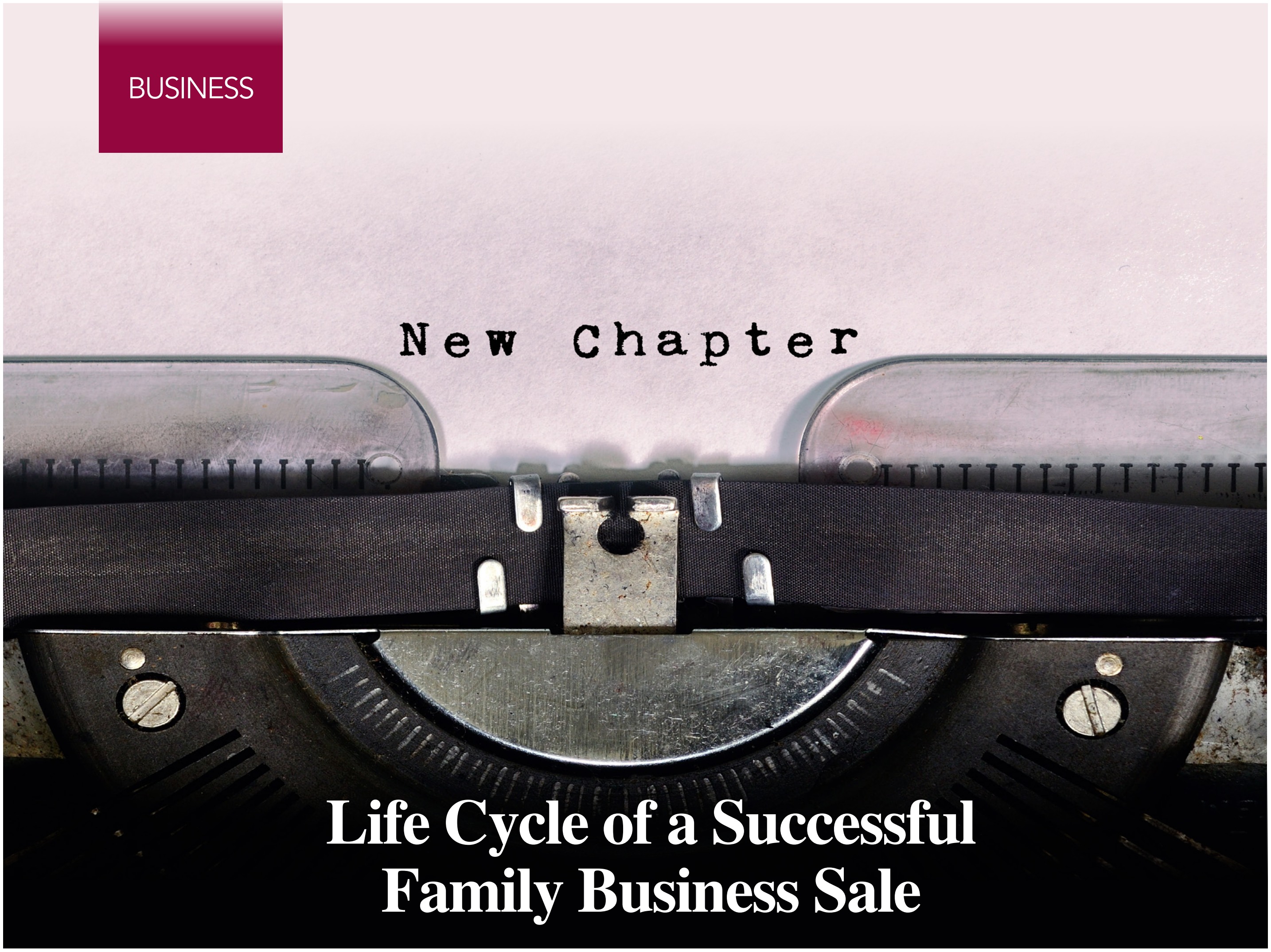
BUSINESS



Life Cycle of a Successful Family Business Sale

BY ANDREW MYERS

When family business owners decide to sell their company, they embark on a once-in-a-generation event. Once the decision to sell is made, understanding the lifecycle of the impending deal can help reduce unease and achieve a successful transition.

TIMING

Family business owners may ideally want to pass the business to the next generation, but that is not always a feasible option. External factors sometimes precipitate the sale of a family business, such as the death of a family member, an extended market downturn or changes in the competitive landscape. Businesses often withstand changes in circumstances and plan for succession deliberately. However, determining the best time to sell a business can be an elusive process.

Family business owners should consider the right time for the company, the market and the owners. If timing is optimal in all three areas, the sale should occur smoothly and at a good price. Two of three will usually lead to a good result. Fewer than two more frequently leads to a lower sales price, a longer process or both.

Many family business owners know instinctively when their company is ready to sell. Objective criteria include company characteristics that reduce risk and show upside potential. Stability in personnel and customer base, positive trends in sales and profits, and the absence of litigation and audits all reflect favorable timing for a company sale.

Optimal market timing can be challenging to anticipate, as markets come in and out of favor, sometimes very quickly. The market for smaller companies in digital advertising was very hot for about 18 months and then became very cold. Some industries stay "in favor" or "out of favor" for longer periods. Some move with the business cycle, others with technological advances. Market cycles can impact business valuations and time required to complete a transaction. Selling near the top, but not at the top, of the market cycle is usually optimal for a family business sale.

Determining the best timing for a sale may require considering the objectives of many family members involved in the business. Some may be only owners. Some will be both owners and employees. Others may be only employees. Each may assign a different weight to different objectives, such as selling at the highest price, preserving the business and maintaining family members as employees.

Often, the controlling family members simply determine they no longer have the desire or capability to continue to operate and grow the business.

Therefore, the timing is right for the family when the majority owners desire to transition the business to a new owner, and there is a broad, if not universal, acceptance to move ahead, even from those who may have initially opposed the transition.

Once the decision is made to proceed with a sale, a deal can reasonably be completed within 270 days. Completion time varies depending, in part, on how prepared the business is before it starts the process, how diligent business leaders are during the process, the type of buyer, and buyer's motivation.

Before commencing the process in earnest, it would be a healthy exercise for the family to imagine life without the business. Take a moment to consider plans to pursue hobbies, travel, charitable and other interests, and family life. Around this time, the family should also engage in discussions with tax and estate lawyers and investment professionals to consider pre-deal tax and financial planning.

PREPARING – PHASE 1

If a family business is not prepared for the sale process, pre-transaction planning could begin 1-4 years in advance of going to market. Long-term advance preparation may include upgrading policies and procedures, nurturing a layer of management competent to run the business if the family owners depart post-transaction, and completing business investments. Otherwise, Phase 1 can take as little as 90 days.

A. Get organized. The sales process will involve teams of lawyers and consultants reviewing books, records, contracts, business processes, technologies, employment practices, insurance contracts, permits, authorizations, and financial information, among other things. Therefore, business files should be complete and organized, so they can be uploaded to a virtual data room. Maintaining orderly records builds credibility and saves valuable time, both of which are critical throughout the sales process.

HAVING A STRONG LEGAL AND ACCOUNTING TEAM IS CRITICAL TO COMPLETE THE SUCCESSION PROCESS SUCCESSFULLY.

B. Find the right banker. Business owners should select their investment banker and negotiate the relationship terms carefully. Bankers may have different areas of specialization or experience within a market. Biggest is not always best. The family owners should communicate their objectives to the banker honestly, be it getting the highest offer, continuing the business or hiring family members.

Most bankers will help write a "deal book" that professionally highlights the business strengths, and will then orchestrate an auction process to elicit the best offers. A good banker will stay involved throughout the process to help smooth out business issues as they arise, serve when needed as an owner's proxy in business negotiations and help drive the deal to completion, always putting the client's needs first.

C. Round out your professional team. Having a strong legal and accounting team is critical to complete the succession process successfully. General practice lawyers, or even corporate lawyers unfamiliar with market terms, will not serve a business well during the process. You should engage someone familiar with the M&A market and process, who can anticipate issues and work with a sense of urgency to bring the deal to a successful conclusion.

D. Consider engaging third-party experts to provide supporting reports. Depending on the nature of the family business, buyers will often engage third parties to assist in the due diligence process, which can delay the process. If the family owners obtain third-party assessments in advance, they may increase the number of bids, potentially increase the bid amounts and speed the process. Reports could include a quality of earnings or market analysis or environmental assessments. Sometimes, a seller can persuade a buyer to use reports the seller makes available if they are from reputable, independent parties. This also gives the family influence over the scope of the reports.

E. Consider the business's key competitive factors. Every business relies on specific factors to give it a competitive edge. It may be one or more supplier or customer relationships, protection of intellectual property or management employees required for a successful transition. Guaranteeing that these competitive elements remain post-transition reduces the buyer's risk. This may mean ensuring relationships are stable, contracts are signed or renewed, reasonable measures have been taken to protect intellectual property, or retention bonuses and/or post-employment restrictive covenants are in place for key personnel.

F. Get a preliminary tax assessment and consider the optimal deal structure. Different deal structures may have vastly different after-tax outcomes. Non-tax factors may exist, which the deal structure will impact, such as legal requirements for third-party consents to assign contracts, permits, or authorizations. Such consents may be required for an asset sale, but not for a stock sale or merger. Business owners should understand basics of different deal structures before they embark on the next phase.

SOLICITING - PHASE 2

This phase begins once the banker is selected.

A. Preparing the book. Investment bankers will prepare an investment thesis in the form of an offering document based on information the business provides. The offering document will highlight the positive business attributes and acknowledge competition and competitive elements. A critical component of the offering document will be a financial package, including the business's historical and estimated earnings before interest, taxes, depreciation, and amortization (EBITDA), as adjusted to eliminate non-recurring costs and expenses, including expenses that will decrease or terminate post-transaction. Buyers will often value a business based on a multiple of "adjusted" EBITDA, so these adjustments must be well considered, presented clearly, and defensible.

B. Conducting meetings. Once the field of bidders is whittled down, potential buyers will want to meet the principal family owners and other management team members, particularly if family owners intend to depart post-transaction. Having a succinct, good pitch, supported by professional materials and a knowledgeable, confident, yet open-minded and well-rounded team will entice strong, final bids. Often, buyers will require, as a condition to close, that non-family, management members attending such meetings remain employed at the business post-transaction and execute employment agreements with the new owner. This can put stress on the transaction, as the employee who feels loyalty to the family now must negotiate his or her future employment terms as a condition to closing. Nonetheless, this is required in most transactions if the family owners intend to depart. Indeed, in such circumstances, it will be critical to have developed a capable management team if likely buyers intend for the business to remain operationally independent post-transaction.

C. Negotiating the Letter of Intent. Letters of Intent (LOI) will broadly contain two categories of provisions – binding and non-binding. Non-binding provisions will include a description of the deal structure and economic terms. Binding provisions will include a confidentiality clause and an exclusivity period during which the family business owners agree not to solicit any other buyer for a period of time (usually a minimum of 90 days), to allow the transaction agreements to be negotiated and signed.

THE IMPORTANCE OF MAINTAINING A HEALTHY BUSINESS DURING THE SALES PROCESS CANNOT BE OVERSTATED.

LOIs that only include a price and general conditions may indicate a buyer has not fully considered the transaction and wants to quickly tie up the seller, in order to negotiate favorable terms during the exclusivity period. Although non-binding terms are subject to change, it can be hard to justify a change to a term specified in the LOI. Therefore, care should be given to the LOI, with legal counsel involved.

More detailed LOIs tend to shorten the road to close. Although not every detail should be determined at this stage, the LOI should include sufficient detail to ensure the owners understand the structure, price, and material terms, as well as buyer's funding requirements and other transitional matters.

At the end of Phase 2, the family owners should be reasonably comfortable with the buyer and their ability to consummate the transaction, and should understand, the buyer's plans for the future of the business.

CLOSING - PHASE 3

This is perhaps the most difficult and stressful part of the process for owners. It is also one in which buyers and sellers interests diverge. After the LOI is signed, the seller has an interest to close as quickly as possible, whereas the buyer wants to ensure it avoids any mistakes and will, therefore, proceed with caution and deliberation, as its lawyers and experts become more involved.

A. Maintaining secrecy. Knowledge of a pending transaction can cause angst within an organization, because employees may feel uncertainty about their jobs and the new owners. Delays tend to increase unease. For these reasons, most sellers will try to keep the transaction confidential until the last moments (often a day before or the day of the closing).

LOIs THAT ONLY INCLUDE A PRICE AND GENERAL CONDITIONS MAY INDICATE A BUYER HAS NOT FULLY CONSIDERED THE TRANSACTION AND WANTS TO QUICKLY TIE UP THE SELLER.

B. Keeping an eye on the ball. Nothing can sour a deal like a drop in sales. Management can under-estimate the time and attention required to sell a family business. Having a good banker and professional team in place will help, but business owners must ensure the company meets sales objectives, keeps customers happy, maintains quality, and avoids accidents. The importance of maintaining a healthy business during the sales process cannot be overstated.

C. Maintaining deal momentum. Keeping deal momentum moving forward at a reasonable pace is a critical factor to a successful sale. This means having both the internal and external resources to respond to the buyer's due diligence requests, being available to resolve business issues as they arise, and engaging experienced professionals who can drive the deal to closure. Having access to the buyer at multiple levels, either directly or through the broker, to move the deal forward as business issues arise can help significantly.

The stakes are high in any business sale. Selling a family business involves both emotional and financial consequences, and being prepared is critical to ease some of the uncertainty as you transition your business and establish a legacy. ♛

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