule and not theirs. A good advisor will know when the time is right to sit down and hammer out a deal with the buyer.

8. Sparing the bad news

No one likes to be the bearer of bad news - particularly when the news contains potentially damaging information about a company that is for sale, or reports about the company's key players. Unfortunately, the later bad news becomes public, the greater the threat of derailing the entire deal. By addressing bad news up front you can establish a strong case and avoid potentially damaging innuendo. Negative reports can certainly impact overall valuation, but cover-ups or omissions, which will undoubtedly be discovered during buyer due diligence, could easily result in a broken deal that no price adjustment can repair.

9. Information leaks

More than likely, you are not going to be able to keep the fact that you are selling the business a secret. It is best to avoid conflicts and protect your credibility by being direct with employees and key customers about the news, on your own terms.

10. Rushing to market

If you are looking to maximise your company's value, overcome the disruptive effects of a sale, and cash-in when it's all over, don't expect it to happen as an overnight event. Critical to the successful sale of a business is the development of solid, experienced middle management, particularly if you will no longer be involved in running the company. In addition, strong financial reporting systems and historical statements (preferably audited) are essential. They must support the financial data presented to potential buyers, and ensure that all the required documentation can actually be generated.

Finally, a word of warning - selling your business is a difficult, complex and stressful process and not something you should undertake lightly. You should make every effort to prepare your business to ensure it is sold successfully first time.

Preparation and planning are the critical success factors in all business sales.

Notes:

Notes:

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Selling a business is a time consuming and emotional process. We will work with you to maximise the price received for your business and to structure the transaction in as tax effective a manner as possible. We will manage the process and ensure that all advisers are working together for your benefit.

Entrepreneurs considering selling their business are very welcome to discuss their specific requirements with us.