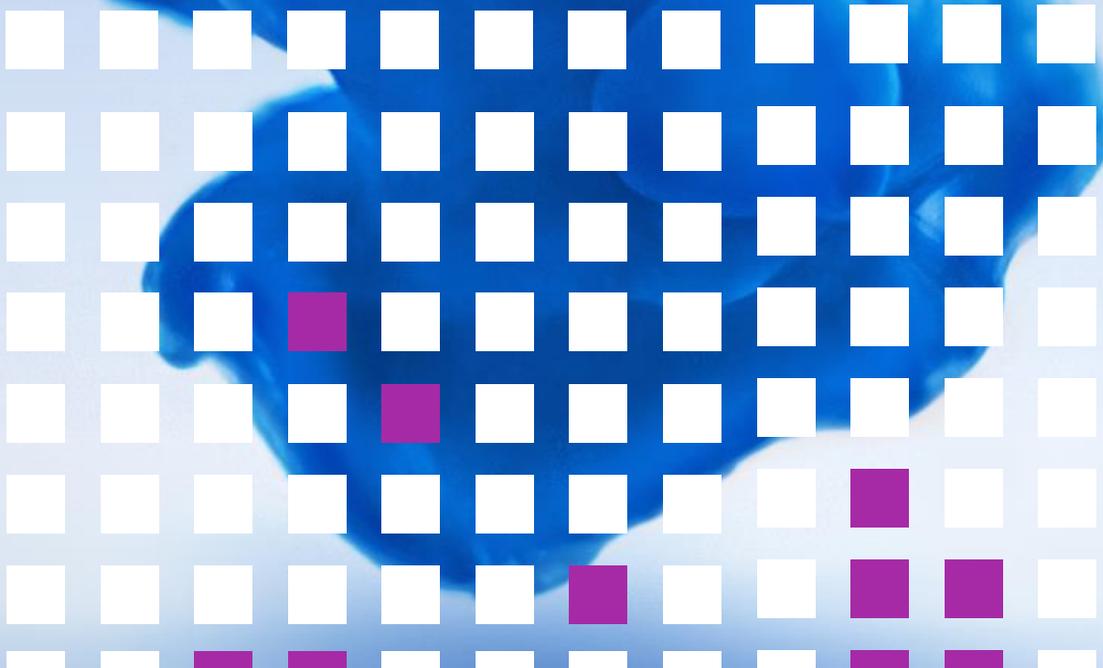




ERRORS IN THE SALE OF A COMPANY 2

THE NEGO- TIATION



INTRODUCTION



Knowing how to negotiate means knowing how to listen to what is said and, above all, what is not said, in order to strike a balance between the interests of all parties.

The process of selling a company or finding investors is like a dance, and all dances require technique and artistry. Within the sales process, negotiation represents the central body of the dance, where the most delicate and complicated steps are performed.

Knowing the particular dance, as well as knowing how to dance, is a determining factor at this stage of the sale in order to successfully complete the performance.

Negotiating a sale involves handling financial and technical aspects, but it is also a process in which emotions and psychology play a major role. It is crucial to understand and control your emotions, as well as the needs and aspirations of the prospective buyer. You must not only effectively manage your emotions, but also those of the other party, in order to bring the sale to the best possible outcome.

Many entrepreneurs sell their business at the first offer they receive, skipping key steps in the negotiation, such as managing the documentation, reviewing the buyer's finances, or setting targets and payment terms. Attention to these aspects can raise the offer on the table, or even, with the right advice, a better offer can be found.

Any entrepreneur who has spent many years building a business, taking care of every detail and creating value, cannot just sell to the first person who is willing to buy. You have to plan the sale and look for the ideal buyer.

Of course, finding the ideal buyer requires a lot of effort: it involves using a solid search methodology and combing the market for all possibilities. But it will be worth it in the end because the price difference will be substantial.

However, all this will be of little use if, due to lack of experience or outlandish aspirations, the operation fails at this critical moment: the negotiation.



To negotiate well, the first thing to know is where we want to get to and why. Our goals will guide us, but our expectations will give us the strength to negotiate by convincing us that we deserve what we want.

In this e-book, we will show you the most common mistakes to avoid during this critical phase of the sales process. We will tell you:

- What aspects you should focus on as an entrepreneur during the sales process.
- What expectations you should and should not have.
- How to identify what role you should play during the sale.
- Why you should rely on the expertise of specialist advisors to conduct the negotiation.
- How to justify the price you are asking for your company,
- What information you should provide and what information you should withhold.
- What forms of payment you can establish and how to do it.

Negotiation is the central part of the sales process, the moment when one false step, one mistake, can ruin the successful closing of the deal.

Spare yourself the mistakes we have seen many entrepreneurs make. We provide you with all the information you will need in the negotiation to achieve success and the best possible result in the sale of your company.

*If you don't know where
you're going, you'll end up
somewhere else.*

- Yogi Berra

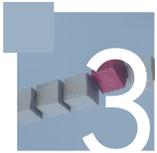
TABLE OF CONTENTS



1 | ERRORS IN THE COMPANY'S MANAGEMENT



2 | ERRORS WITH DOCUMENTATION



3 | ERRORS IN THE COMPANY'S SUBJECTIVE VALUE



4 | ERRORS IN THE COMPANY'S TARGET VALUE



5 | ERRORS RELATING TO THE BUYER



6 | ERRORS IN PAYMENT METHODS



7 | CONCLUSIONS



ERRORS IN THE COMPANY'S MANAGEMENT

1.1 | NOT FOCUSING ON THE COMPANY'S
GROWTH DURING THE SALES PROCESS

1.2 | DISENGAGING YOU FROM THE SALES
PROCESS

1.3 | IGNORING SHAREHOLDER CONFLICTS



CONTROL EVERY AREA OF THE COMPANY DURING THE NEGOTIATION

Completing the process of selling a company usually takes, if all goes well, between nine months and a year.

During the previous stage, the preparation stage, in order to arouse the buyer's interest, the previous year's results and what is expected for the current year will have been explained to the buyer. During the sales process, as the months go by, it will become clear whether or not these projected figures materialise.

The buyer will check on a quarterly basis whether or not what is expected is met and, if not, will use the figures as a bargaining tool to lower the final price. **It is therefore essential that the year of the sale is the best possible year from a financial perspective.**

Rely on your advisors to find buyers and negotiate. During this stage, you should focus on contributing to the area where you can play the best role: in your own company.

If your business starts to suffer because your mind is on other things, the selling price will suffer too, and in a big way.

So, we enter the realm of mistakes to avoid in terms of your relationship and commitment to the company during the negotiation period.

1.1 | NOT FOCUSING ON THE COMPANY'S GROWTH DURING THE SALES PROCESS

We have said that during the sale you should dedicate yourself to the company and you may think that once you have hired an advisor, your job is done. Nothing could be further from the truth. Unfortunately, many salespeople make the mistake of disengaging completely from the sales process once they have signed a brokerage agreement with their advisor. Finding the delicate balance between your dedication to the business and attention to the sale is one of the keys to a successful transaction.

No one has more motivation to sell, or insider knowledge of the business, than you. If you haven't already done so, have a conversation with your advisor about how you can contribute to the sale of the business without stepping on their turf, so that there is a clear and equal division of roles from the outset.

Once the advisor has found a few qualified buyers, you will play a key role in instilling confidence in the buyer that the business can be successfully acquired and managed.

Your interaction with the potential buyer will have a major impact on the sale of your company.

At the same time, a decline in revenue or profits, the departure of a key employee, the loss of a major customer, a new legal problem, a competitive breakthrough or the decline of your industry represent a new risk to the buyer.

The best service you can do to the success of the operation is to know how to play these two roles simultaneously.

It is a mistake to lose sight of what is needed at any given moment to reach the goal. You must remain vigilant throughout the process.

Finding a buyer, or even getting an offer to buy, does not mean that the company is sold. As tempting as it may be to ease back on the company's business, a sudden drop in sales and profits, or the loss of key employees, may cause the buyer to look for a way out of the deal or renegotiate the price.

Some deals fall through due to an inability to secure financing, unforeseen environmental conditions, family or partner disagreements with the buyer, or the inability to get approval from a franchisor.

The sales process can be a minefield of hidden problems, with the possibility of finding yourself at square one by losing a buyer just when the closing table is in sight.

The important thing is to stay focused on managing your business for maximum profitability and stability until you have signed the sale and purchase agreement.

Don't make the mistake of taking your foot off the accelerator during the sale process. Even in good times, it can take time to find the right buyer and get to the closing table.

1.2 | DISENGAGING YOU FROM THE SALES PROCESS

After you have hired your consultant, don't completely disengage yourself from the process.

Many salespeople make this mistake, thinking that the advisor alone will be enough to make the process successful.

As we have said, the first stakeholder in the success of the sales process is you. The advisor can attract interested parties, but it is your job to convert those interested parties into buyers by conveying confidence about the future of the company. Also, always remember that the deal is not closed until the very moment of the signing.



Years ago, we represented a buyer of a professional services organisation. The company he wanted to buy was run by two owners who were active in the business. As the transaction progressed, the owners became less and less active. While it was good that the company continued to operate without them, this sent the wrong message to our client, the buyer, and the employees of the selling company. Our client was concerned that the owners would not be involved at all after the closing and the agreement required them to consult with us and remain involved. The company's employees quickly felt abandoned. Had the owners been more accessible and communicated more throughout the process, they could have easily managed both sets of concerns.

As the closing approached, a problem arose and we were unable to contact either owner for almost a day and a half, in the middle of the week, not on a weekend. Our client abandoned the operation and ended up buying another company. We later learned that the owners were able to get things back on track, but only after struggling for many months to regain the trust of their employees after the deal was canceled.

You must finish strong, keeping your commitment. If you are noticeably disengaged, a buyer will be inclined to think you don't care about the deal or the company. Remember, the buyer does not know that you have spent 80 hours a week for years building your company, no matter how tired you are.

The buyer will only perceive what they see during the sales process and, if you don't seem to care about the drift of the company, they may question during the sale how well you have run the ship. Show that you care, keep your commitment, finish the job strongly and close the deal.

1.3 | IGNORING SHAREHOLDER CONFLICTS

Even if you have a majority shareholding, it is important to have minority shareholders aligned with you from the beginning. It is a mistake not to assume that there are other shareholders with different motivations and interests than yours. We have seen many cases where minority shareholders have ruined a transaction when it was almost closed.

You must also manage conflicts between family branches well. Family conflicts are of a different nature, and you have different motives than unrelated shareholders. Interpersonal relationships intersect with business, making the professional become personal.

In fact, this type of conflict often transcends economic interests and, although it may seem like something out of fiction, personal affronts from the past, envy, desire for revenge or reparation is more common than it seems. In addition to family conflicts, there are also economic interests.



We had a sales experience where the company was originally owned by two founding brothers. The uncle ran the company and his brother, and the father of our clients split his 50% into four parts (12.5% for each of his three sons and the rest for himself). His eldest son was aligned with his uncle and the relationship with his two younger brothers (our clients) was very tense, which led to a very violent episode at a meeting, which fortunately we were able to stop.

The operation was very complicated, but the day of the signing arrived. During the sale process the father of our clients passed away, but we managed to include in the transaction the part of the inheritance that corresponded to our clients, 12.5% of the property of the deceased father. At the notary's office the mother, aligned with her eldest son and not with our clients, said that if her two sons did not sign a document at that time that would solve some disagreements in the distribution of the inheritance, she would not sign the transaction.

The mistake, on the part of the uncle, knowing perfectly well how the family relations were, was not to propose that she be given power of attorney to sign the transaction on behalf of all that part of the family.

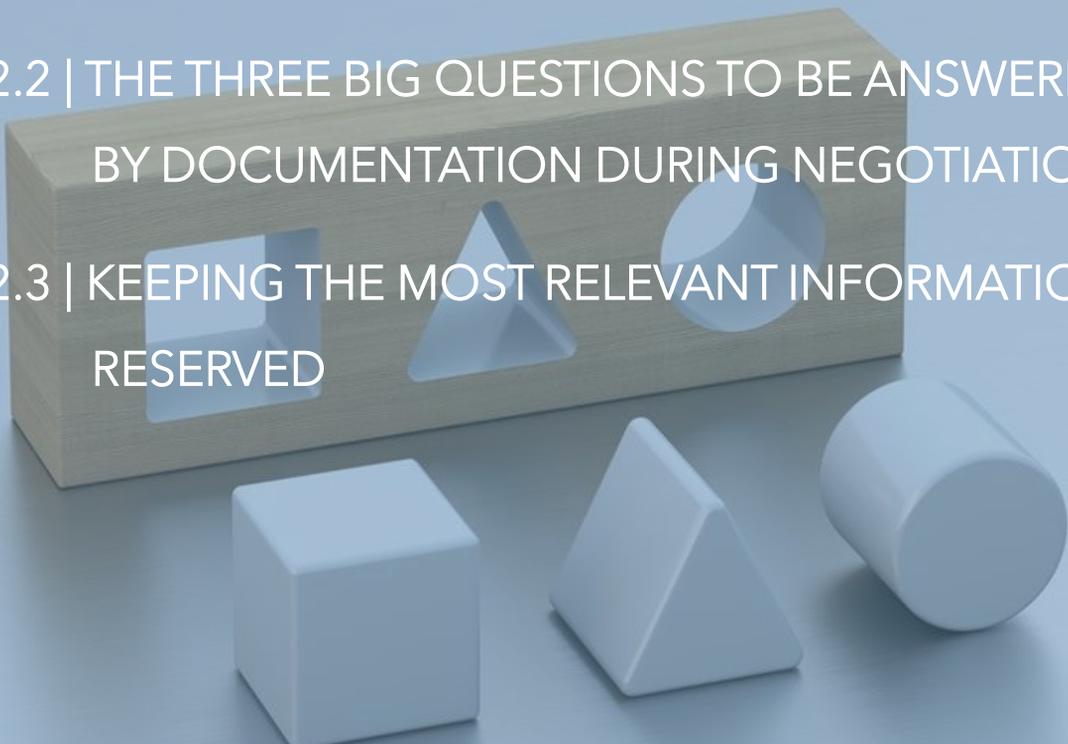


■ ERRORS WITH DOCUMENTATION

2.1 | DOCUMENTATION FOR NEGOTIATION

2.2 | THE THREE BIG QUESTIONS TO BE ANSWERED BY DOCUMENTATION DURING NEGOTIATION

2.3 | KEEPING THE MOST RELEVANT INFORMATION RESERVED



WHAT INFORMATION TO SUBMIT AND WHEN

Failure to give adequate importance to the preparation and provision of relevant descriptive information about the company is very detrimental to the negotiation phase of a sales mandate.

The less information the buyer has, the more uncertainty will be generated and, therefore, the lower the price offered and the lower the closing guarantees.

2.1 | DOCUMENTATION FOR NEGOTIATION

Running any business requires some specific knowledge. No one knows your business as you do, and you will smooth the transition and handover process if you share that information with the buyer.

The clearer the path for a buyer to take over and get up and running quickly, the easier it will be for you to sell.

To facilitate the best possible image and a safe transition, we must provide some documents during the negotiation phase. These documents will contain critical information about the business, its management, and the transition planning and next steps after the sale.

STANDARD OPERATING PROCEDURES (SOP)



The Standard Operating Procedures (SOP) Manual should contain:

- Every job and function in the company; the more detailed, the better.
- The **team** that will be present and in charge of the **next phase** after the takeover of the company. Positions and functions.

INFORMATION MEMORANDUM



- It is the document that will be presented to potential buyers, after signing an NDA, **describing your company**, in order to arouse their interest in your company.
- The Information Memorandum (Information Memorandum, Infomemo or Sales Memorandum) is the document in which the best face of the company is presented. Below we will see what information should be included in order to achieve this.

Information to be included in the Information Memorandum

An Information Memorandum is both a business offer and a marketing brochure. It answers many questions buyers ask about your company and should explain why buying your company is a good investment.



In addition, you should specify whether you want to work with the company after the sale or whether you want to dissociate yourself completely from the company.

If you intend to stay with the company, you should define your possible role after the closing in this document.

The purpose of the Sales Notebook is to encourage the buyer to take the next step, but without answering all the questions they may have or giving all the sensitive information about the company.

2.2 | THE THREE BIG QUESTIONS TO BE ANSWERED BY DOCUMENTATION DURING NEGOTIATION

When presenting your company's documentation to a potential buyer, you should focus on providing essential information to start the negotiation phase. To find out what that information is, you need to answer three main questions:

1. Why is the company for sale?

The first question buyers usually ask is why you are selling a highly successful business. You may be making that decision for personal, family, or changing interests, but buyers don't know that.

Anyone who decides to invest a large sum of money in a project will want to be sure to minimise the risks of the investment. If your business is successful and for sale, they will explore the possibility that it might not do so well. Don't be offended by this—it's common and logical.

Give an honest answer explaining why it is the right time to sell and you will reduce the unspoken fear of any buyer who may be hesitating.

2. Does the company have good prospects for the future?

Provide projections of future revenues, profits and cash flow, and justify them, describing the basis for the projections and citing the accuracy with which you have been able to project your company's recent results.

3. What are the hidden opportunities and risks?

Address issues that could arise that are not explicitly included in the quantitative projections, including opportunities that are unique to the buyer. Be candid in acknowledging challenges and describe the steps you have taken or recommend to reduce risk.



REASONS FOR THE SALE OF THE COMPANY

- Family and personal.
- Business.
- Opportunity of the sector.
- ...



EXPECTATIONS FOR THE FUTURE

- Economic growth.
- New products and services.
- Opening to new markets.
- ...



HIDDEN OPPORTUNITIES AND RISKS

- Dependence on customers or suppliers.
- Need for technological adaptation.
- ...

2.3 | KEEPING THE MOST RELEVANT INFORMATION RESERVED

Similarly, just as important as knowing what information to provide, and at what time, is knowing what information to keep to yourself. Do not share your company's "secret room", customer contact information, or detailed financial information until the buyer submits a **written offer in a letter of intent** and you accept the offer.

For example, if the buyer, during this phase, asks for competitive information, such as your marketing plan or procedures manual, reply that these materials will be provided during the due diligence process.

You should also not allow the buyer to contact customers or employees who are not involved in the sale, as the rumour that the company is for sale could be detrimental to the business.

Also, let your advisor handle the more difficult questions, such as those about the sale price, payment structure, or terms and conditions.

It goes without saying that not providing all the necessary information to advisors slows down the process and chills buyers' interest. Full transparency with them is essential for a quick, clean, and profitable transaction. Advisors will protect your interests by looking at your reality and your numbers.

Buyers will ask for breakdowns by customers and other segments in order to understand precisely what drives the business. You must be able to present a complete picture of the demographics that buy your services and products and the qualities of your products that give you an advantage over your competitors.

While you shouldn't show adverse information, don't hide it either. If your company has problems, the buyer is likely to find them in due diligence. When a buyer finds problems that you haven't told him about, his first reaction is likely to be, "What else is there that I haven't found yet?" and his second reaction will be to ask for an increase in the bonds required in the LOI.

Even if a problem goes undetected, it is very likely to be found after closing, when the buyer could withhold payments on the grounds that you have withheld information about the company. Since the purchase contract will contain representations and warranties, honesty is more than a good policy - it is a necessity. So, if your company has problems, communicate them to the buyer early in the process and share your strategy for correcting them or mitigating their impact.



■ ERRORS IN THE COMPANY'S SUBJECTIVE VALUE

3.1 | INCLUDE THE ECONOMIC OPERATION AND REAL ESTATE IN THE SALE.

3.2 | BEING "OVERCONFIDENT"

3.3. | BEING FOOLED BY SIZE

3.4. | DISTINGUISHING BETWEEN THE CONCEPTS OF VALUE AND PRICE





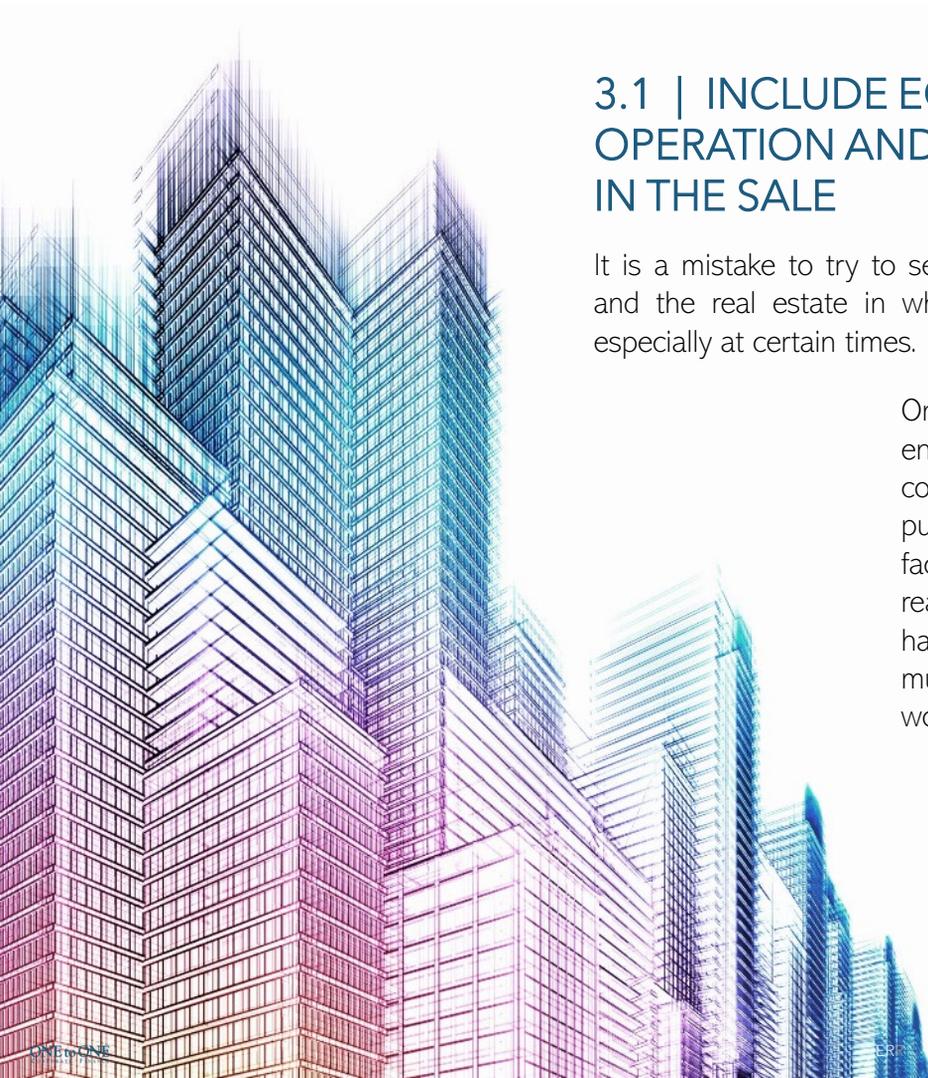
CONFUSING REAL VALUE WITH PERCEIVED VALUE

A very common mistake is to try to charge the sentimental value that the company has for the entrepreneur, and that no buyer is going to value or pay.

The entrepreneur is a bit of a child's father and sometimes does not know how to detach himself from this emotional relationship in order to get an objective idea of the real value of his company and a price in line with it when he puts it up for sale.

Possibly this may include, on occasion, the affection for his lifelong employees, which makes the entrepreneur resist any sales approach that could lead to a traumatic downsizing of the workforce.

To determine the real value of a company, a number of factors need to be taken into account. There are a number of mistakes to avoid making if you want to get the most out of the sale:



3.1 | INCLUDE ECONOMIC OPERATION AND REAL ESTATE IN THE SALE

It is a mistake to try to sell both the economic operation and the real estate in which the activity is carried out, especially at certain times.

On the other hand, the entrepreneur has in his mind the cost of the construction or purchase of that property and the facilities incorporated, without realising that the passage of time has made that equipment worth much less than it was originally worth.

3.2 | BEING "OVERCONFIDENT"

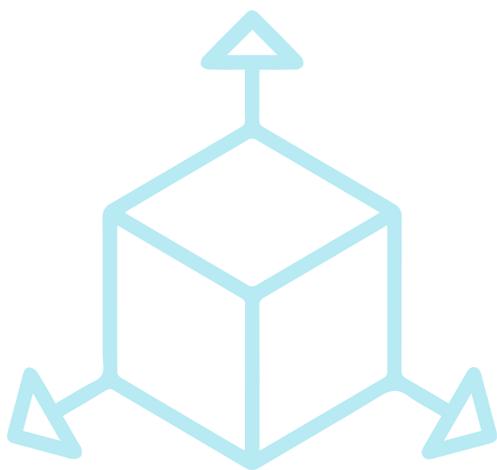
There is nothing wrong with being confident that you will successfully sell your business at a good price, unless that confidence causes you to neglect the activities necessary to make the sale happen.

Too many sellers start the sales process with the confidence that they will get the best price for their company, simply because they believe that is what it is worth. In the real world, valuation is based on quantifiable criteria, not the owner's personal estimation. To avoid this mistake, it is essential to obtain an objective valuation from a third party, or to know at what multiples similar companies have been sold.

Once you have obtained an appropriate valuation for your company, address the issues that could lead to a decrease in value. It is unrealistic, for example, to expect to sell for 40 million a company that makes a profit of one million.



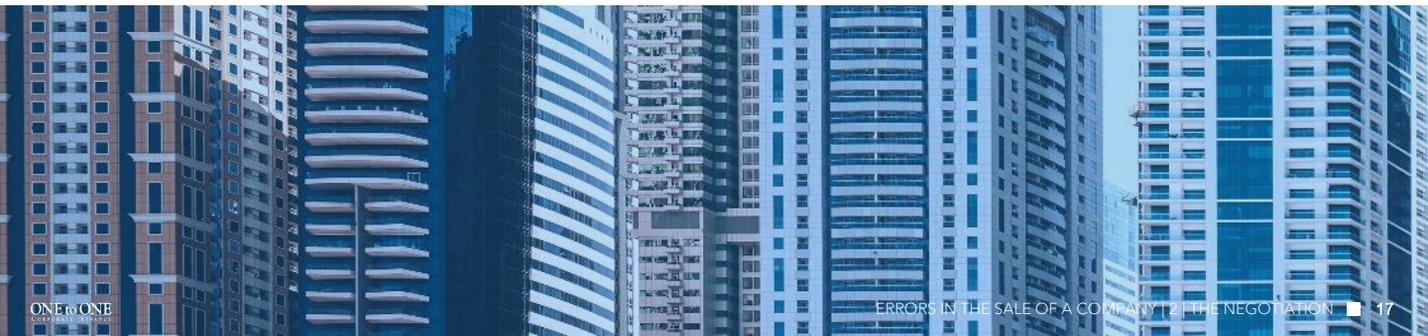
3.3. | BEING FOOLED BY SIZE



Does being bigger necessarily mean being more profitable?

The best possible picture of your company is obviously a good thing when you are going to sell but beware of taking on customers that give you a lot of volume, but you can't make profitable or going into debt to set up the new line that would allow you to sell a new type of product.

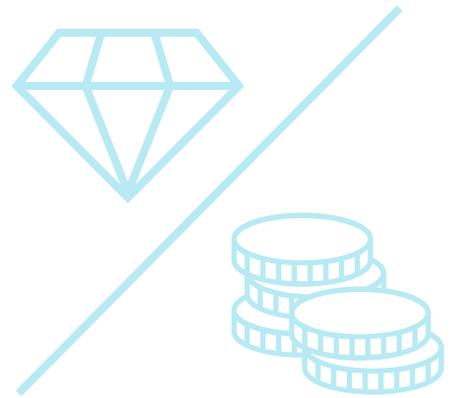
You can be bigger but less profitable. More capacity, but more debt. In which scenario do you think the buyer would pay more?



3.4. | KNOW HOW TO DISTINGUISH BETWEEN THE CONCEPTS OF VALUE AND PRICE

This concept must be clearly understood. The price that may be paid for a company at a specific moment in time, due to exceptional circumstances, does not add to the value of the company.

In other words, if a price has been paid at some point in time that is not related to the real value of the company, it is unlikely that this price will add to the value of the company.



Some time ago we were in contact with the CEO of a food company in which a large supermarket chain had a share of over 70% of sales.

The company was owned by two partners and recently one of them had bought out the other. In order to close the deal quickly, he paid a price equivalent to 7 times EBITDA.

After some time, the partner who had taken all the shares called us to discuss a possible sale of 100%. The problem was that the businessman put his valuation of 7 times EBITDA, which he had obtained under exceptional circumstances, as an immovable floor. There was no way to make him see that that extra price he had previously received did not increase the company's value, nor could it be added to the price he was trying to obtain in the new operation.



4 ■ ERRORS IN THE COMPANY'S TARGET VALUE

4.1 | PROBLEMS IN THE VALUATION OF THE
COMPANY FOR SALE

4.2 | SETTING THE RIGHT PRICE FOR THE COMPANY

4.3 | THE CORRECT VALUATION OF THE COMPANY

4.4 | LACK OF CREDIBLE FINANCIAL PROJECTIONS

4.5 | THE PRICE IS THE RESULT OF THE VALUATION



OBTAIN AND JUSTIFY THE REAL VALUE OF THE COMPANY

As we have seen above, the only way to know the real and market value is to commission a standardised and professional valuation service.

Valuation is the quantification of the elements that make up the company's assets, its competitive position within its sector and its expectations of generating wealth. These factors are value-creating elements that can give us a very general overview. It is a technical and financial work that involves a great deal of background research.

4.1 | PROBLEMS IN THE VALUATION OF THE COMPANY FOR SALE

Setting a price without going through the valuation process can slow down the sale of the company. If you set the price too low, potential buyers may think that the company has a problem.

However, an extremely high price will obviously repel buyers. So, for a smooth sale, it is a good idea to carry out a thoughtful valuation of your company before putting it on the market.

The valuation provided by your advisor usually puts it in a particular value range, but ultimately the price will be what a buyer is willing to pay. And that will depend on the negotiating skills of the hired advisor. Through valuation, you can justify your asking price and have higher aspirations because of the projections it may yield.

Valuation is part science and part art. Generally, you will ask for a price that is at the high end of the scale. It is in the negotiation of the sale price that you will see the profitability of the decision to have hired a sale and purchase advisor. This is where they make their percentage profit. The more involved they are, the better they will do their part. Your profit is their profit, so they will try to get the highest possible price for the sale.

A big mistake related to valuation is not pricing the company to sell. A good advisor will take many things into account when suggesting a selling price for your company. They will consider the industry, similar businesses, cash flow, the economy, the market and other factors when setting the price.

The big trick to setting the selling price is to **be realistic**. Don't expect a top price for a business that is losing money or barely breaking even.

4.2 | SETTING THE RIGHT PRICE FOR THE COMPANY

Overpricing or underpricing a company is a common mistake. As we have said, it is not wrong to be confident that you can sell the company for a reasonable price. Still, it would be best if you did not spoil a negotiation by expecting a sum inconsistent with the company's real value based on emotional arguments.

The actual value is based on quantifiable criteria, not emotional appreciation, and you need to appreciate reality. One way to gauge your perspective of reality is to ask whether you would buy another entrepreneur's company with the same sales and profits at that valuation.

Once you and your advisor have carefully analysed your finances and identified a reasonable selling price, you will understand how buyers will evaluate your company and calculate the price they are willing to pay. You will know that for every euro of increased cash flow you can generate, you can get 2 to 3 euros more in your selling price.

Inexperienced sellers tend to set a (usually high) price before determining the value. This is a big mistake because the price is the most critical factor in determining how long a company remains on the market without ever selling.

Sellers who have taken the time to conduct a thoughtful valuation process before assigning a selling price are more in touch with market prices and are better positioned to defend that price and reap the benefits of a faster, smoother sale.

Several factors can influence the final valuation, and there are many risks to navigate to ensure that your company is priced neither too high nor too low. Make sure you identify the correct valuation method to get an accurate figure for your business.

This may take into account the potential of the business, the costs of creating a similar business from scratch, or even what kind of profit a potential buyer can take away each year. Choose wisely, as, in the end, it is your profit that is at stake.

4.3 | THE CORRECT VALUATION OF THE COMPANY

When setting a selling price for your business, there are no limitations or restrictions. Theoretically, you can set the price as high as you want.

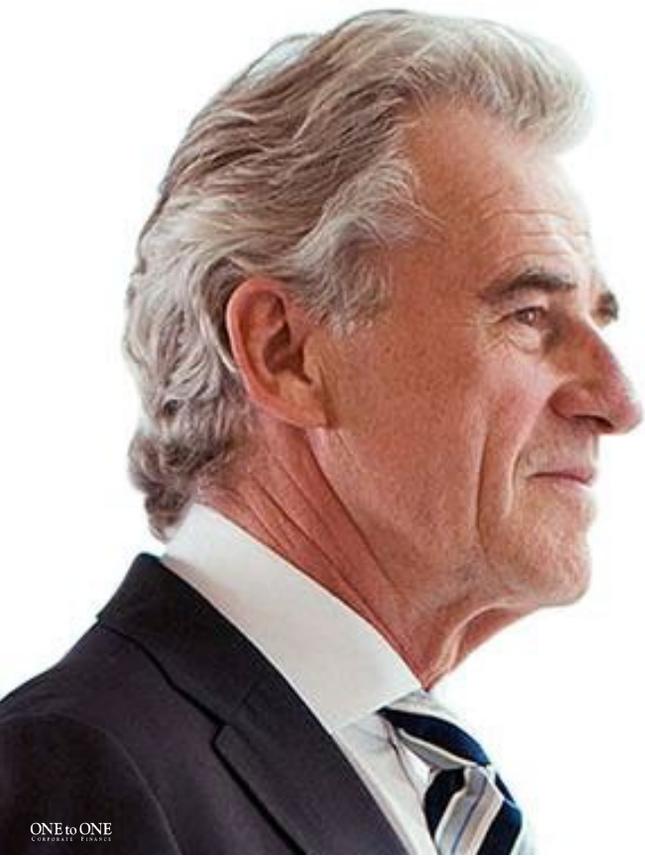
As we have mentioned in previous points, if the price is too high, the market will not take you seriously, and potential buyers will not likely investigate the opportunity further. Selling your business can grind to a halt before it even begins.

Many business owners are stubborn when it comes to a specific idea about the value of their business, but this idea is unfortunately not based in reality. You may believe that your business should be sold for the highest price. However, believing does not make it so. Be pragmatic. Wishful thinking has no place in business. Honesty is the best policy when it comes to selling a business. You may be tempted to believe that a little exaggeration does no harm but can be very damaging. At some point in the sales process, you may be tempted to inflate figures, distort projections or even cover up problems to make your business look more attractive. Don't do this. Even if the embellishments get you a lucrative deal, you will undoubtedly face unintended consequences.

Misrepresentations, even unknowingly, turn on all the red lights when potential buyers review the company's actual figures, and such misrepresentations can become the basis for legal action after the sale.

If your main goal is to sell your business and move on, a long and complicated legal battle is not what you need. Also, remember that litigation is not cheap. Honestly, stating your business's value and market position before selling it can save you a lot of trouble.

The market dictates the value and, consequently, the selling price of any business. Many financial and operational factors ultimately determine value. Therefore, the real key is to be more flexible and be aware of market multiples for your company. Knowing what is reducing your company's value can help you fix the problems and hopefully increase your company's selling price.



4.4 | LACK OF CREDIBLE FINANCIAL PROJECTIONS

The buyer will spend a lot of time researching the company's current finances and future projections. Having unreasonable projections or unrealistic assumptions will negatively affect the credibility of the management team.

If the management team does not know the company's key indicators cold and lacks the ability to convincingly demonstrate the reasonableness of the projections, this will cast doubt on the buyer. Failing to take a realistic stance on issues that weaken your negotiating position, such as financial stress or a negative business trend, is also a mistake.

4.5 | THE PRICE IS THE RESULT OF THE VALUATION

In short, believing that your business is worth a certain amount and expecting potential buyers to settle for it is rather naïve. The price you ask determines the fate of the sale of your business. Asking for much more than your business is actually worth could be the kiss of death to your hopes of a successful closing.

A business owner may have a figure in mind that he or she believes must be achieved, but this fixation can negate the chances of a fruitful deal. The owner may become fixated on an exaggerated value; however, most savvy buyers can tell from a distance that the business is not worth what the owner is asking.

In this process you must exercise humility and accept a hard truth for the sake of the deal: **the owner's personal opinion of the value and valuation of the business does not count for much in the real world.** The market demands quantifiable evidence.

This can be hard to accept, if you take into account the hard emotional process, the lifelong struggle to get your business off the ground. It is easy to identify all that emotional value with the real market value of the company. Don't create expectations of how much you deserve and how much money you should earn by selling your precious company based on these criteria.

This dissonance between false expectations and reality only makes the selling process take longer than necessary, risking its success.

The value of your business is irreplaceable to you - and no one questions that - but if you want to sell well, you must make a realistic and dispassionate analysis of its value.



■ ERRORS RELATING TO THE BUYER

5.1 | FAILURE TO ANALYSE THE FINANCIAL CAPACITY
AND PLANS OF THE BUYER

5.2 | THE DIFFERENCE BETWEEN SERIOUS BUYERS
AND THOSE WHO ARE "JUST LOOKING"

5.3 | NOT PRE-QUALIFYING BUYERS

5.4 | IGNORING FEEDBACK AND WHAT BUYERS ARE
LOOKING FOR



WHO IS YOUR IDEAL BUYER AND WHO SHOULD YOU AVOID?

As part of the negotiation phase, there is an essential process of exchanging sensitive information: due diligence. This is a complex and technical stage of the sale, so it is necessary to have signed a letter of intent before starting the due diligence.

Due diligence is the investigation or audit phase carried out by external consultants, who examine in detail the different areas of the company to determine whether it meets its obligations, whether the growth prospects correspond to reality and whether there are no substantial legal risks arising from its activity. All parties will request and receive further information about themselves and the target company.

As a seller, you have several crucial tasks during the due diligence process and several mistakes to avoid.

5.1 | FAILURE TO ANALYSE THE FINANCIAL CAPACITY AND PLANS OF THE BUYER

THE LETTER OF INTENT

Prior to the start of this process, the potential buyer must have signed a Letter of Intent, a document that ratifies in writing their formal intention to buy the company, which will give them access to more detailed and in-depth information about the company. Most letters of intent make the agreement conditional on the buyer's ability to obtain financing. Therefore, you should assess the buyer's financial capacity during due diligence before signing the letter of intent.

FUTURE OF THE COMPANY AND FINANCING

You need to determine the buyer's future plans for your business to ensure that he can manage the business once the deal is closed.

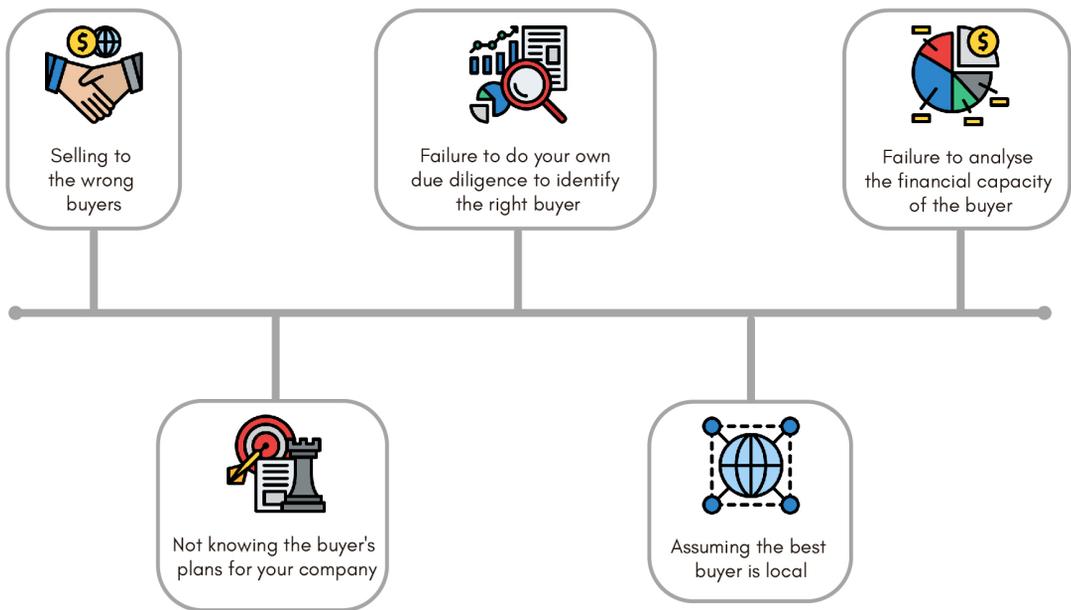
If you intend to provide financial support to the buyer, the question you should ask yourself is: "Can the buyer manage the business well enough to pay me?". As the buyer investigates your business, you must determine whether it has any adverse constraints on its financial condition or management ability. In other words, you must analyse the buyer to identify if he is the proper one.

WHO'S THE WRONG BUYER?

Owners may think that the best investor for the company is a known competitor, a customer, a supplier or even a friend. However, these buyers may not be financially qualified or interested.

Owners mistakenly assume that their best buyer is local, but today's market is global. There are thousands of investment groups - private and silent - and foreign investors who are interested in acquiring profitable businesses.

ERRORS RELATING TO THE BUYER



Identifying the best group of buyers is a key step in successfully selling your business.



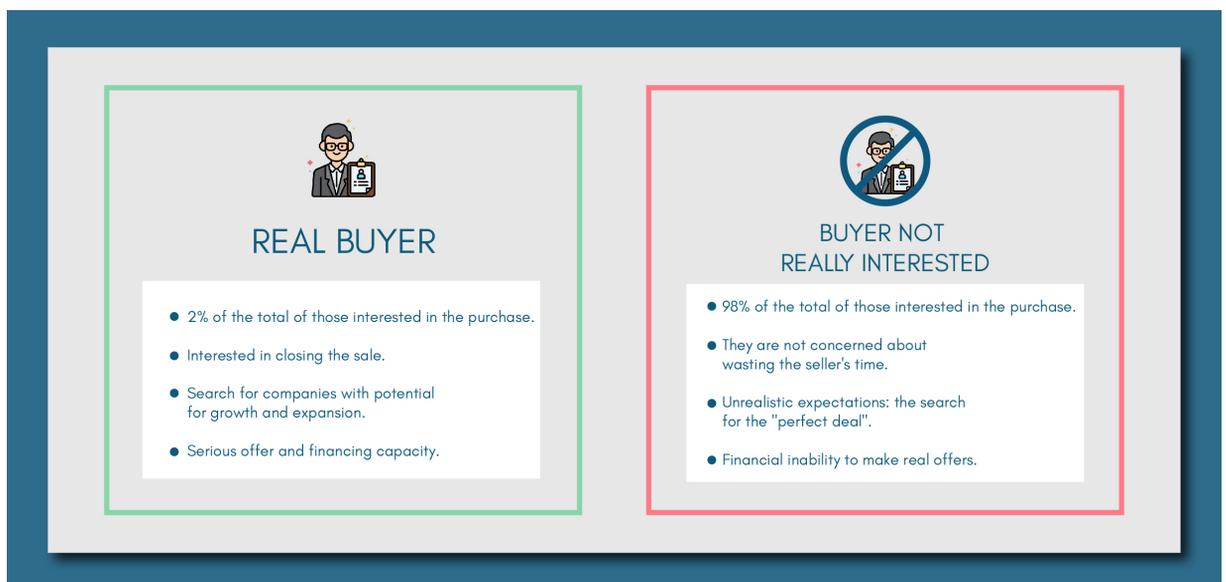
5.2 | THE DIFFERENCE BETWEEN SERIOUS BUYERS AND THOSE WHO ARE "JUST LOOKING".

Only 2% of those interested in buying a company for sale are interested. The other 98% are those who have neither the real intention nor the financial capacity to undertake a purchase.

Many are looking for the illusive "perfect" deal. Others expect the seller to finance the entire deal, have other unrealistic expectations, or struggle to make a decision. Wasting time with those who are not serious about buying a company takes valuable time away from your interaction with those buyers who want to buy.

Buyers who are not prepared to make an offer will not feel guilty about wasting your time, so don't feel guilty about writing them off.

A good sales consultant does not prejudge prospective buyers but discerns serious buyers who are financially qualified to buy your business. It is important to focus your time and energy on the serious buyers, not the "just-looking" ones who want to waste your time with their "paralysis by analysis", criticize your business, and present you with low offers.



5.3 | NOT PRE-QUALIFYING BUYERS

Making sure to pre-qualify potential buyers will save you a lot of headaches in the future.

Sellers are often wary of this step because it can scare off interested parties. However, the reality is that a professional pre-qualification can attract buyers by signing documents to maintain security for both parties.

Make sure you sign a confidentiality agreement, at a minimum, to protect confidential information during the sale process. That way, if the sale does not go through, you will not have to worry about your trade secrets falling into the wrong hands.

Other considerations come into play here as well. Money is not everything, and at no time is this more true than during the sale of a company. Naturally, you want to make as much profit as possible, but at what price? For example, if you have good relations with your staff and you know that a particular buyer is likely to rationalise and cut jobs, will you want to leave your company in their hands?

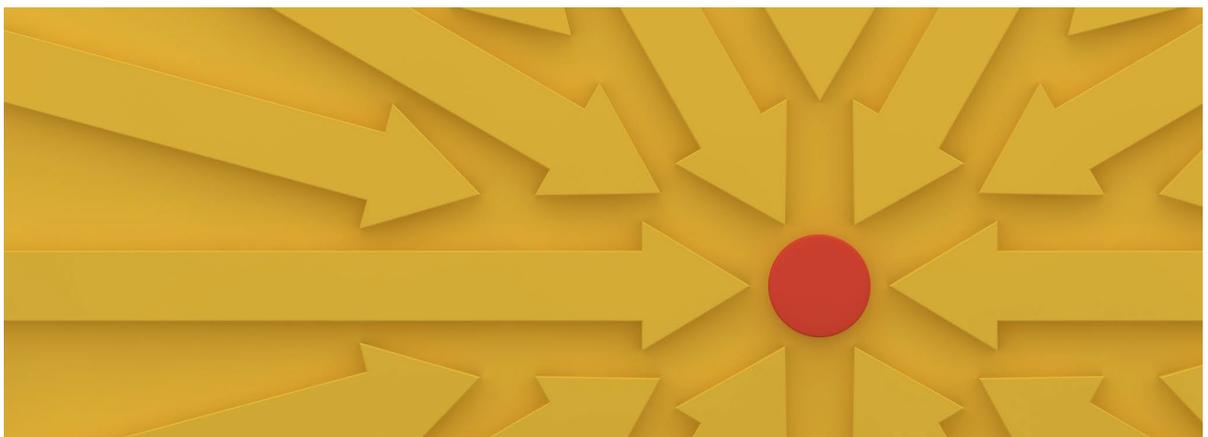


Also, if you plan to operate in the same sector, do you really want to sell your company to your main competitors? Avoid this mistake by making sure that you and the buyer are clear about your intentions.

This is of great importance when assessing how the deal will be financed. Few buyers are in a position to pay cash for the purchase of your business.

Today's buyers are more likely to need help in arranging third-party financing or to rely on you for seller financing of 50-80% of the sale price.

A good advisor will have contacts with major national banks that finance business and real estate acquisitions under an SBA loan guarantee program. A good advisor who can get your business "pre-qualified" by a lending institution will give you a powerful advantage in selling your business.





5.4 | IGNORING FEEDBACK AND WHAT BUYERS ARE LOOKING FOR

Potential buyers will tell you everything they have perceived: what you want and don't want to hear. Listen carefully so that you can, if necessary, modify your offer or make changes that can secure the sale. Owners must understand what different buyers are looking for in order to best position the business.

Some of the intangible qualities that many buyers look for are key factors in closing the sale:

- ✓ **Lack of dependence** on the owner
- ✓ A **diversified** client base.
- ✓ **Opportunities** for growth.
- ✓ Good company **reputation**.
- ✓ Sector **leadership**.

Documenting the improvements that can be made with the new capital can help increase the perceived value of your business.



ERRORS IN PAYMENT METHODS

6.1 | INCLUSION OF THE EARN-OUT CLAUSE

6.2 | STEPS TO FOLLOW WHEN NEGOTIATING
EARN-OUT



SECURING AND MAKING THE MOST OF THE PAYMENT

6.1 | INCLUSION OF THE EARN-OUT CLAUSE

In a company sale transaction, buyer and seller do not always agree on the price, as the perspectives of each party on future profits do not always coincide. The buyer pays particular attention to the risks involved in the acquisition, and the seller wants to maximise the company's potential, resulting in a significant difference between the expectations of each party regarding the price. Both parties can be satisfied with the earn-out clause in the purchase contract.

The earn-out is a clause that may appear in company purchase and sale contracts and implies that the price of the transaction will have, in addition to the fixed part, a variable part, which will depend on the performance of the purchased company over a certain period.

This clause is established to bridge differences in the valuation of the company between buyer and seller and to reach a price agreement that satisfies both parties. The sale agreement should specify how to calculate each earn-out and that the calculation should be done by an independent advisory firm, acceptable to both parties, as some earn-outs are based on figures that could be manipulated by the buyer, for example, EBITDA.

If complex earn-outs are included in a sale agreement, they should be accompanied by covenants from the buyer to secure the following points after the sale:

- ✓ **Retain** key employees.
- ✓ **Do not delocalise** work.
- ✓ **Do not interfere** with operations.
- ✓ **Do nothing** to disqualify an offer.
- ✓ **Maintain** specified capacities.
- ✓ **Limit** the buyer's personal compensation.

On the other hand, if the buyer plans to increase profits by reducing costs, it may try to exclude cost savings from the EBITDA calculation. In any case, the best practice is to keep earn-outs simple to avoid the need for complexities in the sale agreement.

6.2 | STEPS TO FOLLOW WHEN NEGOTIATING EARN-OUT

As a seller, you need to be aware of the do's and don'ts when negotiating the proceeds. To avoid unpleasant surprises, here is a breakdown of the steps to follow:



1 | Compensation

Base rewards on specific events or measurable results: winning a competitive contract, contract renewal, new customer acquisition, retention of key employees, total revenue, new product or service revenue, or gross margin.



2 | Profit structure

Avoid structuring profits on the basis of net profit or EBITDA: the cost structure changes when the new buyer takes over.



3 | Classification of earn-outs

Classify earn-outs as increases in the purchase price so that they can be subject to capital gains. Buyers want to treat earn-outs as bonuses so that they are deductible, but then they become ordinary income to you.



4 | Coherence

Make profits consistent with the buyer's business objectives.



5 | Permanence

If profits are specified in the sale agreement, stay with the company for the entire period of profits, if possible.



6 | Earn-out period

The earn-out period should be two years or less, except in unusual circumstances.



7 | Stages

Define whether the earn-out has stages, and whether it is linear or non-linear, e.g. a certain amount for the first increment and less for the second.



8 | Profits

Do not assume that you will receive any of the profits. You should consider a base selling price that is sufficient for you to compensate for the fact that you will never receive any of the proceeds.



9 | Earn-out escrow

If the buyer is a foreign company, consider an earn-out escrow. Escrow payments are payments where the money remains in escrow or deposit until the transaction giving rise to the payment is successfully completed.

Be flexible when negotiating profits. As the seller, you know more than the buyer about what is likely, so earn-outs should work in your favour.

In our experience, more than half of the earn-outs are achieved. Remember that earn-outs are always circumstantial and that, in the end, payment depends on the reputation and character of the buyer.



CONCLUSIONS

As we have seen, negotiation is a critical point in the sale. This is where all the attractions and shortcomings of the company will come to light. It is crucial to know how to highlight the value of your sales proposition and, above all, to deal with potential buyers to secure high offers.

Negotiation is the moment where the game is played and the ones most likely to win are the professional players.

An organised negotiation process, as only professional advisors know how, will maximise the value of the company. A disorganised process will lose value at every stage of the process. Disorder leads to surprises for the buyer and surprises are always considered risky elements that will ultimately reduce the perceived value of the company.

Moreover, in terms of time, experience shows that an unplanned negotiation takes much longer and, given the complexity of selling a company, the probability of failure increases.

Only professional advisors know how to find a buyer who sees the most value in your company. At the same time, they know how to present the best face to the buyer, manage all communication properly, frame the negotiation around the most valuable aspects and are prepared with good alternatives and other potential buyers.

With the right advice, and avoiding the mistakes outlined in this book, you will play your cards in the best possible way and complete an excellent negotiation, which will put you on the path to getting the maximum price for the sale of your company.

ONEtoONE CORPORATE FINANCE

ONEtoONE Corporate Finance Group is a global investment bank focused on middle-market companies. We specialise in mergers and acquisitions, company valuations, investor search, and financial advisory services.

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