

EXIT STRATEGIES

Selling a private company —preparing for the sale

By Howard E. Johnson and Rakesh Jain

PEOPLE OFTEN FORGET HOW IMPORTANT pre-sale planning and preparation are when selling a private company.

Whether a business owner is contemplating a transition of the business to family members, a sale to management, or selling to a third-party buyer, adequate planning and preparation are essential to ensure that their personal and financial objectives are met.

Ideally, pre-sale planning and preparation should commence two or more years prior to the time that a sale of the business is contemplated. This is because many of the initiatives take time to implement or to ensure that the benefits are fully realized. Even for those business owners who are not contemplating a sale in the near future, preparing for an eventual sale is prudent, in case of an unsolicited offer or a sudden change in circumstances (e.g. health issues) that dictate the need for a sale.

TIMING OF THE SALE

You can never determine the ideal time to sell a company with absolute certainty. Important factors to consider include the owner's personal and financial situation, the company's recent and prospective operating performance and general economic and industry conditions. From a conceptual standpoint, companies normally fetch higher transaction prices and better deal terms where they have a demonstrated history of

revenue and earnings growth, combined with realistic expectations that growth will continue.

INCOME TAX AND ESTATE PLANNING

Business owners can realize considerable upside where the income-tax burden on a sale is reduced. In this regard, the Canadian Income Tax Act offers business owners legitimate ways for reducing or deferring income taxes on a sale of their business. One example is the lifetime capital gains exemption, which eliminates income taxes on the first \$750,000 of capital gains income, when you meet certain criteria. In some cases, you can multiply this exemption among several family members.

FINANCIAL RESTRUCTURING

The price paid for a private company often is significantly influenced by its most recent financial results, such as its trailing EBITDA (earnings before interest, taxes, depreciation and amortization). Therefore, business owners often benefit to the extent that they work to increase the EBITDA of their company in the years prior to a sale.

Managing the balance sheet can also deliver incremental value to the seller. By controlling accounts receivable, inventories and other assets, business owners can enjoy a dual benefit in terms of improved cash flows and being better able to meet working

capital targets that are stipulated upon the closing of a transaction.

OPERATIONAL INITIATIVES

Business owners should strive to make their company attractive to prospective buyers from an operational standpoint. This means having a sustainable competitive advantage and organizing the affairs of the company to reduce transitional risk. For example, key personnel should enter into employment contracts to decrease the risk that they may solicit the company's customers in the event that they leave.

Operational initiatives also include relatively minor items such as ensuring that the company's machinery and equipment are in good working order and keeping the company's website up to date.

ALIGNING THE RIGHT TEAM

Business owners should obtain sound, objective professional advice to assist them in preparing their company for sale, including legal, income tax and financial advice, plus experienced transaction intermediaries. The right advisors can prove highly beneficial in enhancing shareholder value by improving the price and terms of the deal, and reducing the overall tax burden. <<<