Initiation and Beginning Stages

There are a couple of documents you will need to prepare in advance of acquisition discussions. Whether you ultimately decide to go through a broker or manage the process on your own, there are a few standard items that you should have in hand.

Typically, this could include any business plans, product/software information, market data including high-level industry trends as well as information on customers and suppliers. In terms of the financial information required for the initial discussions, buyers will want to see historic Income Statements, recent Balance Sheet and financial projections for at least the next 3 years.

If you plan on engaging an investment banker in the process, they will require the above items, likely in more detail, to understand your business inside out. They can then use the information to prepare the teaser and the Information Memorandum. The teaser is the first document to be distributed to prospects in order to gauge initial interest. It is marketing material that should not contain competitively sensitive information. The Information Memorandum is a package detailing the full description of the business and would include product information, industry trends, market research, customers and supplier data, historical financials and future projections. The purpose of the document is to attract buyers to the process, while not overselling the business such that it loses credibility.

Before engaging in discussions with buyers, the board of directors should start evaluating the company to arrive at an agreed upon ballpark valuation range. One method to value your company is to calculate the net present value of the future earnings potential. This is done by applying an industry multiple to your EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) and subtracting any capital expenditures. Typically, valuations can range from 3-6x EBITDA, though this figure varies considerably across industries. To get a more accurate sense of this range, you can check precedent transactions within the industry.

Once the prospective buyers have had a chance to review the documents, they will return with a non-binding letter which outlines the price and structure of the proposed transaction as well as any terms and conditions.

If you do not have the financial aptitude or the capacity to run a sale process while running your business operation, retaining an investment banker may be the best option. Since the process of selling a company can be very time-consuming, it can add to the stress of the management team's already busy schedule.

The job of an investment banker is to guide you through the process of selling your business from start to finish. Their services include the preparation of the Teaser and Confidential Information Memorandum.

Upon receipt of your financial statements, they can run a projection of your business and determine an appropriate valuation for the business. As investment bankers typically have an industry focus, they are experts in understanding how to best position your company to attract the most suitable buyers to get you the best possible deal. They can help you evaluate the offers and assist with the negotiation process. The fee structure for investment banks is typically a retainer and success fee. The retainer is the fixed amount of money the client agrees to pay in advance to secure the services of an investment bank. The success fee is based on the percentage of transaction values. While this percentage varies greatly between banks, the typical range is between 5-10% for a mid-market business.

There are several ways to maximize the value of your business. Aside from a business with increasing revenues and earnings, buyers also like to see a high percentage of recurring revenues and a low attrition rate. As well, buyers tend to prefer companies that do not have a high dependence on one or a few key individuals such that the business operations falters completely when the key individual decides to leave post-acquisition. One tip for sellers of businesses is to minimize the usage of personal expenses on the company's financial statements as this decreases earnings, which can work against you when buyers are applying an EBITDA multiple for their valuation.

Once you receive the indicative offers from the interested parties, it is time to evaluate the offers. Aside from the monetary incentives, it is equally important to understand the characteristics of the buyer. Buyers can typically be divided into financial and strategic buyers.

Examples of financial buyers would be private equity firms, venture capital firms, hedge funds and family investment offices. Financial buyers target companies with attractive future growth potential and invest capital in them, in hopes of realizing a return on investment with a sale or IPO within 4 to 7 years. They evaluate opportunities as stand-alone entities, while ignoring synergy effects. Since they often purchase businesses partially with debt, their primary focus is ensuring the business' capacity to generate cash flow to pay off the debt. In regards to the efficiency of the transactions, the process is typically seamless and much quicker since financial buyers often have their own execution team who are in the business of acquiring companies.

Strategic buyers target businesses that can help grow their existing P/L to create long-term shareholder value. Since they take these synergistic benefits into consideration, the buyers will usually pay a premium price to get the deal done. Their plan is to hold the businesses indefinitely and some may even integrate the company into their existing business.

There are several questions you may want to ask when choosing your investment banker. Essentially, you want to ensure that they are the best fit to market your business, attract the appropriate buyers and find the best possible deal for you. First of all, you will want to understand their relevant experience in marketing a similar business as yours and the types of buyers they have access to. You may also want to know the typical length of the engagement process and their success rate. It is important to understand each bank's cost structure.