Mastering M&A transactions

How sellers can fetch top dollar for their companies in the M&A market

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As the economy improves and the M&A market heats up, many small business owners are preparing for the most important transaction in their life: selling their business. Many sellers have never been through this process before and can make costly mistakes.

"Managing a deal is like a second full-time job. And you still have to run your business, all while handling the deal and maintaining confidentiality within your organization," says Peter J. Smith, a member at Semanoff Ormsby Greenberg & Torchia, LLC, who has experience representing sellers in M&A transactions.

Smart Business spoke with Smith about the mistakes sellers often make and how to avoid these oversights.

What mistakes do sellers make?

There are three general areas of concern:

- Not adequately preparing the business for sale.
- Not following a good sales process.
- Poor execution of the transaction.

How could sellers better prepare the business for sale?

Have complete books, records and contracts. Make sure all corporate records, documentation, contracts, leases, employee personnel files, benefit plans, etc. are up to date and complete. Due diligence is not the time to clean up.

Have employment contracts with key employees and restrictive covenants with sales personnel. If possible, put contracts in place with key customers and vendors that a buyer will need.

If you don't have audited financial statements, or at least accountant-prepared statements, consider getting them. Also, consider working with your CPA to prepare a recast P&L showing what adjustments might be made without the seller (and seller perquisites), which will not be incurred by the buyer.

How does a seller fail to properly maximize the sales process?

Sellers miss out when they fail to create a strategic and competitive sales process. Ideally, sellers want multiple bidders so they can leverage the competitive environment. However, sellers should keep in mind that private equity firms and strategic buyers are very different audiences and adjustments in approach should be made when pitching each.

Have a data room ready to go with documents buyers should see and consider. If some agreements are confidential, prepare summaries, charts or reports. Have a good non-disclosure agreement and know what due diligence you want from a buyer to pick your best suitor.

Finally, the seller wants to negotiate all the key terms of the deal up front in a letter of intent. This is the biggest mistake sellers make. Sellers shouldn't let buyers make excuses as to why they can't commit on certain issues or rush the seller into a definitive agreement. The seller will never have more leverage than at the letter-of-intent stage and the deal terms will only get worse for the seller as the transaction progresses.

Where do sellers fall down during a transaction?

Without an experienced M&A negotiator to organize and lead the negotiations — usually a seller's counsel — sellers will likely stumble. Alone, sellers might not take into consideration the tax implications of the deal, or might not understand that agreeing upon the purchase price is only one small piece of determining the seller's net, after-tax result from the overall transaction.

There will be earn-outs and holdbacks, consulting agreements and indemnities, definitions of working capital and inventory, and collection of AR. It is in all of these areas that sellers can lose significant value.

Additionally, most sellers are not prepared for the extensive time, effort and emotional drain a deal will take. Deals can take six to nine months from first solicitation to closing, and 30-75 days from letter of intent to closing. The seller also should expect many ups and downs as negotiations wax and wane. Not all issues will go their way.

Sellers should educate themselves before the transaction begins. Hire a good investment banker and an experienced lawyer early in the process. They'll help quarterback the transaction to the fastest and best solution for the seller. ●