OUR GUIDE TO SELLING A SMALL BUSINESS

For small business owners who want to sell their business for the best possible price and the least amount of hassle.

Find out:

- **The best time to sell your business**
- **The simple steps you can take to maximise its value**
- **How to find an eligible buyer**
- **Whether to sell assets or shares**
- **How to seal the deal in the quickest possible time**
- **And much, much more...**

"Have the confidence to sell the future of the business. Tell the story of the foundations you have built for the buyer to take the business forward. Prepare well and let potential buyers compete to have what you have and they haven't, well not just yet..."

A Truelegal Guide, written by Martin Truman, specialist business transfer solicitor with over 20 years' experience of acting for business sellers

TRUELEGAL GUIDE TO SELLING A BUSINESS

Contents

Why sell your business?

If you own a business then, sooner or later, whether by choice or circumstance, thoughts of selling are likely to cross your mind.

Reasons for selling vary enormously. For those who are lucky enough to have successfully grown their business, a sale presents an opportunity to cash in, retire, and reap the rewards of years' of hard work. Or perhaps to release equity to invest in an exciting new venture. A sale can also allow you to become part of a larger company or to hand over succession of the business to a family member or business partner/s.

On the other hand, a sale may be forced due to ill health, poor performance or changes in the marketplace.

But whatever the reason for selling, and whatever the size of the business, the process which must be followed to achieve a sale is largely the same and can be time-consuming, complex and costly. Appointing experienced specialist advisers is a must if you wish to make the process as painless and profitable as possible - as is your willingness, where circumstances allow, to take certain steps to adequately prepare your business for sale.

When is the best time to sell your business?

In an ideal world, you would choose to sell your business at a time when the economy is growing, your industry is growing and your business is growing, with the prospect of continued strong future growth.

However, life rarely deals such a benevolent hand.

If you adopt the text book approach to selling your business advocated by so many business experts, you will ideally begin 'grooming' your business for sale at least 2 to 3 years before you go to market. But as economic crashes so dramatically demonstrate, it is not always possible to accurately predict the future of the wider economy, or of particular industries or market sectors. You may sit on your business while you work hard to fine tune your internal processes and documentation only to find that, by the time you're 'ready' to sell, the bottom has fallen out of your market, or a key customer has decided to take their business elsewhere.

And, of course, if you have the misfortune to suddenly suffer ill health, or your business for some reason goes into freefall and is losing money by the day, you may not have the luxury of planning when to go to market.

Nevertheless, regardless of your circumstances and the reasons for selling, there are steps you can take which will significantly improve your chances of securing a quick sale and maximising the value of your business. My mantra is "built to sell". Put yourself in the position that your business could be sold for maximum value at any given time and don't be a forced seller.

The importance of choosing the right professional advisers

Far from being a wasted expense, the right team of professional advisors working together on your behalf to sell the business should provide you with an invaluable return on your investment. The key is to choose specialist advisers who:

- have significant relevant experience and a proven reputation for completing successful deals
- can commit their personal involvement at every stage of the process (rather than passing your work off to junior and/or inexperienced colleagues)
- offer transparency and certainty with regard to their fees (for example, probably best to avoid solicitors who insist on charging you by the hour) and
- equally as important, a team with whom you feel you have a strong personal compatibility. The sales process can be a long one; it's important that you get on with your advisors and feel that they have as much passion for securing the best deal for your business as you do.

For small and medium business enterprises (SMEs) looking to sell, there are three types of professional adviser essential to the sales process:

Business Transfer Agent, Broker or "market maker"

A good BTA is worth their weight in gold. He or she will understand the marketplace inside out, have an extensive list of contacts, be able to give you sound valuation advice, offer sophisticated and extensive marketing, bring experienced negotiation skills to the table and, hugely important, weed out spurious prospective buyers who have the potential to suck up endless wasted hours of your time.

Crucially, appointing a broker and a solicitor to act on your behalf frees up your time to focus on keeping your business operating on an even keel and preparing it for sale. If you use a good broker, this in itself more than justifies their fees.

At Truelegal we are fortunate to work with some fantastic business transfer agents and brokers who share our values and commitment to client satisfaction. If you'd like a referral, please contact us.

Business solicitor

The process of selling a business is governed and affected by very specific areas of law. So, when looking for a solicitor to advise on your business sale, you should clearly be looking for one with specific business law and sale expertise. Whilst you may be tempted to think that bigger is better, be wary of instructing large corporate law firms where, from an SME point of view, solicitors are frequently over-specialised. In such firms you may find you end up paying for, and trying to manage, three or four different solicitors for their individual input on different aspects of the deal and the coordinated picture and common goal is lost.

In bigger law firms it's also common practice to delegate work to more junior members of the team. And, of course, there is the issue of cost. Big law firms command eye-watering hourly fee rates.

At Truelegal, buying and selling businesses is all we do. Our tight team of senior solicitors each have many years' experience of advising on successful deals and, as a result, are business savvy and commercially minded. Our experience means we often anticipate potential issues before they arise and are adept at finding workable solutions to possible last-minute deal breakers. We understand the importance of moving the deal forward and will project manage the process on your behalf, influencing the timetable and pushing the deal forward to a conclusion.

What's more, we give you the certainty of a fixed price fee agreed at the outset, and provide you with a single point of contact who will be available to advise you when you most need them.

If you're thinking of selling your business, why not contact us for a free, no-obligation, initial consultation.

Financial adviser

The main driver behind the sale of any business is a desire to achieve certain financial goals. To be certain of realising these goals not only relies on achieving a particular price for your business but also on careful financial planning. Tax planning, in particular, is a significant aspect of selling a business. For example, whether or not you choose to sell just the assets in your business or the shares, or just a partial sale of shares, will have a major impact on your finances.

It's important, then, that you make the time to set out and discuss your financial goals with a specialist adviser before you put your business on the market. Your accountant is usually the best starting point but don't be afraid to supplement this advice with third party specialist business sale financial advice and tax planning.

Structuring your (once in a lifetime?) sale in the most tax efficient manner to maximise Entrepreneurs Relief, for example, or pushing for a share sale over an asset sale could make a significant difference in your exit value or at least what's left in your pocket.

How to prepare your business for sale

The aim of preparing your business for sale (which used to be commonly referred to as "grooming" before that word sadly became associated with other stories in the news) is to get your business into the best possible condition both to attract interest and to secure its maximum value. In essence, this means scrutinising your business for any shortfalls that could reduce its value and taking steps to put them right. There's simply no point in ignoring troublesome issues in the hope you can pull the wool over the buyer's eyes. You can be sure that any issues will be uncovered when the buyer and his/her solicitors complete their own investigation of your business. That risks breaking the important element of trust and almost certainly slowing the transaction down. In addition, you will be required to make certain warranties and disclosures in the sale and purchase agreement about the state of the business at completion, which will leave you on the hook for longer post-sale.

Put yourself in the buyer's shoes and look at your business from their perspective. If you were buying the business, what would worry you? If there are gaps in your business' information or documentation, now is the time to fill them. Are there certain areas of the business that could be better be presented?

- Check that your statutory documentation is in order, for example incorporation certificate, company registers
- Accounts for the last 3 years and management accounts for the period since your last year end, the latter presented in a buyer friendly format, completed tax returns and HMRC correspondence
- Assessment of any extraordinary expenses and unusual tax planning
- Details of any loan agreements and overdrafts
- Contracts with customers (preferably evergreen or long term) and key suppliers
- Employee contracts and details of any pension arrangements and share options
- List of properties and assets owned or leased with details of use and ownership
- Registration and licence documentation for any intellectual property rights
- Details of any disputes and pending arbitration or litigation
- Health & safety audit, assessments and compliance certification

The more detailed and up-to-date your information, the more time will be saved as the sale progresses and the more likelihood there will be of negotiating an acceptable offer. Serious prospective buyers will undertake their own due diligence of your business, assisted by their solicitor. Any irregularities will undoubtedly be flushed out at this stage and may prove to be a deal breaker - putting you back to square one. So, make sure your pre-sale preparation is as thorough and focused as you can in the time available to you.

What is your business worth?

There is no precise answer to this question other than to be realistic. There are many different valuation techniques but, when it comes down to it, your business is worth what an interested purchases is prepared to pay; this will reflect not only their commercial view of what your business is worth in isolation, but also their own strategic goals. For example, a buyer who wishes to break into a new geographical territory, or acquire certain assets or customer/supplier introductions, may place a higher value on acquiring your business than another prospective purchaser. <u>Creating competition for your business will give best value.</u>

In addition, valuations are usually calculated on the assumption that payment will be made by cash in full on completion whereas, in reality, the structure of the final deal may include, for example, deferred consideration or part payment in shares. Tax planning also impacts on price—is it an asset or a share sale.

What are you selling?

Business sales take many different shapes. Do you want to sell the shares in your business or just the assets? Do you want to retain an interest in the business and stay on as an employee or consultant, or do you want a clean exit? Are you prepared to consider providing a secured loan to potential purchasers to assist them in buying the business? What liabilities will the purchaser be required to assume responsibility for? Do you, your business or your pension fund own the freehold property and want to lease this back.

And just because you own a business that provides you with a good income does not mean that it is saleable. If the value in the business is completely based on the knowledge and skills of one person (or customer), then when that person (or customer) departs, there is nothing of value left. The value lies in what can be transferred to others.

How to arrive at an initial valuation

Your business transfer agent or broker is best place to calculate a starting value for the business. S/he will have the knowledge, contacts and experience to make a sound commercial judgement based on the trading information you provide. Setting an unrealistically high price for your business will only serve to scare away potential buyers or, at best, delay proceedings so that your business then suffers the stigma associated with being on the market for a long period of time.

Of course, any price is open to negotiation and the value at which you market the business may not be the price that you secure on completion. Although it is a mistake to overvalue your business, you should also take care not to undervalue it either. In consultation with your advisers, and bearing in mind your financial goals, you should always have in mind your 'drop dead' price, below which you refuse to proceed. Using a good broker, solicitor and accountant should protect your value.

How to find an eligible buyer for your business

The nature and size of your business will have an influence on how you market it for sale. In a larger company, it may be that there is interest internally with partners or fellow directors looking for a management buy out. For small, niche businesses, word of mouth or advertisements placed in trade journals can have good effect.

However, the majority of SMEs will rely to a large extent on their professional advisers to promote their business on their behalf. Brokers and business agents generally have a wide network of contacts they can solicit and will also be approached directly by individuals looking to buy a business.

Preparing a sales pack

One of the first things to be done is to prepare a sales pack, or Information Memorandum (IM) or particulars of sale. It is against these particulars that prospective purchasers will be expected to make their initial offer and so the IM needs to present an attractive proposition whilst at the same time being accurate and truthful. As well as summarising the nature of the business, its assets, operations and financial status, the IM must also disclose any risks facing the business. An experienced business broker or agent will help you present any weaknesses and risks in a positive light, for example, by detailing steps being taken to address them.

At this stage you will not be disclosing sensitive confidential information such as specific details about your customers, suppliers or employees. Neither will you disclose the name of the business or its location.

Qualifying prospects

There may be lots of people who wish to find out information about your business without having any intention, or financial backing, to make an offer. A good business broker or agent will really come in to their own here and will qualify prospective buyers to ensure they are genuine and can show proof of funding before issuing them with the IM.

Keeping it confidential

Once qualified, prospective purchasers will also be expected to sign a Non-disclosure Agreement (NDA) or Confidentiality Agreement. This is a legally binding agreement which will give you recourse to legal action should a person misuse the information they receive in the IM.

Receiving offers

Remember, any initial offers received in response to the IM are just that. They do not constitute final formal offers as the prospective purchaser has not, as yet, had the opportunity to carry out due diligence. Next steps are likely to be for you to meet with prospective purchasers face to face so that they can ask initial questions and you can get a feel for their intent.

Pre sales process

No matter what the size or nature of your business, there is a typical chronology of events before completion can happen.

Preliminary meeting

Prospective buyers will want to meet you, preferably at the business premises, in order to expand their knowledge beyond the Information Memorandum. If you don't yet want to alert any employees to the possibility of a sale, you'll need to be discreet and seek out advice from your professional advisers.

At the meeting, be prepared for lots of questions and be sure to answer positively and accurately. If, for example, you know of weaknesses in the business, be prepared to outline what steps you are taking to tackle them. Following the meetings with your selected prospective buyers, you and your advisers may dismiss one or more as unlikely candidates.

Negotiating price and structure of the deal

Once the prospective buyer(s) have had the opportunity to meet with you and ask questions, and assuming they are still interested, they will then be expected to make you an offer. But it is a rare transaction where an initial offer is accepted at face value without quibble. What follows next will be an intense period of negotiation around not only the price, but the exact structure of the deal.

For tax reasons, as a business owner you are likely to want to sell the shares rather than just the assets - but the buyer may have other ideas, particularly as buying the shares will also mean they buy all of the business's liabilities. The structure of the deal and the level of risk to the buyer will, in turn, have an impact on the extent of due diligence (or investigation) which the buyer will insist is completed before a final offer can be made.

There is also the question of how the consideration will be paid. Insisting on a cash deal is likely to significantly limit your pool of prospects or overall price received. A buyer may not have the desire or ability to pay the whole price in cash at completion - it doesn't follow that they are a bad buyer. Negotiations will need to factor in the possibility of deferred or contingent payments and whether, for example, any of the consideration is to be paid for in shares. The buyer may request an earn-out arrangement whereby part of the consideration is paid to you out of future trading profits. Such arrangements can be complex and time-consuming to agree and document. However, the reward may be justified in a higher price. A good team of advisers can assist to help you evaluate whether the deferred payment structure is merited or too high risk.

Heads of Terms

When the price and structure of the deal have been agreed, the next step is for the agent or the buyer’s solicitor to draw up Heads of Terms - a document summarising the components of the buyer’s offer, which is issued subject to contract. Heads of Terms will usually include:

- The agreed price
- The structure of the deal
- Details of the specific requirements the buyer has of you, for example, that you stay on as a consultant for a period after completion
- Any conditions attached to the offer, such as the buyer’s insistence on carrying out detailed due diligence
- Reference to an adjusting figure payable following completion on finalisation of “completion accounts” by reference, for example, to a Net Current Asset Value or similar figure or “peg”.
- Details of any exclusivity period granted to a preferred buyer

Due diligence

This process essentially gives the buyer and his/her solicitors access your business’ books and records to conduct their own detailed investigation, or audit, as to its health and worth.

Matters which will be investigated will include legal information and documentation relating both to the ownership, structure and compliance of the business but also to its relationships with third party customers, suppliers, debtors, employees and licensors/landlords. The buyer will also be keen to ensure there are no disputes pending or outstanding. In addition, investigations will be made to ascertain the nature of ownership and any restrictions on use or condition with regard to any business premises.

The buyer’s offer will have been based on your levels of trading performance for the business so it also goes without saying that the buyer and his/her advisers will insist on carrying out a financial audit of the business, including a review of your accounts and your systems, policies and procedures.

As part of the due diligence process, the buyer and his/her advisers will also be taking a wider look at the strategic picture and the relative position of your business within its sector and industry, as well as making a judgement about the culture of your business.

Preparing for and managing the due diligence process well as a seller can make a big difference in the end value and protecting this value against future warranty claims. At Truelegal we have developed a specific process and programme to manage this risk for sellers.

Sealing the deal: the Sale and Purchase Agreement

The Sale and Purchase Agreement is the legally binding document which, once signed, sets out the contract for sale. In practice, much of this contract (which is typically first prepared by the buyer's solicitor), is drafted as the due diligence proceeds.

As well as setting out the agreed price, terms of payment, deal structure and conditions of sale, the sale and purchase agreement will also include a raft of representations, warranties, indemnities and disclosures required from the seller by the buyer in an attempt to mitigate his or her risk in proceeding with the deal. It is negotiation of the exact wording of these areas that can significantly delay proceedings. It is normal for the draft contract to pass backwords and forwards and run through several iterations before a final document is agreed by both parties.

Examples of common warranties (or guarantees) required from the seller include that s/he is unaware of any pending or existing litigation against the company and that the business has the right to assign or licence intellectual property rights, such as a trademark. A breach of a warranty by the seller entitles the buyer to make a claim against the seller for damages for breach of contract. The value of the claim will vary according to the circumstances giving rise to the claim.

An indemnity, on the other hand, guarantees the buyer specific compensation in respect of a particular breach, such as an unexpected tax liability.

As a seller, you and your advisers will work to try and limit the extent of the warranties and indemnities in the sale contract, both in terms of the duration for which they stay in force and the total amount for which you may become liable to pay if in breach. The warranties may be subject to exceptions set out by you as seller in your "disclosure letter". Managing this disclosure process together with your solicitor is key to protecting your "sleep easy" status post-sale.

Other documents and agreements

Share ale completions often have 20-50 ancillary documents ranging from resignations and appointments, to intellectual property assignments to bank releases.

Asset sales by contrast are more unpredictable but often have other twists and turns such as employee consultation, customer contract transfer and lease assignments.

Managing this process can be quite daunting, but an experienced team of business sale specialists on your side can be used to navigate your way through to your retirement or next venture.

Completion

Just as with the sale of houses, the happy day that you and the buyer sign the contract will not necessarily be the completion day. If the agreed funds are not in the seller's account on that same day then the event will be regarded as an 'exchange' - in other words, both parties are bound to complete the deal but ownership of the business will not pass to the buyer until the consideration is paid.

In such situations, the sale and purchase agreement will also include covenants, or promises, relating your continued operation of the business up until completion. This gives the buyer reassurance that you will not make any significant changes to the legal structure of the company or the way it operates. The contract may also contain a covenant that prevents you from entering into business in competition with the buyer after completion, although the terms of such a covenant would need to be quite specific.

Get in touch for professional help along the way

At Truelegal we have chosen to focus our advice solely on helping business buyers and sellers. Our team of solicitor experts and the support staff are all experienced in the business selling process and have seen many transactions of the type that you are contemplating.

If tapped into at an early stage — often earlier than a prospective seller thinks — we can apply this experience to striking a better deal for you, sometimes adding several thousand pounds to your purchase price. Early advice and investigation may also prompt you *not* to sell or to spend more time preparing the business to be sold, for a significantly higher value.

By specialising in the business selling field we also come across other business selling experts such as accountants, brokers and transfer agents, and we would be pleased to connect you to the right one.

****

Please contact me or one of my team to get a flavour of what we can do to assist you with your own plans. Rather than the generic guidance provided in this guide, we can focus in on your specific needs and business selling opportunity.

Don't worry, the "billing clock" won't be ticking. We provide fixed fee quotes once we know more about your own requirements.

Good luck with your exit planning!