GETTING READY

SELLING YOUR BUSINESS IN 2023

STEPS TO PREPARING A SALE IN ANTICIPATION OF A RECESSION | DECEMBER 2022

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Fear of recession and market outlook

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Five steps to strategic preparation

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Preparedness and mutual opportunity

MARKET OUTLOOK

As business owners prepare for year-end closing and plan for 2023, they are concerned about a possible recession. It may seem odd to discuss selling your business at this time, but it would not be challenging if your business is strong, growing, and prepared.

Outlook: Global economists believe that Europe will enter a recession by the end of this year, and the US stands to enter a recession by mid-2023. Economists at Citi warn that the global economy faces uncertainty in 2023. "As we survey the prospects for the global economy, we see many reasons for concern, including continued challenges from the pandemic and the Russia-Ukraine war, high inflation, and headwinds from central bank rate hikes," Citi chief economist Nathan Sheets wrote in a client note in late November.

Interest rate increases have sparked recession fears. This year, the Federal Reserve raised interest rates four times by 0.75% each. The Federal Reserve intends to restore inflation to 2%, but high interest rates have resulted in recessions in the past.

M&A in the middle market: Historically, the M&A market declines during recessionary periods when sales decline and margins thin. In light of global economists' warnings, interest rate hikes, supply chain issues, and other geopolitical situations, it would seem logical that a sagging economy would dampen overall business activity. It may, however, be different in 2023, with several indicators point to a better outlook, if not robust, for M&A.

- The U.S. economy grew during the Q3 after two previous quarters of negative growth, giving some hope that the country can avoid a recession.
- The real GDP of the U.S. grew at an annualized rate of 2.6% in Q3 compared to a 0.6% decline in the US economy in Q2, according to data released by federal officials in late November.
- While the overall 2022 deal volume is down from the record year of 2021, M&A activity this year is still in line with the robust volumes from 2018 and 2019.
- Availability of abundant fresh capital, as private equity (PE) firms have been actively raising funds. Also. investors may feel pressured to fund deals to utilize $1.6 trillion “dry powder”.

Despite the growing activity in the big pharma, biotechnology, and information technology sectors, well prepared midsized businesses with solid fundamentals will still attract potential buyers.

Small and midsized businesses can better position themselves for an exit by strengthening their operations and becoming more marketable to potential buyers. This will increase the valuation and enable them to negotiate more lucrative deal terms during an exit.

Getting ready for a potential sale in 2023: With M&A activity still on the table in 2023, business owners can focus on crafting a strategy for their companies.

This preparation process should include these five strategic steps.

1. **Maintain accurate and up-to-date records.** Consult your in-house accounting team or financial advisor to gather and analyze the company’s financial, sales and marketing, employees, and operational data. Also, consult with a third-party counsel or your CPA, and check if a formal audit or “quality of earnings” review is in order or necessary.

2. **Draft detailed marketing materials.** Your company's business must be portrayed in the most compelling way possible. Prepare a draft executive summary that summarizes the business overview, market information, critical operational metrics, key personnel biographies, and financial data. Keep it up-to-date by reviewing it once a quarter. Include all factors that contributed to your business' survival during the global pandemic, as well as the short-, mid-, and long-term growth strategies.

3. **Assess your company's key talent.** Identify and retain key employees or partners who could be critical to a successful transaction. Then, at the right time, communicate your expectations and discuss the key steps and issues related to the transaction, the new ownership and transition, their roles post-transaction, and any bonuses they may receive.

4. **Build your core team.** Establish a trusted internal 'key management team,' including a CFO. As well as an exit planning advisory team comprising an investment banker, a CPA, and an attorney. Hire a full-time CFO if you don't have one. Your CFO and investment banker can help you prepare early on, and the key management team can ease your burden during due diligence and management meetings.

5. **Planning for the personal financing impact.** Consult your tax and legal advisers to improve tax efficiency post-transaction. Planning early does not mean things are set in stone rather, it provides a clear roadmap for success. There are many post-deal estate and tax strategies that should be in place well before a potential "letter of intent" (LOI) is signed. An advance tax and wealth planning strategy will provide buyers with a better understanding of the sellers' goals during volatile economic times. Getting started early will prevent any last-minute hassle.

Takeaway: The decision to sell a business is emotionally taxing and operationally tedious. In some cases, it may take several months or years to be intentional and explicit with business owners about their goals and how to build and implement an exit plan, especially in a softening economy known for appalling investors.

Nevertheless, a combination of positively changing market dynamics and companies with solid fundamentals may shift the conventional wisdom and spur more significant M&A activity in 2023 than most business owners or sellers anticipate. Therefore, companies should opportunistically prepare their businesses for sale because PE and strategic buyers will likely adopt a similar approach to look out for established businesses that are financially stable, innovative, and well-prepared.

Business owners can better position themselves for an exit by strengthening their operations and becoming more marketable to potential buyers. As a result, they will be able to find the right home for their business, boost its value, and negotiate better exit terms. Contact your investment banker if you need help organizing and gathering market intelligence. ■

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