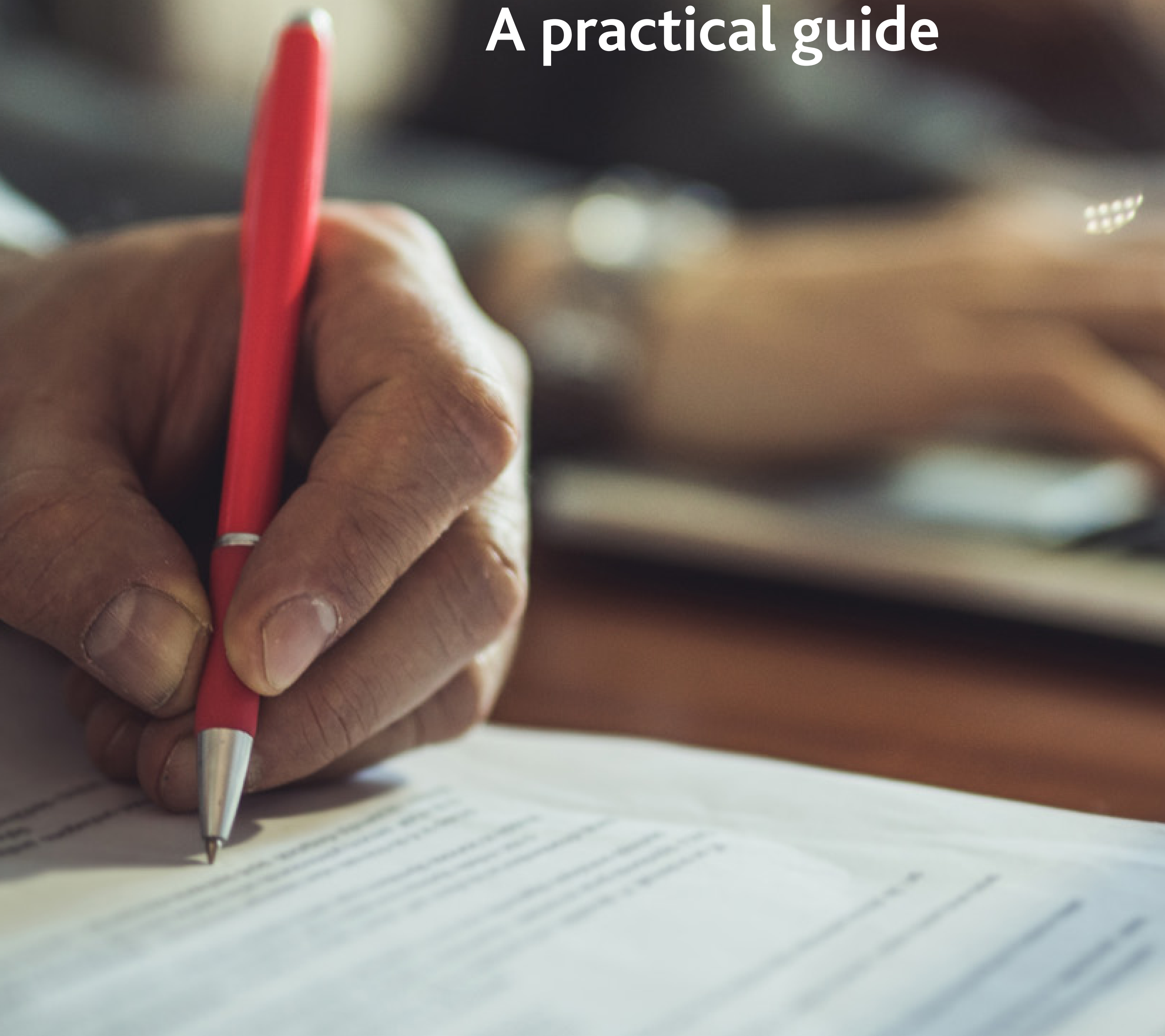
BDO

IDEAS | PEOPLE | TRUST

Selling your business: A practical guide



BB csm
30 kd
A
STREAM A
M
X
236 pt
H6 csm
CODE ID 032/43
ENCRYPTION STS
PRIVACY KEY
ENCRYPTION STS
S-PIN
S-PIN
DIM
S-PIN
WEIGHTS
R7

CONTENTS

Guide to selling your business

INTRODUCTION ______ **05**

Preparing your business for sale ______ **06**

The transaction process ______ **10**

The structured sale process ______ **12**

Is your business ready to manage the process? ______ **13**

Structuring the sale ______ **14**

Preparing an information memorandum ______ **16**

Should you approach one buyer or several? ______ **19**

Handling meetings, offers, and negotiations ______ **20**

Indicative offers, first-round negotiations, and meetings ______ **21**

Final offers and letters of intent ______ **22**

Introduction

Selling your business or practice can be both exciting and bittersweet because of all the time and hard work you put in building your team, a customer base, and growing the business. Once you have begun thinking about selling or someone approaches you with an offer, the whole process can be overwhelming. But with a plan and the right people in place to help you every step of the way, selling your business can be less stressful.

You may want to sell in order to retire or because you don't have a succession plan. Also, there are many exit options available to you. For example, a sale could be to a strategic buyer or your management team.

The most important thing for owners who are thinking of selling their business is to start preparing. Planning ahead (at least two years in advance) will make the process much easier. It also helps to have a team of seasoned professionals by your side to help along the way.

Preparing your business for sale

If you are considering the sale of your business in the near future, you may be able to enhance its value by preparing it for sale now.

The objective is not just cosmetic enhancement but both structural and operational change depending on the situation and the value it can create. Some of the changes required can involve considerable effort and discipline and may not be capable of being completed in the short term.

There can be different tax implications depending on whether it's a sale of shares or assets. For instance, getting ready for sale may reduce the overall tax burden by accessing the 50% Capital Gains Tax (CGT) concession, and/or small business CGT concessions – subject to satisfying certain criteria.

Another key tax item to consider during a divestment process is the tax efficient repatriation of any excess cash funds in the business.

Not all private companies require such preparation. The relationship between effort and reward should be your guide. An adviser will include general comments, but these are not a substitute for discussing your own situation more fully with them if you decide to proceed with selling your business. An adviser can help you complete a review of your current business to help you identify quick wins that, if implemented, may significantly enhance the attractiveness of your business to potential purchasers.

However, a buyer's due diligence will almost certainly discover any quick fixes that are unsustainable—particularly those relating to revenue and profit margins. There is not an advantage in presenting a great-looking company to a buyer when it becomes evident during the due diligence process that the presented information or performance is not sustainable.

Planning ahead can reduce or eliminate the amount of tax you pay on the sale of your business.

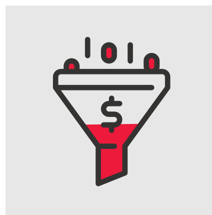
An adviser will provide guidance on key valuation drivers and a potential value range that the market may place on your business. As you are preparing for a sale, these drivers offer areas for evaluation from an operational perspective:

MANAGEMENT

If you're heavily involved in the day-to-day running of the business, the purchaser may be keen to retain your services for a period after the sale. Depending on your personal position, this may be something you wish to avoid.

Where possible, developing a sound management team and having a succession team in place for key positions can greatly enhance the value of a private company. It helps to demonstrate that you're not critical to the business and it reduces the buyer's investment risk.

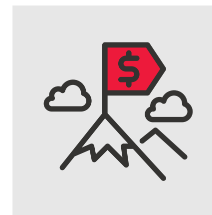
PROFITABILITY



Increasing sales and margins as well as controlling overhead spending before entering into a transaction are important and desirable. It's likely that this is exactly what you're already doing in the normal course of running your business.

Easy solutions are rare and often need to be viewed with caution. You should attempt to capitalise on opportunities that exist to improve the profitability of your business.

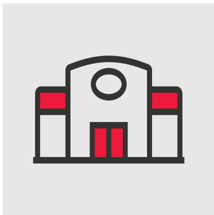
CAPITAL EXPENDITURES



If you're considering a sale, deciding whether to incur significant capital expenditures in the run up to a sale is always difficult. A buyer will consider the quality of assets when deciding how much it thinks the business is worth. If the business has been run to maximise cash and there's been underinvestment in capital and operational resources, a sensible purchaser will focus on what remedial investment is required and factor this into its assessment of the value of the business.

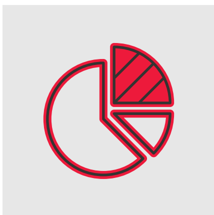
In most cases, it's sensible to continue investing in your existing business as though you were going to continue running it. However, it's also often prudent to avoid major capital expenditures on new projects leading up to a sale as it can introduce unnecessary risks for the buyer.

NON-RECURRING EXPENDITURES



Identifying non-recurring expenditures is a valuable exercise. These expenditures may include exceptional owner's expenses and pay, and one-off expenditures, such as the costs of relocation or unusual disruption to normal business.

FORECASTS



Most buyers will want to understand your forecasts for the business over the next few years. Credible budgets and longer-range forecasts can enhance value enormously.

They should be underpinned by reasoned assumptions and be prepared on a bottom-up basis with the full involvement of the management team.

LEGAL

Your buyer's lawyers will conduct extensive legal due diligence, including a review of all material contracts and title to assets. A common issue for entrepreneurially managed businesses is the absence of contracts or documentation where they might reasonably be expected to exist. This issue may become acute in relation to a key employee, customer or supplier, intellectual property or asset ownership. Where practical you should ensure this is addressed before sale.

The sale and purchase contract will contain extensive warranties and indemnities you must give as the seller. Having a good understanding of the state of the company and its tax, financial, environmental, customer and supplier relationships and other legal affairs is therefore, imperative.

WORKING CAPITAL

Working capital (current assets minus current liabilities) is required for the buyer so they can continue to run the operation once the business is sold. Calculating working capital on the last day of every month for one year and averaging it out over a year is typically fair for both the buyer and seller.

Working capital is often included in the sale price of your business. Sellers shouldn't expect to be paid extra for these assets although there usually is special treatment for cash. There are often opportunities to lower the amount of working capital in the business and take more cash out of the business. However, often there needs to be a track record of being able to operate the business at lower working capital levels for at least one year.

The transaction process

The sale of your business is the ultimate reward for the risk and the effort that you have put into your business over many years.

Key objectives of the sale process may vary from seller to seller. However, they almost always include maximising the sale price and finding the right new home for the employees and customers. Achieving a seller's objectives requires a significant amount of research and leveraging of information, rigorous planning, and maintaining a high degree of control over the process as well as strategic negotiation skills.

The structured sale process is time consuming. Having advisers you can trust to help you achieve your objectives is vital. They can carry the administrative burden and manage your controlled exit so you can continue to run the business. This will alleviate much of the distraction that comes with an important transaction while ensuring that your other goals and objectives for the sale transaction are met.

The structured sale process

The structured sale process involves the following:

- Preparing the business for sale
- Understanding the likely value and preferred deal structure
- Tax planning
- Undertaking vendor due diligence to mitigate any historic or tax issues
- Compiling information and preparing an information memorandum
- Identifying and contacting potential buyers
- Receiving initial offers
- Holding further meetings with shortlisted buyers and receiving revised offers
- Undertaking further negotiations
- Signing a letter of intent
- Facilitating the due diligence process
- Facilitating legal documentation and finalising the sale
- Post-closing support as it relates to purchase price adjustments and post-closing matters.

Further information on key steps in the sale process is set out in the following sections.

Is your business ready to manage the process?

The sale of a company creates a great demand for information. An adviser can help coordinate and prepare the information required as part of the sale process – building confidence with prospective buyers.

If you do ultimately decide to sell your business, it can take six to 12 months or more to complete a transaction. During this period, the company must continue to run effectively despite the diversion of your time. Your management team must therefore be strong enough to cope with the additional demands likely to be placed on it during the sale process.

As mentioned earlier, it's recommended that the planning process begins well in advance. This will give you time to prepare for tax planning and clean up the company's balance sheet. Most buyers usually look at the last three years of the company's operations so the better shape the company is in, the more likely you can get a better price.

As such, it's usually a good idea to start preparing the information that potential purchasers are likely to require well in advance of any sale process. Also, ensuring the information that purchasers will want to review is comprehensive and well organised is essential to the smooth completion of any transaction.

Examples of the types of information you may need – supported by an adviser – to put together for the benefit of potential buyers include:

- Corporate/legal information
- Company information
- Management/organisational structure
- Details of products and technology
- Systems and financial reporting
- Tax information
- Historical and forecast financial information
- Insurance details.

Much of the information noted above is typically contained in key transaction documents to a buyer, including information memorandums, process letters, a draft sales and purchase agreement, due diligence reports, etc. A good adviser provides the appropriate level of disclosure and confidentiality. An adviser helps to ensure management focus on running the business.

Structuring the sale

Having a view on your preferred structure is important before starting the sale process. Informing buyers at an early stage will help ensure the offers you receive comply with your objectives.

If you plan to leave the business soon after the sale, you will most likely want your consideration paid on completion. If, on the other hand, you believe there are significant opportunities for additional growth under the new owners and you wish to stay on with the business, you may want to consider an element of deferred consideration linked to future performance, usually called earn-outs. These are less risky for buyers and can increase the final value you receive for the business. However, they could be risky for you and are fraught with complications.

If you have private use of assets owned by the company that are not required for carrying on the business, these should be identified early so that they can be transferred out of the business and the buyer is informed of this intention. For example, if your property is owned by the company which is not part of the sale, it could be distributed prior to sale.

It's fair to say that almost every aspect of a sale has tax implications associated with it. As a result, it's crucial that you receive detailed tax advice at the earliest possible stage of the sale process to help ensure any tax paid on the sale is minimised.

Pre-sale tax planning is important to enable any reorganisation or removal of assets to occur in a tax-efficient manner. Doing this in advance helps ensure you give enough notice to a buyer of your requirements.

In general, you will need to consider your requirements in relation to the:

- Sale of shares or sale of assets
- Form of the consideration offered (e.g. cash or shares)
- Timing of the consideration offered (on completion of the sale, deferred, or contingent consideration)
- Assets you wish to keep and need to transfer out of the business (e.g. property, vehicles, or surplus cash)
- Tax structuring of the consideration offered.

Preparing an information memorandum

The information memorandum is a key document that explains the business to qualified, interested parties. As a selling document, the information memorandum should present your business in a positive light. However, at the same time, it must be both factually accurate and complete.

You need to provide enough information to enable buyers to make a reasonable assessment of your business. However, sensitive information such as customer names, pricing, and details of unregistered intellectual property should be withheld until the later stages of the sale process. This avoids the potential damage to the goodwill of the business, which the distribution of this information may cause.

The document should be positive, emphasising the particular benefits that ownership could bring to a buyer. The profile must always be truthful, accurate, and complete. Any elements that are misleading could subsequently undermine the buyer's trust in you, their interest in the transaction, and the sale price.

The information memorandum needs to clearly articulate the following:

- Investment highlights
- Business model
- Management team
- Growth strategy
- Financial performance
- Transaction process.

Should you approach one buyer or several?

A structured sale process will often involve some form of confidential auction to a carefully selected, tightly controlled group of buyers. Having an adviser shows you're taking the sale process seriously and that other buyers may be interested, which you can use to your advantage to get a better price.

While this is a more complicated process than dealing with a single purchaser, a competitive process has many advantages over a one-on-one negotiation. For instance, if you don't explore the market, you will never know whether you could have achieved a better deal and price.

Buyers also often try to use the results of their due diligence on the company to reduce the agreed price. Your preferred bidder is much less likely to do this if they know you're in a position to sell your business to someone else if they don't deliver on the agreed terms. A competitive sale process is likely to be the best way to realise the value of the existing business.

For those businesses/assets that have a unique element to them, however, it's often better to focus on finding the right buyer rather than trying to facilitate a competitive sale process. In many cases, finding the right buyer can help to unlock the true value of an asset in a relatively quick and less complicated way.

Handling meetings, offers, and negotiations

Having reviewed the information memorandum, buyers are asked to submit an initial offer. The information memorandum aims to provide sufficient information for buyers to submit an offer, however, while it's not typical, some buyers may ask for a first-round meeting with management. Based on strategic alignment, you and your adviser may select to move forward with that meeting.

This is an opportunity for you and an adviser to establish a relationship with the potential buyers and learn more about them and their level of interest. The purpose of this meeting is rarely to start negotiations but to allow you to describe the business in greater detail and highlight the key issues.

An adviser can convene and chair these early meetings and explain to the purchaser the rules of the sale process and timetable. This may include structuring the transaction and the form of consideration to meet your tax-planning requirements.

All businesses have their more difficult issues to be considered. It's usually better to present these earlier while several buyers are interested and in competition to purchase your company, rather than later when you're in discussion with one potential buyer.

Indicative offers, first-round negotiations, and meetings

To maintain momentum and an orderly sale process, a deadline should be set for the receipt of indicative offers from all potential buyers. The indicative offers are based on the information memorandum.

However, in some cases, control over the sale process and value is enhanced by also providing potential buyers with a due diligence report (known as vendor due diligence) prepared by an accounting firm and a draft sale and purchase agreement before indicative offers are submitted.

This has three key advantages:

- Once exclusivity is granted, the vendor inevitably loses a substantial degree of negotiating leverage. Vendor due diligence can reduce the period of exclusivity with the final preferred buyer and therefore enhance your control.
- Due diligence always comes up with some negative issues – early disclosure while there's competition between buyers will help negate their impact and reduces the scope for the buyer to attempt to renegotiate the deal.
- Key issues such as warranty limitations, the scope of warranties, indemnities, and retentions are established early and these are more likely to be accepted while there's still competition.

Having received indicative offers, the field of potential buyers can be narrowed down to the top two or three. Without revealing their identity to other buyers, this is a good opportunity for an adviser to give the leading buyers a clear view as to what they have to deliver in order to purchase the company.

If necessary, a meeting can be held. Certain updated or additional information, necessary for a full and more informed offer for the company, may be required before revised offers are submitted.

Final offers and letters of intent

Providing all material information has been disclosed, robust final offers should then be submitted.

Having selected the preferred buyer, the letters of intent sets out the agreed deal and the period and terms of exclusivity given to the purchaser must be negotiated and signed. If final offers have been submitted in light of a draft sale and purchase agreement, then any major legal issues can be agreed upon at this stage.

A conventional sale process will involve selecting the preferred buyer and granting a period of exclusivity in which it can conduct any remaining due diligence and agree to the sale and purchase agreement with you.

HOW BDO CAN HELP

The sale of your business is likely going to be one of the biggest financial transactions of your life. You want a team of experienced transaction professionals including financial and tax professionals who understand the processes and complexities of mergers and acquisitions (M&A).

First and foremost, we understand business owners' objectives and have designed a transaction process that best positions them as shareholders for success. We've helped thousands of business owners sell their companies every step of the way.

Our team of M&A advisers and tax professionals can help you with the sale of your business by developing the right presentation materials, negotiating legal agreements, providing valuations, determining the optimal purchaser population, finding potential buyers, offering wealth advisory, and assisting with tax planning. Contact us to find out how we can help.

1300 138 991

www.bdo.com.au

NEW SOUTH WALES
NORTHERN TERRITORY
QUEENSLAND
SOUTH AUSTRALIA
TASMANIA
VICTORIA
WESTERN AUSTRALIA

AUDIT • TAX • ADVISORY

M&A and Corporate Finance services

Brisbane

DAVID WARD
Partner, M&A
+61 7 3859 4335
david.ward@bdo.com.au

Adelaide

DAVID FECHNER
Partner, Corporate Finance
+61 8 7421 1413
david.fechner@bdo.com.au

Melbourne

TONY SCHIAVELLO
Partner, M&A
+61 3 9603 1716
tony.schiavello@bdo.com.au

Perth

JUSTIN BOYCE CAM
Partner, M&A
+61 8 6382 4951
justin.boycecam@bdo.com.au

TODD GROVER
Partner, M&A
+61 8 6382 4949
todd.grover@bdo.com.au

Sydney

ANDREW McFARLANE
Partner, M&A
+61 2 9240 9895
andrew.mcfarlane@bdo.com.au

DANIEL COOTE
Partner, Corporate Finance
+61 2 8264 6655
daniel.coote@bdo.com.au

SEBASTIAN STEVENS
Partner in Charge, Advisory
Corporate Finance
+61 2 9240 9725
sebastian.stevens@bdo.com.au

ABOUT BDO

BDO is a leading provider of professional services to clients of all sizes in virtually all business sectors. Our team delivers a comprehensive range of assurance, accounting, tax, and advisory services. As part of the international BDO network, we're able to provide seamless and consistent cross-border services to clients with global needs.

This publication has been carefully prepared, but is general commentary only. This publication is not legal or financial advice and should not be relied upon as such. The information in this publication is subject to change at any time and therefore we give no assurance or warranty that the information is current when read. The publication cannot be relied upon to cover any specific situation and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact the BDO member firms in Australia to discuss these matters in the context of your particular circumstances.

BDO Australia Ltd and each BDO member firm in Australia, their partners and/or directors, employees and agents do not give any warranty as to the accuracy, reliability or completeness of information contained in this publication nor do they accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it, except in so far as any liability under statute cannot be excluded.

BDO Australia Ltd ABN 77 050 110 275, an Australian company limited by guarantee, is a member of BDO International Ltd, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO member firms.

© 2023 BDO Australia Ltd. All rights reserved. EV-CF-0010