

# What to consider if you're thinking of selling your business

Services offered through Wells Fargo Bank, N.A.

When should you sell your company? The answer depends on two separate timelines. Your company should be sold when it is ready to be sold and when you can and want to be apart from it. Many business owners focus on the latter when both need consideration.



## Personal timeline

As a business owner, you should consider the financial risks and rewards of owning your company and how it fits into your long-term financial plan.

### Investment and Insurance Products are:

- **Not Insured by the FDIC or Any Federal Government Agency**
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- **Subject to Investment Risks, Including Possible Loss of the Principal Amount Invested**

On the plus side, beyond your compensation and distributions, your company ownership may provide you with benefits such as health / life insurance, covered automotive expenses, and other costs borne by the company.

On the negative side, you may be exposing yourself to risk if most of your assets are tied up in the success of the business. Many owners are so accustomed to ownership that they fail to appreciate potential dangers of their assets being concentrated into one venture until economic shocks or business downturns highlight unnoticed risks that were always present.

One way to analyze the risk and reward of owning your business is to utilize a discounted cash flow approach, a valuation method that forecasts future cash flows from the business while also accounting for the associated risk. Cash flow projections should incorporate matters such as company growth prospects, expected margins, and capital expenditures, among other things. The risk to cash flows can be mathematically calculated using a discount rate, which incorporates a risk-free rate and then is increased for risks from equity markets, your industry, and finally risks specific to your company.

Every business is unique and different businesses have different levels of risk. For example, a company that sells subscriptions for business-essential software in multi-year contracts likely has a fairly low risk profile versus to a general contractor that competitively bids on projects, because recurring revenue that is shielded from economic downturns generally has more value than episodic revenue that is subject to changing economic conditions.

Once you understand the potential risk and reward of the asset you own, it may become easier to compare it with other assets you could potentially own if you divested some or all of your business, such as cash, real estate, or a diversified investment portfolio.

Next, consider your involvement in the company and your desired retirement timeline. In a third-party sale, you may have to commit to remain with the company, in some fashion, for several years. Financial buyers such as private equity firms often insist on keeping the management team during their hold period. Depending on your role in the company, you may need to stay on for a transition period of months or years, so factor this time into your personal plans.

Lastly, realize that your business is probably much more than just your job. Judging a successful sale depends on your perspective after closing. In many cases, an owner's company is a source of pride and passion, so consider the source of your passions and sense of identity in your next chapter.

## Timeline for the sale of a business

You've weighed up the pros and cons of keeping your business and have decided to sell it, but when? The right time to act on this decision is probably not tied to your birthday. You need to consider the overall economic environment as well as the performance and prospects for your company.

The overall economic environment and outlook can have a tremendous impact on the valuation of your company but can also impact the likelihood of a successful sale. Financial buyers are likely to be challenged in higher interest rate environments while economic downturns can depress public and private company valuations. Since you can't control these factors, it is important to be ready to act when the market is favorable.

Similarly, in a changing tax environment, capital gains and ordinary income tax rates can influence your decision. Keeping your enterprise to maintain current compensation and distributions levels may not be the most advantageous choice if your incremental cash flows are offset by a tax liability. Strategizing with your tax advisor years in advance can increase what you net from a sale.

Your company's operating state is of primary importance. Buyers typically base valuations on the trailing 12 months of financial performance. Things like business size, profit margin, growth prospects and trends, customer / supplier

diversification, and management depth will help determine valuation. While you can't control the economy, you can prepare your company for a sale to make it more valuable to a potential buyer.

Availability and the cost of capital, especially debt, can impact your options. This is particularly relevant if you plan to sell your business to an employee stock ownership plan (ESOP) or to key managers in an installment sale. Financial modeling of different scenarios can help you decide on a path forward with a given fact pattern. Evaluating your options and understanding how they translate into net proceeds is important to make a fair comparison.

## Be in control

The Business Owner Advisory team from Wells Fargo Bank, N.A. has found in its experience that most owners value control, especially as a transition approaches. The decisions related to a business sale are complicated and impact many. Your leadership of the process, timing, and structure of an ownership transition may help enhance the outcomes for the company and the new owners. Your involvement may ensure your economic and non-economic goals are attended to simultaneously. Most owners have an idea who the best next owner should be, so take control of that decision and try to accomplish your objectives.

## Actionable next steps

- Assess the risk of your business cash flow by drafting a list of operating and financial risks of your enterprise and the offsetting factors. A formal approach is to engage a valuation professional to conduct a risk review. The objective is to recognize the risk of your cash flow, not just what you perceive it to be.
- Consider becoming acquainted with economic and business trends through resources such as your accountant, commercial banker, an investment banker / business broker, or other advisors. Their perspective on timing your transition may help inform your decisions.
- Document your ownership priorities and preferred outcomes, and share them with your heirs, management team, and professional advisors. Their input could enhance your transition success.

The complexities of risk, the timing of the transition, and your ability to control the outcome warrant a comprehensive keep/sell analysis. If you would like to evaluate your business ownership path forward, contact your advisor to learn more.

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All investing involves risk including the possible loss of principal.

There are special risks associated with an investment in real estate, including the possible illiquidity of the underlying properties, credit risk, interest rate fluctuations and the impact of varied economic conditions.

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