Buying or Selling Small to Medium-Sized Businesses

Overview

- Part I (15-20 minutes)
  - Understanding the M&A Market Place
  - Questions
- Part II (30-40 minutes)
  - Understanding the M&A Process
  - Questions

The Market Place

- Who Are the Buyers/Sellers of Small to Medium-Sized Businesses?
- What Are They Paying—i.e. Valuations?
- What Are the Terms?

Buyers/Sellers

- Main Street
  - Restaurants, bars, small businesses of all types
  - Average sale price of 250k
  - Sells at a multiple SDE—i.e. 2.5 x SDE
  - Deals brokered by business brokers
  - Marketed at business MLS sites—i.e. www.bizbuysell.com
  - Buyer is generally an entrepreneur who will own/ operate the business.

Buyers/Sellers

- Wall Street
  - Large publically and privately held businesses
  - Sale Price of 250M plus
  - Sells at multiples EBITDA/REV—often announced as a premium over the publically traded share price
  - Deals brokered by investment bankers—i.e. Goldman Sachs and Morgan Stanley
  - Marketed privately through private auctions
  - Buyers are large corporations or PEGs

Buyers/Sellers

- The Middle Market
  - Businesses in between Main Street and Wall Street
  - Sale price of 2M-250M
  - Sells at multiples EBITDA/REV
  - Deals brokered by business brokers, intermediaries and M&A advisors
  - Marketed privately through sites and private auctions
  - Buyers are generally smaller corporations and PEGs
  - Marketplace is a hybrid of Main Street and Wall Street

Buyers: Main St. and Wall St.

- Strategic Buyers—corporations in the same or similar industries
  - US and cross-border buyers
- Financial Buyers
  - Private equity groups
    - Looking for platforms
    - Looking for add-ons (really a strategic)
- Individuals
  - Owner/operator entrepreneurs
- Brokers prefer: strategics, then financial, lastly individuals—and generally only for Main Street

Example of Strategic/PEG

- iMEDX/Unknown
- Accentus/High Road Capital Partners
- OnCourse/Riverside

VALUATIONS

- Size Matters
  - Main Street: (Median Price of 250K) 2.5 X SDE
  - Middle Market: 5xEBITDA or 1x REVENUE
  - Wall Street: 10-15x EBITDA
- Industry Matters
  - Manufacturing 5x EBITDA or 1 x Rev
  - Software 9x EBITDA or 2X Rev
- Buyer's Motive Matters
- Financial vs. Strategic

Deal Terms for Small to Medium-Sized Businesses

- Asset vs. stock deal
- Cash down 50-100% of target price
- Financing: bank (i.e. SBA)/note/earnout
- Earnout for up to 50% of deal and most certainly on any at risk or future revenue
- Employment contract for CEO
  - Probable if private equity
  - Perhaps if strategic
  - Training/transition if purchased by owner/operator

Earn Out Example

- Total Purchase Price $3,000,000
- Down Payment at Closing $1,500,000
- Balance Paid as Earn-out over 12 Months

  $1,500,000/12= Monthly Payments of $125,000

  Monthly payment assumes and is contingent upon achieving next 12 months of revenue of 3,000,000—or $250,000 monthly. Thus the monthly earnout payment is set at 50% of revenue and shall be 50% of revenue up or down of the target payment of $125,000.

Questions Regarding the Marketplace

- The Buyers
  - ✓ Strategic, Financial and Individual
- The Deal Terms
  - ✓ Asset vs. Stock
  - ✓ Cash Down
  - ✓ Payment with Stock
  - ✓ Earnouts
  - ✓ Notes (financing the buyer's purchase)
  - ✓ Employment Contracts

The M&A Process

- Packaging to Buy/Sell
- Pricing to Buy/Sell
- Marketing
- The Modified Auction
- The LOI
- Due Diligence
- The Purchase Agreement
- Closing

Packaging the Deal
(The First Two Weeks)

- Document Preparation
  - The Confidential Memorandum—Sellers only
  - The Blind Profile of Sellers
  - The Open Profile of Buyers
  - The Confidentiality Agreement

Packaging the Deal
(The First Two Weeks)

- Documentation Delivery (See marketing.)
  - Blind Seller or Open Buyer profile
  - Confidentiality agreement
  - Confidential memorandum

Pricing the Deal

- Internal Expectations Determined During the Documentation Preparation
- Financial vs. Strategic Pricing
- Communicating Market Realities not Exact Pricing
- Methodology for determining FMV Expectations:
  - Comparable Sales Metrics: Price to Rev/ Price to GP/ Price to Profit
  - Better Terms=Higher Price

Marketing
(3-12 Months)

- The Proprietary Deal vs. the Auction
- Building the Database
  - Strategic buyers
  - Financial buyers
- Emailing the Database
- Posting at Deal Sites
- Personal Phone Calls
- Resourcefulness, Diligence & Perseverance

The Modified Auction

- The Dance—to create a sense of urgency without manipulation
- Using confidentiality to your advantage
- Never fabricate, always be vague

The Letter of Intent

- When to move from providing information to soliciting LOIs or term sheets?
- Whenever the timing seems right but ideally when more than one party is prepared to do so
- The buyer wants vagueness, seller details
- Leverage before LOI is with seller, afterward with buyer

LOI Deal Terms

- Stock or Asset
- Cash/Stock/Paper
- The Earnout
- Employment Contracts
- Assets Being Sold
- Accounts Receivable
- Working Capital Adjustments
- Purchase Agreement Due Date
- Reverse Breakup Fees
- Closing Date

Due Diligence

- Varies from Buyer to Buyer
- Thoroughness is in proportion to Cash Invested
- Financial Due Diligence
- MT Due Diligence—IC vs. FTE
- Customer Due Diligence—Are the contracts in jeopardy of being lost?
- Vendor Due Diligence—i.e. platform/technology and licenses/contracts

The Purchase Agreement

- Surprises in Proportion to LOI Thoroughness
- Draft Due a Couple of Weeks Before Close

The Closing

- Sixty to Ninety Days After LOI
- Virtual
- Payday—Funds Wired to Your Account!

Questions Regarding The M&A Process

- Packaging to Sell
- Pricing to Sell
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Broker Fees

- Packaging and Marketing Fee
- Monthly or Quarterly Retainer
- Success Fee—x% of Sales Price
- Marketing/Retainers Credited Against Success Fee

Broker Fees

- Small Business Example: 500k sales price fee might be 10% Success Fee plus 2500 marketing and 2500 due diligence fees
- Middle Market Business: 25M sale price fee might be 1% plus 100k (Lehman) and 25K retainer
- Buy-Side fees might be Lehman plus 3-5k monthly

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