



COASTAL
COMMUNITY BANK®

Selling for Optimal Value

How to Prepare Your Business for Sale



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Introduction



Business owners have a host of reasons they start researching how to sell their business, but they all share the same question: How can I obtain an optimal price for my company?

Businesses are complicated to value, market, and sell. But, business owners can take steps to show the value of the business to potential buyers. When buyers see a well-documented, stable business – one with no meaningful disruption in the foreseeable future – they can get comfortable more quickly, which makes way for sellers to strike a deal at a desirable price.

Selling a business for optimal value is all about that preparation. This guide will take you through each major consideration to put your business on the market.

Table of Contents



Page 4....	Providing a Clear Vision of Value
Page 5....	Can It Be Marketed and Sold?
Page 7....	Preparing for Valuation
Page 9....	The Right Broker
Page 10....	Financing Fit
Page 13....	Contracts: Ensuring Revenue and Relationship
Page 16....	Finding a Match

Providing a Clear Vision of Value



Buyers want clarity. Strong financials can pique their interest; they show the business has performed in the past. Sellers, though, can dial up buyers' perceptions of their company by removing uncertainty about the future.

What can they use to paint that picture?

Similar to a homeowner preparing a house for market, owners and managers should find an expert to help market the business. Then, they need to work their way through each of the following six areas to ensure it is ready for showings:

Marketability

Financials

Broker Relationship

Financing

Contracts

Finding a Match

Can It Be Marketed and Sold?

Sellers belong to a wide range of demographics, from Millennials in their 30s to members of the Silent Generation in their 90s. Some worked in their parents' business and eventually took it over. Others started the company when they were young and have managed it for their entire career and most of their life. Whether their reason for selling is age, health, or just a desire for more time with family, all businesses must answer: Can it be marketed and sold?

Interested sellers should consider: Would the business need to close without its current owner? When owners work in the business rather than on the business, they can still be great companies, but a sale is about transferring the company to someone else. Can the new owner step in and run the business with the same success?

"Are you the anchor of the operation? If you disappeared, would the business go on running without you? These are questions that can define your ability to sell," said Kara Gibson Brzytwa, Managing Broker at Exit Equity, a business brokerage based in Edmonds, Wash. "Businesses with transferrable value often have a manager or management team, sales personnel, and people and processes to deliver their service or bring their product to market."

That transferable value is the "goodwill" that drives prices higher than the sum value of the company's assets. Machines, for example, are necessary – but not sufficient – for businesses to create revenue and profits. "The business has a brand, team, processes, location, and history in the community or industry," she said. "They add a certain something more that a buyer can't purchase."



Questions to Assess or Create Marketability

- ↘ Would the business need to close without the owner working the day to day?
- ↘ Can the owner create processes to move themselves out of operations?
- ↘ Can the owner delegate to a manager or salesperson?

Preparing for Valuation

Financials are the foundation for value when selling a business.

Sellers should begin looking at their financials with a broker at least three to five years before they want to sell, said Gibson Brzytwa, whose firm provides M&A intermediary and business brokerage services to privately held companies from \$1 million to \$55 million in revenue.

“I tell clients when I meet with them for the first time: It is about financials, financials, financials,” she said. “If we’re getting ready early enough, we can have that conversation about value. If the financials don’t indicate a number in the seller’s ballpark, we can create an action list together.”

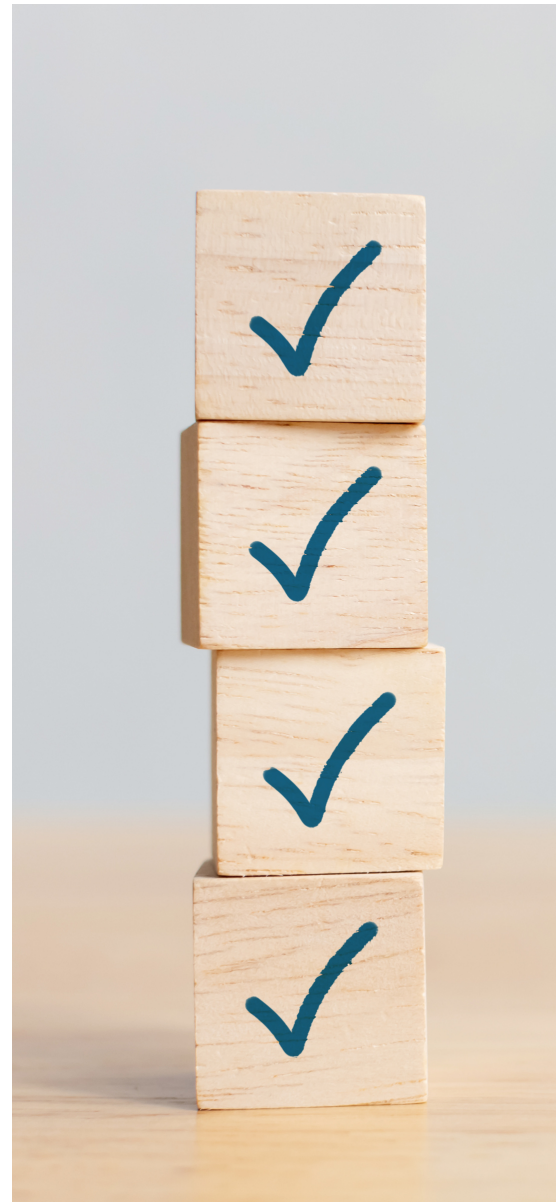
To affect a higher price, sellers will clean up financials, especially discretionary spending, to identify add-backs – expenses not inherent to the operation of the business – which can improve its cash flow. Owners should consider hiring a key manager and/or salesperson to make the business more marketable.

Taxes and their relationship to profits also become important to valuation. “About 90% of the valuation is reliant on your financials and how they tie to your tax returns,” Gibson Brzytwa explained. “Your CPA may help you look like the business makes zero profits, but we should work through discretionary spending items to show true cash flow. By the time the buyer and the bank see it, it should look like the business has its act together.”



Checklist | Are my financials:

- **Complete?**
- **Clean?**
- **Consistent?**
- **Organized?**
- **Available in Digital Form?**



The Right Broker

Sellers need a sounding board that knows how buyers will look at their business, and they need one that knows how mergers and acquisitions work for companies of their size, and in their industry.

“Some brokers specialize in restaurants, others specialize in main street businesses,” said Debbie Webber, Vice President, and Relationship Manager at Coastal Community Bank. “Owners sometimes know a few brokers, and I can give them a few names as a lender, but they should interview each one to find the best match for their business, and for them.”

Webber, who has helped customers and brokers sell businesses for over 20 years, recommended asking brokers about their expertise in the business’s industry, and their past transactions and experience. (See the checklist for each question she recommended.)

Brokers who serve the business’s industry and size tend to gather buyers interested and capable of running companies of that same size and industry, Gibson Brzytwa said.

“You should assess style and approach closely,” Webber added. “If you do not see eye to eye, you do not want to choose that broker. Even if they say they will get you more money, don’t put yourself through disagreeing with them for 12 to 18 months as you try to sell your life’s work.”

When sellers find a good relationship with a broker, it can make all the difference, Webber said. “Brokers have no emotional ties to the business and can negotiate a better price/deal,” she observed. “If you’re meeting the buyer, and their lawyer and broker, how will you respond to them if they say you’re asking too much? A broker can bridge that discussion and represent you.”

Compare brokers by asking them:

- Are you licensed?
- How long have you been in business?
- Do you specialize in my industry?
- How many businesses have you sold in this industry?
- What is your normal customer size?
- Do you work with just sellers? Or do you work with buyers too?
- What is your process?
- What will it cost me?

Financing Fit



Lenders also recommend sellers focus on their financials early. Financials and how they are represented can limit financing options for buyers. If the company does not have room between cash flow and expenses for financing, financing from banks or the U.S. Small Business Administration (SBA) can become off the table – leaving the business with only the available pool of cash buyers.

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But, while brokers can calculate add-backs when it comes to valuation, discretionary expenses – such as country club memberships, charity donations, or car payments for children – can reduce the company’s debt service, Webber explained. Banks may not allow add-backs that reduce the business’s ability to service debt.

“It makes sense to pay lower taxes,” Webber added. “We can add back in some of that, but when we run it through analysis with SBA and it shows a loss every year, the SBA will not allow us to finance the purchase.”



Financing Fit

Owners cause a similar challenge when their business makes \$100,000 in net income, for example, but the owner takes \$150,000 in compensation. “It can show as if the company has zero or even negative value,” Webber observed. “Underwriting at a bank will pass on that kind of a loan.”

When analyzing a business, brokers gather five years of financials, and lenders gather three years of profit and loss, balance sheet, accounts receivable, accounts payable, work in process, tax returns, and a list of assets.

Experienced loan officers also can be invaluable for sellers as they prepare to market their business, especially when their current arrangement with the bank involves reviews of annual tax returns. In addition to referrals to brokers, they can provide insightful advice early on to navigate collateral and financing from a buyer’s perspective.

“About 99% of business purchase transactions utilize SBA financing,” Webber said. “Often, the transactions utilize the 7(a) loan program to acquire the business and the 504 program to finance purchasing real estate. The bank is required by SBA to provide collateral in a 1-1 ratio with the loan amount if possible.”







SBA also recently increased expectations for lenders. “It is now a priority for SBA loans that we ask for experience in leading a business in the seller’s industry, before we consider lending to them,” Webber said. “Or, if a buyer does not have industry experience, what experience do you have in business that shows you can run a business in a new industry? You can work to gain experience in that industry and business as you prepare to purchase. And the broker can likely help with that.”

“That requirement shows why broker selection is so important,” she added. “Buyers working with a broker are more likely to qualify for SBA’s guidelines.”





Key documents reviewed by bankers and brokers:

-  Profit and loss
-  Balance sheet
-  Accounts receivable
-  Accounts payable\work in process
-  Tax returns
-  A list of assets

Contracts: Ensuring Revenue and Relationship

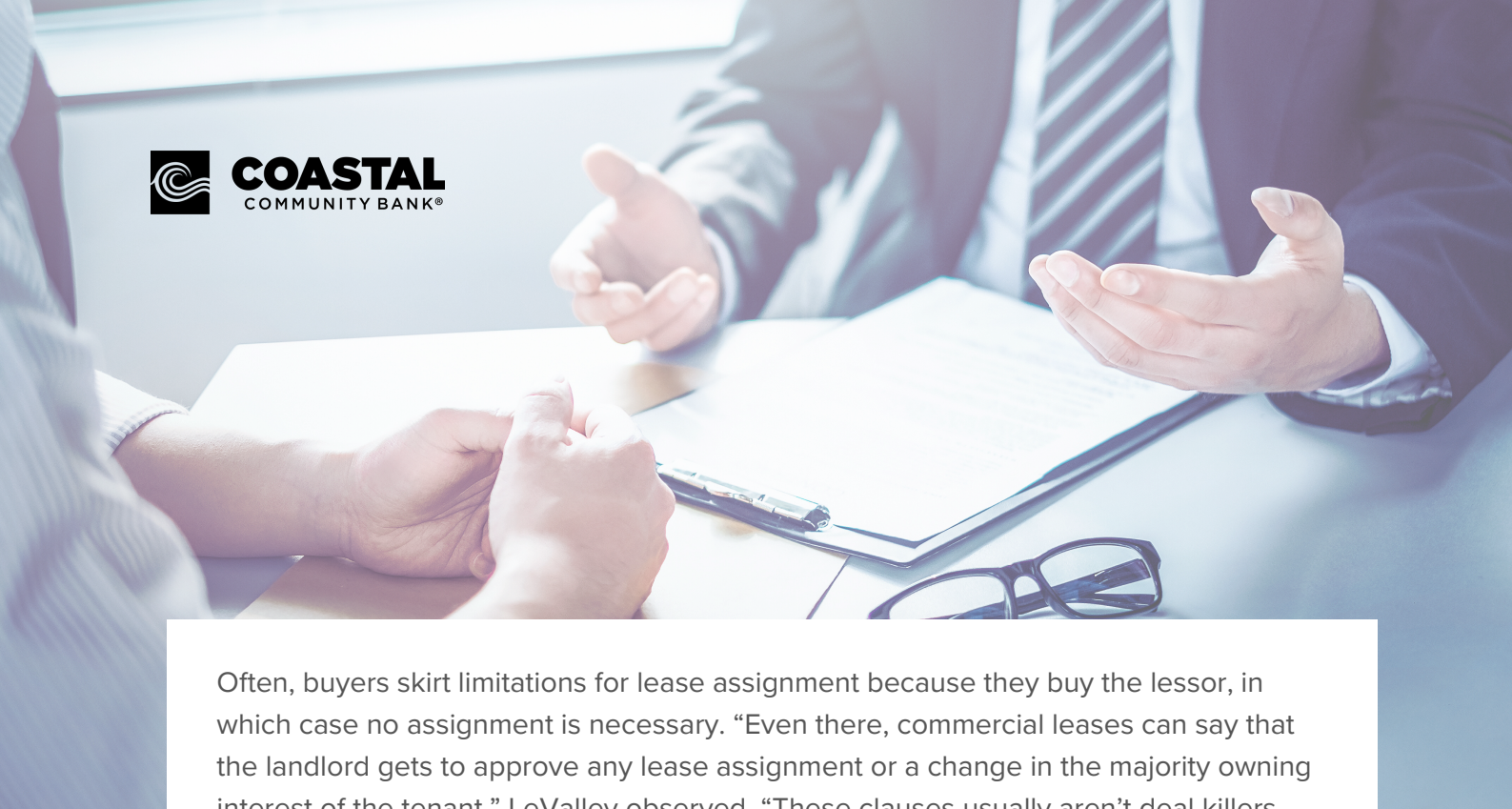
Contracts take center stage when removing uncertainty about the future for buyers. “The first thing I recommend to sellers is a legal inventory with an eye for documents necessary to a sale,” said Dylan LeValley, an attorney at Adams & Duncan, based in Everett, Wash. “You’re looking for legal steps needed to formalize the business’s value and to show greater certainty about the business’s future.”

Lease contracts are one example. Sometimes, companies lease real estate from a company owned by the business owner (see the sidebar for more details), but what about scenarios where the landlord is a third party?

“If you’re a manufacturing company or a retail business, any company that cannot just get up and move, you want to know what your lease says about assignability,” LeValley said. “Leases can provide landlords the ability to decline to assign a lease to a new company.”

One client of LeValley’s leases space from a landowner. The business has less than five years on its lease, and the owner is looking to retire. But it’s a retail business, and its value is highly location-dependent. “I’d want to have more than five years on a lease if I were that business owner because it’s a very valuable business where a decent part of that value is bound up in the lease extension,” he said. “The current landowner is wishy-washy on a renewal. The uncertainty now creates a challenge for – and delays – a sale.”





Often, buyers skirt limitations for lease assignment because they buy the lessor, in which case no assignment is necessary. “Even there, commercial leases can say that the landlord gets to approve any lease assignment or a change in the majority owning interest of the tenant,” LeValley observed. “These clauses usually aren’t deal killers. Many landlords would love to lock up a long-term lease with dependable cash flow. But for them, five years is a long way away. Sellers will want to plan for these contingencies.”

Customer contracts are similarly significant. “A good time to move forward if you’re thinking about selling is once you’ve secured a long-term contract renewal with a really large client,” Gibson Brzytwa said.

“Sell when revenue is stable or going up. I call it the avocado moment: If it looks good today on your kitchen counter, waiting for tomorrow may mean it’s overripe.”

Sellers should consider adding language for assignability to their master service agreement before a big customer renews, Gibson Brzytwa said.

For employee contracts, the new rule from the Federal Trade Commission in 2023 bans most non-compete agreements (see page 15 for more details). But that doesn’t mean the contracts are void. “Revisit how and when the agreements were signed. Are they still enforceable?” LeValley advised. “You want to ensure it can prevent a key employee from going to a competitor after the sale.”

Ensuring the transfer of vendor contracts can be just as important. “Steve, who delivers a core component for manufacture might be a longtime friend that’s provided that service for 20 years,” LeValley said. “But you want that written down and defined in a transferrable way.”



When the Business Leases Space from the Owner

Sellers commonly own a commercial real estate company that rents a building to their business.

"It's just a line item in the business owner's mind," LeValley said. "But buyers looking in from the outside, and lenders as well, want to see a clear picture of the financial obligation from the business to the real estate company, even in cases where they have the same owner."

One should have a lease contract from the other, he said.



New FTC Rule Proposes to Ban Most Non-Compete Agreements

The Federal Trade Commission is still considering a proposed rule that would ban non-compete clauses in employment contracts, according to a press release from the agency on Sept. 21.

The FTC took action several times against "unfair, deceptive, and other unlawful acts and practices, as well as unfair methods of competition, that harm workers" in 2023.

According to the FTC's proposed rule, non-competes are not banned entirely. Businesses may still utilize them for:

- A person who is selling a business entity or otherwise disposing of all of the person's ownership interest in the business entity,
- A person who is selling all or substantially all of a business entity's operating assets,
- When the person restricted by the non-compete clause is a substantial owner of, or substantial member or substantial partner in, the business entity at the time the person enters into the non-compete clause.

Non-compete clauses covered by this exception would remain subject to Federal antitrust law. Once finalized, all U.S. businesses would be required to comply beginning 180 days after publication of the final rule.

Finding a Match



Sellers can feel like they need to impress buyers with a pitch to win them over. While that's part of it, they should also assess their buyers, Gibson Brzytwa recommends.

"Most sellers want to know: What will happen to my team? Or to the vendors who helped me build my business?" she said. "It should be a two-way interview."

Gibson Brzytwa said she sees early indicators of a likely deal in how they communicate. "When a buyer is genuinely interested and asking how you build your widget, or how an important part of the business works, they stand out," she said. "It's a different impression than someone only concerned with how much vacation you take or how many hours you work."

When sellers look ahead to closing their deal, it's normal for them to focus on fetching an optimal price. With the help of the right team of a banker, broker, and attorney, they also can find a good buyer who can carry on their legacy.

PREPARING YOUR BANKER

Businesses should involve their commercial and retail bankers as soon as they can before a sale, said Katy Woods, Coastal Community Bank Branch Manager. Lenders and retail bankers require different documentation, so it's important to involve both.

Woods recommended a kickoff meeting with the bank as a best practice. "I'm working with a business right now where a new owner is purchasing it," she said. "About four months ago, he brought in the current business owners, controller, and day-to-day office manager - everyone on the accounts - and we met to discuss their deposit account plan."

To talk with a local banker at Coastal Community Bank, call us at 425.257.9000. To see our full range of business banking solutions, visit www.coastalbank.com. View other business resources like this one at www.coastalbank.com/businessresources.