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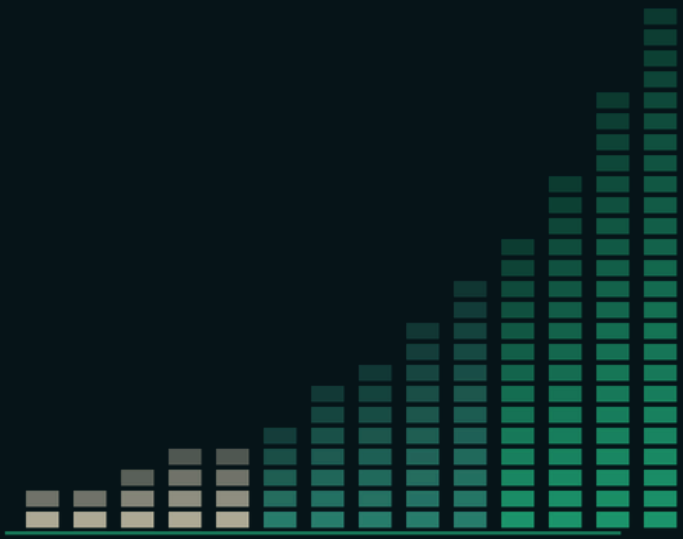
EXIT READY

Transform your profitable company into a buyable one



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150+ M&A ENGAGEMENTS · $200M+ ENTERPRISE VALUE ADVISED

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Intro

This book is for you if you're a founder or business owner who has built a profitable business and wants to know what would happen if you decided to sell your business.

By the end of this book, you will have a very tactical, detailed understanding of the fundamentals of building and selling a valuable business.

Whether you are a seasoned founder, just getting started in your business, or working on becoming an owner via a startup or acquisition, this book will contain the frameworks you need to *build with the end in mind.*

Our team has supported hundreds of small business owners and advised on over 200 M&A transactions.

I've personally consulted on over $200 million in M&A transactions, and I've personally founded and acquired multiple businesses, and have raised well over $2 million dollars of debt and equity capital to scale my business.

Before we dive into the details, I want you to **imagine this scenario in your head**:

On a Tuesday evening, after a long day of juggling customer calls and several sticky operational issues that your team needed help with, you're finally catching up on emails.

You see a message in your inbox from this morning. Someone interested in buying your company.

*You've received these spam mailers before, **but this one gets your attention**. Three things catch you by surprise:*

1. *They know your industry unusually well*
2. *They've acquired businesses that you recognize and integrated them flawlessly into their own company.*

3. *They indicate that they have secured financing as part of their expansion program, and your business would be the perfect fit for their next acquisition.*

You agree to a call.

After discussing the high level details of your business, you feel an energy you haven't felt in months. This feels like the beginning of something fresh and new.

You hang up, look around your office, and reflect on the thousands of hours that have been poured into your life's work here.

But as you reflect, you feel a sudden dread as you consider how they'll really feel when they dig deep into your business.

You might be thinking things like:

- What will they expect to see in my finances?
- Will my valuation come down because I reduced my profit with multiple write-off strategies?
- Who's going to help me manage the M&A process while I run the business?
- What are they going to offer for the business? Is that what I really feel like it's worth?
- Will they be scared off if they realize that most of the day-to-day runs through me?

Considering that you started at zero, you've built a wildly successful company without ever having to answer to anyone (and that's why you went into business in the first place).

If all goes well, you might just get paid a life-changing amount of money.

But there are so many unknowns in this process, and you currently don't know how to navigate it yourself. You may also realize that your current advisors, your CPA and attorney, aren't deal professionals.

You might have heard horror stories about people trying to sell and getting paid considerably less than they expected. Or even worse, people whose deal fell apart completely and shut down the company and retired without a payout.

While there are a ton of unknowns for most business owners in M&A, the one that people never think about is *when* the deal will happen.

Many SMB exits are not voluntary, carefully timed sales at all. They are forced or accelerated by partner disputes, financial trouble, or an owner's health.

This book is not just about getting your dream exit (although it will help you do that).

This book is about how to make your company **exit ready** at any time.

The benefits of being exit ready are more than just being able to sell your company one day.

When you adopt an exit ready mindset, you can:

- Raise equity to scale up without fully exiting
- Invest in growth and expansion through an equity building framework, rather than a vague "growth at all costs" mindset
- Reduce your downside risk by knowing you have a backup plan

The "Exit-ability" problem

Over the course of advising on more than 200 lower-middle-market transactions, my team and I have done tons of work on the opposite side of the founder's team. This has meant working with:

- Strategic acquirers buying their competition

- Private equity firms
- Independent sponsors
- Search funds evaluating targets

These are the main profiles that will entertain acquiring your company if you are worth between $1 million and $100 million in enterprise value.

My role in those deals is simple: look under the hood and identify risks, inconsistencies, and unsupported claims in the seller's financials to protect the buyer from making a bad investment.

Working with dozens of buyers has taught me the exact playbook that every seller should have before they venture to sell their company.

Unfortunately, I have seen tons of otherwise strong companies whose financial reporting was unstable and unreliable.

When our diligence team dug deep and raised questions, sellers often had nobody prepared to answer them. Most of the time, it was uncomfortable and, honestly, a bit heartbreaking to watch honest founders struggle to explain the value of their business.

Their CPA may have understood their tax returns.

Their broker was committed to finding willing buyers.

But the work after the letter of intent was signed (defending the numbers and deal economics) was almost always incredibly weak on the other side of the table.

I'm writing this so you never go through that (or have to feel hopeless when the deal gets serious).

What this book will do

This is a practical guide to the small-business M&A process for founders who have never sold a company.

You will learn:

Which segment of the market your business lives in today, and which types of buyers will be most interested in your company.

The attributes that buyers will overpay for, how to support your business's strengths, and which weaknesses can reduce the price or stop a deal.

How to identify the risks that buyers try to uncover, so you can address them before negotiations begin.

How to build a compelling body of financial evidence for your company: accrual financials, a monthly close, unit economics, a defensible adjusted EBITDA schedule, and a well-organized data room.

How to translate your headline price into your net exit cash payout. You'll learn how to model out your "net proceeds" to give yourself a realistic estimate of how much cash you'll be receiving at closing, so you don't get halfway through a sale process and feel a sudden pang of regret about your exit.

About me

I co-founded Edler Zain in 2022 because I saw a massive movement taking place.

We are entering a generational wave of small-business ownership transitions.

This is a multi-threaded movement spawned by:

- A large cohort of baby-boomer business owners reaching retirement age
- Large pools of private equity "dry powder" available for acquisitions, pushing some investors farther down-market
- A revolution of independent buyers looking to leave the corporate world to become entrepreneurs
- A wave of artificial intelligence and global connectivity making business ownership more attractive than ever

My career before co-founding Edler Zain spanned financial, tax, and advisory work for global publicly traded corporations, high-growth mid-market startups, bootstrapped small businesses, and even individuals and families. My favorite

work, by far, was working with small-business owners with a growth-oriented, ambitious mindset. So I went all in on that.

We built our CPA firm to be custom-made for entrepreneurs doing M&A deals because we see M&A as the pinnacle of the growth and ambition that entrepreneurs aspire to achieve. Our service portfolio consists of:

- Quality of earnings
- M&A tax structuring
- Fractional CFO and accounting support
- Tax compliance and planning

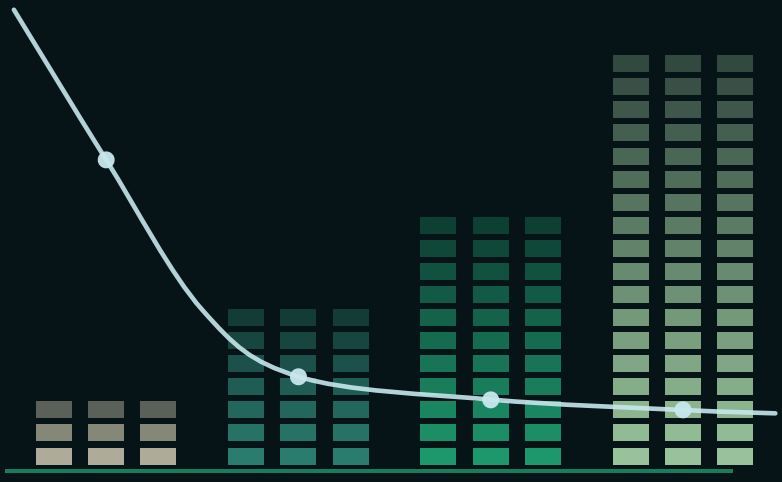
A single issue we find for a client can create a six- or seven-figure swing in total purchase price, exit valuation, or net proceeds.

We appreciate that many larger firms might not care for a few hundred thousand dollars of impact, but for our clients, those impacts are life-changing (and so we treat them as such!)

With that, let's jump in and get you Exit Ready.

PART 1
The SMB M&A Market

Understand how the market environment works for small business M&A



Chapter 1: Understand Your Market and Your Buyer

The first question business owners ask me when we get started is, “How much do you think my business is worth?”

There’s a lot to understand before I can reasonably answer that, but the first question is not actually, “What is it worth?” It’s, “Who sees it as worth buying?”

The buyer pool for your business may just end up being the largest lever to affect the price, deal structure, and post-closing compensation you receive for your business.

In fact, there are tons of entrepreneurs who make fistfuls of money by buying businesses for a modest multiple, combining their operations, and selling them at a different rung in the market for a considerable EBITDA multiple premium simply because they have shifted into a different market segment.

Three Segments of the Market

I use three practical categories to explain the SMB M&A market to founders.

These segments are a bit fluid, but they’re a useful rule of thumb for benchmarking your company, understanding your exit options, and building a game plan to advance to the next level.

Books of business

In a “book-of-business sale,” the buyer is mainly acquiring customer relationships, contracts, a brand, or selected assets. The price may be based on revenue, customer retention, or tangible asset values.

These tend to be either sole proprietorships or founder-led companies in which the founder performs most of the services, with a small cast providing administrative support.

The buyer of a book of business will typically look for seller financing for a few reasons:

1. They are a fellow small business or beginner in business who does not have access to financing.
2. They view your book of business as a risk because of the *transferability* of the customers or relationships you own.
3. They want you to finance part of the sale, giving you an incentive to transfer the book properly.

Because these transactions are small and often relationship-dependent, buyers may assign limited value to transferable goodwill and make more of the price contingent on retention.

In terms of post-closing involvement and compensation, you may be asked to work within the business for a limited period of time to support the transfer of assets.

While these sales are the least attractive of the market segments we'll discuss, they account for a large share of total deal count. In this framework, they sit below roughly $1 million of enterprise value.

Your best shot at selling a book of business is to prioritize the following buyer personas:

1. Local competitors
2. First time independent buyers

You can expect a book-of-business deal to be priced as a percentage or multiple of retained sales. These businesses are typically too small and too integrated with the founder's work to trade cleanly on an EBITDA or profitability figure.

To recap:

- Books of business are usually companies with less than $1 million in sales and an enterprise value of $1 million or less.

- Valuation is often based on a percentage or multiple of revenue retained after closing, with benchmarks varying widely by industry.
- Financing for these deals often includes a meaningful seller note or earnout, with the balance coming from buyer cash, outside financing, or both.
- Local competitors and first-time business buyers are your most likely buyer candidates.

***Author note**:*

The first M&A transaction I ever participated in was the purest form of a book-of-business sale. It was a distressed sale of a small practice's client list after the owner unexpectedly passed away.

I was bubbling with energy about the opportunity (I was a 23-year-old fool who didn't know what I didn't know… and felt great about it). My employer at the time bought the book and hired me to operate the practice, hoping to cross-sell additional services.

The book was small and spread across hundreds of clients. Yikes!

We paid a small amount of cash up front, and the rest was a seller note paid over a few years (totaling 60% of sales).

I won't say much else… but if price is what you pay and value is what you get, we paid a pretty cheap price and got even less in return. I humbly tell my buyer clients to avoid deals of this size like the plague. I earned the right to that opinion as the boots on the ground!

Main Street businesses

A “book of business” company becomes a “Main Street” business when it does the following:

- Consistently breaks $1 million in sales
- Has a team of employees that perform billable production work in lieu of the founder
- Starts to carry a bit of a brand or reputation

This population represents a smaller but meaningful share of businesses for sale in the SMB M&A market.

If you’re selling a Main Street business, your buyer pool will expand a bit compared to your book-of-business counterparts. You may receive offers from:

- Local competitors
- Regional competitors
- Independent buyers (self-funded searchers)
- Smaller independent sponsors and search funds

This expanded buyer pool is a byproduct of the fact that you have proved your company has more muscle than just founder effort. You’ve retained a team of professionals, a formidable customer list, and some operational processes to turn $10 of work into $1–$2 of profit.

They might not be the prettiest of processes just yet… but you’re in the top 20% of SMBs!

In terms of valuation, this graduated level gets you from a revenue multiple, heavily subject to retention, to what we call an SDE multiple.

SDE means seller’s discretionary earnings and is effectively the net benefit that an owner-operator receives through both salary and the net profit of the business.

In many Main Street deals, valuations hover around 2x–3x SDE, with some reaching 4x–5x when the company shows considerable promise of scaling into the next market segment we'll discuss in a moment.

In terms of deal structure, the greatest benefit compared to book-of-business sales is that you will graduate from majority seller financing to a healthier cash payout.

Many Main Street deals include a seller note, often alongside buyer equity and SBA-backed financing. The exact mix depends on the lender, the buyer, and the transaction.

Author note: SBA-guaranteed loans are an incredible tool for the SMB M&A market. The guaranty enables participating lenders to finance eligible small-business acquisitions that might not fit conventional underwriting, often at more accessible terms for buyers. That said, the process is document-heavy and can be a huge pain in the ass.

Deals can take longer when SBA-backed financing is involved, and program rules can materially affect seller notes, equity injections, partial changes of ownership, and transition arrangements. Those rules change, so have the lender and M&A counsel confirm the current requirements before you sign an LOI. For these reasons, SBA-backed buyers can be less attractive when you have several well-capitalized options.

When it comes to post-close involvement, most Main Street businesses still have a considerable amount of owner involvement, which means a seller transition is the market standard.

Six to twelve months tends to be the standard. Sometimes technical professional-service practices require a two- to three-year transition because of additional founder dependencies, while motivated sellers in less technical industries may opt for a 60- to 90-day transition.

"Platform" businesses

A platform business can mean a lot of things to a lot of people.

For the purposes of this book, I am referring to companies earning roughly $1 million to $10 million of EBITDA.

Notice I said EBITDA and not SDE. Buyers are going to expect a business with management costs already included in net profit calculations at this level.

A "platform" acquisition is typically one where a financial buyer (usually a private equity fund or a PE-backed buyer) is buying their first company to enter an industry.

Because of this, they are looking for a geared-up machine with excellent processes, a strong brand, and expansion potential. It serves as the hub in a hub-and-spoke acquisition strategy, and platform deals can earn a healthy premium compared with their Main Street counterparts.

In terms of valuation, you can expect anywhere from 3x–5x EBITDA for smaller platforms and 5x–10x EBITDA for larger platforms, or more in hot industries or low-interest-rate market frenzies. The largest I've heard in the lower-middle market is about 20x EBITDA (if you're interested in buying my CPA firm for 20x EBITDA, feel free to DM me on Twitter).

The deal terms and financing structure for these acquisitions will be the most complex. They will typically have a conventional bank (or more recently, potentially a private credit partner) as the anchor to the financing stack, with the balance being paid for with buyer equity, seller financing, and potentially a healthy chunk of rollover equity if you'd like a "second bite of the apple" which we'll discuss in more detail later.

Author note: *If your business is in the Main Street tier but approaching the platform segment, it's time to think long and hard about how to play the game smarter, not harder. You might be a handful of strategic shifts away from doubling your profit and picking up several EBITDA multiple points. The combination can yield millions of dollars in value.*

Buyer Personas

We touched briefly on the buyer personas that tend to appear in each market segment, but understanding these buyers in greater depth will help you radically improve your chances of a successful exit.

Each buyer type has a different set of valuation expectations, diligence requirements, post-close involvement levels, and deal-making capabilities that will ultimately make or break your transaction. It's in your best interest to understand them well.

Private equity firms invest capital committed by their investors. They are professional company buyers, and their teams may or may not have founder or operating backgrounds. Their primary objective is to acquire businesses and add value through improved operations, sales, and financial structuring, often using leverage.

Keep in mind that most traditional closed-end private equity funds plan to sell their portfolio companies within a defined holding period, often roughly three to seven years, although structures and timelines vary. Their investors eventually expect capital to be returned, and the fund term is established in the governing agreements.

On larger deals, expect hyper-detailed diligence that may involve major consulting and accounting firms.

They may want you and your management team to stay and help grow the business. Keep in mind that while there may be a promising pay package to do so, you might not love having a boss again (especially one who doesn't have the industry or entrepreneurial expertise you do).

Independent sponsors are a hybrid of private equity and entrepreneurship-through-acquisition. They find a deal first, then raise equity from family offices, private equity funds, institutions, or individual investors to finance it. For this reason, they are commonly called "fundless" sponsors. The sponsor buying your company will not necessarily become the CEO or

operator. The post-closing operator may be you, someone on your team, or someone hired for the role.

You can expect due diligence to resemble a private equity process, although the scope may be somewhat narrower. Negotiations can be just as aggressive as those with a PE fund.

Search funds are investment vehicles that back an entrepreneur who searches for a company to acquire and operate as CEO.

The buyer may be an individual, but the investor group and diligence process can be institutional.

Search-fund processes can be comparable to independent-sponsor processes in terms of due diligence rigor.

Self-funded searchers use personal capital, often alongside SBA financing and sometimes outside investors.

Their ability to pay depends heavily on their equity and lender underwriting.

Self-funded searchers typically have smaller diligence budgets, although lenders and outside investors can still impose extensive requirements.

Strategic buyers are companies acquiring other companies in their industry. This is usually to enable a competitive advantage such as entering a new market, rapidly adding customers, or combining product or service capabilities. Cost savings or additional sales may enable strategic buyers to bid more than their financial-buyer counterparts.

You should ask every serious buyer the same fundamental questions:

- Who is funding the equity in the deal, and what is their commitment level?
- What debt financing is required, and what has the lender approved?
- Who makes the final investment decision after underwriting?

- If you have equity investors, what is their investment cycle, and when do they expect an exit or return of capital?
- What comparable deals have they closed?
- What role do they expect you to play after closing?
- Who will be operating the company after closing?
- What is the timeline and expectation for due diligence?

Deal Types and Your Role After Closing

A sale does not always mean selling 100% for cash and retiring immediately.

A “recapitalization” lets you sell part of the business while retaining an investment. You receive some liquidity now and keep exposure to future growth.

The later sale of that retained equity is sometimes called a “second bite of the apple.” It also means part of your wealth remains at risk. Think carefully about whether you want to “buy in” to your buyer’s strategic plan, their balance sheet, and their operational capability.

Aside from determining whether your deal will be a full buyout or a recapitalization, you must determine what deal structuring tools you are comfortable with in your transaction.

An earnout makes part of the price contingent on future results. Some, or all, of these future results will be outside of your control.

A seller note makes you a lender to the buyer. While they are contractually committed to paying you, seller notes are typically subordinated to senior debt (meaning that in a bankruptcy or default scenario, you may recover little or none of the balance).

A transition agreement defines the work you will perform after closing (and the compensation structure). You must determine if you are up to work under

someone else's management, and whether your new compensation structure is reasonable and market-appropriate.

Before marketing the company for sale, decide which outcomes you would consider: a full exit, a period of employment, an advisory role, or continued ownership.

Getting clarity on those levers helps you evaluate the buyer and the offer together.

Chapter 1 Recap

- Your business will fall into one of three market segments: a book of business, a Main Street business, or a platform business
- The market segment you fall into drives a large portion of your deal terms (price, terms, contingencies, financing, etc.)
- Each market segment has multiple buyer types that may be interested in your company.
- Buyer personas have wildly different acquisition strategies, diligence requirements, negotiating methods, and operating styles
- You don't have to sell 100% and walk away. "Recaps" and other forms of buyouts are available in addition to traditional buyouts.
- Your exit offer will include more than a headline price; the deal terms you're comfortable with will dictate what type of transaction you can close and with whom.

Chapter 2: What Makes a Business "Buyable"

Now that we understand the market segments and buyer personas, you need to understand what makes a business objectively "buyable." Cracking this code will significantly increase the valuation of your business and your likelihood of a successful exit.

When I explain how buyable a business is, I am really talking about the "quality" of the business.

In the world of M&A, quantitative analysis is brutally overhyped. Everyone wants to boil each company down into a list of model assumptions.

But companies are inherently complex, and the best ones find ways to beautifully blend all the variables into a harmony of execution that turns some form of widgets into cash through dozens or hundreds of discrete processes.

I could write a whole book on the quality of businesses (and one day I just might!), but for now, the two most important things for you to know are these: What is the definition of quality, and how do buyers sniff it out?

1. What is "Quality"?

I define business quality as the "resonance" of each of its parts. And for those less nerdy than me, "resonance" simply means how well the parts of the business complement one another.

Examples: Does the pricing model bode well for customers? *Does production consistently churn out testimonials or case studies that can be used for marketing? Do the payment terms and working capital management policies feel natural to the company's best customers and vendors?*

When you've implemented resonance into your company, you've created quality. You've set yourself up for more enduring profits. A more natural growth rate. Cash flows that hit your bank regardless of how many labor hours you personally clock…

2. How do buyers sniff out quality?

Most buyers are financial buyers by trade. So they don't always know how to spot a beautiful business unless it shows up in the spreadsheets (sigh).

But lucky for you, I have a simple eight-step framework that you can use to determine the quality of your business without explaining the intricacies of your product and operations. Those will help, but being able to cross-verify them against these financial characteristics will make buyers foam at the mouth (hopefully not literally).

Let's look at what buyers are willing to "pay up" for.

Earnings

Earnings are the bedrock of what financial buyers seek. They want enduring, stable profits with juicy margins that ultimately lead to attractive returns on capital.

If you can't prove your earnings to the market, I hate to say it but your chances of a strong exit are slim, my friend.

Getting this part right is paramount to achieving a formidable valuation.

Buyers will evaluate your earnings through the following frames:

1. What is the trend line of earnings (EBITDA) over the last several years?
2. What are the EBITDA margins compared with industry averages?
3. Is there any earnings risk from customer concentration or other operational dependencies?
4. What will recast EBITDA look like after accounting for normalizations and pro forma adjustments?

We'll discuss this in much more depth in the "quality of earnings" due diligence section of the book.

Cash Flow

It may surprise you that there are two separate categories for earnings and cash flow… but here we are.

We'll discuss this more later, but assume that all analyses of your company are going to use "accrual" financials. This is a big learning curve for most business owners.

Because we measure earnings on an accrual basis, we need to know how consistently those profits convert into cash flow.

There are four levers that tend to prevent earnings from dropping into the cash coffers like clockwork each month:

1. **Working capital: A dollar of sales does not always equate to a dollar of cash. Some companies take anywhere from 30–180 days to complete their cash-conversion cycle. A strenuous cycle will significantly degrade financial quality for buyers.**
2. **Seasonality: Separate from cash conversion, some companies' sales and profits are highly concentrated in small portions of the year.** This is equally, if not more, disturbing for buyers, because most debt-funded buyers have to make *monthly* debt payments. Obviously not fun to be making monthly payments while your company operates in the red 9 out of 12 months per year…
3. **Capital Expenditures:** EBITDA is the main measure of profit (which excludes depreciation), but CapEx will still be reviewed by buyers. If every dollar of EBITDA requires 50 cents of CapEx just to maintain sales volumes, you can expect a significant haircut on your valuation.
4. **Cyclicality**: Cyclicality is the measure of how much volatility there is in a company's profit generating cycles based on the economy. If you are in a "boom or bust" industry, your cash flow is not very stable and will be downgraded by buyers who require enduring cash flows regardless of that year's economy.

Cash is king. Fix these risk areas and your business will compound rapidly.

Growth

Growth… is it not the coveted golden goose all entrepreneurs crave? I don't know many ambitious business owners who get into business without being a bit of a scaling junkie…

Yet by their very definition, small businesses typically don't have much growth history. Otherwise, after enough time, they would no longer be small, would they?

But when you do have a clear history of growth, it is like rocket fuel for your valuation. Growth is the only lever that can add exponential valuation improvements for your business.

Here's what you should be considering to achieve a high-quality level of growth:

- **The nature of growth**: Is it repeatable (not reliant on your manual genius) and enduring (not a fad)?
- **The cost of growth**: How much lifetime profit does a dollar of marketing and sales yield?
- **The cash conversion of growth:** How long are your sales cycles? And how quickly do new sales convert into cash?
- **The fulfillment of growth:** Does your company have repeatable playbooks for turning sales into profit and client success stories? Do you have repeatable hiring playbooks to add more capacity to fulfill future growth?
- **The dependency of growth:** Does your growth have external dependencies like social platforms, partnerships/joint ventures with other businesses, or reliance on someone else's product ecosystem?

Growth is the hardest skill to learn for most SMBs. And honestly, I would treat this one as a bit of an optional bonus unless you are dead set on getting a massive valuation.

Author note: Of all the pursuit areas listed in this quality overview, pursuing growth presents the most reward but the most risk. It's also easy for even the most humble entrepreneurs to get caught in the ego-fueled pursuit of growth, leading to a "growth at all costs" mentality. Ask me how I know. If done improperly, this can tank your valuation in the short term (false-start growth initiatives can quickly turn into stranded costs and bleeding margins).

Reporting

If there were a Tim Duncan of business attributes… it would be reporting (the Big Fundamental).

Is there anything more boring for the daredevil entrepreneur chasing bold visions of grandeur?

Yet the boring fundamentals earned Tim Duncan five NBA championships and 26,496 regular-season points. What would doing the boring stuff in your business enable you to earn?

In this case, it might just be a multi-million dollar valuation!

And similar to cash, reporting and data tend to act like oxygen for business owners.

You don't think too much about it when it's there, but when there's a crisis and you don't have it, you'll wish you had it more than anything.

I *cannot* emphasize how common it is for SMBs to underinvest or mishandle their reporting needs. Most look at it as an administrative burden, or a luxury they just can't afford.

Business buyers know this too (this is literally the principle that my CPA firm was founded on). SMB owners just rarely keep good records, and debt-fueled, financially oriented buyers *crave* financial reporting more than anything.

We'll talk more about financial reporting in a bit.

Tax

Your tax situation may not always be essential to a buyer, but many times it can be.

If your company gets sold as a stock deal, having a clean tax history massively reduces the risk profile of buying your business.

Additionally, tax structure will typically impact your deal structure. So getting the tax structure right and being up to date on your tax compliance is a simple yet powerful way to improve your exit readiness.

We'll talk more about tax structuring and tax modeling in Part II.

Capital

Buyers will bring their own capital to the table to acquire your company, but maintaining a clean and healthy balance sheet is an excellent way to prove that your company is a financially attractive investment.

Think of it this way: If your company requires hundreds of thousands of dollars in debt from high-cost lenders just to stay afloat, how will a buyer feel about taking it over and adding a few million dollars of new debt?

Aside from your actual balance sheet, your creditworthiness could be a major asset to a platform buyer.

If a buyer acquires your stock rather than selected assets, the legal entity and parts of its credit history remain in place. That continuity may help preserve vendor terms, customer contracts, licenses, and bonding capacity, but lenders and counterparties can still re-underwrite the company after a change of control.

Aside from your credit history, getting your equity capital stack in line can be critical.

Most businesses have a single-owner structure, but if you have partners or investors, now is the time to review your operating and equity agreements and make sure everything is well documented.

The last thing you want is an internal shareholder dispute on the allocation of proceeds or some other equity mechanic.

In addition, if you have more than one owner and do not already have a buy-sell agreement, consider putting one in place with legal counsel. A properly drafted agreement can provide a mechanism for handling a partner dispute or ownership transfer before you go to market, but the agreement's actual terms will control.

Valuation

Valuation is a bit of a melting pot of the other factors, but keep these five levers in mind specifically as you think about your valuation:

- **Cash flow**: How consistent is my historical cash flow?
- **Owner compensation / owner involvement: How will my workload or my partners' workloads be recast in the financials? What would the market rate be to replace us?**
- **Durability**: What variables in my business today could put tomorrow at risk of being worse than today? (Weak contracts, cyclicality, employee risks)
- **Transferability:** What areas of the business would be immensely difficult to transfer to someone else?
- **Growth rate: Does my company** have a proven growth story? Remember, nobody pays for growth potential. They pay for proof.

Lifestyle

Lifestyle is the most slept-on lever of quality, but mastering it can add several turns of EBITDA to your multiple.

Nobody wants to buy a business that looks like a nightmare to operate from the outside. Their best indicator of what it would be like to own it is often you.

Businesses that appear to provide the owner a massive amount of flexibility *always* earn a higher multiple than their owner-dependent counterparts.

This is truly one of the few times in life where you may just *get paid more for doing less.*

Consider these questions to gauge your lifestyle in relation to the business:

- Do you feel forced to work more than you want to?
- Do you feel passionate about what you do or who you work with?
- Do you like your team and your clients, or do you just tolerate them?
- Do you feel reasonably compensated for the work you put in?
- Does your business steal your time or energy from your spouse, kids, or loved ones?
- Do you have a difficult time maintaining your health or happiness because of your commitments to your business?

I've noticed in my practice that the hustle mindset is so culturally ingrained in the American entrepreneurial landscape that most of my clients and prospects cannot even fathom what it would be like to have a genuinely fun, flexible, and fulfilling lifestyle. I have dozens of calls per month that start like this after I simply ask how they're doing:

"Oh, you know, just so busy. But I guess that's a good thing, right?"

"Just grinding through it as usual."

Or sarcastically… "Another day in paradise."

There is always a fire to put out, a new milestone to chase, or some imperfection to dwell on.

I won't delve any further into mindset frameworks or the philosophy of entrepreneurship… but keep this in mind as you continue to scale and develop your business for a potential exit: You, as the founder, are the life force of the company. If you are stressed and scatterbrained, your company will be too. If you take a stand to make your business *work for you*, you'd be shocked at not just the

improvement in your day-to-day, but also in your cash flow, your operations, and your growth potential.

Packaging it all together

If you can master the eight levers of quality, you have an incredibly strong chance at building a platform which can earn a multi-million dollar exit.

Getting to platform status (a minimum of $1 million EBITDA per year) will slingshot you into a new pool of buyers, a richer valuation multiple, and greater opportunities for you and the business in general.

Driving quality across these eight levers also makes it increasingly easy to explain the value of your company. You could even simply build your exit marketing material around these levers if you and your deal advisor wanted to.

The eight levers of quality will not only raise your deal attractiveness but also open you up to a unique pool of holding-company buyers. These are independently wealthy, financial buyers who prefer to acquire and hold businesses for much longer timeframes. They also tend to change a lot less about the business once it's been acquired. If preserving the quality of your business is important, then opening your business up to these types of buyers will be to your advantage. But they typically won't buy your company unless they find it to be well-built and highly durable.

And lastly, remember that quality is what drives demand in the market. Building with quality at heart means that the demand for your company's stock will outstrip its supply, and therefore the price of your equity will skyrocket.

Chapter 3: Why Most Businesses Never Exit

Unfortunately, there are thousands of businesses every year that have poured a ton of time, money, and effort into improving their businesses but still ultimately end up unsellable.

Let's explore the four main drivers of exit failure for small businesses.

Valuation Expectations

The truth is, every business has some price at which it could eventually sell.

But many times, the prices that buyers feel comfortable acquiring the company for are significantly lower than what the owner expects their business to be worth.

This usually happens for 3 reasons:

1. Effort is conflated with value

We discussed in the lifestyle section of Chapter 2 that most business owners view "the grind" as a rite of passage. They view it as the driving force of their company's existence.

And after all, that is true. The company would indeed not exist without the vision, inspiration, and constant effort of the founder.

But none of these factors actually determine your valuation in the M&A market.

In fact, buyers want to see founders being *less involved* to keep the business afloat, as this is the strongest indicator that the company has sufficient durable assets and infrastructure that will continue to produce profits after the founder steps out.

I've had many conversations with business owners doing below $1 million in profit who felt like their company was worth at least $7–$10 million. When I ask them how they arrived at that figure, they usually start rattling off all the different things they've done to get to where they are today.

For example, I once worked with an entrepreneur who built a nice small business around proprietary technology.

When he first came to me, he assumed (or hoped) that his business was worth a premium price based on the tech that he had built.

Unfortunately, the off-market buyers who had solicited him were bidding less than a third of that figure.

When we reviewed his financials, his net income was a thin slice of his sales.

Luckily, we were able to find a myriad of reasonable adjustments to his EBITDA figures, and his adjusted EBITDA came in at more than four times his reported net income.

This enabled us to do real financial valuation math. We ended up getting his business listed to the market at an asking range roughly double the off-market bids.

He was thrilled to get to a potential range much closer to his initial expectations. As important as product and intellectual property are, you can't make the math work without knowing the financial output the market will use.

The faster you can rid your mind of input-based thinking and adopt an output-based approach, the faster you will start to appreciate the way the market values your company.

2. Owners utilizing the wrong value benchmarks

The next common fallacy for entrepreneurs who have moved beyond the effort-based valuation mindset is to use rule-of-thumb valuation benchmarks they've heard from peers or found in cheap publications.

The risk here is that many business owners attach their valuation to a lofty multiple of revenue because they heard of a tech company or a fast-growing enterprise that sold for a blistering valuation.

Your company is going to be valued based on the attributes of your company size, growth rate, and industry.

Trying to assign venture-style tech-company valuation math to your small business will only lead to disappointment.

3. Ego and lack of buy-in

The last mindset failure that tends to kill deals is when business owners don't buy into a formal M&A process.

This is usually the prototypical hardworking business owner who originally expected to work till they die (and perhaps even die at their desk!)

When they find out that someone has some interest in their business, their immediate logic is that they should dictate that they will only sell for a mind-blowing amount of money, and that if the buyer says no, they didn't lose anything anyway, because they never expected to sell.

Thinking in this way is the fastest way to degrade trust between you and your potential buyers, and your advisors if you do hire them.

Nobody wants to work with someone whose main goal is to pull a fast one on the person taking over their business. This type of erratic behavior also won't be tolerated by most reputable advisors. You'll end up having to sell the business on your own (and probably failing).

Reporting

Assuming you've gotten your mindset around valuation properly calibrated, the next biggest risk to your company's ability to sell is your reporting.

To most business owners, reporting feels like an after-the-fact administrative responsibility to get your taxes filed and stay in compliance with the IRS.

But the truth is that from an M&A perspective, potential buyers will place a ton of weight on your reporting.

If this feels confusing to you, consider this.

Your personal opinion and perspective on the business is based on a near 100% surface area of *every single thing that has ever happened* in the company's existence.

A buyer has to take a massive risk in the sense that their knowledge surface area of the inner workings of your company is near zero.

Your reporting paper trail will be one of the quickest and most valuable ways for them to get oriented on the quality and performance of your company.

Without a decent base of reporting data, most buyers would rather just walk away and find the next deal opportunity.

Remember, your company is just one in a population of thousands that financial buyers will evaluate for acquisition. They don't *have to* acquire your company, and if they can't get a good understanding of what's going on in the company through a single source of truth, they'll find a company that has already assembled the proof required to transact.

Documentation

Documentation may sound like the same thing as reporting, but there's a large difference.

Reporting is the financial, operational, and sales data compiled into packages that can be reviewed to understand the performance of the business.

Documentation consists of the underlying contracts and paperwork that **protect** your company from a legal and financial perspective, and **prove** that your operation will be able to sustain ongoing operations.

Consider if you have the following forms of documentation:

1. Articles of incorporation and operating agreements (establish legal formation, governance, and ownership rights)
2. EIN and tax returns (show the company's tax identity and filing history)

3. Licenses and permits (show that you're authorized to operate in regulated industries)
4. Customer contracts (document the key terms and obligations a buyer may inherit with customers)
5. Supplier contracts (proof that procurement of critical materials and services will not be disrupted after an M&A transaction)
6. Employment agreements (document key employment terms, compensation obligations, and change-of-control provisions)
7. Buy-sell agreements between partners that dictate when an exit or buyout is feasible and under what terms and conditions.

Without proper documentation of your company's operations, the transferability of your company starts to degrade quickly.

This is a simple way to improve your exit-ability without reinventing the wheel.

Owner Dependency

Owner dependency is a universal risk area in small business M&A. You really can't overthink or overplan for this dynamic. The more that you do to reduce your owner dependency, the more luck you will have in selling your company one day.

I like to think about owner dependency in the following buckets:

1. Delivery of services or products
2. Relationship management with customers and vendors
3. Internal operational management
4. Sales
5. Marketing
6. Legal & licensing
7. Financial administration

For most business owners, you probably have your hand in most (if not all) of these 7 buckets.

I've listed these seven dependency variables in terms of how much risk they present to a potential buyer if the dependency level in that category is high.

Delivery of services/products and client management are the most dangerous dependencies *by far.* If you plan to sell, it is mandatory that you fix these as soon as possible.

Operations management is the next most valuable area to remove yourself, but removing yourself from operations should be easier and less psychologically complex to handle than removing yourself from your coveted secret sauce of delivery and client relationships.

Sales and marketing dependencies are usually the last to come off the table because they're not "mission critical" in terms of maintaining the day-to-day. Founder dependency for growth is not a terrible thing. Leveraging a personal brand and abnormally high sales conversion rates from founder-led sales can be an asset for a buyer to retain and a nice way for you to pad your compensation after a sale.

Legal and licensing covers the company's ability to operate legally. Many industries that are popular for SMB M&A have complex personal licensing requirements where a key employee or owner must carry a technical license. Determining whether your buyer will need you to stay as a license holder or will have its own is critical before you get into deal negotiations.

The last is finance and administration. You, as the founder, add absolutely no value by doing finance and admin work. Get this into someone else's hands immediately if you're doing this!

Let's discuss each dependency risk and how to mitigate it.

- **Delivery of services and products**: This dependency level is strongest in the book-of-business sales, particularly in practitioner-led technical industries. If you are an accountant, engineer, doctor, consultant, attorney, wealth advisor, etc. this is an existential risk for you. Your

business started by you hanging your shingle and doing on your own what you were previously doing for a larger employer.

    - **Mitigation: Your main mitigation mechanism** will be to hire other qualified professionals and build compelling compensation and retention structures that incentivize them to stick with your business instead of leaving to start their own practice (like you did!)

- **Relationship management**: If you've successfully gotten out of the day-to-day delivery, there's a good chance that you're still the guy or gal the big customers "want to talk to." They know you have that magic sauce, problem-solving ability, and you've trained them over the years to hit you up when they had a hairy problem.
    - **Mitigation**: Your main strategy for mitigating risk is to develop two things: a client success *framework*, and an internal coaching program. The shortcut that lots of companies try to take is hiring a customer success rep and other client-facing support reps, but this doesn't work for high-ticket, high-trust services (which are the most prone to key-person risk). What client wants to talk to a salesperson, a delivery manager, a customer success rep, and a billing specialist just to get their needs fulfilled? The fallacy here is that too many companies build their roles and departments by what's most convenient for the business, not what's most convenient for the customer. You need to coach your delivery team into becoming advisors that can solve complex client problems without you.
- **Internal operations management: Once you get out of client delivery**, removing yourself as the main operational resource will be critical. This is usually the stickiest of dependencies to get out of, because it feels like it covers a hundred different small tasks.
    - **Mitigation:** This requires two developments: the first is building a strong operational leader role within the company. This can be called a director of operations, a chief operating

officer, or a president. The main function of this person is to become the "heartbeat" for the company's operating rhythm. This person should hold your team accountable to KPIs, overseeing reporting and delivering news to you or your executive team, and ultimately setting the internal operational plans that enable execution of the company's larger strategic vision. Second to this is installing an operating framework. One popular version of this would be EOS. The key to any of these frameworks is that they give your operations leader a roadmap to follow instead of just being a firefighter. The framework should include the who, what, when, why, and how of the operation. This should include KPIs, accountability systems, standard reporting formats, job descriptions, performance reviews, and standard operating procedures.

- **Sales:** Sales is one of the last things you'll hand off as a founder, but the main reason to do this is once your company's demand outstrips your ability to schedule calls on your own calendar.
    - **Mitigation:** Similar to operations, you'll need to start hiring and building a sales-management framework. Sales roles tend to fall into two buckets: sales development (prospecting, outreach, appointment setting) and sales conversion (discovery calls, scoping work, writing proposals, closing deals). Building rock solid SOPs and KPIs will be crucial. You **must** avoid the instinct to just hire reps and see what happens. They will not be able to close at the same clip as you (no employee closes deals as easily as the founder). Installing a robust sales methodology and accountability framework will work wonders for you.
- **Marketing: There are two separate dimensions of marketing: brand marketing and conversion marketing. Conversion marketing is one you should be able to hand off fairly quickly. This is the technical aspect of building marketing assets that capture leads for your sales**

team to close. Brand marketing may be harder to hand off if you have built your company on your personal reputation.

    - **Mitigation:** Build marketing assets around your reputation and company history that reduce the amount of manual marketing work you and your team need to do. There's no problem with a company telling the founder's story in a marketing brochure or on a landing page.

- **Legal and Licensing:** You can largely disregard this for founder dependency purposes unless you're in an industry where your personal license or credential is required for operations. This typically includes CPAs, attorneys, wealth advisors, and other professional-service providers, but it can also include technical trades such as HVAC and electrical contracting.
    - **Mitigation:** Your easiest mitigation here would be to prioritize selling to a strategic buyer who already has a key license holder in place. If that is not an option, you will have to explore one of the following options: the buyer finds its own licensed employee, you promote one of your key employees to be the primary license holder, or you stay and hold the license.
- **Finance and administration:** This should be one of the first things you hand off simply because there's no intrinsic value to you doing this work.
    - **Mitigation**: Larger companies may consider hiring a full-time finance team. Smaller companies can remove this work by utilizing a mix of offshore bookkeeping staff, executive assistants/administrators, and fractional CFOs who provide the higher-end finance work you may need but at a much smaller clip than a full-time CFO.

Chapter 3 Recap

Getting a deal done doesn't just require you to build a strong company.

You must overcome the most common blockers that make your company difficult to buy in the SMB M&A market.

- **Valuation expectations**: Avoid having unrealistic valuation expectations that create strife with buyers. This requires a shift from input-based thinking, unsupported valuation benchmarks, and ego-driven exit thinking to a market-driven, output-based mindset.
- **Reporting**: Remember, you have a near 100% surface area exposure to the quality of your company, but your buyer has near zero. Your reporting will be their strongest proxy for understanding your business enough to buy it.
- **Documentation**: Documentation is not just paperwork. It's proof and protection of your company's most important assets. Get your company papered up properly across all its key relationships (government authorities, customers, suppliers, employees, and partners).

Part I Recap

You should now have a clearer picture of where your business fits in the M&A market, what makes it attractive to buyers, and what could prevent an otherwise promising exit.

Remember:

- **Your buyer pool shapes your exit**. A book of business, a Main Street company, and a platform attract different buyers with different financing, valuation expectations, and plans for your involvement after closing. Understanding who could buy your company helps you decide both how to build it and which offers deserve your attention.
- **Business quality gives buyers a reason to pay more**. We explored how the parts of your company work together, and how that quality shows up across earnings, cash flow, growth, reporting, taxes, capital, valuation, and lifestyle. The goal is to build a company whose

performance can endure beyond the circumstances and personal effort that created it.

- **An otherwise strong company can still be difficult to sell**. Unrealistic valuation expectations, weak reporting, incomplete documentation, and owner dependencies can stand between a willing buyer and a completed transaction. Addressing those gaps gives the buyer a clearer understanding of what they are acquiring and how it will operate in their hands.

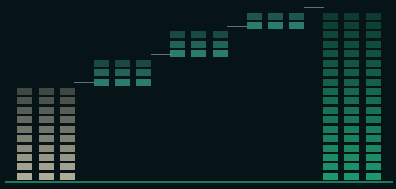
Now that you have an understanding of the fundamentals of the market and your company's place in it, it's time to dive deep into *transaction readiness*.

This section will be more technically rigorous, but you don't need to become an accountant to understand the material.

The goal of this part is to help you understand the technical aspects of the transaction at a level that will enable you to speak the language of your buyer and advisors, understand the deal-level implications, and ultimately steer your company in the right direction.

PART 2
Transaction Readiness

Understand the tactics to make your company “default ready” for an exit.



Transaction readiness as a business owner boils down to one thing.

You must translate your big picture, visionary understanding of your company's value into a set of detailed, financial proof assets that convince even the most skeptical acquirers of your company's true value.

We will break down:

- **Valuation Methods**: How to reasonably estimate and set your valuation before going to market
- **Financial Reporting**: How to write a story of value with your company's numbers.
- **Quality of earnings: How to strengthen your company's financial story in the M&A industry's most familiar underwriting format: the QofE.**
- **Net working capital**: How your balance sheet will affect your M&A transaction
- **Tax structuring**: How your current tax position and deal structure will impact your net take-home cash proceeds after closing
- **Net proceeds analysis:** How to understand the full cash flow waterfall that ensues in an M&A transaction at and after closing

Let's get into it.

Chapter 4: Valuation Methods

As we discussed before, finding a reasonable valuation level that the buyer will respect will have a huge impact on your ability to exit properly.

There are three main approaches for estimating business value: the asset, income, and market approaches.

While business valuation specialists can be helpful, it's important that you understand these valuation frameworks yourself and can confidently estimate your own value.

If you feel like the valuation math is a black box, you will never feel comfortable with anything else in your M&A transaction.

Let's dive into each approach.

Asset Approach

Fair Value of Assets - Fair Value of Assumed Liabilities = Net Asset Value

The asset approach estimates the value of what the company owns, less its liabilities. It is particularly relevant for asset-heavy companies or businesses with limited earning power compared to the size of their balance sheet.

Intangible assets can also matter. In a book-of-business sale, buyers often value customer relationships using retention, revenue, and market benchmarks rather than relying on their book value.

I've also seen businesses that are valued primarily on asset values in the following industries:

- Towing or heavy-equipment-based service companies
- Equipment lease portfolios
- Washing machine or vending machine businesses
- Retail companies where the real estate is owned rather than leased

- Technology or licensing companies where the intellectual property is the primary asset

Keep in mind that book values may differ substantially from sale values.

Your asset values could have the following variations compared to what your balance sheet states:

- You may have depreciated your assets faster than their true value depreciated
- Your assets may have *appreciated* while you depreciated them for financial purposes
- Your assets may not appear on the balance sheet at all if they were developed internally and expensed through the P&L or if they had no acquisition cost.

For most companies, getting valued on an asset approach is not ideal.

Author note: I once worked with a company after a private equity group had acquired it for less than the fair value of its identifiable net assets. In accounting terms, that can produce a bargain-purchase gain, historically called negative goodwill. I imagine the seller was not very happy with the payout, but the private equity group was not so happy with its bargain after twelve months of operating the company. The operation was effectively lighting money on fire. The PE group couldn't get a grip on it and ended up investing substantial additional equity just to keep the business alive. After a couple of years, its total investment was much higher than the bargain price it initially paid.

As a seller, you want your company to be valued with substantial goodwill and other intangible value above and beyond the observable assets on your balance sheet.

This is where the income approach comes into play.

Income Approach

Capitalized income: Maintainable income ÷ capitalization rate = value. Multiple method: Maintainable income × valuation multiple = value.

The income approach values a business based on future economic benefits, either by capitalizing a normalized earnings stream or by discounting forecast cash flows at a rate that reflects risk.

Most SMB transactions are negotiated using a multiple of SDE or EBITDA, a practical application of the income approach informed by market evidence.

The income stream is typically one of the following:

- SDE (seller discretionary earnings)
- EBITDA (earnings before interest, taxes, depreciation, and amortization)
- Free cash flow (cash generated after operating expenses, taxes, working-capital needs, and capital expenditures; definitions vary)

EBITDA is commonly used in lower-middle-market transactions for the following reasons:

- EBITDA is a widely used measure of operating earnings before financing, taxes, and noncash depreciation and amortization. It is not cash flow; buyers still analyze working capital, taxes, and capital expenditures when testing debt-service capacity.
- Interest expense is excluded because the buyer's capital structure will differ from yours. Buyers analyze acquisition debt service separately when calculating debt-service coverage.
- Income taxes are excluded because entity and owner tax profiles differ, so buyers usually compare pre-tax operating earnings.
- Depreciation and amortization are noncash charges, but the assets they represent may still require replacement. Buyers may subtract normalized maintenance capital expenditures when converting EBITDA toward cash flow.

For a stable, single-period earnings base, a capitalization rate and a valuation multiple are reciprocals: the multiple equals one divided by the capitalization rate. Do not confuse a capitalization rate with a discounted-cash-flow discount rate, which is related but not mechanically identical. Think of it like this:

- A capitalization rate of 25% is a 4x multiple
- A capitalization rate of 20% is a 5x multiple
- A capitalization rate of 10% would be a 10x multiple.

As we discussed in Chapter 1, valuation multiples will vary based on a handful of factors, but typically as your company grows and becomes more durable, the valuation multiple goes up (because the capitalization "risk" factor declines).

One useful, if imperfect, way to remember the trade-off between risk and price is to compare earnings yields and required returns across public assets. These are not directly comparable valuation methods, but they show how expected growth and perceived risk influence price. The figures below are snapshots as of September 2026:

- **Safe and sound: On September 11, 2026, the 10-year U.S. Treasury yield was 4.96%, whose reciprocal is roughly 20x. That reciprocal is only an intuition aid, not a bond valuation multiple. Treasury obligations carry minimal default risk in U.S.-dollar terms, but a fixed coupon does not provide the same earnings growth potential as an operating company.**
- **Cash compounders: As of September 11, 2026, Apple traded at about 38x trailing earnings, an earnings yield of roughly 2.6%. That does not mean Apple is safer than a Treasury bond. It means investors were paying a premium for the durability and growth they expected from Apple's future earnings.**
- **The effect of risk: Nike offers a different lesson. After strategic missteps in its shift from wholesale to direct-to-consumer distribution, its market value fell sharply, management changed, and S&P Dow Jones Indices scheduled it for removal from the S&P**

100. The point is not the exact multiple; it is that perceived durability and execution risk can reprice an asset quickly.

Obviously, a small business, a public company, and a government bond are not directly comparable, but the contrast is a useful frame for thinking about risk and price. Are you a safe and steady investment with low growth potential, a compounding growth machine, or a risky turnaround bet?

Market Approach

The market approach is used for many assets, including operating businesses, when reliable comparable companies or transactions exist. Residential real estate is the obvious example, but M&A buyers use the same logic when they apply observed SDE or EBITDA multiples to a private company.

The market approach estimates value by comparing the subject asset with similar assets or transactions and adjusting for meaningful differences.

For most SMB companies, market evidence does not stand alone; buyers combine it with normalized earnings and company-specific risk.

In practice, the market approach is often how buyers select an EBITDA or SDE multiple, while the earnings measure supplies the base to which that multiple is applied.

In many lower-middle-market deals, buyers do not build a formal capitalization-rate analysis from scratch. They start with observed market multiples, then adjust for the size, growth, durability, and transferability of the company.

How to Estimate Your EBITDA Multiple

Your market rate EBITDA multiple will typically be determined by four factors. These map cleanly to the income-based capitalization-rate method, but allow buyers and sellers to use a bit more of a rule of thumb approach to calculating the final number.

1. Earnings Magnitude

The larger your company's earnings, the larger the multiple will generally be, all else equal. Scale can reduce concentration and key-person risk, but size alone does not make a company safe. This is why public-company earnings multiples should not be compared directly with small-business EBITDA multiples.

2. Cash Flow Durability

Cash-flow durability is measured in two ways. First, buyers examine your historical results. A consistent trend of profitability demonstrates a degree of durability. Second, buyers examine contracts and other proof assets to determine whether future performance is supported. We'll discuss additional durability factors in the quality-of-earnings chapter.

3. Transferability

Transferability is mainly driven by the owner dependency factors we discussed in Chapter 3. Drive down your dependencies, drive up your transferability, and your multiple will follow.

4. Growth Rate

As shown with the comparison of a government bond and an investment in Apple, a formidable growth story can materially increase your valuation multiple. It is one of the strongest ways to increase valuation over time.

Chapter 4 Recap

Your company will most likely be valued on the level of your profits at a reasonable market rate based on the big four valuation drivers (earnings magnitude, cash flow durability, transferability, and growth rate).

In some circumstances, your company may be valued off its assets rather than its earnings power.

The lowest risk way to boost your valuation is to improve your durability and transferability.

Accelerating your company's growth can increase both earnings and the valuation multiple, but it carries more execution risk.

Now that you know how your valuation will be determined, you need to maintain a crystal-clear picture of the inputs that will go into your buyer's valuation model.

Chapter 5: Financial Reporting Requirements

Financial reporting is the single largest holdup we see in small-business deals (and is why we are most commonly called in).

Unclear financials will slow down due diligence, create arguments over valuations, and ultimately reduce the number of buyers who are willing to entertain your deal.

Use these principles to prepare your financial reporting and you will be removing one of the biggest blockers to getting a deal done.

Accrual Accounting

The accounting method you use may seem like a mundane topic, but it is one of the most critical elements in establishing strong reporting for your deal.

Accrual accounting records revenue when earned and expenses when incurred, rather than simply when cash moves. It takes more work than cash accounting, but it gives you and a buyer a clearer picture of performance.

Accrual is the gold standard for investors and acquirers, while cash basis accounting tends to be the simple standard adopted for ease of implementation for SMBs.

This conflict in preference is one of the most frustrating sticking points for both buyers and sellers in the SMB M&A market.

That being said, accrual financials help you:

- *See when revenue was earned and how it grew over time*
- *Match revenue with the costs of delivering it*
- *Track receivables and payables on the balance sheet*
- *Assign prepaid and accrued expenses to the months they belong in*
- *Track fixed assets, debts, and equity*

- *Calculate EBITDA and net income from consistent records*
- *Support net working capital calculations*

Aside from providing accrual financials to a buyer for diligence, you should learn how to use these numbers yourself to drive up the value of your company.

Remember, you should not be the one doing the accounting. You have bigger and more valuable things to do to increase valuation.

I generally recommend bringing on a controller to oversee the closing of the books and the quality of the financials.

A bookkeeper will maintain transactional data entry; the controller should review reconciliations, accounting treatment, and the completed reporting package. A controller will also build financial-control systems that accelerate reporting, improve the protection of your company's assets, and help you translate the data into storytelling building blocks.

Depending on the role, they may also support budgets, forecasts, and key performance indicators (KPIs).

Monthly Financials

If your books are updated only once or twice a year, move to a monthly reporting package before trying to sell. Otherwise, you will struggle to explain recent performance reliably (and your valuation will therefore be based on stale, old numbers that hold back your exit price).

The monthly close is the process of reconciling accounts, recording adjustments, and finalizing the month's financial statements.

I strongly recommend the following:

- Keep a month-end close checklist tailored to your business.
- Keep all required documentation to run the close in one folder.

- Put the due dates for everything in the process, including the deliverable date, in a calendar.
- Set a date and an agenda to review your financials monthly.

Author note: *At Edler Zain, our own monthly operating review brings together finance, marketing, sales, and operations. The financials show the final results, but each department is also responsible for bringing its own leading and lagging KPIs. When you implement this at first, it may feel a bit disjointed. But after doing this for months in a row, you will find that the departmental KPIs will start to make sense in conjunction with the evolution of your company's financial performance. Now that we've gotten this rhythm down, I leave every monthly meeting feeling reinvigorated and refreshed (even as a team of financial professionals, our first few monthly meetings sucked! Just get the first one done and keep improving from there.)*

How to Maintain Clean Books

The work that goes into maintaining the books during the month will pay dividends at month end (figuratively and eventually literally!)

You need to build a small, powerful accounting team, either internally or by partnering with a trusted accounting firm that knows how to perform accrual accounting in a timely manner.

The systems I recommend include:

- An accounting platform such as QuickBooks Online.
- API connections between the accounting system and the point-of-sale, project, or inventory systems, with regular reconciliation of the data.
- Bank feeds and rules that are reviewed for accuracy.
- A controlled process for employee spending and accounts payable, using a tool such as Ramp where appropriate.
- A payroll system such as Gusto or Rippling, with payroll reconciled to the accounts.

- Have your bookkeeper keep transaction entries current so the month-end close does not begin with a backlog.
- Organize your chart of accounts so you can distinguish revenue streams, delivery costs, overhead, and unusual expenses.
- Have your team build its own SOPs for daily, weekly, and monthly responsibilities. Have a third party provide or review them, rather than trying to figure out the bookkeeping yourself.

I recommend tracking:

- cash daily
- sales, AR, AP, and changes to cash weekly
- A 13-week cash forecast updated weekly
- A monthly financial-reporting package with month-end P&Ls, balance sheets, and cash-flow statements, plus KPIs and budget-to-actual reports.

Keeping this routine in place makes the eventual QofE easier and reduces the amount of cleanup you must do under a buyer's deadline.

Author note: This is one area that every business owner I talk to is patiently waiting for AI to replace. My recommendation is to focus on using the right platforms and maintaining best-in-class SOPs for the books. As AI evolves, you will have an elegant infrastructure for it to inherit. But today, more companies are making a mess of their books by finagling with AI than by putting clean, old-school automations and procedures in place.

Once you have rock-solid books and reports, you are ready to take the final step in building a story of value with your numbers.

Your internal financial reporting then needs to be converted into a sell-side quality-of-earnings analysis, which translates the books into an adjusted EBITDA presentation that buyers and sellers can evaluate.

Chapter 6: Quality of Earnings

What a QofE Does

A quality of earnings analysis takes the reported financials of a company and does the following:

- Provides independent transaction analysis of the reported financials; a QofE is not an audit or assurance opinion.
- Normalizes historical financials for supportable go-forward and pro forma adjustments.
- Documents the support and rationale for addbacks that affect adjusted EBITDA.

A sell-side QofE gives you a chance to discover problems and proactively demonstrate your attractiveness so that your buyer does not control the narrative.

Let's examine what typically gets packaged into a QofE report.

Revenue Quality

Buyers want to know how much revenue will persist during their ownership period, where that revenue is sourced from, and whether it has been recorded correctly. You want your revenue analysis to display:

Consistency: Show whether revenue continues across periods and which customers or contracts support it.

Unusual Revenue: Identify one-time projects, windfalls, or spikes that may not recur, then adjust to the core revenue run rate.

Churn and Retention: Flat revenue can hide lost customers being replaced by new sales. Show a revenue bridge, a reconciliation of the change between periods, separating new customers, expansion, contraction, and churn. If your churn is low, this is an excellent highlight to add to your marketing materials for the deal.

Seasonality: Show when sales occur and when cash is needed to deliver them. Seasonal demand can change the working capital a buyer needs to bring to finance their operating cycle. Being proactive about displaying this will help avoid downstream delays in diligence and negotiation.

Revenue Recognition: Document when revenue is earned, when invoices are issued, and when cash is collected. Buyers will test whether the accounting matches the work delivered.

System Reconciliation: Reconcile customer and sales reports from operating systems to the general ledger, the detailed record of accounting transactions. Resolve unexplained differences before diligence.

Unit Economics

Unit economics is a fancy term for translating how total revenue, cost, or profit is created at the transaction, product, customer, or departmental level in your business. Useful measures include:

- Revenue per customer
- Revenue per sale / average order value / average contract value
- Revenue per employee
- Revenue per order
- Revenue per unit delivered

Pair revenue measures with the related costs to show where the business makes its profit.

For example, suppose comparable HVAC operations generate $200,000 of revenue per technician while yours generates $130,000. A buyer would want to understand whether the difference comes from pricing, scheduling, job mix, or technician capacity.

Labor costs need the same scrutiny. If wages fall as a percentage of revenue, explain whether productivity improved or whether you are simply short-staffed.

Buyers will also investigate large changes in expense accounts. You should have the underlying detail ready: employee lists, compensation history, roles, and explanations for unusual periods.

SDE vs EBITDA

Your QofE should show proper documentation of owner compensation so that a buyer can understand both total EBITDA and SDE.

For smaller owner-operated businesses, document SDE and then reconcile it to EBITDA by including a supportable market cost to replace your work. Institutional buyers will usually focus on adjusted EBITDA, and each may use its own replacement-compensation methodology.

The biggest thing to remember as it relates to QofE and the presentation of SDE and EBITDA is to know which figure is ultimately getting plugged into the valuation model.

If you think the company is worth 5x SDE but your buyer is expecting 5x EBITDA, you may have a million-dollar discrepancy in valuation.

Quality of Earnings Adjustments

I group common QofE adjustments into six categories. Understanding these commonly accepted adjustment areas will help you supercharge your EBITDA without having to be aggressive or dishonest (which I see plenty of sellers try to do…).

1. Non-Recurring Items

Non-recurring items are revenues or expenses tied to events that are not expected to repeat. An accepted adjustment removes their effect from the ongoing earnings baseline. Buyers will challenge expenses described as “one-time” if similar costs recur each year.

Examples may include a one-time legal settlement, severance, a specific consulting project, or transaction fees. The circumstances determine whether an adjustment is supportable.

Non-recurring items are especially common leading up to a sale because you're doing a bunch of one-time projects to improve the valuation and preparation of the company.

This could include your broker's fees, legal costs to shore up your documentation, fractional CFO or QofE fees related to preparing the financials, and more.

2. Normalizations

Normalizations replace a historical expense with a realistic ongoing amount. If the owner's salary was unusually high or low for tax purposes, the analysis removes it and includes the cost of replacing the work at a normal market rate.

Examples include a market-rate replacement salary, related-party rent adjusted to market terms, and the ongoing cost of new software or insurance contracts.

These adjustments can reduce earnings as well as increase them.

Author note: *Getting crafty with this adjustment type can yield substantial sums.*

I had one savvy client who, once I explained to him how EBITDA adjustments worked, realized that he was paying a software vendor a hefty annual fee. He was already thinking about coding up his own solution to maintain the capability internally.

When he found out that every dollar of that profit improvement could be worth several dollars at closing, he wasted no time in building it out and cutting the vendor contract! We then had adequate documentation to include it in the QofE.

Warning: You can't just normalize anything you want. Normalization adjustments are strongest when the change has already been implemented or is contractually committed and supportable, such as a terminated vendor contract or a signed new lease.

You can't just decide that you think you could reduce your marketing budget or that you might not need one of your employees and adjust for it if you haven't taken sufficient action to prove it in your operation.

3. Non-Operating Items

Non-operating items reflect income and expenses running through the general ledger that do not originate from the core business operations being acquired. Common non-operating entries include interest income and expense, third-party rental income, investment returns, or secondary business activities commingled in the operational entity.

This will also include personal expenditures you may have incurred, including meals, entertainment, vehicle and travel costs, etc.

For some, this can include pretty exotic expenses that were used to minimize taxes (even if they could be challenged by the IRS).

I've seen private jets and personal home renovations included in company expenses.

Tax deductibility and treatment as an EBITDA adjustment are separate questions. A buyer may accept a well-documented adjustment for an owner-specific, non-operating cost, but the adjustment does not validate the tax deduction. It is usually obvious that a buyer will not need to pay for a home renovation in go-forward operations!

4. Extraordinary Items

Extraordinary items are outlier events driven by severe external forces outside standard operational cycles. These rare, high-impact events can distort revenue or earnings in either direction, such as severe weather anomalies that cause temporary demand spikes, or major catastrophic disruptions that interrupt business activity.

Author note: These are not very common *(because they're extraordinary!) but I have seen a handful in my day.*

One deal involved a once-in-a-decade weather event that caused massive spikes in revenue. We guided our buyer client to rely on the core historical average and to not bank on the massive upswing.

Another deal involved a major one-time event in the pre-sale period that drove a multi-year surge in the company's revenue.

The seller wisely engaged a sell-side QofE provider that actually did a great job normalizing this event and showing what the business would have looked like in a stable operation without it. We validated the calculation for our client and also proved that the post-event revenue run rate was returning to normal. They were able to smoothly present the QofE to banks and investors to underwrite the deal without relying on massive revenue swings.

5. Accounting Errors

Accounting errors include revenue recorded in the wrong period, misclassified expenses, or unreconciled balances. The diligence team assesses what could affect the transaction.

I once worked on a deal where the sale of a vehicle had been recorded twice. Not only did we have to remove the non-operating income for the sale, but we also removed the duplicate entry. The combined swing in EBITDA had not been accounted for by the seller's team and amounted to over 10% of EBITDA.

6. Cash-to-Accrual Conversions

Cash-basis books record receipts and payments when money moves. A cash-to-accrual conversion assigns revenue and expenses to the appropriate periods. It may raise or lower the reported earnings.

Cash-to-accrual conversions can have massive implications for companies with a long cash conversion cycle, where there are large disparities between earned profits and collected profits.

This effect is amplified when companies are in growth mode and cash lags earned revenue because accrued revenue is rapidly being added.

Fixing this has added 10–20% to total EBITDA in some of our sell-side engagements and created a clearer explanation of the company's EBITDA growth.

Presenting Adjusted EBITDA

The QofE report will include a written summary and a detailed workbook. The key schedule bridges reported EBITDA to adjusted EBITDA, with support for each change.

Expect at least two completed fiscal years, the most recent year-to-date period, and trailing twelve months (TTM). TTM means the latest twelve months of results, which may span two fiscal years.

It will also show monthly or quarterly trends as well as annual totals. If earnings improved, the buyer will want to know when the improvement began and whether it continued.

Keep the analysis current while the deal proceeds. Last year's financials alone will not explain this year's business.

Explain Performance Through KPIs

A good KPI package helps a buyer follow how the business earns money, which helps build conviction in your company. It should also be useful to you as a manager before you sell.

Use it to answer five questions:

- **What changed?** Show revenue, margins, cash conversion, and the operating measures that explain them.
- **What supports your strengths?** If you claim loyal customers or pricing power, show retention, contract values, and margins.

- **What went wrong, and what did you do?** Explain weak periods alongside the action taken and the subsequent results.
- **Do you understand the causes?** Trace changes in staffing, capacity, or customer behavior through to financial performance.
- **Where could the business improve?** Show the capacity, customer demand, and investment behind the opportunity.

I like the following KPIs to show a more compelling explanation of company performance:

- Revenue retention
- Labor hours or other key unit drivers
- Utilization (what amount of available resources were consumed)
- Gross margin and contribution margin
- EBITDA margin
- Cash-conversion days or NWC as a percentage of sales
- CAC, LTV, and other scale-economics indicators

Using Pro Forma Financials

A pro forma helps bridge historical results to expected future results.

It may recast historical results for an implemented change or project a future period.

Pro formas can be extremely powerful for improving accepted valuations, but they typically are received with lots of scrutiny because of the manipulation that brokers, bankers, and aggressive owners will utilize in assembling them.

Your best shot at building an acceptable pro forma is by packing the model with rigorous assumptions and documentation.

When Can a Pro Forma Be Used?

Three situations can justify presenting a pro forma, provided you show the costs, timing, and risks:

Expansion is already underway. If you have opened locations, launched a business unit, or invested in capacity, show the current results and the assumptions required to reach the proposed run rate. An investment already made does not mean the buyer will pay for mature earnings before they exist.

A change in the business model. A shift in services or a major new contract may make older results less representative. Show what has actually changed. A master service agreement sets commercial terms; it does not necessarily guarantee revenue without committed orders or volumes.

Implemented cost changes. If you have closed an unprofitable line or renegotiated a supplier agreement, show the effect separately. Include related revenue losses, implementation costs, and any expense needed to sustain the savings.

Where Pro Formas Lose Credibility

Pro formas lose credibility when the assumptions behind them start to feel less like explanations of reality and more like pipe dreams.

If the business has grown 3–5% annually for years, a sudden 25% forecasted growth rate will feel absurd (yet I see dealmakers attempt it all the time).

Unsupported forecasts can distract from an otherwise credible business.

Present the historical results first, then make the assumptions and their limitations easy to inspect.

Let's talk a bit about reasonable methodologies for driving pro formas.

How to Forecast Revenue Growth

Your revenue forecast should be based on detailed datasets that can be audited and accepted by a buyer.

You can build a revenue forecast from customers, sales volumes, pricing, retention, and expected changes to product mix. A topside “15% growth” assumption without any of these drivers is difficult to evaluate, and will usually be disregarded if not supported.

Break the forecast into:

- Expected new accounts or new sales volumes
- Existing-account expansion versus new accounts
- Calculating net new growth rates, churn rates, and retention rates

As you put these together, you can expect these to be compared to historical rates. So make sure you bridge your analytics to historical results (and that when you compare them, your new assumptions don’t look ridiculous).

How to Forecast Margins

It is extremely common for sell-side financial professionals to want to bake in some margin expansion to the forecast.

Many times this is unreasonable. But there are a few occasions where margin growth is logical and can be worked into your forecast.

When higher margins are supportable:

- **Fixing abnormally low capacity utilization:** If active personnel, software licenses, or facilities are currently underutilized, demonstrating how additional revenue absorbs fixed overhead without increasing operating expenses is highly defensible.

- **Demonstrating true operating leverage:** Clearly separate fixed vs. variable costs to prove how gross and net margins naturally expand as volume grows beyond your fixed expense baseline.

Assumptions buyers will challenge:

Ignoring incremental costs. Include the support, commissions, staffing, and other expenses required for additional sales. If capacity already exists, show it.

Unproven efficiency gains. Separate savings already achieved or contractually secured from improvements you merely hope to make.

Chapter 6 Recap

You now understand how your internal financials can be supercharged into an M&A-grade analysis that drives up valuation and increases the likelihood of having your numbers accepted.

- Your QofE will evaluate whether the accounting methodologies are sound and reasonably applied.
- The QofE will then go a layer deeper to show the underlying trends of the business that help buyers underwrite performance.
- The quality-of-earnings analysis will bridge reported EBITDA to a supportable adjusted EBITDA that buyers can evaluate.
- This then becomes the basis on which you or a buyer can build a pro forma. This is your opportunity to tell your growth story and capture incremental upside.

Once your EBITDA story is fully underwritten, the other main financial investigation will be around your balance sheet.

The main balance sheet area to understand will be your “net working capital”.

This tends to be a complete mystery area for most business owners, so learning this now will help avoid major deal risks down the road.

Chapter 7: Net Working Capital

What is Net Working Capital?

The textbook definition of net working capital is current assets minus current liabilities. In a sale, net working capital takes a transaction-specific form.

In a typical SMB deal, cash and funded debt are handled separately.

Therefore, net working capital often includes accounts receivable, inventory, and prepaid expenses, less accounts payable and accrued operating liabilities.

“Cash-free, debt-free” generally means the seller retains excess cash at closing, and is responsible for paying off the company’s debt, subject to the agreement.

A high working-capital balance can mean cash is tied up in slow receivables or excess inventory, although the required level depends on the company’s operating cycle. Customer prepayments can produce negative working capital, but the buyer still inherits the obligation to deliver the goods or services.

Before signing an LOI, have your advisor identify the accounts to include, the historical balances, and any unusual items. The definitions can matter as much as the target amount.

What is a Net Working Capital Peg?

The peg is the agreed target amount of working capital you must deliver at closing. The buyer’s price assumes the business arrives with that level of operating support.

A peg exists because operating assets and liabilities can fluctuate greatly from day to day or month to month, unlike fixed assets and goodwill. A reasonable target is established so the business arrives with a normal level of operating support and the seller cannot drain working capital before closing.

If you deliver more or less than the target, the agreed mechanism adjusts what you receive.

This can be a highly contested concept in many M&A deals.

I once worked on a deal where the seller's balance sheet included a substantial amount of inventory.

The seller felt strongly that keeping more than roughly 40% of it in the business would be ridiculous.

However, the buyer, my client, could not find a reasonable explanation for how it would run the business without the full inventory balance. It was not clear that any of the inventory was stale or obsolete.

This would mean that to run the business properly, the buyer would have to find a significant amount of extra cash to maintain the operation while rebuilding the inventory.

It was a non-starter for both sides. This was *after* the seller engaged a reputable M&A firm and had a sell-side QofE done.

To my knowledge, the company has still not sold.

How the Peg Mechanism Works

A trailing-twelve-month average is a common starting point for negotiating the peg. Growth, seasonality, unusual balances, and accounting policies may justify another basis.

Suppose the parties agree to a $500,000 peg:

- Deliver $600,000 at closing, and a dollar-for-dollar adjustment adds $100,000 to your proceeds.
- Deliver $400,000, and the same mechanism reduces your proceeds by $100,000.

The agreed target is already part of the deal economics. Only the difference between the target and the amount delivered creates the adjustment.

Managing the Seasonality Trap

A full-year average may not represent a seasonal business's needs at the closing date.

If you're selling your company leading into a seasonal period with a massive working-capital buildup, you may be expected to peg to a seasonal average instead.

For example, assume you're an e-commerce company that has to ramp your inventory 150% in October leading up to Black Friday and the holiday season and you're closing your deal October 31st (spooky!)

Rather than the peg being set on a 12-month average, the buyer would expect to receive the average of the last several years' October working-capital balances.

This would set the peg significantly higher, meaning that you don't get compensated for the temporary spike in working capital.

Author note: Fixing your working-capital profile well ahead of your deal date will do wonders for several reasons. It can make the peg less contentious; free up cash for reinvestment or distributions; and make future growth easier by reducing the working-capital drag. Triple whammy.

Working Capital in Smaller Deals

In smaller asset sales, the seller may retain receivables and cash while inventory is purchased separately. The buyer then funds the business's initial cash needs.

In my experience, formal pegs become more common as deals move above roughly $1.5–$2 million, but there is no universal threshold. Confirm what transfers in your transaction.

As the seller, make sure the buyer understands the cash required after closing. A price that leaves the buyer unable to fund operations is unlikely to be a workable offer.

Chapter 8: Tax Structuring for Exit

Tax structuring is commonly overlooked by businesses for two reasons.

1. You are not a tax expert
2. You assume that your current tax advisor has it covered

Unfortunately, most CPAs are tax-compliance experts but have very minimal experience in M&A and structuring.

Forgoing proper tax structuring before an exit can literally cost you millions.

In our practice, it is not uncommon for us to save entrepreneurs hundreds of thousands of dollars from one well-executed tax-structuring engagement (which usually costs no more than $15,000–$20,000, typically well under 5% of the savings).

Let's look at the main levers that influence your tax structuring plan.

Understanding Transaction Structure: Asset vs. Stock Deals

The first question is what form of transaction will be conducted. Whether you're selling the entire company or not, your company may be sold either as an "asset" deal or a "stock" deal for tax and legal purposes. The tax impact can be enormous.

- **Asset Deals: In an asset deal, the buyer acquires specified assets and assumes specified liabilities from the company. This structure can limit the liabilities assumed, although successor-liability rules and negotiated terms may still transfer certain exposures. The buyer generally receives a new tax basis in the acquired assets and may recover that basis through depreciation or amortization, subject to the asset class and applicable law.**
- **Stock Deals: The buyer acquires ownership of the legal entity, which retains its contracts, history, assets, and liabilities. This can simplify operational continuity, but absent a qualifying election or other structure, the buyer generally does not receive a step-up in the**

inside tax basis of the company's assets. Stock sales are often more attractive to sellers, although the actual result depends on entity type, allocation, and deal terms.

Because of this stock-versus-asset tension, the tax code provides statutory elections, including Sections 338(h)(10) and 336(e) when their requirements are met, that can treat a qualifying stock transaction as a deemed asset sale for federal income-tax purposes.

These elections can preserve the legal form of a stock sale while creating asset-sale tax treatment, but they can materially change the seller's tax cost and must be negotiated.

Your Entity's Tax Treatment

The current tax treatment of your company will have a massive impact on your effective tax rate.

Remember: An LLC is a legal form and can have different tax classifications. The tax result depends on that classification, not simply the letters after the company's name.

- **Pass-Through Structures: S corporations, partnerships, and many LLCs generally avoid the classic C-corporation double-tax regime. However, the character and timing of gain in an asset transaction still depend on the entity's tax classification, what is being sold, and how the purchase price is allocated.**
- **C Corporations**: A C corporation can create a significant double-tax problem in an asset sale because the corporation may recognize gain on the asset disposition and shareholders may then recognize a second layer of tax when proceeds are distributed. Stock-sale treatment, potential Section 1202 eligibility where applicable, and other structuring alternatives should be evaluated well before a transaction is signed.

Do not underestimate the potential value of the Section 1202 qualified-small-business-stock exclusion, commonly called QSBS.

Section 1202 is a statutory gain-exclusion regime, not an election made at sale. Eligible noncorporate shareholders may exclude some or all gain on qualifying stock, subject to issuance-date, holding-period, issuer, business, gross-asset, and shareholder-level requirements.

This is a complex regime with multiple eligibility requirements. Many of the relevant facts are established when the stock is issued and throughout the holding period, so planning must begin early and current law should be checked before relying on the exclusion.

Separate What Is Being Sold

In many mature lower-middle-market businesses, the operating structure has accumulated complexity: real estate may sit in a separate LLC, intellectual property may be held elsewhere, or personal and non-operating assets may be commingled with the business being sold.

Resolve these boundaries before diligence. Identify which entities and assets are being sold, what remains with you, and where the proceeds will go. Separating real estate, intellectual property, or non-operating assets can require tax and legal work well before a sale.

Keep employment pay, consulting fees, and retention payments separate from purchase consideration. They may have different tax treatment. Your net-proceeds model should also show any equity you retain or reinvest.

Cash and Deferred Payments

Beyond the legal form of the transaction, the composition and timing of the purchase consideration also affect the seller's tax profile. A 100% cash-at-closing transaction creates immediate liquidity, but it also generally accelerates tax recognition into the year of sale.

To bridge valuation gaps or reduce buyer risk, lower-middle-market deals frequently include structured payments such as installment notes or earnouts:

- **Installment Sales**: Spreading eligible payments across multiple tax years through an installment obligation may defer recognition of a portion of the gain. The tradeoff is credit risk because the seller remains exposed to the buyer's ability to make future payments.
- **Earnouts**: Tying part of the purchase price to future performance creates additional tax and drafting complexity. The tax treatment depends on how the contingent consideration is structured, and it should be modeled before the definitive agreements are finalized.

Purchase Price Allocation

In an asset sale, purchase price allocation is one of the most important tax negotiations between buyer and seller. The parties must agree on how the purchase price is allocated among the acquired asset classes, such as receivables, inventory, equipment, identifiable intangibles, noncompete covenants, and goodwill.

- **The Seller's Goal**: Generally, the seller prefers more value allocated to assets that produce capital-gain treatment, such as goodwill, and less value allocated to items taxed as ordinary income.
- **The Buyer's Goal**: The buyer generally prefers allocations that create faster depreciation or amortization deductions after closing.

Agree on a supportable allocation alongside the price and structure, while both parties can still evaluate the tax consequences.

Personal, State, and Estate Planning

The sale also affects your personal finances. Coordinate transaction planning with the advisors responsible for your broader tax and estate position.

- **Individual and State Tax Planning:** Residency, state sourcing, the timing of the sale, and the timing of other income can materially change your effective tax rate. These decisions require advanced modeling.
- **Estate and Succession Planning:** Transfers of equity, trusts, gifting strategies, and other estate-planning techniques are highly timing-sensitive. Once a sale is effectively locked in, the available planning options can narrow substantially.

Chapter 8 Recap

Your tax structure will have a massive impact on your effective tax rate.

Use a disciplined process to optimize your tax setup, and begin far enough ahead of the deal to preserve the widest range of options.

1. Understand the deal structure itself
2. Understand your current entity structure and what may require changes
3. Understand the flow of funds (cash, seller notes, earnouts, etc.) and how they will affect their tax treatment
4. Understand the personal tax ramifications both at closing and for your family's tax situation in the years to come.

After taxes are considered, there are a handful of other deal variables that will impact the "net proceeds" you receive from an M&A transaction.

Chapter 9: Net Proceeds Analysis

While taxes have a large impact on the net amount you receive from an exit, there are multiple variables that impact the net proceeds of your deal in total.

Founders should model net proceeds before going to market.

The biggest reason I advocate for this is not simply for tax planning.

There is a phenomenon I call “proceeds sticker shock.” Psychologically, it’s quite easy to assume that a $10 million sale will put $10 million in your bank account.

Most founders are shocked to discover, deep into the process, that they may receive far less than the headline amount on closing day.

Let’s walk through all the factors that impact net proceeds.

How Cash-Free, Debt-Free Impacts Net Proceeds

Many lower-middle-market transactions are quoted on a cash-free, debt-free basis. In practical terms, the headline enterprise value assumes a normal level of working capital but excludes excess cash and funded debt. The bridge from enterprise value to the seller’s equity proceeds is negotiated separately. Put simply:

- **Your Cash Is Yours**: Cash is generally retained by the seller rather than transferred as part of enterprise value, subject to the agreed working-capital mechanics and the structure of the transaction.
- **Deferred Revenue and Customer Deposits: Businesses that collect cash before delivering goods or services may carry deferred revenue, customer deposits, or similar liabilities. Depending on the purchase agreement, those balances may be treated as working capital or as debt-like items. Buyers may require enough cash or other working capital to fund the inherited delivery obligations.**

- **Your Debt Is Yours**: Funded debt that is excluded from the agreed enterprise value normally must be paid off at closing. This will reduce your net proceeds.
- **Debt-Like and "Shadow Debt" Items**: Unpaid taxes, accrued bonuses, transaction expenses, unpaid PTO, disputed liabilities, and other debt-like items can reduce the seller's proceeds even if they are not labeled as traditional bank debt.

Tax Modeling

This is the time to plug your updated tax structure's logic into your net proceeds model.

Include the entity's tax treatment, asset or stock structure, purchase price allocation, and federal, state, and local taxes.

Keep historical tax exposures separate. Unresolved sales, payroll, or income taxes may require repayment, an escrow, or an indemnity.

Transaction Costs

Selling a company is a big effort and quite expensive. A realistic proceeds model should include both success-based fees paid at closing and professional fees incurred during the process.

- **Broker or Investment Banker Fees**: Success fees should be modeled using the actual engagement letter rather than a generic percentage assumption.
- **Legal, Accounting, and Advisory Fees**: M&A counsel, transaction accountants, sell-side diligence providers, tax advisors, and wealth advisors can create significant transaction costs, especially in complex or prolonged deals.

- **Insurance and Other Closing Costs**: Tail policies, escrow fees, filing fees, and other transaction-specific expenses may also reduce cash available at closing.

Transaction costs can reach the high single digits as a percentage of enterprise value, especially in smaller or more complex deals, but there is no universal benchmark. Model the actual engagement letters and current fee estimates. Plan accordingly.

Earnouts, Seller Notes, Escrows, and Other Deferred Proceeds

A headline purchase price may include consideration that is not paid in cash on closing day. Net proceeds should distinguish guaranteed cash at close from amounts that remain subject to time, credit, performance, or indemnification risk.

- **Cash at Closing**: This is the portion of the consideration that is actually funded and distributable at closing after the flow-of-funds deductions.
- **Seller Notes**: A seller note converts part of the purchase price into a receivable from the buyer. It may defer cash collection and, depending on the structure, some tax recognition, but it introduces repayment and subordination risk.
- **Earnouts**: Contingent consideration is only valuable to the extent the performance conditions are achievable and the buyer is contractually constrained from undermining them. It should not be treated as equivalent to cash at close.
- **Escrows and Holdbacks**: Amounts held back for indemnification, working-capital disputes, or other post-closing adjustments are part of the purchase price but are not immediately available to the seller.

Build the Net Proceeds Waterfall

With these items, you can build a schedule that moves from enterprise value to equity value, then to cash received and cash available after tax.

Here is an illustrative $10 million transaction. The amounts are assumptions used to explain the mechanics, not market fee or tax benchmarks.

- Enterprise value: $10,000,000.
- Less funded debt of $1,500,000 and debt-like items of $200,000: $8,300,000.
- Less a $100,000 working-capital shortfall: $8,200,000.
- Add $200,000 of excess seller cash: $8,400,000.
- Less $800,000 of transaction fees: $7,600,000.
- Less $1,000,000 of rollover equity, a $500,000 seller note, and a $300,000 escrow: $5,800,000.
- Reserve $1,740,000 (30%) for modeled taxes: $4,060,000.

Remember: The rollover equity, seller note, and escrow have not vanished, but they are not spendable cash at closing. Track them separately, along with any earnout. Taxes may be paid after closing, which is why the reserve is shown after cash received.

Part II Recap

In Part I, we looked at what makes your company attractive to a buyer. In Part II, we worked through how to support that value with financial evidence and determine what an exit would actually put in your pocket.

Six lessons are worth carrying forward:

- **Your valuation needs a defensible foundation.** Understand whether buyers are valuing your assets or your earnings, which earnings figure they are using, and how size, durability, transferability, and growth influence the multiple. A valuation you can explain is a much stronger starting point than a number you simply hope to receive.
- **Clean reporting makes your business easier to understand.** Monthly accrual financials, reconciled accounts, and operating KPIs give buyers a way to examine the company without having spent years inside it. Build that reporting rhythm before a transaction forces you to reconstruct the history under pressure.
- **A QofE turns reported results into an earnings case you can defend.** Supportable adjustments, revenue analysis, and explanations of unusual periods help establish what the business can reasonably earn under new ownership. The purpose is not to produce the largest EBITDA number possible. It is to produce a number that holds up when someone starts asking difficult questions.
- **Working capital is part of the deal economics.** Your buyer needs enough operating resources to run the company after closing. Understand which balances transfer, how the peg is established, and how growth or seasonality could affect the adjustment to your proceeds.
- **Tax planning belongs before the terms are settled.** Your entity's tax treatment, the transaction structure, purchase price allocation, and timing of payments can materially change what you keep. Bring the right expertise into the conversation while there is still room to change the outcome.
- **The headline price is only the beginning of the calculation.** Model debt repayments, fees, working-capital adjustments, taxes, and deferred consideration before going to market. Separate cash you can use from money that remains invested, withheld, or

dependent on future events. Proceeds sticker shock is much easier to handle in a planning meeting than halfway through a sale.

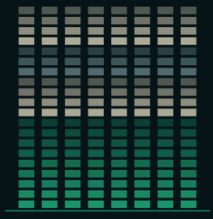
Together, these analyses give you a financial position you can explain, support, and negotiate from. They also help you decide whether an offer is worth pursuing in the first place.

Part III moves into the transaction itself: when and why an exit begins, who belongs on your deal team, how to approach buyers, and what happens through diligence, negotiations, closing, and transition. You'll see how to put this preparation to work while continuing to run the company whose value you're trying to protect.

PART 3

Timeline & Process

The mechanics of what happens once you are in a transaction process.



Chapter 10: Triggering Events

Most founders imagine an exit as something they decide to do one day far in the future. You think you'll pick a date, hire an advisor, and begin a carefully planned process executed to perfection.

That happens… sometimes.

But plenty of exits start because life makes the decision for you first.

It may be that your partner suddenly wants out.

It could be that a health issue changes your life priorities.

Your company may be in financial distress and a sale is the only alternative besides bankruptcy.

A divorce may create a liquidity problem during a settlement.

This is why I advised you earlier on being "default-ready".

A founder with a preplanned timeline has all the time in the world to fix reporting, reduce customer concentration, clean up the balance sheet, build management depth, and create buyer competition.

But many times, founders end up with a surprise ninety-day timeline and have to sell the business that exists in its current condition today.

The Five Ds

In the M&A world, the classic unplanned exit triggers are often summarized as the five Ds: death, disability, divorce, distress, and disagreement.

- Death can turn an owner-dependent business into an immediate succession problem.
- Disability can expose how many decisions, relationships, passwords, approvals, and responsibilities live only with the founder.

- Divorce can create a valuation and liquidity event whether the company is ready for one or not.
- Distress can force a company into the market when buyers know the seller has limited alternatives.
- Disagreement between partners can freeze decision-making precisely when the business needs clarity.

Being ready gives you more options when the timing is no longer entirely your choice.

Remember, as we discuss this, the goal is not to be grim or to expect that you are going to go through turmoil.

The goal is to remember that life is full of unexpected twists and turns. The best thing you can do as an entrepreneur is control what you can and put yourself in the strongest position to execute at any given moment.

Chapter 11: Preparation

Now that you understand the “triggering events” that tend to cause sales, you can begin to prepare yourself to be in a default-ready mode.

We’ll discuss building your deal team, staging your data, and anticipating deal terms so you are ready at any moment.

Build the Deal Team

Building a deal team is a sticky area in SMB. It is extremely common for a small business owner to already have advisors that they know, like, and trust. But unfortunately, much of the time they are not transaction specialists.

Working with generalists in highly complex, high-stakes transactions is a bad idea.

I strongly recommend that clients evaluate transaction specialists alongside their regular advisors if they plan to keep the general team involved.

Author note: *Call me biased, but there is one particular deal advisor that in my experience (and in many others) tends to blow up more deals than any other advisor. I don’t want to point fingers, but here I am. It’s those damn generalist attorneys. I don’t know what’s in the water at these law schools, but I’ve never seen any other professional advisor so commonly hijack transactions with seemingly no other intent but to prove that they are right about their opinion. I’ve seen several inexperienced lawyers argue on deal terms that had virtually no economic substance and almost killed the deal entirely. Beware!*

Keep in mind, no single advisor will manage your entire transaction for you. The most common mistake I see is assuming the investment banker, broker, lawyer, or CPA is "handling the deal." They are handling their piece of the deal.

Someone still has to own the gaps between them.

- The intermediary or investment banker owns positioning, buyer outreach, process management, and competitive tension.

- M&A counsel owns the LOI, purchase agreement, legal diligence, and the allocation of legal risk.
- The tax advisor owns transaction tax modeling, entity considerations, purchase price allocation, and after-tax consequences.
- The QofE or transaction accounting advisor owns the defensibility of earnings, net working capital, and financial diligence support.
- Your CFO, controller, or internal deal lead owns the flow of information and protects you from becoming the human routing system for every buyer request.
- Your wealth advisor helps translate the transaction into the personal financial plan that comes after it.

Assign an owner to each major responsibility.

Depending on who you're working with, you may have one advisor who has enough experience and strategic knowledge to act as your deal "quarterback" to allow you to run the business while they execute the majority of deal responsibilities on your behalf.

Author note: *Maybe an M&A-focused specialist CPA firm with an in-house team of CPAs, a tax attorney, QofE specialists, and fractional CFOs could quarterback it for you… just a thought!*

Run Sell-Side Diligence on Yourself

We discussed the details of a sell-side QofE earlier. As you start to plan your deal timeline, you can now engage a QofE provider to make your financial packages deal-ready.

Stage the Data Room

Use the data room to organize the documents supporting your financial and operating claims.

At a minimum, prepare the core corporate records, historical financial statements, detailed general ledger support, tax filings, ownership information, material contracts, customer information, employee and compensation data, intellectual property records, operating metrics, and the schedules that support your growth and earnings claims.

Keep the information consistent with the confidential information memorandum (CIM), the detailed document used to present the business to qualified buyers. Conflicting versions force buyers to repeat work and question which numbers are reliable.

Stage the room before outreach, then control access. Do not give every prospect every document on day one. Confidentiality agreements, buyer qualification, staged disclosure, and careful treatment of employee and customer information matter.

Deal Term Planning

Before you receive an offer, build the net proceeds model we discussed in Part II.

Do not tell yourself you want "$10 million." Decide what economic result would actually make the transaction worthwhile after debt, taxes, fees, rollover equity, escrows, seller notes, and earnouts.

This matters because the highest headline price is not always the highest-value offer. A slightly lower price with more cash at closing, cleaner tax treatment, less contingent consideration, and a shorter transition can be the better deal.

Chapter 12: Go to Market

Going to market is not simply the act of putting your business on BizBuySell. It is the process of creating enough qualified interest that you can compare alternatives instead of negotiating from dependence on one buyer.

Pre-Market Outreach

Some processes begin with a small number of carefully selected buyers. A blind teaser or limited outreach can test valuation, positioning, and buyer fit without immediately exposing the company to the full market.

This can work well when confidentiality matters, the logical buyer universe is narrow, or one or two strategic acquirers clearly stand out. It can also fail if the early group is too small to create real competition.

Choose the scope of outreach based on the likely buyers, the need for competition, and the disruption to the business.

Broader Market Outreach

A broader process gives you more data. You learn how different buyer types value the company, which risks they focus on, how they intend to finance the deal, and what they expect from you after closing.

This is why buyer quality matters almost as much as buyer quantity. Ten buyers who cannot finance the transaction, misunderstand the industry, or need a structure you will never accept are not ten real options.

Qualify early. Ask about capital. Ask about financing. Ask about prior deals. Ask about the expected structure. Ask who makes the final investment decision.

IOIs and LOIs

An Indication of Interest is usually an early, non-binding expression of price and general terms. It is useful for narrowing the field.

The LOI may still describe itself as largely non-binding, but once you grant exclusivity to a single buyer, the buyer gains something very valuable: *time without competition*.

Resolve as much of the economics as possible before signing an LOI.

- What EBITDA number is the buyer actually applying the multiple to?
- Is the transaction an asset deal, stock deal, or something economically similar?
- How much is cash at closing?
- How much is rollover equity, a seller note, escrow, or earnout?
- What financing has the buyer actually secured, and what does it expect to use?
- What are the working-capital principles?
- What transition period is expected from you?
- How long is exclusivity and what conditions allow the buyer to extend it?

Do not negotiate the headline and postpone everything else. Those "everything else" items are where a lot of purchase price disappears.

Chapter 13: Due Diligence

During diligence, the buyer and its advisors test the information used to make the offer.

Your job is to coordinate that work while keeping the business on track.

What the Calendar Usually Looks Like

A well-run diligence process is typically organized around a 30- to 60-day window, although plenty of deals take longer. The exact timing depends on deal size, financing, buyer sophistication, regulatory issues, and how prepared the seller is when exclusivity begins.

The first week is usually the heaviest setup period. The buyer and its advisors issue detailed request lists, open the main diligence workstreams, and begin reviewing the data room.

Weeks two and three usually generate the first major wave of follow-up questions. The buyer's advisors have now reviewed enough information to identify inconsistencies, missing support, and areas that require management explanation.

Management calls, financial diligence meetings, tax calls, legal discussions, HR reviews, and commercial interviews often happen during this middle period.

By the later weeks, the process should move from broad information gathering toward resolving open issues. This is when the buyer begins translating findings into purchase agreement language, working-capital definitions, debt-like items, escrows, indemnities, and any proposed changes to price or structure.

Track whether requests are moving toward resolution. New questions are normal, but recurring questions without clear owners signal a process problem.

Treat the Request List Like a Project Plan

Manage the buyer’s requests through a central list, rather than scattered emails.

Use one central tracker. Every request should have a number, an owner, a status, a date received, a target response date, and a link to the document or response that satisfies it.

I would typically use simple statuses such as:

- Open
- In Progress
- Submitted
- Follow-Up Required
- Closed

Assign the requests by workstream. Financial requests should flow to the CFO, controller, or transaction accounting team. Legal requests should flow through counsel. Tax requests should go to the tax advisor. HR requests should have a designated internal owner. The founder should not be the default owner of every row.

Have one person control the master tracker. Otherwise, three advisors will answer the same question three different ways and nobody will know which response the buyer is relying on.

Review the open list at least several times per week during active diligence. The objective is not merely to respond quickly. It is to prevent old requests from quietly becoming buyer frustration or perceived evasiveness.

Manage the Data Room Like a Controlled Record

The data room should mirror the request list. If Request 3.7 asks for the monthly revenue detail by customer, the buyer should be able to find the response without searching through twenty similarly named spreadsheets.

Use clear folder structure and consistent file names. Avoid duplicate versions unless the earlier version genuinely needs to remain available.

When a schedule changes, make it obvious which version is current. Do not leave the buyer deciding whether 'Revenue Detail Final,' 'Revenue Detail Final 2,' or 'Revenue Detail UPDATED' is the correct file.

Maintain a record of what was shared. This becomes particularly important for sensitive information, late-stage disputes, and questions about what the buyer knew before signing.

For highly sensitive information such as customer names, employee compensation, pricing details, or proprietary contracts, use staged access when appropriate. Not every bidder or advisor needs every piece of information at the same time.

Expect Follow-Up Questions, Not One-Time Requests

Founders often assume diligence works like a checklist: upload the document, check the box, move on.

That is not how serious diligence works.

The first response usually creates the next question.

You provide customer revenue by month. The buyer sees a decline in one account and asks why. You explain that a project ended. They ask for the underlying contract. The contract reveals a renewal clause. They ask whether the customer renewed. Now management has to explain the commercial history.

That sequence is normal.

Answer consistently and provide support so each exchange moves the issue toward resolution.

This is why internal coordination matters. Before answering a sensitive question, make sure finance, legal, and management are telling the same story.

Management Interviews

At some point, the buyer will want to hear directly from the people who actually run and explain the business. In most lower-middle-market transactions, that usually means the founder or CEO and the CFO, controller, or senior finance lead.

These calls are not a company-wide interview process. In fact, you generally want to keep the number of employees pulled into diligence as small as possible unless there is a specific reason to involve someone else.

The buyer is typically testing two things at once: whether leadership understands the business at the same level the deal materials suggest, and whether the financial story holds up when they ask questions live.

Expect the founder or CEO to handle questions around customers, competition, pricing, strategy, growth, operating capacity, leadership, and the future of the business. Expect the CFO or finance lead to handle the numbers: revenue trends, margins, addbacks, working capital, cash conversion, customer concentration, forecasts, and unusual periods.

Before the call, make sure the founder or CEO and finance lead agree on the facts and understand the schedules already shared.

If there is a known weak month, unusual customer loss, margin dip, accounting adjustment, or major change in the business, decide in advance how it will be explained. The explanation should be accurate, concise, and consistent with the data already provided.

Bring other executives or functional leaders into specific discussions only when their expertise is needed. Keep the transaction team small enough to protect confidentiality and avoid unnecessary distraction.

Be prepared to explain the business and the numbers without contradicting the materials already provided.

Run a Formal Q&A Cadence

Once the question volume increases, ad hoc responses become dangerous.

Set a recurring internal diligence meeting. During an active process, that may be daily or every other day for the core transaction team.

Review the new requests, overdue requests, items waiting on management, sensitive responses that need advisor review, and any issue that could affect valuation or closing.

Then maintain a separate cadence with the buyer. Consolidated Q&A calls are often more efficient than allowing twenty isolated email threads to develop across advisors.

Where possible, close questions live on the call. If support is still required, assign the follow-up immediately and log it in the tracker.

Do Not Let Diligence Kill Current Performance

The transaction is not the only thing happening during diligence. You still own the company until the closing documents are signed and the money moves.

The buyer is watching current performance the entire time.

Missing the quarter because management spent six weeks answering diligence requests can create a new diligence issue. A slowdown in sales, margin compression, employee departures, or a lost customer can all give the buyer a reason to revisit its underwriting.

Protect the operating team from unnecessary transaction noise. Route questions through designated owners. Limit the number of employees pulled into the process. Keep someone accountable for the normal monthly operating cadence.

Roll the Numbers Forward

A longer transaction needs updated financials.

The QofE may have been built through June. By September, the buyer is no longer underwriting a June business.

Each new month changes the trailing results and may change customer concentration, working capital, debt, cash, and the backlog.

You need a formal roll-forward process.

At each month-end during an extended process, update the core transaction schedules:

- Monthly P&L and balance sheet
- Trailing-twelve-month revenue and EBITDA
- Adjusted EBITDA bridge and any significant new adjustments
- Customer concentration and major revenue movements
- Net working capital and the likely closing peg exposure
- Debt and debt-like items
- Cash balance
- Major pipeline, backlog, or bookings metrics that support the growth story

Do not wait for the buyer to ask why the numbers are stale.

If performance improves, the roll-forward can strengthen your position. If it deteriorates, you want to understand the problem before the buyer discovers it and defines the narrative for you.

When the Deal Drags

Longer deal cycles create a second problem: documents and representations go stale.

A contract that had nine months remaining at LOI may have four months remaining by closing. A key employee may leave. A customer may renew. A lawsuit may emerge. A tax notice may arrive. Financing assumptions may change.

Build a habit of asking: what has changed since the information was originally provided?

Update the buyer proactively on material developments with your advisors. Surprises discovered late are almost always worse than developments disclosed and managed as they occur.

You should also watch exclusivity carefully. If the buyer is moving slowly while you remain prohibited from speaking with alternatives, the economic cost of delay belongs disproportionately to you.

Escalate Issues Before They Become Retrades

Not every diligence question is equal.

Some are administrative. Some are analytical. A few can change the deal.

Create an escalation rule for anything that could affect EBITDA, working capital, debt-like items, tax exposure, customer retention, legal liability, financing, or the buyer's willingness to close.

Those items should move immediately to the founder and the relevant transaction advisors.

The earlier you identify an issue with economic consequences, the more options you have to explain it, document it, solve it, or negotiate around it.

The Objective of Diligence

Resolve material questions and document the remaining issues before closing. The buyer should understand what it is acquiring, and both parties should understand how unresolved risks are allocated.

Use the QofE, working-capital analysis, tax model, and net-proceeds schedule from Part II to evaluate findings as they arise.

Chapter 14: Negotiations & Closing

Many founders assume the negotiation ends when the LOI is signed.

The LOI usually sets the broad economics, but diligence will usually uncover a broad set of topics that buyers will attempt to use to negotiate detailed updates to their offer.

As a default-ready and properly prepared founder, you will avoid most major diligence bombs. But being prepared to handle negotiations will suit you well.

Translate Findings Into Deal Terms

If a buyer insists that something in their diligence findings carries enough risk for a re-trade, you do not have to let them cut away at purchase price right away.

Remember, a deal has multiple levers. And that means you can plan to negotiate other levers besides price if you prefer.

Use the following to your advantage:

- Size and contingencies of seller notes
- Terms and conditions of earnouts
- Indemnity caps, baskets, escrows, and other protections for legal issues
- Tax treatment of the deal
- Net working capital adjustments
- Amount of post-close transition services / consulting

You're doing a deal. So be a dealmaker! Be willing to be assertive and logical with adjustments to your deal terms. Just because you may be selling your business to a professional, repeat buyer doesn't mean you have to let them call all the shots.

The Purchase Agreement

The purchase agreement will be a large, complex document managed by your attorneys, but it also contains all the critical deal terms that dictate how and when you get paid, as well as legal contingencies that may affect your net proceeds.

I am by no means a legal expert, but here are the main legal terms you should expect to be in your agreement:

- Reps and warranties
- Caps and indemnities
- Conditions to close
- Restrictive covenants (i.e., noncompetes)

Make sure your attorney walks you through the key economic terms you are agreeing to in plain language. Don't let the attorneys blindly handle it.

The Closing Flow of Funds

The closing statement is where the $10 million headline finally turns into actual wires.

Reconcile the closing statement to your latest net-proceeds model. Check the working-capital estimate, debt payoffs, transaction expenses, cash treatment, escrows, and deferred consideration against the signed agreements. Confirm wire amounts and keep the expected tax payments or reserves visible.

This is why I want founders modeling net proceeds before going to market. Closing day is too late to discover that the number you mentally retired on was never going to reach your bank account.

Chapter 15: Transition

Once the deal has been finalized, your transition from your current role in the company will commence.

Depending on the nature of your business and your deal terms, you may walk away immediately; enter a transition period; or stay on for business as usual.

Making sure you are clear with the buyer on expectations is critical to ensure that operations run smoothly after closing.

Assign the Handover Tasks

In a stock sale, the legal entity may remain intact, but contracts, bank authority, insurance, systems access, customer communications, and change-of-control consents may still require work.

In an asset sale, the operational transfer can be much more extensive. Contracts may need assignment. Licenses may need to be reissued. Payroll may move. Bank accounts change. Software subscriptions, vendor accounts, and customer billing can all need new ownership information.

Build a transition checklist with an owner and a deadline for every item. Do not assume the signature on the purchase agreement magically moves the business.

Use the Systems You Built

Use the transition period to help the buyer operate the systems already in place.

The sales process, pricing model, customer onboarding workflow, close checklist, KPI package, operating calendar, SOPs, and management routines should continue working after the ownership change.

If the buyer needs you to recreate routine processes from memory, the handover will take longer and leave you more involved than expected.

Working Capital True-Up

The final working-capital balance is often not known with certainty on closing day because the books still have to be closed.

The parties therefore settle initially using an estimate and then complete a post-close true-up once the closing balance sheet is finalized. The purchase agreement should define the accounts, accounting methods, dispute process, and timing.

A sloppy definition can create a six-figure argument after everyone thought the deal was over.

Your Proceeds May Still Be at Risk

If you accepted an earnout, seller note, escrow, holdback, or other contingent consideration, closing is not the end of the economics.

Know what has to happen for you to receive each remaining dollar. Know who controls the inputs. Know what reporting you are entitled to receive. Know the dispute process. Know what happens if the buyer breaches a covenant, misses a payment, or changes the operating model.

Deferred proceeds should be treated as an asset with risk, not as cash that merely happens to arrive later.

The Founder Exit

Plan your own transition as carefully as the company's.

For years, the company may have been your schedule, identity, social circle, financial engine, and scoreboard. Then the wire hits and someone else owns it.

Decide what your post-close role actually is. If you are staying, define the authority, expectations, compensation, and end date.

If you are leaving, make sure the break from the company is clean and you have clear guidelines for how the buyer should handle anything for which it believes it needs your unique knowledge or judgment.

A successful exit should not leave you as the permanent unpaid consultant to the asset you just sold.

Final Recap

You have now worked through the market, financial preparation, and sale process. Keep these points in view:

- Profitability alone does not make a business easy to sell.
- Buyers need evidence for the earnings, growth, and operating strengths you claim.
- A supportable valuation starts with the right earnings measure and a relevant buyer market.
- Model what you keep after debt, taxes, fees, working capital, and deferred payments.
- Prepare before a buyer's deadline limits your options.
- Manage diligence while continuing to run the company.
- Keep tracking the economics through closing and any post-close payments.

You do not need to be planning an immediate sale to use this guide. Start with the records or decisions that are least clear today, and assign the work needed to resolve them.

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Appendix A: M&A Glossary

Use this section as a quick-reference guide for the terms you are most likely to encounter during a lower-middle-market sale process.

Adjusted EBITDA

EBITDA after normalizing the historical financials for items that do not reflect the ongoing earnings of the business. Typical adjustments can include non-recurring expenses, owner-specific costs, accounting corrections, and other defensible normalizations.

Addback

An expense included in historical results that a seller argues should be added back when calculating normalized earnings because it is non-recurring, non-operating, owner-specific, or otherwise not expected to continue under new ownership.

Cash-Free, Debt-Free

A common transaction convention in which the seller generally retains excess cash and delivers the company without funded debt, while still providing the normal level of operating working capital required to run the business.

Confidential Information Memorandum (CIM)

The detailed marketing document provided to qualified prospective buyers, usually under a confidentiality agreement. It describes the company, operations, financial performance, and proposed investment opportunity.

Data Room

The controlled digital repository used to provide buyers and their advisors with financial, tax, legal, HR, commercial, and operating information during the sale process and due diligence.

Debt-Like Item

An obligation that may not appear as traditional bank debt but is treated economically like debt when calculating the seller's equity proceeds. The exact definition is negotiated and can include certain accrued, deferred, or transaction-related obligations.

EBITDA

Earnings before interest, taxes, depreciation, and amortization. In many lower-middle-market transactions, adjusted EBITDA is the primary earnings metric used to establish valuation.

Enterprise Value

The value assigned to the operating business before adjusting for cash, debt, debt-like items, working capital, transaction expenses, and other items that determine the seller's final equity proceeds.

Equity Value

The value attributable to the owners after adjusting enterprise value for the negotiated treatment of cash, debt, debt-like items, working capital, and other closing items.

Earnout

Contingent purchase consideration paid after closing if specified future performance or other conditions are achieved. Because payment depends on future events, an earnout should not be treated as equivalent to cash at closing.

Escrow / Holdback

A portion of the purchase price that is withheld at closing for a defined period to cover specified risks, adjustments, indemnification claims, or other post-closing obligations.

Indication of Interest (IOI)

An early, generally non-binding expression of a buyer's proposed valuation range, structure, and interest in acquiring the company. IOIs are commonly used to narrow a buyer pool before more detailed negotiations.

Letter of Intent (LOI)

The document that summarizes the principal proposed transaction terms before the final purchase agreement is negotiated. Many economic provisions remain non-binding, while confidentiality and exclusivity provisions may be binding.

Net Proceeds

The amount the seller is expected to retain after moving from headline purchase price through debt repayment, transaction expenses, working-capital adjustments, taxes, escrows, deferred consideration, and other closing items.

Net Working Capital (NWC)

The operating current assets less operating current liabilities required to support the normal day-to-day operation of the business. The exact accounts included in NWC are negotiated for each deal.

Working Capital Peg

The agreed target level of net working capital the seller is expected to deliver at closing. Delivering above or below the peg may increase or reduce proceeds depending on the purchase agreement.

Working Capital True-Up

The post-closing reconciliation of estimated working capital delivered at closing to the final closing balance sheet. The true-up determines whether an additional payment is owed by the buyer or seller under the agreed mechanism.

Quality of Earnings (QofE)

A transaction-focused financial analysis used to determine the earnings a buyer can reasonably underwrite. A QofE typically analyzes adjusted EBITDA, revenue quality, trends, working capital, customer concentration, and the support behind proposed adjustments.

Rollover Equity

The portion of a seller's ownership value that is reinvested into the buyer's post-closing ownership structure rather than paid entirely in cash. It preserves future upside but also leaves part of the seller's proceeds invested and at risk.

Seller Note

A portion of the purchase price financed by the seller and repaid by the buyer over time under agreed terms. A seller note creates continuing credit risk after closing.

SDE

Seller's Discretionary Earnings. A commonly used earnings measure in smaller owner-operated businesses that generally starts with business earnings and adds back the owner's compensation and certain discretionary benefits to reflect the economic benefit available to an owner-operator.

Teaser

A short, often anonymous marketing document used to introduce a business to prospective buyers before confidential information is disclosed.

Trailing Twelve Months (TTM)

The most recent twelve-month period of financial performance. TTM results are frequently used during a transaction so buyers can evaluate the company's current earnings rather than relying only on the last completed fiscal year.

Appendix B: Typical Exit Timeline

No two deals move on exactly the same schedule. Financing, buyer sophistication, company preparedness, transaction structure, and diligence findings can all change the timeline. The sequence below is a practical guide to how a well-run process commonly unfolds.

Phase 1: Default Readiness | Ongoing

- Maintain clean monthly accrual financials and a disciplined close process.
- Track valuation, earnings, working capital, cash flow, customer concentration, and the KPIs that support the business story.
- Keep ownership, tax, legal, and operational records organized.
- Reduce issues that would become difficult to fix under a buyer's deadline.

The best time to do this work is before you have decided to sell.

Phase 2: Pre-Market Preparation | Roughly 4-8+ Weeks

- Select the core deal team and assign ownership for each workstream.
- Complete or refresh the sell-side QofE and adjusted EBITDA analysis.
- Analyze net working capital and likely peg exposure.
- Model tax structure and expected net proceeds.
- Resolve major accounting, tax, legal, customer, or ownership issues that can be addressed before market.
- Stage the data room and prepare the core schedules buyers will request.
- Prepare the marketing materials, buyer list, and outreach strategy.

Phase 3: Market Outreach | Roughly 4-8 Weeks

- Distribute a teaser or conduct targeted pre-market outreach.
- Execute confidentiality agreements before releasing sensitive information.
- Provide qualified buyers with the confidential deal materials.
- Answer preliminary buyer questions and qualify financing, fit, and transaction certainty.
- Collect IOIs or other preliminary proposals.
- Narrow the buyer pool and move the strongest candidates toward final offers.

Phase 4: LOI Selection and Negotiation | Roughly 1-3 Weeks

- Compare more than headline valuation. Evaluate cash at closing, rollover equity, seller notes, earnouts, financing, working capital, transition expectations, and tax structure.
- Model expected net proceeds under each leading offer.
- Negotiate the major economic and process terms before granting exclusivity.
- Select the buyer and execute the LOI.

Phase 5: Due Diligence | Commonly 30-60+ Days

- Open the formal request list and data room to the buyer's diligence teams.
- Assign every request to an internal or external owner and manage the process through one master tracker.

- Respond to financial, tax, legal, HR, commercial, and operational requests.
- Prepare the founder or CEO and CFO or finance lead for management calls.
- Run a formal internal Q&A cadence and keep the buyer's follow-up questions organized.
- Continue closing the books monthly and roll forward TTM earnings, customer concentration, working capital, debt, cash, and other core transaction schedules.
- Escalate any issue that can affect valuation, structure, financing, legal exposure, or closing certainty.

If the deal runs longer, the diligence file must keep moving with the business. A stale QofE, outdated customer schedule, or old working-capital analysis eventually becomes a new diligence request.

Phase 6: Purchase Agreement and Closing | Often Overlaps With Diligence

- Negotiate the purchase agreement while remaining diligence items are resolved.
- Finalize definitions for debt, debt-like items, working capital, transaction expenses, indemnification, escrows, and contingent consideration.
- Confirm financing and any required lender approvals.
- Prepare the final flow of funds and closing net-proceeds calculation.
- Complete final tax, legal, corporate, and third-party consent requirements.
- Sign the transaction documents and fund the closing.

Phase 7: Post-Close Transition | Varies by Deal

- Transfer bank authority, systems access, contracts, licenses, customer relationships, vendor relationships, and operating responsibilities as required by the transaction.
- Complete the working-capital true-up.
- Track earnouts, seller notes, escrows, holdbacks, or other deferred proceeds.
- Complete the founder's agreed transition period and move into the post-close role, if any.