



Preparing a Closely Held Business for Sale

Ready to Retire?

By Nathan A. Scharton

WHETHER you are the principal of a \$1 million empire or of a small corner shop, owners of businesses often have two things in common — too much work and too little time. It should come as no surprise, then, that most of these business owners give no specific thought to their own retirement (or to use the jargon, their “exit strategy”) except to make sure the golf clubs are packed and the Winnebago is on order. Indecision and lack of planning for the eventual sale of a closely held business can be expensive, not only to the business owner, but also to the business owner’s family, employees, vendors and customers.

Perhaps the first and most important step in preparing to sell a business is, simply, taking time to think about selling the business. Without planning and forethought, the natural life cycle of the business owner (or of the business itself) may take over and determine the outcome of the sale, often in less than favorable circumstances. Whether as a result of the principal’s health, divorce, changing economics, creditor demands, employee relations or other outside factors, dollars are at risk if the business owner fails to plan.

What should the business owner think about? A good place to start is to

whom will the business be sold? Three basic options exist when considering the eventual sale of a business: 1) the business can be sold or transferred to a family member or a key employee (often referred to as “succession planning”); 2) the business can be sold to an unrelated third party (in a stock or asset purchase transaction); or 3) the business can be closed down. The first two options require similar, although not identical, steps to successfully accomplish the sale.

Succession planning requires the identification of a successor. Ideally, the successor will have talents and skills that are complementary to the

talents and skills of the selling principal. The succession process often involves a gradual transfer of ownership interests and management responsibility from the seller to the successor.

Selling a business to an outside party typically involves a different set of negotiation points. From the buyer's perspective, the easiest way to buy a business is to purchase a seller's assets, free and clear of all liabilities. In an asset purchase, the buyer does not purchase the underlying entity or its liabilities. Further, the buyer may recognize certain tax benefits such as a stepped-up tax basis on the assets acquired in the purchase, may decide to hire, or not to hire, the seller's employees, and can determine which contracts to assume.

From a seller's perspective, a stock (or entity) sale transaction to an outside party is usually more desirable. The seller may be able to realize capital gains on the sale of the stock or entity, thus avoiding double taxation, which may occur with an asset purchase. (In an asset purchase, the business entity is taxed on the sales proceeds, then the shareholders are taxed again on distributions that they receive.) Further, the liabilities of the entity sold follow the sale, thus providing greater confidence in a clean break to the seller.

Although many of the aspects of the sale of a business are subject to negotiation, the following areas are within the control of the business owner:

>> A business owner should prepare business financials and keep them current. The best buyers will demand a high level of comfort about the accuracy of cash-flow statements, accounts receivable lists and other financials. A business owner will gain the most benefit from his or her investment in audited financial statements upon the sale of the business.

>> A business owner should establish a value for the company and update the value regularly. The science and art of valuation of a closely held business is

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vastly different than the valuation of a public company. As such, the valuation process takes into consideration a variety of concerns including the market for the business, majority and minority interests, and other performance criterion.

>> A business owner should time the transaction right. Buying low and selling high is a good practice. It is important to pay attention to what is going on in the company and industry generally. The best time to sell is most likely not when business is bad and the principals want out, but rather when business is good and everyone is happy.

>> A business owner should not expect to totally abandon the business upon its sale, nor should he or she expect to continue business as usual post-sale. Two very common buyer demands in the sale of closely held businesses are 1) a noncompetition agreement and 2) post-closing consulting. Therefore, a business owner should not expect to be able to set up shop in the same town immediately after closing, taking advantage of valuable market knowledge without the burden of the accumulated overhead of the business being sold. Further, most buyers will insist on a clause stating that the seller will not try to hire key employees away from the business to be sold. Additionally, the buyer may want to have access to the seller on a consulting basis post-closing, so the buyer is not forced to operate in the blind for the first several months.

Finally, a business owner should involve experienced professionals. If the owner has managed not to engage a lawyer or an accountant until the time comes to sell the business, he or she may be sorely tempted to think that neither is necessary. This assumption is incorrect. As a general rule, people do not consider removing their own kidneys, and neither should they attempt to sell their business alone. A good team of professionals can make the process much easier in the long run, and should be sought out and consulted as early as possible. ■

Nathan Scharton focuses his practice in commercial real estate, general corporate and business law, including acquisition, disposition and financing of commercial real estate, mergers and acquisitions and general business transactions. He represents developers, lending institutions, closely held businesses and public companies. He joined Callister, Nebeker & McCullough in April 2005. Visit him on the Web at www.cnmlaw.com.

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