



Preparing the Private Company for Sale

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"...careful planning and preparation on the part of the company and its advisors well in advance of embarking on the sale process can help to smooth the transaction process and ultimately lead to a better likelihood that the owners' goals are successfully achieved."

For owners of privately held businesses, the decision to sell is a momentous one. Consideration of a sale may be triggered by the liquidity needs of owners, for whom the business may represent their largest single asset; by succession requirements, as subsequent generations opt out of operational participation in the business; or by business requirements, as capital needs increase or competitive pressures intensify. In determining the optimal time to evaluate a sale, savvy owners will also take into account recent company performance, trends in capital markets and corporate valuations, as well as industry dynamics.

As distinguished from the decision confronting public companies, the choice to sell a private company is often an intensely emotional one. Such factors as a long family association with a particular company, the inevitable intertwining of an owners' personal identity with that of the business he has created, and loyalty felt by owners toward employees or a community are often as important as financial or strategic considerations.

Consequently, regardless of the underlying reason behind the decision, once it has been reached, owners are often anxious to initiate the actual sale process quickly. However, careful planning and preparation on the part of the company and its advisors well in advance of embarking on the sale process can help to smooth the transaction process and ultimately lead to a better likelihood that the owners' goals are successfully achieved.

Taking the First Steps

Typically, sellers need to engage an advisory team consisting of legal counsel, an accountant or auditor, and an investment banker. To the extent that these relationships do not exist, owners should engage advisors approximately six months prior to the actual sale process.

The advisory team can provide crucial assistance in articulating objectives that owners are seeking to achieve through a transaction process. Some key issues for consideration, such as generational transfers or tax planning concerns, ideally will have been at least initially considered long before a decision to sell is reached. An imminent transaction, however,

will require a closer investigation of the ultimate personal and corporate objectives owners may have regarding the business.

For example, an experienced financial advisor can evaluate alternative strategies to an outright sale, such as recapitalization, as a means of addressing both owners' liquidity objectives and corporate funding needs. Other issues may include the owners' desire to retain any financial interest or operational involvement in the company post-sale; identifying assets within the company that the owner would prefer to retain; focusing on specific tax consequences related to the sale; or determining valuation expectations. The advisory team should work to ensure that owners' objectives are reasonable and achievable, and to implement strategies aimed at ensuring the achievement of those goals.

The investment banker will also work closely with owners in helping to devise the appropriate transaction strategy, including the timing of sale process and identifying the strongest potential acquirers. Additionally, they will help to craft the appropriate message with which to contact buyers.

Preparing the Company

Once a sale strategy has been determined, it is highly advisable for sellers and their advisors to conduct an in-depth review of key corporate operations prior to embarking on a transaction process. The review should include such key areas as:

Financial Statements: Since the advent of recent accounting scandals and the passage of Sarbanes Oxley legislation, it has become increasingly common for buyers, particularly those that are public, to view unaudited financial statements with suspicion. Sellers are always at an advantage if any required audits are prepared by their own advisors, rather than by the acquirers' audit firm as part of the due diligence process, and therefore should consider engaging a professional firm to prepare 3 years of audited historical financial statements. Such a review can also help to uncover problems of which owners may not have been aware, and allows mitigating adjustments to be made before any financial

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information is presented to potential buyers.

Pro Forma Financials: It is often the case that certain expenses incurred in operating a private company will not be passed on to buyers, such as owners' salaries or other expenses. The seller's advisors can help to identify and eliminate those expenses as well as any extraordinary items so that financial statements, on which buyer valuations will be based, can be presented in a more appropriate pro forma format.

Financial Forecasts and Systems: A key element of inviting buyer interest and realizing potentially higher valuations is the ability to articulate the company's future growth strategy and prospects. Owners and management should devote significant time to developing both a near term budget and a longer term financial forecast, derived from a credible business plan. They should also anticipate that buyers will expect to receive regular and detailed financial updates as the transaction process unfolds, and if possible, put into place the financial systems that will allow the company to meet those expectations in a timely and accurate manner.

Management Team: Owners should evaluate whether the existing management team will be viewed as complete by buyers, particularly if they themselves will not be involved going forward, and should move to fill any potential gaps prior to the sale process. Additionally, if owners are depending on the assistance of key employees through the sale process, they may wish to consider implementing incentives to ensure their cooperation, such as stay bonuses, equity incentives, or management contracts, before the transaction process begins.

Contracts: Buyers will certainly review key customer or supplier contracts, and not uncommonly will request access to such parties during the diligence process. Sellers should ensure that legally-reviewed, consistent contracts are in place with key customers and suppliers as appropriate. In preparing the sale strategy, they should also evaluate their willingness to allow such access, and at what point during due diligence they would agree to do so.

Environmental Issues: Another often difficult issue in deal negotiations is that of environmental liabilities. If there is any suspicion of the existence of potential liabilities on company owned or operated sites, sellers are well-advised to engage a professional environmental firm to

conduct at least a preliminary site assessment. Sellers will be better prepared to negotiate costs and responsibilities with buyers if they have an idea of the likely magnitude of any existing problems.

Intellectual Property Position: Uncertainty around intellectual property ownership can cause significant transactional delays or, in some cases, derail transactions entirely. Prior to embarking on any transaction process, owners of companies dependent on technology positions should have a clear understanding of their existing and pending patent portfolios; compliance with any required license or royalty agreements; index of non-patented, proprietary information or trade secrets; and any pending or threatened legal issues related to intellectual property.

Other Legal Issues: The seller's legal team can assist in conducting a pre-emptive review of other common legal issues, including shareholder and securities documents, key corporate records, and any ongoing litigation.

Preparing for a transaction should be a deliberate process, one in which owners and advisors work collaboratively well in advance of initiating contact with any potential buyers. Sellers can often be dismayed at the idea that preparing for a sale can take six months to one year, and will most likely require a significant amount of management and owner time. However, when properly executed, taking preparatory steps such as these will be of invaluable assistance in assembling marketing documents, preparing for buyer due diligence, and most importantly, anticipating and addressing potential issues that may arise during deal negotiations.

About Stonebridge Associates, LLC

Stonebridge Associates is an NASD-registered investment banking firm that provides mergers and acquisitions, private placements of debt and equity securities, fairness opinions, and other strategic and financial advisory services to middle market and emerging growth companies. The firm's division, Stonebridge Technology Associates, specializes in raising equity capital and providing merger and acquisition advisory services to software, hardware, Internet, health-care, and other technology product and service companies. To learn more about Stonebridge, please visit our website at www.stonebr.com.