DAILEY RESOURCES, INC.

PREPARING FOR THE SALE OF YOUR

PRIVATELY HELD BUSINESS

For an entrepreneur, selling his or her business can be the largest and most important deal of his or her career. Whatever prompts the sale - illness, age, partner disputes, financial hardship, or other reasons - selling your business is a high-stakes transaction, with far-reaching financial and emotional consequences.

Whether you've begun to think about selling your business now, or you hope to sell it in the future, it is important to take steps now to properly position your business in order to ensure a successful and profitable sale. There can be many reasons why a company is difficult or even impossible to sell. Most of those reasons can be attributed to a lack of planning. If you want to sell your business at a favorable price, you should implement a plan that makes your business more attractive to potential buyers.

Business owners often approach us about wanting to sell their business "yesterday," although they have done nothing to position themselves or the company for the sale. The "pre-sale positioning" process consists of the steps necessary to prepare a business for sale. Several steps of the pre-sale positioning process are discussed below.

The first step is to get advice from professional advisors, such as a Certified Business Intermediary (A Broker who specializes in businesses valued at $2,000,000 or less) or a Master Mergers and Acquisitions Intermediary (A Intermediary specialized in businesses valued over $2,000,000.

Depending upon the size and complexity of the transaction, other members of the Deal Team would be added as needed or required. Examples of other Deal Team members include **transaction** Attorneys and **transaction** CPAs. These professionals have experience in the Mergers and Acquisitions market and/or experience with business transfer transactions. They can offer invaluable advice concerning the legal and tax implications that arise from selling a business.

It is in your best interests to find a business intermediary whose company has knowledge, experience, credentials, professional designations, and tenure as a business transfer professional. When interviewing business intermediaries or brokers, ask for references about his or her professional designations, credentials, and memberships in trade organizations. Ask if he or she is a full-time business intermediary; ask about the sizes and types of businesses the intermediary represents; ask how long the intermediary's company has been in business, and if his or her company has an office. It is important for the intermediary to have an office so that he or she has a place to meet prospective buyers.

A professional business intermediary knows what information is needed to market your business. That information should be packaged in a professional manner and distributed only to qualified buyers. Using the services and advice of a competent business intermediary greatly enhances the probability of successfully selling your business.

Making the decision to sell

Why do you want to sell? The following factors are among the reasons indicating that now may be the time:

- Owner's Burn-out
- Want to retire
- Health problems
- Children do not want to enter the family business
- Get estate in order
- Lease expiring and you do not want to renew
- Other business interests
- Under capitalized
- Bank unwilling to renew or expand credit lines
- Largest account is in financial trouble
- Largest account went to your competition
- Supplier problems
- Employee problems
- Customer habits are changing
- Changing technology
- Business relocation or re-routing of expressways or roadways

If you have other partners or stockholders, be sure that everyone agrees (in writing) to offer the business for sale.

Whatever the reason for making the decision to sell, if you have the luxury of time, you should start preparing your business two to three years before your desired time of sale.

Pre-sale planning

The first objective of pre-sale positioning is to deal with any negative aspects that might hinder or prevent a sale, and to determine strategies to show the business in its best light.

Start by assessing the Company's financial records. Small business owners often have their books and records prepared so as to minimize their federal tax liabilities. Some business owners also operate their businesses in a way that maximizes the personal benefits they receive as business owners. However, if you want to achieve the maximum value for your business, your financial statements should be recorded in a way that illustrates the Company's true revenue and earnings, as well as showing its growth potential.

Financial Records

At a minimum, you should have three years of financial statements and tax returns. If there are substantial differences between taxable income and book income (e.g. cash basis vs. accrual), those must be identified and explained. It is also important to identify all significant discretionary expenditures and any unusual and non-recurring expenses.

Balance Sheet

A Company's Balance Sheet represents its financial history at a moment in time—normally the end of the Company's fiscal quarter or year. The Balance Sheet indicates an important characteristic—the Balance Sheet must balance. The value of the Assets must equal the sum of the Liabilities and Equity (Owner's Interest).

The assets consist of the items owned by the Company that are used to conduct business. The liabilities and equity represent the claims against the value of the assets. Liabilities are what the company owes to others. Equity (Owner's Interest) is essentially what is left over. Equity is the value of all of the Company's assets less all of its debts.

Are all assets properly reflected? Tight controls must be exercised over your receivables and payables. Most Buyers will not pay for receivables that are more than 90 days old, and many Buyers will often discount receivables that are more than 60 days old because of poor chances for collection.

Any notes owed to the Owner(s) should be converted to bank debt because Buyers seldom give consideration to Company debts owed to the Owner(s).

Are there assets owned by the Owner(s) that are used for the benefit of the Company and that should be owned by the Company? Are there assets owned by the Company that are not essential to the operations of the Company (personal car)? If so, those adjustments must be made.

Make sure inventory is current and accurate. Excess or unused capital assets should be sold. You should attempt to remove all personal guarantees from Company notes or leases.

Income Statements

The Income Statement reports on one of the most critical company figures—its earnings. The importance of being able to read and understand Income Statements is that it helps to identify trends of key items that impact a Company's earnings.

The goal of the Income Statement is to determine revenue for a specific period and then match the corresponding expenses to that revenue. The Income Statement, sometimes referred to as a Profit & Loss Statement, presents a picture of the Company's profitability for the entire period of time covered (month or year).

The Income Statement presents the results of revenues and expenses in a statement that is designed to be read from top to bottom. The Income Statement is useful because it reflects management's decisions, estimates, and accounting choices. However, by focusing only on the bottom-line profits (losses) may mislead potential purchasers. A methodical, step-by-step review of the Income Statement is useful in judging the quality and content of the bottom-line earnings or losses figure.

Because no single year will accurately portray the financial health of a Company, it is necessary to compare several periods of Income Statements. Such comparisons of periods help indicate specific changes in the Company's performance and in identifying trends.

Recasting financial statements

Recasting the Income Statement is one of the most important exercises that can be performed because, if performed correctly, it provides a more realistic depiction of the Company's true earnings and/or earnings potential.

A recast Balance Sheet is often used to reflect the real value of the Company's assets.

Tax planning

Depending upon the size and complexity of the deal and how it is structured, the Owner(s) may realize capital gains tax liabilities upon selling the Company. Therefore, careful consideration and planning must be given to potential tax issues. The Company's current CPA may or may not be well-versed in such matters. Therefore, it is in the Owner(s) best interests to meet with the Deal Team CPA/Tax Advisor early in the pre-sale planning process.

Legal considerations

Legal proceedings can have a major impact on any Company. In addition to the monetary drain of legal costs, there are "hidden" costs due to the distracting factors of the legal proceedings and the Owner(s) having to redirect Company resources.

Notes to the financial statements should disclose any legal proceedings that may affect the Company. Besides describing any such legal proceedings and potential liabilities, the Owner(s) should provide an opinion regarding the validity of the claims, the expected outcome(s), and the potential impact on the Company.

Beyond legal proceedings, there will be other legal considerations. If the business is owned by a corporation or other legal entity, then there may be legal formalities, contingent liabilities, and unresolved tax problems or audits to deal with. Compliance with all local, state and federal agency laws, rules or policies is a must because the Owner(s) will be asked to represent and warrant that the Company is in compliance. Also, it must be determines if regulatory approval is required for the sale of the Company.

Operations

The Owner(s) should identify all products and services provided by the Company and the specific markets it serves. It is important to define the strategic advantages enjoyed by the Company in its respective niche. Additional consideration should be given to comparative gross profit margins for each product and service.

Records should be formalized and should clearly document all transactions so that a Buyer or Manager can take over with minimal training. Efforts should be made to eliminate inconsistent business practices. If the Company has similar vendors or customers who are receiving different payment terms, or if the Company has played favorites with friends and relatives, then the Company must establish unilateral rules. The Buyer should not be placed in the position of having to face the customer who expects special treatment or to be forced to cancel a long-standing verbal agreement with the Company's oldest customer. If handshake pacts cannot be canceled, document the arrangement so the Buyer is not surprised.

Examine all supplier and customer contracts. Make sure terms and conditions will not expire or require renegotiation just as the Buyer assumes control. Terminate contracts that might cause trouble for the Buyer, and/or those that drain the Company financially or serve no purpose.

As records are examined, codify Company policies and procedures that exist as unwritten rules. Create a procedure manual that documents exactly how to best run the business, and be sure to include any unspoken and/or undocumented techniques.

Review the Company's real estate leases, especially if the success of the business is "tied" to its location. Make sure the lease does not expire or require renegotiation during, or immediately after the selling process. If the Company's current location does not provide any competitive advantages or will discourage Buyers, consider moving the location *before* you place the business for sale.

Equipment leases also require scrutiny. Analyze each lease from a Buyer's perspective. Don't encumber the Buyer with leases that include high interest rates or leases that have already earned tax advantages. Such leases will diminish the value of the Company. Be prepared to use the proceeds from the sale of the Company to pay off existing leases.

You must also fully evaluate and record Company assets including, but not limited to FF&E (furniture, fixtures, & equipment), inventory, and employees. Potential Buyers will want to see the records and assess your tracking system. If the Company has not invested in computer upgrades designed to manage and control the flow of inventory, this should be done during the pre-sale planning process. No one wants to buy a company that's rooted in the Dark Ages.

During the pre-sale planning process, keep inventory at minimum levels to demonstrate company efficiency and to maximize profits. If advisors suggest a complete sell-off of inventory, do it.

If the Company does not have a website, the Owner(s) need to evaluate that decision. Although many small companies have not yet made the switch to e-commerce, companies that are already doing business online will bring a higher price.

Management Structure

Buyers have concerns about the depth, breadth and ability of the current management team, as well as the willingness of those managers to stay on board after the deal is consummated. The Company should have an Organization Chart which defines the titles, duties and responsibilities of each manager. The Company should also have a management profile available that gives a brief resume of each manager that includes salary history and longevity with the Company.

Key employees may be crucial to the Buyer's success, and the loss of key employees during a sale can kill a deal. It is important to determine which employees are prepared to stay with the Company during and after the transition. It is also important that the employees hear about the pending sale of the Company from the current Owner(s), and not from a third party, at the correct time in order for the Buyer to retain as many employees as possible and to ensure a smooth transition.

Other questions to consider are (1) does the Company have secondary management in place that can run the company for an absentee owner or perhaps as a division of another company, (2) does the Company have excessive management or supervisory personnel, (3) does the Company have excessive bonus programs that negatively affect the profitability of the Company, and (4) does the Company have employment agreements or contracts?

Growth Opportunities

While certain Buyers purchase businesses at prices predicated on analyses of current and historical financial statements, Buyers are also concerned about the ability to grow the Company at a rate that exceeds the norm for similar opportunities. It is important define growth opportunities in terms of product extensions to current lines, existing products to new markets, better market penetration, wider geographical distribution, etc.

Facilities

Are the Company's existing facilities adequate for future growth? Is the real estate owned by the Company or is it owned personally be the business Owner(s)? If leased, is the lease at favorable or market rates? Are there options to renew the lease? Is the building in good repair? Is it clean and organized? Is the facility in compliance with regulatory requirements?

Selling price

Has a realistic expectation of a fair sale price for the company been established? If so, how was that expectation determined?

Deal Structure

As the size and/or complexity of a transaction increases, the need for creative and innovative structuring alternatives also increases. Structuring often requires balancing the Buyer's interest with those of co-investors, sellers, managers and lenders. Multitudes of formats are available for structuring business transactions, such as direct taxable stock acquisitions and taxable asset acquisitions, or more advanced strategies such as forward triangular mergers, reverse triangular mergers and IRC 338(h)(10) deemed asset acquisition elections. Choosing the right structure for your Company's transaction will be a focus of our Deal Team.

Buyers need to analyze their operating environment and select an operating structure that will minimize their legal risks, minimize their taxes, and allow for future expansion yet be flexible for managing current operations. Sellers need to contractually secure their ability to be paid, to minimize the amount of tax to be received by the government and to plan for how to invest the sale proceeds.

The individual desires and needs of a Buyer and Seller must be addressed and *managed*. The Buyer and Seller have to find common ground upon which to agree regarding the terms and conditions of a Buy/Sell Contract. Having an *experienced* Deal Team to help chart this course is extremely important.

A partial list of services for the Business Owner(s) is shown below:

- Pre-Sale Exit Strategy Options
- Purchase Price Allocations
- Tax Implication Analysis
- Tax Deferral, Minimization and Elimination Strategies
- Negotiating Tactics and Strategies
- Business Value Enhancement
- Transaction Structure Solutions
- Investment and Financial Planning
- Advise throughout transaction on ANY transaction issue

There can be hundreds of items to take into consideration when positioning your company for sale, but the effort and expense are well worth the reward. **Remember, it's not what you get but what you keep that counts!**

Dailey Resources, Inc. is the team that will maximize your business value and step you through the process with the highest of ethics and professional services.

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