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business sales and acquisitions for entrepreneurs

A GUIDE TO SELLING YOUR BEAUTY OR PERSONAL CARE BUSINESS

Frequently Asked Questions

Deciding how and when to sell your business is an important and complex process. At Hughes Klaiber, we guide our clients through every step of selling a business, from initial planning to a successful exit.

In the pages that follow, we've assembled many questions beauty entrepreneurs ask as they begin to consider a potential sale – during and post COVID.

Selling a business can be time-consuming, and sometimes stressful. However, with a clear understanding of how the process works, you'll be better prepared to take advantage of the mergers and acquisitions market for beauty and personal care companies.

HOW IS COVID IMPACTING MERGERS AND ACQUISITONS IN BEAUTY AND PERSONAL CARE?

COVID has obviously had a significant impact on many businesses and industries, and acquisitions across all industries ground to a halt at the start of the pandemic in March 2020. However, acquisitions and investment activity for consumer products companies, including personal care, wellness and beauty, has seen a steady rebound.

Buyers who sat out a good portion of 2020 are now looking for opportunities, and have cash available for acquisitions.

Many categories of consumer goods are particularly attractive to acquirers, compared to other industries, given the consumer's ongoing demand for products, and ongoing access to products through grocery, mass or online distribution channels that have all remained open throughout COVID.

A development we've seen underway but which has been amplified due to COVID is increased interest in smaller acquisitions by bigger acquirers. A smaller transaction is an ideal way for a big buyer to make acquisitions, while limiting risk. Private equity is also focusing on "add-on" opportunities which are smaller companies that complement their existing portfolio holdings.

After a surge in interest from buyers pre-COVID for premium skin-care brands, we are now seeing the pendulum begin to swing back, with renewed interest from buyers in mass products, and in hair, nails and other categories. Given the migration of the consumer online, demand for acquisition targets with direct-to-consumer distribution is also very strong.

WHO MIGHT BUY MY COMPANY?

There are two primary types of buyers who purchase beauty companies:

- Strategic buyers are companies already involved in the industry, who want to build their own business via acquisition. Many companies find that buying another company is easier and quicker than building a brand organically. You've heard of acquisitions by leaders like L'Oréal, The Estée Lauder Companies, Unilever, and Johnson & Johnson; but there is also a whole group of mid-sized beauty companies who are interested in acquiring brands that don't meet the size requirements of the large players.

- Financial buyers include private equity firms or other types of investment groups that have raised capital and may be interested in helping you or another management team expand the company for a future sale or other liquidity event. Financial buyers are usually looking for companies with strong current and projected growth. Just like the strategic buyers, financial buyers range in size and acquisition criteria, from Castanea Partners and TSG Consumer Partners, who are generally interested in larger deals, down to three- or four-person private equity funds with a focus on acquiring small brands or those in a turn-around situation.

High-net-worth former entrepreneurs or corporate executives also buy smaller consumer products companies, either by themselves or in conjunction with other partners who may provide some financing. We find this type of buyer especially common in New York City, where there is a significant base of family and individual wealth.

We have also sold businesses to hybrids of these types of buyers, such as private-equity backed strategic buyers, successful serial entrepreneurs who have started small private equity firms, or wealthy individuals starting a family office.

Strategic buyers have historically had the reputation for paying the best prices to acquire a company, but in today's market - with excess private capital funds available - strategic buyers may be outbid by aggressive private equity buyers. The buyer that pays the most for *your* business is likely to be the one that sees the best fit and upside potential for *your* business, no matter the category of buyer.

Very recently we have seen venture-backed acquirers such as Thrasio enter the market, looking for Amazon-only or DTC brands to acquire. Thrasio's success in raising over a billion dollars in start-up capital has encouraged other players to enter the market, and there are now several other buyers with similar models. Given the limited number of DTC acquisition opportunities available, these buyers are also looking at companies with brick-and-mortar distribution. Thrasio promises a fast close, but other buyers may provide a more attractive combination of valuation and deal structure.

It's important to consider a wide range of buyers. Careful planning and execution of the sales process helps bring the best buyers to the table, to generate the best outcome for your company.

HOW MUCH IS MY BUSINESS WORTH?

The most common way to value a privately held business is as a multiple of last 12 month's earnings before interest, taxes, depreciation, and amortization (EBTIDA), adjusted to exclude some one-time, non-recurring revenues or expenses and to normalize owner's compensation.

So if you hear someone use a term like a "seven times multiple," it generally refers to a valuation that is seven times the company's trailing 12-month adjusted EBITDA. The appropriate multiple used to value your company is derived from recent sales of comparable companies, but will also vary up or down, based on factors specific to your company.

In addition to using the multiple-of-EBITDA approach, some buyers in the beauty space value companies using a multiple-of-revenue approach. Both approaches are based on the assumption that past performance will reflect the future performance of the business. Sophisticated buyers and private equity firms may also use a discounted cash flow model, which projects the future income of the business over multiple years, and helps them figure out how much they can afford to pay you.

While valuations for beauty companies are generally strong compared to other categories, the valuation of your company will depend on many factors, including your branding, product differentiation, margins, distribution channels, retailer relationships, and financial performance.

Bear in mind that the value of your business as stated on paper is really a hypothetical amount. The true value of the business is how much one or more buyers will pay for the business. No two buyers put the exact same value on a company, and buyers' perceptions of value are also driven by their ability to build future income.

It's easy to fixate on a price for the business, but the terms associated with the transaction are just as important as the price. An all-cash-at-closing-deal may be significantly more attractive than a higher valuation that includes some delayed or contingent payments. The way in which the transaction is structured can also significantly impact how much you pay in taxes. Working capital adjustments, escrow, your compensation post-closing, your non-compete terms, and many other issues can also all play a major part in the real value and attractiveness of a transaction.

Finally, the way in which you market and position your beauty business, and find and manage potential buyers, is also an important driver in obtaining value. An effective sales process, that includes compelling marketing materials, organized financials, and a credible road-map to grow the company can all help increase value.

WHAT IS DRIVING M&A ACTIVITY IN BEAUTY AND PERSONAL CARE?

Putting aside changes due to COVID, the beauty and personal care space is particularly attractive given strong gross margins; changing consumer preferences for organic, natural, and indie beauty brands; and emergence of new distribution channels. There is also a large universe of strategic acquirers willing to buy beauty companies from private equity firms, which creates a ripple effect, and drives private equity buyers to acquire smaller companies to build and resell. These factors have all combined to create a perfect storm of demand for acquisitions across multiple beauty categories, which contributes to higher valuations.

However, high valuations are a double-edged sword. Companies grabbing the best deals must show that they will continue to grow, even if business dynamics change. Some buyers are willing to make strong bets on companies they believe will continue to grow, but are carefully screening each opportunity, and staying away from those that cannot justify a high valuation.

The challenge of finding companies that are growing and available for sale has also caused some buyers to be more flexible in other aspects of their acquisition criteria, including size, geography or industry. We are seeing some private equity firms and strategic buyers looking at companies that are smaller than they might have historically considered. For entrepreneurs who are selling companies on the low end of middle market, this new flexibility from buyers can also increase the size of the buyer pool, increasing valuation multiples.

WHEN IS THE BEST TIME TO SELL MY BUSINESS?

There are typically three main factors to consider and balance regarding timing a sale: your personal goals; the growth trajectory and financial performance of your business; and the current demand from buyers.

In an ideal world, to obtain the best value in an exit, your personal desire to sell comes at a time when the company is growing quickly, and when strong economic conditions are driving attractive valuations.

But, like many other aspects of life, these three factors may not all conveniently align at the same time. Often an entrepreneur's personal desire to sell is greatest when the company has hit a plateau in growth, when additional investment is required, or when the business needs more experienced leadership that the founder can provide. Conversely, it's not so tempting to exit when the business is growing, and the future looks bright.

It can be challenging to decide whether to sell now, or to stick it out and try and build the business. Some of our clients have decided to postpone a sale, further built their business, and captured more value by selling later. Others decided that the challenges to build the business, and their personal desire to sell, trumped potentially obtaining more money in the future.

If you are evaluating timing, we can help you work through these complex issues, and help provide you with information to develop a solution that strikes the right balance.

WHAT IF MY BUSINESS HAS DEBT OR EXISTING INVESTORS?

For beauty or personal care businesses that are boot-strapped, it's not uncommon for the business to also have a significant amount of debt, including a line of credit, factoring, or a business loan. Most businesses are sold on a "cash free, debt free" basis, which means that you have to pay the debt back out of the proceeds of the sale. For example, if your company valuation is $8 million, but you have $500,000 in debt, you will net $7.5 million after the debt is paid off at closing. In some cases, a buyer may assume the debt, but this is the exception, not the norm.

If you already have investors, the proceeds from the sale will be split between all shareholders according to your cap table (unless you have "preferred" investors who may get paid first.) You will need to ensure your investors are all on board with a sale (unless you have "drag along rights" which means you may be able to "drag" them along, even if they don't agree.)

HOW LONG DOES IT TAKE TO SELL A COMPANY?

Historically, the average time to sell a company is six to 12 months, from the time you hire a mergers and acquisitions advisor to a successful closing. However, this varies from company to company and can also be faster in a strong economy, and slower in a challenging environment.

WHEN SHOULD I TELL EMPLOYEES ABOUT A POTENTIAL SALE?

Most entrepreneurs choose to keep a potential sale confidential, to ensure that employees do not become concerned about the company's future prospects. It's not unusual to let some of the employees know that the company has been sold after the transaction is complete. Confidentiality is also important to ensure that clients or vendors don't hear of a potential sale. In some very limited circumstances, it may make sense to let key employees know about your plans. For example, if you are in a precarious financial situation, it may help to reassure your employees that you are looking for a way to continue.

DOES THE FOUNDER NEED TO STAY ON AFTER THE SALE?

Most buyers require the founder to help with transition issues. Whether the founder stays on in a management role after the initial transition generally depends on the goals of both the buyer and seller. A strategic buyer may have their own existing team, and may not need you to stay, whereas a private equity buyer will often want the founder to remain committed to the business, retain some equity, and continue to run the company. Sometimes a founder will agree to stay with the business in a key role such as product development, or continuing to act as the face of the brand, while relinquishing the day-to-day management headaches.

WHAT STEPS ARE INVOLVED IN SELLING THE BUSINESS?

There are three key phases to successfully sell a beauty company:

1. Preparing the business for sale. Careful preparation for sale can help ensure a successful outcome and maximizing value in a sale. We work closely with clients to understand and evaluate the business, identify a likely valuation range, and develop sophisticated, professional marketing materials to highlight the unique characteristics and growth opportunity of your company. Sometimes you might hear these materials referred to as a "CIM" (short for confidential information memorandum) or a "book." Proper preparation helps ensure the later due diligence process moves smoothly, resulting in a higher potential selling price, and increased likelihood of a sale.

   An equally important component of preparing for a sale is developing a list of qualified prospective buyers, who have the ability to continue to run your business, and the financial wherewithal to acquire it from you. While there are sometimes valid reasons to limit the number of prospective buyers, reaching a broad section of qualified buyers can generally increase the likelihood of success, and increase the attractiveness of the valuation or deal terms. Over time we have built a large database of buyers looking to acquire beauty companies.

2. Buyer conversations. Once your marketing materials and buyer lists are complete, we start to reach out to buyers. The time and effort spent preparing the business for sale and developing professional marketing materials pays dividends in ensuring buyers are able to understand your business, and quickly decide whether to move forward. Of course, all buyers sign a non-disclosure and confidentiality agreement before they receive any confidential information on your business.

   As buyers express interest in your business, you will meet with them to answer their questions, and have an opportunity to ask them your questions. We help you navigate these meetings, helping you put your best forward, and highlighting the benefits of your business that will appeal to each buyer.

3. Finalize the transaction. This last and very crucial step in successfully selling your business includes moving from a buyer's initial interest to obtaining and negotiating one or more strong letters of intent ("LOI"), which outline all the proposed terms associated with the acquisition. Once a final buyer is selected and acceptable LOI signed, your buyer will likely want to conduct additional due diligence, to confirm that all information provided during the earlier stages is accurate. We manage this process, and help you provide the required documentation.

   In conjunction with the due diligence phase, the buyer's lawyers will generally prepare asset or stock purchase documents, based on the terms in the letter of intent. Your legal counsel will generally negotiate the legal points in these agreements, and prepare detailed closing documents, which can vary based on the type of transaction.
   Your final steps in the process are to review and sign the documents, receive payment (usually by wire transfer to your bank account), and assist the buyer with the transition to new ownership.

WHO SHOULD I HIRE TO HELP SELL MY BEAUTY BUSINESS?

Selling any business can be a time-consuming and challenging process, and most entrepreneurs decide to hire an M&A advisor or investment banker with experience to provide advice and guidance on valuation, prepare marketing materials, introduce buyers, and manage the overall process to get to a successful sale.

At Hughes Klaiber we are experienced M&A advisors and can help you manage the entire process. We typically focus on working with beauty, wellness, personal care and other consumer goods companies with annual revenues of at least $4 million. Set up a confidential conversation to discuss how we can assist you here.

Other equally important members of your deal team are your CPA and your lawyer. The legal aspects and pitfalls in a transaction can be complex, and your lawyer and accountant should have experience buying or selling companies similar to yours.

WHERE DO I START?

Please contact us to schedule a free, no-obligation confidential conversation to discuss your business and your goals, and to answer your specific questions about selling your business.

You can reach out via email, call us, or schedule a confidential consultation here: https://calendly.com/sallyannehughes

ABOUT HUGHES KLAIBER LLC

At Hughes Klaiber we guide clients through every step of selling a business, from initial planning to a successful exit. We represent entrepreneurs who have built privately held beauty, personal care, wellness and other consumer products companies.

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