BUSINESS GUIDE

# GUIDE TO SELLING YOUR BUSINESS

Jersey Business

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Purpose
Building better businesses.

**About the Author**

We at Purpose are delighted to present this booklet in partnership with Jersey Business. In this guide, Luke, our Director, will take you through the process of selling your business so you know what to expect.

Having qualified in 2002 at Big-4 firm KPMG, Luke bought his business in 2007 from its previous owner and decided in late 2011 to sell 75% of the customer base and focus on being much more helpful to fewer customers.

Having attended over 1,000 client board meetings across 35 industries over the last 12 years, he has seen the problems before and knows how other successful businesses have solved them. Working together with clients he implements the changes needed to create success quicker.

Luke says, "we never stop learning, inside the classroom or out and make sure we always offer potential solutions".

He has significant experience in mergers and acquisitions and performing local business valuations for sale or in divorce or other disputes, including giving expert testimony in the Royal Court and at family law mediation.

Luke has now set up a business brokerage to support clients looking to buy or sell their business in the Channel Islands.

**Luke Smith, Director at Purpose**

*For more information on our services, visit our website at www.purpose.je or call 01534 766233*



# INTRODUCTION

Ultimately, selling a business is as easy as signing a share transfer form and updating the company books. However, to get to that point can take a long time, a lot of money and a huge amount of emotional effort.

This guide describes the process that great advisors go through with their clients to ensure the process is as profitable and painless as possible.

A good goal to have is that within 12 months you have found someone willing and able to buy your business on terms you are happy with, without negatively impacting your life or the business' current performance.

Everything in the process should support that goal and whilst working with advisors may incur costs from a financial point of view, it is better not to be penny wise and pound foolish. Choose them carefully, making sure they will work positively and constructively with you to get a great deal.

Although comprehensive, this guide is not a substitute for the in depth knowledge and experience that you will get from working with professional advisors. However, it should give you the necessary background so that you understand the process, know what to expect and what to ask your advisors.

Good luck with the exit journey. Remember, we are here to provide you with confidential advice and support so if you need an objective sounding board to talk to please do get in touch.

**The Jersey Business Team**

FIRST THINGS FIRST,

# WHY TAKE THE TIME TO READ THIS GUIDE?

## FOR EVERYONE

**Exit planning offers you control**

Although the intention may not be to sell soon, unexpected offers to purchase your business could change your mind. With a plan in place you'll know quickly if the offer feels like it is a good one.

**You can proactively develop the business with the future in mind**

Planning strategically helps you decide what you want to achieve from being in business. It helps you demonstrate to purchasers and their lenders and funders that you're a risk worth taking.

**You need time to prepare**

When done properly, selling a business requires considerable preparation time. Getting the best valuation needs increasing revenues, effective technology, efficient processes and to have your terms and conditions, leases and contracts up-to-date so your price doesn't get reduced during due diligence.

**Plan for retirement and potential ill-health**

An exit plan should be a major part of your retirement plans, but is also crucial in case you suffer ill health. It allows you to move quickly if unexpected circumstances necessitate a rapid sale.

**Keep it simple**

It doesn't need to be rocket science; the simplest of exit plans can just be knowing the value you require for the company and the date by which you want to sell. Even simple plans require some effort to understand your business as a potential purchaser will see it and to give you a plan to improve your valuation on an ongoing basis.

**Finally...**

Do you really want to sell? Planning properly will identify all the opportunities you have and may make you fall back in love with the business. You might decide that it creates a good return for the risks involved.

Alternatively, you could see an opportunity to merge or create a strategic partnership with a complementary business. Whilst this doesn't normally free up much cash or decrease the stress in your life, it could increase the value of your shares in the future if the joint venture is successful.

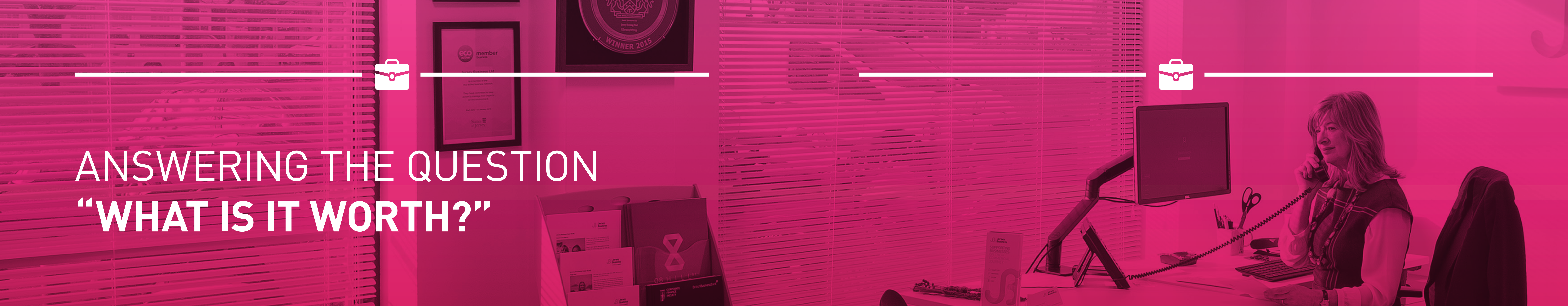
## FOR OWNER MANAGERS

For most owner-managed businesses, the shares an owner has in their business are one of, if not, the largest asset they own. How, and for how much, those shares are disposed of can have a dramatic impact on their families' lives and their personal finances.

Many business owners, who are relying on their business to give them a pension, are at risk of hardship in later life if they do not create a semblance of a plan for their future exit. So, planning an exit before you get to the point of having to release cash from your business is very important.

## FOR DIRECTORS

If you're running a business on behalf of shareholders, you have a legal responsibility to act in the company's best interests. If your shareholder wants to sell, you may be able to negotiate a healthy bonus for securing an increased value of the business or, if you are interested in taking control, be able to prepare for a Management Buy-Out.



# ANSWERING THE QUESTION **"WHAT IS IT WORTH?"**

If you are being proactive about exiting your business, you'll probably only want to sell your business if it's worth more to you sold than it is with you still owning it. In order to understand the tipping point, you need to have a feel for what it is worth.

There are a number of valuation methods which are described below. Valuing a business isn't an exact science, the result will depend not just on the method used but also the person doing the valuation and their appetite for risk and reward.

## VALUATION METHODS

### Mathematical valuation

Mathematical valuations of businesses can be done where there are:

- profits on a commercial basis,
- significant known ongoing revenues or
- assets which can be acquired.

Often a professional valuation considers all three so a fully rounded view of the valuation can be obtained.

"On a commercial basis" just means taking out of the profit and loss account all transactions where the business might be subsidised by its owners or where the owners are paying themselves more than they would pay someone to replace them at a market salary.

In addition, when presenting the profits of the business to a potential purchaser, there may be other adjustments that an accountant might make to better show the profits of the business in a truer light. These can include things like one-off bad debts, legal expenses or other extraordinary events.

Once a "normalised" profit or revenue figure is calculated, a multiplier is applied. When using profit, a multiplier might be between 1 and 16 times with an average of around 3.4, and for revenue between 0.1 and 3 with an average of about 0.7.

All multipliers depend on the types of revenues the business makes and who the potential purchaser is. As a result, the value of the business will differ from one purchaser to another. For example, a competitor that can save overhead costs and increase supplier bargaining power by acquiring your business will use a different multiplier from another purchaser that can't create the same synergies.

Goodwill is the purchase price of a business over and above the value of its identifiable assets and liabilities. So, when multiplying profits or revenues by a figure to calculate a valuation, the goodwill is the amount above this number which is otherwise "unexplained" value.

### Working capital valuation

The devil is in the detail but, broadly, working capital is current assets minus current liabilities and usually represents how much liquidity there is in a business.

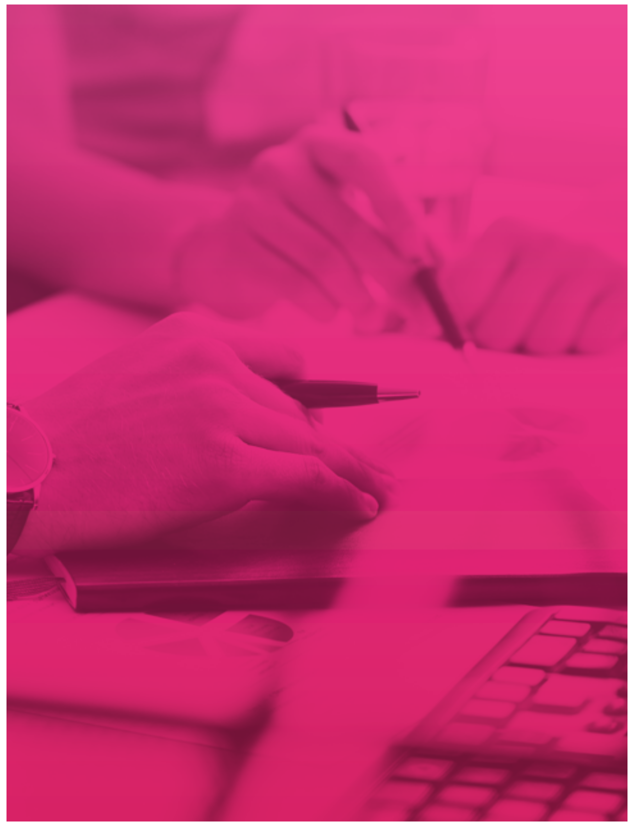
Often as part of the deal, profits up to the date of the sale are attributed to the seller with profits accruing post completion due to the purchaser.

Sometimes "excess" working capital is used for the valuation rather than the total value of working capital.

### Calculation of valuation

Subject to the terms of the deal the valuation will be goodwill plus working capital or in some circumstances goodwill plus net assets.





### Discounted cash flow valuations

When a business is starting up or has huge growth potential, a fair valuation of the business will probably not be mathematically calculated. In these circumstances both parties will be assessing future cashflows of income and expenditure and what they believe the business to be worth over an extended period of time.

This is called a discounted cash flow valuation - discounted because the cash flows are discounted for the time value of money. The assessment being made by the investor(s) will be based on a feeling of how much risk they want to take and how much control over the business they want to maintain.

The obvious problem with a discounted cash flow valuation is the attempt to predict the future. Not many people can do that well which creates a significant risk that drives down valuations.

The more you, as the seller, can decrease the purchaser's risk the more they are likely to pay for the business. If you were financially rational and investing in a business then you would want to know what your risks were and how quickly you could repay your investment.

# WHAT DO I HAVE TO NAVIGATE TO GET THE BEST PRICE FOR MY BUSINESS?

Selling your business takes time and effort, and it is unlikely that you can get a great price if you are selling at a time when you or the business are struggling. Taking time to get your business into shape to sell is worthwhile and is more likely to get you the right purchaser in the end.

## GETTING THE TIMING RIGHT

Each business is different and each business owner is different. For some, deciding to sell is a financial decision, and for others, it is the personal desire for a change which drives them.

### Financials

The financials are important. For many entrepreneurs, making money is the reason they set up their business in the first place. It, therefore, makes sense to sell your business when profits are strong to achieve the best price.

A business with falling profits is unlikely to be as desirable, and buyers who are still interested will be looking to negotiate hard when it comes to price.

Conversely, selling a business that has reached its limit can diminish the potential future opportunity in the eyes of purchasers. Make sure you are clear there is growth ahead and how it will be achieved.

### Life changes

Life changes such as divorce, your health or that of a business partner may force your hand. You might be bored or find that the stress and day to day operations of the business are too much for you to deal with anymore.

If this is driving your decision, then the timing is more about when is best for you and your current situation. While getting a good price might still be a key objective, the financial settlement may be less important than other considerations.

### Timing is everything

When it comes to getting the best price, timing is hugely important; but it is impossible to predict the future with certainty and what it holds for you and your business.

Undoubtedly though, it is easier to sell when the market is healthy and obtaining finance is relatively easy.

## BETTER FINANCIAL PERFORMANCE & RISK REDUCTION

Any way in which you can demonstrate existing and on-going growth of the business will reduce risk and increase the valuation you can achieve.

John Warrillow's book "Built to Sell" highlights the mathematically proven factors affecting the valuation of a business. Summarised below, they are:

### Revenue size – the bigger your turnover, the less risk there is

By working to grow your revenue in advance of your sale, you can increase the multiple you might achieve. You might even consider acquiring a supplier, customer or competitor to dramatically increase your valuation.

### Growth potential – how easy would it be to cope with 5 X demand?

If you can grow fast in the future, someone will pay more for the business because once they own it, they will benefit from the growth. To get the business to this position, you will need to invest in technology or change aspects of how your business trades to be in the position to cope with extra demand profitably.



### Pareto Principle – how reliant are you on key customers & suppliers?

The Pareto Principle is better known as the 80/20 principle. 80% of your profits come from 20% of your customers or products, or thereabouts. If you have high reliance on a small group of customers or suppliers, or even team members, then the risk goes up, and your valuation goes down.

Reducing that reliance on a small number of customers or suppliers decreases risk and increases your valuation.

### Cash requirements – how much cash do you need to run the business?

Businesses that need a lot of cash to run and grow do not usually have enough to also pay large dividends. This reduces shareholder return, increases risk and therefore reduces the valuation.

Changing your terms of business with key customers or suppliers can reduce the business' cash requirements and increase your valuation.

### Recurring revenue – what % of your revenue is recurring?

Having to constantly win new work can be challenging and increases risk. Having signed contracts with customers for fixed periods gives comfort to potential purchasers, reduces risks and improves your valuation.

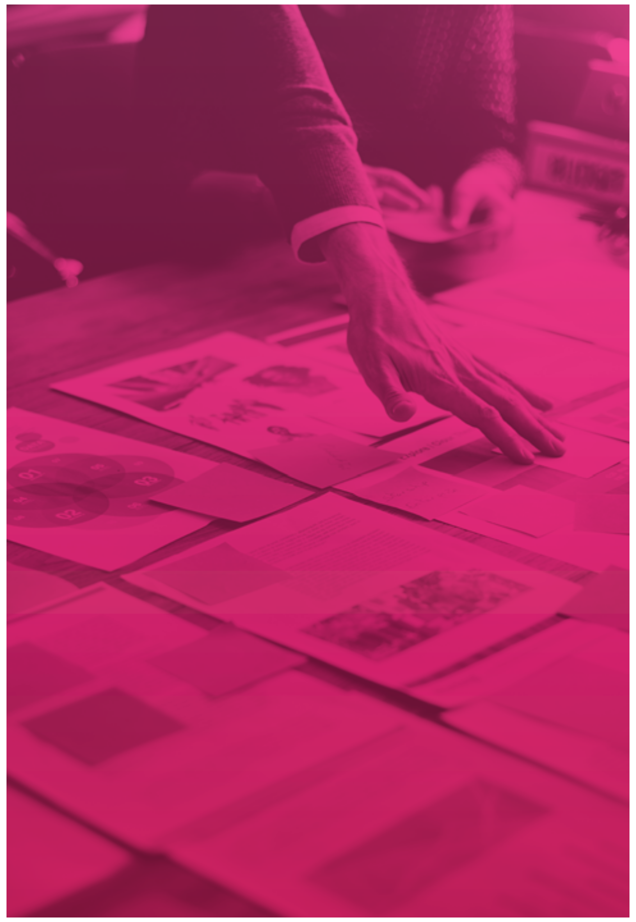
### Industry control – have you got a well-defined niche or industry control?

If you haven't got many competitors, then the risk of someone taking your customers reduces; as risk reduces, your valuation increases. If you can realign or focus your business to some degree to reduce the competitive nature of your market, you can decrease risk and improve your valuation.

### Customer satisfaction - what's your net promoter score?

It's obvious that if customers love you, they will stay with you and refer you positively to their friends. If you don't know how your customers feel about you, then how can you influence a potential purchaser?

Gathering data from a recognised, independent method of surveying customers is a great start. If the score is good, it should be in your presentation. If it is bad, then you need to do something about it! You may be limiting the number of potential purchasers you get if you have low customer satisfaction and loyalty.



**Employees – what is the risk posed by your employees?**

Will the new owner want your employees?
The longer you have employed your staff, the greater the financial risk if they are not required. A new owner may be a competitor wishing to merge your business with theirs. The employees they do not require may need to be made redundant before you can make the deal.

**Is the business all about you?**

Is your business built on your own knowledge and experience? Do you or specific individuals in the team have the important relationships that drive your business? If so, when you, or other key employees, leave the business, these relationships might also go and devalue what is left behind.

This obvious risk can be reduced to some extent by ensuring that everyone in your team is able to service your customers and also by proactively managing the transfer of relationships to new members of the team.





# CREATING DEMAND

Basic economics states that if demand outstrips supply, the price of anything will increase. If you can create a number of interested buyers, then you have more options and therefore more leverage during negotiations.

# EXCELLENT PRESENTATION

Spending time and money on presenting your business' financial information in a beneficial way makes sense. Much like you'd do up a property you're looking to sell, presenting your business in a good light is vital to ensuring you get the best valuation you can.

A Sale Memorandum is a document which sets out all the things a normal potential purchaser would want to know before making an offer. It illustrates and gives context to the current business performance, addresses the obvious business risks and identifies strong opportunities for growth. It should also set out why the business is being sold now.

# SPECIAL PURCHASERS

If you can find a special purchaser, you will often achieve a better valuation than the average.

The International Valuation Standards Council definition of a Special Purchaser is a particular buyer for whom a particular asset has special value because of advantages arising from its ownership that would not be available to other buyers in a market.

# MANAGEMENT BUYOUTS (MBOs)

MBOs are less likely to achieve a higher valuation but are advantageous because:

- Confidential information is not shared with outsiders reducing the chance of financial and operational details falling into the hands of others and compromising ongoing success.
- They require minimal buyer due diligence in comparison with a trade sale.
- They provide greater confidence for you, given the management team's in-depth experience of running the company.
- You are negotiating with a purchasing team that is incentivised to grow a business with which they're fully engaged.

The downside is that the management team might find it difficult to source the funding to buy the company outright.

As a result, MBOs are generally financed with a mix of funding. The management team is usually expected to fund a proportion themselves with the remainder typically obtained from a variety of other sources, including:

- Asset-based financiers
- Cash flow loans
- Private equity
- Seller loan notes

In order to achieve a sale to an MBO, you might have to accept a form of deferred consideration and may need to still be involved in the business for some time.

# HOW CAN I FIND SOMEONE TO BUY MY BUSINESS?

As with your products or services, it is worth thinking about the target market for your sale. Who is likely to want to buy it? But also, who do you want to sell to?

One thing you should be sure of is the criteria you might want to evaluate a buyer by. Other than the financial return for you, clarify if there are other characteristics that you want to see in a buyer. You might, for example, be looking for a business that will protect your staff, or have the same ethical or geographical outlook as your existing business.

## DEVELOP A COMMUNICATIONS PLAN

If you have decided to sell, you will need to get the message out there in a way that does not damage the existing business. Try and control your message and remember that change is uncomfortable for many customers and suppliers so if they hear through the grapevine, or perhaps directly, that the business may be sold it might weaken confidence in the business.

Develop a communications plan, so you know who you are going to tell and when. Consider the message you want to convey about why you want to move on and the positive benefits to the business, staff, customers and clients.

## WHO COULD YOU SELL TO?

- The existing management team of the business, often called a "Management Buyout";
- A customer who wants to benefit from cheaper supply costs;
- A supplier who wants a more guaranteed customer;
- A local competitor who wants your customers and to save overheads;
- Someone in your industry who is not already trading in Jersey and wants an easy way in;
- Someone passionate about working in your industry;
- Someone who owns complementary businesses to yours who wants to expand; or
- If you're big enough, you could list on a stock exchange and sell shares to the public.



## IDENTIFYING A BUYER

There are obvious challenges to being open about wanting to move on, but unless you tell people about your decision no-one will know. There are relatively few options:

**Tell people you meet you are looking to sell**

Using your network is a controllable way of sounding out the potential for a sale.

If you know well-connected people that you trust you should talk to them about selling, but before any detailed information gets transferred it is worth getting a Non-Disclosure Agreement in place. More on that later.

**Ask your accountant or lawyer to help you**

Historically, business owners have asked their accountant and/or lawyer to write to their contacts confidentially to identify potential purchasers through their networks.

This process has limited success, and often these professionals will charge for the cost of time and materials in issuing the letters or emails.

**Hire a business broker**

A good broker will work hard on your behalf to find a number of potential purchasers, only charge a commission on completion of a deal and communicate well. They should keep you apprised of any interest in the business and answer your questions simply and clearly when you have them.

The cost of a broker will often be around 5% of the total consideration, that is the total amount of value received by the shareholders under the terms of the deal.

**Promote and advertise your success**

Increase your company's marketing, enter awards and start generating significant PR about the success of the business. Your good news might encourage a potential purchaser to approach you directly.

# HOW DO I AVOID TIME WASTERS?

Selling a small business is a process; that's a given. But veteran or repeat sellers know that this process can be made even longer and more difficult by "tire kickers", prospective buyers who lack the skills, interest or financing to successfully acquire the company. Instead of advancing the sale, these buyers waste the seller's time and divert attention away from more qualified prospects.

Although indulging every interested party might seem like the polite thing to do, you have to focus your efforts on prospective buyers who have a genuine interest in acquiring your business and the ability to close the deal. The way to figure out if a prospect meets these requirements is to ask a handful of targeted questions designed to assess their expectations and level of readiness.

Many business sellers expect buyers to ask questions but haven't given much thought to the types of questions they should be asking. By asking strategic questions, you can quickly evaluate the strength of the prospect and accumulate information that will be valuable as you move toward finalising the deal.

## IS THE BUYER QUALIFIED TO OPERATE THE BUSINESS?

One of the first questions you should ask is whether or not the prospective buyer is qualified to run the business. If the buyer has already owned a similar company, conduct basic research to determine the buyer's reputation in the industry. If they haven't owned a business before, ask how long they have been thinking about going in to business and why they believe your company is right for them.

Remember, even after the sale is finalized, your reputation and the livelihoods of your employees will be linked to the buyer, so it's important to feel comfortable about their qualifications. Even more importantly, since most deals include at least some level of seller financing, your ability to receive full payment for your business rests upon the success of the ongoing business.

## HOW DOES THE BUYER ENVISION THE TRANSITION PERIOD?

It's important to evaluate the buyer's expectations about the transition period as soon as possible.

Typically, the buyer expects the seller to remain involved for a specified period of time after the sale, often from three to 12 months, particularly if the buyer has limited experience in the field.

If the transition period is over an extended timeframe, you will need to work some form of compensation, e.g. a consulting fee or salary, into the deal. Qualified buyers understand this dynamic and should be able to intelligently discuss the options and scenarios.



## HOW MUCH CAPITAL DOES THE BUYER HAVE FOR A DOWN PAYMENT?

The question of capital is where the rubber meets the road for most prospective buyers. Buyers who have considered business ownership for a while understand capital requirements and will have an adequate down payment for the purchase.

On the other hand, if the buyer expects to finance the purchase with little or no down payment, you know that they aren't a serious prospect and it's time to move on to more qualified buyers. Knowing the size of the buyer's down payment can also be useful information during the negotiation stage.

## WHAT ARE THE BUYER'S CONCERNS?

Buyers who possess the skills and capacity to purchase your business have probably thought about owning a business for a long time, but legitimate concerns have held them back. By openly addressing the buyer's concerns, you begin to create a relationship built on trust and pave the way for a much smoother sale process.

Alternatively, prospective buyers that approach you with little knowledge of the questions to ask shows the likelihood that they will be the eventual buyer of your business is slim.

## HOW IS THE BUYER PLANNING TO FINANCE THE PURCHASE?

Financing can be an insurmountable obstacle for unqualified buyers. It's completely reasonable for sellers to make early inquiries about how the buyer intends to finance the entire acquisition.

If the buyer has a solid financing plan in place, including discussions and preliminary approval from potential lenders, it's an indication that the buyer is a strong candidate worth pursuing.

By learning about the buyer's financing plans, you can also gain important insights about how long you will be attached to the company, especially if the buyer wants you, the seller, to finance part of the purchase.

# HOW DO I GET A BROAD DEAL AGREED WITH A POTENTIAL PURCHASER?

To get to a broadly agreed deal there are three documents a rational purchaser and their advisors will want to see:

- Non-Disclosure Agreement
- Sale Memorandum
- Heads of Terms

## NON-DISCLOSURE AGREEMENT

A non-disclosure agreement (NDA) is a legal contract between two or more parties that signifies that a confidential relationship exists between them. The confidential relationship exists because the buyer and seller share information which should not be made available to any other parties outside of those involved.

An NDA may also be referred to as a confidentiality agreement but are legally binding confidentiality agreements so not acting in accordance with one means being subject to potential fines or other legal repercussions.

NDAs are a very common way to protect your business' secrets. It is particularly important to get an NDA in place before you start sharing sensitive information about how your business operates, which you are likely to do in a sale memorandum, for example.

If an NDA is breached by one party, the other party may seek court action to prevent any further disclosures and may choose to sue the offending party for monetary damages.

It is best to get help from a Jersey advocate when preparing an NDA to make sure it is enforceable, especially if your buyer is not based in Jersey.

## SALE MEMORANDUM

This document, produced prior to selling your business, is your opening pitch to prospective buyers.

It's your chance to shout about the positive aspects of your business and state the reasons your business is an attractive investment prospect.

It is the first significant written description of the business that your eventual buyer will have, so it's well worth investing considerable time and effort into making sure the right message is conveyed ensuring everything in it is factually accurate.

The contents will vary; however, an effective one will typically contain:

- A brief overview of the company's history and how it got to its current position.
- Details of how your company operates, and the products you sell or service you offer. It will cover how you buy raw materials, produce the end result, and how you reach your customers.
- A discussion on your company's competitors, and what makes your company different.
- Your reason(s) for selling the company.
- Details of the premises you operate from, if they are they owned or leased, and if you work from multiple locations.
- Details of any staff you employ and the details of their contracts.
- An outline of your customer base. Include details of your typical customer and any key customers who are particularly important to the business.
- An overview of the general financial health of the business, providing historic turnover and profit figures, details of the business's assets and any company debts or other liabilities.



- A projection for the business going forward, such as profit forecasts.
- Your expectations regarding the selling price of the business, the terms of sale and desired time scales for completion.

The length and complexity of the sale/information memorandum will largely depend on the size of your business and the amount you are likely to sell it for. A larger, more valuable company will need a longer and more detailed memorandum than a small, simple business.

At this stage you want to ensure you include enough information to present your business in the best possible light to gain the interest of potential investors. However, you must also be careful not to divulge too much information which could be of use to your competitors.

You should only show the memorandum to parties with whom you have signed an NDA. This will give you legal protection to stop those in possession of the memorandum from distributing the information contained without your express prior permission.

## HEADS OF TERMS

A Heads of Terms is a document which sets out the terms of a commercial transaction agreed in principle between parties in the course of negotiations.

Heads of Terms provides evidence of serious intent and have moral force, but do not legally compel either you or the buyer to conclude the deal on those terms or even at all.

Putting together this document is often the most efficient next step. It enables you to get the principles of the sale agreed before engaging with professional advisors such as lawyers or accountants and might help keep costs down.

## MANAGING EXPECTATIONS AND NEGOTIATION

There are lots of good books on negotiation that you could read, and we do not have space here to regurgitate them all, but like any transaction, there will be some back and forth and often the devil is in the detail.

Throughout the entire process, the purchaser might try to reduce the price for this reason or that. Be prepared to come back with a good argument as to why you won't budge.

## DEAL STRUCTURING – WHAT TO EXPECT AND POTENTIAL PITFALLS

There are a number of different ways to structure a deal which will often reflect the buyer's ability to pay and your desire to get out of the business.

It may be that the purchaser just wants to buy the assets of the business, not the limited company which comes with liabilities and warranties.

When it comes to the consideration a purchaser may not want or be able to pay for the whole business on completion and may, therefore, offer to pay the consideration in portions, often referred to as "tranches".

For example, a deal could be 70% upfront with 10% after each 12 months that passes until completion, or any variation of percentage upfront and the number of years post completion.

It is riskier to leave larger amounts of the agreed consideration to be paid later, and a seller should be recompensed for this.

If you have to accept some deferred consideration, try to negotiate a higher price and an interest rate on the deferred consideration element as this is effectively a loan you have given to the purchaser and money that you can't use for another purpose.

Remember, there are tax consequences to the way deals are structured, so getting an advisor on board at the Heads of Terms stage is a clever thing to do.

## COMMENCEMENT OF DUE DILIGENCE

Once the Heads of Terms are agreed, due diligence will commence.

# WHAT IS DUE DILIGENCE AND WHY DO I NEED TO GO THROUGH IT?

Due diligence is a thorough investigation carried out by a prospective buyer, or their advisors, before signing a contract but after a formal offer has been accepted.

It is foolhardy for a purchaser to borrow money or invest capital without confirming that what they have been told they are buying is what they are getting.

It's not just an analysis of the financials, but also a review of your employer, supplier and customer contracts and lease agreements. That's why it's sensible to make sure your records are in order before starting the sale process. You don't want to find any skeletons in the cupboard that could lead to a purchaser justifiably reducing the price they pay to you.

Due diligence is a comprehensive process and also typically involves an examination of the legal structure of the business including its position regarding property, assets, staff and will flag up any potential litigation being brought against the company. Wider environmental, sector and competitor research may also be undertaken.

As a seller, it can be annoying that the process takes so long. Keep in mind that due diligence is a vital step in the buying and selling process and take comfort in the fact that this kind of in-depth examination of your business shows the potential purchaser is serious about purchasing.

It is in your interest to remain patient throughout and respond to any questions or requests in a timely and honest manner. Withholding information or being generally difficult may suggest that you have something to hide, which will not only prolong the due diligence process but may also harm your chances of completing the deal.

## WHO DOES WHAT WITH WHAT?

### Financial statements

Once you or your accountant have provided the annual accounts of the business, the purchaser will review them to confirm what you have said. They will look to see if there are any areas where the business might have unrecorded liabilities or is showing assets which do not exist.

### Employment contracts and handbooks

The purchaser may want to make some changes to the terms of your employee's contracts or handbook. They will look at what you have in place to make sure, firstly, that they are legal and, secondly, that they are able to make changes.

The more complete and consistent these documents are, the more comfortable a purchaser will feel about buying the business and the less likely you are to have further calls for a price reduction.

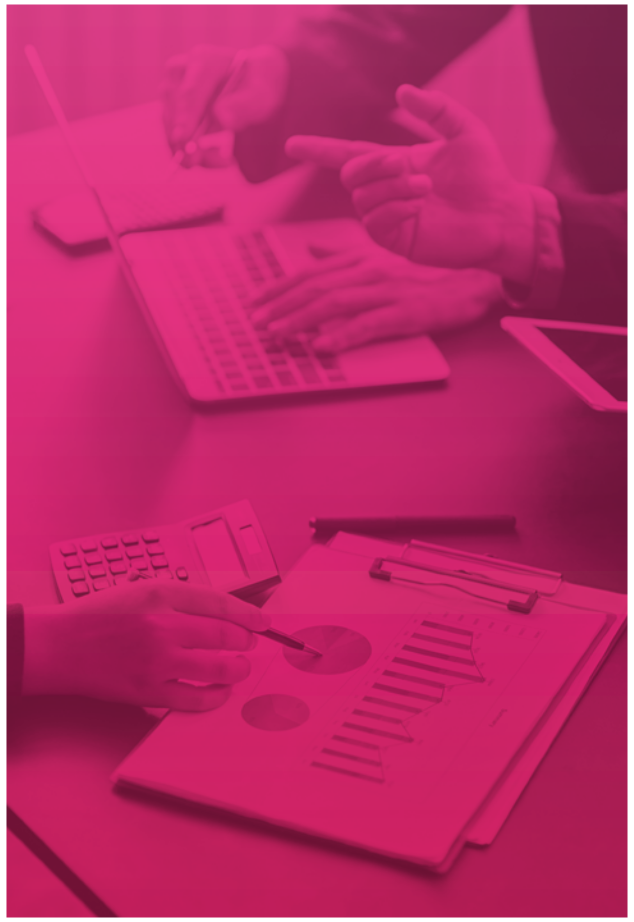
### Leases

All the future liabilities of the business premises or finance leases will be examined, so a buyer understands what they are getting themselves into.

Fairly frequently, leases for premises will have clauses about dilapidations or putting the premises back to their original state. These are costs which may not have been put in the balance sheet. If not identified at the Heads of Terms stage, a purchaser may want to bring these costs in to reduce the price, and they are very hard to quantify.

Be armed with as much information as possible about all of your contracts and obligations and be ready to negotiate if needs be.





### Customer contracts

If the 80:20 principle applies to your revenue generation, a purchaser is going to be very keen to ensure they maintain those relationships post-sale. If you do not have contracts with your customers, then expect the value of your revenue to be lower than if you did.

### Supplier contracts

Similarly, if you are dependent on certain brands or suppliers for your products or services, then the risk of losing those suppliers will be taken into account during the due diligence phase.

There may also be "change of control" clauses in contracts where customers or suppliers are allowed to renegotiate or cancel the contracts if the ownership of the business changes.

Being aware of this and tackling the issue before getting to the Heads of Terms stage is important as the buyer, if they have good advisors, will focus in on this as a means to reduce the price.

# WHAT IS A SALES AND PURCHASE AGREEMENT AND WHY DO I NEED ONE?

A SPA is a "Sales and Purchase Agreement". This is the legal contract that obligates a buyer to buy and a seller to sell. It forms the basis for the exchange of consideration, usually in the form of cash or shares.

The SPA serves as a basis for the transaction to take place, providing a framework for how it will proceed, what is included in it and, if necessary, what is excluded.

It allows the buyer and seller to negotiate and ultimately agree upon a final price and the terms of the deal. It also serves to protect both buyer and seller from unforeseen consequences of the transactions post-sale and gives clarity to everyone involved.

A good Heads of Terms will dramatically reduce the cost of the advocates in preparing the SPA.



## KEY THINGS INCLUDED IN A SPA?

**The legal titles of the buyer and seller**

Legally and from a tax point of view, it is vital to know who the legal purchaser is and who the legal seller is.

**What happens at completion**

- When and how will cash change hands
- What forms of consideration are there and when will they be received
- What practical things need to be done for:
  - o Bank account mandates and logins
  - o Accounting records
  - o Company books and records
  - o Social Security, Company Registry and the Tax Office
- How working capital is calculated and by whom

**Warranties and indemnities**

Warranties and indemnities are essentially a method of allocating risk in the sale/purchase process. They mitigate the risk for buyers that you have misrepresented your business in some way, but by disclosing information surrounding a warranty, you can speed up the sale process whilst also limiting the risk of a future claim.

In the case of a limited company, purchasers take over the existing and contingent liabilities when they buy the business, but some of these liabilities may not be obvious at the time of purchase.

For this reason, the buyer will seek warranties and/or indemnities to protect themselves, whereas, as a seller, you will want to minimise your exposure to the risk of future claims.



**Warranties**

Warranties provide the buyer with assurances about potential future outlay after the purchase has gone through. It is a written statement provided to the purchaser to back up claims you have made about the business during the sales process.

Your purchaser will request warranties covering commercial, legal and financial aspects of your business. The list can be extensive, and may include the following:

- Legal disputes
- Accounting and other financial information
- Machinery and equipment
- Employees and pensions
- Insolvency
- Intellectual Property rights
- Property and other assets
- Contracts
- Tax issues
- That the information you provided, and on which they base their decision to purchase, was accurate and up-to-date.

**Indemnities**

Indemnities help the parties deal with the unforeseen business-related issues that could arise post-sale. Indemnities offer security for the buyer from known and specific circumstances that are defined within each indemnity. They make you, the seller, liable to cover the buyer's losses in these circumstances without them having to make a claim against you.

Your purchaser may require indemnities to cover certain situations, including:

- Ongoing legal disputes with customers or clients
- Existing employee disputes/tribunals
- Litigation regarding a product
- Tax liabilities

You will want to limit the scope and extent of indemnities where possible, and ensure they relate to specific instances to reduce your potential liability.

## CLOSING THE DEAL

Getting to the wonderful moment where you close the deal can take a long time and takes more effort than you think it might.

Regular communication between all parties involved is vital to keep up momentum and sustain your desire and that of the purchaser to continue with the deal.

Similarly, the way you and your purchaser manage your advisors is key to a smooth transaction. Agreeing the outline of the deal and being clear about your expected timeframes and how the process will be managed should enable you both to be proactive in moving things forward.

# IS THERE ANYTHING ELSE TO CONSIDER?

**Funding required to deliver a successful exit**

Think about the financial budget that you will need to prepare the relevant documents, for advisors and perhaps for travel to meet advisors or buyers.

**Selection of advisers**

Take time to select the legal firm and other advisors you may want to work with. Consider not just price but how their expertise might benefit you during negotiations with the purchaser. Look at their experience in your sector and their availability to get the deal done.

**Keeping the management team on board**

If you have a management team or other key employees, you will need to be open about your desire to exit from the business. Think about how you will excite them about the possible change and see what ideas or connections they might have to help the process.

Remember, this could also be an opportunity for them to think about buying the business so, keeping the team up-to-date with progress should help with a smooth transition.

However, it is also worth considering how you would cope, and the impact it would have, if key employees left the business during the sale process. If you think this would be significant, then you need to consider proactive ways of keeping them on board.

**Continuing to deliver business performance in an exit process**

Most importantly, you need to ensure that the business continues to perform during the negotiations. The sales process can be long and time-consuming, and so it is worth reviewing who will be involved in the negotiations and who will focus on running the business. If necessary, you may need to amend roles and levels of responsibility to make sure you can deliver on all fronts.

**Developing an alternative i.e. a Plan B**

Finally, you might go through the process without finding a buyer or the right buyer. So, from the start, have an endpoint in mind, which might be a timeframe or a valuation number, so you know when to stop looking and put your energies back into running your business.




**WHETHER YOU ARE THINKING OF STARTING A COMPANY, WANT TO IMPROVE OR GROW YOUR EXISTING BUSINESS OR NEED TO MANAGE YOUR EXIT PLAN, JERSEY BUSINESS IS HERE TO HELP YOU ACHIEVE YOUR GOALS.**

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