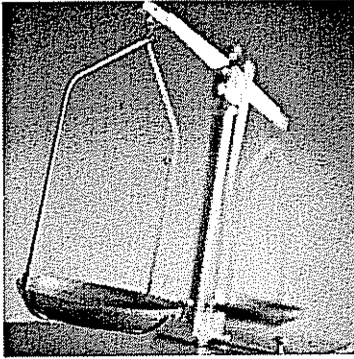

General Legal Issues

Business Survival GUIDE

Following a structured process paves the way for selling a business

SELLING A BUSINESS

GARY W. MILLER

Business owners may be experts at growing and running a business but may never have been through the process of selling one. Fortunately, there is no real mystery to it; selling a business is a structured process.

• **Finding a buyer.** Depending on the business, the identity of the likely purchasers may be easy to determine. Often, the owner need look no further than the nearest competitor who may be interested in horizontal integration or the firm's biggest supplier who is looking to move down the chain vertically.

An owner can save a healthy commission by finding his own buyer, but an investment banker or business broker can offer special knowledge in the industry, experience and an ability to insert himself in a positive way between the owner and potential buyers.

Expect to pay a professional a retainer for out-of-pocket expenses and a success fee based upon a percentage of the selling price. An often-used payment scale is the "Lehman formula," which is 5 percent of the first $1 million, 4 percent for the second, 3 percent for the third, 2 percent for the fourth and 1 percent for every $1 million thereafter. For deals under about $3 million, expect to pay more, although these fees may be negotiable.

For the fee, the owner should receive a complete analysis of the business, incorporated into booklet format, significant assistance in locating and negotiating with potential buyers and consultation throughout the deal. An attorney should review any agreement executed with a broker or investment banker.

• **Setting the price.** There are various ways to value a business, but many are sold based upon a multiple of annual earnings before interest, taxes, depreciation and amortization of debt. Typical multiples may run from three to occasionally as high as eight times the sum, depending on the industry and other factors.

Long-term debt is usually subtracted from, and cash is usually added to, the multiple to arrive at a purchase price. The actual purchase price will be negotiated, but the owner should look to his professional selling consultant and an experienced accountant to assist in determining the value of the business.

• **Enter the attorney.** While it's good to

HOUSTON BUSINESS JOURNAL
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use an attorney who has, for years, helped the business review leases and collect from slow-paying customers, selling a business requires an attorney who is expert with the process.

The owner, understandably, will be concerned with what this process is going to cost and when payments will be made. However, it's best to deal with these issues once the attorney knows enough about the deal to be able to discuss it intelligently.

Don't expect a firm price, as no one can predict with certainty how smoothly a deal will go. Do expect to be kept informed as the deal progresses on cost to date. Do ask hourly rates and how the deal will be staffed. If the owner chooses to hire the senior partner, he should make sure that the lawyer is going to lead the effort. But he should also expect and want junior (and less expensive) attorneys to be involved.

Choose the attorney when the decision is made to sell the business, but get the attorney actively involved in the initial structuring of a potential transaction and the letter-of-intent stage.

Many deals have been handed to attorneys after the letter of intent has been signed. However, important issues need to be handled by the attorney in the initial stages of the transaction. The letter of intent may purport to be nonbinding, but it is an uphill battle that erodes goodwill between the parties to attempt to change the basic terms.

• **Initial agreements.** Before going into detail about the business with a potential purchaser, have the other side sign a confidentiality agreement prepared by an attorney. Those looking at a business not only should keep quiet about proprietary information provided about the business, they need to keep confidential the fact that the discussions are taking place to avoid giving competitors an edge and making employees feel at risk.

Once the owner has settled upon a buyer, it is time to enter into a letter of intent, which describes the terms for the sale as well as related matters such as any employment contract the owner may have with the buyer. These agreements are, for the most part, nonbinding, but the final transaction will likely look a lot like the deal spelled out in the letter of intent.

• **Due diligence.** After the letter of intent and the confidentiality agreement are signed, the potential buyer will send in accountants, attorneys and sometimes other professionals to figure out if he wants to move ahead with the transaction. This process will easily take several weeks.

Even though there will be strangers in the office, knowledge of the potential transaction should be confined to a few of the firm's top people. Have as much of the work as possible done outside of the office.

Selling a business is time-consuming and distracting, and generally not good for business. So that the process can be done as quickly and efficiently as possible, the owner should be forthcoming with the information requested by the potential buyer.

• **Definitive agreements.** Once the purchaser is comfortable, he will give the word to his attorneys to prepare a draft of the definitive purchase agreement. An owner selling a multimillion dollar business can expect a 35- to 45-page thriller of a document that spells out the terms of the deal.

The purchase agreement describes what is to be received and what is being sold. It includes representations and warranties relating to every aspect of the business from the accuracy of the financial statements to lack of default on company contracts. The agreement describes any conditions to closing, such as execution of an employment contract or renewal of an important lease.

Of great importance are the indemnification provisions toward the end of the contract, which describe what will happen if something represented about the business turns out to be false. The owner and his team will negotiate the length of time representations about the business will remain in place, limits on the amount the owner will have to repay the buyer if one or more representations prove to be untrue and the amount the buyer must be damaged before he can expect a reimbursement for those damages.

It may be the selling consultant's job to negotiate for the maximum purchase price, but it is the attorney's job to help the seller hang on to as much money as possible if the buyer later questions the accuracy of the statements about the business made in the purchase agreement.

• **Pop the champagne.** With some deals, the definitive agreement is signed and the deal is closed that very day. With other sale transactions, there may be some things that need to happen after the parties are legally committed to do the deal but before it can be closed. However, most deals eventually close once the definitive agreement has been signed.

At a closing on larger deals, the seller can expect a room full of paper and more people than he really cares to pay, facilitating the closing. After the contracts are all signed, wire transfers are sent or stock is issued, depending on the structure of the compensation, and hopefully, everyone goes home happy.

This is not litigation where one side is trying to beat the other. Often, the buyer and seller will have a continuing relationship, so the best deals are win-win. ■

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