Viewpoint on Value

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Deal of a lifetime

Market a business to maximize its selling price

When it's time to sell, how a private business is marketed can have a significant impact on the cash available for distribution to owners. For many private investors, their business interests are their primary assets, so their livelihoods often depend on receiving top dollar.

Hot market

2015 was a record-breaking year for mergers and acquisitions. U.S. deal volume topped $2.1 trillion, and the momentum is expected to continue — and trickle down to smaller companies. The hottest industries include technology, health care, financial services, and oil and gas.

Business sellers should beware, however, that some opportunistic buyers are looking for deep bargains. So it's important to price your company with the help of an experienced valuation professional using current market data. Failure to achieve a full value for the company can lead to seller's remorse or lawsuits from minority shareholders who dissent to the sale.

Asking price

When setting the asking price for a business, it's tempting to rely on industry rules of thumb. For example, folklore in the manufacturing industry might indicate that a manufacturing company will sell for three to five times earnings.

These pricing multiples are simple, but they're also ambiguous, which can lead sellers to under- or overestimate how much their business is worth. The example provided leaves many unanswered questions, including:

- What does the term "earnings" mean?
- Where within (or outside of) the three-to-five range does a specific company fit?
- What does the formula include or exclude?
- Do you need to subtract debt or add working capital to arrive at the value of the business?

Comparable, real-world transactions provide a much more meaningful indication of how much the company is worth in today's volatile marketplace than rules of thumb.

Valuation professionals can help find a sample of "guideline" transactions. Then they can convert these guideline transactions into relevant pricing multiples that can withstand scrutiny from minority shareholders who may question the deal.

If comparable transactions aren't available, the seller may need to perform a discounted cash flow analysis to arrive at the asking price. An outside professional can help calculate a reasonable discount rate based on market evidence, estimate the company's expected cash flows and make discretionary cash flow adjustments, if necessary.

Buyer's perspective

Once sellers establish the asking price, it's time to solicit potential buyers. Whether they're private equity firms, venture capitalists or closely held competitors, prospective buyers will intensely scrutinize business operations and financial results. It's important for sellers to maintain bargaining power during due diligence by doing their homework *before* putting the business on the market.

This means the seller needs to consider the buyer's perspective and compile a package of information for buyers to review. Gather such documents as the last five years of financial statements, business plans, forecasts and projections, marketing collateral, and contracts with customers, suppliers, subcontractors and key employees. Buyers are also likely to ask questions about tax issues, operating risks, and potential threats such as litigation — and sellers should be ready with the answers.

By planning ahead for buyers' information requests, sellers appear prepared, experienced and credible, thereby expediting the due diligence process. Doing so also allows the seller to cast the presentation of financial and operational information in the most favorable light. They can, for example, play up factors that enhance value and minimize the need for financial statement adjustments, which tend to turn off prospective buyers. In some cases, a seller may decide to settle lawsuits, divest unprofitable business lines or buy out minority shareholders in anticipation of a sale.

Deal structure

Last but certainly not least, sellers need to think about deal structure and tax issues in advance. In general, sellers tend to prefer stock deals, rather than asset sales, from a tax perspective. However, buyers generally prefer asset sales, which allow them to cherry-pick the most desirable assets and exclude the seller's liabilities. Installment sales, earnouts, and postdeal consulting and noncompete agreements are additional issues to address before negotiating with prospective buyers.

By planning ahead, sellers can identify problems and take action to enhance the company's value. An outside valuation professional can help "market" a for-sale business to maximize its value to selling shareholders.

Sidebar: Open season for online equity crowdfunding

In May 2016, the Securities and Exchange Commission's (SEC's) equity crowdfunding rules went into effect. So far, the market response has been tempered, as start-ups and

other small businesses try to navigate the rules and determine whether the benefits outweigh the costs.

The new guidelines allow private companies to sell shares to investors regardless of wealth or income as long as the company has submitted annual financial reports to the SEC. Those reports must be audited for offerings of more than $500,000.

Other restrictions apply. For example, a company can raise only up to $1 million through SEC-approved online crowdfunding portals. The SEC also limits how much individual investors can contribute via crowdfunding in any 12-month period based on their net worth and annual income.

These restrictions make equity crowdfunding more complicated and costly. Congress is currently contemplating legislation that would simplify the rules. If enacted, simpler guidance could help equity crowdfunding become more widely accepted as a method of financing for private businesses.

Do you have a **Question?** or want to speak to

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