Selling Your Business in Iron County

A quick guide to the key aspects of selling your business

Why Are You Selling?

The first question to ask yourself is why are you looking to sell your business?

- You are looking to retire
- You need to raise personal capital
- Some family event means you can’t run your business in the future (moving, death, etc.)
- You are looking to capitalize on the value in your business and move onto a new opportunity

You’ll also want to ask yourself what are the other important aspects of selling your business beyond just the sale:

- Do you want your business to remain open and continue in the community?
- Do you want to pass the business on to a new owner who is already engaged?
- Do you want the sale to happen quickly?
- Can you invest money to make your business more attractive for selling?

Valuing Your Business

Coming up with the selling price of your business is one of the most challenging tasks in selling. You want to maximize your return, but have the price as fair as possible and attractive enough to catch the attention of potential buyers.

If an important aspect of your exit strategy is to keep the business open and operating in Iron County, then your valuation needs to be at a level that the buyer of your business can operate the business profitably and meet their own earnings needs. Given our location and sparse population, you’ll probably need to price your business below your calculated valuation to give the new owner a chance to make a successful transition.

Most experts agree that the starting point for valuing a small business is to adjust the business’s net earnings to get a number called the “Seller’s Discretionary Earnings (SDE).” SDE is the pre-tax earnings of your business before non-cash expenses, owner’s compensation, interest expense and income, or one-time expenses that aren’t expected to continue in the future.
Here are some examples of things that would be pulled out of the net income reported on your tax return (if not already excluded) to calculate SDE:

- Your owner’s draw, or that of all the owners (if more than one)
- Any perks you or other owners receive (like personal travel or a vehicle)
- Family members on payroll holding non-essential positions
- Non-cash expenses such as depreciation and amortization
- Leisure activities, such as business golf outings
- Charitable donations
- Any personal expenses, like the purchase of a personal vehicle, that were noted as expenses on the business tax return
- Business travel that’s not essential to running the business
- One-time expenses that are unlikely to recur after the sale of the business, such as the settlement of a lawsuit

Your accountant can help you figure out which of these are relevant to your particular business.

Businesses typically sell for somewhere between one and four times their SDE, and often on the lower end of that spectrum here in Iron County. This is called the “SDE multiple” or sometimes the “cash flow multiple.” Finding the right SDE multiple is really more of an art than a science because it varies based on:

- The industry sector
- Location (such as Iron County)
- Company size
- The business’ tangible and intangible assets
- And other variables

The biggest factors influencing the SDE multiple is usually owner risk, market size (based on location) and the industry outlook. If the business is highly dependent on you or another owner, it cannot be easily transferred to new ownership and the business’ valuation will suffer. If you’re selling a business in an industry and/or area that is expected to grow in the near future, the SDE multiple will be higher. Locally, working with an SBDC counselor is probably the best way to determine an accurate multiplier for this region (odd are, it will be between 1.25 and 2 for Iron County).

Business’s Estimated Value = (SDE) * (Industry Multiple) + (Real Estate) + (Accounts Receivable) + (Cash on Hand) + (Other Assets Not in SDE or Multiplier) – (Business Liabilities)

Here’s an Example:

Angie’s Awesome Family Restaurant

- Annual Revenue (cash generated by sales): $195,000

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- SDE (the number you get after adjusting the earnings with add-backs): $75,000
- Real Estate (estimated worth of property owned): $68,000
- Furniture, Fixtures, and Equipment (FFE) (fridges, fryers, booths, counters, etc): $20,000
- Inventory/Stock (food, napkins, ketchup, etc): $1,500
- Liabilities (debt, interest, etc.): $29,000

Value based on SDE: ( $75,000 x 1.65) = $123,750

Total Estimated Value: $162,750 = ($123,750 Estimated Business Value) + ($68,000 Estimated Real Estate Value) - ($29,000 Liabilities)

Depending in your business type as well as what has happened in your business while you were operating it, there may also be some very real value to your intangible assets. In businesses with well-known names, products, and reputations, up to half the business sale price often covers the purchase of intangible assets — things buyers can’t hold in their hands, but confer value to the income potential of the business.

While things such as patents and trade-secrets and other intellectual property can be a key aspect of a business’ value, for a small retail or service business in Iron County, things such as reputation, processes, strategies, and general know-how together contribute to business value over and above the value of the tangible assets. These intangible assets compose what’s called the “goodwill” of your business.

Goodwill assets often include:
- Your business name and brand identity
- Your trained workforce
- Loyal clientele
- Strong and durable supplier and distribution networks
- Phone numbers, websites and social media reputation
- Proprietary technology, systems, and processes
- Brand equity, which is the value of the competitive advantage of your name and reputation in the minds of consumers and business and industry partners.

Potential for growth - your business may have great potential for growth and expansion in its existing market or by expanding to new markets. Often, this potential opportunity is a key reason why someone might be interested in your business. You can’t really add “potential” into the value of your business, but be sure to point out any opportunities you see in the future. It’s up to the buyer to determine the value of those opportunities as they evaluate your business.

Preparing for a Sale

When you’re preparing to sell your business, preparation is the key. You’ll need to eliminate as much debt as you possibly can, gather all of your important financial documents for potential...
buyers to analyze, and discover any potential weaknesses. You will want to also make sure your physical location is as attractive as possible: neat, clean and professional. This will help you maximize the overall value of your business and speed up your sale process.

Every business has weaknesses, and potential buyers will be quick to point them out. The best way to deal with them is to shore them up before you sell, and be honest with any problems you can't fully solve before a sale.

What documents do you need to show potential buyers when they express initial interest? Here are a few key documents you should have on-hand:

- Year to date (YTD) income statement (showing your business’s revenues, costs of goods sold, operating expenses, as well as operating profits and net profits)
- YTD balance sheet (breaking down your business’ assets and liabilities)
- Your cash flow statement (a breakdown of all the money that comes in and goes out of the business, including net gain)

Buyers are going to want to confirm that you have filed and paid taxes for the business. Also, they will look at revenue, net income, and tax payment numbers to confirm that the financial statistics you’ve provided them with your financial statements are correct.

Finding a Buyer

In Iron County, this is probably one of the most challenging aspects of selling your business. Like Valuing Your Business, Finding a Buyer also needs to take into account the reason you are selling your business. For the purpose of this guide, we are going to assume you are looking to sell the business to a buyer who will continue to operate the business in Iron County.

Unquestionably, the best source of a buyer would be someone who knows your business already, and ideally how it operates. Do you have a senior employee or manager who would be interested in taking over the business? If so, this could be your best bet.

If you are looking to sell your business to a buyer you don’t yet know, then they will have to discover that your business is for sale and then they’ll need to determine if it meets their needs and goals.

One of the challenges of just listing your business with a real estate broker is that it can create the often incorrect impression that your business is suffering and you just want to get out of it. If you are listing with a broker, if at all possible, be sure the listing includes the reason for the sale so potential buyers aren’t seeing a red flag out of the gates.

It’s probably best to reach out to the ICECA and SBDC before you list a business sale, because they may have contacts with potential buyers. Also reach out to family, friends, employees, your
professional partners (accountant, lawyer, etc.) and your suppliers - they can be a great connection to a potential buyer.

If you do indeed list the sale of your business publicly, make sure that it has solid curb appeal and you have all the documents ready. You want the offering, just like selling a house, to be as attractive as possible to a potential buyer.

If you are looking to sell off the assets of your business and are not interested in keeping it open, then often separating the real estate from the inventory can be helpful - there are different markets for both, and you might be able to sell off your assets more quickly.

**Due Diligence**

When you have a buyer who is serious about buying your business, you will enter the due diligence stage, in which both the buyer and the seller research more deeply to determine the feasibility of the sale. For the buyer, that means determining that the value of your business fits your pricing and that the earning potential is there. For you, you are trying to determine if the buyer has the financial position to actually purchase the business.

Before you share more information than the basic reports outlined above, you’ll want to sign a non-disclosure agreement (NDA). Your lawyer can help you pull together a simple NDA (you can also find workable boilerplates online). An NDA is a legal document signed by both seller and buyer in which both parties agree to keep each other’s private/financial information confidential. A buyer who is willing to sign this agreement is at least interested enough in your business to sign a legally binding contract.

Here are the most important documents that you need to have ready after the NDA is signed:

- Proof of business ownership
- Business licenses
- Payroll summaries for the last year
- Outstanding accounts payable
- Outstanding accounts receivable
- Current loan information
- Leases
- Sales contracts
- Details of any chargebacks or “owner’s draw” in your financials
- Three years of profit and loss statements
- Three years of cash flow statements
- Three Years of balance sheets

Remember that due diligence is a two-way street - ask for the potential buyer’s personal financial summary and a copy of their current credit score. If the NDA did not scare away a non-serious buyer, this certainly will (after all, you don’t want to waste your time). If a buyer is
willing to provide sensitive personal financial information to you, he or she probably has more
than just casual interest in your business. This will also weed out any potential buyers that are
wanting to pitch the purchase to other buyers they find for a fee, instead of purchasing the
business themselves.

Closing the Deal

On average, businesses take at least six to nine months to sell, starting from the time you
actively start looking for a buyer. To be safe, a rule of thumb is that you can assume a year from
the start of the process to the completed sale of your business.

Should you offer seller financing? Businesses that are owner-financed almost always sell better
than those that aren’t. In addition, businesses that offer seller financing often sell for 10-15%
higher than businesses that do not, although it is more about opportunities to close the deal
than actually adding value.

With seller financing, you can expect to finance around 60-70% of the sales price, with the rest
as an upfront payment. Terms generally last five to seven years and 6-10% is a common
interest rate. When you provide seller financing, you are making a decision to trust that the new
buyer has the ability to run the business effectively and pay off the loan (so make sure you do
your research!).

The length of time it takes to close depends on your buyer, how complicated your business is,
and how extensive your negotiations are. Generally, you can expect 30-90 days for due
diligence, 30-60 additional days for negotiations, and another 30-60 days to draft all contracts
and close the transaction. You’ll need to engage your lawyer early in the process, and have him
review any purchase offers when you receive them.

When you sell your business, the money will go to paying off any outstanding debts that the
buyer didn’t agree to take, and then you’ll have a profit left over. That profit will be a capital gain,
which will be taxable income on your personal tax return. If you’ve owned the business for more
than one year then you’ll likely face a 15% tax, but if you’re in the highest tax bracket then the
tax will increase to 20%. You should prepare for this tax with your accountant before you close.

Are you going to train the new owner? If your buyer is not completely familiar with your business
model or market, some training and mentoring might be a great way to help them succeed.
Often, some sort of transitional training and explanation is expected when you sell the business.
If more mentoring is needed, perhaps consider a consulting agreement with the new buyer to
help them get up to speed - just be sure to put limits the time you agree to spend, whether you
are compensated or not.
Resources to Help

Your most important resources for the sale of your business, and preparing any needed documentation are your current accountant and lawyer. Iron County’s local real estate brokers can be a great help in valuing the real property in your business (the buildings) as well as help marketing the sale of your business and facilities.

All the resources listed below are completely confidential and free to access.

Iron County Economic Chamber Alliance (ICECA)
Your best first step to get the process started. Also, help accessing potential local and regional buyers.
Paul Schuytema, Executive Director
50 East Genesee Street
Iron River, MI. 49935
(906) 265-3822
www.iron.org
paul@iron.org

Small Business Development Center (SBDC)
Business counseling across all areas, with specialised counselors to help you through the entire sales process.
Dar Gronevelt, Business Consultant
Michigan SBDC - Upper Peninsula Region
Michigan Technological University
1400 Townsend Drive, ATDC Building
Houghton, MI 49931
(906) 523-4125
SBDCMichigan.org
dmgronev@mtu.edu

Service Corps of Retired Executives (SCORE)
Volunteer retired successful business mentors to help council and advise.
Paul Werner, Business Mentor
SCORE - Upper Peninsula
770 North Main Street
L’Ansa, MI 49946
(906) 201-1995
www.score.com
paul.werner@scorevolunteer.org

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