Jon Siebers:

I'm a puzzle person, and transactional law is kind of like putting together puzzles. Especially with mergers and acquisitions, there are so many moving pieces of the puzzle that you have to fit together that it's challenging and it's fun and rewarding.

Jeff Large:

That's John Siebers, a shareholder and attorney at Rhoades McKee. John's specialty is mergers and acquisition.

Jon Siebers:

Usually in the sale or purchase of a business, it's a team effort. So you're working with multiple other advisors, you're working with your clients, other attorneys, investment bankers, business brokers, bankers, CPAs, all those people. So you get to work with a lot of different people. It's just fun.

Jeff Large:

Today on Conversations with a Business Attorney, we are talking about everything you need to know when it comes to selling your business. I'm your host and fellow business owner, Jeff Large.

For my discussion with John, I want you to listen for a few key things. Many aspects of your business can affect its value and its ability to be sold, and I was actually surprised by a few that John listed. Negotiations play a big part of the sale, and there are many nuances in deal making that you can use in your favor. Even if you never plan on selling your business, you'll see that there are many benefits if you run your business like you want to sell it.

John and I start with the basics. What does it actually mean to sell your business?

Jon Siebers:

A sale of a business typically involves either an asset sale, where the business, the entity itself, is selling the assets it owns, or it involves the sale of the equity in the business itself. So a stock sale or an asset sale.

Jeff Large:

What's the practical difference?

Jon Siebers:

In an asset sale, think of a couple of buckets. You've got a bucket in your garage with a bunch of soccer balls and basketballs and footballs in it, and somebody wants to buy those from you. In an asset sale, they bring their own bucket and they simply empty your bucket of balls into their bucket.

In a stock sale, they buy the bucket itself, including all the balls that are in it.

Jeff Large:

Okay, okay. One other thing I wanted to set the premise on is who needs to know about selling a business?

Jon Siebers:

Typically, we're working with the business owners themselves, but it could be an investor in a business. It could be a lender that is involved in the business. It could be some other person that has some interest in the business. But usually, it's the owner of the business that we're working with or their management team.

Jeff Large:

What I'm wondering, say I don't have intention of selling, is there any reason that I should listen to this episode?

Jon Siebers:

Well, you're going to exit your business one way or another at some point, either on a stretcher if you hold onto it past your death, or you're going to sell it or transfer it to a key employee or to a family member. So even if you're not thinking about selling now, usually a sale process and preparing a business for sale, it takes a period of months, if not years, to do it properly. So even if you're not thinking of selling in the next three, four, or five years, now is the time to start thinking about it.

In fact, we tell people the time to start thinking about your exit is when you form the business because you always want to have a game plan in place for how this is going to end, and how you want it to end may impact what you do while you own the business.

Jeff Large:

If we were beginning here at the front of this, setting the framework, what are some situations that people find themselves in where they're going to need to sell? You said death obviously is one of them. What else?

Jon Siebers:

Well, in the ideal scenario, they have gotten to a point where they're financially stable and they have other things they want do in their life and they're prepared personally to sell, the business is prepared to sell. So it's a deliberative process. That's the best case scenario.

The worst case scenario is when someone dies and they own the business. I've sold a number of businesses on behalf of the surviving spouse. That's never fun because they don't usually know the ins and outs the way that the former owner did.

The intermediate ground or the middle ground in terms of best to worst would be something other than death happens in your life. You are burned out, a key employee quits, you have health problems, the business is in a downturn, there's a recession and you don't want to go through that again. You've been through the Great Recession, you've been through COVID, and you don't want to go through another downturn like that. So you just want to get out as soon as possible.

Jeff Large:

It sounds like this topic is beneficial for any business owner-

Jon Siebers:

Correct.

Jeff Large:

... in general, whether you plan on selling or not. I know I've firsthand seen and even worked with different coaches who typically when you ... Even if you don't have intent of selling, your business will often get better when you prepare it to sell, if that makes sense.

Jon Siebers:

That's for sure. Yeah, definitely.

Jeff Large:

You'll just run a better business. I'm curious, again, at this baseline stage, even if you don't plan on selling per se, what are some basic things that we should have in place from a legal standpoint that can help us along this journey of, like you said, being ready to do it when the time comes?

Jon Siebers:

I think first thing you need to do is make sure that you have a plan that you put in your desk for what happens if you pass away. So whether that's a plan with your spouse, whether that's a plan with your business partner, whether that's a plan with your key employee, have some plan in place for what's going to happen if you pass away suddenly because that covers that emergency scenario where everybody has to drop everything and figure out, "All right, what are we left with here? So-and-so has passed away. What are we supposed to do next?"

Jeff Large:

Just to clarify, is it something that I can draft myself, or are we talking that I should be working with an attorney to create this plan?

Jon Siebers:

I would be working with an attorney and a CPA, and there are a lot of exit planning consultants out there as well that can help with that.

The other thing is preparing your business. You mentioned before, if you are working on your business and trying to prepare it for a sale, a lot of times you're improving the business. One of the improvements could be that you're improving your profitability. So looking at your business, figuring out what can we do to increase our earnings? Most companies when they sell, the valuation is based at least in part on what their earnings have been in the past and what their projected earnings are in the future. But the more your earnings are, obviously the more you're going to get for your company.

Looking at ways to improve your earnings from a legal standpoint, just making sure your books are clean, making sure that if you have a partner, that you have a good buy-sell agreement in place that talks about what happens if a death or a disability or a bankruptcy or divorce occurs. If you have key employees the business is really dependent on, making sure those key employees are tied to the business in some way. That can be done either through a carrot, through incentives, or through the stick. The carrot or the stick. The stick is typically going to be a non-compete type of a restriction.

Jeff Large:

Okay. All right. There's a lot of places that I think we can dive into. I want to back up just a tiny bit though. I'm assuming that we will have another episode that we're discussing succession planning, and so we'll likely cover that there as well. But just to get your take, what are some basic things or what should this plan that you mentioned, what are the things that that should cover?

Jon Siebers:

Typically, a plan would cover what events trigger the plan. So is it just a death? Is it a death or a disability? Is it a death, disability, divorce, other involuntary transfer? It should address who has either the right or the option to purchase the business and the timing of that. It should talk about the value. What's the purchase price? Is the purchase price determined based on a formula? Is the purchase price going to be determined through a valuation? Is the purchase price going to be agreed on annually by the partners? It usually talks about how the purchase price is paid too, if it's cash at close, if it's cash and 10% down and then the rest on a note. Those are usually addressed in that plan.

Jeff Large:

You mentioned a few, but in terms of doing some of this baseline preparation, you've seen it obviously make it easier in the case of an emergency. You've seen it increase profitability. What other results, positive results, have you seen in businesses that begin this process?

Jon Siebers:

Another thing that we recommend that clients do is look at their contracts and see if they have issues with customers in their contracts, customers or vendors. Or if they don't have contracts at all, can they go out and get contracts? A lot of times if you have a contract that locks in a revenue stream, your company is going to be viewed as less risky and therefore more valuable to a buyer. So looking at your contracts and figuring out where are risks and where can we clean things up, it's going to make it better for a buyer and it's probably going to make it better for you as the seller while you still own the company as well.

Another thing that we typically recommend is that for key contracts, you look at the assignability clause in the agreement. A lot of contracts state that you can't assign that contract from one party to another unless you get the other party's consent. So if you're leasing property from XYZ leasing company, you can't assign your lease to the buyer of your company without XYZ leasing company's consent. So those are things that can create roadblocks in a transaction, third party consent requirements. So getting an idea of what those are in your company and if you can avoid them, trying to avoid them. If you're renegotiating a lease for five years and you think you're going to want to sell in the next two or three years, you need to pay very close attention to the assignability clause in your lease.

Jeff Large:

As you can hear, there are many things you can do as a business owner to improve the value of your company in getting it ready for a sale, things like making sure your accounting is clean and that you review the contracts you have in place with all of your clients and all of your vendors.

You also want to make sure that you have an understanding of your intellectual property and patents.

Jon Siebers:

Looking at if you've got valuable IP that's either in or outside the company, making sure you understand who owns that and what it takes to transfer it. A lot of times, patents are held by the individual and inventor of the product rather than by the company. If that's going to be valuable and increase the value of the company, do we want to put that patent into the company before we sell?

If you have valuable logos, trademarks, other things like that that are not registered, should you go out and register them so that they have more protection and thus more value for a buyer? Usually, if the owner of the patent is the owner of the company, it's an easy transfer.

The bigger issue is if you've been using a trademark or a trade name for years and you've never registered it, when you go to sell, the buyer's going to want to know, "Well, is there anyone else out there that could be using this trademark or trade name? If so, that decreases the value of it to me." So by going out and doing that registration process and figuring out, do we have exclusive rights to this and trying to lock in those exclusive rights can help you when you go to sell the company.

Jeff Large:

All right. What about who are typical buyers for a business?

Jon Siebers:

Well, there's a whole spectrum of buyers, and one thing I would say is that every buyer is not right for every seller. I think most sellers don't understand that different buyers bring different things to the table. As a seller, you really need to figure out what your goals are. What are your goals that you're looking to achieve in the sale of the business? Are you looking to maximize profit? Are you looking to maintain the legacy of your family business that's been running in the family for three generations and you want that business to continue to be a shining example in the community? Do you want to protect your employees and make sure that the buyer doesn't come in, buy your company, shut down the plant, and move all the jobs to California? So those are different goals that sellers often have in the sale, your typical financial goals and your legacy goals and your employee protection goals.

Different buyers can help achieve different goals. So your typical list of buyers would be a strategic buyer, which would be another company that's going to come in and buy you; a private equity group, which is essentially a professional buyer that comes in and buys your company. Most PE firms try and increase profitability over a very short window of time so that they can turn around and flip it in the next five to 10 years. Then there's your typical financial buyer. It could be somebody who is an executive in corporate America, and they don't want to work for a big corporation anymore. They want to buy their own company. So it's just a wealthy individual that's coming to buy.

We've seen more different types of buyers come into the marketplace in the last five to 10 years with more and more family offices as buyers. A family office would be wealthy families, like a family who's made a billion dollars with a company. Now they're taking that money and investing it in other companies. Tribal organizations are buying businesses. They're trying to take their gaming revenues and diversify their portfolio by buying operating companies. Buyers often include family members and key employees as well.

Jeff Large:

Okay. Yeah, so I mean I hear all that, and I could tell you I begin to get overwhelmed.

I'm curious if we go back to the intent that you were saying, if we go back to those goals, because I'm sure our listener, and especially if they are considering buying, how would you advise them on each of those three, when we're looking at it from finances, when we're looking at it from legacy, and when we're looking at it as employee protection? How do those differ in terms of how you would advise me wanting to sell?

Jon Siebers:

Okay, so I'm going to give you some general rules. There are always exceptions, but the general rule would be if you're looking to maximize your returns on the sale, a strategic buyer, another company that wants to come in and buy you. It could be a competitor. It could be somebody else in your supply chain. Or a private equity group would typically be the ones that can pay the highest purchase price. There are a lot of different reasons for that, but suffice it to say, typically your strategic buyers and your PE firms are going to be paying the most.

But that comes at a cost. Usually, they can pay more because they're going to get certain synergies after they close the transaction. Those synergies are usually gained by cutting costs. So they may take all the productions that they have in Michigan and move them into an Indiana operation. So your legacy, your family legacy, and your protection of employees just got thrown out the window with those two buyers.

Now again, there's exceptions to those rules. If you want to maintain legacy and protect your employees, usually I would say a financial buyer, someone who is just going to buy your business, they're not looking to buy your business and add it onto another business, they're buying your business as a standalone investment, is going to be the best option because typically they're not coming in and looking at making a lot of changes to the company and then flipping it in a few years.

The thing to consider though, is some of the financial buyers have to put so much leverage on the company. If you sell to the wrong financial buyer who doesn't have the necessary financial support to continue to operate the business post-closing, you're not doing your legacy or the employees any good. So you want to make sure that any way you go, you really vet your buyer carefully.

Jeff Large:

Because you've seen both sides of this process, as a seller, what should I know about my potential buyer, or what things should I be considering about their point of view in order to make this the best agreement or the best transaction for both of us?

Jon Siebers:

Well, I think you want to understand, number one, what's their plan for the company after they close? Are they going to shift everything from Michigan to Indiana? Are they going to continue to operate status quo, and if they're going to continue to operate status quo, what's their culture? Is it a good fit? Will your employees and the buyer's employees be like oil and water, or will they mesh very well together? Those are some of the things that I would look at if I was selling to a strategic or a PE firm.

I would want to know how they're paying for it. Especially if there's going to be seller financing involved, how much debt am I going to be subordinated to? How much debt does the bank collect before I get paid on my seller note?

I'm going to want to know what changes they're going to make with customers and with vendors. Are they going to come in and immediately shift all their relationships, or are they going to try and continue the status quo? If you're really looking to protect your employees, you're going to want to think about and ask, what kind of salaries are you going to be paying? What are the wages going to look like? What are the benefits going to be? What other things do you offer employees that I can't offer today?

Jeff Large:

That was an interesting one. All right, so looking at setting the stage of who this is appropriate for, sounds like in some capacity, everyone. There's a lot of different options that we have for potential buyers. There's obviously a lot of reasons that we can sell. These are all things that we should be thinking through. There's also this element of the actual payout. Tell me about that.

Jon Siebers:

Well, I would say there are three main ways that sellers get paid, and a lot of times a transaction will include a combination of those ways.

The first is all cash at closing, and that's what most sellers prefer, although there may be tax reasons why deferring some of the payment into a later year is beneficial. But the least risky way to structure a deal from a seller standpoint is where the entire amount of the purchase price is paid at closing.

In a lot of my deals, I would say probably close to 50% if not 50% of my deals, we have seller financing involved. Seller financing is when a seller gets cash at closing for a portion of the purchase price, and the remainder is paid after closing on a promissory note. It's a promissory note that the buyer signs and delivers to the seller just like they would to their bank.

So let's say your purchase price is $5 million and you're going to have 10% seller financing. In that situation, you would have $4.5 million in cash at closing, and then the balance of $500,000 would be paid on a promissory note. And that when you're doing seller financing, you want to think about what's my collateral? Is there any collateral? Is it a secured note or is it unsecured? Am I getting a guarantee from the buyer? If they default, can I go after the buyer personally on the note? Usually, there's a senior lender involved, and almost always the seller note is subordinated to the senior lender's note. The bank always gets paid first, so you want to think about what's my risk that they're going to default to the bank? If the bank comes in and takes its collateral, is there anything left for me? So those are the considerations in seller financing.

The third method of payment is an earn-out. An earn-out happens when the buyer pays the seller some proceeds after closing dependent on some metrics being achieved in the business after closing. A lot of times it's based on earnings after closing or revenue after closing or customer retention or things like that. So if the business does really well after closing, maybe the buyer pays the seller an extra 10%, which would be treated as purchase price. If the buyer doesn't do well after closing, then the seller doesn't see any of that.

There are all sorts of considerations to think about when you're structuring earn-outs. Most sellers want an earn-out to be based on revenue because revenue can't be manipulated by the buyer in the same way that earnings can. If you have an EBITDA-based earn-out, a buyer can come in and start making changes to the company that impact the EBITDA and make it less likely that the earn-out is going to get paid.

Jeff Large:

Will you define that term for me?

Jon Siebers:

EBITDA is earnings before interest, taxes, depreciation, and amortization. EBITDA is used a lot in valuation rules of thumb and valuation of companies. A lot of times, they will look at multiples of EBITDA. EBITDA is often used as a metric for earn-outs as well. But again, if I'm representing a seller, I don't like EBITDA-based metrics or EBITDA-based earn-outs because of the fact that they can be manipulated by the buyer.

Jeff Large:

All right. But I am curious in terms of what you see and maybe what you see more broadly even outside of your own clients, how do those three different types of transactions typically pan out? What percentage of each? You have X percent of people paying cash at the time of purchase. You have X percent with version two. You know what I mean? I guess, what do I expect as a seller?

Jon Siebers:

I would say in probably 95% of my deals, all or a majority of the purchase price is paid in cash at closing.

Jeff Large:

Okay. Is that normal? That feels high.

Jon Siebers:

Well, when I say or a majority, that leaves room for the seller financing too. Let's say 40% of my deals, the entire amount of the purchase price is paid in cash at closing. In probably 50% to 60% of the deals that I see, there's a majority of the purchase price is paid in cash at closing, and the balance is paid on a promissory note through seller financing. Then I see earn-outs in maybe 10% of my deals. The earn-outs are not as common as seller financing.

Jeff Large:

Yeah. It seems like it's almost conflicting as well. I guess it seems like in a lot of situations it would be beneficial for the seller to just get paid at the time of closing, but it seems like it's the opposite for buyers. What I'm more curious about is, how does the seller align and negotiate something like this well with a buyer?

Jon Siebers:

Well, a lot of times, notes and earn-outs are used to close the gap between what the buyer thinks the business is worth and what the seller thinks the business is worth. So if the buyer thinks the business is worth $5 million and the seller thinks it's worth $6 million, maybe we close that million dollar gap with a seller note or a combination of a seller note and an earn-out.

Another problem that seller financing solves is when the senior lender will only loan the buyer a portion of the purchase price. So let's say the purchase price is $6 million and the bank will only loan $4 million and the buyer has $500,000 in cash. They've got $1.5 million gap to close there, and usually that's done through seller financing or an earn-out. More commonly seller financing.

Jeff Large:

Another important aspect you should understand is the negotiations and the roles different assets play on how the deal should be structured.

Jon Siebers:

When we negotiate, usually I first become really actively involved in a sale when there's a letter of intent being negotiated. I always encourage the seller to have their CPA involved in that process as well because what work ... the letter of intent or LOI will state what the deal structure is and whether it's an asset sale or a stock sale. Typically from a legal standpoint, doesn't make a huge difference to the seller. But from a tax standpoint, it can make a significant difference. So when you're negotiating purchase price, you need to also think about structure and what's the net take-home going to be to the seller. If you structure it in a way that's tax disadvantageous to the seller, you may have a great purchase price, but your net proceeds are going to be lower than if you had structured it some other way. So that's something to consider when you're looking at getting paid.

Jeff Large:

Yeah, that's important. Let's double back to what we were saying about, you said asset or stock. Give me situations. When might I want to sell as an asset versus when might I want to sell as a stock?

Jon Siebers:

Usually ... and this is again a general rule of thumb. There are exceptions to every rule. The general rule is that buyers typically want to do an asset sale, and there are two reasons for that. Number one, there's a legal reason in an asset sale. Buyers avoid a lot of the carryover liability from the seller. Number two is the tax reason. Usually, buyers get a tax benefit in doing an asset sale because they can get quicker depreciation of their assets in an asset sale.

As a general rule, sellers typically want to do a stock sale if they're a C corporation because a stock sale will provide significantly less taxes than an asset sale would for a C corp. If the seller is either an S corp or a partnership or a disregarded entity for tax purposes, usually there's not as big of a tax difference between an asset sale and a stock sale. From a legal perspective, it usually doesn't make that much of a difference for a seller between an asset sale and a stock sale. So it's usually the tax difference that's going to drive the decision of what's best for the seller.

Jeff Large:

Okay. So it sounds like then in terms of the people who are helping in this process, a solid attorney, an accountant. Is there anybody else that's typically involved?

Jon Siebers:

Well, and I would say the accountant should be somebody who is very familiar with transactions because there are a lot of CPAs out there that are very good at doing tax returns, but if they don't provide the type of advising that you need in a transaction, they're going to be out of their league. So you want to find somebody who's got a lot of experience with M&A transactions.

A lot of times, the sellers' bank, if they have a close relationship with their banker, will be involved in helping them vet the deal. I would say in probably a majority of the transactions that I

do, there is either a business broker or an investment banker involved that is basically there as the intermediary to facilitate the transaction.

The personal financial advisor of the sellers, the owners of the business themselves a lot of times are involved as well, just making sure that we're structuring a deal that's going to put the most money possible into the owner's pockets and figuring out what they're going to do with that money after closing.

Jeff Large:

Valid point. Obviously, the focus of this show is the legal side of things. I just think any time we're talking to a professional like yourself, you have a very unique perspective. What kind of things as a seller should I be looking for in the attorney that I want to hire to help me with this process?

Jon Siebers:

Experience is the number one. So the first thing that I would look for is an attorney who specializes in mergers and acquisitions. It's very frustrating to work with attorneys on the other side of transactions who don't do M&A deals because we're constantly trying to educate them on how things work in the M&A world. So you want to find somebody who knows what they're doing. In the end, it will cost you less money to get a really good M&A attorney because they're not going to be spinning their wheels the whole time, and you're going to get a better deal as well.

I think that the second is looking at the bench strength of the attorney. If you're looking at an M&A attorney in a very small firm who doesn't have a lot of other specialties around them, it's harder to do big transactions. What I mean by that is when I represent sellers, oftentimes we'll have tax issues come up that we need tax lawyers for. We'll have employment law issues come up that we need employment attorneys for. We'll have environmental issues come up that we need an environmental attorney on. If you don't have an environmental, a tax, an employment attorney in your firm, it's harder to address those. Now, Rhoades McKee has all those. A lot of the bigger firms do as well. So that would be the next thing is looking at not only the attorney themselves, but what kind of bench strength do they have around them?

Jeff Large:

Valid points. We talked about a lot of the things to look for and how to position these deals. What are maybe red flags from you going through this process multiple times as a seller, maybe especially things that I might not notice? What are the red flags that I should be looking out for in deals that I potentially might enter into?

Jon Siebers:

If I'm a seller and I'm trying to vet a buyer, here are some of the things that I'm going to look for. Number one, do they have good people around them? Do they have advisors who know what they're doing? If I can't make that determination as a seller, I'm going to ask my advisors, my attorney, my CPA, "Hey, have you ever worked with these people before, and do they know what they're doing?" So that's one thing I'm going to look at.

Another thing is if I know that this buyer has been involved in other transactions, how did they go? Can I go and talk to somebody else that this buyer has done a transaction with? A lot of times, you'll see private equity firms maybe rolling up businesses in a certain niche industry. Do I know other sellers who have sold their company to this buyer, and if so, can I talk to them and

see how did the deal go? Did the things they told me before the deal happen after the deal, the assurances that they gave me? Are they good to work with? Those are a couple of things.

I think you want to be very cautious as a seller of the financial backing of your buyer. If the buyer doesn't have the financial resources to purchase your company, it doesn't matter how good they are to work with, you're not going to get a deal done. I think those are probably the top three that I would be thinking through.

Jeff Large:

Yeah. What about just from the amount of times that you've either gone through this process and consulted people, what are some frequently asked questions that you see that perhaps we haven't covered yet?

Jon Siebers:

I think a question that people ask me all the time is, "When should I start thinking about selling?" We talked about that before. The time to start thinking about selling is well in advance of when you have to sell or well in advance of when you want to sell. The more time you put into it and the more thought and planning that goes into it, the more options you're going to have when you go to sell.

Another question that I get all the time is, "When should I bring in my attorney? When should I hire an attorney?" What I typically tell people is, I need to get actively involved with negotiating the nondisclosure agreement that the buyer is going to sign and with negotiating the letter of intent. From then on, I'll be very active in the transaction.

Typically, the NDA, the nondisclosure agreement, is the first thing that gets signed. A lot of times I'll look at the NDA, that'll get signed, and then I don't hear anything for months because the buyer and the seller are negotiating financial aspects of the deal. The buyer may be doing some basic financial due diligence. It's not until they have proposed valuation for the company in at least general terms for the deal that they come and get the attorney involved. But the earlier that I'm involved, the more I can help keep you from going down the wrong path. So whether that's before you sign the NDA or just before you sign the LOI, it really depends on the deal.

I see a lot of sellers who say, "I want to sell within the next year or two, but I want to put my team together now. So I want to have an M&A attorney. I want to have an experienced CPA and any other advisors, whether it's a business broker, an investment banker, I want that team to be assembled now so that when I am ready to pull the trigger, I don't have to scramble to find the right people to work with me."

Jeff Large:

One thing I've learned from both the coaches I've worked with and from conversations like these is that it's in your best interest to run a business like you're going to sell it, even if you're never actually going to.

Jon Siebers:

I talk to clients all the time that don't have any intention of selling in the next 10 years, but they've engaged me. In addition to having a focus on mergers and acquisitions, I do a lot of general outside counsel type stuff where I'm helping clients with their operating agreements and shareholder agreements and things like that. So having an attorney that can see the big picture

of the lifecycle of the business, looking at their general corporate law issues as well, I think is beneficial.

A lot of companies don't have a plan and don't have a team, and they wait until two months before they sell, and then they say, "I'm ready to sell. I better put together a team." It's never too late to do that. I've had deals where a seller has come to me and said, "I need to close within two weeks. Can you help me?" I've helped them close that quickly. That's not ideal, but it can happen. But again, the longer ahead you start planning for it, usually the better off the transaction is going to be.

Jeff Large:

Okay. So it sounds like then maybe as you're vetting your attorney too, if you think it's even a dream at some point, the sell, somebody that maybe has that broader scope alongside those specialties that you've talked about.

Jon Siebers:

Yeah.

Jeff Large:

Okay, that makes more sense. That makes more sense.

Jon Siebers:

Or if they don't themselves, they have colleagues in their firm that do.

Jeff Large:

True, true. Like you said, who's on their team. So that's really important.

One more that I wanted to ask in this vein is, what are the things that you wish clients were a little more informed on before they came to talk to you?

Jon Siebers:

There are a couple of things that take a lot of coaching in an M&A transaction. The first is networking capital adjustments and what the role is of networking capital in the business.

Jeff Large:

What does that mean?

Jon Siebers:

The example that I often give is, if you're selling a business, the buyer is going to assume that there's a certain amount of networking capital that's included in the purchase price. In the same way that when you go to buy a car, you're going to assume that there's a certain amount of gas in the gas tank. If you buy a car that has no gas in it, it doesn't run. It doesn't matter how great the car is, it's not going to be valuable. So usually a buyer is going to want some reasonable amount of working capital, and the most common forms of working capital are going to be inventory and receivables minus payables.

But usually, there's a whole section in the purchase agreement, whether it's an asset sale or a stock sale, that talks about how we're going to determine what that normal amount of working

capital is and what's going to happen if you sell the business if when we close the business has more or less than that normal amount of working capital. Working capital for a lot of sellers is really hard for them to get their heads around. So that's one thing that I think if I was coaching people on things to look into before they go to sell, they should look into, well, what's the role of working capital in an M&A transaction?

Another would be the role of the allocation of purchase price. In an asset sale, the IRS requires the buyer and the seller to allocate the purchase price over various ... There are seven asset classes that the IRS says you have to allocate the purchase price across. How you dump the purchase price into those seven buckets impacts the taxation of the buyer and the seller. In stock sales, there are certain stock sales where if you make a certain type of an election, it's called a 338 election, it's a stock sale from a legal standpoint, but it's taxed as an asset sale. So in an asset sale or in a stock sale with a 338 election, you have to have an allocation of purchase price. That can have a big impact on the net take-home to the seller because it impacts their taxation.

Jeff Large:

What about final tips? What would you like to leave the listener with?

Jon Siebers:

Most of my seller clients, their company is by far their biggest asset, and they need to understand that selling a company takes time and it's time-consuming and it's complicated. So you want to make sure that you have the right team.

You also want to think about how am I going to meet the demands of the buyer during the due diligence process and run the business at the same time? Can it be done? If I can't do it myself, do I need to loop in one or two key employees who can help me? Those are things that you need to consider. If I can't run the business and respond to all the diligence requests of the buyer at the same time, something's going to suffer. Either the business is going to start to go down, which no buyer likes to see, or you're going to tick off the buyer because you're not being responsive.

So trying to figure out who can I trust, at what point do I bring them in? The general rule is that you don't tell your employees, your customers, or your consultants or your vendors until after the deal closes. But there are exceptions to the rule, and one of those exceptions for employees is, who do I need to help me in order to get this deal done?

Jeff Large:

A big thanks to John Siebers for sharing his time and expertise on today's show. If you have any questions about selling your business, consider reaching out to John or one of his peers, and you can learn more at rhoadesmckee.com. I'll make sure that link is in the show notes.

Conversations with a Business Attorney is a project from Rhoades McKee, and it's produced by Come Alive Creative. Big thanks to Rachel Workman, Isadore Nievez, Elaine Mohre, and everyone who helped make this show possible. I've been your host, Jeff Large.

Last, please do me a favor. If you actually found this helpful, share it with somebody else who might need to hear what we talked about today. Your share goes a long way.