Before you sell your nursery

Here are questions to ask before talking to potential buyers

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WHEN NURSERY OWNERS contemplate selling their business, many jump straight to transaction price. However, there are many other considerations that should come first.

Before price even becomes a discussion, setting goals and plans for a future transaction helps owners not only protect their own interests, but also make their business more valuable to a prospective buyer.

Even if a sale isn't on the horizon for you — perhaps because you intend to keep your business in the family for the foreseeable future — the same principle applies.

The following steps will help you prepare for a successful sale, and they're also good business practices to consider more generally in your strategic planning.

Know your business

The act of preparing for a transaction is essentially creating a compelling résumé for your business.

If you haven't done so for your own purposes, prepare a clear business plan and a market analysis. Define your position relative to your competition, and articulate your overall strategy in a way that clarifies to a prospective buyer what your business is and where it's going.

Next, document plans to address weaknesses within your organization, and address any obvious holes in your management succession and people development plans. Doing so helps communicate your nursery's strengths and also demonstrates sophistication, which ultimately bolsters transaction price.

Put the sale in perspective

Before you push headlong toward a transaction, step back to consider what it would mean for your business, your management team, your personal finances and your legacy.

Ideally, how much do you want (or expect) to be involved in the business after the transaction? In today's transaction environment, upper-level business leaders (including founding executives) are often perceived as assets to a buyer. So, if you plan to enjoy your retirement on a beach one year after a transaction, your approach to a transaction will be very different than one where you plan to continue working for the business while transitioning out of your current role.

Regardless of how you expect to transition, a strong emphasis on management succession in your presale due diligence is absolutely paramount. Private equity buyers, for example, typically place a heavy emphasis on retaining existing management teams.

On the other hand, strategic, competitive buyers — your competitors — are typically less inclined to retain existing management because they already have a team of their own in place.

A transition within the family or to existing members of management will probably fall somewhere between these two examples.

To this end, you'll want to do your own due diligence on any potential buyer, which may include hiring a third party to assist you.

Make sure the buyer's goals align with your vision for the future of the business, your wishes for existing management, and your personal financial needs.

Consider culture fit. If you end up in a situation with multiple bidders, remember the highest offer isn't always the best one. Defining your priorities and understanding how a range of transaction prices would impact your lifestyle early on will help you stay focused on finding the right fit.

Analyze your inventory

Inventory is at the heart of most nursery businesses, yet few have a thorough understanding of what theirs is worth. Because buyers' tastes change over time, and considering that the three to seven years it takes to prepare a plant or tree for sale is no small investment, the value of a nursery's inventory can be especially unpredictable. Furthermore, economic factors, such as a downturn or upturn in the regional housing market, can impact how much customers are willing to spend on plants and what they buy.

Even more fundamental than the need to anticipate demand or respond to economic conditions, however, is proper cost accounting. Make sure you understand the costs associated with every item you sell, including the time, labor, materials and indirect costs associated with each. Once you've identified your high- and low-margin items, present them in a way a buyer can make sense of. For example, break out your top 10 products and explain how your lower-margin items fit into your customer strategy.

Nurseries should perform regular inventory counts in fields, greenhouses, canyards and other facilities to make sure products aren't walking out the door, and to ensure you aren't experiencing excessive plant mortality rates. A lack of sound internal controls and intelligence concerning something so fundamental is likely going to be a red flag to a potential buyer.

Weigh the impact on personal taxes

In today's transaction environment, most buyers prefer to structure a transaction as an asset sale rather than a stock sale. Doing so provides the buyer a step up in basis for the acquired assets, both tangible and intangible, which in turn provides immediate tax benefits in the form of depreciation and deduction.

On the seller's part, however, many don't realize an asset sale can cost more in taxes than a stock sale, depending on existing entity structure. Both seller and buyer benefit when the seller has structured himself efficiently for tax purposes long before an anticipated transaction — internal or external — so now is the time to review your entity structure.

This is one of the very best tax planning exercises owners can engage in. (If you're currently structured as a C corporation, pay special attention to the previous sentence.)

Another tax consequence sellers don't always see coming is their post-transaction exposure to the 3.8-percent net investment income tax (NIIT), which came into effect under the Affordable Care Act.

Once an individual's modified adjusted gross income exceeds a certain threshold ($200,000 for a single taxpayer or $250,000 for a married couple filing jointly), the NIIT applies certain kinds of so-called "passive" income above the threshold, including dividends, rents, royalties and most importantly, capital gains.

The term passive is an important one to keep in mind, especially if you plan to step out of your current role in the business prior to a transaction. Becoming a passive rather than an active participant in the nursery business would make you subject to the NIIT, so work with your tax advisor to make sure you understand the impact before you start down the road to a transaction.

Tidy up business tax issues

As both buyers and sellers have become more sophisticated, performing sell-side due diligence has become the norm. Though many sellers aren't keen on the idea of paying for their own due diligence, getting out ahead of any tax issues can be well worth the expense, especially since any tax skeletons will eventually come to light one way or another during formal due diligence.

Pretransaction due diligence gives you the opportunity to correct outstanding issues, or at least understand how they'll affect transaction price, so you can plan accordingly. Demonstrating you've taken the time to address potential concerns can lead to a boost in price that's well worth the upfront expense.

Keep in mind that it isn't only federal income tax that comes up in due diligence. State and local tax issues are a far more » likely item of discovery in due diligence. As hunger for tax revenue has increased among states, so has the complexity and compliance burden of state income, franchise and sales tax reporting. Many well-meaning, capable nursery owners and operators simply don't have the bandwidth to address the state and local issues, and many aren't aware of their exposure. A due diligence examination will reveal any potential discrepancies involving sales and use tax, business and occupation tax, and other local taxes.

While repetitive, it's worth mentioning one more time: C corporations are currently the most punitive entity structure for tax purposes because they're taxed twice in a transaction. In an asset sale, they're first taxed on the gain from the sale of assets, then on the dividend paid to shareholders.

In a stock sale (although these are less common), the double exposure occurs because the tax previously paid on the corporation's income doesn't increase the owner's basis in the business or reduce the gain on its sale, as would be the case in other entity structures. As a result, the owner pays tax on the corporation's income, then pays tax again on the value of the business itself.

If you do plan to restructure, be aware that the process can take some time. You'll need to start looking into the specifics well in advance of a transaction.

Don't rush

The bottom line as a transaction approaches? Take your time in up-front reflection and planning. Too often sellers rush toward a deal. Mapping out priorities, desired outcomes and needs before you even start looking for a buyer can help you structure your transaction in a way that benefits both you and the future owners.

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