WHITE PAPER

How To Avoid Deal Killers While Selling Your Business

By David Tobin, Mary McKinney Flaherty, Bruce Bishop, & Chuck Gottschalk

What's inside:

Recently, four of our partners got together for an informative talk on a topic that is critical for anyone selling a business: How to avoid bumps in the road – deal killers – on the journey to a successful sale.

Enjoy this conversational format as we share from our experiences helping business owners maximize and monetize their company's value. The podcast is available **here** if you'd like to listen in.

From a numbers perspective, how do I prepare for selling my business?

Chuck Gottschalk
TobinLeff Partner; former COO, CFO, CPA and former Senior Manager at Ernst & Young:

From a financial reporting standpoint, here's what surprises many clients: When it's time to sell your business, you need to focus your financial statements on the GAAP (Generally Accepted Accounting Principles) basis. For many companies, the GAAP is not relevant to the day-to-day operations of the business; they've built their companies over twenty years and never had to comply with GAAP rules for accounting.

However, if you go to market to sell your company, GAAP is the language of business, the banks, and of the M&A advisors. You'll need to convert your financial statements to a GAAP basis. If you don't, there's tremendous risk that the numbers won't line up with the buyer's due diligence.

In this context, the numbers must be based on the *accrual* basis, not the cash basis. That's an easy bump to avoid to set you on a better path for the successful sale of your company.

For example, it's not uncommon for our clients to pay their employees every two weeks, and then record this expense in that form. That's not GAAP. You'll end up with 10 months that have 2 pays and 2 months that have 3 pays. The 2 months that have 3 pays will significantly understate the income. The months with 2 pays will overstate the income. You can't do that when you go to market, because you need accurate numbers on a monthly basis.

We always tell our clients to conduct their business as they always have. But, you'll want to add GAAP compliance to your accounting processes. The good news is, your numbers will actually become more predictable, and you'll understand them better.

Believe it or not, when you do go to sell your business, the *last* thing you want to be talking about are the numbers. If you find yourself constantly explaining numbers, as in, "Why was there a loss in March?" then you can explain that it's because there were three payrolls that month, but the whole conversation is a needless distraction – for all parties. When we do our job to prepare financial statements for the sale of your company, the numbers speak for themselves.

We help our clients present their numbers properly, eliminate speed bumps, and stay focused on the value proposition of the business. *The value proposition of your business is the vision.* The numbers are there to support that vision.

Action item: Be sure your M&A advisors understand the need for GAAP compliance and add it to your accounting process as part of preparation for your future sale.

How can owners prepare for selling their business from a legal and business perspective?

Mary McKinney Flaherty
TobinLeff Partner; 20 years career experience in law, corporate governance, and investment analysis:

Fortune favors the prepared, and that's so true throughout the M&A process.

It might sound trite, but you really must begin with the end in mind before you start the process of selling your company. This means clarifying, in great detail, what you as a business owner really hope to accomplish in the future transaction, and what aspects matter most.

- Is it the amount of cash at closing?
- Or specific payments over a period of time?
- How much do you care about what happens with your company *after* the transaction?
- What's the best outcome for your team, and how will you help them prepare?

Why are these questions important? The M&A process will test every one of your convictions because the buyer's vision will always be somewhat different, which leads to a related point: Are your expectations realistic? First and foremost, you need to have a realistic valuation of your company. If the current value of your business isn't where you need it to be for your selling goals, what steps can you take to increase it? We can certainly advise you on ways to build your business value so that it's positioned to sell for an above-market rate.

Some improvements and changes might be very short term, others could be longer term. You might decide to wait two months or two years before going on the market. Either way, you'll be in a stronger position to hit your goals.

Another integral element of preparing your business for a sale is to get in front of any weaknesses that exist. (This is me putting my lawyer hat on.) When it comes to sharing weaknesses, *how much should a business owner share*?

I have a formula for this… share *everything*.

Tell your M&A advisor every negative, or potentially negative, detail. Maybe there was an HR issue a few years ago. Detail that. Does 30% or 40% of your business come from one client? Discuss that with your advisor *right away*. The quicker you get ahead of your weaknesses, the quicker they can be cleaned up and set the sale of your business up for success. The last thing anyone wants is to be in view of the finish line when unpleasant realities come to light.

Finally, have a Plan B.

In order to negotiate from a position of strength, throughout the entire M&A process, it's important to develop a Plan B that you're genuinely happy with.

Everyone goes into the process assuming it's going to work. But things can happen. You could lose a major client, the market could shift, and so on. If a deal hits a bump in the road, your Plan B might be to step back for six months, or it might be to re-focus on growth in a particular sector to strengthen weaker areas.

Bottom line: a good Plan B for selling your business can keep you from getting desperate and strengthen your bargaining power throughout the process.

Action items:

- ☑ Make sure your vision and expectations are realistic.
- ☑ Get real about your company's value and weaknesses and address them.
- ☑ Have a Plan B you can be happy about.

How can owners prepare for the trials and tribulations of the M&A process?

Bruce Bishop
TobinLeff Partner; former CFO of global holding companies and large marketing communications agencies; he has spearheaded more than 30 M&A transactions:

Do yourself, and your business, a favor by continuing to run your business the way you've always run it throughout the entire process of selling the company.

When I was on the *buy* side, if a company didn't have a lawyer early on in the transaction, we would probably walk away. Why? Because then we would know that they weren't serious.

Speaking of your team, you need to make sure your team members are already adequately compensated. In addition, consider an equity participation plan for key positions. This is also referred to as a *phantom plan*, because you don't want a key individual leaving in the middle of the selling process; this can derail a deal.

The same principle can apply to key clients.

If you haven't started doing so already, create monthly rolling forecasts. This will not only help you address potential issues, but a track record of hitting or exceeding forecasts is valuable to a potential buyer.

It's also important to get your CIM (Confidential Information Memorandum, the document used to market your business to prospective buyers) designed well, showing what differentiates you from other potential opportunities or businesses a buyer will also be looking at. Articulate your investment thesis and growth plan so the buyer appreciates this early on.

Action items:

- ☑ Don't take your foot off the gas pedal during the M&A process.
- ☑ Make sure your key people are adequately compensated.
- ☑ Create monthly rolling forecasts.
- ☑ Make sure your CIM is top notch and clearly presents your investment thesis, value proposition, and growth opportunities.

How should I handle meetings with potential buyers?

Mary McKinney Flaherty:

Meetings with prospective purchasers are a *huge* piece of the go-to-market phase. You could be meeting many different buyers from different backgrounds. There may be financial sponsors or strategic buyers with different goals and plans.

The most important ingredient in these conversations is to practice empathy.

Yes, really. Step into the buyer's shoes.

What are their pain points? What are their needs? Only then can you become a problem solver.

Also be realistic and honest about whether it's a good match. Have many detailed meetings, in different settings, to make sure that there is chemistry, as well as alignment of cultures, values, and vision. When potential bumps in the road are spotted, talk through those openly.

The lack of cultural alignment can be a major factor in a deal going off track.

Action items:

- ☑ Whether it's a current prospective buyer or your dream buyer, take time to put yourself in *their* shoes, and prepare to communicate accordingly.
- ☑ Communicate openly about culture, values, and vision.

What kind of forecasts do I need to present to potential buyers?

Chuck Gottschalk:

When you prepare the Confidential Information Memorandum (CIM), keep the numbers fresh.

These forecasts need to be updated systematically, because buyers don't want to wait two or three months to see your data. They want to know how you're doing through that process.

As Bruce talked about rolling forecasts, you need to have a process in place to update the numbers regularly. Clients sometimes tell us that they only have a forecast of revenue of *known deals* and don't want to forecast the unknown.

That doesn't work when you go to market.

The *unknown* is essential, because you need to tell a full year story about where you are headed. What markets are you working to expand? What sectors are you working to break into? Forecast these and, as Bruce mentioned, keep your foot on the gas!

As with all these considerations, the investment you are making in these details is a win-win. Your operations will benefit by a renewed view of the numbers – and renewed pursuit of growth.

When your company misses a forecast, you need to explain why your expectations were not met. On the other hand, don't assume that exceeding a projection is always a good thing. It might indicate that you don't understand your business.

Action item: Keep your numbers up-to-date: Forecast, assess, and revise.

Moving through the process and preparing for the sale

Bruce Bishop:

As discussions progress, and all parties are confident that the deal will close, it's time to populate a data room. It's time to get the right information organized in a place where you can share with the prospective buyer or buyers.

This won't start out as an exhaustive list, but the point is to begin. Trust me, once you start, relevant data will grow. The sooner you begin, the less pressured you will be in the final weeks, and the information will be higher quality.

If you're not sure where to start, prepare answers to potential buyer questions – and questions you have for the buyer – so that you make sure, early on, that there's a fit.

Then, pivot your planning by addressing what integration might look like, post-deal. Putting yourself in the buyer's shoes, and addressing likely scenarios, will help the buyer transition and maximize your earnout.

Make sure you're clear on what you want to get out of an LOI (Letter of Intent. The LOI is a letter from the potential buyer, outlining an agreement in principle to acquire your company. It lays out the proposed transaction details at a fairly high level). The more time you spend on those specifics, the less time you'll spend later on with lawyers drafting the purchase agreement.

Chuck Gottschalk:

I'd like to add to what Bruce said about the letter of intent. You need to understand *who* is sending that letter of intent. You also need to do due diligence on the potential buyers.

The reason we need to do the due diligence is the fact that, unfortunately, there are people who present themselves well, create a nice web page, and look like a real buyer, but they're not. They want to put you under contract on an LOI and *then* try to get their act together.

These can be delicate conversations, and that's where our team comes in.

Action items:

- ☑ Get your data room set up and begin to populate it.
- ☑ Have a detailed list of what your ideal LOI includes.
- ☑ Thoroughly vet potential buyers.

I signed the letter of intent and I'm ready to cross the finish line. What's next?

Mary McKinney Flaherty:

Coming back to what Bruce began on the importance of assembling a quality M&A team: Having an attorney involved at the beginning – someone who has experience in M&A transactions, and ideally, in your industry – can make or break a deal.

Experience is among your most valuable assets.

Stay focused on the things that matter while also paying attention to the details, but don't get distracted by them. There's going to be seemingly endless requests for information. It can be a slog, but you have to focus on every single detail and make sure you get the information out.

But when it comes to terms and contracts and working through them, make sure that the whole deal doesn't get lost or distracted by minor ancillary provisions. Be sure that your legal counsel has clarity and is focusing on what matters most to you.

What, specifically, really matters to you?

For example, how do you set this deal up to ensure that not only are you receiving the cash at close, but that you're also in a position to meet your earnout? How are your key employees being incentivized? The point is, make sure the things that are priorities for you are plainly and specifically covered in the contract.

Some aspects can get heightened and emotional. Sometimes there are unexpected bumps in the road. This is where experienced legal counsel is crucial. The more prepared your team is, the more of a problem-solving approach you can present to the buyer. This can open up the negotiation, as opposed to having it turn into a battle.

In the process, be prepared to manage your legal team based on what's most important to you. Let's face it, lawyers can sometimes argue back and forth on minor points. You don't have to win every single point to walk away with an excellent outcome.

Action item: Make sure your legal and M&A advisors are clear about what matters most to you, and make sure everyone stays focused on moving those areas forward.

How do I manage working capital during the selling process?

Chuck Gottschalk:

What is the right amount of capital to leave with a buyer to operate the business? I refer to it as the *gas in the tank*. You're selling your car, and you have to leave gas in the tank.

You don't have to leave it full, but you can't leave it on empty. And there's a big range between full and empty.

I advise leaving an eighth to a quarter of a tank. The buyer will want three quarters of a tank, and that can become a battleground. Deferred revenue is also a potential battleground, so you need to understand how you're recognizing your revenue, and if you're doing it properly.

David and I recently received a call from a business owner who didn't do the right things up front. They went to market *without* advisors, and the issue of working capital came up. "Hey, can you help us out?" they asked. And we agreed.

We found out their previous year earnings were 50 percent higher than they had shown them to be, and it all came back to working capital. We helped them identify this reality and equipped them to explain that their company was a fundamentally stronger company.

The working capital picture changed, and now they're going to get a better outcome. But they came very close to underselling.

Speaking of numbers, make sure they are easy to understand – from the buyer's standpoint.

Action item: Set a realistic expectation of how much *gas* you'll leave in the tank, based on feedback from your M&A firm.

How can I prepare myself for the process?

Mary McKinney Flaherty:

It’s a marathon, not a sprint. Envision the process like a marathon runner – training, preparation, and even visualization are tools that can be helpful.

What’s the 23rd mile going to feel like? It’s going to be pretty tough and miserable. *But what will crossing the finish line feel like?*

Get mentally ready so you can excel through each phase of the process of selling your business. It’s easier when you know what to expect. That’ll help you get in front of the emotional roller coaster.

Action item: Make sure that your M&A advisor brings more than just a glitzy document to the table. Solid documents are important, but it takes the right team to get you over the finish line.

Lessons from over 100 profitable exits

David Tobin
TobinLeff Founder and Management Partner; David is a serial entrepreneur who founded and crafted exit plans for three companies of his own. Over the past 15 years, he and his partners have helped more than 200 business owners craft exit plans and complete transactions to strategic buyers, private equity groups, and members of the management team.

Keep your eye on the prize. There’s going to be plenty of noise – internal and external.

Intentionally balance the importance of building relationships through this process, while being efficient and building momentum.

Time can kill M&A deals, but there are no shortcuts in getting to know the prospective buyers. No matter how the transaction is structured, the buyer is your partner in one form or another.

Finally, *trust your instincts*. If something just feels wrong, it’s wrong.

Chuck mentioned that a prospective client called with a question. There’s no fee for that. If you have a question, **contact one of our seven partners today**.

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Testimonial

"The team at TobinLeff was our 'partner' at every stage of the process. They helped us craft an exit plan and appreciate our options. When we decided to sell, TobinLeff brought us many qualified potential buyers and investors. And, most importantly, they were with us through the negotiations and due diligence stages to help keep the deal on-track and get it over the finish line."

– MARK PETROSKY, FOUNDER & CEO, DP+

About TobinLeff, LLC

TobinLeff is a leading M&A advisory and exit planning consulting firm, helping owners sell to strategic buyers and private equity groups. With 15 years of service, TobinLeff's team of senior advisors brings a wealth of Mergers & Acquisitions experience as former business owners, accountants, attorneys, and bankers dedicated to the mission of helping their clients maximize and monetize their life's work. TobinLeff is the go-to resource for business owners looking for true partners in their exit planning journey. TobinLeff.com

Checklist: Takeaways from the Conversation

From a numbers perspective, how do I prepare for selling my business?

- ☐ Add GAAP compliance to your accounting process as part of the preparation for your future sale.

How can owners prepare for selling their business from a legal and business perspective?

- ☐ Make sure your vision and expectations are realistic.
- ☐ Share everything with your advisors to get ahead of any weaknesses that may exist.
- ☐ Have a Plan B you can be happy about.

How can owners prepare for the trials and tribulations of the M&A process?

- ☐ Don't take your foot off the gas pedal during the M&A process.
- ☐ Make sure your key people are adequately compensated.
- ☐ Create monthly rolling forecasts.
- ☐ Make sure your CIM is top notch and clearly presents your investment thesis, value proposition, and growth opportunities.

How should I handle meetings with potential buyers?

- ☐ Whether it's a current prospective buyer or your dream buyer, take time to put yourself in their shoes, and prepare to communicate accordingly.
- ☐ Communicate openly about culture, values, and vision.

What kind of forecasts do I need to present to potential buyers?

- ☐ GAAP compliant, regularly updated income statements and balance sheets as well as updated forecasts through year end.

Moving through the process and preparing for the sale

- ☐ Get your data room set up and begin to populate it.
- ☐ Have a detailed list of what your ideal LOI includes.
- ☐ Thoroughly vet potential buyers.

I signed the letter of intent and I'm ready to cross the finish line. What's next?

- ☐ Make sure your legal and M&A advisors are clear about what matters most to you, and make sure everyone stays focused on moving those areas forward.

How do I manage working capital during the selling process?

- ☐ Set a realistic expectation of how much gas you'll leave in the tank, based on feedback from your M&A firm.

How can I prepare myself for the process?

- ☐ Make sure that your M&A advisor brings more than just a glitzy document to the table. Solid documents are important, but it takes the right team to get you over the finish line, including holding your hand through every part of the process, even after the deal closes.