Preparing to Sell: Five Key Focus Areas for Sellers

By Peter Schaefer and Greg Sutton

Many owners of printing and packaging companies don't fully grasp what they'll be facing when they make the decision to sell their businesses. Planning ahead for an M&A transaction can make the process much more efficient, In an ideal world, selling a printing or a packaging company would be as simple as selling a car – or at least not much more complicated than selling a house. In the world in which we live and do business, there's a good deal more to the process than that. Being prepared is key to making this process efficient, preserving the value of the business, and reducing the risk of post-closing claims.

By way of background, we'll mention that New Direction Partners and Stevens & Lee have collaborated in the sales of many printing and packaging companies, with Peter Schaefer in the role of investment banker and Greg Sutton as the M&A attorney specializing in the legal aspects of M&A. In working through transactions, we have found that sellers often don't have an adequate idea of everything that the transaction process will entail on their end, which is all in addition to keeping the business running efficiently.

We identified five main areas of focus for our selling clients to consider as they prepare to sell their businesses. This column gives a condensed version of action items that sellers should be ready to carry out to help ensure a smooth transaction and preserve their value.

1. Due Diligence Readiness. Poor diligence preparation is one of the leading causes of purchase price reductions, delayed closings, and post-closing claims. Sellers who fall short here risk breach of representation claims and loss of leverage if issues are discovered late in the process.

Financial due diligence is critical at this stage. Most buyers are thorough in their due diligence, often engaging third parties to pressure-test a seller's financial numbers, usually by way of what's known as a quality of earnings report. It is therefore crucial that a seller have full, current, and accurate financial statements prepared.

In addition, a buyer's legal team will want to thoroughly review the seller's contracts, corporate and tax records, employment files, environmental records, intellectual property, and other items. Before going to market – and undergoing this diligence process – the seller should identify and remediate material issues that could slow the progress of the transaction or raise unnecessary issues or "red flags."

2. Purchase Price Protection. In some cases, the stated purchase price is not the amount the seller ultimately receives. To avoid post-closing purchase price disputes, the seller must carefully negotiate factors such as working capital methodology, treatment of cash and debt, earnout metrics, any potential seller-financing, and transaction expenses. This is an area where an experienced investment banking firm or financial advisor, as well as capable, experienced M&A counsel, can provide critical advice based on past experience and market practices. Issues to be aware of include:

- Industry specific valuation metrics (i.e. industry standards used to determine purchase prices, such as earnings multiples) and purchase price payment terms (earnouts, rollover equity, and seller financing).
- Accounting methodologies used to determine working capital and earn-out payments.
- Purchase price "waterfalls" (i.e. payment of debt and transaction expenses from closing proceeds).
- Security for post-closing purchase price adjustments and indemnity claims (i.e. escrows or holdbacks).

3. Tax Planning and Transaction Structure. A seller's after-tax proceeds can vary dramatically depending on how the transaction is structured. Among the action items to analyze from a tax perspective are asset sale versus stock sales, equity rollover, pre-closing reorganizations or tax elections, and purchase price allocation .

While tax issues can be daunting, experienced tax advisors on the banking, legal, and accounting sides can provide practical and comprehensive guidance to help navigate. Because these issues arise repeatedly in deals, experienced advisors are ready to assist sellers with strategies approaches to maximize their deal value.

4. Limiting Post-Closing Liability. The seller's objective in an M&A transaction is not only to maximize price, but also to keep the proceeds. Sellers often do not realize the indemnity exposure they could face after closing from items they did not properly address during due diligence or in the purchase and sale agreement and related disclosures. In the worst cases, sellers could be subject to unanticipated, extensive liability as a result of poorly drafted purchase agreements or disclosure schedules.

Once again, experienced investment banking and legal advisors can help reduce this risk significantly. They can provide strategic guidance to sellers on limiting representation and warranty survival periods, capping indemnification exposure, narrowing definitions of indemnifiable losses, and resisting broad special indemnities. They can also advise on the availability and cost of Representation & Warranty Insurance (RWI), which insures against post-closing exposure on the part of sellers and is becoming increasingly common in the overall M&A marketplace.

5. Closing Certainty and Business Continuity. Keeping a deal intact throughout the entire process – from the initial introductory discussions through closing – requires the seller to remain committed to running the company with the same efficiency throughout the entire process. We often advise sellers to run their businesses in the same manner they would run it in the absence of a deal.

This means preserving key customer and employee relationships, securing necessary consents and approvals, and executing on planned business objectives. Along with preserving the value of the business, these efforts reduce the risk of earnings deteriorations and unexpected legal or business issues that can cause a buyer to “re-trade” the deal.

Final Thoughts

Sale transactions are labor intensive and distracting to sellers, especially when coupled with the need to continue to run the day-to-day business. Enlisting the assistance of advisers who are well versed in the financial and legal intricacies of M&A can make a seller’s experience far more manageable, preserve value, and reduce risk. Securing that assistance is the seller’s first step on the journey to a successful and profitable closing.