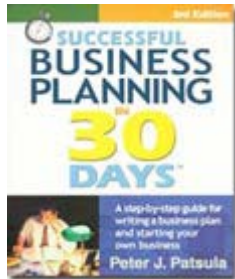


The **ENTREPRENEUR'S** Guidebook Series™

Next
Page

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This book has helped me a great deal in thinking about my business

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PERSONAL PLANNING

Guidebook #87:

Selling Your Company 4

Deciding When to Sell Your Business5

Sell all or part of your business when5

Planning the Sale of Your Business.....8

1) Deciding How to Sell Your Business 10

Selling to Corporations10

Selling to Partners.....10

Selling to Other Investors11

Selling to Other Shareholders.....11

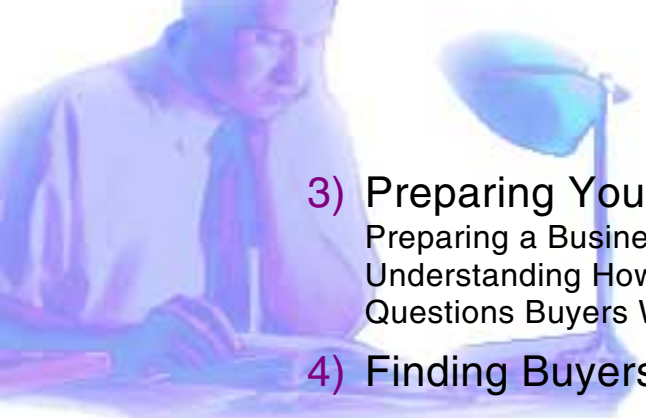
Selling to the Public.....12

Trading Stock for Other Things of Value17

2) Determining the Value of Your Business..... 18

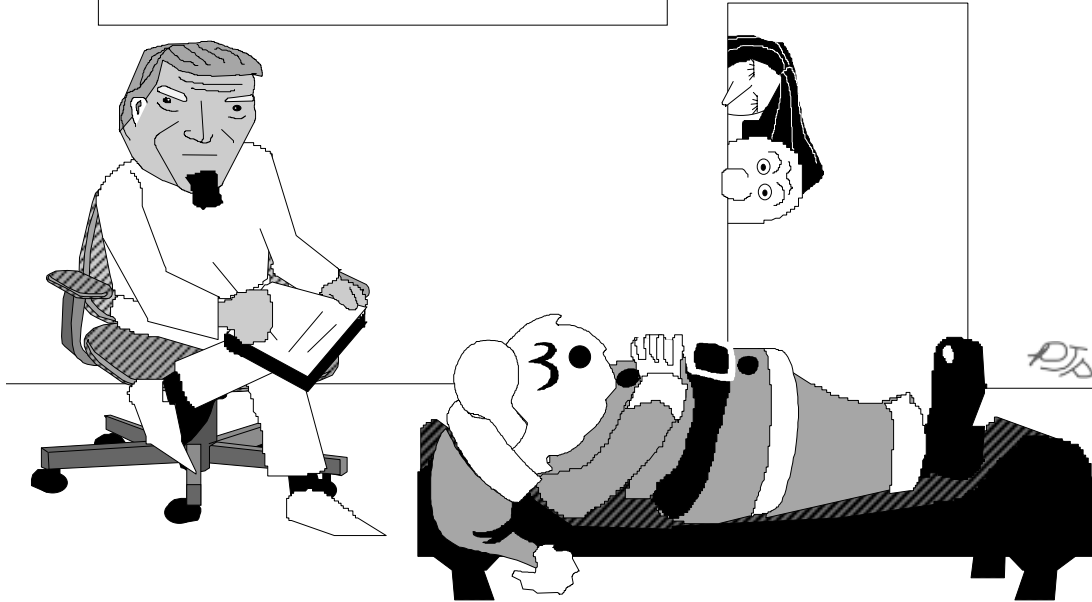
Factors that Influence the Value of Your Business.....18

Calculating the Value of Your Business23



3) Preparing Your Business For Sale	30
Preparing a Business Presentation Package	30
Understanding How Buyers Will Evaluate Your Business.....	32
Questions Buyers Will Often Ask	33
4) Finding Buyers	37
5) Structuring the Transaction	40
Structuring the Purchase and Sale of the Business	40
Structuring How the Purchase Will Be Paid For	42
6) Negotiating the Transaction	45
The Role of Advisors	46
7) Writing Up a Selling Contract.....	48
8) Closing the Sale.....	52
Meeting the Conditions of the Sale	52
Types of Settlements.....	52
Documents Required.....	53
Contingent liabilities	55
FIG. 1 – A Summary <input checked="" type="checkbox"/> of the Items Buyers Will Likely Want	
to Review and Obtain Info On.....	56

CAREER COUNSELING



“The problem is . . . I really hate making toys.”

Smallbusinesstown.com

SELLING YOUR COMPANY

ANY business you build, on your own or with the help of others, may be the most valuable asset you have. However, sooner or later you may want to use part of that asset to invest in outside interests, or you may decide to withdraw entirely from your business and move on to other interests.

At this point, your goal will be to convert **“worth on paper”** to **“money in the bank.”**

ACKNOWLEDGEMENT Information contained in this guidebook is based largely on public domain document, “How to Buy or Sell a Business” by John A. Johansen (SBA).

DECIDING WHEN TO SELL YOUR BUSINESS

SELLING PART or all of your business is a very personal and complicated decision, but one every business person must eventually face. Below are some common reasons and circumstances that might interest in you in selling part or all of your business.

Sell all or part of your business when . . .

- ❑ *Sales and earnings have plateaued* – If you lack the working capital or management resources to grow, you may need to sell part of your business to gain access to those resources.
- ❑ *The personal interests of the team of people that started the business with*

Money is a terrible master but an excellent servant.
P.T. BARNUM

you are changing – If no one really seems interested in running the business, then you must get out before the business falls apart and is of little value to no one.

- ❑ *There is an illness or death of a partner* – Upon the death of a partner, unless otherwise noted in the partnership agreement, a partnership must be dissolved.
- ❑ *There is a serious partnership dispute* – Selling the business might be the only way of resolving serious problems within a partnership.
- ❑ *You are becoming bored* – If the excitement and thrill of running your business is beginning to wear thin, it's time to sell it and move on to greener pas-

tures.

- ❑ *You are becoming nervous about having all your eggs in one basket* – As a result, you may become more cautious in running the business and over time lose your market share to a more aggressive competition. Therefore, it may be better to sell now.
- ❑ *Your business has matured and is prosperous* – If your venture is five to ten years old, has had substantial growth in sales during the period, and in recent years has achieved an acceptable level of earnings, then perhaps you should consider selling it. You should also consider selling it, if you feel that it has reached a stage where it must make the transition from being

Few men of action have been able to make a graceful exit at the appropriate time.

**MALCOLM
MUGGERIDGE**

founder dominated to one which utilizes more formal and more disciplined management practices and you don't wish to participate in this transition.

- ❑ *Your business starts to lose money* – If your business is losing money and you can't see a way of turning things around you better get out fast to keep your debts to a minimum and get the most for any assets you have left. There's always a chance that some other business person may have the resources and know how to make your business work.
- ❑ *You want to enjoy the fruits of your labor* – If your share of ownership in the business has achieved value but remains almost completely non-liquid, it

may be time to cash some of that ownership in and change it to more liquid assets.

- *Your want to retire* – Sell your business if you are at a point in your life where you have enough security, perhaps your children have reached college age and you want to pursue other simpler pleasures or take a long deserved rest.



A celebrity is a person who works hard all his life to become known then wears dark glasses to avoid being recognized.

FRED ALLEN

PLANNING THE SALE OF YOUR BUSINESS

INTELLIGENT BUSINESS owners carefully plan out the decision to sell their business. They recognize that a business should be sold only after proper preparation and not because of sudden personal frustration or a short-term downturn in business. In fact, more often than not, plans to sell a business should be made years in advance of the actual sale.

One reason for this is that nearly every privately held business is operated in a manner that minimizes the sellers' tax liability. And unfortunately, the same accounting practices and operating techniques that minimize tax liability also minimize the value of a business. As a result,

Plan to sell your business about 3 to 5 years in advance.

there is often a conflict between running a business the way an owner wants and preparing the business for sale.

Therefore, plan to sell your business about 3 to 5 years in advance. This will give you the time required to make necessary changes in accounting practices that demonstrate a 3 to 5 year track record of maximum profits.

Below is a summary outline of the eight steps of selling a business:

- How to Sell Your Business
 - Determining its Value
 - Preparing the Business for Sale
 - Finding Buyers and Sellers
 - Structuring the Transaction

- Negotiating the Transaction
- Writing up a Sales Contract
- Closing the Transaction

NOTE Although it is possible to reconstruct financial statements to reflect the actual operating performance of the business, this process may also put the owner in a position of having to pay back income taxes and penalties.



Although it is possible to reconstruct financial statements to reflect the actual operating performance of the business, this process may also put the owner in a position of having to pay back income taxes and penalties.

1) DECIDING HOW TO SELL YOUR BUSINESS

IF YOU don't care what happens to your business after you sell it, you will of course sell to the highest bidder and hope for cash in return. However, if you still want to be a part of the business or have vested interests in keeping in thriving, your options and decisions will be more complicated.

Selling to Corporations

Every large company has an acquisitions department that is often interested in buying businesses to improve their marketing position, reduce costs and increase profit-

Every large company has an acquisitions department that is often interested in buying businesses to improve their marketing position, reduce costs and increase profitability.

ability. They are ideal buyers if you can find them, because typically they can give you the most money and fast, either in cash or in exchange for their stock.

NOTE If you sell for cash, all the uncertainty of the transaction is removed, but your profits may be taxable immediately. If you take stock in the acquiring firm it may be possible to defer taxes on the gain, sometimes permanently. However, the long-term value of the deal will of course vary depending on the performance of the acquiring company.

Selling to Partners

In a closely held company, selling part or all of your ownership to one of your partners is a convenient way to cash in some

chips, providing that your partners are interested. It is a simple process legally, but has the drawback that you may have to take much of your money on an installment plan. There are also tax implications that you will need to look into.

Selling to Other Investors

If you are one of several partners active in the operation of a business, selling all or part of your share to an individual not already associated with your company may be difficult to arrange. This is because in addition to the financial aspects of the transaction, you must find a willing investor who is acceptable to the other owners. However, if your company is not publicly held and already has a number of outside investors, the sale of all or part of your

Retirement at sixty-five is ridiculous. When I was sixty-five, I still had pimples.

**GEORGE
BURNS**

share to another outsider can be a fairly simple transaction, provided the buyer is willing to accept the same restrictions that you have.

NOTE Too many restrictions tend to lower your asking price.

Selling to Other Shareholders

If you have a number of passive shareholders, probably as a result of raising capital through a private sale of stock, you may be able to arrange to sell them the rest of your shares without too many problems from other shareholders. However, being that the shares are restricted and there is no public market, expect the buyers to negotiate to their advantage.

Selling to the Public

If you have not done so already, going public (selling shares on the open market) is one way to liquidate some of your assets. However, most financial experts advise new companies not to go public too soon. To sell your business you must look good on paper. You need pre-tax profits of at least \$100,000 and net sales of one to two million.

Advantages of Going Public –

Going public results in having at least several hundred small shareholders rather than a handful of very large ones. As long as you are the largest shareholder you are likely to retain control of the company. Other advantages of going public are:

- *You can get a higher price* – When

going public you can almost be sure to get a higher price for your stock than if you sell them privately. Private investors drive very hard financial deals.

- *You increase the liquidity of your founding and public shares* – Stock purchased in a public issue can be traded more freely by outside investors. The people who buy from you are not forced to leave their money tied up for five years or more. And although there still remain substantial restrictions on when and under what circumstances you, other founding members, officers, directors, and/or major shareholders can sell stock, ultimately you will achieve greater liquidity and find it easier to sell shares in founding stock

It is better to wear out than to rust out.
PROVERB

as well as public stock.

NOTE Founder stock can be sold as part of a general offering. However, it may be called a bailout or a secondary offering depending on how kind your underwriter wants to be. Frequently underwriters will refuse to include founder stock in a public offering, but even so, going public may be your best approach because it sets the stage for you to sell your founder stock more readily at a later date, usually in several years.

- *Your company becomes more visible and credible* – This means that hiring new employees will be easier, and doing business with other companies

In a 1990 survey of about 100 companies that had recently gone public, more than 50 percent of the respondents listed enhanced credibility with customers, suppliers, banks, et., as the most important benefit.

will be easier.

NOTE In a 1990 survey of about 100 companies that had recently gone public, more than 50 percent of the respondents listed enhanced credibility with customers, suppliers, banks, etc., as the most important benefit.

- *Your future selling price will escalate* – If initially, all you want from going public is to cash in a few chips, in the future, if you decide to merge or sell out to a larger company, another benefit you will realize is that buyers' will pay more for publicly owned companies than they will pay for privately owned companies. In other words, going public is an excellent

strategy to position your company to be acquired. For example, in the case of a publicly owned company, the price is normally the quoted price plus a premium. Acquiring firms will often pay 40 or 50 times earnings and more. In negotiated deals for privately held companies, the range is more likely to be 7 or 10 times earnings.

Drawbacks to Going

Public – As said earlier, going public has the advantage of bringing in hundreds of small shareholders rather than a handful of very

Proprietorships are often more difficult to sell than large publicly or privately owned corporations. The purchaser of a small enterprise may buy a business with only a small down payment, paying the balance out of income over a period of years. However, all too often, problems arise that transform the long-term sale into a short-term fiasco and the seller may have to take back his or her formerly owned business and try to rebuild it – if indeed it can be resuscitated.

POWERPOINT

large ones. The problem with this however, is although your prospectus will describe the risks in great detail and with great emphasis, the typical small investor may not fully understand them. This can lead to:

- *Increased pressures will be put on management to achieve short-term profitability in its desire to keep the price of the stock up* – This means that long-term planning efforts may fail. Ultimately this can hurt the company.

- *Increased legal, printing and accounting*

fees – Legal fees and printing costs for a public stock offering will be considerable, and if you use an underwriter to sell the stock, commissions will also be considerable. Also, going public can create some serious tax implications. Being that tax laws are complex and changing continually, hefty accounting fees will become a regular part of your overhead.

- *Increased length of time to realize your profits* – Going public means in most cases you will need approval from the SEC, which can be a long and complicated process. You won't be able to realize the profits in going public until at least a few years down the road. There is also the possibility that the price of your stock

By selling your stocks below market value, its worth will rise rapidly building confidence in your company.

will fall below the offering price, which may make it more difficult to sell your company.

Other Factors to Consider – Before going public in the efforts to cash in some of your chips, you should also consider the following factors when making your decision:

- *Consider selling your first offering of stock below value to build company momentum* – By selling your stocks below market value, its worth will rise rapidly building confidence in your company. In your next offering, you can then ask for a higher price. Again people will likely jump upon your bandwagon, driving your stocks up higher.

- *Don't create misleading prospectuses* – Many companies who write misleading prospectuses before going public are being successfully sued for large sums by groups of their initial investors. The reason for these lawsuits is that the stock price dropped substantially a short time after the offering because of a downturn in business. The lawsuits claimed, and may well be right, that the companies should have known trouble was brewing and failed to disclose the news in its prospectus offering circular at the time the stock was first sold.
- *Research SCOR* – During the late 1980s, the government made available a faster and far less complex way for small companies to raise capital by

Before going public, you must seek counsel from experienced securities and tax lawyers.

going public. It is known as SCOR (Small Company Registration Offering). If you plan to go public, it is worth looking into. By early 1992, about 21 states had adopted the SCOR registration process. Among the

restrictions in SCOR are that the maximum amount of money that can be raised is \$1 million and the stock must be priced at \$5 per share or higher.

- *Seek security and tax lawyer's experts* – Before going public you must seek counsel from experienced securities and tax lawyers. Securities laws are complex; especially regarding the sale of stock by officers, directors or principal owners of a business. They change from time to time and at best are confusing, and

hard to interpret, and understand.

Trading Stock for Other Things of Value

Trading stock or bartering for other things of value may be a legal way to achieve some degree of liquidity. You might perhaps use restricted stock to pay an orthodontist to straighten the teeth of your children or as security on loans for large transactions.



Trading stock or bartering for other things of value, may be a legal way to achieve some degree of liquidity.

2) DETERMINING THE VALUE OF YOUR BUSINESS

PROPER VALUATION of your business can help eliminate guesswork and the painful trail and error method of pricing that so many owners rely on. All too often, they arbitrarily decide on an excessive price for the business and then go to the expense and effort of developing prospective buyers, only to be unable to strike a deal. It is only after gradually lowering the price and repeating this folly several times that they learn what their business is really worth.

Preparing to sell a business is very much like preparing to get a loan or seek investment funds.

POWERPOINT

Factors that Influence the Value of Your Business

Most often the value of a business is determined by its sales, net worth, earnings and fair market value. However, determining the value of your business can be very difficult if its worth depends on intangible assets such as goodwill and company image. The value of your business will also be subject to your skill as a negotiator – giving on some points, taking on another – supply and demand, psychology, and how anxious your buyer feels you are to get out. These factors and others that influence the value of your business are explained in more detail below.

NOTE Keep in mind when determining the

value of your business that it makes no difference how much time or money a previous you have already put into the business. From a buyer's point of view, they are only interested in the *future earning potential* of the business.

Balance Sheet Value – There are a number of balance sheet methods of valuation including book value, adjusted book value, and liquidation value. All of these approaches call for s for the assets of the business to be valued.

- *Adjusted Book Value* – This value is calculated by adjusting the asset's book value to equal the cost of replacing that asset in its current condition. To arrive at the adjusted book value, the total of the adjusted

Adjusted Book Value is calculated by adjusting asset's book value to equal the cost of replacing that asset in its current condition.

asset values is then offset against the sum of the liabilities.

NOTE Adjusted Book Value is considered the most useful balance sheet method of valuation.

- *Book Value* – This value is calculated by taking the figures from the company's record books, as depreciated at time of sale or amortized according to generally accepted accounting principles or current tax legislation.

NOTE Book value can pose some problems for sellers, especially if they have depreciated their assets too much in order to gain prior tax advantages.

- *Liquidation Value* – This value is the

amount that could be realized if all your assets, such as inventory, equipment, and furnishing, were sold separately. This value is usually much lower than your companies intrinsic value, however if you know this value you can use it to help establish a bottom-end asking price.

Condition of the Company –

The general condition of your facilities, equipment and the completeness and accuracy of your books and records have a bearing on its market value.

Economic Conditions – The economic climate in your area, especially the cost and availability of financing can directly affect the value of your business.

NOTE It is almost always better to sell a

business when economic conditions are favorable. Lower interest rates for example, often mean higher asking price.

Fair Market Value – This is the value of the business that buyers and sellers trade similar businesses in an open marketplace, adjusted for specific or local differentials. It is based upon the amount that could be realized if your business entity were sold as a whole and not in parts. Determining this value often involves researching and comparing similar businesses in your area; what they asking prices were and what they actually sold for.

NOTE It should be noted that businesses rarely change hands at fair market values.

Future Profit Potential – If your type of business is on the verge of a market ex-

It should be noted that businesses rarely change hands at fair market values.

plosion, or in the least on the verge of tapping into a new market with a new product or service, your asking price can be higher.

Goodwill Value – This value is difficult to calculate and is based on what your business has accomplished, where is it going, and how fast did it take to get there. Goodwill value can range from nothing to millions.

NOTE The value of your business will also depend upon the ability to transfer its goodwill and other intangible values to a new owner. If for example, the intangible value of your business is based upon your bubbling personality or stellar personal reputation, you will likely have difficulty convincing a buyer that he or she will be able to keep most of your present custom-

Businesses with high intrinsic value typically have pre-tax profits of a least \$100,000 and net sales of one to two million.

FUNFACT

ers or clients.

Income Statement Value – Income statement methods of valuation are most concerned with recent profits or cash flow produced by the business's assets.

Intrinsic Value – This value is based on having the right combination of company assets, earnings, assured prospects, management, and so on. Businesses with high intrinsic values can readily be expanded to very large size, by timely infusion of additional capital, by additional management, by access to national media or to national markets, or by any combination of these.

Market Demand – If your particular type of business is the latest fad, and as soon

as it goes up for sale ten people are knocking on your door, than obviously your asking price can be higher.

Opportunity Cost – Buyers of a business will look at what is known as its opportunity cost i.e., its rate of return on their investment. They will ask themselves, given the same amount of risk and hard work, how will the rate of return investing on your business compare with the rate of return on other businesses they are thinking of buying or for that matter other investments?

Recent Profit History – With all other things being the same, a profitable stable

The modern world regards business cycles as the ancient Egyptians regarded the overflowing of the Nile. The phenomenon recurs at intervals; it is of great importance to everyone, and the natural causes of it are not is sight.

JOHN BATES CLARK

business will command a higher asking price than a similar business that isn't so profitable or is more volatile.

Special Circumstances of the Buyer

or Seller – The more anxious or desperate you are to sell, the more cautious the buyer will be and the lower your asking price. Likewise, if you sense a buyer is anxious to buy, although you may have difficulty raising your asking price, you might be able to negotiate more favorable terms.

Tax Consequences – Depending on how the transaction is structured, it can have negative or positive tax consequences for the buyer or seller which may influence the final selling price.

Tradeoff Between Cash and Terms –

To avoid having to carry the financing of the sale, as often happens, you may decide to drop your asking price so the buyer can afford other methods of financing.

Calculating the Value of Your Business

The following methods of calculating the value of your business will get you in the ballpark of its true value. However, they do not necessarily reflect exactly what your selling price should be. Use these methods as guidelines.

Using Rule of Thumb Formulas – Rule of Thumb Formulas are calculated as a percentage of either sales or asset values, or a combination of both. The rule for using rule-of-thumb formulas for pricing a business, such as those in the chart above, is

Business Values

Apparel Shops and Retail Stores – .75 to 1.5 times net + equipment + inventory.

Beauty Salons – .25 to .75 times gross + equipment + inventory.

Fast Food Stores – 1 to 1.25 times net + equipment + inventory.

Grocery Stores/Supermarket – .25 to .33 times gross including equipment.

Personnel Agency – .75 to 1 times gross (including equipment).

Restaurants – .25 to .5 times gross including equipment.

Travel Agencies – .04 to .10 times gross (including equipment).

don't use them, or at least don't pay them too much attention.

The problem with rule-of-thumb formulas is that they rely too much on a one-size fits all approach, when in fact, no two businesses are identical. They address only a few of the factors that affect a business' value. Rule-of thumb formulas do however, provide a quick means of establishing a ball park figure.

According to the chart on the previous page, if you were selling a personnel agency with annual gross revenues of \$3.0 million and computer equipment and office furniture with a present value of \$150,000, then your asking price should be between

When selling a corporation, you want the income statements to look good in order to encourage investors. In sole proprietorships, you want to build up an asset base to keep your taxes low.

SUPERTIP

$[(.75 \text{ to } .10) \times \$3 \text{ million}] + \$150,000 = \$375,000 \text{ to } \$450,000.$

Using the Adjusted Book Value

Method – This method of valuation is useful when your business generates earnings primarily from its assets rather than contributions from its employees, or when the cost of starting a similar business and getting revenues past the break-even point doesn't greatly exceed the value of the business's asset.

Using this method, the book value of each asset is adjusted to equal the cost of replacing that asset in its current condition. The total of the adjusted asset values is then offset against factors such as:

- *Accounts Receivable* – Adjust down to

reflect the lack of collectability of some accounts.

- *Inventory* – Usually adjusted down since it may be difficult to sell off all of the inventory at cost.
- *Furniture, Fixture and Equipment* – Adjust down if the items have become obsolete. Adjust up if those items in service (probably more than a few years) have been depreciated below their market value. *It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.*
- *Real Estate* – Adjusted up or down depending on whether the value of the real estate has increased or decreased since it was purchased. **WARREN BUFFET**

Using the Income Statement Method of Valuation – Although the adjusted book value method (based on a company's balance sheet) is sometimes the most accurate means to value a business, it is more common to use an income statement method.

One of the more frequently used methods is the “discounted future cash flow” method. This method calls for the future cash flows of the business, before taxes and debt service, to be calculated using the 4-step formula outlined below:

Step #1: *Project cash flows for the next three to five years.* Compute as follows:

- **PROJECT** the net profit or loss of the business (use historical cash flows as a

basis for these projections). In the example on the left, the projections have been made for five years.

- **ADD** the owner's salary in excess of an equivalent manager's compensation.
- **ADD** discretionary benefits paid to the owner, such as automobile allowance, travel expenses, personal insurance and entertainment.
- **ADD** interest (unless the buyer will be assuming the interest payment).
- **ADD** non-recurring expenses, such as non-recurring legal fees.
- **ADD** non-cash expenses, such as depreciation and amortization.
- **SUBTRACT** equipment replacements or additions (this figure should be deducted from the other numbers since

it represents an expense the buyer will incur in generating future cash flows).

NOTE In the example below cash flow was projected to be \$300,000 a year with a 10% yearly increase.

Present Value of the Sum of Discounted Projected Cash Flows

Year	Projected Cash Flow	Discount Factor	Present Value
<i>Year 1</i>	\$300,000	.714	\$214,000
<i>Year 2</i>	\$330,000	.510	\$168,000
<i>Year 3</i>	\$363,000	.364	\$132,000
<i>Year 4</i>	\$399,000	.260	\$104,000
<i>Year 5</i>	\$440,000	.186	\$82,000
Total			\$700,000

Step #2: *Discount cash flows BACK to their present values.* This is done by selecting a reasonable rate of return (often referred to as the capitalization rate) for the buyers' investment. The selected rate of return varies substantially from one business to the next and is largely a function of risk. The lower the risk associated with an investment in a business, the lower the rate of return that is required. The rate of return required is usually in the 20 to 50% range, for most businesses, it is in the 30 to 40% range.

NOTE The example shown on the previous page demonstrates how the conversion is made with a 40% rate of return. It is calculated as follows: The discount factor lowers the value of the cash flow in each succeeding year. It can be deter-

The example shown on the previous page demonstrates how the conversion is made with a 40% rate of return.

mined by using a financial calculator, a set of present value tables available in most book stores, or by multiplying $(1 - 28.6\% = 71.4\%)$ to the discount factor of the preceding year (e.g., Year 3: $.510 \times 71.4\% = .364$). If you multiply 71.4 by $100\% + 40\%$ you will get 100.

Step #3: *Calculate the residual value of the business.* The residual value is the present value of the business's estimated net worth at the end of the period of projected cash flows (in this example, at the end of five years). This is calculated by adding the current net worth of the business (from the balance sheet) and future annual additions to the net worth and then discounting it to its present value (see chart on the left).

NOTE The annual additions are defined as the sum of each year's after-tax earnings, assuming no dividends are paid to stockholders.

Step #4: *The residual value is added to the present value of the sum of discounted projected cash flows.* In this case, adding the residual value of \$279,000 to the present value sum of projected cash flows of \$700,000 yields a discounted projected cash flows value of \$979,000.

NOTE If you had made projections for only three years and performed all the calculations correctly, your discounted projected cash flows value would be \$958,000.

It should also be noted that although the above “discounted future cash flow” method is widely used, it should not be considered definitive. This method fails to

address issues such as the buyer's working capital investment, the terms of the transaction, or the valuing of assets like

Calculating Residual Value

Year	After Tax Income
Year 1	\$100,000
Year 2	\$110,000
Year 3	\$121,000
Year 4	\$133,000
Year 5	\$146,000
Total Additions to net worth	\$610,000
Current net worth	\$890,000
Total net worth	\$1.5 M
Residual Value (1600 x .186)	\$279,000

real estate which may not be needed to produce the projected cash flows.



We know what happens to people who stay in the middle of the road. They get run over.

**ANEURIN
BEVAN**

3) **PREPARING YOUR BUSINESS FOR SALE**

AFTER YOU have made the decision to sell your business, set-up your accounting records to reflect maximum profitability and calculated the value or asking price of your business, you should make three additional preparations.

FIRST, put together a business presentation package.

SECOND, gain insights into how your business will be perceived and evaluated by potential buyers in order to prepare for and influence their conclusions.

When looking at a business for sale, buyers generally start by reviewing the business's history and the way it operates.

THIRD, anticipate and prepare for the multitude of questions they might have.

Preparing a Business Presentation Package

When looking at a business for sale, buyers generally start by reviewing the business's history and the way it operates. They also ask for information on how the business was started, how its goals may have changed since its inception and what past events occurred to shape its current form. They also seek to understand the business's present methods of acquiring and serving its customers and how the functions of sales, marketing, finance and operations interrelate.

Therefore, to help the buyer form conclusions about these areas of your business and at the same time help influence those conclusions, one of your first steps in preparing your business for sale is to put together a business presentation package. This package should contain:

- A history of your business
- A description of how your business operates
- A description of your facilities
- A discussion of your suppliers
- A review of marketing practices
- A description of your competition

You don't understand. In America, anyone can sell anything he wants, at any time. You're going to have to get that straight. That is just American capitalism.

THOMAS KEMPNER

- A review of personnel including an organizational chart, description of job responsibilities, rates of pay, and willingness of key employees to stay on after the sale
 - Identification of all the owners
 - Explanation of insurance coverage's
 - Discussion of any pending legal matters or contingent liabilities.
 - A compendium of 3 to 5 years' financial statements
 - A valuation report that clearly states how you arrived at your asking price

In short, with the exception of the valuation report, much of the information contained in your business presentation package should be about the same as that found in an updated business plan.

However, you should revise the tone of the information extracted from your business plan to target buyers and reflect the fact that you are now selling the business not looking for investors. In other words, try and present all the facts of your business in a way that answers buyers' objections and at the same time sells them more completely on the positive aspects of your offering.

NOTE Audited financial statements are

The second step in preparing your business for sale is to try and gain insights into how your business will be perceived and evaluated by potential buyers, in order to influence that perception or evaluation.

preferred by buyers as they can easily be verified. However, you may want to keep this information confidential, at least initially, and therefore may opt for a compilation or review of the information contained in your financial statements. Included in this review, you should also consider calculating and showing key financial ratios such as your current ratio, quick ratio, debts to assets ratio, accounts receivable turnover, inventory turnover and sale/accounts receivable.

Understanding How Buyers Will Evaluate Your Business

The second step in preparing your business for sale is to try and gain insights into how your business will be perceived and evaluated by potential buyers,

in order to influence that perception or evaluation.

To do this you must look at all the factors outlined in the chart at the end of this guidebook on **page 56**. All the factors identified in this chart will be carefully scrutinized and weighed by your potential buyers. Some factors will have a positive influence on their decision to buy. Others will have a negative influence. In some areas, however, you may withhold certain information until a bona fide offer, contingent upon obtaining that information, has been made.

NOTE At some point in the investigation process, it may be necessary to sign a confidentiality agreement and show the seller a personal financial statement. A

At some point in the investigation process, it may be necessary to sign a confidentiality agreement and show the seller a personal financial statement.

confidentiality agreement pledges that the buyer will not divulge and information about the business to anyone other than immediate advisors.

Questions Buyers Will Often Ask

The third step in preparing your business for sale is to try and prepare yourself for the many questions buyers will have about your business and operations. In general, these questions will be directed towards issues like:

- age of equipment
- anticipated transferability of clients or customers
- client relations and customer loyalty

- company reputation and image
- competition threats
- franchise agreements
- leasing costs
- location conditions
- maintenance and heating costs
- obsolete inventory
- parking availability
- staff turnover
- street traffic
- traffic patterns

More specifically, potential buyers might ask questions like:

- Are there any innovative financing methods that will make the acquisition

[The superior man] acts before he speaks, and afterwards speaks according to his actions.

CONFUCIUS

of your business more economical and less dependent on outside financing?

- Are you willing to let my accountant examine at least three years tax returns?
 - Does your business have a negative cash flow? And why is this? Is it due to: Management? Product? Location? Economics? Fashion trends? Marital problems? Partnership problems? Security leaks? Owner's death?
- How long will the non-compete clause in the selling contract be in effect?
- How long will you make yourself available for consultation after the business is sold?
- How long will you be involved in or as-

sist in the day-to-day operation of the business after it is sold?

- How much is the non-returnable down payment?
- How personal is this business? Has its success depended upon your charisma or the charisma of other owners?
- How will installment payments be made and what provision for collection will be required in case of delayed payments?
- Since good will is an intangible asset that is often overvalued by sellers, is this item negotiable?
- What does the asking price actually cover? Inventory? Equipment? Good will? Receivables? Cash on hand? Mail-

Potential buyers may ask questions like, "What is the turnover of merchandise and the age of various parts of your inventory?"

ing list? Computer files?

- What does the competition say about your business?
- What forecasts can be made about the future of your business? Obsolescence? Trends? Popularity? Growth?
- What insulation from liabilities is in effect? Starting when?
- What is the trade or industry opinion about your business?
- What is the turnover of merchandise and the age of various parts of your inventory?
- What kind of contracts are you bound to? For the lease? Key employees? Major lines of merchandise? Raw materials? Discounts?

- Will your business suffer when you leave?
- Will you keep the accounts receivables, or sell them at a substantial discount? How old are they?
- Will you retain some equity position so that cash or loan requirements can be minimized?



Potential buyers may ask questions like, "Will you retain some equity position so that cash or loan requirements can be minimized?"

4) FINDING BUYERS

BUYERS for your business can be found using:

- print advertising
- trade sources
- intermediaries such as business brokers (commercial real estate agents), and merger and acquisition specialists

Print Advertising – Business opportunity classified ads are a viable way to advertise a business for sale. Sundays and Saturdays are generally the most popular days for these ads. Larger, privately-held businesses (so-called middle-market companies) are more likely to be advertised in the Wall Street Journal on Thursdays. The Wall Street Journal pro-

duces several different regional editions of their paper. Businesses for sale in any one edition are most likely to be located in that region.

To write a business opportunity ad, whether for a small or large business, describe the business in several short phrases, keeping its identity anonymous, and list a phone number to call or post office box for reply. The ad should be worded to demonstrate the business's best qualities (both financial and non-financial) and may include a qualifying statement designating the kind of cash investment or experience required. A telephone number in the ad will draw more responses than a post office box number, but may not permit the anonymity of a post office box.

Business opportunity classified ads are a viable way to advertise a business for sale.

Trade Sources – Every industry has a trade association and trade association publications can do a good job of communicating the sale of business in their industry. If a seller thinks a buyer is likely to come from the same industry, the trade association's publications department should be contacted to see if classified advertising is permitted.

Intermediaries – Business opportunity intermediaries generally can be divided into two groups:

1. business brokers
2. merger and acquisition specialties

The differences between these two groups are subtle, but in general business

Business brokers primarily handle the smaller businesses, and merger and acquisition specialists handle the larger middle-market companies.

brokers primarily handle the smaller businesses, and merger and acquisition specialists handle the larger middle-market companies. Both groups will usually ask for a contract with a 180-day or more exclusive right to sell the business.

Business brokers charge a fee usually amounting to 10 percent of the purchase price. Merger and acquisition specialists also charge fees, although often the fee is well under 10 percent since the transactions they work on are much larger.

A portion of those fees for both a business broker and an acquisition specialist can be paid in advance, as either a flat fee or an hourly fee.

For the fees paid, the intermediary can offer assistance in:

- Pricing the business
- Setting the terms
- Compiling a comprehensive business presentation package
- Professionally marketing the business
- Screening potential buyers
- Negotiating and evaluating offers
- Making certain that proper legal steps are taken.

Intermediaries can help in compiling a comprehensive business presentation package.



5) STRUCTURING THE TRANSACTION

TAX AND OTHER consequences of the structure of a transaction have an important effect on the overall value of the transaction to the principals. Each type of structure carries with it different tax consequences for the buyer and seller. The type of corporation owned by the seller (regular corporation or S corporation), the size and date of the transaction, and the type of consideration paid may all have a bearing on the tax consequences.

Since tax law is constantly changing, it is important to seek legal and tax advice in determining the best way to structure the purchase of the sale.

The disposition of a business must be as carefully planned as the acquisition.
SUPERTIP

Structuring the Purchase and Sale of the Business

The sale of a business can be structured in either of two basic formats:

- the purchase of the assets of the sellers' business
- the purchase of the stock of the sellers' corporation

Asset Transactions – In an asset transaction, all the assets of the business as specified in the contract, except for cash and accounts receivable and none of the liabilities of the business, are transferred to the buyer. In other words, the buyer purchases all of the business's equipment, furniture & fixtures, inventory, trademarks & trade-names, goodwill and other intangible as-

sets and is responsible for none of its liabilities.

It is up to the seller to use the proceeds from the sale to liquidate all short-term and long-term liabilities such as federal and state income taxes, payroll withholding taxes and legal actions. The seller must also pay taxes on the difference between his basis in the assets and the price paid by the buyer for the business.

NOTE An asset transaction generally favors the buyer. The buyer for the most part avoids the possibility of becoming liable for any of the seller's undisclosed or unknown liabilities and acquires a new cost basis in the assets, which may allow a larger depreciation deduction to be taken.

A verbal contract isn't worth the paper it's written on.

**SAM
GOLDWYN**

Stock Transactions – Stock transactions generally call for all of the assets and liabilities of the seller's corporation and the stock of the corporation to be transferred to the buyer. In some cases, the buyer and seller may choose to exclude certain assets or liabilities from being conveyed. The seller must pay taxes on the difference between the sellers' basis in the stock and the price paid by the buyer for the stock.

NOTE Sometimes stock deals are more expedient for both parties.

Stock transactions provide for continuity in relationships with suppliers. They also preclude the necessity of obtaining a lease assignment when the lease is held only in the name of the corporation and when there is no provision in the lease calling for an assignment in the event of a

change in the controlling interest of the corporation.

The risk of inheriting undisclosed debts of the seller in a stock transaction can be minimized by providing for the “right of offset” to future payments due the seller.

Furthermore, in choosing to structure a deal as a stock transaction, the seller should be aware that the U.S. supreme Court has ruled that the sale of the stock of a closely held corporation falls under the umbrella of federal securities laws. This places a greater burden on the seller in a stock transaction to fully disclose all material information about the business. Failure to do so opens the seller up to the risk of securities fraud litigation.

Men keep their agreements when it is an advantage to both parties not to break them.
SOLON

Structuring How the Purchase Will Be Paid For

It is rare for a privately held business to change hands for an all-cash price. Almost all transactions are structured as either installment contracts, leveraged buyouts, earn-outs or stock exchanges.

Installment Sales – An installment sales contract provides for the seller to receive some cash, but for the bulk of the purchase price to be owner financed. For small privately held businesses, the down payment often ranges from 10% to 40% of the selling price and the buyer executes a promissory note (secured by the assets of the business only) for the balance. Such notes are typically for a period of 3 to 15 years at an interest rate that varies with

the prime rate but is most often 9% to 12%. The payments required to retire the debt service should not exceed 25% to 50% of the discretionary cash flow.

Leveraged Buyouts – Just as in an installment sale, a leveraged buyout uses the assets of the business to collateralize a loan to buy the business. The difference is that the buyer in a leveraged buyout typically invests little or no money, and the loan is obtained from a lending institution.

NOTE This type of purchase is best suited to asset rich businesses. A business that lacks the assets needed for a completely leveraged buyout may be able to put together a partially leveraged buyout. In this structure, the seller finances

An earn-out is a method of paying for a business that helps bridge the gap between the positions of the buyer and seller with respect to price.

part of the transaction and is secured by a second lien security interest in the assets. Because leveraged buyouts place a greater debt burden on the company than do other types of financing, buyer and seller must take a close look at the buss's ability to service the debt.

Earn-Outs – An earn-out is a method of paying for a business that helps bridge the gap between the positions of the buyer and seller with respect to price. An earn-out can be calculated as a percentage of sales, gross profit, net profit or other figure. It is not uncommon to establish a floor or ceiling for the earn-out.

NOTE Earn-outs do not preclude the payment of a portion of the purchase price in

cash or installment notes. Rather they are normally paid in addition to other forms of payment. Because the payment of money to the seller under the provisions of the earn-out is predicted on the performance of the business, it is important that the seller continue to operate the business through the period of the earn-out .

Stock Exchanges – In some instances, a business owner may want to accept the stock of a purchasing corporation in payment for the business. Typically, the stock receives (if its is the stock of a publicly held company) may not be resold for two years. If the stock may not be freely traded, it is not as valuable as freely traded stock, and its value should be discounted to allow for this lack of marketability.

In some instances, a business owner may want to accept the stock of a purchasing corporation in payment for the business.

NOTE There is an advantage to the seller in this kind of transaction. Taxes incurred by the seller on the gain from the sale of the business are deferred until the acquired stock is eventually sold. This kind of transaction is termed a tax-free exchange by the IRS. There are several tests that must be met to qualify for this tax treatment. Check with a competition accountant or tax attorney or request a ruling from the IRS Reorganization Branch in Washington, D.C.



6) NEGOTIATING THE TRANSACTION

THE ART of negotiation plays an important role in buying or selling a business. Differences of opinion are inherent in the negotiation process and only realistic negotiators can find creative solutions to such differences. It is imperative that the parties know the issues that are important to one another. Each should understand the other's position on these issues.

Businesses change hands most easily when the parties assume a non-adversarial posture.

Sellers naturally have the upper hand in negotiations since they best know the business. A seller should make full use of that advantage. A buyer should minimize the sellers' advantage by learning as much as possible about the business.

SUPERTIP

Price – Determining the value of a business is the part of the buy-sell transaction most fraught with potential for difference of opinion. Buyers and sellers usually do not share the same perspective. Each has a distinct rationale, and that rationale may be based on logic or emotion.

NOTE A buyer should determine a range of value for the business. An appraisal of the business as is can be used to establish a pricing floor. A pricing ceiling can be established by using an appraisal that capitalized projected future cash flows under new management.

Terms – Price is just one aspect of the transaction to be negotiated. Terms are

just as important, particularly the period of time over which the debt is to be repaid and that allocation for tax purposes of the purchase price.

The Role of Advisors

A variety of resources are available for those buyers and sellers wanting to obtain professional advice. These resources include business owners in the industry, SBA counselors, industry consultants, professional intermediaries, business valuation experts, accountants and attorneys.

Of these resources, business owners, SBA counselors, consultant and intermediaries should be approached first as they are usually the best source of industry information and operating suggestions. Later on, as the negotiating process become

more serious business valuation experts, accountants and attorneys may play more important roles.

Business Valuation Experts – Business valuation experts can independently appraise a business's value. Bear in mind, however, that they rely on the representations of the seller. They render a conditional opinion based on the assumption that the financial statements are accurate and complete.

Contract: an agreement that is binding on the weaker party.
FREDERICK SAWYER

Accountants – Accountants are best used to perform an audit, help interpret financial statements, or provide advice in structuring the transaction to minimize tax consequence for the buyer and seller.

Attorneys – Probably the most often consulted advisor in the purchase or sale of a business is an attorney. Attorneys are asked to do everything from assessing the viability of a business and appraising its value to negotiating the purchase price and preparing the necessary documents.

Attorneys, however, cannot assess the viability of a business under taking. That is something only the buyer and seller can do. Attorneys also generally cannot value a business, but they can occasionally help negotiate a price between buyer and seller. The involvement of an attorney (or any individual other than the principals) can however, strain the lines of communication between buyer and seller, so they should be

The primary function of an attorney is to prepare the purchase and sale documents as negotiated by the parties. It should include reasonable and balanced protections for both parties.

be allowed into the negotiation process only after careful consideration.

NOTE The primary function of an attorney is to prepare the purchase and sale documents as negotiated by the parties. It should include reasonable and balanced protections for both parties. Experience and reputation are important criteria when selecting an attorney. The attorney chosen should have experience handling similar transactions. It may make sense to choose one attorney to represent both buyer and seller. This avoids the adversarial relationship that opposing attorneys often adopt and improves the odds of successfully completing the transaction.



7) **WRITING UP A SELLING CONTRACT**

IN SELLING a small business, it is as important to have a good contractual agreement as it is to have good chemistry between seller and buyer. This means taking into considerations:

- What does the seller want out of the sale?
- What can the buyer realistically afford and still keep the business acquisition functioning?

Both seller and buyer need to set down all the factors that they want out of the sale or purchase and have an attorney incorporate them into a sales agreement.

When writing up your selling contract, leave out demands that ask for the moon; no flights to it have been scheduled for a long time.

SUPERTIP

Below is a list of key areas that should be carefully and clearly thought out and included in the selling contract.

- 1. Total Price to be Offered** – The selling contract should indicate the dollar value of the negotiated and agreed-upon price.
- 2. Components of the Price** – The selling contract should specify the amount of the non-refundable security deposit, down payment, amount of bank debt, and amount of seller financed debt.
- 3. What Liabilities and Assets are Being Purchased** – The selling contract should specify all the liabilities and assets that are being purchased including if part of the deal, the mini-

mum amount of accounts receivable to be collected and the maximum amount of accounts payable to be assumed.

4. **The Operating Condition of Equipment**

– The selling contract should specify the operating condition of all equipment at settlement.

This is to protect the buyer in case a machine breaks down and needs to be repaired before the buyer takes full possession. The repairs will be at the expense of the seller.

The selling contract should include a clause that gives the buyer the right to offset the purchase price in the amount of any undisclosed liabilities that come due after settlement.

5. **Provisions to Protect the Buyer from Future Undisclosed Liabilities**

– The selling contract should include a clause that gives the

buyer the right to offset the purchase price in the amount of any undisclosed liabilities that come due after settlement as well as any variance in inventory from that stated in the agreement.

6. **Provisions for Passing Inspections**

– The selling contract should contain a provision that the business will be able to pass all necessary inspections.

7. **Provisions for Compliance with the Uniform Commercial Code**

– The selling contract should contain a provision calling for compliance with the Bulk Transfer provisions of the Uniform Commercial Code.

NOTE This does not apply to sales of the

stock of the corporation.

8. Provisions for Existing Warranties and Contracts –

The selling contract should specify warranties of clear and marketable title, validity and assumability of existing contracts if any, tax liability limitations, legal liability limitations and other appropriate warranties.

9. Provisions for Conditions of the Sale –

The selling contract should contain a provision (where appropriate) to make the sale condition on lease assignment, verification of financial statements, transfer of licenses, obtaining financing or other provisions.

10. Provisions for Prorated Costs –

The selling contract should contain a provision for any appropriate prorated costs such as rent, utilities, wages and prepaid expenses.

The selling contract should contain a provision for any appropriate prorated costs such as rent, utilities, wages and prepaid expenses.

11. A Non-competition Covenant –

The selling contract should contain a provision which restricts the seller from opening a similar business that competes with the buyer. This document is sometimes part of the purchase and sale agreement and is sometimes a separate exhibit to the purchase and sale agreement.

12. Allocation of the Purchase Price –

The selling contract should specify the allocation of the purchase price.

13. Provisions for How the Business

Will be Operated Until Settlement

– The selling contract should outline any restrictions on how the business is to be operated until settlement.

14. Date of Settlement – The selling contract should state when the deal will be formally closed.

15. Provisions for What Happens if the Deal Falls Through

– The selling contract also needs to detail any special conditions, such as what happens if the deal falls through? Will the owner get the business back? What recourse is there if the buyer cannot continue running the business but has not yet paid it off? What security can be offered against nonpayment or default? What happens

to the money already paid in and to all the records of the business in case of a default and recourse?

NOTE These provisions are important if the owner is carrying all or part of the financing of the sale.

The selling contract also needs to detail any special conditions, such as what happens if the deal falls through?



8) **CLOSING THE SALE**

TO CLOSE the sale, the seller must:

- meet all the conditions of the sale
- hire an attorney or an escrow to handle the settlement
- make sure all the necessary documents are included and filed
- take into account any contingent liabilities

Meeting the Conditions of the Sale

After buyer and seller have entered into a binding contract, there may be several conditions to be met before the sale may be closed. Such conditions often address issues like assignment of the lease, binding of financial statements, transfer of li-

censes, or obtaining financing. There is usually a date set for meeting the conditions of sale. If a condition is not met within the specified time frame, the agreement is invalidated.

Types of Settlements

Business settlements or closings as they are called are usually done in one of two ways: using either an attorney or an escrow agent.

Using an Attorney – In this procedure the attorney for the buyer, or an independent attorney acting on behalf of both buyer and seller, draws up the necessary documents for settlement. Buyer and seller meet with the settlement attorney at a predetermined time (after all conditions of sale have been met). Docu-

To close the sale, the seller must first meet all the conditions of the sale.

ments are signed at the meeting by buyer and seller.

Using an Escrow Agent – In an escrow settlement, the money to be deposited, bill of sale, and other documents are placed in the hands of a neutral third party or escrow agent. The escrow agent is usually an escrow company or the escrow department of a financial institution. Buyer and seller sign escrow instructions that name the conditions to be met before completion of the sale.

It is harder to change a decision than to make one.

ANON

Once all conditions are met, the escrow agent disburses previously executed documents and disburses funds. There usually is no formal final meeting at which the signing of the document takes place. Buyer and seller usually sign them inde-

pendently of one another.

Documents Required

A number of documents are required to close a transaction. The purchase and sale agreement is the basic document:

Settlement Sheet – Shows, as of the date of settlement, the various cost and adjustments to be paid by or credited to each party. It is signed by buyer and seller.

Escrow Agreement – This agreement is used for escrow settlements. It is a set of instructions signed by buyer and seller in advance of settlement that sets forth the conditions of escrow, the responsibilities of the escrow agent and the requirement to be met for the release of escrowed funds and documents.

Bill of Sale – Describe the physical assets being transferred and identifies the amount paid for those assets.

Promissory Note – Used only in an installment sale, it shows the principal amount and terms of repayment of the debt by the buyer to the seller.

Security Agreement – Creates the security interest in the assets pledged by the buyer to secure the promissory note and underlying debt. It also sets forth the terms under which the buyer agrees to operate those assets, which constitute collateral.

Financing Statement: Creates a public record of the security interest in the collateral and therefore notifies third parties that

certain assets are encumbered by a lien to secure the existing debt. It is used only in installment sales.

Covenant not to Compete – Protects the buyer and his investment from immediate competition by the seller in his market area for a limited amount of time. The covenant not to compete is sometimes included as a part of the purchase and sale agreement and is sometimes written as a separate document. It is not required in every transaction

A covenant not to compete protects the buyer from immediate competition by the seller in his market area.

Employment Agreement –

Specifies the nature of services to be performed by the seller, the amount of compensation, the amount of time per week or per month the services are to be performed, the duration of the agreement and

often a method for discounting the agreement before its completion. Employment agreements are not required in all transactions, but they are used with great frequency. It is not uncommon that the seller remains involved with the business for periods of as little as a week or as much as several years.

Contingent liabilities

Contingent liabilities must also be taken into account and provided for when a business is sold. They most often occur because of pending tax payments, unresolved law suits or anticipated but uncertain costs of meeting regulatory requirements. Contingent liabilities can be handled by escrowing a portion of the funds earmarked for disbursement to the seller. The sum escrowed then can be

There is nothing more likely to start disagreement among people or countries than an agreement.
E.B. WHITE

used to pay off the liability as it comes due. Any remaining money can then be disbursed to the seller.

NOTE Regardless of whether escrow or a settlement attorney is used, requirement of the bulk sales act must be met if the assets (not the stock of the corporation) of the business are being sold. This law calls for the business's suppliers to be notified of the impending sale. The supplier must respond within the allowed time frame if money is owned by the seller. A lien search is also performed by the attorney or escrow agent. This determines if any liens against the business's assets have been filed in the records of the local courthouse.



A Summary of the Items Buyers Will Likely Want to Review and Obtain Info On

BALANCE SHEET

Accounts Receivable

Obtain an A/R aging schedule and note any concentration among a few accounts.

Determine reasons for overdue accounts.

Find out if any amounts are in dispute.

Are any A/Rs pledged as collateral?

Is the reserve for bad debt sufficient?

Review the business's credit policy.

Inventory

Is the inventory determined by physical count and divided by finished goods, work in progress and raw materials?

Assess the method of inventory valuation?

Determine age & condition of inventory.

How are damaged/obsolete goods valued?

Is the amount of inventory sufficient to operate efficiently and for how long?

Should an appraisal be obtained?

Marketable Securities

Obtain a list of marketable securities and determine the fair market value.

Are any securities restricted?

Should the portfolio be sold or exchanged?

Real Estate

Obtain a schedule of real estate owned.

Determine the condition and age of the real estate and establish the fair market value of buildings and land.

Are repairs or improvements required?

Are maintenance costs reasonable?

How is the real estate financed?

Are the mortgages assumable?

Is the real estate adequately insured?

Should appraisals be obtained?

Machinery & Equipment

Obtain a schedule of machinery & equipment owned and leased.

Determine condition & age of machinery & equipment and frequency of maintenance.

Identify machinery & equipment that is state-of-the art and those that are obsolete.

Identify machinery & equipment used in compliance with EPA or OSHA standards and determine if additional machinery & equipment is needed to comply.

Will immediate repairs be required?

Should appraisals be obtained?

Accounts Payable

1. Obtain an A/P schedule and note any concentration among a few accounts.
2. Determine the age of amounts due.
3. Identify all amounts in dispute and determine the reason.
4. Review transactions to determine undisclosed and contingent liabilities.

Accrued Liabilities

1. Obtain a schedule of accrued liabilities.
2. Determine the accounting treatment of: unpaid wages, accrued vacation pay, accrued sick leave, payroll taxes due, & accrued Federal income taxes.
3. Search for unrecorded accrued liabilities.

Notes & Mortgages Payable

1. Obtain a schedule of notes payable and mortgages payable.
2. Identify the reason for indebtedness.
3. Analyze the terms & payment schedule.
4. Are there any prepayment penalties?
5. Are there any balloon payments due and what are their amounts?
6. How will the acquisition effect the debt?
7. Are the notes or mortgages assumable?

INCOME STATEMENT

1. What is the potential earning power of the business?
2. Do past income statements and tax returns verify this earning power?
3. What is the owner's salary & fringe benefits, non-cash and non-recurring expenses and how do they reflect the business's hidden earning power?

FINANCIAL RATIOS

1. What are the company's key financial ratios, particularly its current ratio, quick ratio, A/R turnover, inventory turnover and sales to A/R ratio?

LEASES

1. What is the remaining term of the lease?
2. Are there any option periods, and if so, is the option exercised only be the choice of the tenant?
3. Is there a percent of sales clause?
4. Is the tenant or landlord responsible for maintaining the roof, heating and air conditioning system?

What additional fees (e.g., common area maintenance or merchants association dues) are paid over and above the base rent?

Is there a periodic rent increase called for to adjust the rent for changes in the consumer price index or for an increase in real estate tax assessments?

Is there a demolition clause?

Under what terms & conditions will the landlord permit an assumption or extension of the existing lease?

PERSONNEL

What are the job responsibilities, rates of pay, and benefits of each employee?

What is each employee's tenure?

What is the skill level of each employee and are they employed under a contract?

Will key employees stay after the business is sold?

Are any employees part of a union?

MARKETING

Are any of the products proprietary?

What are the company's new upcoming products and projected sales?

What is the business's geographic market area, % of market share, competitive advantage and annual marketing budget?

PATENTS

Obtain a list of tradenames, trademarks, logos, copyrights and patents.

Note the expiration dates.

TAXES

Are FICA, unemployment, and sales tax payments current?

What was the date and the outcome of the last IRS audit?

LEGAL ISSUES

Are there any suits now or soon to start?

What OSHA and EPS requirements must be met and are they currently being met?

Are all zoning requirements being met?

Review the articles of incorporation, minute books, bylaws, and /or partnership agreements.

What are the classes of stock and the restriction of each, if any?

Has any stock been canceled or repurchased?