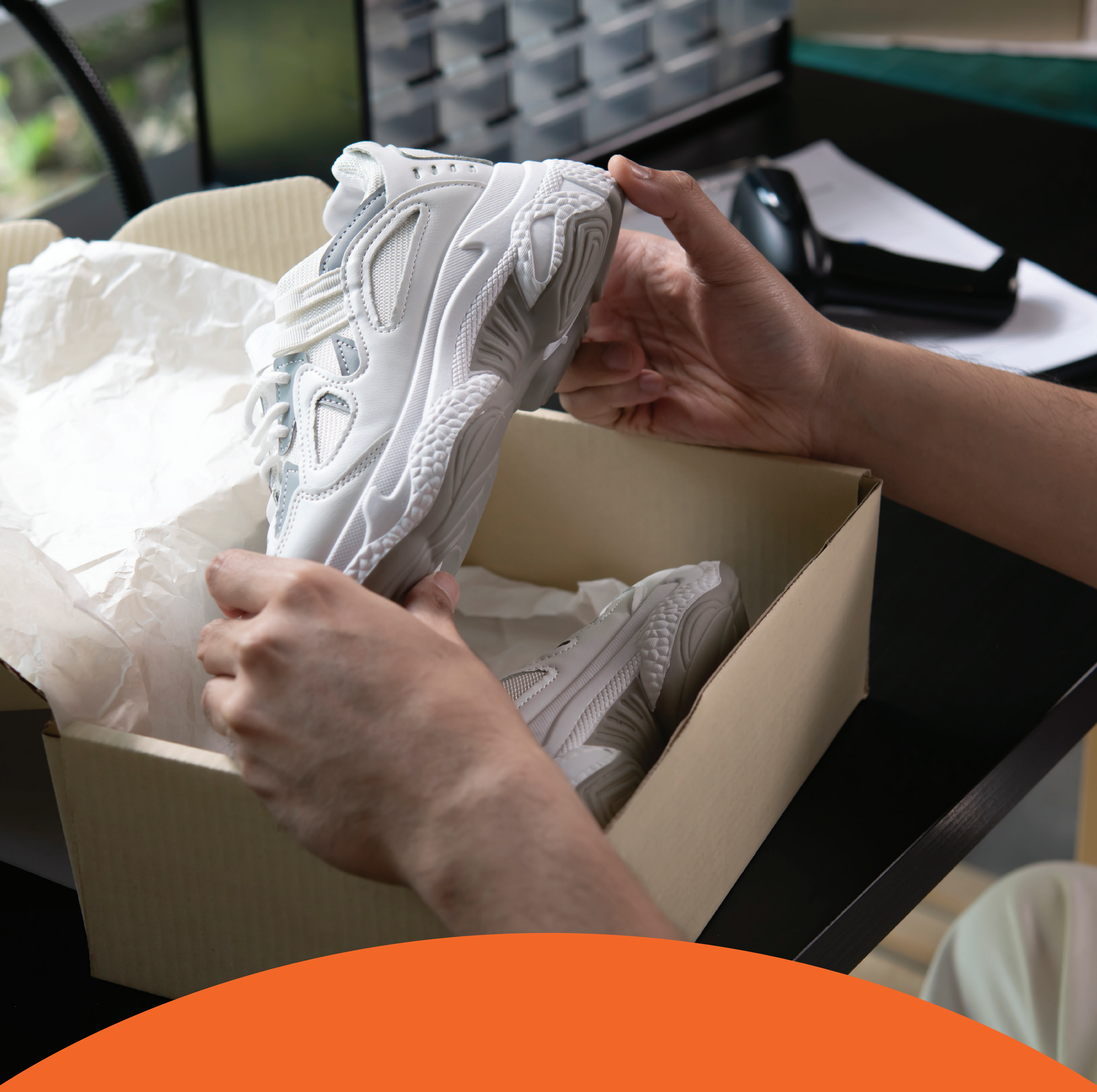

The Process of Selling an e-Commerce Business

The process of selling an e-Commerce company is very similar to the process of selling most firms. There are four significant phases to this process.

Preparation (1-2 Months)

Once a contract is executed with an Investment Bank, the process really begins. Over the course of the next four to eight weeks, the Investment Banker will prepare three key items:

1. Potential acquirers list and contact information

- This list will include all the potential acquirers, both financial and strategic, that the Investment Banker will approach. The seller typically has a great deal of influence on this list, particularly the number of prospects and the individual strategic prospects.
- A list can vary from one prospect to several hundred. A more targeted list diminishes the likelihood of a successful transaction than a broad one. But many sellers do not want the risk that the market finds out the business is for sale.
- Like direct marketing, if an Investment Banker approaches a hundred potential acquirers, only around fifty may sign NDA's to receive a copy of the CIM. Then, only ten to fifteen may put in an Indication of Interest ("IOI")
- Finally, five to ten may put in a "non-binding offer." So, while a client may know the perfect buyer, the process is a little bit of a numbers game. There is a saying among Investment Bankers, "One buyer is no buyer."

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2. Confidential Information Memorandum ("CIM")

- The CIM describes the business in great detail. It should contain all the information necessary for a potential acquirer to decide whether to submit a preliminary bid and its value. CIM's can range from about twenty-five pages to a hundred pages or more.
- The company's history, financial data, e-Commerce data, products, operations, and management team are all discussed in the CIM.

3. Executive Summary or Teaser

- The Teaser is typically a one-page summary of the selling points and description of the company. Most are presented on a confidential no name basis, as the teaser is designed to attract potential acquirers to sign an NDA in order to receive the CIM.

Other Preparation Tools

Seller's Quality of Earnings reports ("Q of E") are quickly becoming the norm for well run processes. An accounting firm is hired by the seller to review the financials, make adjustments, and examine the ongoing expenses. Buyers will typically perform a Buyer's Q of E during due diligence. Therefore, in recent years, sellers have been going on the offensive by preparing a Seller's Q of E to anticipate likely issues raised by a Buyer's Q of E.

Marketing (2-3 Months)

Once the Teaser and CIM are complete, the Investment Banker will reach out to the prospective acquirers via email, phone, and snail mail. The Banker will use the Teaser, and phone conversations, to entice the potential buyer to sign an NDA. The NDA specifies that the potential acquirer will keep the information and potential transaction confidential, and to use the information only for the purpose of evaluating the acquisition. Typically, the acquirer is allowed to share the information with its advisors, if the advisors agree to abide by the NDA. After 1-2 months, the Banker asks for preliminary bids in an Indication of Interest. After IOI's are submitted, several potential acquirers are invited to meet management, tour facilities, and ask questions directly of the seller. This management meeting is a precursor to asking for a Letter of Intent ("LOI"). Not everyone who submits an IOI is invited to these management meetings. Only those with "acceptable" IOI's are invited.

Negotiation (1-2 Months)

After management meetings, the Investment Banker will ask for Letters of Intent from the interested parties. Here all the key business terms are laid out, including price, type of consideration, key representation and indemnity principles, and sources of capital. The Investment Banker and client will negotiate with those that submit LOI's to increase value and improve the terms for the seller. It is quite usual to create an auction where one buyer tries to outbid the other. Eventually, an LOI is signed with one potential acquirer. The LOI spells out the key terms but is not binding. Diligence must be performed to verify all the data presented and to uncover all the known and unknown liabilities. The LOI is like a formal handshake agreement.

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Diligence and Closing (2-4 Months)

Diligence can be very exhausting. First, all the facts of the business, including sales, profits, marketing, current liabilities, costs, and payroll are confirmed and examined. Secondly, all the legal documents are examined. Contracts, corporate documentation, and employee benefits must be up to date and complete. Lastly, all the liabilities and assets are reviewed. Tax liabilities, environmental conditions, information systems, and inventory quality are all examined in detail. Diligence enables a buyer the opportunity to perform an extremely thorough examination of every nook and cranny of the business.

There are several areas of diligence that consistently arise as issues for e-Commerce companies.

1. Sales Tax Liability

- Ever since the Wayfair ruling, companies are responsible for remitting sales taxes to each jurisdiction. Any liability for not submitting is with the seller. Most buyers require the seller to pay the taxes and be current with each state and jurisdiction by closing.

2. Escheatment

- Though not as much an issue as sales tax, buyers may require the amount be remitted before closing.

3. Aged & Obsolete Inventory

- While entrepreneurs often carry inventory that is more than a year old, or slow to sell, buyers typically discount the value of old inventory. This becomes an issue when calculating Net Working Capital Adjustments.

4. Privacy

- Regulations in California and Europe are driving privacy policies and cookies. Being up to date on all regulations is necessary to make sure that the company is PCI compliant.

5. Covid-Bump

- Normalizing sales and profits to accurately estimate the effect Covid had on the business is typical.

6. Cyber Security

- Proper software and procedures are examined.

Diligence may also include a Seller's Quality of Earnings report. Other reports prepared by expert third parties (accounting, tax, employee, and HR) are typical. The buyer wants to know exactly what they are buying.

Concurrent with diligence is the preparation of the definitive documents. Purchase and Sale documents ("P&S"), employee contracts, and non-compete agreements are all legal documents required to close the transaction. The P&S is the key document. In it, aside from the price, are the conditions and warranties agreed to by the buyer and seller. Using an experienced M&A lawyer is just as important as using an experienced Investment Banker.

Closing is the fun part. Documents are signed, sometimes over a dozen of them, and the payment is wired. Congratulations, your company is sold!

What can an owner do to smooth the selling process?

Get the business modeled in Excel. This will help both parties understand what drives profits and sales.

Know the Cost of Acquisition ("CoA") of a new customer and the LifeTime Value of customers. Businesses should be built upon the premise that LTV is greater than CoA.

Have historical financials audited if the company has sales greater than $50MM. If the company has sales between $5-50MM, then at least have an accounting "Review."

Keep all software licenses current.

Collect relevant e-Commerce data over time:

- Cost of Acquisition by Channel
- LifeTime Value by Channel
- Repeat Customer Rate
- Visits and Conversions
- Ad Spread by Channel
- Seasonality
- Shipping Revenue
- Fulfillment Costs
- Average Order Size
- Merchandise Gross Profit
- Sales

Does a business owner need an Investment Banker to sell?

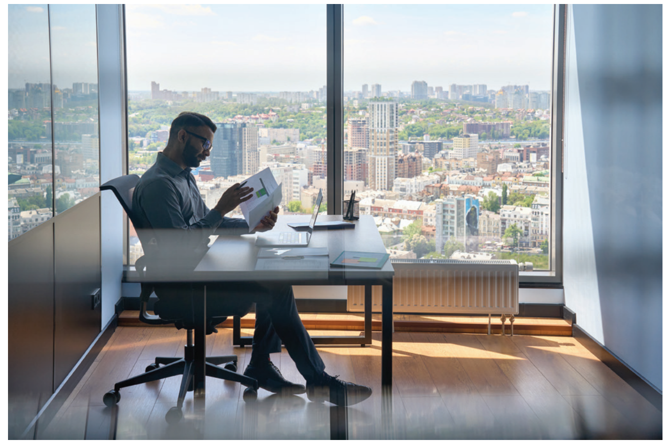
Technically, no.

However, a good Investment Banker will increase the realized value of a business in a few ways:

1. An Investment Banker lets executives focus on running the business;
2. An Investment Banker has experience negotiating deals;
3. A good process will result in a competitive auction to increase the value realized;
4. An Investment Banker knows many of the likely buyers.

Why hire an Investment Banker?

1. The lower middle market is inefficient. An Investment Banker will attempt to source multiple offers. The offers may be wildly different. It's not unusual for the highest offer to be 2x-3x the value of the lowest offer.
2. Running a process with multiple potential acquirers increases the likelihood of a successful transaction. Although there may be a "perfect buyer" on paper for the business, there is no guarantee that the perfect buyer will be ready, able, or willing to purchase the company.



What should a business look for in an Investment Banker?

Prior, successful transactions in the applicable industry.

Expect to pay an Investment Banker both retainers and success fees. A good Investment Banker will charge monthly retainers. This lowers the bank's risk and ensures that an owner is serious about selling. Without a retainer, do not expect a robust process. However, the success fee should be 80-90% of the total compensation. The Investment Banker "makes money" only if the deal closes. This arrangement aligns the interest of the potential seller and its banker.

Why do deals not close?

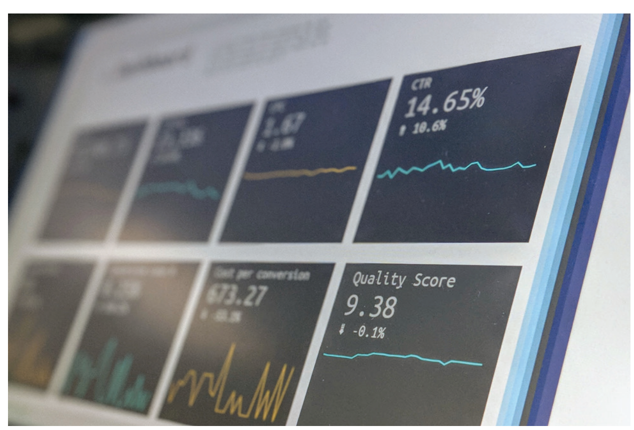
A good Investment Banker should close 75%-90% of retained processes. However, deals do not close for a variety of reasons.

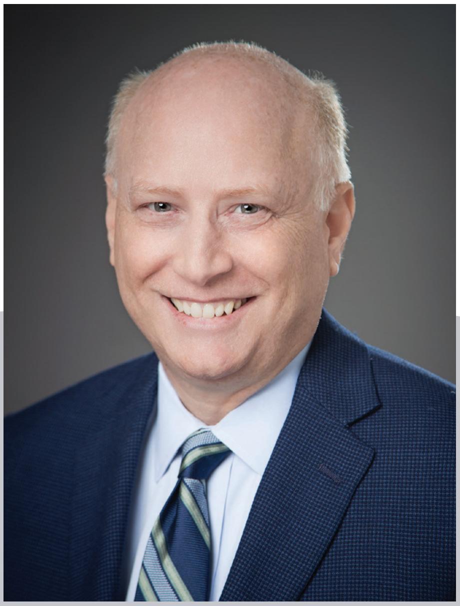
1. The number one reason why deals don't close is because the company's underlying performance does not achieve the predicted forecasts.

2. The second reason is "deal fatigue." If a company is less prepared for a process than it should be, the process can drag on. The buyer and seller just give up on processes that are not smooth and orderly.

3. Additionally, deals do not close because diligence reveals there are liabilities that were not previously disclosed. For instance, sales taxes need to be paid in every state. They are the responsibility of the seller, yet not every e-Commerce company remits sales taxes consistently.

75%-90%
of deals should close





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