M&A Corner

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5 Mistakes to Avoid When Selling Your Business

By **Jim Anderson**

After working hard over the years to build a successful tag and/or label converting company, perhaps you are finally ready to sell. Whether you decide to do this on your own or with the help of an intermediary or broker, there are some common mistakes that you'll want to avoid in order to make the process go smoothly for you and your other shareholders. Here are five of the biggest mistakes that can potentially make or break a future transaction.

1. Poor Financial Controls

The biggest single mistake our boutique intermediary firm sees on a regular basis is shoddy financial statements — and they start with the level of reporting your firm is receiving (or not receiving).

Internals: If you have no bank borrowings, you may have elected to simply prepare your Income Statements and Balance Sheets in-house using one of the many manufacturing industry-specific software programs or even QuickBooks.

Compilations: If you have decided to hire an outside CPA firm to prepare your company's financials from your internals, which is a "step-up", but frankly not worth much more to anyone looking at them than an internal statement. Because your CPA firm will be preparing your financial statements directly from the records you provide, it will not need to verify the accuracy or completeness of the information and is not required to issue a formal report.

Reviews: This is what I recommend for companies in the range of $7.5 million to $10 million in sales. A review is one in which the CPA firm performs analytical procedures, inquiries and other tests to obtain limited assurance on the financial statements and is intended to provide a user with a level of comfort on their accuracy. A review is typically appropriate as your business grows and seeks larger and more complex levels of financing and larger credit lines.

Audits: This is what I recommend for companies with sales exceeding $10 million. An audit is the highest level of assurance that a CPA performs and is intended to provide a user comfort about the accuracy of the financial statements. The CPA firm will issue a formal report that expresses an opinion on whether the financial statements are presented fairly and in accordance with GAAP (**G**enerally **A**ccepted **A**ccounting **P**rocedures). An audit is typically required when you are seeking complex or high levels of financing or are seeking outside investors or preparing to sell or merge with another business.

Note: The computation of what I like to refer to as "fully-burdened manufacturing cost" is a major issue with many financial statements in that the allocation of Materials, Labor, Factory Overhead (including Depreciation) may not include all the key ingredients leading to a Gross Margin **%** that is not only too high, but frankly inaccurate. Take a look at the Income Statements of the larger public label and other printing companies and you will see what I mean here.

2. Unrealistic Valuation Expectation

This is the No. 2 problem our firm encounters. Business owners need to have a realistic idea as to what their company is worth. Unlike real estate (residential or commercial), companies don't enjoy the same comparables, such as price per square foot or the last 10 sales in your neighborhood or section of town. What they do have are "comps", such as EBITDA (**E**arnings **B**efore **I**nterest, **T**axes, **D**epreciation and **A**mortization), percentage of selling price to sales and/or gross margin, or a multiple of book value. Your CPA or attorney can help you with some of this, but it might be best to talk to someone who appraises businesses for a living. Don't be surprised if you're given a valuation range that is less than what you think your company is worth.

3. Outside Sales Reps

As possibly a former Sales Rep yourself, you are obviously sympathetic to making sure your reps are happy financially. If your comp plan is based on a split of gross margin dollar (many are), hopefully it is in the 60% (house)/40% (rep) range. If it is higher, say 50/50, or worse, 60% to the rep, you are going to have problems with most buyers. The most common split we see is 60/40 in favor of the house. Also, if you have your own or a public warehouse, those expenses should be added into cost of goods sold (COGS) before computing gross margin dollars.

If your comp plan is based on a percentage of sales, that is easier to compute but make sure the percentage is not so high as to leave the “house” with too little profit.

And, perhaps more importantly, you should have all your Sales Reps signed to non-compete/non-solicitation agreements or, at minimum, confidentiality agreements. The new owner of your company will most likely want to sign your outside Sales Reps to theirs in any event. While you may not think non-competes are enforceable, they certainly make a Sales Rep think twice about changing employment or branching out on their own.

4. Customer (or Sales Rep) Concentration or Woman/Minority-owned

Your company — whether a manufacturer or a distributorship — probably began by taking a large account away from your previous employer (most likely one of the larger converters or printers). As you grew, you added several other large accounts, along with Sales Reps. If 50% or more of your company’s sales come from just a few large accounts, this will be a concern for any buyer. Conversely, if you or one of your Sales Reps control 50% or more of the total sales of your company, that will be an issue as well. As you approach the time you would like to exit, it is best to transfer most (or all) of your personal accounts to your outside Sales Reps. Try to make yourself as invisible to the daily operations of the business as possible.

Additionally, if your firm is classified as woman and/or minority-owned, please be aware that a new owner most-likely lose that designation and potentially some key customers along with it. Buyers will be most concerned about this!

5. Physical Facility

Prospective buyers will want to conduct a site visit, so now is the time to tidy up your office, plant and warehouse. Also, leave any pets at home that day. If you have a manufacturing plant, make sure you control the time and day of the tour so that the plant employees are at their machines and they are running. The worst thing a potential buyer wants to see is a “quiet” plant on his/her initial plant tour. First impressions mean a lot!

This all sounds pretty basic, right? Well, it is harder than you think. While you might be a great salesperson yourself, how many businesses have you sold lately — or ever? The sale of your business will be the most important sale of your life and you don’t want to blow it. What do you think when you see a house or commercial building “For Sale by Owner? The mere involvement of a realtor in the marketing and sale of a house or commercial building will more than cover the commission.

So, talk to your CPA or attorney and seek the advice of some local business brokers or investment bankers they might know. Or, ask trade associations like TLMI or Printing United Alliance if they are aware of any companies familiar with your industry that can handle this for you. This is not something that you should try to do alone.

Good luck and good selling!

Jim Anderson is the Founder & President of Scottsdale, AZ-based Corporate Development Associates (“CDA”). CDA is a boutique Merger & Acquisition consulting firm that has focused 100% on the printing industry since 1987.
Website: www.printmergers.com
Contact Jim via email: janderson@printmergers.com
or cell/text: 602-432-0426