FINANCIAL POST

Step cautiously when selling your business

Brad Cherniak Apr 10, 2012 – 9:17 AM ET | **Last Updated: Apr 10, 2012 10:08 AM ET**

Molly Riley/Reuters files

In the heat of the hunt for a sale or a hire, employees can give away too much in trying to convey the strength of the company.

The first golden rule to selling your company is to treat your financial information like money — don't hand it out to everyone, and don't leave it hanging about. As I wrote in an earlier column, once small to mid-sized businesses are in position to confidently field unsolicited calls and indications of interest in buying their companies, the next step is knowing what information should be shared, and when.

As a preliminary step, all SMBs should do a thorough scrub of their corporate and sales presentations for sensitive financial information. It is surprising how much of this information is included in presentations. In the heat of the hunt for a sale or a hire, employees can give away too much in trying to convey the strength of the company. Often, there is no central vetting at smaller companies about what is fair game to disclose.

It is equally surprising to see where such presentations end up. As people move from role to role, company to company, they often take and share these documents with colleagues and investment bankers. Once presentations are scrubbed, you can more meaningfully control what information gets into the hands of potential suitors.

Related

- Ready to answer suitor's call
- Where do you really make your money?

The second rule is that the most treacherous thing you can do with your business is to try to sell it. This is particularly true when selling to players in, or close to, your industry. There are plenty of stories about business owners that compromise their business or its value by getting too excited about the prospect of a sale and leaving caution to the wind. They soon begin treating the interested party like a partner, and the deal as done, and stop filtering what they share.

It is a delicate balance. If you have a good business, the more information you share, the higher the likelihood of a deal. The corollary is the more you share, the higher the likelihood the information is misused.

This can include companies:

— Copying proprietary software code or using the basic architecture to hasten development of their own product. Many companies have used acquisition discussions as an excuse to do unauthorized research and development. You may think you are selling your company, but actually you are giving your recipe to another restaurant for free.

— Getting customer or price lists, and profit margins by product or customer in order to better compete with you.

— Finding out your company's financial condition and using it to spook customers or prospects, or poach employees.

So, how do you proceed, given all this?

Share virtually no specific financial information in the early phases of an unsolicited discussion. Serious buyers will want to talk about fit (by market, product line, strategy, or even personalities) and be willing to wait for full disclosure. Those with other agendas will tend to jump right to asking about specific customers and profit margins.

If things continue, the discussion will get to sales and EBITDA. These are the two most common metrics for assessing and valuing private companies, although certain industries will have specific metrics.

Make sure you speak in fairly wide terms at this phase. The prospective buyer should also be talking about their acquisition criteria in terms of the ideal target sales, EBITDA margins and historical growth rates.

At this point or even the previous step, you should be asking the party to sign a non-disclosure agreement. But keep in mind you are still relying on the kindness of strangers, even after the NDA is signed back, when you disclose sensitive information.

It is customary to provide more detailed information once you have the NDA, including financial statements for the past several years, product information and specs. It is often best to have a formal Information Memorandum prepared.

What should still be left out or redacted are customer names and source code, or other proprietary blueprints to your product or service offering. Sensitive information on margins by product or customer could also be aggregated in a way that it is not obvious who or what the information specifically applies to. You should only be conveying the strength and health of your business, not its secret sauce yet.

Around this time, the parties should be entering into a formal Letter of Intent (to be discussed in another column), but for now it is important to note that in any sale discussion there is a point where you need to drop the kimono completely, to allow full and final due diligence on all aspects of your company.

This may include having software engineers review your code and testing your platform in-depth, and reviewing specific and sensitive financial information. Even speaking directly with some of your customers.

There is no guarantee having done all this, that you will not fall prey to hidden agendas. But this way, you at least have the opportunity to get a feel for the prospective buyer, and for imposters to slip up and show their real hand.

- Brad Cherniak has spent more than 20 years as a principal, advisor to and investor in private companies. He is co-founder of Sapient Capital Partners, a Toronto-based advisory firm to companies from early stage to $50-million in revenues. He can be reached at brad@sapientcap.com. Follow Brad on Twitter as @SapientCapital.