

Preparing Your Business For Sale

Businesses are complicated and preparing yours for sale can seem intimidating. We've prepared a partial checklist to help get the process started. We hope you find it useful!

Please note that the following list is not comprehensive and should serve only as a guide. All businesses are different and will have different circumstances. You should consult with your attorney and accountant.

Business Formation Documents and Associated Records

These are all of the legal papers that relate to the formation of your company and how it's organized and governed. In an asset sale, unlike a stock sale, you will probably not need to show all of these documents to the prospective buyer. Collect the information that relates to the formation of the business and its associated governing documents.

Most small businesses are formed as LLCs (Limited Liability Companies) or Subchapter S Corporations. Sometimes other structures are used like C Corporations or LLPs (Limited Liability Partnerships), or even GPs (General Partnerships) or Sole Proprietorships. Most of these will have similar governing documents, though the name of the documents will vary.

- Articles of incorporation / formation
- Corporate by-laws
- Stock / ownership records and shares
- Board of Director meeting notes
- Shareholder meeting notes
- Most current periodic report showing company is in good standing
- Resolution signed by all owners authorizing the offering of the business for sale

Products and Services

Every business is different and offers different products and services in many ways to a variety of markets. Collect the information that relates specifically to your products and services. Here are some suggestions:

- List of each product or service with a brief description of each
- Gross margin (%) for each product or service line
- Geographic area served for each product or service
- Invoices / bills of sale / contracts showing individual sales for the past two to three years

Marketing, Advertising, and Sales

Marketing, advertising and sales can vary widely from business to business. Some businesses survive solely on word-of-mouth while others require extensive marketing campaigns and/or the efforts of salespeople. Provide a narrative of your sales, marketing, and advertising processes and goals.

- Marketing and advertising channels used (e.g. social media companies, radio, mail, email, etc.)
- Amount expended on each platform, including receipts for the past two to three years
- Inside sales people and their duties and methods of operation
- Outside sales reps and their duties and methods of operation
- Reputation of the company in general and on relevant platforms (social media sites, google, etc.)
- Agencies and Creatives employed along with contracts and receipts for services rendered
- Website address

Research and Development

Some companies will have active R&D projects while others have none. Collect any information you may have on ongoing or planned product development projects.

- List of ongoing R&D projects
- Project objectives
- Project budgets
- Project schedules

Personnel

People are the most important part of every business. Clearly show how your business is organized and how each employee fits into its operation. Also, make sure you describe how you attract and retain your employees.

- Organizational chart
- Document describing each job position in your business including
 - Job description
 - Salary for each person
 - Salary range for each position
 - Experience required
 - Certifications required
- Employment benefits
- Identification of key employees
- Future plans of key employees (staying on, taking on additional responsibilities, retiring, etc.)
- Employment contracts
- Salary increase projections

- Availability of labor
- Company culture description and plan

Vendor Relationships

You will have to transfer all of your vendor relationships to the new owner. You will need to review all of your vendor relationships to ensure that these relationships can be transferred and the method of doing so. This is critical. Deals will fall apart if key vendor relationships can't be transferred.

- List of all contracts, distributorships, licensing agreements (including software), etc.
 - Vendor name and contact information
 - What product or service they provide
 - Alternate sources for each
- Copies of all of these along with a summary of:
 - Exclusivity agreements (territory, etc.)
 - Pricing
 - Discount programs
 - Advertising requirements and restrictions

Customers

Customers pay the bills and a prospective buyer will be very interested in who they are, how loyal they are, how much of your business they represent, how long they've been with you, and whether what you provide them is considered a critical product or service. Include a short narrative describing your most important customers.

- Copies of all customer contracts
- Progress on each job if applicable
- Business backlog (business won but not finished - include signed contracts, invoices, etc.)
- Bidding activity, if applicable, and estimate of the probability of winning each contract
- List showing % of total revenue for top ten largest customers
- List of all customers for the past three to five years showing repeat business
- Contact information
- All customer invoices for the past two to three years to prove revenue

Competition

You know who your competitors are better than anyone. Providing insight to the buyer as to their market share, strengths and weaknesses will help the buyer feel comfortable going forward.

- List of all important competitors, their market share, location, service area / product lines, strengths and weaknesses, etc.

Strategic Alliances and Partnerships

List any mutual aid relationships you have with other companies such as pooled advertising agreements, cross-sales agreements, maintenance agreements, etc. Include all details, whether in writing or by verbal understandings.

Industry Outlook

Provide a short narrative of the outlook for your industry in your region.

Financial Statements

Your company's financial statements will be the primary focus of much of due diligence. Work with your accountant to compile accurate and error free financial statements for your business for at least the past three years, preferably five. Additionally, provide at least one year and the trailing twelve months of monthly financial statements. The buyer will need these to understand the seasonal nature of your business, working capital requirements, and the timing of cash flows which are critical during the transition phase of the business.

- Income statements
- Balance sheets
- Cash flow statements
- Add-backs and other adjustments (document each of these carefully)
- Quality of earnings report
- Projected income statement
- Summary of working capital accounts

Assets

Some businesses require a lot of equipment to operate while others require almost none. You will want to provide a list of the equipment your business uses, and describe what it's used for, how it's maintained, and when it will need to be replaced. Provide the buyer with an estimate of the amount of capital expenditures required each year necessary to keep the business running and/or growing. This is important as assets that have not been regularly maintained or upgraded can kill a deal if not disclosed early.

- List of all assets, their age, their remaining service life, and their fair market (used) value
- Provide maintenance schedules and logs

Working Capital

Working capital is cash-equivalent accounts and other materials needed to operate the business on a day-to-day business. Critically, working capital transfers with the business and is included in the price the buyer will pay for the business. This is because the business is transferred as a going concern.

It's important to identify which accounts are "working capital" accounts and to determine what level they need to be at to support the business operations and growth. You and the buyer will work together to determine this amount. Working capital is traditionally defined as Accounts Receivable (AR) + Inventory - Accounts Payable (AP) but other accounts are often included and will vary for every business.

- List of inventory, including inventory that is obsolete
- List of each item in AR, it's amount, terms, and payment status
- Divide and summarize AR into buckets (current, past 30, past 60, past 90, etc.) as makes sense for your business
- List of each account in AP and the amount, terms, and payment status
- List of other working capital accounts, and how they're used (e.g. unearned revenue, prepaid items, etc.)

Real Estate

Most businesses need a place to operate from. Provide a narrative of the real estate necessary to operate your business, why it's suitable, needed upgrades, and other important considerations. Real estate is not generally considered an asset of the business, though real estate leases are. Real estate often transfers to the buyer in a separate transaction via purchase or lease.

- Address of each location
- Size of current space
- Unused portion of space that can be used for growth
- Copy of the lease(s), summary of the rent and terms
- If the real estate is available for continued occupation
- If the real estate is available for purchase separately and the price and terms
- If the real estate is available for long term lease, the amount and terms

Legal Matters

It is vital to disclose all current, former, and pending lawsuits or other legal actions that the business has been, or might be involved in. Don't hide any skeletons in the closet. Past litigation is discoverable during due diligence and undisclosed pending litigation will inevitably lead to problems down the road.

- List of any and all legal actions, past, present, and future
- Account for any past, present, and future worker's comp claims, tax liens, etc.
- List of all potential legal claims that you should reasonably know about
- Describe the outcome of all settled actions and the status of all present actions

Taxes and Jurisdictions

Businesses are subject to a myriad of taxes, license fees, and other government collections. Provide an accounting of all of these to the buyer. You will need to provide proof at closing that all taxes have been accounted for and paid.

- List of all taxes and other fees owed (sales, payroll, property, etc.)
- List of the associated jurisdictions (federal, state, county, city, special districts, etc.)
- Provide proof that these have been paid

Licenses, Permits, and Regulatory Requirements

Many businesses require special licenses and permits to operate or operate under specific regulatory regimes. Provide a list of all of these, associated fees, and the current status of each.

Environmental Issues

In many business transactions, there is the risk of exposure to environmental liability. If you know that you have this type of exposure, it's best to prepare for an environmental audit ahead of time as you can expect the buyer and/or the bank will order one. Be sure to disclose any known or suspected environmental problems to the buyer. Being up front here will keep the due diligence process moving and get the deal closed faster.

Insurance Requirements and Policies

Typically the buyer will obtain new insurance policies unless the business is being transferred in a stock sale. Regardless, the buyer will need to know the details of the policies that must be maintained for the operation of the business. Provide copies of all of your insurance policies to the buyer. You will also have to prove that you have maintained these policies up through closing.

Post-Sale Training and Consulting

Before offering your business for sale, consider how much training you will need to offer to the new buyer to make sure the business continues to prosper. Since there will be a seller carry note, and possibly an earnout involved, this will also insure that the business continues to succeed and you will get paid.

A typical training clause will provide for 6 months of uncompensated full-time training with an additional optional consulting period. The details are negotiable and depend on what you think is required to successfully train the new owner and how much the new owner feels they need.

Stakeholders and Your Rationale for Selling

The buyer will want to know who every stakeholder in your business is, both voting and non-voting, as well as any influencers, such as the company accountant, attorney, management team, spouse, or children.

Being able to clearly articulate your reason for selling your business is very important. Buyers are very wary of sellers that can't explain their decision to sell. Why don't your children want to continue the business? Why doesn't a key employee want to buy it? What is your spouse's opinion? Your accountant? Are you retiring? Health issues?

Deals can fall apart at the last minute if all of the stakeholders aren't on board. Buyers are acutely aware of this and will ask about this early on in the process. Take the time to work all of this out ahead of time.

Non-Compete and Non-Solicitation Agreement

Expect to be asked to sign non-compete and non-solicitation agreements by the buyer. They want to know you aren't going to set-up shop across the street! These agreements are normal and are usually geographically and time limited in some way.

Company Advantage

What advantage do you have over your competitors that allows you to maintain and increase your market share? Is it an exclusive licensing deal? Is it a long term relationship with a client or clients? Is there a high barrier of entry into your business? Do you have key intellectual property rights?

Think carefully about why your business is successful and what is keeping a competitor from luring away your customers or someone starting their own business from scratch and competing with you. The buyer wants to buy your business because it's already operating successfully, but it's a question they consider because once they own your business, they want to know what's to stop others from taking business away from them.

Valuation and Asking Price

Before you sell your business, you'll need to understand what your business is worth and come up with an asking price which can be a fixed number, a multiple of your earnings, or some other way of determining how much you will sell your business for. This is a complicated subject, and is outside the scope here. We have a separate white paper that discusses how to value your business.

Asset or Stock Sale

Business purchases are generally one of two types: a stock sale or an asset sale, with the asset sale being the much more common method.

A stock sale involves the sale of the stock of the company and is the simplest method. Despite this, it's rarely used at the lower mid-market level because in a stock sale, the buyer is assuming all the liabilities of the company, including hidden liabilities. This requires a much higher standard of due diligence and is very expensive. It's still sometimes used in some specialized circumstances, for example if key vendor or customer contracts can't be transferred to the new owner.

An asset sale involves the sale of all of the assets of the business to the new owner who forms a new company to buy them. Assets include the physical assets of the business but also things like the business name, logos, customers, working capital accounts, etc. The amount that the buyer pays the seller over the fair market value of these assets is referred to as "goodwill" and becomes an asset for the new owner. Asset sales avoid most of the liability issues that come with a stock sale and are by far the most common way to transfer a small business. To the outside world it appears that nothing has changed.

There are many implications of both types of sale, including tax implications, and you will need to consult with your advisors about the advantages and disadvantages of each.

Conclusion

Taking the time to compile this information ahead of the sale will make the process much easier and less frustrating for both you and the buyer. It will make all parties, including debt and equity sources, feel confident with the transaction. Best of all, it will save time and get the deal to closing much faster. Remember: time (and too many lawyers) kill deals!