Ep19: Preparing Your Business For Sale

July 5, 2019

PATTI BRENNAN: Hi, everybody. Welcome back to the "Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives. I can't think of a better episode to talk about that than the episode we have today. We have Matt Coyne. He is president of Brandywine Mergers & Acquisitions.

Matt is a business broker. He helps people in the transactions, in the preparation of selling a business, as well as the entire sale process. In the first podcast, we talked about how to prepare your business to get maximum value. Just to tease you on that, for those of you who own businesses, you want to start this process three to five years out to really max out the value. Right, Matt?

MATT COYNE: That's the ideal, yeah.

PATTI: Let's say that we've been doing that. We've got the financials up today, we're looking at the monthly, we've got them on accrual basis, etc. Now we're at the point where we really want to start looking at selling this thing. How am I supposed to find a buyer without anybody finding out my employees, my competitors? How do you go about doing this?

MATT: There's a process and it's the most important thing, because oftentimes people would come to me and say, "Well, I've already talked to some of my competitors about it," and you don't want to do that.

PATTI: Why? Just out of curiosity, why is that?

MATT: The competitors will sell against you, for sure. By the way, most of my clients are really good, honest people who care about their people, and I'm sure the folks listening to this are as well.

They feel they need to take their people aside and talk to them about, "I'm going to put the business on the market," like that's supposed to put them at ease. Well, it freaks them out.

PATTI: Oh yes.

MATT: Completely freaks them out and the good people leave, if they can. The people who can't get another job elsewhere stays. It's not good for the business.

For everybody involved, when you wake up in the middle of the night and say, "It's time. I'm going to sell." Some people, we set three to five years, that's the ideal. The reality is most people, something happened in their life. They just buried a friend or they just decided, they had a meeting with their wealth advisor and they said, "Listen, if you can get X amount for it, you can retire." "I'm in."

First thing you do, don't tell anybody.

PATTI: You know, Matt, what I so appreciate you is that you really know your audience. You know your people. You understand. We're going to be talking about ideal scenes here, but people are people, and that's exactly right. There's often a catalyst that makes someone say, "You know what? What am I doing? Life is short. Let me figure out what's going to happen in the next season of my life."

You might not have done that preparation. It's OK. You still want to start.

MATT: Yeah, if you have prepared everything, it'll be a smoother process. If you haven't prepared, it doesn't mean you can't get through the process. You're just going to have to be doing some catch-up. The way you find a buyer, Patti, is by confidentially advertising the business.

In my line of work – as I said, I'm a business broker, an M&A broker – we run confidential processes. When we advertise a business, we will say, "Light manufacturing company, Southeastern Pennsylvania."

PATTI: It's very generic?

MATT: Very generic. People will contact us. We'll have them sign a confidentiality agreement before we talk about the name of the business. That's how you do it. You can do that by hiring somebody like me. You can have your lawyer do that for you. You can have an accountant. You could do it yourself. I think you're going to mention a book I wrote.

I actually put a chapter in that book on how to do this yourself. If you look at that, that's why I did that. Some people are relatively small business and they have time, and they can do it themselves, but there's things you have to know. For example, I'll give you one example, you can't send out something that has your email on it. It takes me about 15 seconds to figure out.

If you Google me, you'll find out I ran a 5K four years ago. Even on my personal email, you could get back to my company in 60 seconds, or your kids could in 60 seconds, find out who I am. When you start a process, if you're going to do it yourself, I use things like, "You need a brand-new email you've never been used," and "Gmail, it's free," those types of things. Confidentiality is absolutely the number one thing in this process.

PATTI: That is such a great tip. A lot of people wouldn't have thought about the email. Get a completely different email that's not tied to anything that you've done before. That's really key.

Since, Matt, you've brought it up, let me just highlight the book for the listeners today. The name of your book is "Straight Talk from the Front Lines." Feel free to go to the show notes. You'll find how to get the book from the show notes.

That is a wonderful thing to do for people who are listening. Just, "If you want to do this yourself, here are the dos and don'ts that you need to be thinking about."

MATT: You're going to find, if you go to sell your company, "I have some great competitors in this area, but not a lot." It's a very unique kind of niche. If your business is particularly small or you might have had some bumpy times, it might be hard to find somebody to represent you. You don't need somebody. Look it in the book. If you have an accountant to help you, you can do this on your own.

PATTI: For those of you who listened to prior podcasts, even though the name of your company is Mergers and Acquisitions, I always thought – silly me – that to go with Mergers and Acquisitions firm that you had to have a 5 or 10 million dollar business. In fact, that's not the case, is it?

MATT: No, it's not the case. For us, we'll handle a company that's making, probably for the minimum, it's around $250,000 of annual income, or EBITDA, which we talked about in the last podcast.

PATTI: Since you did that, just in case, why don't you define EBITDA for everybody here.

MATT: EBITDA is kind of the international M&A term for cash flow. It's your earnings before interest expense, before taxes, and before depreciation and amortization.

A buyer looks at your company. What they want to see is how much cash flow does this company throw off, as it is today before they pay taxes.

Most deals are tax-efficient so the buyers can have a different tax rate. They're going to borrow money to buy your company, so they're going to have their own interest expenses. They want your cash before you paid interest. Then depreciation and amortization are non-cash expenses.

When you come up with this EBITDA number, that is your number. Once, if it's not every month, every quarter, you need to say, "My EBITDA is $500,000."

If you put together a plan, God bless you if you do – most people don't – but if you do put together a business plan people say, "My budget this year is to do a million in EBITDA." No one cares about your net income. No one cares about a bunch of different measurement you use. When they come to buy your business, they'll be talking about EBITDA.

Let me make one more comment on that if I can, Patti.

Let's say you're running your business and we talked about growth in the last podcast. If you say, "If I bought a new assembly line for a million dollars, I could double the size of my business." I'll ask you, "What is the impact on your EBITDA?" You might say, "It's going to cost me millions and my earnings are going to drop by a million."

That's not true. You're going to borrow the money to buy it. It's not an expense. It's something that's on your balance sheet. You get to add back the interest expense.

So long as you're willing to take the risk, it's not going to impact your EBITDA. It's those types of discussions we can't get too deep into it now. When you put together a business plan have your financial advisor, controller, or your accountant go through this with you, because what you'll find out is you can put money in your business and double your value – and do it pretty easily.

PATTI: Just to keep it really simple, as always, EBITDA is always higher than your net cash flow because you're adding those things back in.

MATT: It's higher than your net income, but it should be similar to your cash flow.

PATTI: Exactly. It's so interesting because we confuse the terms – cash flow versus net income – and they really are not the same. What the buyer wants to know is, "What is your real cash flow?" That's the key.

MATT: That's the key. Cash is king. You might have the most beautiful building, the wonderful product, incredible potential. "What's cash flow?" If it's such a great product, there should be cash flow.

PATTI: Let's say that we've got a business owner and they're running their business. Now people are approaching them. They're getting emails. People are saying, "Hey, if you're ever interested in selling, talk to me first." What should they do with those kinds of inquiries?

MATT: That's a great point, because people will get them, especially in a market like today. If someone's interested, I would have your lawyer draw up a two-way confidentiality agreement and get a confidentiality agreement in place. I would talk to them.

I wouldn't go sending over a bunch of information. I'd have lunch. I'd say, "Next time, we're at a trade show together, let's sit down and talk." See what they have in mind because they may be the best buyer ever.

But they approached you so, once again, it's not an issue of your people saying, "You're selling the company?" Say, "No, I'm smartly listening to a strategic possibility." That's it.

PATTI: You know, if nothing else, you might uncover some ideas in that lunch that you weren't doing or weren't aware of. Again, I'm always about this process, can just make you a better business owner – period. I think that that is a really important point, just go ahead and have lunch.

MATT: Watch the professional sport team. They do it all the time. When somebody wants to talk to you about strategic matter, remember you have two ears and one mouth. You're listening. They're probably going to tell you what their plans are, and hey, if my competitor wants to tell me their plans, I'm up for a burger.

PATTI: There you go. Absolutely.

How do you tell between a good offer and a not so good offer? Is there rules of thumb? How do you go about evaluating different offers?

MATT: First thing, you want to see it in writing. Some people will talk about "Oh, we talked about this, we talked about that..." If somebody wants to talk to you about buying your business and they sit down, let's say it's at that lunch. "Yeah, we'd be interested in paying you. We pay a high multiple. We pay six times."

You're sitting there thinking "Oh, that's six times..." What did you hear? You heard "Six times my best year ever. All cash. 30-day close." That's what you heard. That's what a business owner would hear.

I generally say, I'm flattered, thank you. I think maybe we could do something together. If you could put that in a letter of intent or term sheet...Those are the two terms you need to know, letter of intent or term sheet. Term sheet is even like a single page – that I can share that with my wife and my accountant. Could you do that?

That will save you so much trouble. Because what's in there is the answer to that question. That six-time multiple? Assumed it was zero-down at closing and paid over ten years. Not the same offer.

That's how you do it. You take that piece of paper, and then you go to your trusted advisors, your wealth advisor, your accountant, your attorney. Frankly, any of them can help you. Go to the one you trust best.

I'd go to your wealth advisor. Because your wealth advisor can then put that into your financial plan and, based upon the timing of the payments, it might be perfect for you, it might not work.

PATTI: It's interesting, because that's what we do, we always run the numbers. We look at best case, worst case, as a transaction begins to evolve just to make sure that, if things begin to break down, or during the negotiations which…it's probably going to happen…you're probably going to be giving some things up…You could be. Let's make sure that it's even worth going through the process if you're getting three or four-times instead of the six.

MATT: When people come and approach you and want to buy your business, that's your single-best negotiating position, so don't be so quick to push that out. But recognize that's why I have the confidentiality agreement in place. That's why we have your attorney involved. You're going to have to share some financial information. They're not just going to make up a number.

There's a certain level of information that's appropriate. Your reviewed annual statements, maybe your tax returns. Don't forget to black out your social security number if you give them. They need those to understand the profitability of the company.

Sometimes people come to me and they're like, "Can you imagine what those people asked for? They wanted my tax returns." I'm thinking "Well, they were probably taking them to take to their bank to see if they can fund the deal." You do need your trusted advisors to look over your shoulder and give you some help. You are going to have to share some information before you get an offer, just know that.

PATTI: What does this whole process look like in terms of time? How long does it typically take and what is the due diligence that's involved? What's the buyer going to want to see? Who're they going to want to talk to? What's the timing even of all of that?

MATT: That's a good question. Soup to nuts, six to nine months. If somebody walks into my office today and says, "I want to sell my company. I'm relatively well-prepared." Let's assume they haven't done three to five years, but their stuff's pretty good. We'll take about a month to package it. Then we will confidentially market it for another four weeks.

Marketing is very efficient when you use a professional because we know how to get to the buyers. We have databases so we send out a very basic teaser. "Southeastern Pennsylvania Manufacturing Company." By the way, what are the sales, and basically what is the EBITDA. That's what a buyer needs to know. they call us, they sign our confidentiality agreement, we start into dialogue with them.

Ultimately, they'll want to meet you, but first they will have a dialogue with them. Then, we might have a conference call, and we're working our way towards a letter of intent. They're going to give you a letter of intent, and the one thing it's going to say in there is "Here's the price, here's the terms, etc." We're going to negotiate that and then we're going to sign it.

Now we're into due diligence. If you haven't been through it before, you will hate it. I had root canal earlier...This is better. Root canal was better than due diligence, I assure you, because people are going to challenge everything you've ever done in your business. Expect to be offended. Expect to be challenged in your judgment. "Why did you do that?" "Why did you change accounting policies?"

The buyer's job is to find problems. They're not there to pat you on the back. That can take up to three months. A lot of that is "How good are you?"

Now, let's say, for example, Patti, you don't have a financial controller. The buyer wants all kinds of financial information. Well, you're going to have to come in and get the financial information for them.

Let's say you have a controller but you don't want them to know about the process. That's totally up to you. That depends on how well you trust your controller. By the way, if you tell one person, you tell your controller.

PATTI: Very good point, yeah. That's very, very important.

MATT: If that person can help turn around documents...I'm going to get requests for five years of cash flow statements, five years of balance sheets, all this type of stuff...if I get all that information to them...

By the way, we deliver all that electronically in a secure deal room. We populate the deal room and then the buyer starts looking at it. That whole process, say three months, and then it's done.

You asked a question about if they want to talk to your employees. Most offers include a desire to speak to key employees, key customers, key suppliers, and you look at that and say "No way." Well, here's the "way" because sometimes they'll say "Well, we're not going to buy it."

If a buyer is a private equity group or a big public company, for example. These are people, by the way, who have a job. They are not business owners. They will lose their job if they do the wrong deal, so they're very risk-averse.

So, when do they talk to your employees in the process I just talked about? You have a letter of intent, we went through due diligence, then we get to an agreement of sale. That's when the lawyers negotiate the purchase and sale agreement. Once that agreement's done, then we're really close to closing.

I put in that agreement, "This agreement is subject to a discussion with my key employees, discussion with my key suppliers, and my key customers." That happens the week of closing.

PATTI: I can understand why they would want to talk to your key employees and I'm curious at what point you tell your employees that you're selling the business, we're in that process. Why would they need to talk to their customers?

MATT: They want to make sure the key customers are not going to leave when they take over, and it's a fair point. Also, if your business has contracts with some of your key customers, there will be assignability clauses in there, where you'll actually have to approach the customer and say "I'm selling the business. I need your approval to assign the contract."

If that happens, once again, let's take off the table everything we can. We did the due diligence. Are you satisfied with the books and records? Yes. Is the bank onboard, are we ready to be funded? Yes. Is the agreement of sale done, my employment agreement done, the seller note done, the lease done? All the stuff the lawyers have to do is done. It's in a box. Then we say, "We're ready to close as soon as we check these last boxes."

Two things happen. One, leave a very short timeframe for people to get freaked out, which is very important. Two, the buyer, if they're a private equity group, just probably dumped $200,000 into the process. They're only backing out if it's really, really bad. If your biggest customer says, "Patti leaves, we're out," then you've got a problem.

By the way, I don't know how you defend against that. Well, I do know how you defend against that. You don't leave. If part of the deal is that Patti's staying for the next three years, then your discussion with them is, "Hey, I'm going to retire in a couple of years and I'm going to get funded by this new private equity group that's going to become my partner," because maybe you own ten percent of the company.

Now, you're telling the truth and nobody's freaked out. If you say "I'm out of here, I'm going to Florida," is that customer going to stay with you? It's a good question.

PATTI: When you think about the deals that you have done, on a percentage basis, what percentage did you find that the owner stayed there for a period of time after the deal closed?

MATT: There's two answers to that. One is there is a transition period of two months. Show me where the light switches are. That's more and more rare. Most of the time, it's a year to three years. I had one guy, a good friend – became friends – he had told his father almost on his death bed that he would not work past 65 and he was 64.

We fought like heck to get him one year. They offered him, I'll make up the number $300,000 a year for three years. He said, "I don't want the last two. I'll take the first one."

They didn't call him after a week. We would have lunch and he'd say, "You know they would be paying me now if I'd just said yes." Because all they wanted was access to him. They just wanted to be able to go to him if they got into trouble. He was that smart.

If you're a business owner out there and they want you to stay for two to three years, it's not how long, it's what they want you to do. They might want you to go annual trade show, they might want you to take people to the Masters every year. I'm good with that.

PATTI: I am too. Sign me up.

MATT: Exactly. You want me to come in open the doors every day, that's a different story. What we're talking about, Patti, is risk. If there's any risk of the customers, the suppliers, the employees and you don't go anywhere, your risk profile dropped dramatically. That's why I want to be talking to people that are 58 opposed to people who are 79. So you have some window there to play with.

PATTI: I think it's so interesting, Matt, to talk through the preparation process and the sales process, the due diligence. Really warn our listeners that as you go through, especially the due diligence, you've got to have some humility. It can be painful. They are going to pick this thing apart and try and figure out a way to negotiate the deal down during the process.

MATT: You say negotiate the deal down. Sometimes yes but sometimes no. A private equity group is an investment vehicle. So picture, there are limited partners that have put their money into this pot. They've hired people to do their jobs and to find them companies.

Those people have a fiduciary responsibility to ask all these questions. They're not just trying to be difficult but they have to report back to these folks. They're going to go back and make a broad presentation that says, "I bet my job on this deal." When they get stuck on a point, it may very well be a point they just need to get an answer to.

Don't be offended by it. Do not go into this defensively and you'll come out the other side. Just be prepared for a battle. The more work you do upfront the easier the process is going to be. It's not a fun process. But on the other side, that's one of the things we talked about. What's on the other side? We talked about some of the key things to think about.

One thing I always challenge people to do is to think about the other side. If you don't have a vision of what you want to do or what you were going to do afterwards, I don't have many people around there that can remember when they did not work. You're now going to not work.

PATTI: Oh, Matt, we have this conversation all of the time whether it be selling a business or retiring. Tell me what that looks like.

How are you going to be spending your day? What are you going to do when you wake up? How much golf can you really play? Where did the grandkids live? What's that look like for you? What are your hobbies? Is there any non-profits that you're passionate about?

To really make sure that they're prepared, not just financially, but psychologically, because it's a major, major transition. It's a major shift in a person's life.

MATT: When you get into the real tough part of due diligence and you're scraping back-and-forth, and the lawyers are yelling at each other...Not that they yell, but they're defending you. You could look and then say, "Why am I even doing this?" You need to remember that.

There'll be people you're doing it for. Those are your employees, those are your customers, those are your suppliers. If you don't have the energy you had at one time, you're doing the business a disservice and your family. You just have to keep your eye on the prize.

It'll take you time to after the close till when you can really settle down into your new life, but don't be afraid to dream, because that will help carry the day.

PATTI: I think that also, it's also OK to have a feeling of ambiguity, of a little bit of fear. That's OK, that's perfectly normal. Just focus on what your life could look like if you're no longer running this business 24/7.

Let's pull this together, Matt. In terms of action items or takeaways. Number one, what I heard from you is when you're thinking about this and you're beginning the process, do not tell a soul. That could really hurt you in a long run.

MATT: That with the exception of one of your trusted advisers to help you with it, yeah.

PATTI: Exactly, exactly. Number two, be flexible. Have some humility as you go through this process. You may have a particular number in mind, or a process in mind and just understand that if you're working with a business broker or someone who's specializes in M&A, they'll kind of walk you through what's realistic. Understand that you're going to be flexible. It's just part of the process.

Last but not least, my favorite part of what you talked about today is to have a vision. Make sure that you really spent some time with your significant other, you spouse, your family, and talk about what this is going to look like once the business is sold, because you don't want to be subconsciously sabotaging the deal.

As you get into it, you're thinking, "Well, this is my legacy. This is my life. I've spent 30 years doing it." And you find ways to kind of make the whole thing derail. If you thought about it in advance and you've allowed yourself to dream, it just makes things go so much easier, doesn't it?

MATT: It does. It does, and it'll carry you through.

PATTI: Fantastic. Matt Coyne, I can't thank you enough for being with me for both of these podcasts. I don't know about you all who are listening to this. I got a lot out of it.

Again, let me remind all of you. I, personally, when I talked about selling a business, etc., I have no intention of selling. It's just putting myself in your place to understand what the process is all about. If you're having fun and you enjoy your business, by all means, keep doing it.

There will always be a point in a person's life where you have to think about, "Gee, what does this look like when I'm no longer willing or able to continue running this company? How do you get maximum value? Who are the players that you need to put into place? How do you set up your financial so that you get maximum value?" That's what we're talking about here.

So that's it for today's show. Thank you so much for spending some time with us. Your time is so valuable and the fact that you continue to tune in week after week, it's just...What a compliment it is to all of us! I'm so happy.

The feedback that we're getting is terrific. The topics seem to be resonating for everybody. For those of you who have gone on our website at www.keyfinancialinc.com, you've given us your commentary. That's what led to many of these subjects and these podcasts. We really want to talk about the things that you want to hear about in very clear, actionable ways.

So folks, that's it for today. I am Patti Brennan. Thank you, again, so much for joining us. We'll see you in the next episode.