



# The Letter of the Law



## THE SHAFER LAW FIRM

LAWYERS WHOSE PRACTICES HAVE BEEN BUILT ONE REFERRAL AFTER ANOTHER

### SELLING YOUR BUSINESS



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Business owners spend years growing and nurturing their business, with almost the same care as raising a child. And yet, at some point in time, almost every business owner considers selling their company. Why? Many reasons. Divorce, death of spouse or business partner, or tempting thoughts of a warmer, more relaxed retirement often prompt an owner to sell. A family business might be sold when the next generation is not interested taking over leadership. However, despite their best efforts, many owners make critical mistakes when it comes to selling their company.

#### WHEN TO PREPARE TO SELL?

Plan to sell the day you start your company. You simply cannot plan too early. Today's decisions impact a future sale. For instance, what type of legal entity is your business? Pennsylvania C-Corp or S-Corp? Each type will receive different tax treatment at sale time. You must understand what to do now to save yourself thousands of dollars later.

Many owners also underestimate the length of time required to sell their company. It is not uncommon for a sale to take at least one to two years, depending on the type of company and its competitive position in the market.

#### HOW TO SELL?

First, assemble your team. Hopefully, you trust your lawyer's and accountant's confidential advice, and they understand your business. Discuss your goals with them. Are you looking for a slow phase out from your company over several years, or do you

want to be in Florida next winter and out for good? Do you have set financial targets of what you need for a price? Discuss these issues first to help guide the process and make future negotiations easier.

Know that sales of businesses require precise legal and accounting strategy. It is a very important transaction for both the buyer and the seller, with serious legal and tax ramifications. Together, you and your advisors will address several important questions, such as: How should a deal be structured- asset or stock sale? When should I tell my employees and customers? How do I keep a potential sale confidential until I am ready for everyone to know?

#### Confidentiality is Key.

Imagine the worst case. You are negotiating the sale of your company, and word of a potential sale leaks to your employees, customers and competitors. Key employees become nervous and exit stage left- customers soon follow, and the deal falls through. Confidentiality is imperative until the time is right to disclose the sale to employees, customers and the community. Your lawyer can be instrumental in controlling the sales process- screening prospective buyers as to their actual interest, and enforcing strict confidentiality agreements that each prospective purchaser signs before obtaining any information regarding your company. Often times, your accountant or attorney may know other business people who might be eligible purchasers of your company, and can arrange confidential exchanges of information where each party remains anonymous until the time is right to disclose identities.

Another critical decision for a seller is whether or not to hire a business broker or investment banking company

to market the company for sale.

#### Business Brokers:

The benefits of hiring a business broker may include their knowledge of local and national market conditions, issues related to pricing and financing, and personal knowledge of strategic buyers who might be prospecting for an acquisition. A broker will likely bring more prospects to the table than you could on your own. However, such service often comes with a price tag of 10% of the business sale, to be paid at closing.

#### Investment Bankers/ Marketing Companies:

These companies provide a detailed analysis of your company, and will market the company nationally, and in some instances, internationally. A downside is cost- typically, investment banks and marketing companies require an advance payment of approximately \$45,000 to complete the financial analysis, or "platform" as it is often called, and then receive a percentage commission based on a sliding scale. Such companies would include RSM EquiCo, a subsidiary of H&R Block, and Geneva, a subsidiary of Citibank. You can learn more about them at [www.RSMEquiCo.com](http://www.RSMEquiCo.com) and [www.genevaco.com](http://www.genevaco.com)

**BUT PLEASE DON'T SIGN THE CONTRACT WITHOUT TALKING TO YOUR LAWYER.**

#### The Valuation Process:

Whether or not you engage a broker or marketing specialist, the sales process requires you to present your company's past and future performance in the best, most accurate light. Your advisors will prepare a detailed financial analysis of your company's performance for at least the past five years, including profit and loss statements and cash flow reports. Your profit and loss statements will then be recast to discount items such as owner's compensation and other discretionary items, to show a buyer the true picture.

Next, pro formas of future performance **must be**

**prepared**, and will be a critical part of a valuation of the company. Other factors critical to the valuation will include the breadth of your customer base and industry dynamics.

A prospective buyer will examine the historical cash flow of the company and then discount the value of that projected future cash flow to reflect the amount of risk inherent in the business. They will compare projected cash flow and profits against what their money could be earning in a "risk free" investment such as U.S. Treasury bills.

Above all else, remember this: a **strategic** buyer will focus on the future cash flow of your business, not just past performance. An **economic buyer** will only focus on **past performance**. Even if your company is currently distressed due to poor cash flow, lack of capital, or a declining customer base, a strategic buyer may see real value there. The experience and tenure of your employees, the location of your facility, or the quality of the management might be very attractive. Don't undersell your company. In order to capture its full value, work closely with your accountant and your lawyer, and focus on presenting the promising future of your business to strategic buyers.

*Gary Alizeo has been admitted to practice law in Pennsylvania for over ten years. He recently served for three years as CEO and General Counsel of Sipco Molding Technologies, in Meadville. Gary counsels many business owners on a wide range of issues, including strategic growth initiatives and business sales. He can be reached at The Shafer Law Firm at (814) 724-4540, ext. 225 or at [gallizeo@shaferlaw.co](mailto:gallizeo@shaferlaw.co)*

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