

Morgan Stanley

# The Anatomy of a Deal

Three questions to ask when preparing to sell your business

What is the best way to sell your business? Given all the considerations that matter to a founder and potential buyers, there isn't one right way to answer this question. But small to medium-sized founders can set themselves up for a successful exit by asking themselves several questions as they prepare for sale.

## What are my goals for this transaction?

Identifying your objectives for the transaction and articulating them to your advisory team is a critical first step. For some owners, maximizing the near-term value generated from the sale is the top priority. For others, the goal is to create liquidity while retaining opportunities to participate in the company's future growth. Some owners want a clean break, while others want to keep working at the company after the sale.

Sellers wishing to remain involved with their business after a sale may want to focus on selling to private equity firms, which frequently welcome the owner's continued involvement. Strategic corporate buyers, on the other hand, generally pay a higher price because of their lower cost of capital and ability to capitalize on synergies between the businesses, but don't typically want the founder to remain involved after the acquisition.

When you are seeking to stay involved in the business following a sale, making sure your interests are aligned with the goals of a potential private equity buyer is essential. It's important to keep in mind that not all private equity firms are the same: they have different strengths, personalities and exit timelines. Owners should approach a relationship with a private equity buyer with discernment.

It is a best practice to provide a list of disclosures and potential hurdles for buyers upfront. Of course, sellers can't anticipate every potential issue. Although they should be avoided, unforeseen challenges can, however, serve as opportunities to assess how well aligned the two parties are and their ability to solve problems together. Above all else, sellers must get their houses in order before starting the sale process to help minimize the possibility of a deal falling apart.

## Am I prepared for the due diligence process?

Regardless of whether they are strategic acquirers or private equity firms (also known as financial sponsors), buyers will inevitably conduct a rigorous business analysis before making an offer. A seller needs to be prepared to answer tough questions and provide potential buyers with the information they need during the due diligence process. The sooner potential sellers start preparing, the better.

Quality of earnings is essential, and many private businesses will require significant time and investment to get their accounting and bookkeeping up to industry standards. Buyers want to see financial statements that reflect Generally Accepted Accounting Principles (GAAP). To the seller's detriment, private equity buyers often discover that a business' reported earnings before interest, taxes, depreciation and amortization (EBITDA) were multiples lower than they would have been under GAAP accounting. It is not uncommon for private equity buyers to pause or terminate the due diligence process until the seller improves the quality of their earnings reports.

## Do I have the right team in place?

Executing a sale is a complex, high-stakes process, so having the right team of advisors, including bankers and lawyers, representing the company and the owner's interests is essential.

A sell-side banker's role is to orchestrate an efficient process to maximize the sale price while accomplishing the seller's holistic goals. The sell-side advisory team works on behalf of the seller, with not only the buyer but also their bankers and lawyers to ensure that a deal closes as anticipated. The sell-side bankers take the pressure off sellers, who can continue to successfully run their day to day business operations.

Choosing the right banker is critical: they should know your industry, not be a generalist and actively do deals for businesses like yours. This market knowledge allows the banker to position the company attractively relative to its industry peers. The banker will also help the company prepare for the due diligence process by identifying questions that will arise and preparing presentations and data that address buyers' questions.

Once this prep work has been completed, the banker's focus shifts to maximizing the competition for the company among potential buyers. This involves ensuring the most interested buyers are identified and engaged throughout the process.

A top-tier investment bank will be able to create an auction process with a range of potential buyers and potentially could produce a better outcome than if you limit your discussions to people you know, competitors or larger strategic buyers.

The seller's attorneys also play a critical role in ensuring a successful transaction. Their role is to make sure that everyone gets the deal they think they are getting, to align interests and to find solutions to problems.

## Start planning for a liquidity event today

Founders should involve their wealth management advisors as early in the process as possible. Advisors can provide the connective tissue among all the players involved in achieving a successful sale and effectively managing the proceeds of a liquidity event.

Morgan Stanley's financial advisors can help founders understand the implications of a potential sale and create a plan for turning that liquidity into an enduring financial legacy. In addition, these advisors can tap into Morgan Stanley's internal investment banking and capital markets expertise as well as its network of middle market investment banks.

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