BUSINESS OWNER'S CHECKLIST

A How-To Guide Helping Business Owner's Plan A Successful Exit

STANTON VALUATION ADVISORS LLC

Stanton Valuation Advisors, LLC

This document is not intended to provide legal and/or tax advice. Business transactions are unique to the parties involved, and buyers and sellers should consult with the appropriate professionals when contemplating a business sale.

Congratulations on your success as a business owner. Your hard work has culminated into the sale of your business. We developed this guide to assist you with some of the common elements that are important to a successful sale.

Why are you selling?

There are many reasons why you want to sell your business. Defining the purpose of the sale will influence:

- The range of prospective buyers;
- How much they will pay; and,
- How you will be paid.

Be aware that buyer's like to know the reason(s) why you are selling the business. Common reasons include:

- Retirement
- Shareholder Disputes
- Owner Health Issues or Family Illness
- Owner has a life event such as moving, marital divorce, etc.
- Wish to pursue other business or professional interests.

The reason for selling the business will determine how much of the business will be sold. Determine at the beginning if you wish to sell all or a portion of the business. Your liquidity needs can have a major influence on the range of prospective buyers, how much they will pay, and how you will be paid. The table below will help you consider your options:

You are selling for…	Buyer Types	Impact on Value	How You Are Paid
Liquidity – Sale of a <u>Portion</u> of the business	♦ Key Managers /Employees ♦ Employee Stock Ownership Plans (ESOP) ♦ Financial Buyer (Someone looking for a commensurate return on their investment)	♦ Possible to achieve a value at the higher end of the value range.	♦ Receive a lump sum up front or over a period of time. ♦ Buyer may ask you for seller financing to achieve desired value.

Liquidity – <u>100%</u> Sale of the Business	♦ Strategic buyer / Competitor ♦ Key Managers/Employees ♦ ESOP ♦ Family Members	♦ Highest value is most obtainable because buyers may pay a premium to own the business due to the perceived synergies from the acquisition.	♦ Buyers may pay a portion up front. ♦ Buyers may ask for seller financing. ♦ Buyer may Holdbacks funds or use an Earnout to ensure revenue & growth targets are achieved.
Succession	♦ Family Members ♦ Gifting/Sale to a trust	♦ May not achieve the highest value due to lack of funds available of the buyer type.	♦ Receive payment over a period of months or years. ♦ Payout maybe funded by the business.

Do you want to work?

Depending on the buyer type you must also consider if you plan to remain in the business after the acquisition. Some items to consider:

- If you wish to completely exit the business after the sale, consider the following:
    - The buyer may ask you to stay on for a period of time to assist with and facilitate the transition. If so, you must consider:
        - How long will you stay on?
        - What is the scope of work you will (and will not) perform?
        - Hours worked per week?
        - Do you want to be compensated for your time during his period? And if so, how much?
    - Since the buyer cannot rely on you during the transition of the business and must navigate the transition on their own, they may try and reduce the purchase price, increase the amount held back at the time of sale, or increase the earnout paid to the seller to ensure performance is maintained.

- If you wish to stay with the business as an operator or advisor under the new ownership, consider the following items:
    - Define your role including what you will and won't be doing.
    - Define any key performance indicators (KPI) to assess your performance.

- Define your compensation structure so that it is in line with your KPI's and ensure you are being paid for the work you are doing. Be careful not to have your compensation linked to the purchase price but instead viewed as a senior employee of the business.

Tip: When the time comes, have an attorney draft the employment contract to ensure everything is made clear at the start of the acquisition.

Gather Your Advisors

Selling a business can be a long process and includes many complex tasks that require experts to assist with matters related to taxes, legal issues, buyer due diligence, and valuation. As you are planning your exit be sure to gather and consult with key advisors early in the process to find knowledgeable advisors you enjoy working with. Key advisors include:

Accountant	Advise on tax implications related to the transaction. Can help strategize on the best transaction structure for your tax needs.
Attorney	Advise on the transaction legal structure, legal liability & risks, document review & drafting, and negotiations.
Business Broker	Facilitate with sourcing & vetting buyers, maintaining buyer discretion, and managing seller communication & due diligence needs.
Business Appraiser	Assist with determining a single or range of values for your business. Appraisals serve as a gauge for sale price expectations, establish a listing price, and provide credibility to the asking price.
Real Estate Broker/ Real Estate Appraiser	If you own the real estate that your business uses, and you plan to sell or lease it to the buyer, engage with a real estate broker to determine market lease rates a real estate appraiser for a valuation.

Tip: We recommend engaging with advisors 3 to 5 years before you plan to sell. This allows time to vet advisors, make any tax or legal changes, and identify the value of the business to keep expectations in check.

How Will You Sell Your Business?

Buyers and sellers can structure the transaction in two ways: ***Asset*** or ***Stock*** sale. There are many factors that influence the desired structure because both provide benefits and disadvantages to the buyers and sellers. At times the selection can have opposing implications which can create additional challenges in the negotiation process. Taxes and risks are important motivators for the selection of the transaction structure.

The following tables provide a brief overview of asset and stock sales from the perspective of the buyer and seller. Please consult with your accountant and tax attorney for a more comprehensive review of these transaction structures and their impact on you:

94%

The percentage of Asset sale transactions reported by DealStats (a private transaction database) for U.S. based firms with sales under $25 million from 2018-2022.

Asset Sale

An asset sale is the purchase of the individual assets and liabilities of the business. The buyer will select which assets to acquire such as equipment, inventory, furniture & fixtures, customer lists, domain names, software code, and tradename.

Buyer's Viewpoint	Seller's Viewpoint
♦ Tax benefits include a 'step-up' in tax basis where the buyer can depreciate the acquired assets starting at the price paid for the asset. Buyer must retitle assets & incur additional costs in the process.	♦ Can generate higher taxes because intangible assets are taxed at capital gains and hard assets are subject to ordinary income taxes.
♦ Goodwill, which is the amount paid over the tangible and identifiable intangible assets can be amortized over a fixed period.	♦ C Corporations can be double taxed, once at the entity level, and second at the shareholder level. If an S-Corp was formerly a C Corp it can trigger built-in gains (BIG) taxes.
♦ There is a reduction of legacy liabilities such as product warranties, contract disputes, and employee lawsuits as those issues remain with the seller's entity. However, customer, supplier & employee contracts may need to be renegotiated as these do not transfer in an asset sale.	♦ The seller still needs to liquidate any assets or settle any outstanding liabilities not transferred in the sale.

Stock Sale

A stock sale is the purchase of the owner's shares (or membership interest) in the entity. The buyer will purchase the shares of the entity and absorb all assets and liabilities.

Buyer's Viewpoint	Seller's Viewpoint
♦ No tax benefits from the step-up basis in assets for depreciation.	♦ Can be a simpler transaction process.
♦ Buyer is accepting historical liabilities (however, buyer may be indemnified in the purchase contract).	♦ Provides seller with favorable after-tax proceeds as taxes are typically assessed on lower capital gains rates.
♦ Patents, copyrights, large contracts, or other difficult to assign contracts are easier to transfer in a stock sale. If the business is reliant on a few large customers or suppliers, a stock sale may reduce the risk of losing those contracts.	♦ Seller's responsibility of historical liabilities issues can be reduced. However, buyer may be indemnified against historical liabilities.

Get Your House In Order

Buyers generally want to purchase a business with clean financials and turnkey operations. Sellers generally want to receive the highest value possible for their business. For the seller to receive the most desired price, it is important to spend time, resources, and money to prepare your business for sale.

The following sections discuss steps you can take today to improve finances, operations, and the company overall.

FINANCIALS & FINANCIAL STATEMENTS

Buyers will rely on financial statements, tax returns, and internally prepared financial documents to establish the purchase price, effectiveness of management, economics of the business, and overall desirability of the acquisition. Below are matters to consider related to the financial operations of the business:

INCOME STATEMENT	
Discontinue Non-Operating Expenses	If applicable, discontinue paying owner discretionary expenses and other non-operating expenses that are unrelated to the business. If you wish to continue with these expenses, one suggestion is to classify them clearly and separately in a distinguishable account so that a buyer can easily review the expense.
Ensure consistency when classifying expenses	Ensure your bookkeeper and accountant are classifying expenses consistently. Expenses that are misallocated or inconsistent can raise red flags to a buyer and require further explanations by you.

Industry Cost Structure Comparison	Use a business appraiser to complete a comparative analysis of your business's financial metrics compared to industry peers. This will help you gain a better understanding of your performance versus competitors.
BALANCE SHEET	
Divest underperforming and/or underutilized assets & liabilities	If you own assets that are no longer utilized by the business or are underperforming, it is a good time to dispose of those assets.
Refinance Debt	If you have debt on assets of the business that you anticipate the buyer will assume, take steps to refinance the debt to 1) lower the interest rate, or 2) reduce the monthly payment amount to increase cash flow.
Shareholder Loans	Loans to or from a shareholder should be resolved before the sale date.
OTHER ITEMS	
Customer or Supplier Concentration	If your business has high concentration of customers or suppliers, working to diversify them before sale can mitigate future risks and buyer concerns. If diversification is not achievable, be ready to discuss buyer's concerns head on. Implement any risk mitigating factors if possible.
Poor Financial Performance	Running a business is not easy. If you have had poor historical performance but anticipate the future to be better, be open with the seller as to why this happened and why the future is different.

OPERATIONS

Clearly defined business functions & roles	Document the key functions of your business (sales, operations, marketing, finance, etc.) including who is responsible, what they are responsible for, and how their performance is measured. This shows a low reliance on a key person.
Business process	Outline and document your business's key processes. This shows the buyer your business has systems in place to function independently.

Ensure commercial contracts are in place & transferable, include… - Lease agreements - Customer contracts - Supplier credit agreements - State & local licenses	Buyers want to ensure all contracts are in-place upon the transition of the business. If there is no contract, seek to obtain one, or be prepared to disclose why no contract exists. Understand the transferability of the contracts and the necessary steps to complete the transfer.
Ensure store, office, facilities, vehicles, equipment look their best – Get new assets if necessary	Remove or replace old technology, vehicles, flooring, equipment, etc. that your business uses. Buyers may see deferred maintenance as a reduction in purchase price.
Keep up to date inventory lists	Ensure your businesses inventory tracking is up to date. Note how and when inventory is counted and how it is reflected on the financial statements (LIFO, FIFO, etc.).
Passwords	Consolidate all passwords used by the company.

COMPANY

Business & Marketing Plans	If you prepare business or marketing plans, have them ready for the buyer to review. These can help buyers understand the company's goals and how they plan to be achieved.
Key Person Risk	If your company relies on a key person (typically the owner) for the generation of new business or operations, then implement staff training to reduce the reliance on a key person(s).
Management Depth & Competency	Assess the depth and competency of your current managers. Conducting both internal and external training seminars maybe necessary to ensure managers are property trained.
Employment Contracts	Key managers may be necessary to the transition and future success of the business. Establishing and codifying 'golden handcuff' style employment contracts to retain key management and employees may be necessary to sell the business.
Employee Issues	Resolve any outstanding employee issues such as terminating underperforming employees, relocating employees across functions, or reviewing excess employees.

Licenses & Permits Requirements & Transferability	Ensure the licenses you use to operate the business are up to date and if necessary, understand the transferability of the license to the new owner. These include general licenses, sales tax license, health permits, liquor license, occupational licenses, etc.
Employee Handbook & Benefits Plans	Be prepared to provide an employee handbook and benefits plans to the buyer. If you do not have these documents in place, it may be a good time to get this completed.
Lawsuits & Litigation	If the business is involved with any threatened, pending, or ongoing litigation, it is best to resolve these issues before the business is sold.
Real Estate	If the business, or the owner owns the real estate through a separate entity, decide if you plan to sell the real estate or if you wish to lease it back to the buyer. The value of the real estate will be determined separately from the value of the business. It may be necessary to engage with a real estate broker or appraiser to provide market rental rates (if you choose to lease) or valuation (if you choose to sell).

Working with the Buyer

Selling your business can be a long process. It is not uncommon for business to take over 200 days to sell (as reported by DealStats). As part of the buyer’s due diligence process you will be asked to provide a large amount of personal and business information. At times the volume of documents requested by a buyer can feel daunting and the depth of the buyer’s questions can feel invasive. Relying on your advisor during this process is paramount to a successful transaction.

Your attorney or business broker may ask you to prepare a buyer due diligence packet that includes commonly requested documents that can easily be made available to qualified buyers.

To assist you with preparing the buyer due diligence packet, buyers generally want to see the following information:

- 3-years of tax returns (federal & state)
- Internal financial statements for interim periods

Below is a list of additional documents to consider when preparing the buyers due diligence packet:

Financial

- Inventory list
- Revenues/Cost of Goods Sold by Customer (or Customer type)
- Fixed Asset List
- Accounts Receivable
- General Ledgers
- Owner Expenses & Perquisites

Operational / Company

- Business & Marketing Plans
- Advertising Campaigns
- Customer Agreements
- Supplier Credit Agreements
- Real Estate Lease Agreements
- Equipment Lease Agreements
- Intellectual Property Documents
- Licenses & Permits
- Governmental Notices
- Employee Contracts, Employee Handbook, and Explanation of Benefits
- Pending or Ongoing Litigation

Conclusion

We hope the Business Owner's Checklist – Planning a Successful Exit was helpful with the beginning stages of your journey. Please reach out to us with any questions as you start planning your exit.

Stanton Valuation Advisors, LLC is a national business valuation and financial advisory firm located in Phoenix, Arizona. We offer Business Valuation and Financial Advisory services for business owners, investors, and operators. Our services include:

- Gift and Estate Tax Valuations
- Mergers & Acquisitions Valuations and Advisory
- Succession Planning
- Shareholder Dissolutions
- Marital Divorce Valuation

Check Out Our Website For Additional Services

For more information visit our website at StantonValue.com

Or contact us at (602) 699-6340 or charlie@stantonvalue.com