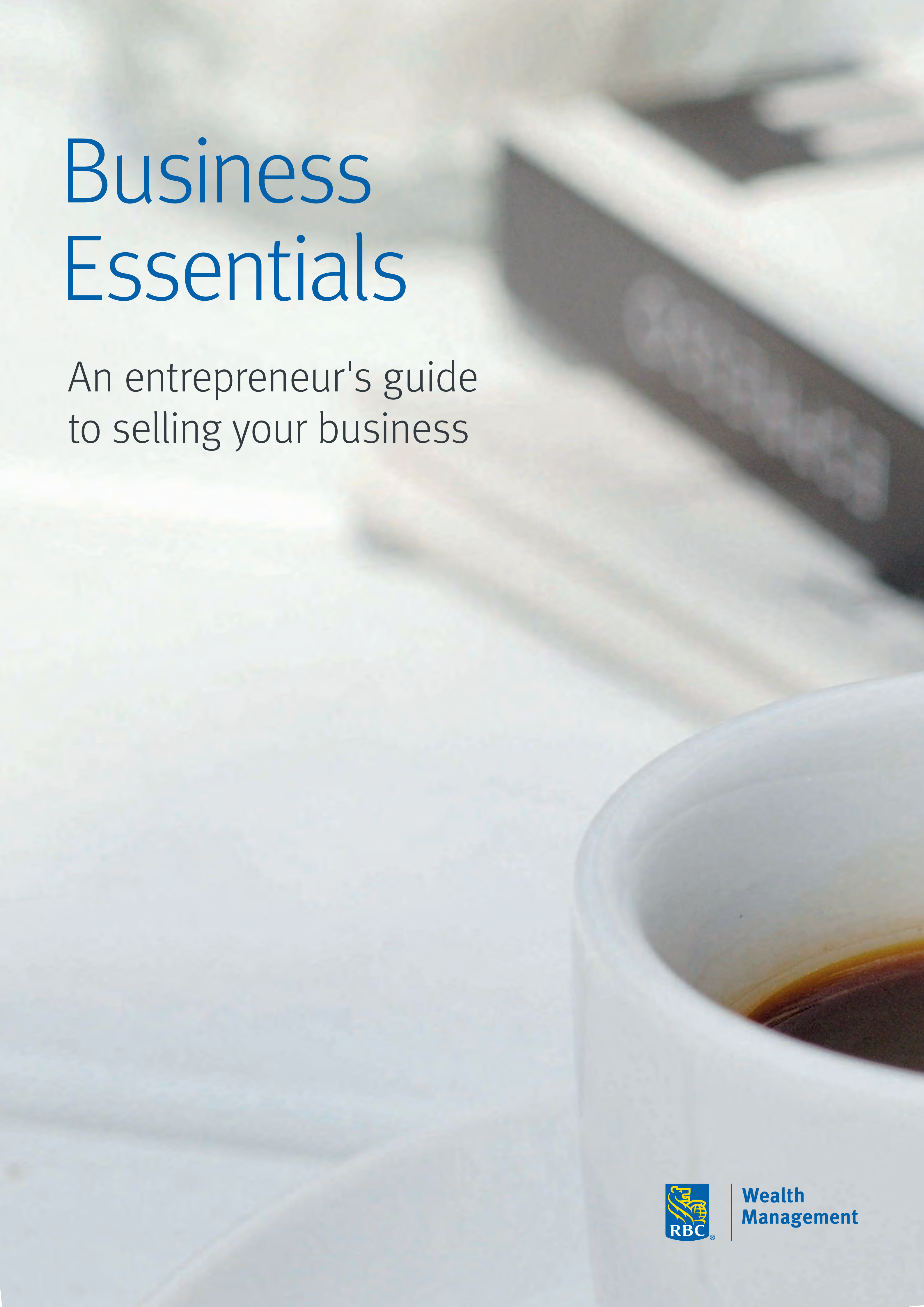
Business Essentials

An entrepreneur's guide to selling your business



RBC Wealth Management

Contents

RBC Wealth Management is committed to helping you build a goal-based financial plan that reflects what's most important to you. Discover how we can help you grow more than wealth.

Are you ready to sell?

Exiting a business isn't merely about putting up a "for sale" sign. It requires careful mental and financial planning.

01

Selling a business is one of the biggest decisions a business owner or entrepreneur will ever make. Whether it's your first sale, or your fortieth, the process can be long and complex, and will likely require more mental and emotional preparation than you first imagined.

Knowing when to call it a day

Exiting a business isn't necessarily about cashing out once and for all. While for many business owners the decision to sell means the culmination of a lifetime's work, the reasons for selling can span a broad range of possibilities.

"For some it's retirement. Others are serial entrepreneurs and will be looking to start another business and repeat the trick," says Simon Smales, a relationship manager at RBC Wealth Management in London. "Others wish to grow the business to the next level and this will usually involve selling some of their shareholding to a private equity firm or listing on the stock exchange to help fund that growth."

Once you've made the decision to sell, the next hurdle is coming to terms with handing over the reins. For many, this is the biggest challenge to overcome. Katherine Waller, a relationship manager at RBC Wealth Management in London, says this is due to the emotion and hard work that goes into building a successful business, as well as the personal and financial risks taken to build it.

"Many business owners and entrepreneurs can find it challenging when negotiating an exit strategy, even if they plan to continue working with the new management team," Waller says. "Such an exit can lead to exciting new ventures and a change in their financial profile. But this can also create new and unexpected burdens including the struggle to relinquish control of something that is so important to them."

Plan your financial future

The financial impact of selling your business is an important consideration. Don't make the mistake of deciding to sell before considering how much you will need to fund your lifestyle post-exit. This can become problematic when what you want to earn from the sale differs from the amount you actually need.

Dion Lindskog, head of wealth structuring at RBC Wealth Management in London, says this is when effective financial modelling comes into its own. "We use a modelling tool that can take into account the after-tax returns from a number of investment sources and your income

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>
> Simon Smales

requirements to see whether or not your objectives can be achieved."

Effective personal wealth planning will help determine exactly how much capital will be needed and whether this can be achieved solely through the proceeds of a sale. This is just one reason why it's important to consider an exit long before the event is likely to happen.

"All too often the decision on how and when to exit the business may be focused on a personal need or on the growth and value the owner can continue adding to the business," Waller says. "Instead, you should consider both what you need and how you can continue to grow the business to its greatest capacity ahead of an exit."

Will it be a complete or a partial sale?

Another factor to consider is whether you will sell the entire business or instead sell part of it and continue to be involved in it going forward. To that end, it is important to consider the following:

- Will you continue to work and invest in new businesses?
- Who do you need to provide for?
- What type of legacy do you wish to leave?
- Are you interested in growing the business?

The answers to these questions will help you decide whether you should exit, what format this will take and the value this strategy will add to your family and your business.

While making a partial sale is attractive for business owners who want to maintain ties with the company, there are circumstances when a complete sale is in fact the best course of action, says David Tosh, a relationship manager at RBC Wealth Management in London.

"More often than not it seems to make more sense to sell the entire business rather than seek a partial sale or an investment partner. Some businesses are victims of their own success and outgrow their capital and cash flow," Tosh says.

"Some of our clients have decided that an outright sale benefits everyone because it allows them to secure their financial future while also ensuring the future of the business under the stewardship of a new owner. Entrepreneurs are typically head strong and it often does not sit easily for them to be directed by new co-owners on what was their business creation."

No matter which direction you take, it is essential to be mentally prepared to exit your business both in terms of letting go of the reins and also in reconciling the difference between what you think your business is worth and what it is actually worth.

"If you're not ready to sell your business, it doesn't matter how much you can get if the psychology isn't there," Smales says.

Preparing to sell

What are the key things to consider in your exit strategy?

02

Most entrepreneurs are likely to go through an exit process at some point during the life cycle of their business, so the time will come to put plans in place. But when should this begin?

"A business requires a great deal of effort in order to grow and become a success, so thinking too far ahead might compromise certain goals being reached," says Simon Smales, a relationship manager at RBC Wealth Management in London. "At the same time, entrepreneurs need to put thought into what will happen both for the company and for them personally when they want to retire or release equity from their business, so having an end game in mind is always a good idea."

What happens after you make the decision to sell depends on why you are selling. For example, are you planning to retire or start a new venture? Are you seeking a clean exit or do you intend to remain involved with the company while selling part or all of your stake?

You might have several reasons for selling your business, ranging from selling shares to raise money for much-needed investment to simply exiting so you can tackle a different challenge.

Whatever your reason, the process is complex and time-consuming. Much of what happens next will depend on your motivation for selling, whether you want to be involved with the business after the sale and the timeframe you have in mind. All three of these factors will influence how you go about selling the company, so it's good to have clarity from the outset.

Planning makes perfect

One of the best ways to ensure a smooth and successful exit is to build your exit plan into your business plan well in advance of making a sale, Smales says. Given all of the moving parts associated with selling a business, it is crucial that everything is in place well in advance of any deal being signed.

To help you to formulate and execute this, identify professionals with relevant legal and financial experience – such as accountants and lawyers – as well as mergers and acquisitions specialists who have experience in your sector. They will help you to prepare the business for a sale by taking a deep look into the operations and balance sheet, contracts and even lease agreements. In addition, advisers will discuss the best options available given your reasons for exiting and, if appropriate introduce, you to credible buyers.

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>
> Katherine Waller

Most business owners prefer to appoint a different set of advisers to help them with the corporate transaction to those who manage their personal affairs.

"That doesn't mean they can't be from the same company," says Katherine Waller, a relationship manager at RBC Wealth Management in London. "Typically, however, the business owner will want a degree of separation between the advisers. This is so the individual feels comfortable and confident they are having conversations about their personal wealth, separate to what the business is doing. Choosing the right advisers is key."

It is important to make sure your professional advisers understand your values, objectives and timeframe for selling the business. With their help, you should consider any potential tax liabilities that may arise as a result of the sale and how to minimise them.

In order to do this, personal financial planning arrangements will need to align with your plans to sell the business. For example, think about how you hold shares in the company and who stands to realise value from the sale of these shares. Have potential inheritance tax and capital gains tax liabilities been considered? Do you have entrepreneurs' relief you can utilise? Will the transaction take place in two parts?

"What you don't want to do is have a liquidity event from selling your business having not spoken to your wealth manager about wealth structuring for you and your family to ensure that everything is in order. It's all about getting your ducks in a row early," Waller says.

Ultimately, the more preparation that takes place in advance of a sale, the better the outcome. This period of taking stock of a business can span multiple years and include several deals that are turned down. "Among our clients who have sold either part or all of their businesses, the process has tended to take much longer than expected and this is something that some entrepreneurs underestimate," says David Tosh, a relationship manager at RBC Wealth Management in London. "Even when things go smoothly, the negotiation process can be lengthy. This can be a stressful experience and for some people it can be overwhelming, so it is important to speak to the right advisers early on so that you are prepared for every possibility."

Think seriously about your business's value

Once advisers are in place and you are ready to start the sale process, it is important to understand how much your business is worth and the price it can realistically command in the market. It is a conversation that can prove difficult for a founder who has poured their heart into the company over the years; nevertheless, it is an important discussion to have.

"The business is always going to have an emotional value versus a financial value. You need to be realistic about the value of your business, and the value you have in it, at the moment and in the future," Waller says.

From an objective point of view, is the business in good health? The best time to sell a business is when it is doing well, has good management in place and has a

successful financial track record. Nevertheless, whether it is performing well or has room for improvement, think about what needs to happen to achieve the best possible price. This could mean renegotiating inefficient contracts or hiring in new senior staff, for example.

Moreover, are all contracts, permits, legal documents and other papers in order? It is also crucial to have an accountant to help you consider any tax implications that might affect the sale. The due diligence process will take time.

Finally, go into the process with your eyes wide open: be prepared for delays and obstacles along the way. For some business owners, the sale of a business can take weeks, and others years.

"There are various ways in which you can exit a business. Depending on who you sell to, it can be a drawn-out and stressful process that takes up a lot of your time. Having the right team around you both pre- and post-exit can only help to alleviate this," Waller says.

Just remember that planning makes perfect.

Creating a strategy for selling

Understanding your company's assets and having a solid plan in place will help to ensure the best possible sale price.

03

A key part of the process of selling a business is to engage professional advisers who will work with you to develop a clear strategy to ensure the company is ready for a sale. Part of this will include recruiting talented employees, communicating your plans to staff, and having a strong understanding of what your company is worth in the market.

Hire the best talent

If you plan to step away from the business you have run for many years, how can you make sure it is no longer dependent on your involvement? This might mean bringing in a new chief executive, chief financial officer or a fresh management team altogether.

"A business is worth more if there are people within it that you can rely on," says Katherine Waller, a relationship manager at RBC Wealth Management in London. "If that business is solely reliant on you, the likelihood is it is not going to be scalable without you."

Where a strong management team is already in place, it could make sense to communicate your sale plans to staff at an early stage to ensure their co-operation later on. Ultimately, the sale may be contingent on their future involvement.

The value of the business will come down to your staff, the strength of customer relationships, and the contracts in place, alongside the assets of the business. You should think about how to maximise value across all of these areas. During the early stages, work with your advisers to review the health of the business, get paperwork in order and make any changes that could aid the sale.

"There needs to be value in the assets. You don't want there to be a huge liability that no-one knows about. Be transparent about what the assets and liabilities within your balance sheet are producing going forward. You also need to understand the longevity of your customer-base," Waller says.

Come up with a communications plan

Communication and information flow are an integral part of the strategy. From the outset, it is important to consider how you intend to communicate with shareholders, your management team, potential buyers and the wider workforce.

"There is no point telling staff you are going to sell if you are not going to sell," Waller says.

"You need to be in a firm mindset, have an idea about who you are going to sell to, and be far down that process before you involve too many people. Your board is likely to be involved early on and your shareholders will be the next people to talk to," she adds.

In Waller's experience, the best way to get buy-in from shareholders is to articulate the value that can be realised from the deal. Meanwhile, staff are likely to be concerned about job security and the future of the company, so you will need to reassure them about the credibility of the buyer and the structure of the deal.

Of course, there is the possibility that the deal might fall through. Should this happen, it is important to be transparent with any shareholders or stakeholders, as well as being clear as to why it was not the right time.

Simon Smales, a relationship manager at RBC Wealth Management in London, says there have been several occasions when clients have had to back out of deals to sell their businesses.

"An event like that can place further stress on them following an already long process, but in most cases it turned out to be the right decision for the circumstances," he says. "For one client in particular, it was disappointing in the short term but a better deal came along a few years later and that made up for it. Getting the timing right is the key to maximising value."

For David Tosh, a relationship manager at RBC Wealth Management in London, unrealised deals are stressful not only for the business owner and co-owners, but also on other stakeholders in the business, such as employees.

"It can affect morale, but it is important to have a long-term view because terminating a deal may be best for everyone involved," Tosh says. "Successful entrepreneurs learn from mistakes and, in many cases, those who have had to halt the sale of a business are provided with an opportunity to reflect on their priorities and then successfully seek a buyer that is aligned more closely with their objectives."

Communications to potential buyers will also need to be well thought-out. A company's valuation will be based on a number of factors, including its competitive advantage, revenue growth, intellectual property, scalability and the present value of future cash flows.

Any information that is presented to buyers, particularly within the information memorandum, must highlight the maximum future cash flow and the minimum cost of capital.

"Your balance sheet and cash flow analysis needs to be bullet-proof. If there is anything that is slightly questionable, you will lose value. If someone doesn't understand it, they won't attribute a value to it," Waller says.

Know your company's market value

Your advisers should provide you with a valuation range to expect from potential buyers, based on a number of metrics for your business, comparable recent transactions and valuations of rival companies that have been sold or listed on the stock market.

A business owner should also determine their 'walk-away price' early on in the sale process. This is the price that signals when you will walk away from a buyer during negotiations. In Waller's experience, the walk-away price is likely to be defined by

how much the business owner requires to fund their plans after the sale.

"You have to be sensible about what your business could be worth from an internal and external perspective, and how much is enough for you and your family. That comes back to its marketable value, which refers to the multiples of earnings your company can realistically achieve in the market," she says.

Another way to boost the sale price is by creating competitive tension among potential buyers. This will come down to your professional advisers and their ability to put you in touch with credible buyers, who are able to deliver the type of deal you are seeking.

Once you reach the final stages, hold your nerve and take a pragmatic approach during negotiations. It is likely to have been a long journey to have reached this point and no one wants to fall at the final hurdle.

Making the sale

The preferred route for the sale of your business can create its own challenges.

04

The structure of the deal and the route you take to sell your business will depend on a number of factors. These include the amount of involvement you wish to have in the future and the health of the business. Both will affect the profile of prospective buyers or the viability of a stock market listing.

Potential buyers are likely to include existing employees, competitors, new market entrants, family members, suppliers, customers and investors.

Here's an overview of some of the different sale options:

- Full exit/share sale – the transfer of all of the seller's shares to the buyer, with the entire sum paid to the seller up-front once the deal is closed.
- Earn-out - this means an initial price is agreed for the business, but the seller can receive additional compensation if the business achieves specific goals in the future.
- Partial sale – the business owner chooses to sell a portion of the company or a percentage of their shares.
- Asset sale – only the assets of the company transfer to the new owner. Should any liabilities arise, they are the responsibility of the previous owner.
- Initial Public Offering (IPO) - the sale of a company's shares to the public via a stock market listing.
- Management buyout (MBO) – a company's management team purchases the assets and operations of the business.
- Private equity sale – a partial or full sale of the shares to a private equity firm, which hopes to grow the business and sell it for a profit in the future.

Your intentions will determine the type of sale

There are different risks and benefits associated with each path, says Katherine Waller, a relationship manager at RBC Wealth Management in London.

"The choice will come down to how much involvement you would like to have, and what, if any, shareholding you would like to retain," she says.

Your future aspirations for the company will also have a bearing on the sale route you pursue. If you want to protect the staff and management team, you may not wish to enter into discussions with asset strippers or private equity firms, as they may be more likely to change senior personnel and make redundancies.

Another consideration is whether you are comfortable with the publicity that is typically associated with each exit route. For example, an IPO is likely to attract more press attention and scrutiny than a management buyout.

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Likewise, your choice of professional advisers will influence the route you end up taking, the prospective buyers you enter into talks with and the tone of negotiations.

"Make sure you have got the right advisers in place, including a corporate financier, accountants and lawyers. Choosing the right team for your negotiations is paramount," Waller says.

"Choose the right one. Not because they have the best price, but because they understand you and your objectives as well as the business, its balance sheet and trajectory the best," she adds.

Poring over potential buyers

The next stage is to come up with a broad list of potential buyers with your corporate broker. Keep an open mind about prospective purchasers and consider how you can utilise your professional network to identify interested parties.

"When you talk to a corporate financier, have an idea of the type of exit you would like and be open-minded. They will then be able to give you other ideas based on their knowledge of what is going on in the market and can help you to draw up a shortlist," Waller says.

One of the key factors to consider when you are looking at any prospective buyer is whether they are credible. What is their track record? Do they have the finance necessary to undertake a deal?

It is also essential to ensure confidentiality during discussions to avoid sensitive information being leaked to the press or competitors.

With input from your corporate broker, put together a shortlist of serious buyers to receive the information memorandum. This document outlines the history of the business, how it differs from rivals, the ownership structure and financial performance. It should clearly articulate the company's competitive advantages.

Working out when to tell staff about the sale can be a dilemma during the process. It also highlights the importance of managing information flow.

"It isn't necessary to inform staff until you have a clear and focused outlook about the sale process, and know what is going to be deliverable. The other side is that anyone who is involved in the process should be deemed an insider, so that knowledge and information is kept private and confidential," Waller says.

Once you have a shortlist, an experienced broker should help you to create competitive tension among the interested parties.

It is then a case of holding your nerve during final stage negotiations: take a pragmatic approach and keep one eye fixed on the finish line.

Don't forget to plan for life after exit

In many ways, selling your business marks the transition into a new phase of life. But what this transition entails depends on the type of sale and how it is structured. Therefore you should think through your options in advance, says Simon Smales, a relationship manager at RBC Wealth Management in London.

"If it is a trade sale or a sale to a private equity investor, there will often be an earn-out period where the seller is tied in for a few years to ensure a smooth handover and that the business continues to grow," he says.

"If it is an outright sale, then the next step is usually a pause for breath. Often this is the first time you will have had so much liquidity, and it is a good idea to put that hard-earned cash somewhere secure and take a holiday before deciding what to do next."

Indeed, the question of what to do next is what many business owners forget to consider when selling their business, says David Tosh, a relationship manager at RBC Wealth Management in London.

"After more than 15 years of meeting and looking after entrepreneurs, I have found that many business owners are so focused on the deal and the corporate sales process that they inevitably overlook properly thinking about themselves as individuals during this process," Tosh says. "Too often the tax consequences as individual shareholders are considered too late and likewise individual priorities and goals for life after exit are not fully thought through."

He adds, "Many business owners don't have a clear view of what they will do following the sale of their business, while others have done little preparation financially. Seeking advice from a wealth manager and private client tax adviser specialist ahead of the sale provides numerous benefits including wealth structuring following a liquidity event."

Above all, if a liquidity event is on the horizon, Waller says the best thing a business owner can do is seek advice before it happens. "The ideal time to come for advice is actually before the liquidity event because there are some sensible steps you can take up to 12 months prior to a sale to ensure you make the most of what is, for many, a one-off opportunity," she says.

Start the conversation

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