Brooks Holdings, LLC

Broker Sales Process

CONTENTS

INTRODUCTION

In an effort to assist with a potential interest in selling one or more of their existing businesses, we have developed the following information. The goal of the program is to assist the business owner in achieving a timely sale of the unit(s) at an acceptable price and terms.

The position of the Broker in this process needs to be clearly understood. We do not represent the interests of either the buyer or the seller nor will we act as agent or salesperson in any such transaction. We will, at our option, assist both the seller and the buyer to make the transaction as smooth as possible.

Broker conducts a regular, ongoing effort to solicit and process interested prospective buyers. This portion of our business involves considerable expense to us in terms of advertising and solicitation costs.

There are a few factors that must be addressed in order for the process to result in a successful outcome. These factors, which will be discussed in detail, include:

1. Preparing sales related information that will be provided to buyers;
2. Pricing or valuing the business for sale;
3. Marketing the business to attract potential buyers;
4. Managing the negotiation of the sale terms; and
5. Dealing with any financing needs of the buyer in the transaction.

Failure to adequately address any of these factors during the process of selling the business may result in delays in the sales process, a lower price being realized or even an inability to complete a sale. It will be the obligation of you and your company to assist with communication and to provide information in a timely manner.

<u>Here is a basic summary outline of the process for communication with prospects</u>:

1. Broker will receive calls from potential prospects. Only very basic information is discussed in this initial conversation:
    - Industry: ie, Automotive, Business Services, Home Improvement, etc.
    - Community demographics
    - History of Company
    - Confirmation of Price
    - Owner/Operator, Absentee Ownership, Passive/Semi Absentee
2. If additional information is requested, an NDA is discussed, delivered, signed and returned prior to any further discussion or delivery of material.
3. Summary financial information is provided to prospect for review as well as a more in-depth discussion about the business. Name, Location, Physical Plant, etc. Maintenance of confidentiality and no contact with the physical location is addressed/mandated.
4. If the prospect continues interest, additional information is discussed and provided.
5. Phone or personal introduction to Owner
6. Negotiation of price and terms are discussed

7. Letter of Intent is signed
8. Due Diligence process begins
9. Asset Purchase Agreement is prepared and Signed
10. Business Visit and additional Due Diligence are scheduled for an appropriate time
11. Candidates are introduced to Franchisor - if Applicable – and franchise approval process is completed
12. Closing

PREPARING SALES RELATED INFORMATION

There are a number of sources of information that a potential buyer is going to need or want to examine in relation to evaluating the purchase of your business. The first step to selling your business is to make sure that you have these sources prepared and ready to share. The key sources of information you will need include:

Your last THREE years of financial statements.

The balance sheet is less relevant to a buyer but they will want to examine your income and cash flow statements closely. Any personal expenses that have been charged to the company should be documented. This information will provide a better understanding of what the business has generated before these expenses are taken into account.

Your last THREE years of tax returns.

These tax returns do not have to include your complete personal returns because what the buyer wants to do is verify that you are reporting to the IRS the same information they are seeing on the financial statements.

If you file separate returns for the business, or if you file the business information on a Schedule C to your personal return, these filings should be sufficient.

YOUR PROPERTY LEASES.

The buyer is going to want to examine the site lease for the business to analyze total occupancy costs as well as any automatic increases in rent or CAM charges. They will also want to ensure that the lease is assignable, and under what conditions. Additionally, the term left on the lease and the option to renew the lease at a favorable rate will be very important to a prospective buyer.

EMPLOYEE STATUS.

The buyer is going to want to know that your employee base is stable and dependable in most situations. You should have information ready concerning the number, tenure, compensation (including benefits), and results of your employees.

TREND DATA.

You should assemble any information you have in relation to the trends of your specific business, such as seasonality.

VENDOR RELATIONSHIPS.

You should prepare a list from your payables information outlining every relationship that will have to be transferred to a buyer if you sell the business. This list must be thorough and include all principal suppliers for the business.

COMPETITOR INFORMATION.

It will very be helpful if you have prepared a summary analysis of the principal competitors to your business.

VALUATION DOCUMENT REQUEST.

We may also provide a Valuation Document Request that will assist with information gathering necessary to provide a complete valuation.

VALUING YOUR BUSINESS

It is critical that the seller has clear and realistic objectives before any activities to sell a unit commence. The first of these objectives is setting a reasonable price or value on the business to be sold. Though there are many methods that can be used in setting a value on a going concern business. we will address only the three, in our experience, that are most commonly used.

Keep in mind that the clearest definition of fair market value for any business is the price agreed upon between a motivated buyer and seller acting without duress. What will someone pay? Any price you set for your business will ultimately have to pass the test of appearing reasonable to the buyer (and potentially their advisors and lender) or your business will not sell. The two most common valuation techniques are:

1. INCOME APPROACH

You begin with the pre-tax income that your business is producing. This value is most often derived from your prior year financial statements or tax returns. To this figure you add all expenses paid to owners or for the benefit of owners that would not have to be paid or duplicated by a new owner. This value could include items such as salaries, bonuses, benefits, automobiles, memberships, and entertainment not directly related to the running of the business. In addition, you would add any non-cash depreciation and amortization expenses.

The figure produced from this exercise is meaningful because it represents the actual discretionary cash flow ("DCF") being produced by the business. In order to place a value on the business using this method, you multiply the DCF by a factor standard to a given industry. The multiplier used for many small businesses is two to four times the DCF.

2. ASSET APPROACH

Basically, this business valuation method totals up all the investments in the business.

- A **going concern asset-based approach** lists the business's net balance sheet value of its assets and subtracts the value of its liabilities.

Using the asset-based approach to value a sole proprietorship is more difficult. In a corporation, all assets are owned by the company and would normally be included in a sale of the business. Assets in a sole proprietorship exist in the name of the owner and separating assets from business and personal use can be difficult.

3. MARKET VALUE APPROACH

Market value approaches to business valuation attempt to establish the value of your business by comparing your business to similar businesses that have recently sold. Obviously, this method is only going to work well if there are a sufficient number of similar businesses to compare.

Assigning a value to a sole proprietorship based on market value is particularly difficult. By definition, sole proprietorships are individually owned so attempting to find public information on prior sales of like businesses is not an easy task.

Although the Earning Value Approach is the most popular business valuation method, for most businesses, some combination of business valuation methods will be the fairest way to set a selling price.

VALUE OF TOTAL DOLLARS INVESTED

It is essential that the seller understands that the amount of money that has been invested in the business prior to the point of sale is irrelevant to the buyer. The buyer is not concerned with the past other than as an indicator of the future. For those small business owners that choose to sell a business with little or no cash flow, a buyer and/or their advisors and lender will typically look to the depreciated assets as a basis for valuation, with little to no allocation toward goodwill since the business is not producing any profit. The bottom line is that if your business is not operating at a profit, you are almost certainly not going to get as much out of it in a sale as you have invested to date. In order to maximize your selling price, your best strategy is almost always to focus on improving the operations of the unit until you have achieved consistent profitability before you consider selling.

The preceding valuation techniques provide a guide for your use in setting a price range for your business. Several favors will influence where your business will sell within this range. These range determinants include, among other things, your time frame for completing a sale, the terms you are willing to offer the buyer for payment of the purchase price, and the performance trends of the business over the recent past. Your business may only sell for the value of its assets if it has historically poor performances and is showing a loss.

TERMS

You need to also consider what, if any, terms you are willing to provide the buyer in conjunction with the sale of the business. As a general rule, though most sellers prefer to get all cash when they sell a business, you will usually get a higher price if you are willing to finance part of the purchase price paid by the buyer. The primary issue on a sale under terms (often referred to as a contract sale) is the security of the financed portion of the purchase price. This security usually includes the assets being sold and the seller may also require other security (such as a lien on other real property) to ensure that they receive the payments called for under their sales agreement. Obviously, under any such arrangement, the buyer and seller will also have to agree on the length of time involved in any stream of payments and the interest rate to be applied. These factors are all subject to negotiation between the parties. If the seller has a current loan in place and the seller's lender has a security position on the assets of the business, these values must be satisfied in order to finalize a sale of the business. Depending on the seller's arrangement with its lender, in some cases the loan may be assumable by the purchaser. Also, please keep in mind that most buyers are going to seek financing, at least in part, through a third-party lender. Those lenders will typically require a "first position" ahead of any seller financing. Also, the bank usually scrutinizes the entire deal (especially SBA deals), and might perhaps comment on or disallow any balloon payment, or other types of compensation to the seller, if they drive the price above what the bank feels is appropriate.

RECENT PERFORMANCE

If your business is showing strong growth consistently over time, you may be able to convince a buyer to pay a purchase price that is in the high end of the range since they might therefore have confidence that the business will continue to improve and grow under their ownership. If the trends are negative or flat, it will be difficult to get a price above the lower end of the range.

Please note that most sellers initially ask for a higher price and better terms than what they are ultimately willing to settle for. Most buyers reverse this process. Therefore, you may very well want to start out a little higher than where you want to end, so you have some room to negotiate.

MARKETING YOUR BUSINESS

Once we have established the price and terms under which you are willing to promote the sale of the business, we need to find potential buyers.

1. ANOTHER FRANCHISEE.

If appropriate or realistic, we will speak with other franchisees in your market. They already know the business, may wish to expand and may look at your unit(s) as a good opportunity to do so. Of course, as with all potential buyers, maintaining confidentiality will be a priority.

2 ADVERTISING BUSINESS FOR SALE.

The main advertising sites we use are:

1) www.Bizquest.com

2) www.bizbuysell.com

3) Wall Street Journal

4) New York Times

5) www.bizjournals.com

6) www.businessesforsale.com

7) www.businessbroker.net

8) www.businessmart.com

9) www.mergerplace.com

10) www.buyabusiness.com

11). www.mergernetwork.com

12). www.globalbx.com

13). www.buybusiness.com

14) www.BusinessNation.com

NEGOTIATING THE SALE

Once the offering price and terms are determined by the seller and potential buyers are located, the next step is negotiation of the actual terms of sale. These terms are not only financial in nature but also reflect the type of sale transaction (from an accounting and legal standpoint) and the actual contracts and forms needed to complete the sale.

We will assume, for purposes of this section, that the type of sale will be an asset purchase. This form is the most common form of purchase, though there are other types of sales that may be more appropriate for any given buyer and seller, depending on their circumstances. In an asset sale, the buyer is purchasing all assets associated with the business but assuming no liabilities other than those specifically identified in the sales contract.

It is essential that both the buyer and seller are represented by their own competent legal and accounting counsel in any business sale transaction. Under no circumstances should both parties use the same legal and accounting source. Using qualified professional advisors to assist you is the best way to ensure that your transaction will be completed according to your expectations with a minimal risk of unintended consequences.

1. Due Diligence.

In order to become confident enough to make an offer on a business, the buyer will need to analyze historical performance data concerning the business. The scope of general information that you should have ready to show a potential buyer was covered earlier in this document.

The buyer may also wish to receive additional information such as substantiation of the “owner” related expenses that are being added back to cash flow to determine the DCF figure, discussed above, in the valuation section. Finally, there are usually other requests that are unique to a specific potential buyer that you will need to address.

The purpose of gathering all of the above data is to provide the buyer with enough information to independently calculate what they believe to be a reasonable range of value for the business. It is important to be frank and forthright in this exchange of information with a potential buyer because if they find out during the process that the seller has been hiding unfavorable data, it generally kills the sale. The seller will almost certainly have to sign a contract that warrants or represents that all relevant information has been disclosed and that it is true.

It is typical that the interested buyer will sign a confidentiality agreement prior to the release of the above information. These agreements can be as simple as a declaratory statement that the buyer will not disclose any of the information provided to them other than to the buyer’s attorney, accountant or financing source. It is also common that a no contact clause, related to the employees of seller, be in place. At this time, a “good faith” deposit will be requested. This deposit would normally be placed in escrow with the seller’s attorney.

2. LETTER OF INTENT.

Though an actual letter of intent is not required and is typically not binding on either party, it is representative of the stage in the process where the parties come to an agreement on the basic terms of the sale. These terms would include: (i) the price; (ii) the length of time, monthly payments and interest rates of any financed portion of the purchase price; (iii) the asset classes that will be included in the sale; (iv) the liabilities of the seller that will be assumed by the buyer; (v) the method by which the purchase price will be allocated to the assets purchased; (vi) the proposed transaction or closing date for the sale; (vii) any contingencies – i.e. franchisor and landlord approval – that must be met prior to Closing; and (viii) any other matters deemed important to either the buyer or seller.

In some cases, the buyer and seller come to an understanding on these issues and proceed directly to preparation of sales contracts rather than dealing with a letter of intent (also referred to as a letter of offer or an offer sheet). Regardless of whether or not a letter of intent is used, the matters outlined above need to be decided prior to being able to draw up contracts to reflect the agreement for the purchase of the business.

3. CONTRACT COMPLETION.

A letter of intent is not intended to answer all issues involved with the sale because that is the purpose of the definitive contracts. In many cases questions will arise that were not decided at the letter of intent phase of the negotiation but that still must be dealt with in order to complete the actual sales contracts.

There are typically a few different agreements or contracts that have to be completed to accomplish the sale of the business and the transfer of the Franchise Agreement. These would include the Asset Purchase Agreement, the Bill of Sale, the Assignment of Lease, Franchise documents (if applicable), and the Promissory Note. Release of Lien documentation will also be required from any lender or individual financially involved in the business. Typically a search will be conducted by the buyer's attorney to uncover any liens on the assets of the business. The principal areas of negotiation for each of these contracts are listed below.

a) <u>The Asset Purchase Agreement</u>.

It is very important that the buyer and seller have a clear understanding of what assets are to be included in the purchase price. The most common area of contention in this section concerns deposits, particularly on customer orders and leases, and whether these assets were included in the sales price.

The allocation of the purchase price over the assets to be purchased is usually more important to the buyer than the seller. The seller is going to realize the same gain or loss on the sale regardless of the allocation, but the buyer may achieve tax advantages depending on the allocation. The seller typically agrees to any allocation, within reason, that is provided by the buyer's accountant.

The definition of the exact liabilities to be assumed by the buyer is a critical component of the Asset Purchase Agreement. The only liability that is typically assumed is the obligation under the lease for the site of the unit. Accrued vacation time through the date of sale is normally paid in cash by the seller to the employees of the business on the closing date of the sale, though the seller may adjust the purchase price so the buyer will assume this liability as well.

Typically, the buyer will want to receive some assurance in the purchase contract that the amount and condition of the inventory and other personal property in the unit is as it should be so that no extraordinary expense will have to be incurred to continue the operation of the business after the closing.

If you are a franchise, no sale of an existing unit is complete without the franchisor's consent to the transfer of the franchise and the appropriate paperwork being completed with all required fees paid.

b) <u>The Bill of Sale</u>.

The Bill of Sale document is simply an abbreviated but binding contract that confirms the transfer of the assets. This contract is typically completed so that, if a public filing or recording of the transfer is required, the entire Asset Purchase Agreement will not have to be disclosed and made a public document.

c) The Assignment and Assumption Agreement.

This document is the agreement that allows the buyer to receive an assignment of the lease for the business. A careful review of the lease prior to this point in the process is essential to the buyer. The buyer must know that the lease is, in fact, assignable. The buyer will also want to know what fee, if any, will be required in conjunction with said assignment and whether a special form of assignment will be required or whether this sample contract form will be acceptable to the landlord. It is also quite possible that the landlord will require personal guarantees from the principles of the buyer entity prior to approving the assignment.

d) The Promissory Note.

There are many forms of promissory notes that can be used to document the financed portion of any sale. The only fairly common consideration that may be included would be a personal guarantee from the principals of the buyer entity on the performance required from this note.

CLOSING THE SALE

Once a definitive sales contract document set has been agreed on by the parties, they are ready to begin the final planning for the closing of the sale. There are a number of final steps that have to take place, which are listed below.

1. TRANSFER OF FRANCHISE IF APPLICABLE

There are forms, fees, and other requirements that must be completed with the franchisor relating to the transfer of the franchised business, prior to any close of the sale taking place. The seller needs to allow time for the forms to be prepared by the franchise administration department. In the case of a buyer that has not been properly disclosed according to the current F.T.C. rules, they must be disclosed and wait at least two weeks before a transfer or assignment can be processed. The Franchisor also requires that the buyer submit all required documentation and meet all current requirements for approval as a new franchisee, if the buyer is not already a franchisee. The Franchisor has no obligation to approve the buyer and cannot be held liable for sales lost due to the buyer's failure to meet the requirements of franchisor. In addition, the franchisor may have a right of refusal period from the receipt of all required documentation concerning the sale within which to exercise its right of first refusal on the sales transaction. Finally, for new franchisees, there is typically a training requirement that must be satisfied prior to approval of the transfer. Since training classes are typically held according to a pre-determined schedule, it is a good idea to understand the dates of upcoming training classes – this can sometimes drive the entire process.

2. FINANCING THE SALE.

In many cases, even when the buyer is paying all cash to the seller for the business, the buyer is actually financing part or the entire sale through a third-party lender. Though it is the responsibility of the buyer to arrange this financing, it is often helpful for the seller to lend assistance whenever requested.

3. PHYSICAL INSPECTION.

The buyer will typically conduct a physical inspection and inventory of the assets in the unit just prior to closing. In lieu of physically counting all product and other miscellaneous assets in the unit, many sellers simply prepare a report of inventory and warrant to the buyer that it is an accurate statement of what exists in the unit at the time of closing. Ensure that any product at the seller's warehouse or delivery company is included.

"Work in Progress" must be discussed and agreed as to how payables, commissions and other related expenses will be covered. Outstanding service issues must be documented and an agreement must be in place as to how any expenses incurred will be covered.

4. EMPLOYEE COMMUNICATION.

The closing typically takes place at the end of the last day in a payroll cycle and the seller has prepared final checks for each employee in advance. A meeting is usually held at the unit for the seller to explain to the staff what has transpired and introduce the buyer. If the buyer wishes to interview the employees of the business prior to this point in the process, extreme care needs to be taken to ensure that the employees do not become nervous or scared to the point of leaving prior to the sale being closed.

5. EXCHANGE OF CLOSING REQUIREMENTS.

After all other requirements have been completed, the buyer and seller meet at an agreed upon time and place (often just prior to or after the employee meeting) and exchange all the other closing requirements of the Asset Purchase Agreement. These would include signed copies of all appropriate documents and the consideration for the sale.

SUMMARY

The preceding information, is designed to answer your questions about how we price, market and sell your unit if you wish to do so. Please use this resource as a guide. It is designed to be educational in nature but it is not a substitute for using your own professional advisors, such as competent legal and accounting counsel, to advise you in this process.

Good luck in achieving a successful outcome to your endeavor!