

# Should You Sell Your Company?

The answer isn't easy, especially in a recession. Here's how to think it through.

By Sharif Tanamli and Eric Lomas

**T**HE PUNDITS WOULD HAVE YOU believe dealmaking has all but dried up in this dismal, credit-starved economy. Take a closer look, though, at the market for smaller companies and the picture isn't so dire.

According to Thomson Reuters, the dollar value of all mergers and acquisitions in the U.S. totaled \$1.1 trillion through Nov. 30, 2008—a 30% drop from the same period just a year earlier. Yet while overall volume is down, interest in transactions worth \$100 million and below has held up.

Dealogic estimates that the number of deals in that range during the first three quarters of 2008 increased by 15% over the same period in 2007. And valuations, while down slightly, have held up reasonably well relative to transactions involving larger firms.

The reason for this resilience: Smaller companies still fuel the growth of larger acquirers. Moreover, many of those smaller firms are privately held—meaning that there's less pressure to downplay a modest valuation to appease antsy shareholders.

Why sell? The reasons run the gamut—succession issues, estate and tax planning, the threat of deeper-pocketed competitors or just the simple exhaustion of managing a business. The key is understanding your options.

Start with who's buying. There are two kinds of acquirers: strategic buyers and financial buyers (such as a private equity firm). Strategic acquirers tend to be larger companies that would rather bolt on a fully formed business or product line than build it from scratch. Some may be willing to pay dearly for the chance to instantly increase their market share or snag a proprietary technology. Such a sale may mean handing over the keys to the business entirely.

For entrepreneurs who want to stay on but hedge their bets on valuation, a sale to a PE shop may make sense—especially if the business is intended to be a new platform for a larger entity the acquirer has yet to piece together. In these deals the entrepreneur is often left with a minority stake. With any luck the PE shop unloads the business five years later (or maybe longer in this environment), and the entrepreneur gets a second luscious chomp at the apple.

Prepare to be creative and flexible with the financial structure, especially with pri-

at closing: a \$10 million note (meaning the seller is helping to finance the deal but that his position in the new capital structure is subordinate to the bank that financed the deal); and an "earn-out" payment, based on the company's hitting certain milestones during a specified period of time, worth perhaps another \$8 million. If all goes well, the deal is potentially worth up to \$38 million (excluding the time value of money effect).

**OPTION C.** The seller agrees to a \$30 million purchase price, broken down as follows: \$20 million in cash, a \$10 million note—but instead of the earn-out, the original owner gets to reinvest with the new equity investors at the same cost of equity. Without getting into the math, the point here is that the seller gets the benefit of the buyer's access to cheap financing (which there isn't much of right now). This way the seller might reap a windfall—that second chomp—on the future equity value of the company.

**OPTION D.** The seller takes \$25 million in cash at closing, along with the right to retain certain intangible assets, real estate holdings and intellectual property agreements—and the future income streams they kick off. In this scenario the entrepreneur takes home lower proceeds from the sale but may make it up over time from rent and royalties.

The permutations are myriad. Just remember: No matter what route you choose, shop around. The more suitors you attract, the higher valuation you'll get. **F**



ivate equity buyers. For a feel of your options, consider a theoretical company with \$25 million in annual revenue and no cash or debt on its balance sheet. Say a private equity player bid \$30 million for it, while a strategic buyer bid \$33 million.

**OPTION A.** The seller accepts the strategic buyer's \$33 million, all paid in cash at the closing. Clean and neat—which things rarely are.

**OPTION B.** The seller agrees to a \$30 million valuation from a private equity group. The deal includes \$20 million paid in cash

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