How to Sell Your Business at Full Value in a Down Market

"I want to sell my business but can't right now..."

This lamentation is being sounded now more than ever. If you listen carefully, you can hear its plaintive wail in the machine shops of Chicago's West side to the boardrooms of America's multinational iconic companies.

"I want to sell my business..."

are the words whispered by the sojourner who must move on or shouted by the executive responding to the perceived torture tactics of an unyielding adversary be it lender, customer, market, competition or partner.

"...but can't right now..."

For many business owners, the "but can't right now" in its complete form is really: "I want to sell my business but can't right now because my revenue is down, or my earnings are flat, or I lost a big customer, or I'm about to land a big customer or project, or I've just invested a lot of money in my equipment or systems."

If any of these statements are the key obstacle to selling your business, here's the good news – **EARN-OUT**.

An earn-out simply stated is a contingent payment tied to future performance. It is structured in a way that will compensate a seller when and if the business performs well, hopefully arriving at the same price that the seller would have achieved had he/she stayed in ownership for the same period. In short:

- If revenue and earnings increase... more Purchase Price;
- If that big customer is landed... more Purchase Price;
- If that investment in equipment pays off... more Purchase Price.

Earn-outs tend to give all parties a comfort level especially in a tight credit environment. Most banks look at an earn-out in a very favorable light when they are reasonably structured and, of course, subordinate to their security interest and debt repayment. Ultimately, the banks will determine the terms by which earn-out payments can be made.

A buyer, for obvious reasons, takes comfort in an earn-out structure and also hopes to pay the earn-out, which means the business is performing well. This type of structure serves to make all parties a cohesive unit, at least through the critical transition stage of new ownership. The seller's ongoing involvement in the company may not be a condition of an earn-out structure.

To intelligently craft an earn-out, an M&A advisor must intimately understand the business, its marketing, ongoing management, competition, history, and forecast. Likewise, there must be an understanding of the buyer's business and its culture. This is the foundation on which the financial matrix for achieving the earn-out can be built – one that is structured in fairness to both parties, easy to calculate, and achievable. The convergence of art and science will increase the likelihood that the formula is indeed an earn-out rather than an earn-not.
An earn-out can be tied to qualifiers such as gross revenue, gross margin, EBITDA, or units sold. To avoid a potential shoving match down the road, the qualifier and earn-out formula should be simple and as close to the top line of the Income Statement as possible. The last thing anyone wants is to have to go through expense reports and question why a business meeting expense included dessert because the earn-out is tied to bottom-line earnings.

The term of the earn-out can be one to five years. A short earn-out allows the seller to quickly receive the additional Purchase Price, but it must be balanced against a fair amount of time to avoid putting undue financial strain on new ownership.

Other considerations include the traceability of earn-out qualifiers, especially when considering the melded post sale business. In other words, does the earn-out qualifier become blurred when the entities are combined as in every step of the sale process? The earn-out must be well thought out and properly documented in the purchase and sale agreement.

At the end of the day, the basic question remains: "Does this business stand in the way of you doing something else with your life?" If yes, then create a deal structure that gets it done. If no, then hold and revisit the question on another day.