Thinking of Selling Your Business…Be Thoughtful!!

By: Tony Fiore, Principal, Reflective Advice, LLC

ABSTRACT

This article presents a general review of the process involved in selling a business and a condensed discussion of the personnel, financial, estate planning, legal, accounting and tax matters shaping the decision to sell. It is not intended to be an exhaustive review but instead is intended to challenge and provoke thought in making the decision to sell.

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Thinking About Selling Your Business - Be Thoughtful!!

By Tony Fiore, Reflective Advice, LLC[1]

1. *Introduction*[2]

Exiting[3] a business is not a simple, straightforward task. It is complicated with numerous financial and personal consequences that can be caused by ineffectively limiting your tax exposure and any post-sale legal liability. The process can be exhausting, time-consuming and raise issues of the fulfillment of your aspirations, family goals and wealth management. At times, the process can feel overwhelming and too slow as due diligence and negotiation of the transaction documents becomes prolonged, taking away from the steady operation of the business. It will test an owner's emotional readiness to exit as the reality of a transition from a gratifying life's work to unfamiliar post-sale life springs to the forefront.

There are numerous personal, financial, estate planning, legal and tax matters that can strongly shape the decision to sell. You need to begin planning early, often 2 to 3 years before your desired exit date. You want time to define your goals clearly, prepare yourself and your family, and ready the business to be attractive to potential buyers. The guidance of competent advisors well versed in your industry and proficient in negotiating the sale of a company like yours is critical. Also, all buyers are not the same. There are three types of buyers (each more fully explained in Section 6)

- Strategic – companies in your or related industry seeking to accelerate long-term growth.
- Financial – private equity firms seeking to invest in growth and exit in 3 to 5-years.
- Family/Employee – family members or key management may seek to follow an owner.

Other possibilities to exit include options to liquidate some, but not all, of the value you built. Each buyer will address the purchase decision differently, as will be discussed more fully in subsequent sections of this article.

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[1]. Tony Fiore is the principal of Reflective Advice small business advisory firm located in Mansfield, MA. For further information about Reflective Advice see our website: www.reflectiveadvice.com.

[2] This article is not intended to be an exhaustive review of each subject matter presented, provide any legal or tax advice, or a substitute for knowledgeable, experienced advice. Instead, it aims to provoke thought. Anyone considering selling a business is advised to retain competent advisors.

[3] A business exit can be achieved by succession or sale. This article will concentrate on the sales process but will discuss succession planning generally for context.

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Choosing skilled advisors is fundamental. Skilled advisors assure a successful and timely transaction. An unsuccessful sale can be fatal to your business. Your customers and employees may react negatively to a pending sale, never mind a broken deal. Advisor inexperience can significantly raise the risk of delay. Many factors can change over time, such as market conditions and industry economics, each can negatively affect value. Once initiated, you want the sale to conclude timely and successfully at the agreed to price.

Practical point: You need to make sure you insulate the operation of the business from the sale process. A "bump" in operating performance can derail the transaction. There is nothing more dangerous to the future of a company than a failed deal.

2. Planning

At some point, an owner will decide its time to exit the business. Many reasons and motivations may drive an owner's decision to sell, including:

- no likely succession path, either by a family member or with key management
- health
- retirement
- financial
- competitive pressures
- the presence of an opportunity to sell

Regardless of the motive, a sale is the ultimate reward of years of hard work and sacrifice. The business has provided you with the personal satisfaction and accomplishment of starting and building a successful business. You and your family have lived comfortably and have gained respect and esteem in the community. You have long-term, trusted employees who helped you succeed who you care for.

For me, proper planning imparts sureness in the decision to sell. Goals and objectives are clear and ultimately reflected in the choice. Certainty alleviates anxiety for both you and the buyer and eases moving forward. You will be ready to sell. You will think clearly during the process. You will be able to seamlessly transition the company to the new owner and yourself to your chosen post-sale life. You do not want to have second thoughts during the process, or "seller's remorse" after the sale. One survey notes that 3 out of 4 business owners interviewed 12 months after the sale "profoundly regretted" the decision to sell as their post-sale life does not fully satisfy the internal drive that made them successful.

Most business owners devote little or no thought to planning and insufficient time to properly accomplish the task. Preparation readies you and your family. It defines your personal goals, examines the capital required for retirement with financial security and to pursue your desired post-sale life. It encompasses estate planning to minimize estate taxes and income tax planning to maximize the after-tax proceeds

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from the sale. And financial planning to assure you can live the post-sale life you wish.

First, thoroughly evaluate your financial situation. Work with your financial advisor to prepare an age-adjusted financial plan showing the financial assets required post-sale to maintain your standard of living and fund your post-sale lifestyle. It is crucial that you understand the portion of necessary financial assets expected to come from the after-tax proceeds from the sale. Your family, wealth and tax advisors are prominent in this discussion.

Be sure to spend sufficient time thinking candidly about your post-sale life. I cannot stress this enough. Will the imagination, initiative and hard work that fueled the creation of a successful business be amply satisfied post-sale? Do you wish to stay involved post-sale, either as an employee or consultant, if at all, or for any length of time? Discuss your thoughts and ideas with family and trusted friends and to the extent possible, inquire of other owners you know that have sold their business. Building a satisfying post-sale life is often harder and takes longer than most business owners believe.

Consider rewarding or protecting your management team, especially those employees who helped you succeed. A bonus plan payable at the time of sale, a severance plan triggered upon a sale providing employees with protection from termination by the new owner, or a retention bonus rewarding the employee for services post-sale are possible approaches. These types of awards provide an incentive for the employee to cooperate in the sale process and the transition to the new owner.

Practical point: Be thoughtful. Begin the planning 2 to 3 years beforehand to give yourself sufficient time to plan and reflect. Get yourself, your family and the business ready. Readiness is an essential step.

3. Your Advisors

You cannot do it alone. As with all meaningful decisions in life, trusted and able advisors are invaluable. An exit will test you emotionally. Knowing your personal and financial goals are well thought out will ease the anxiety related to negotiating and completing the transaction. It is your business, in the final analysis, your decision, but at least take counsel of competent advisors. Spend the time and funds necessary; the result will be worthwhile.

The breadth of advisory services involved includes:

- financial advisor
- estate planner
- insurance professional (medical, long-term care)

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- deal advisor, a broker or investment banker
- legal, tax, and accounting professionals with depth of experience in mergers and acquisitions

While each advisor is involved in specific stages of the process, the goal is to execute a transaction that provides you with the best price, the highest post-tax proceeds, the least post-sale liability, and your assets placed in the appropriate estate plan and invested safely. You will be able to pursue your chosen retirement and have the ability to pass wealth to your survivors with minimal estate tax ramifications. The degree of involvement of each advisor depends on the complexity of the transaction.

Practical point: Select advisors with the ability to work collaboratively. Often, some advisors claim to have overlapping expertise with others. Be careful; only choose advisors with a verifiable depth of experience in their field. You do not want dueling advisors.

Retain a skilled business broker or investment banker with extensive knowledge and experience in your industry to promote and market your company professionally. A seasoned broker or investment banker will have the most significant influence on the success of the sale second to you and your management team. Sellers of private firms generally fair significantly better financially when engaging a capable deal advisor. The more favorable price reflects the deal advisor's experience in selecting bona fide buyers and running an auction process that keeps all bidders actively engaged. Without a deal advisor, the seller does not have a sufficient mechanism to set price with supporting market data. Also, buyers tend to have significant "input" on the structure and contractual terms, not always favorable to the seller. A competent deal team can meaningfully counter those terms. You should interview more than one advisor and check references for credibility and ease of the working relationship.

Both of these intermediaries can and do represent owners on "sell-side" and buyers on the "buy-side. As you would expect, the role is different. With investment bankers, the sell-side advisory is more focused on market conditions, value and the selling process itself. On the buy-side, the advisors will also focus extensively on the target, and its industry, strategic fit, synergistic opportunities and the bidding strategy.

Business brokers and investment bankers pursue different client bases and employ entirely different processes.

Business brokers typically work with companies having less than $2 million in revenue that will likely sell to an individual buyer, although the major brokerage firms will handle more substantial sales. Business brokers use a method similar to a real estate agent, such as having an appraisal, preparing an informational document to support marketing the company and advertising the sale in an industry

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newspaper and various broker websites with an asking price, akin to an MLS listing. A broker will request an upfront, non-refundable retainer plus a closing fee of 3% to 10% of the overall selling price. Smaller individual-owned business, so-called main street businesses, such as dry cleaners, plumbing and HVAC service firms and restaurants, are typical clients. Any business broker you engage should be a Certified Business Intermediary and a member of the International Business Brokers Association, as some assurance of professionalism, training, and competence.

Investment bankers use a more formal, targeted sale process and provide a broader range of services. Investment bankers provide research and insight to the current M&A market, more in-depth industry knowledge, awareness of current market values and potential buyers. Investment bankers are purely transaction driven and seek companies with revenue above $10 million and EBITDA above $2 million. The typical fee structure comprises a monthly retainer to compensate for preparatory work and a tiered success fee (referred to as the Lehman Formula or Lehman Scale) declining from 10% to 3% with transaction value. An investment banker will assist in all aspects of the deal from selecting the transaction structure, determining valuation, choosing of the process (auction or private sale) and accessing market timing. The banker will also assess the readiness of the company for a sale and suggests strategic and operational changes to maximize value.

Both advisors will seek to generate a rigorous, competitive "auction process." Each will hold introductory meetings to screen and qualify interested buyers and coordinate your interaction with those qualified to lessen disruption to your business. An interested buyer will often execute an **Indication of Interest** ("IOI") indicating the buyer is serious but recognizing that a great deal of further discussion and review is necessary. The IOI is intended as the first offer but will only provide guidance on valuation and generally outline other deal terms. Usually, in a well-executed auction process, several potential buyers will execute an IOI.

The next step is the execution of a **Letter of Intent** is a formal offer intended to set forth the final firm price, closing date and deal structure and terms. At the LOI stage, the buyer will ask for an exclusivity period to conduct full due diligence and negotiate the transaction documents.

Practical point: You should strive to maintain a constant dialog with the buyer. While your advisors can deal with the particular issues that arise, and you should let them, you need to hear the buyer's points and raise your points. Form an open and candid relationship. It will build trust that may help resolve complex matters more effectively

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4. Structure and Tax Considerations[4]

While getting the best price is important, you want to maximize and protect the after-tax proceeds. The amount of tax you incur from a sale depends at a personal level on how your ownership is held and, at the business level, on the corporate form of your business and the transaction structure.

Tax planning is vital. You need to involve your tax advisor and estate planner at the beginning of your thought process. Many approaches employed to reduce estate tax and delay income tax on the proceeds are best implemented well before the sale. Numerous estate-planning techniques are available to minimize estate tax on transfers to family members.

The transaction structure has significant and at times may have opposing federal and state tax considerations for both you and the buyer. The tax consequences may vary considerably in a stock sale as compared to an asset sale. Also, whether a stock or asset sale, a tax-free exchange (where at least 40% of the sale price is in buyer stock) allows deferral of the tax on the gain of the shares received until sold (a so-called "tax-free transaction"). The tax on the cash portion, referred to as "boot," is payable in the year received.

Practical point: *If the buyer is a private, non-public entity, accepting buyer stock or a buyer note as all or part payment is risky. Unlike public companies there is no active market for shares in a private company – the shares are illiquid. Holding illiquid stock is a risk as a seller you may not wish to undertake. Also, before you accept stock or a buyer note as part of the purchase price, be sure to perform due diligence on the buyer to understand the likelihood of payment on the note or the value and liquidity of the stock.*

The sale proceeds comprise two components, the price of the asset sold and the basis of that asset. The difference between purchase price and tax basis of an asset is the tax gain. The gain can be treated as ordinary income and taxed at ordinary income rates or as a capital gain and taxed at capital gain rates – either short or long-term. The gain from the sale of an asset held for longer than 12 months is a long-term gain and taxed at the much lower capital gain rates; otherwise, the gain is short-term and taxed at ordinary rates. Obviously, you want as much of the sale proceeds as possible recognized as a capital gain[5].

The corporate form of your business has tax consequences in a sale. For this discussion, I will consider only two types of ownership – a C-corporation and an S-corporation. Both have the same corporate law protection of limitation of liability

[4] This section does not include changes to the tax code recently enacted by the Tax Cuts and Jobs Act ("TCJA") that went into effect on January 1, 2018. Exhibit 1 presents a summary of the amendments relating to business sales.

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and operate the same way-but can have significant tax differences for shareholders. Much of the discussion relating to S-Corps also applies to limited liability companies ("LLCs).

An **S-corporation** is classified as a "pass thru" entity by the IRS, meaning the corporate entity itself is not considered a separate taxpayer from its shareholders. The income generated is directly passed thru to the shareholders and not recognized by the corporation. Only the shareholders pay the tax. The "pass thru" provides a substantial tax benefit by avoiding the double taxation borne by C-corporation shareholders.

A **C-corporation** is classified as a taxable entity by the IRS meaning that a C-corporation is taxed separately from its owners. This classification is an important distinguishing characteristic of a C corporation from an S corporation that generally is not separately taxed. Most major companies (and many smaller companies) are C corporations for U.S. federal income tax purposes.

This separateness produces "double taxation." The tax on income (operating or otherwise) generated by a C-corporation is imposed on and paid by the corporation itself first. Any distribution of income to its shareholders in the form of the dividend is again tax at the applicable tax rate. Thus, double taxing the sale income.

The structure of the transaction is also a central issue. There are two primary alternatives for structuring a deal: a stock purchase, often accomplished in the form of a merger, and an asset sale.

In a stock transaction, the purchaser benefits because the acquired company continues uninterrupted and does not require many of the legal or contractual consents of an asset deal and can simplify post-acquisition integration.
However, despite some advantages, buyers do not favor stock transactions because of unfavorable tax treatment.

Regardless of corporate form, a seller should seek to sell stock not assets. Here, the buyer purchases all the shares directly from the shareholders for cash, stock or a combination of each. The seller's corporate entity is not a party to the transaction and remains unchanged, retaining all of its assets and liabilities post-transaction. Sellers benefit from a stock sale for two critical reasons: the transfer of obligations and liabilities of the business to the buyer, and the elimination of the possibility of double taxation.

The difference between a stock and asset sales have very different tax treatment. Stock sales produce capital gain, while asset sales provide a mixture of capital gain and ordinary income. A merger has the benefit in certain circumstances of tax deferral of at least a portion of the sale proceeds if in the form of acquirer's stock (i.e., "boot," as discussed above).

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For federal tax reporting, in a stock purchase, the buyer is required to "carry over" the basis of the assets as valued on the seller's balance sheet and continue with the same depreciation and amortization schedule after the transaction as was in place before the transaction. In an asset acquisition, the buyer can "step up" the basis of the purchased assets to fair market value. Given the fair market value of the assets is often higher than the historical cost basis of the seller, the step-up in basis provides the purchaser with more significant depreciation and amortization deductions, less future income tax, and an increase in after-tax cash flow. This additional cash flow now available to subsidize working capital.

In a sale of assets, the buyer purchases particular assets and assumes only explicitly identified liabilities of the business. The seller shareholders retain ownership of the corporate entity and any assets and liabilities remaining after the sale and will need to liquidate the corporate entity following the applicable federal and state laws. An asset purchase shields the buyer from all pre-acquisition liabilities other than those assumed. However, the shareholders of a C-corporation face "double taxation" of the proceeds as discussed above.

In certain situations, the buyer can elect under IRC Section 338 to treat a stock purchase as an asset purchase for federal tax purposes. Under this rule, for tax purposes, both the buyer and the seller must recognize the transaction as an asset sale and account for it accordingly. The buyer's decision to elect such treatment is a financial one. It will depend on the present value of the future tax saving being higher than the current tax due on the increase in the assets caused by the step-up in the basis.

However, an asset sale may result in adverse tax consequences for the seller. The balance between the advantages gained by the buyer in an asset sale compared to a stock sale is often a point of contention. The main point of contention is the allocation of the purchase price among the various acquired assets in an asset sale. Agreeing on the purchase price allocation can produce intense negotiation that will most likely require some experienced guidance. Generally speaking, the buyer wants as much allocated to items that are currently deductible such as a consulting agreement and to assets that have short depreciation schedules. The seller typically wants as much of the price allocated to capital assets, that is those assets that enjoy capital gains treatment, rather than to assets that bring ordinary income. Asset allocation must be handled thoughtfully with the advice of an experienced accountant. Do not leave this to a post-closing adjustment; it can have severe economic consequences.

Practical point: *You should work with your tax advisor to develop a distribution model of the after-tax proceeds at an illustrative price under a stock sale compared to an asset sale. The model should detail the federal and state tax implications of each under various payment scenarios, all cash, buyer issuing a note or stock, installments, and earn-outs. The exercise will enable you to decide on the best deal structure for you.*

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The deal structure also has essential legal considerations – namely transferability of liability, required contractual consent, and stockholder approval. In a stock sale, the responsibilities and liabilities your company become the responsibility of the buyer. However, in an asset sale, only the liabilities assumed explicitly by the acquirer are transferred the rest remain with your company. This difference is the reason sellers seek stock sales.

State Taxes. There are also important state tax and local tax (SALT) considerations, both income tax and potential liability unpaid sales and use taxes, in each state the business operated. Also, many states have enacted various tax provisions related to business sales, both as to the seller and the buyer, that impose tax liability that differ from, or are in addition to, federal tax liability.

Practice Point: Be sure that you fully assess any potential state tax liability for each state your business operates to avoid any unanticipated liability.

5. Valuation

Accurately valuing a business is challenging. Two things are sure about a valuation - it is probably wrong and should not to be confused with the purchase price, which reflects various factors, such as market timing, each affecting the buyer's assessment. At best, it is only the starting point adjusted after some detailed financial/operational review and business judgment. The final purchase price will follow the straightforward principles of timing, risk and negotiation leverage. Companies in stable industries experiencing sustainable growth and capable management independent of the owner are less risky and will realize premium prices.

Also, valuation is not solely an analytical modeling exercise. It results from an assessment of company-specific risks such as:

- self-sufficiency/management
- profitability,
- competitive position and
- macroeconomic and industry trends.

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There are two primary valuations approaches – the income approach and the market approach. The **income approach** uses the expected, sustainable cash flow and the market approach uses the capitalization of earning at the appropriate multiple, such as EBITDA, earnings before interest, taxes, depreciation, and amortization, attained in recent sales by a peer group of public and private comparable companies in your industry.

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The primary income approach is discounted cash flow (DCF). DCF casts value as is the current worth of the estimated free cash flow to be generated by the business over a three to five-year horizon plus a single estimate of the value (known as the "terminal value") of the continuing activity past the forecast period. By applying a discount rate that reflects overall risk (company, market, industry), the future cash flows are brought forward and summed to represent total value. DCF can be a powerful tool but has severe limitations when applied to private firms, including the difficulty of correctly estimating cash flows, and establishing appropriate discount and growth rates.

The **market approach** compares the trading multiples of a peer group of public companies or past transactions of a peer group of private companies, in each case, having business characteristics (such as risk, growth, market, industry) similar to yours and adjusted for your company's specific characteristics. It is not any more accurate than the DCF method. The market approach is just another data point as to value. Determining "similarity" to construct a relevant peer group is often more art than science. The most use trading multiples are revenue and EBITDA - earnings before interest, taxes, depreciation, and amortization.

EBITDA is a rough, but accepted estimation of operating cash flow. It is very company specific. The estimates from peer groups need adjustment for your particular business. EBITDA is first adjusted (i.e., normalized) by applying any add-backs. Examples include salary expense for you and other family members, preferential lease terms, and to recognize the over or understatement of certain costs attributable to your operation of the business and not required by the buyer,

Practice point: It is not often that a sale will involve a detailed discussion valuation models and you do not want to have that discussion. It is senseless. The purpose of valuation is to give you a sense of value.

An analysis of the synergistic effects potentially realized by the buyer is essential. The potential increase in earning related to any synergies is often more significant than other normalization factors. Uncovering and implementing opportunities for revenue growth and expense reductions to improve gross and operating margins and net profit can considerably increase both cash flow and EBITDA. To emphasize the point, a $100,000 increase in EBITDA at a five-times multiple represents $500,000 in value to you.

Most acquisitions are negotiated on a cash-free and debt-free (CFDF) basis. Simply, this means the seller keeps all cash and pays off all debt. Often the detailed terms are not clearly defined in the letter of intent and are left to further discussion as part of diligence. Determining the actual terms can be contentious, and can significantly affect the economics of a deal.

Another point of contention is the purchase price adjustment if any to provide sufficient working capital to the buyer. This provision is intended to make sure the

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buyer has sufficient working capital top fully run the target operationally after the acquisition. As you would imagine, it can also develop contentiously and may require cash remain with the buyer.

Practical point: Your account and legal advisors are best equipped to negotiate the CFDF and working capital provisions. Both can be complicated and intricate issues that require expert attention.

6. ***Potential Buyers***

Not all buyers are the same. Different buyers have different motives that can dictate price, structure, and other essential deal terms, as well as the pace and timetable of the transaction. Buyers may need financing, expecting you to issue a seller's note for a portion of the purchase price, or pay for the purchase in installments.

You may receive an unsolicited approach from a buyer or may contact a potential buyer to begin discussions. It is always good to talk. Be careful, keep the conversation general. Under no circumstances should you reveal sensitive, confidential information at this early point in discussions. If the talks become involved, include your advisors. A single buyer has leverage, delays other potential buyer activity, and you will be susceptible to aggressive negotiation. So don't focus on an individual buyer at first. Use the process to garner knowledge of the buyer market and to learn to recognize and weed out the tire kickers and bottom fishers.

Practical point: Remember – one buyer is essentially the same as no buyer.

There are two kinds of buyers – financial and strategic. Other exit paths are available, such as purchases by family members and partners or employees using an Employee Stock Ownership Plan ("ESOP"). Succession and ESPOs are not discussed in this article.

Financial buyers are primarily private equity (PE) firms who have raised an investment fund aimed at acquiring control positions in privately held operating companies. PE transactions are referred to as recapitalizations because the changes to the company's capital structure as the PE firm become an equity owner alongside the existing owners. PE firms seek businesses having a capable management team and high growth potential. PE firms aim to invest in growth to increase value substantially over a three to a five-year time frame. The firm's general partners do not become active in business; instead, they may assign an experience, operating partner to represent them. PE firms view investments as partnerships with existing owners and will seek to have the owner and management employees maintain an equity interest in the business by "rolling over" a portion of their pre-investment equity. PE transactions allow the owner to obtain some liquidity and to stay involved with the hope of higher gains later (i.e. "a second bite at the apple"). You need to be sure that the initial amount of any upfront payment is satisfactory. The

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future benefits you anticipate may not materialize. Also, the structure of the rolled equity can have significant tax consequences.

PE firms buy strictly "by the numbers," structure transactions accordingly, and monitor financial performance carefully. PE buyers seek a threshold return on investment (ROI) set by the firm's investment strategy and maximize ROI by funding the acquisition with a mixture of fund cash (approximately 35-45% and referred to as the equity component) and third-party financing (the remaining 55-65%, referred to as the leveraged portion). The free cash flow generated by the restructured business is required to repay any leveraged debt and support future working capital. The debt repayments can put pressure on working capital and create increased susceptibility to economic and competitive forces increasing the risk of failure.

Strategic buyers have different motives and a longer-term outlook than a PE buyer. They will seek to purchase 100% of the business often at a premium to acquire the anticipated strategic benefits. A strategic buyer is typically a more significant, usually a public or large private corporation in the same or complementary industry looking to increase market penetration, scale, acquire new technology, products, or customers, all with the ultimate goal to increase their value. Strategic buyers also expect to achieve operating and cost improvements from the combination. These synergies can play an important role in setting the price.

In the acquisition of a business, the purchase price can be paid in a number of ways, including cash, debt financing (Small Business Administration or commercial bank), seller promissory note, an earn out and equity financing (shares). Also, earn-outs and other contingent payments are often used to resolve valuation differences, but not well. While they do provide "potential" further proceeds, there is a risk that ultimately the anticipated payments will not materialize. If you are not materially involved in the further operations of the business, you are relying on the buyer's ability to operate the business.

Seller financing in the form of a promissory note (i.e. a "Seller Note") usually includes a loan from the seller to buyer written as a promissory note. If the primary deal is being financed via an SBA or commercial loan, then the Seller Note will have to take a secondary position to the loan. Also, payments on the Seller Note may be restricted for a period of time, usually 2 years, and then the Seller can begin taking payments. Payments on Seller Notes are usually fixed according to the agreed-upon interest rate. In some cases, payments under the Seller Note are made contingent upon the financial or other performance of the business. Seller Notes can take many different forms and you need to seek advice of your attorney to assure that the payment is guaranteed as much as possible.

Earn-Out scenarios are a little different. They usually include variable payments based on the future performance of the business to be sold. The seller faces the prospect of lost payments should the business under-perform while in the care of

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the new owner, so for this reason (amongst many others), it's important that the parties have a great working relationship not just during the pre-Closing stage, but also after Closing.

In a typical earn out structure payments are based on the post-acquisition gross revenue as measured against historical numbers to arrive at a forecast for revenue growth rate. The earn-out might be based on the Seller achieving defined levels of gross revenue. Earn outs can be structured these on earnings comparisons, but they can be far trickier for the parties, post-closing.

While seller financing and earn out arrangements do not necessarily incentivize a Buyer to purposefully cause the business to under-perform (a bite your nose to spite you face decision), changes in accounting practices (such as revenues recognition, recurring v nonrecurring revenue) may cause conflict in the calculation of gross revenue or any other metrics used to determine the earn out. Thus, fully defining the calculation for such contingencies requires a sharp eye of your attorney and accountant to the details of the contract.

Practical point: While earn outs and Seller Notes are often used to bridge the different views of the seller and buyer as to the future performance, and thus the value of the business, they involve risks. The performance metrics and targets for an earn-out are challenging to define and measure with any precision and therefore, open to manipulation, intentional or otherwise. The buyer is in control of the business and is operating it with good or bad skill. Also, if the earn-out is considered part of the purchase price, then it will be taxed at the lower capital gain rates. If the earn-out is an incentive to keep you involved with the business, it may be classified as ordinary income and taxed at ordinary rates. While notes are easier to guarantee, the risk of the buyer's ability to pay is ever present. Again, be careful.

7. ***Business Readiness*** [6]

Market and competitive forces, neither in the owner's direct control, influence the value of a business unpredictably. A business owner's soundest path to maximum value is building a company that is financially strong and operationally self-sustaining. While all owners strive to reach that goal, management gaps do occur. In a sale, the buyer's due diligence is designed to uncover those gaps. If the gaps substantially increase the risk to the business, and most do, they will decrease the value. The buyer will use that argument likewise to request a decrease in price.

To counter this, all owners should perform a **readiness review.** The readiness review is designed to discover and implement the corrective actions to resolve the gaps. The gaps may be inadequate operational and financial controls, the accuracy of

[6] See Attachment 2 for a brief readiness checklist

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financial information, outstanding legal or tax matters, and insufficient protection of intellectual property. The corrective actions may be minor and easy to apply or significant taking several months to implement, for example, if there is an outstanding legal issue or the management team is inadequate and needs upgrading.

Most sellers think of due diligence as a buyer-driven activity. In fact, the sale process involves two diligence processes. The seller's readiness review often referred to as "sell-side" due diligence and the comprehensive buy-side diligence conducted by the buyer. Readiness is a value enhancement activity by lessening risk. The readiness examination business will scrutinize the company with the critical eye of a buyer. A readiness examination seeks to discover any material issue before uncovered by the buyer. Always remember a buyer will perceive risk as decreasing value. By limiting surprises, eliminates unnecessary delays in the sale process, and the buyer will become more trusting in the data presented by the seller. Exhibit B is an example of a Buyer's Due Diligence request. The seller should review these issues as a roadmap for the seller due diligence.

Start with reducing **operational risk**. You want your business to present as successful and able to grow and maintain that success without your continued involvement. Many business owner-operators are the single driving force behind the company's success, raising questions of continuity in the absence of the owner-operator. You need to make the business owner expendable. Having a competent and cohesive management team capable of operating the business without you is crucial. Make sure your management team is self-sufficient. Are all critical roles filled with well-trained, experienced staff? While you don't need "A" players in all positions, you need them in central value-creating operations. Implement formal training programs to develop the next generation of management to gain bench-strength.

You want to present the company as well run operationally and capable of producing competitive, profitable results into the future. Establish effective operating policies and practices that reliably oversee workflow. Operating systems and methods that are rooted in the operation of the company reinforce the likelihood of continued success. Having an effective and centralized IT infrastructure housing the financial and operational tools employed to capture the key operational and financial metrics employed to run the business provides assurance and credibility for the buyer.

Other areas of review include sustainability of your competitive position (especially the ability to preserve or increase margins), the loyalty of your key vendors and distributors, and the quality and concentration of your customers.

You want to portray your company as financially healthy. Any doubt over the accurateness and completeness of your financial information will eliminate most buyers. Your financial systems should report accurate financial results that enable management to understand key performance metrics, including profitability,

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operating cash flow and working capital. Your accounting practices should meet accepted business expectations, primarily as related to revenue recognition, costs and expenses and recording accruals. A quality of earning analysis will include a review of your revenue and cost models. It will assess the defensibility of your EBITDA, normalization of working capital, and the recording of tax liability. EBITDA as a key valuation driver will draw more in-depth scrutiny. Factors that can considerably influence EBITDA are owner compensation and perks, non-arms length and non- market value dealings, capitalization policies, and non-recurring, one-time charges.

Sufficient operating and financial control procedures should be in place assure Operating results are accurate and timely. Your financial statements should have a "reviewed" level of auditor scrutiny to a minimum.

A **legal review** should be conducted to ensure there are no liability, governance or regulatory risks and that proper legal precautions are in place. The company's organizational documents, material contracts, intellectual property protection of essential technology, documents relating to employee benefits, business insurance coverage, regulatory compliance and any pending or actual litigation are all reviewed.

The **tax review** will analyze the historical tax returns and the underlying assumptions and computations, any deferred tax liability, compliance with federal, state and local tax regulations (especially all withholding obligations), prior tax audits and disputes with any tax authority.

A readiness review can be time-consuming. You may want to consider engaging an experienced sell-side advisor to allow you and your management team to operate the business. Also, the sell-side advisor can help you identify "add-backs" to the operational results increasing operating income and therefore, value. Typical add-backs include excess compensation for you and other family members, including benefits, and above market rate expenses (such as rent). The buyer may have specific synergistic assumptions, such as redundancy in management and functional employees. Valuation should take into account these synergistic cost saving. Think about the many personal expenses paid for you and your family by the business. Items that reduce earning also reduce value. For example, $50,000 in non-essential expenses at a 5X earnings multiple represents $250,000 in value.

Practical Point: Readiness is as critical for the business as it is for you personally. Spend the time necessary. Do not give a buyer an opportunity to raise issues that affect the value or delay the transaction.

*8. **The Transaction Process***

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The two paramount issues of the transaction process are maintaining confidentiality and certainty of closing at the agreed price. Thus, all third parties who will have access to your confidential information must sign a non-disclosure agreement first. Even then, you want to be sure the potential buyer is real before disclosing your most crucial business secrets. Your transaction advisor will help control the proper dissemination of your confidential information when appropriate. While it is understandable that as a private business owner you are extremely careful of your confidential and proprietary information, at some point, it will need to be disclosed. The reasonableness of an inquiry is a matter of timing. Your lawyer should play a prominent in this decision.

The process begins with a detailed discussion to educate your transaction advisor (broker or investment banker) on the business and any operating forecast. Then the advisor will prepare and distribute a teaser, a short description highlighting but not identifying the company. The teaser will be circulated to a broad group to test initial interest. Subsequently, a detailed offering memorandum will be prepared for distribution to likely bidders on a confidential basis.

In the case of the investment banker, the confidentiality, offering memorandum ("CIM") is the chief marketing document; it is where you get to tell your story. The CIM will contain, among other topics, an overview of the industry, the competitive market, growth strategy, financial projections, operations overview, and management backgrounds. Unlike a broker, who will advertise the sale, an investment banker will also generate a list of likely buyers both financial and strategic, from personal knowledge and industry sources. Before the distribution, you should review the initial set of possible buyers. You want a controlled process. Initially contacting a broad universe of buyers can decrease credibility and make potential buyers leery by suggesting inherent weakness or problems with the business.

Commonly, both the broker and investment banker will require the ultimate buyer to execute some form of an offering document describing the deal. Brokers tend to use a binding offer to purchase. The binding offer contains the same closing conditions as stated above and is accompanied by a deposit refundable if the contingencies are unmet. Individual business owners believe this approach is more favorably given its binding nature, figuring only a meaningful buyer will agree to execute a binding offer and put "money on the table." Again, it all depends on the conditions to closing that will determine the likelihood of closing.

Investment bankers usually use letters of intent ("LOI") because the transactions encountered tend to be more complicated. An LOI is a non-binding offer to purchase that defines the transaction, contingencies, the due diligence period and closing conditions. The only binding provisions are those dealing with confidentially, exclusive dealing (a so-called "no-shop provision") and choice of law.

While letters of intent are considered optional or not necessary for a private sale, I believe it is good practice to negotiate and execute an LOI. The LOI should set forth

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the material terms, including structure, price and payment terms, closing conditions, the diligence period, and the scope and length of any non-compete you will be asked to sign. The confidentially and exclusivity provisions of an LOI are binding, as is the choice of law provision. The process of negotiating the LOI solidifies agreement on structure, price, and other essential terms before wasting time and potential renegotiation in drafting definitive agreements. Any LOI's should be evaluated and reviewed with your accounting, tax and legal advisors to get a clear apple-to-apple comparison of the relative value to you before signing.

Once the winning buyer executes an LOI, the complex phase of the transaction process begins in earnest. The sale process involves many, and at times, awkward conversations with the buyer. The centerpieces are buyer's due diligence and the negotiation of the agreements reflecting the sale and any post-sale employment or consulting arrangement with you.

Concurrent with due diligence, the seller will begin preparing the definitive agreements. The purchase and sale agreement defines the structure, price, closing conditions and the often-contentious representation and warranties, indemnification and escrow provisions, as well as the terms under which the parties are obligated to close the transaction. Your attorney will review this agreement carefully and discuss with you in excruciating detail the issues raised by the documents. Listen and understand so you can clearly and persuasively articulate any objections to the buyer.

As the seller, you want the sale to close as soon as possible, at the agreed to purchase price and that no post-closing event will occur that requires a refund of any of the escrow amount. The buyer's concerns are opposing. The buyer wants the right to cancel the sale in the event due diligence uncovers any unacceptable legal, financial or business risk, or be granted a price reduction and intends to be compensated post-acquisition economic loss because of an undisclosed issue resulting from seller's operation of the business. The point always is the price. The price reflects the sharing of risk each party is willing to assume for a given price. Risk allocation contained in the representations and warranties, limits on liability provided in the indemnification provisions and escrow provisions of the purchase agreement.

The representation and warranties are detailed statements, usually to the "best of the Seller's knowledge," given by the seller and relied on by the buyer as to the condition of the business as of the closing. The indemnification obligations cover breaches of the representations. Indemnification is limited in amount and timing and protected by an escrow of a portion of the purchase price. It is in the negotiation of the breadth of the representation and warranties and the protection under the indemnification that allocates the risk. For the seller, the added risk because of the scope of the representation and warranties may not justify the purchase price, so without an appropriately low limitation of liability the transaction may not be worth concluding.

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You may be asked to execute a non-compete agreement. These need to be reviewed carefully for any legal implications as to its scope and period. Non-competes are upheld when integral to sale, but even so, you need to be sure that it is limited to the "business" you sold and is valid for a reasonable period. Non-competes can have tax consequences. If characterized as compensatory, the consideration received is taxed as ordinary income, whether the transaction a stock or asset sale. However, if the non-compete is part and parcel of the purchase of the business, the compensation received is taxed as a capital gain.

Practical point: Do not underestimate the importance of a knowledgeable deal advisor with experience in your industry. Their understanding of the current market conditions, potential buyers (both private equity and strategic), value and reasonable terms is indispensable.

9. ***Buyer Due Diligence***

In performing due diligence, the buyer will follow a "trust but verify" approach. The buyer will issue a due diligence request (the "due diligence checklist") seeking backup documentation of everything, including:

- the financial statements, policies and procedures
- earning management
- revenue recognition policy
- intellectual property protection
- operational procedures
- customer and employee lists
- the existence of valid contracts with key customers and vendors

The buyer is not only interested in the operational effectiveness of your company but also in the quality of the earning and availability of working capital.
Due diligence allows the buyer to confirm its knowledge used in forming the basis of the price. The buyer is seeking to uncover any unanticipated issues that affect the price. It is essential that the LOI contain a provision requiring the buyer to inform you immediately upon discovering any material problems. You do not want to be in a position of the buyer attempt to renegotiated price, if at all, just before the closing date.

At some point, the buyer will ask to speak to key employees and have access to review your most sensitive business information, such as price and customer lists, proprietary technology and operational processes. These are appropriate requests, but can be disruptive and should not be agreed to until you are sure the transaction will close and not until you have informed key employees and any customers the buyer intends to interview. Even though the buyer does not plan to be disruptive,

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the process can be. Your key employees and customers need comfort and assurance of the benefits of the sale to them.

Practical point: Remember, due diligence can be a restless, exhaustive process with moments of intense disagreement. It is often easy to personalize the process as your records and business practices are scrutinized and questioned.

10. ***Negotiations and Closing***

You should allow your transaction advisor and legal counsel to negotiate the transaction. They will be objective and have the experience to deal with the every-day rigor and at times, the ego-guided foolishness that enters the negotiation process. The advisor will review with you the points of disagreements and the reasonableness (interpret as strength) of the buyer's position. You still have a business to run. Stay knowledgeable, yet in the background continuing to operate the business until a significant point of disagreement occurs. Any business disruption can detrimentally affect the likelihood of a successful closing. Operate the company without regard the transaction. Proceed with managing, growing, and investing in the ordinary course.

Be prepared, however, to participate actively in the discussion, if called. Understand the CIM and be able to articulate the attributes of the business and the benefits of the acquisition to the buyer. Have a working knowledge of the transaction structure and its implications for your after-tax proceeds. Review with your team all of all the consequences of all the significant deal points in each of the critical transaction documents. You will be better prepared to defend your position more effectively. You are unlikely to muscle the buyer. Good bargaining requires carefully listening to the buyer and providing creative resolutions to solve the debated issues, when possible, or compelling and persuasive responses defending your position.

As you would imagine, both sides request concessions. An experienced buyer will not endure your advisors or you assuming a salesmen mentality, nor should you of the seller. Selling a company is markedly different from selling a product or service. It is a business transaction yes, but with an expectation of knowledge and competence as to the deal points. In asking for a concession or countering a requested concession, a reasonable, well-articulated argument is hard to overcome. In giving a concession be sure the seller understands you gave something of value, but do not expect reciprocation. Know your walk-away position. Try to appreciate the buyer's major deal points - it helps to solve their concerns.

The closing occurs once all the contingencies are satisfied. At the closing, the buyer acquires ownership of the company, and you receive the agreed upon consideration. Remember, the closing does not end the interaction with the buyer. There may be post-closing accounting adjustments, settling any requests for indemnification and

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related payments from escrow, or numerous other integration issues that may arise. So, continue to maintain a stable working relationship with the buyer.

Some critical caveats: Do not chase the deal! It usually results in a terrible outcome. Stay true to your goals. Don't think about spending the proceeds until the check has cleared.

11. ***Post-Sale Integration***

Post-sale integration can significantly influence financial management, operational performance, and employee retention but more importantly, customer retention. A comprehensive post-sale integration plan should be developed during later stages of the due diligence process between the buyer and seller organizations and managed at a sufficiently high level in the seller organization.

Practical point: Often in developing and implement a post-sale integration plan, the seller employees try to take control even without sufficient knowledge of the facts and circumstances in the buyer side that are involved in the decisions.

Activities to Complete the Transaction: The deal may be done, but that may not mean the work is over. There may be various post-closing adjustments that require completion. Examples include the purchase price accounting and working capital adjustments.

Owner Transition. The transition from an owner/boss to a board member, consultant and/or employee can be uneasy and unsettling. The loss of the feeling of ownership and possessiveness can be painful. You no longer manage the business, the buyer does, your ability to deal with a board of directors, being under more financial scrutiny and not exercising the same degree of freedom on business decisions, can be challenging for a long-standing, strongly independent business owner. Alternatively, working with the new owners to grow the business can be stimulating and rewarding, professionally and economically. Either way, think carefully about your post-sale involvement, the activities, and the timing. I am not saying it does not work; just that it does not work for everyone.

Practice Point: As an example, I sold a company that had been in business for 25 successful years. The owners were ready to sell and most took the post-sale transition quite well The President was different. He was truly the drive and architect of the company. He was a well respected in the industry. We sold the company of June 30th. On July 1st the President asks the COO, who WAS a direct report, to do something. The COO said NO and showed him an email of tasks he just received from his new boss. Then operational changes began to happen and the President become more disgruntled as he disagreed with the changes. He remained thru his 6-month employment period and made himself available during his 18-month consulting period, but was never happy.

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*12. **Conclusion***

I hope this article provides you with a context of the scope and complexity of the sales process and the issues requiring your awareness and full consideration. However, more importantly, I hope that it imparts the necessity of thoughtfulness and the support of experienced and knowledgeable advisors.

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Exhibit A – Summary of the Changes under the Tax Cuts and Jobs Act ("TCJA")[7]

The amendments enacted by the TCJA substantially change the federal taxation of corporate income and shareholder distributions from prior tax law. Set forth below is a general summary of the changes and is not intended to be comprehensive or a substitute for experienced tax counsel. Also, many of the regulations required to implement the changes are not issued. The tax rates discussed below on net income or adjusted gross income the calculation of which has been changed by the TCJA. The most noteworthy are the changes to the standard deductions and personal exemptions, limits specific itemized deduction such as the deductions for payments for state and local income and property taxes, and mortgage interest, the phase our of the alternative minimum tax.

C-corporations: At the federal level, C Corporations experience a double tax environment on the income earned by the business. The business pays tax at the corporate level and then the shareholders incur tax on the dividends distributed them – thus a double tax. The effect of this double tax has been substantially lessened by the TCJA. Under prior law, C-corporation income was subject to a maximum federal tax income tax rate of 35%. In addition, shareholders were subject to a 20% tax rate on dividends paid by the corporation. For higher income shareholders, a 3.8% net investment tax on passive income applied. Without taking into account state corporate taxes, and assuming all net income was distributed to shareholders and that the net investment tax applied, the effective tax rate was 50.5%

Under changes enacted by the TCJA, C-corporations are now subject to a flat 21% income tax rate and the corporate alternative minimum tax rate has been eliminated for most corporations. The tax rate on dividends remains at 20%. Consequently, the effective tax rate, assuming all net income has been distributed to shareholders and the net investment tax applied, is 39.8%.

S-Corporations: S-Corporations and other pass-through entities are subject to a single tax at the owner level. Each owner pays tax on its share of the corporation's income regardless of whether the income is actually distributed. Under the prior law, the maximum individual tax rate was 39.6%. Without taking into account state corporate taxes, and assuming the net investment tax applied, the effective tax rate on adjusted gross income (AIG") was 43.4%. Given this advantageous tax treatment,

[7] This summary was derived from an article published in the National Law Review in January 2018.

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pass-through entities were the favorable corporate structure. The beneficial amendments under the TCJA for C-corporations have many owners reconsidering the choice.

The TCJA provides S-corporations, and other pass-through entities, with a significant new tax deduction. S-corporation owners that meet certain conditions are eligible to deduct 20% of their qualified business income ("QBI"). QBI is generally defined as any income derived from a business in the United State but excludes income from many services businesses. The deduction is limited for income over $157,500 for an individual taxpayer and $315,000 for married taxpayers filing jointly. There are a number of exclusions to QBI for factors such as wages earned, and capital purchases. This new deduction lowers the maximum federal income tax rate to 32.6%, assuming the owner is a passive investor and the net investment tax applies.

Practical point: The tax considerations of a sale or other exits are complex and necessarily should be discussed fully with your tax advisor.

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Example of a Due Diligence Checklist[8]

Practice Note: The timing of the disclosure of employee, confidential and other sensitive information to a buyer is delayed until later in the process once the seller is comfortable the transaction will be completed.

A. *Corporate Organization.*

- The Company's Articles of Incorporation, and all amendments thereto.
- The Company's Bylaws, and all amendments thereto.
- The Company's minute book, including all minutes and resolutions of shareholders and directors, executive committees, and other governing groups.
- The Company's organizational chart.
- The Company's list of shareholders and number of shares held by each.
- Copies of agreements relating to options, voting trusts, warrants, puts, calls, subscriptions, and convertible securities.
- A Certificate of Good Standing from the Secretary of State of the state where the Company is incorporated.
- Copies of active status reports in the state of incorporation for the last three years.
- A list of all states where the Company is authorized to do business and annual reports for the last three years.
- A list of all states, provinces, or countries where the Company owns or leases property, maintains employees or conducts business.
- A list of all of the Company's assumed names and copies of registrations thereof.

B. *Financial Information.*

- Audited financial statements for three years, together with Auditor's Reports.

  Note: While audited statements are preferable if the buyer is a private company reviewed statements are generally satisfactory. Also, the detailed financial information is not disclosed

- The most recent unaudited statements, with comparable statements to the prior year.

[8] This checklist is based in part on the SBA checklist.

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- Any Auditor's letters and replies for the past five years.
- Any projections, capital budgets, and strategic plans.
- Analyst reports, if available.
- A schedule of all indebtedness and contingent liabilities.
- A schedule of inventory.
- A schedule of accounts receivable and payable.
- A description of the depreciation, amortization, accrual methods and any changes in accounting methods over the past five years.
- The Company's general ledger.
- Copies of the Company's internal control procedures.

C. ***Physical Assets.***

- A schedule of fixed assets and the locations thereof.
- All leases of equipment.
- A schedule of sales and purchases of major capital equipment during last three years.

D. ***Real Estate.***

- A schedule of the Company's business locations.
- Copies of all real estate leases, deeds, mortgages, title policies, surveys, zoning approvals, variances or use permits.

E. ***Intellectual Property.***

- A schedule of domestic and foreign patents and patent applications.
- A schedule of copyrights, trademark and trade names.
- A description of important technical know-how.
- A description of methods used to protect trade secrets and know-how.
- Any "work for hire" agreements.
- A schedule and copies of all consulting agreements, agreements regarding inventions, and licenses or assignments of intellectual property to or from the Company.
- Any patents and current applications.
- A schedule and summary of any claims or threatened claims by or against the Company regarding intellectual property.

F. ***Employees and Employee Benefits.***

- A list of employees including positions, current salaries, salaries and bonuses paid during last three years, and years of service.

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- All employment, consulting, nondisclosure, no solicitation or noncompetition agreements between the Company and any of its employees.
- Resumes of key employees.
- The Company's personnel handbook and a schedule of all employee benefits and holiday, vacation, and sick leave policies.
- Summary plan descriptions of qualified and non-qualified retirement plans.
- Copies of collective bargaining agreements, if any.
- A description of all employee problems and terminations.
- A description of any labor disputes, requests for arbitration, or grievance procedures currently pending or settled within the last three years.
- A list and description of benefits of all employee health and welfare insurance policies or self-funded arrangements.
- A description of worker's compensation claim history.
- A description of unemployment insurance claims history.
- Copies of all stock option and stock purchase plans and a schedule of grants thereunder.

G. ***Licenses and Permits.***

- Copies of any governmental licenses, permits or consents and correspondence or documents relating to any proceedings of any regulatory agency.

H. ***Environmental Issues.***

- Environmental audits, if any, for each property leased by the Company.
- A listing of hazardous substances used in the Company's operations and disposal methods.
- A list of environmental permits and licenses.
- Copies of all correspondence, notices and files related to EPA, state, or local regulatory agencies.
- A list identifying and describing any environmental litigation or investigations.
- A list identifying and describing any known superfund exposure.
- A list identifying and describing any contingent environmental liabilities or continuing indemnification obligations.

I. ***Taxes.***

- Federal, state, local, and foreign income tax returns for the last three years.
- States sales tax returns for the last three years.

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- Any audit and revenue agency reports
- Any tax settlement documents for the last three years.
- Employment tax filings for three years.
- Excise tax filings for three years.
- Any tax liens.

J. ***Material Contracts.***

- A schedule of all subsidiary, partnership, or joint venture relationships and obligations, with copies of all related agreements.
- Copies of all contracts between the Company and any officers, directors, 5-percent shareholders or affiliates.
- All loan agreements, bank financing arrangements, line of credit, or promissory notes to which the Company is a party.
- All security agreements, mortgages, indentures, collateral pledges, and similar agreements.
- All guarantees to which the Company is a party.
- Any installment sale agreements.
- Any distribution agreements, sales representative agreements, marketing agreements, and supply agreements.
- Any letters of intent, contracts, and closing transcripts from any mergers, acquisitions, or divestitures within last five years.
- Any options and stock purchase agreements involving interests in other companies.
- The Company's standard quote, purchase order, invoice and warranty forms.
- All non-disclosure or non-competition agreements to which the Company is a party.
- All other material contracts.

K. ***Product or Service Lines.***

- A list of all existing products or services and products or services under development.
- Copies of all correspondence and reports related to any regulatory approvals or disapprovals of any Company's products or services.
- A summary of all complaints or warranty claims.
- A summary of results of all tests, evaluations, studies, surveys, and other data regarding existing products or services and products or services under development.

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L. ***Customer Information.***

- A schedule of the Company's twelve largest customers in terms of sales thereto and a description of sales thereto over a period of two years.
- Any supply or service agreements.
- A description or copy of the Company's purchasing policies.
- A description or copy of the Company's credit policy.
- A schedule of unfilled orders.
- A list and explanation for any major customers lost over the last two years.
- All surveys and market research reports relevant to the Company or its products or services.
- The Company's current advertising programs, marketing plans and budgets, and printed marketing materials.
- A description of the Company's major competitors.

M. ***Litigation.***

- A schedule of all pending litigation.
- A description of any threatened litigation.
- Copies of insurance policies possibly providing coverage as to pending or threatened litigation.
- Documents relating to any injunctions, consent decrees, or settlements to which the Company is a party.
- A list of unsatisfied judgments.

N. ***Insurance Coverage.***

- A schedule and copies of the Company's general liability, personal and real property, product liability, errors and omissions, key-man, directors and officers, worker's compensation, and other insurance.
- A schedule of the Company's insurance claims history for past three years.

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