What can a Seller expect to get in Value from his Balance Sheet when Selling?

I often get clients who think they will also receive a whole bunch of extra value (beyond what they sell for) from their balance sheet from the various assets such as cash, accounts receivable, inventory and the fixed assets on top of the purchase price. One client pointed to the $1.5 million sitting in retained earnings and thought he would get that on top of his purchase price.

While it is true a Seller can retrieve some value from their balance sheet above and beyond the core purchase price, on balance Sellers should temper their expectations in this regard depending on whether it is a sale of assets or shares and even on the particular buyer.

The general rule of thumb used in the M & A transactions, particularly when a sale of shares takes place, is a buyer should expect to get most or all the fixed assets required to operate the business and a "normal" amount of working capital *included with the purchase price*. In other words the buyer is not going to pay you a whole bunch extra for your fixed assets or your working capital.

Let's stick with share deals and talk about other points on this subject. Many of you who are owners of small security businesses may have heard that when selling your company buyers like to buy the company "cash and debt free". Doing it this way just makes the deal easier and assumes that the owner will pay off any debt and move out most if not all of the cash before closing. This is a very common rule used across all sorts of small businesses.

Then staying with the share deals, most buyers will expect to get a reasonable amount of working capital left in the business when it is sold. This catches many sellers by surprise but when you think about it, it makes sense. Should we expect a buyer to pay a full price for an operating company and then have to write another big cheque just to finance the business for the first few months?

Working Capital (WC) is generally defined as total Current Assets less Current Liabilities and too often is not paid enough attention to in most businesses. If the business is being run properly WC should be a positive number. In a really well run business, the ratio of Current Assets to Current Liabilities should be 2 to 1`. The amount of working capital required to be left in the business is negotiable to some degree and is driven mainly by the nature of the business. An integration business doing large installations will require much more working capital to cover the ongoing investment in work-in- process. A simple alarm company not requiring much investment in inventory demands much less WC. The amount of working capital can also be driven by how quickly a company collects its accounts receivables.

Arriving at a mutually agreed amount of WC target to be left in the business can be a tricky negotiation. I often tell buyers they cannot just look at what working capital is left in the company on average over a number of months because small business owners don't often move excess cash out of their company or manage their working capital very well. Sometimes small businesses will purposely carry extra inventory in certain times. WC in some businesses can vary through the course of the year. A company selling toys will require a lot more inventory in the last 2 months of the year than at any other time. Failing all else I have sometimes seen a rule of thumb of 10% of sales being the WC target.

Share deals will often include a small holdback of the purchase price to ensure that the target working capital target is met by the Seller. This holdback should be no more than 5% and held for only 60- 90 days until the Seller produces his final set of financials showing the closing working capital.

There is a wrinkle to the WC rule that has established itself in the sale of alarm companies. Owners sell shares of alarm companies mostly to take advantage of their capital gains exemption. Secondly alarm companies *don't usually require that much working capital for buyers*. As a result you can often see share deals done here where the Seller does not have to leave working capital but can actually sell off some of WC assets to the buyer.

As for what happens with fixed assets in share deals if the Seller is a fire, guard or integration company and if the buyer is an experienced buyer, generally the buyer will expect to get almost all the fixed assets involved in running the business thrown in free with the purchase price. The Seller can remove any personal or unused assets such as their own vehicle or computers from the company before selling. With security companies the fixed assets are mostly vehicles. Real estate is usually held in another company.

Ok let's swing over to asset deals where the procedures in regards to how balance sheet assets are dealt with is simpler. With asset deals the buyer will simply specify what assets they are buying. Having this choice is one reason why buyers like assets deals better than share deals. Asset deals in the security industry involve the seller selling the customer base (goodwill including the company name and telephone number where most of the value is contained) plus sometimes the small amount of inventory on hand and a vehicle or two. The Seller is mostly left with dealing with any cash on hand, collecting his own accounts receivable and paying off any liabilities.

The purpose in this article has been to try to tell Sellers what to expect in terms of getting value from their balance sheet when they sell their business. In simple terms, Sellers should **not** expect to " hit a home run" from extra value on the balance sheet but can expect to retrieve some value in the form of any excess working capital above and beyond the working capital target .

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