

JR/JANUS MERCHANT BROKERS LTD.



SELLING YOUR BUSINESS An Insight into the Process

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The Sale Process

Introduction

Selling a private business is a challenging process. From the moment that owner begins to contemplate the sale to the completion of a transaction, it is a process that is fraught with emotion. The owner faces many decisions along the way, and it is not as simple as “Should I sell – yes or no?”.

Therefore we have constructed this discussion of the sale process for a private business with the objective of helping private business owners understand the whole process, and thus what to expect. While each individual situation is different, any process of selling a business will contain a majority of the concerns discussed herein.

We will discuss the process in five stages: deciding to sell, planning the sale, preparing for sale, marketing the business and completing the sale.

No doubt we are biased when we state that the most effective process to sell any business is one which is managed by an experienced professional working for an organization with the strong contacts who can identify and contact a diverse pool of potential buyers and manage the process of narrowing the prospects to the right buyer with the right offer. However, the most important consideration is that there are no guarantees at any point in the process that a deal will be completed, and thus the process should not be entered into lightly. While professional advisors take significant steps to maintain confidentiality, it cannot be guaranteed. With that risk in mind, and understanding that the process is time consuming and distracting from normal daily pursuits, a sale process should only be

undertaken when seriously interested in completing a transaction.

This information focuses on the process for privately held businesses, with family or small groups of shareholders. It does however; largely apply to public companies that choose to divest divisions or parts of their business.

The involvement of a professional M&A advisor such as ourselves is generally not undertaken until after a decision is made to sell the business. We respect however, that the process of making that decision is an integral part of the over-all process and thus we have chosen to begin this outline with some thoughts on making that decision. You will no doubt have professional advisors with whom you have long relationships. The decision and factors you weigh should be discussed with them. Different viewpoints are positive and they most likely will play a role in the process in any event.

We hope you find this outline beneficial.



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Stage 1: Deciding to Sell – Five considerations

There are many facets of the decision to sell a business. They roundly fit in the answers to the following questions:

1. Should we sell the business?
2. When should we sell?
3. Who are the potential buyers?
4. How much of the equity should we sell? and
5. How much will we get for the business?

Should we sell the Business? What are an owner's options?

Generally speaking the business owner has four options. The first option, obviously, is to do nothing. Maintain the ownership status quo and continue to operate the business – “business as usual”. This is in most cases a perfectly logical conclusion; however, it should not be a conclusion arrived at by default because one does not appropriately consider the other four options.

The second option is to hire professional management and transition out of operating the business but maintain ownership. This option works well in situations where the business has existing management that can step up, and an owner who is willing to allow management to run the business. It is a new and difficult balance to create, though. Management must be up to the task and respect the needs and desires of the owners and owners must allow the managers to manage.

In many cases, transition out of operating the business come in combination with a transfer of the business to

the next generation, the third option. The intergenerational management transition and/or ownership transition and should be planned and executed carefully with professional advice. JR Janus does not offer these services.

The fourth option is to sell the Business to management or a third party. This is a difficult decision for most private business owners. Some see it as ‘selling out’ and ‘the business will never be the same’. Some see it more positively of creating liquidity out of years work and the logical progression for the business.

When should we sell? What are the normal reasons for selling?

The decision regarding the time to sell a business is a convergence of personal and business factors.

From a personal perspective, the owner / manager of a private business must be ready to depart the business. Signs of readiness are when it's no longer fun or when the business puts greater demands on an owner's time and energy than they want to commit. The urge to sell is linked to a desire to move on.

Therefore, the most frequent reason for the sale is to realize capital for financial security of the owners. This makes the absolute best time to sell when the value of the business has reached a premium. Maximum valuation is driven by a combination of market and business performance factors. Sometimes, the ‘market’ is right for a particular type of business and sometimes the business is at peak performance and thus very attractive. In rare cases do both converge.



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From a business perspective, a sale may be considered when the industry dynamics change, there is a technology impact or competitive pressures that require a response from the company that the owners may not wish to undertake.

These examples all indicate analysis and a planned response by the owner to a particular situation. This is no doubt the proper situation. Unfortunately many times this is not the case. Sometimes the business is under-performing well and must be sold, either by the owner's determination or by the creditors of the business. Periodically the owner simply fails to plan for his or her own transition out of the business and either death or ill health precipitates the decision. In some cases, plans to transition the business to the next generation either do not materialize or are reconsidered by one side or the other. In many cases, the sale is driven by the needs of one or a small group of shareholders to exit for personal reasons or because of a breakdown in partner relations.

In all cases, it is best to have a clear understanding of why the sale is being made; the best time to sell is when there is no need to. Do not be coy about the reasons for sale; it will usually be one of the first questions from a potential purchaser, so have the answer ready. There are an ever growing group of professionals ready to assist and advise the owner when making these decisions, whether you choose to work with a professional or speak with a trusted friend – take some advice.

In summary, planned exit through careful monitoring of the relevant factors and having a preparedness to adjust plans as the situation develops are the best method for optimizing value.

Exit when the owner's decision is by choice, not by necessity. Either control the situation or it will ultimately control you.

Who are the potential buyers?

Outside of ownership succession within the family, there are three potential buyer groups who should be addressed. The first is management. In many cases owners determine that the management in place are the most logical and desirable buyer. In this case negotiations are generally positive and straight forward. If there is a consideration to sell the business to the management (or employees) it should be dealt with first, prior to consideration of discussions with other buyers. Outside buyers do not wish to 'compete' with management to buy the business as it raises concerns both with the process as well as the ability to work together after the process is completed.

The next buyer group is 'strategic buyers', or companies with commercial activities similar to (or complementary to) the business for sale who may realize a benefit in combining businesses. Strategic buyers may be local competitors, international competitors or complementary businesses. 'Complementary' may take on several forms; the technology may be complementary, or the channels of distribution, or



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there may be manufacturing or other operational synergies. The business may also represent an opportunity for vertical integration for another company. Historically, these buyers have been considered to be the highest value, as the expectation is that by virtue of their existing operations they will reduce costs within the acquired business and thus have higher profits.

Financial buyers are local and international private equity groups, Insurance companies, pension-funds, and other financial institutions. In each case they have a pool of money that has been provided by various investors with the purpose of making private investments. Most of these buyers will look to own a

particular business for between three and seven years prior to resale. They wish to grow the business, perhaps buy others and combine them and then resell for a profit. These buyers are professional buyers and sellers looking to make money for their investors and have no long term desire to own any particular business. They are currently a valuable pool of buyers as they have deep resources and can afford to pay well for businesses, they may see opportunities to combine with existing businesses they own or plan to seek out similar businesses, and thus can foresee potential synergies the same as a strategic buyer.

The charts below indicate the pros and cons of strategic versus financial buyers:

	STRATEGIC	FINANCIAL
PROS	<ul style="list-style-type: none"> ▪ Synergy may translate to higher price ▪ No learning curve, regarding due diligence ▪ Tax advantage in certain circumstances ▪ Customer concentration less of an issue 	<ul style="list-style-type: none"> ▪ Strong demand due to high cash on hand ▪ Usually keep mgmt / employees in place, with equity ▪ Avoids cultural conflict ▪ Liquidity
CONS	<ul style="list-style-type: none"> ▪ Employee terminations ▪ Cultural conflicts ▪ May offer stock as consideration (liquidity discount) ▪ Different terms & conditions of employment for staff. (Unionized, compensation, HR benefits, etc.) ▪ Sharing competitive information with competitors who may not be the ultimate buyer 	<ul style="list-style-type: none"> ▪ Higher return requirements may reduce price ▪ Often “lock in” key shareholders with earn-out ▪ Limited opportunity for tax advantage ▪ Customer concentration a major negative



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How much Equity should we sell?

Most often people think about the sale of a business in 'all or nothing' terms. However, there are alternative strategies available. Owners may consider selling some of the equity now and some later, or one can plan to sell regular amounts of equity over time at a predetermined rate and formula for value.

In most cases, the owner chooses to sell the entire business because they wish to make a clean break. Often, it is assumed that this will result in the highest value as the purchaser gains full control of the business immediately, and it is assumed this means a strategic purchaser. Often in negotiations the seller does not view the risks of future performance of the business in the same light as the purchaser. Why should they, they live with those risks each day and are used to them. In the situation where the seller sees a very bright future and thus a higher value, an earn-out (buy over time) scenario is a means to bridge the gap. If the business performs the way the seller feels it will, the purchaser can afford to pay a higher price, and he has less risk in the value he will ultimately pay relative to the return he will make. In the middle of these two extremes is a partial sale. In some cases this is considered a good thing and the seller will continue with the business through some period to ensure that the purchaser understands the business completely prior to full ownership. In the case of a strategic buyer, this might allow two businesses to help each other commercially and thus have additional benefits to the purchaser. In most cases, this 'partial sale' strategy is used by a financial buyer like a private equity or venture capital fund. In that situation, the decision is that they may buy a portion of the business now, assist management

to grow the business often through acquisition, and create an entity that both may exit later at a premium to the original investment. In this case, both parties win.

Each of these strategies contains its own risks. Regardless of the proportion of equity being sold the seller must consider the representations and warranties they will make to the purchaser regarding the business. (i.e. yes we own the rights to these products and brands) and the indemnity exposure they have in the case that the purchaser makes a claim against one of those representations or warranties. In the case of a full sale, a portion of the purchase price will most likely be held in escrow against the potential of claims. When selling a portion of the equity the seller has an additional risk that certain things must happen to reach the pay-out they anticipate. The business will no longer be under full control and they must trust that they will be able to make those things happen. Often the basic principle of no longer being in full control of the business prevents sellers from considering these types of transactions. This is neither good nor bad as ultimately the seller must know what situation he is willingly to accept, and can function within.

How much should we get for the business?

Ultimately, the value of any business is that which a willing purchaser is prepared to pay a willing vendor. Therefore, the financial aspects of business valuation is approached from two perspectives - market norms and specific financial valuation.

Market norms is simply a review of what similar businesses have recently sold for and the valuation of



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public companies in similar businesses. The valuator will consider multiples of EBITDA, EBIT and Book Value; and the goodwill component of the price for recent transactions. Public company valuations will be adjusted (private companies sell for less) and with this data a range of value is constructed.

The financial valuation specific to the individual company itself is completed using a Discounted Cash Flow approach. Historic and when appropriate, projected income statements for the overall business and major product lines are examined. The cash flow analysis on a stand-alone basis, and also as if the business were in the hands of a full synergy buyer who would be in a position to create immediate opportunities, cut costs, and thereby capture a significant portion of the gross margin as profit are considered. This analysis will present another range of value to be considered.

Where a particular business falls within these value ranges is based on the 'beyond the numbers' evaluation of the business. Every buyer puts a great deal of emphasis on strategic analysis. The valuator must have a clear understanding of the market, competition, the focus of the business, and any proprietary advantages including technology, customer relationships, intellectual property, as well as human and physical resources. However, as this is a largely subjective exercise, opinions regarding each factor will vary. Therefore, in comparing a single business to the market norms, one must consider the strategic factors and estimate how a prudent buyer will view them. Then each individual buyer will factor in their own 'synergies'

in their own estimation of value. Buyers do not want to pay sellers for their synergies; that is evident. However, when faced with a competitive process the strategic desirability of a business leads many of them to pay a higher price than the business would otherwise be worth and accept that they must attain those synergies to ensure that the purchase is a good investment. History has many stories where this does not work out for the buyer. Therefore, as a seller it is unwise to expect that someone will pay more for your business than it 'should' be worth. As a general rule of thumb, the more you hear yourself say "the purchaser should be able to..." The more your valuation is tending towards being unrealistic.

Nevertheless, sellers routinely state "business x sold for 10X EBITDA, therefore my business should be worth x". Often that is followed by "and the buyer should be able to make these improvements (that I have not made) and that should mean it's worth double "x". We cite the following example. Consider two companies each having the same relative sales and profits, trading within the same sector. One company is managed by a controlling owner, with little managerial support. Their sales have been steady or in slight decline recently and their products and brands are 'tired' in the market. The second company is managed by an effective team of managers and their sales have grown 20% per year over time and their brands and products are attractive to customers and 'hot' in the market. Are these two companies worth the same value? Even if their relative sales and profits are comparable at this point in time, the businesses are not of equal value.



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In most cases, the difference will not be as extreme as in our example. However, without a doubt each company will have a different mix of strategic position, intellectual property, management strength and market opportunities for their products and services. All of these factors will influence the value a buyer may be willing to pay, and all will be subjectively judged by each buyer.

Stage 2: Planning the Sale

In most cases, the seller will look to a professional M&A advisor for assistance in deciding whether to sell 100% of the equity or a partial sale, and to help determine the value of the business. Indeed, agreement between the advisor and the seller regarding the expected value of the business is critical to a cohesive process. If the advisor does not feel that the value anticipated by the seller is realistic they should not continue with the engagement. Trying to 'get lucky' or expecting that the seller will 'see the light' when more realistic offers arrive sets the stage for conflict down the road that will not assist the process.

Selecting an M&A Advisor

Many business owners feel that they can manage the sale of their business without an M&A Advisor. In most cases, this comes from a belief that they 'already know' who the purchaser will be and that they are competent negotiators who can handle their own negotiations. With the advice of a competent lawyer and/or accountant to help guide the process they can effect the transaction without the expense of an M&A advisor. Indeed many businesses are successfully sold without and Advisor. The question

that will always remain is "was it the best opportunity?" It may be, but one does not wish to be penny wise and pound foolish.

Research conducted by Ernst & Young in 2005 indicates that 80% of respondents who did not use an M&A Advisor contacted less than 10 potential purchasers while only 52% of those companies with advisors contacted less than 10 potential purchasers. The point here is that competition breeds value, and having an advisor who can bring more potential buyers into the process will ensure that optimum value is reached, regardless of where the business is sold to the 'expected purchaser' or not.

The same research indicates that sellers viewed finding potential buyers, developing a strategy to approach the market and acting as a sounding board for management as the most important factors in choosing whether to hire and advisor. In addition they cited existing/past relationships, reputation and experience as the most significant factors in choosing the advisor.

We feel that these reflect the correct concerns. The personal chemistry that must exist between advisor and principal is important as frequently a sale exercise will involve stressful negotiations with the need to make important decisions quickly. It is important that a cohesive team is presented to a potential purchaser.

In addition an advisor with long experience in managing transactions and significant resources to assist in the identification of potential buyers both domestically and around the world, are very important factors to consider. When considering



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advisors, one should ask their relevant experience and expertise within the sector.

In summary the advisor's role will be:

- to prepare the confidential information memorandum
- to develop the marketing strategy
- to identify appropriate purchasers
- to obtain confidentiality agreements from potential purchasers
- to enter into negotiations with purchasers on behalf of its client

Most advisors will propose a split fee engagement. They will charge a retainer fee for preparation to market the business and then a success fee which is a percentage of the value received. This structure accomplishes two objectives. The seller knows that the advisor is motivated to succeed as the majority of the compensation is success based. The advisor must believe in their potential for success. The advisor knows that the seller is serious about completing a transaction as they have invested in the process. Care should be taken in fee negotiations with advisors to ensure that the agreement covers support for the entire process, the terms are fair and that the advisor will receive fees only from the seller, unless agreed. The opportunity to complete the job properly and earn their fee should exist for the advisor and the opportunity to exit a bad relationship should exist for the seller.

Finally, honesty and full disclosure in the relationship between client and advisor are critical. The seller

should always give the full facts to the advisor, often sellers try and "sell the business" to their own advisors. The advisor cannot focus on reading the potential purchasers if he or she has to worry about what his client is telling or not telling him.

The Transaction Team

All through the process the owner receives advice from several different advisors who together form the Transaction Team. Each advisor has a defined role, and the M&A advisor acts as the quarterback of the process and ensures that advisors are working effectively together. That notwithstanding, the owner continues to make all decisions after consideration of advice from all advisors and no advisor should seek to usurp any other advisor in the process. Any advisor who tries to exercise too much control, or who attempts to provide advice outside of his or her mandate, should be set straight by the owner.

The Accounting advisor has several roles to play in the process. They will provide financial information and assist in understanding of financial performance during due diligence. Accountants generally discuss tax returns and position with purchasers and assist in the understanding of the more technical aspects of the financial position. In addition, the accounting firm generally provides tax advice to the seller and assists in structuring the transaction and documents to ensure the most effective taxation of the transaction.

The legal advisor generally gets very involved after a 'business deal' is reached, assists with development



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of a letter of intent and naturally the purchase and sale agreements and any supplementary agreements. The legal advisor should specifically advise on representations and warranties that the seller will make in the agreement and ensure that the risk of those representations and warranties is appropriate. Naturally the lawyer provides the legal records of the business; the minute book and the like.

The seller often includes an insurance consultant as a member of the transaction team. This advisor can assist in minimizing the risk of the transaction to the seller through certain insurance products such as representations and warranties insurance, key man insurance on new owners (to ensure cash is available for any debts or obligations that are outstanding after closing).

In addition, the purchaser or the seller may engage other specific advisors including environmental consultants to assess risk of environmental hazards, HR consultants to review benefit plans or assess culture and to help with integration planning.

The M&A advisor should be charged with ensuring that the information from one source reaches the destination and ensure that the client has made informed decisions on how to proceed.

Pre-sale Grooming

In order to ensure the best result from a sale process the seller should spend the appropriate effort up front to ensure that the business is 'ready' to be sold. The following are some things to consider.

Review the structure of the business to organize and simplify financial and ownership structures. Give thought to the status of major agreements including customer agreements, collective bargaining, leases and supply contracts. It will be important to demonstrate that the business is in a position to operate effectively and is not unduly restricted.

Ensure quality of assets by cleaning up inventory and receivables, continue sustaining CAPEX. and maintaining regular maintenance routines. The seller should ensure that there are no redundant assets and/or personal assets in the business that should be removed.

Review the business systems including financial reporting where an audit is preferred and independently reviewed statements are a minimum. Ensure that you can demonstrate that adequate management systems, controls and quality assurance are in place.

The seller should consider any disputes and contingencies including tax risks and legal challenges or law suits, environmental issues, trademark and patent registrations or challenges or other regulatory issues. It is better to deal with these prior to discussions than having to explain your view of the potential threat to the business.

Many businesses have a portion of their goodwill locked up in the form of the owner's experience. The seller needs to be committed to the process of transferring that goodwill to a purchaser.



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Other Objectives

In many cases the owners of the business may have objectives other than maximization of the purchase price. Some owners wish to do their best to ensure that employment is maintained, that operations are not transferred to other facilities of the acquirer or that the business continues under the same name. The seller may wish to maintain ownership of facilities or may wish to sell them with the business. They may wish to have a long transition out of the business or they may wish to leave on closing. These other objectives risk limiting the value of the business that someone is willing to pay. They should be discussed and understood so that when competing offers are received, they may be evaluated in the context of all objectives, not just price.

Stage 3: Preparation for the Sale

During preparation for the sale process three tasks are being completed. First, the advisor conducts market research both to understand the company's position in the industry as well as to identify potential buyers. The second task is the financial analysis and development of the Information Memorandum to be provided to potential purchasers. Third is the development of a strategy for contacting potential buyers and managing the process.

Market Research

In the past, it has been a standard assumption that strategic buyers (see above) represented the highest potential for value. However, the overhang of investment capital today with financial buyers,

particularly Private Equity firms, is substantial. They may be induced to pay even more than the strategic buyer.

We tap our clients' knowledge, our own domestic knowledge and research capabilities and the M&A International network to identify participants directly involved in the subject industry, in related fields, and financial buyers. In today's shrinking global and world trade environment, the right buyer is as likely to be across the ocean as around the block.

This research dovetails with the market research required to understand and articulate the market in which the company operates in the Information Memorandum.

The Information Memorandum

Prospective buyers will receive a general description of the opportunity. This summary document has no company name associated with it and is generally limited to one or two pages. In order to proceed further, each must execute a Confidentiality Agreement and provide evidence of financial capability before obtaining the detailed Confidential Information Memorandum.

The Confidential Information Memorandum is provided to assist potential purchasers to decide whether or not the company is a suitable acquisition target. The Confidential Information Memorandum is a sales tool and while it needs to be accurate, the intent is to put the 'best foot forward' for the business. This document is not a prospectus and does not get subjected to the same legal scrutiny as a



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public prospectus. A typical Information Memorandum would include the following:

Section	Purpose
Executive Summary	- for the chief executive to make an initial assessment
Key Investment Considerations	- the key selling points
History of the Business	- background information
Operations	- explanation of what it does and how it does it
Markets and competition	- external factors
Financial	- a summary and explanation of underlying performance
Management and Employees	- including information on management control
Property	- a summary of property matters
Appendices	- including product/service literature, organizational charts

The same information is not always given to all purchasers. In competitively sensitive situations information may be withheld early in discussions, this is a judgment made by the owner and the advisor in each situation. It is not normal practice to advertise a price in the document or as a part of the process. The intention is to let the market determine value. The financial analysis put forward is 'normalized' to adjust for one-time events and other revenue and expenses that will not be incurred by new owners, including any owner's personal expenses and normalization of owners salaries.

While this document is primarily a marketing piece, it should not contain hype or unrealistic or

unsubstantiated claims. If a financial forecast is provided it should be reasonable and supportable.

Marketing Strategy

Using the buyer research conducted earlier, and with substantial input from the company and the owner, a complete buyer list is developed along with their different acquisition criteria and financial capability. The comprehensive candidate list is then prioritized to reflect the perceptions as to the likelihood of a buyer closing at a premium or at minimum the price matching the owner's requirements.



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The advisor and client try to balance the desirability of casting a wide net with the need to preserve confidentiality, while creating competition amongst buyers. Within M&A International, information regarding the company is shared within the group along with potential buyer lists. Individual members have the opportunity to add additional potential buyers to the list, who are not contacted until approval is received. The marketing strategy then determines which buyers will be contacted first and by whom and how long prior to contacting secondary buyers. Some commercially sensitive buyers may not be contacted; contact may be made on a more controlled basis (i.e. no name) or they may have contact deferred.

Stage 4: Marketing the Business

Having analyzed the business, and why it is being sold, determining who might wish to purchase it, and how they might be identified, becomes a more straightforward exercise.

Identifying and Contacting Buyers

It is generally agreed that advertising the business being for sale is seen as the sign of a weakness and desperation. Therefore, the M&A advisor-led anonymous approach to 20 or 30 buyers generally leads to a manageable short list of interested parties.

No information is shared until a Confidentiality Agreement is executed. In the rare case when a buyer refuses to sign such an agreement, we recommend the information not be provided.

Confidentiality Agreements should be as short as possible while protecting the needs of the company. Often these agreements deal with restrictions on solicitation of employees by either party, and restrictions on disclosure that even discussions are taking place. Generally speaking, the larger or more experienced the potential purchaser, the more reluctant to sign standard confidentiality letters. Legal advice might be taken at this stage and the process often takes longer and more energy than anticipated.

Once interested parties have been identified and contacted, the negotiation process has effectively started. The manner in which information is presented at this early stage assists in getting through the initial hoops, to the final important decision making stage, which is the objective of the exercise.

After receipt of the Information Memorandum, a good advisor will answer questions from potential buyers by working closely with the client. Information of a proprietary or highly competitive nature may be withheld, but to the degree possible, provide what each buyer requires to facilitate their valuation. It is better to present information effectively in a clear and concise manner, being accurate and truthful, while at the same time only providing the minimum information that is required.

While there are many different ways to manage a process, they are all variants on a theme. As best possible, try to get multiple interested parties to feel some time pressure to make their best offer to acquire the business. In the best case for the seller, if



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it is clear that there is a high level of serious interest, the owner may decide to run a controlled auction with a short-list of serious buyers.

Alternatively, the owner may require indicative bids from which the seriousness of buyers' intent can be ascertained, before creating a short-list. With either route, handling this process firmly, and with authority, will enable the pace to be dictated by the owner when engaging in negotiations, and enable the direction that the negotiations take to be more easily guided. One of the major contributions of the M&A advisor will be their expertise and judgment in guiding this part of the process.

The Negotiation Process

It is generally accepted that understanding your opponent's requirements assists in creating an agreement that satisfies both parties. Therefore, a good advisor will spend time to understand the potential purchaser's limitations and needs and convey to them those things that are important to the seller. This process allows the advisor to help create a solution that best fits and gains support from both sides.

Inevitably, one of those hurdles is price. There are many ways to bridge these differences, the most obvious being payment over time. As discussed above, purchasers will wish to make those payments contingent on performance as much as possible. Sellers wish to make those payments firm. In that case, where the payment becomes a debt of the purchaser, security on that debt becomes a significant

discussion point. During these discussions the skill and experience of the advisor team becomes significant in assisting the seller to manage away from pitfalls and minimize the risk of future payment. The final negotiation stage will be intense periods and it is essential that the team; the M&A advisor, lawyers, accountants and any other specialist professional advisor, are working together to provide good advice to the seller.

During this process, the M&A advisor acts as the quarterback for discussions, providing advice to the seller and representing the seller in discussions with the buyer but also ensuring that information flows freely between the lawyer(s) and accountant(s) and the client so that the other professionals may effectively provide their advice.

It is normal practice for the business terms of any transaction to be documented and agreed. This non-binding document may be a "Letter of Intent" or a "Term Sheet", dependent upon the desire of the parties to agree on more or less issues. A Letter of Intent is generally a more complete document covering all of the important points and highlight areas for further review. It is often appropriate to agree an exclusivity period at this stage and sometimes a good-faith deposit is requested of the purchaser.

Do not sign a letter of intent lightly. It is an important document which will be referred to while the contract is being prepared and negotiated. Clarity on 'the business deal' allows focus to be placed on the legal and risk items that surround the business



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deal and those fringe items that have not yet been considered. At this point, lawyers become more involved, due diligence accelerates and negotiations of financing arrangements for the purchaser are commenced. The cost of the process begins to mount for each side; therefore it is advisable to ensure that a basic agreement on terms of the transaction is in place.

Stage 5: Completing the Sale

Due Diligence

Once a letter of intent is signed, and discussions have focused on one party, the purchaser will begin serious due diligence. Dependent upon the agreement between the parties, the lawyers will commence documenting the transaction while due diligence continues. Often the agreement of purchase and sale is signed and the transaction closing is contingent on some final aspects of due diligence. Due diligence is an engrossing and extensive exercise. Standard due diligence questionnaires can run in excess of 10 pages or more. The purchaser will review financial books and records, legal records, outstanding contracts, asset lists, employee records and inquire extensively about commercial activities, future prospects, new products and factory operation and quality records. In summary, the purchaser will seek to review as much information as possible about all aspects of the business to ensure that they understand what they are purchasing and that it is what they anticipated.

Completing the Sale

Having been through all of this effort, why do some sales complete and some do not?

There is always a tendency for owners to feel that once the Letter of Intent is signed the deal is done. This is not correct, and often the stage between agreeing to the business terms and completion is the hardest part of the sale.

The purchaser has two mandates; ensure that they understand the business as fully as possible and that their assumptions are correct and, minimize the risk of future loss or lack of profitability.

As issues arise in due diligence, and there are always issues, they get reflected in the agreement as a form of risk minimization. Therefore, a challenge to a patent or a brand however obtuse, not only becomes a discussion of the enforceability of the patent or the ownership of the brand, but a discussion of who will defend the challenge if it ever materializes and who will bear the cost of the defense and any loss that results. The agreement is then translated into the agreement being developed, and wording goes back and forth between lawyers each trying to restrict or expand upon their client's ability to place the liability with the other. Often times these issues seem like very remote possibilities to the seller, and yet the prospect of accepting the liability is no more appealing. It is hard to appreciate that just because I don't think it will happen that the other side will



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agree to pay for it if it does. Complicating this is the fact that more people become involved, more experts advisors and each has an obligation to identify risks. The discussion becomes focused on negatives – this could happen and this might happen. Each of the buyer and the seller must maintain their commitment to getting the deal done and working through issues, or it will not close. In the end, if the volume of issues is greater than the commitment to work through them, or if any of the issues result in an impasse, the deal will not close. This brings us all the way back to planning the sale, where we stated that identification of contingent liabilities and dealing with them prior to being forced to deal with them during an attempt to complete a deal, will assist in the ability to complete a transaction.

Regardless of this exercise the owner should expect issues to arise which he has not anticipated, and be prepared to make compromises in order to find solutions. The seller must remain flexible and open to consideration of alternatives, but should consider the impact on the deal closely. The letter of intent outlines the business deal, stick to it unless there is a very compelling reason not to. The seller should ensure that legal advisors are not renegotiating issues already agreed by principals or spending excessive time on minor points which can be readily agreed

between principals. For all of the participants at this stage, focus and will to complete the task will be required for a successful outcome.

Summary

In deciding if and when to sell a business, the following principles should apply:

- Sell when you want to, not have to
- Sell when business is good and the buyer can see opportunity
- Set reasonable, objective goals
- Plan in advance, as much as possible
- Keep managements' focus on business results
- Retain experienced professionals to manage the process and provide expertise and advice
- After agreements are reached, and you think you have negotiated 'the deal', there is often much left to do. Even when negotiating in the best of faith, differences arise. You must remain open, flexible and determined to complete the transaction or the deal will not close.



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