Preparing a Business for Sale

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Introduction

While every "sale of business" transaction has its own unique trials and tribulations, sellers need to be able to anticipate possible issues from the outset. Before sitting down to negotiate or even placing feelers in the market, prospective sellers must look internally. Business owners have to be honest about their true motives and objectives surrounding the decision to sell their business. Is this a pure liquidation in which money is the only factor to consider? Does the sale need to reach a threshold amount to furnish a comfortable retirement or fund another business endeavor? Some sellers may have sentimental value in seeing their business live on and prosper. Some may feel obligated to their employees or customers or both. Once determined, this motivation will undoubtedly influence how the transaction proceeds.

Business owners should also think about their own personal and financial situations and whether now is the right time to sell. Market conditions will play a significant role. Signs may point that the industry is on the cusp of a seller's market or vice versa. In either case, it may be prudent to sell soon or hold fast. The industry may be consolidating quickly, placing added pressure to join the frenzy. A company may have been underperforming in recent years, despite an otherwise excellent track record, in which case there may be an incentive to recreate that prior success before trying to sell.

Consider the following items as early-stage guideposts in the journey of preparing for a sale. No one item alone is dispositive in how a deal may or may not progress. However, if not adequately addressed, any one of the following items could result in significant ramifications for the outcome of a prospective deal. While there are several transaction structures in which to sell a business (e.g., sale of assets, sale of stock, merger), this article will focus on the "sale of assets" structure, the most common form of transaction for the sale of a private company.

Corporate Housekeeping and Enhancements

Clarity and uniformity are pivotal to success in preparing to sell a business. Prospective buyers do not want the hassle of trying to interpret unclear or disorganized company records. The business record books should unequivocally identify the business's owners, directors/managers, and officers. If the business has already changed hands or there have been prior owners, a buyer will want to know how former owners exited and see the relevant documents.

A seller should have available, at a minimum, three years' worth of financial statements. The accounting presented should conform with industry standards. A formal audit of the business should also be considered. While a formal audit can be pricey, if the results are favorable, a seller may be able to offset that cost as prospective buyers may view the business more favorably and may be willing to pay a higher price.

Turning to the assets themselves, business owners should take a close look and determine if there are any relevant assets that are not in the company's name. Assets such as domain names, contracts, and physical properties

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can prove problematic from the buyer's point of view if such assets are in an individual owner's personal name or worst yet, a prior owner's personal name. If a company has developed valuable proprietary technology, it is important to ensure that intellectual property agreements are in place with service providers, employees and consultants to make clear that such technology is owned by the company and that such service providers do not have any residual rights.

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Third-Party Considerations

It must also be determined whose voice (other than that of the business owner(s)) must be heard before the sale can occur. If leased space or other significant property is involved in the equation, special consideration will need to be given to the lease and the rights of the landlord/lessor. Sellers must examine whether the relevant leases contain anti-assignment provisions and/or if approval must be obtained before assignment.

With leased space, it is crucial to keep in mind that the landlord's motivations will likely not coincide with the seller's. Landlords are concerned with what is best for their property and their rent stream. They may require financial statements from the prospective buyer and mandate that the seller remain on and continue to personally backstop the assigned lease. Some landlords may withhold their permission unless they receive an assignment fee or are reimbursed for their legal costs to review the assignment documentation. Landlord termination rights and the balance of the lease term are also possible stumbling blocks that can influence the sale process and timeline. As with every aspect of preparation, the sooner a business owner determines the current rights under the lease, the sooner the owner can begin negotiating with the landlord for the best course of action.

Creditors are another set of third parties who will have some form of say in the sale process. The core of a creditor's influence derives from the type of debt the business has undertaken in the relationship. If the debt relates to things the company needs to operate, such as equipment, vehicles, or stocked inventory, the seller may want to pass this debt off to be assumed by the buyer. However, issues may arise if the owners have themselves personally guaranteed any such debt, as the selling owners will want to be released from any guarantees. Even if creditors allow the buyer to assume the debts of the business, they may choose to require selling owners to remain personally liable for the debts regardless. Much like the motivations of landlords requiring the former tenant to continue personally to back the assigned lease, creditors would much prefer having two parties on the hook as opposed to one.

PPP Loans

To temper the economic ramifications attributed to the global pandemic, the Small Business Association (SBA) implemented the Paycheck Protection Program (PPP) to support businesses across the nation. Loans made under the PPP add to the equation of things to consider in preparing for a sale of business. SBA Procedural Notice Control Number 5000-20057 provides a roadmap for what business owners and SBA lenders must consider. Among other things, the type of sale and the loan status will dictate the obligations of the parties.

First, consider whether the sale falls under the definition of a change in ownership. In the realm of PPP loans, specifically for asset sales, a "change in ownership" occurs when "the PPP borrower sells or otherwise transfers at least 50 percent of its assets (measured by fair market value), whether in one or more transactions." SBA Form 1353.3 (4-93). If the "change in ownership" definition is met, it then needs to be determined whether the deal requires SBA approval. *Id.* To note, regardless of whether the SBA approves the deal, the PPP borrower remains responsible for the continued performance of all obligations under the loan. *Id.*

Second, consider what notice and approval requirements are at play. Before closing, the PPP lender must be notified in writing of the transaction and be provided copies of the agreements and other documents necessary to effectuate the transaction. *Id.* As for the SBA, things are a little more complicated. If the note is repaid in full, no restrictions will come from the SBA. *Id.* If, however, the note is not fully satisfied, there are two options. *Id.* The first is that the SBA lender, not the borrower, submits to the SBA required documentation to obtain approval. *Id.* The second option provides a route whereby SBA approval is not required before the sale. *Id.* The SBA borrower must complete a loan forgiveness package to submit and create an interest-bearing account that the SBA lender controls pending forgiveness of the loan or, if not so forgiven, for repayment of the loan. *Id.*

Conclusion

Ultimately, it is better for an owner seeking to sell their business to be proactive rather than reactive. At the moment a business owner contemplates a possible sale, the items mentioned above should be almost immediately considered. There is little question that roadblocks will present themselves before the deal closes. A savvy owner will recognize these potential roadblocks early on and address them before any of them matures into a true deal killer.