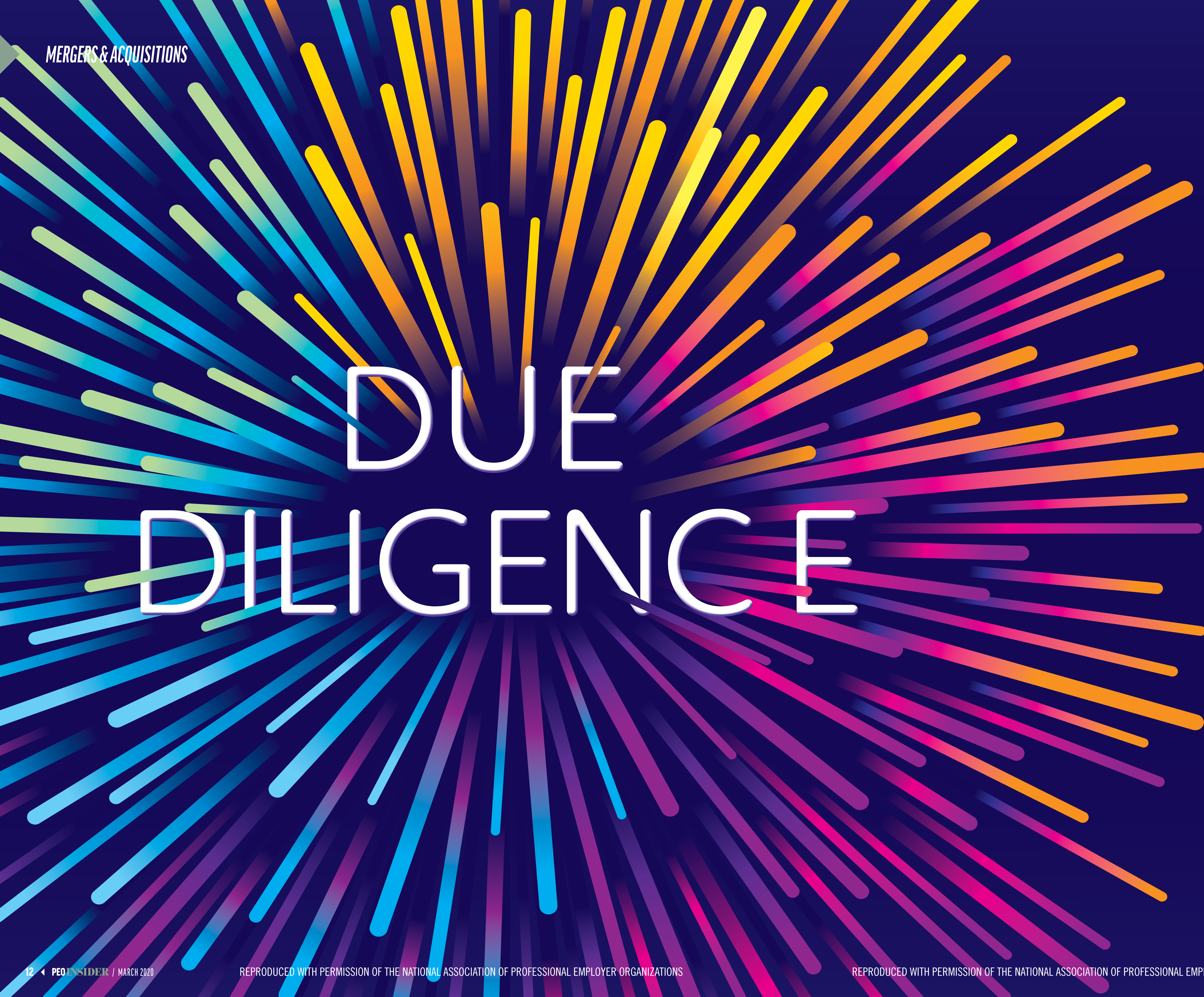

PEO SELLERS: THE IMPORTANCE OF SELF-DUE DILIGENCE

BY NEAL ENGLAND

There is no easy approach to selling a business and no two transactions are ever the same. Buyer appetites, legal frameworks, industry cycles, and macroeconomic conditions are in constant flux, making the idea of selling a daunting one. The silver lining: Successful transactions happen all the time, provided sellers take the necessary steps to prepare early and prepare well. Preparing involves mental preparation as well as a functional preparedness. The functional preparedness is a form of seller due diligence, asking yourself the tough questions that a buyer might ask, and then being prepared to support your answers. Let's explore the process.

PREPARING FOR THE UNDERTAKING

The first step in preparing your company for a successful sale is preparing yourself mentally for the undertaking while establishing a clear, credible reason for selling. Motivations will vary by owner, but typically include retirement, de-risking and diversifying net worth, health concerns, growth requirements, or to take advantage of valuations occurring in a marketplace.

Shifting into a "selling state of mind" isn't as easy as it sounds for most entrepreneurs, whose companies have been their primary purpose and identity and represent the most meaningful way they have committed their time. Pivoting into selling mode from operating mode requires total immersion and dedication, analogous to the dedication invested into building up an enterprise from start-up to profitability.

A successful process demands commitment and sincerity to capture the best personal outcome. Involving stakeholders, key trusted executive management team members, and your CFO can be enormously helpful in easing the burden when preparing to sell. Being aware of your buyer options is also important. Is your interest to sell 100 percent of your

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business, or just a portion? Do you seek to remain active post-closing with the right buyer, or exit soon after the transaction?

Be thoughtful about what your ideal scenario looks like and then allow yourself some margin for flexibility in case you need to adapt or stretch to new circumstances to achieve your goal. Staying flexible with the willingness to adapt to a new role or timetable based on the opportunity or the risk is a key characteristic that will benefit you personally. Selling your company is very personal, but it's a business transaction, probably one of your largest ever. Disciplined emotions will allow you to clearly focus on those important transaction matters.

BUILDING THE VALUE

Laying the foundation and building the value proposition for your firm in preparation of a sale rests on your shoulders as the owner/seller, not the buyer's. Being organized will greatly help you establish respect and credibility with qualified buyers and further enhance the success of securing an acceptable offer. *Now is when your focus on self-due diligence begins.*

Take a candid, introspective look at your company and yourself and ask:

- What are your key strengths?
- What do you do better than your competition?
- Why do customers do business with you?
- What can an acquirer do with your company and your employees?

There are many steps, but start with a process to ensure your company's financials, books, and records are well-organized, accessible, and current. If you have not done so already, put a system in place and develop routine closing and reporting cycles. Develop a chart of accounts with some forethought and tools to produce consistent information looking back two to three years and looking forward at least one year. Index your material in restricted shared drive locations by month, year, reporting hierarchy (monthly, quarterly, annually), tax returns, benefit filings, corporate books, etc. Many PEOs are audited these days, but plenty of transactions occur based on well-maintained, verifiable but internally generated financials.

The buyer will confirm information through due diligence, which is why you should perform a similar analysis of your company *before* you begin the sale process. The following are some examples of thoughtful actions, reporting analyzes, and key performance indicators (KPIs) you might consider as part of your preparation and self-due diligence:

- Participate in NAPEO's Financial Ratio & Operating Statistics (FROS) survey and use the information to know your company's performance compared to industry averages and understand any variations.
- Know the current state of your client service agreements (CSAs) and licensing:
  - Is anything missing or outdated?
  - Is it transferable, and if so, under what conditions?
  - Is current revenue recognition in line with the CSA?
  - Is licensing current in all jurisdictions?
- Sales dashboards and pipeline reporting:
  - Be able to identify who created the relationship-generating gross profit;
  - Show continued growth opportunities and the pipeline to help increase your value; and
  - If customer relationship management (CRM) tools are not available, then track using Excel or another tool.
- Monthly gross profit analysis:
  - Know monthly profitability by client over time, which helps support the quality of earnings;
  - Ensure gross profit reporting reconciles closely with your internal and audited statements;
  - Use profitability modules in your human resources information system (HRIS) if available; and
  - Use big data analytic tools such as Tableau, Power Bi, Qlik, etc.
- Monthly worksite employee (WSE) and client analysis:
  - Track WSE activity and attrition;
  - Track client additions and attritions;
  - Use client termination reason codes; and
  - Track WSE counts by client.

BEING PREPARED FOR BUYER DUE DILIGENCE

Due diligence by the buyer will follow a mutually acceptable offer and will render results that are either neutral or bad. This means that buyers rarely find a reason to increase a valuation in due diligence, but they may lower a valuation based on their findings. That's why it's important to have your company's information prepared and confirmed and make sure your team is aligned and prepared to defend against any potential weaknesses or issues discovered by the buyer.

Due diligence is a critical stage that can prolong the closing process or even result in deal termination should buyers uncover serious surprises not previously identified or reasonably explained. This is extra hard work for everyone—especially the owner/CEO, who still must run the company—so being prepared before due diligence is the best way to achieve the best outcome.

Bringing your CPA and attorney into the loop early is helpful in case some tax or legal pre-planning is needed. It is also recommended to engage an experienced M&A advisor and M&A attorney with some exposure to the PEO industry to handle the uniqueness of a PEO purchase transaction. Consider offering certain members of your leadership team for this process as a closing incentive.

In a nutshell, successful sale elements include a well-prepared presentation, a process that delivers well-matched buyers, favorable market conditions, PEO growth and profitability, credibility of all parties, and realistic seller/buyer expectations. Alternatively, challenges to a successful outcome include poorly prepared materials, absence of multiple buyers, ignoring market conditions, volatile profitability, lack of credibility, and unrealistic seller/buyer expectations. Patience pays, as a rushed deal is rarely an ideal one. ■

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