Do You Have a Lower to Middle Market Company to Sell?

With the current state of the United States and global economies presenting challenges for business owners seeking to sell their companies, it may be necessary to adopt a more accurate terminology to reflect the nature of the process. Rather than referring to the act of selling a business as an "Exit," it may be more fitting to refer to it as a "Transition."

> *"An exit occurs **when an owner decides to end his/her/its/their involvement with a business**. Most often such an exit is accompanied by a sale of the owner's stake in a company, but this is not a necessary condition. For example, an entrepreneur may hire a management team to run the business but still retain equity."*

> *"In the simplest terms, a business transition is **an event or transaction that results in a change in the effective ownership of a business**. How can the owner of a business put their company in the best position to influence the subsequent terms of the change of ownership? Business transition transactions can be complex."*

The use of the term "Transition" provides a more comprehensive understanding of the seller's goals, expectations, and strategy for achieving their objectives. This term acknowledges that the seller is making a deliberate choice to exchange time, operational knowledge, and financing for value preservation and risk mitigation.

Business valuations are sliding and are forecast to continue for the foreseeable future with few exceptions. The why is simple - recession brings inflation, tightening money supply, increasing interest rates, higher taxes (direct and indirect) and heightened regulation. This recession is unique as we are in uncharted waters post-COVID with supply chain disruption, labor force opting out, geopolitical strife, the expected failure of globalization and the Green New Deal expectations.

There is a lot to unpack to fully understand and appreciate the current market conditions and how it affects the decisions and ultimate cost of selling a business.

- *The Valuation Squeeze: valuations are facing downward pressure and a business just 18 to 24 months ago was worth 20 or 30% more than it is today.*
- *Inflation: the dollar does not have the buying power it had, and it impacts everyone involved in a transaction.*
- *Tight Money: capital sources are concerned about risk and have less capital to put out. Buyers cannot access enough capital to buy and then run the business nor afford the interest rates.*
- *Rising Taxes: simply states, this reduces profit debilitating the return on investment for a new owner and making the transaction much less attractive for the risk.*

In light of these challenges, it is important for business owners to fully understand the current market conditions and their potential impact on the cost and outcome of a business transition. The increased supply of companies available for sale, combined with a limited pool of qualified buyers, presents a challenging landscape for sellers seeking to achieve their desired outcomes.

Private Equity and Strategic buyers know they have the upper hand in the process.

The situation of a business owner considering a sale can often feel like a perfect storm, with limited options available. In these cases, it is common for the seller to seek out the assistance of a professional, such as a Business Broker, M&A Professional, or Investment Banker. However, it is important to determine which professional is best suited to meet the specific needs of the business.

To ensure a successful sale process, the seller should ask several key questions upfront. Firstly, it is crucial to understand the market value of the business, as many advisors may ask the seller for their desired price without considering the current market conditions and valuation. Working with a professional can provide valuable insight into both factors.

The compensation method of the advisor is another important consideration. Some advisors may only be paid if the business is sold, while others may charge a retainer fee or allow the buyers to set the price through an auction approach. The seller should also inquire about the advisor's marketing strategy, as simply listing the deal and sending out emails is not always sufficient. A good advisor should actively seek out and pre-qualify potential buyers.

In the event of a quick or "fire" sale, the seller should have a clear understanding of the available options and the process involved. An advisor should provide a transparent and comprehensive explanation of the expected outcome. A well-planned transition is crucial to a successful sale.

Why You Need a Plan

As the population of baby boomers seeking to transfer their businesses continues to increase, the competition for selling a business to a third-party buyer is becoming more intense. Furthermore, managing ownership changes with family members, management teams, or employees is becoming increasingly intricate. To increase the chances of a successful outcome, it is imperative to initiate planning as early as possible. The lack of proper pre-sale planning is the primary reason why many deals either do not close or do not achieve optimal value.

A variety of strategies, approaches, and tools exist for business transition planning, but each plan is founded on several critical factors, such as options, objectives, and expectations.

An owner will need time to plan!

Finally, what goes into a plan and when should an owner start planning? Idealistically, an owner should be planning from the time he/she/it/they take possession of the business. Realistically, as soon as an owner starts thinking they may not want to run the business in perpetuity. Some typical planning considerations follow:

1. Pre-Planning. Pre-planning is critical because it sets in motion how long you and your professionals must prepare for the full transition. Things to consider will include:
    a. Preliminary financial needs analysis
    b. Target departure date
    c. Preliminary valuation
    d. Target successor
    e. Future cash flow estimate
    f. Target market for the sale
    g. Contingency plan
        i. Recapitalization pre-sale
        ii. Acquisition
        iii. Merger/Consolidation
2. Professionals (team). Interviewing and establishing a relationship with your professionals before you activate your plan is important to a successful transition: ♦ M&A Advisor, ♦ Business Attorney, ♦ Certified Public Accountant
3. Due Diligence Preparation. (CRITICAL and a key reason why transitions fail.)
    a. Financial assessment
    b. Organizational assessment
    c. Operational assessment
    d. Management assessment
    e. Employee assessment
    f. Material contracts and agreements assessment
    g. Properties, leases, and insurance assessments
    h. Environmental assessment
4. Business Valuation: ♦ Preliminary valuation, ♦ Updated future cash flow estimate
5. Presentation Package: ♦ Confidential Offering Memorandum, ♦ Detailed valuation, ♦ Due diligence package, ♦ Market study
6. Deal Structure Options.
    a. Transaction type: ♦ Asset Sale, ♦ Stock Sale, ♦ ESOP, ♦ Merger or Joint Venture
    b. Financing options: ♦ Cash, ♦ Cash and Debt, ♦ Cash, Debt and Earnout
7. Go-to-Market Strategy.
8. Negotiation, Closing.

To achieve a successful business transition, a thorough, multi-faceted plan must be in place that considers both the seller's objectives and potential avenues for realizing them. It is crucial for the seller to adopt a dual perspective, considering both their role as business owner and as an investor, to grasp the challenges that may be encountered by the acquirer.

It should be noted that this advice is specific to lower and middle market transactions involving viable businesses, rather than those facing sustainability or viability issues. The seller must have confidence in the long-term sustainability of the company, supported by proper management, financial controls, and resources.