How to Maximize Value When Selling Your Business – Part 2

By Tina Wei, Director, Jason Geisler, Senior Manager and Eric Gelb, Senior Managing Director

While buyers may be attracted to your company's industry, profitability and growth potential, you can increase your company's exit value by enhancing certain business fundamentals, including the actions recommended in this article.

Sell-side due diligence has become more and more popular among recent transactions. Sell-side due diligence benefits both sellers and buyers and can speed up the merger and acquisition process. It also provides the seller with an opportunity to understand its business from the buyer's perspective and enhance the company's value.

Reality Check

Do buyers like "surprises" from the buy-side due diligence? Definitely not! Sell-side due diligence helps sellers perform a reality check to avoid unfavorable surprises (e.g., deal breakers) and adjust expectations of company value. With an in-depth understanding of sell-side due diligence findings, sellers know about their own weaknesses and get prepared for the buyer's possible pointed questions. In addition, sellers can use the information revealed in the due diligence report to address issues and increase their company's value.

Time Saver

There's an old expression, "Time kills all deals." Delays in providing data and responding to buyers' questions lengthens the transaction process, which might lead to "pencils down" or a discount on deal value. By going through the sell-side due diligence process, a seller's management team and finance department can prepare for buyers' requests and questions, which typically significantly reduces the length of a buyers' due diligence process. Buyers and their advisors read through due diligence reports and deal workbooks and many of their questions can be answered directly. Sell-side due diligence is especially needed for transactions which require excessive demand for data and specialized knowledge, e.g., carve-out transactions and transactions based on the consolidation of all subsidiaries.

Value Enhancer

Sell-side due diligence provides insight into normalized earnings, including positive and negative impacts on EBITDA, which is often the basis of company valuation. Sellers will have greater control over the selling process and more confidence in the negotiations. With a better understanding of the company's strengths/weaknesses and a more realistic valuation, sellers can make more informed decisions when searching for potential buyers and, accordingly, discover higher bidders. Sellers can also prepare practical action plans with financial projections based on historical performance and future strategies.

Some sellers might think sell-side due diligence is a poor use of time and money, but sell-side due diligence can help streamline the transaction process and increase the likelihood of a successful close. This will provide buyers with a clear picture of the company's future improvement and growth, which could increase the value of the company.

Tax Strategies

When getting ready to sell a business, there are many things to consider from a tax perspective, such as:

- Review your existing tax structure. Business owners should be asking – is the business structure currently designed in the most tax-efficient structure for a potential sale? Tax structuring is one of the most critical items when you are selling a business and it should be at the top of your list to ensure that you are set up for success from inception. Part of this exercise is also making sure you have the most accurate and up-to-date tax basis schedule. Your tax basis will ultimately drive how much of a gain (or loss) you may realize on a potential deal. In many circumstances, companies have changed accounting firms or accountants over the years, and it can take some time to “rebuild” the tax basis from historical records.

- Get a handle on current and historical tax filings to ensure a smooth tax due diligence review from the buyer. Many deals fail due to the issues that surface during due diligence (especially tax due diligence). It is often advisable for the sellers to conduct due diligence on their company before the buyers get involved. Another benefit of sell-side due diligence is that it can help you proactively identify gaps and resolve any issues so that when the time comes for the buy-side to get involved, the due diligence process is seamless and not causing delays or issues. Discovering missing or incorrect tax filings early can give you time to address any questions, file amended tax returns and other filings and address open or potentially open issues with the regulatory authorities.

- Begin the Trust & Estate (T&E) Planning Process. For example, what do you plan to do with the proceeds, and how will a potential sale impact the potential taxability of your estate? A large sum of money from the sale could push you into a higher income tax bracket and/or create a taxable estate (e.g., the value of your estate in excess of the federal or state exemptions.) Planning, including exploring different scenarios, before a sale takes place gives you the ability to change ownership, make gifts, set up trusts and take advantage of other potentially tax- advantageous opportunities that could yield significant tax benefits down the road.

- Run a simple “Mock Sale” scenario. Why wait until you put yourself up for sale to understand what the results might look like? Run a series of “what if” scenarios to evaluate the potential value a buyer might pay and your potential after-tax proceeds. Regarding the gross purchase (sale) price, you could analyze competitors’ financial statements and take steps to drive your business in that direction to improve your business’s profitability and other performance metrics (Key Performance Indicators or KPIs) to maximize your business’s value. There is no crystal ball as to what might materialize down the road, but running a series of analyses based on a set of simple assumptions, can help you determine potential outcomes from a transaction. By using readily available current financial and tax information, you can run a simple tax projection to determine what your tax rate and tax burden from a sale may look like. This exercise will also be beneficial so you can see how it may play out from a state and local tax perspective. Some states have an extremely complex set of rules when it comes to allocating part of a sale [price] to that particular state so it’s important to understand how the states you file in will treat a sale.

The Takeaway

By analyzing your business as an outsider looking in and conducting sell-side due diligence in advance of a possible sale transaction, you can improve and more accurately reflect your company’s value and take steps to increase its value. In addition, these efforts facilitate a buyer’s due diligence, which can accelerate a sale and increase the likelihood of a successful close.

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PKF O’Connor Davies specializes in pre- and post-merger consulting; buy- and sell-side due diligence including quality of earnings (QOE) analysis; accounting advisory and tax planning, structuring and compliance; valuation and outsource CFO and accounting.

For more information, contact any of the following:

Tina Wei
Director
Pre- and Post-Merger Advisory
twei@pkfod.com | 646.699.2897

Jason Geisler
Senior Manager, Tax
jgeisler@pkfod.com | 551.249.1814

Eric Gelb, CPA
Senior Managing Director
egelb@pkfod.com | 914.341.7049

www.pkfod.com

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