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CEO Insights

This article provides an overview of the process used to sell a company in the midmarket. Privately owned businesses will benefit by gaining an understanding of the parameters, success factors, timeline and risk factors.

The M&A Process

Selling Your Private Business

By Anand Divekar

August 2008

Introduction

Companies are sold for many reasons, including retirement of the CEO, undercapitalization, risk reduction, diversification, or to open the door to new opportunities. Additionally, in the new 'flat' world, the barriers posed by international borders, distances and time differences have less significance than in the past, leading to a transformation of international economic equations. Whereas several new business models have become successful, many older ones are no longer as profitable. Selling a business can open the door to investing in newer and more profitable opportunities.

Prior to initiating a sale, a CEO can consider several activities to increase the value of the business, including the creation of audited financial statements, implementing cost controls, improved customer service, technology infrastructure, product quality, etc. However, most CEOs find it difficult, if not impossible, to manage the sale of their own businesses. A lack of familiarity with the process and a lack of bandwidth to manage the process and its many participants (including potential buyers, lawyers and accountants on both sides and other professionals), make it difficult to market the business, attract qualified buyers, and negotiate and structure the deal. Adding to the risk, buyers often have more experience than sellers with the process. With globalization, foreign buyers present even greater challenges and opportunities.

Understanding the process can help a CEO better appreciate the demands on management time and resources and the potential impact on business operations. Luckily, there is a solution. Finding the right M&A firm to help manage the process will allow management to stay focused and avoid disruptions.

The Process

The process has 4 stages (see Figure 1):

1. *Goals and expectation setting*
   The M&A firm and the seller engage in a dialog which allows the firm to better understand the seller's business, goals and historical financials. The firm will also discuss the MPSP range (Most Likely Selling Price) with the seller to ascertain that the seller's expectations are realistic in light of recent trends in the market.
2. *Creation of marketing materials*
   Professional packaging and marketing of the seller's business are key to attracting buyers. The M&A firm will create a short, anonymous 'teaser' document and a more detailed 'deal book'. The teaser is a anonymous presentation of the company profile. The deal book is a more detailed document describing the business, its industry and trends, competition, products and services, customers, financials and pro-forma statements.

3. *Market the business. Review term sheets.*
   The M&A firm will identify a list of qualified, potential buyers from a pool of strategic buyers (industry participants), financial buyers (such as private equity groups) and other interested parties. The teaser is sent to this group to stimulate interest.

   Of those who respond positively, the deal book is sent to those who sign a non-disclosure agreement. Interested buyers respond with term sheets stating a target price and target structure. Preliminary negotiations may occur with these buyers to finalize term sheets. The seller and the M&A firm then select a primary buyer to move forward with.

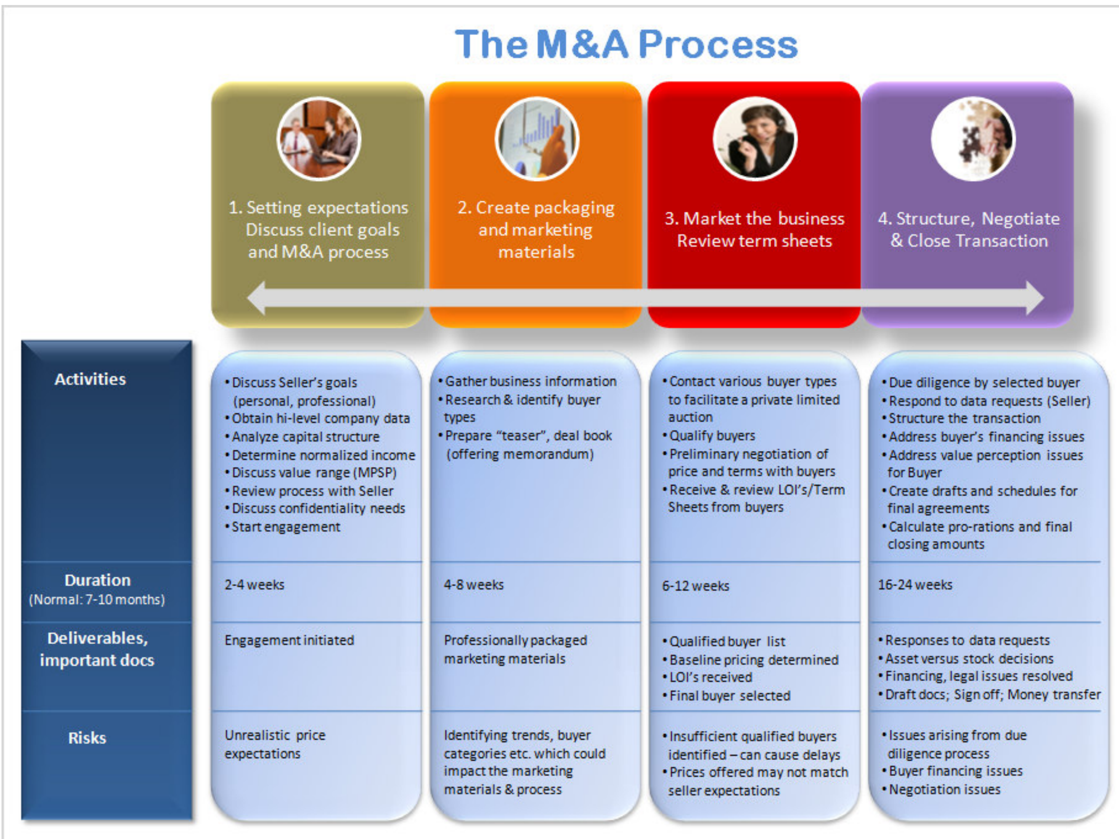


Fig 1: The M&A process

4. *Negotiate, Structure and Close*
   The buyer now starts due diligence to eliminate any source of post-deal surprises. A legal and accounting team representing the buyer will request access to company information including historical financial documents, legal agreements, customer documents and other data. This process is designed to expose business weaknesses, legal issues, future risks, etc. all of which could impact price negotiations. Once due diligence is completed, more negotiations follow before a mutually acceptable deal structure and price are finalized. Finally, all legal contracts are written, reviewed and signed, money is transferred as agreed and the transaction is closed.

The process is complex and usually takes between seven to nine months to complete. However, delays (for example, during buyer communications, due diligence and legal discussions at closing) can extend it to 12 to 15 months.

Finding the right M&A Firm

It should be evident from the above process description, that finding the right M&A firm is critical to a successful sale at the right price. An experienced M&A firm will not only manage the entire process and its participants, but also manage issues and risks, keeping the CEO informed as to status, while maintaining client confidentiality.

The M&A firm's industry knowledge and network of contacts can help quickly identify the right buyers. Professional packaging and marketing of the company helps attract the right buyers and keeps their interest levels high. Facilitating and guiding all parties through the process is of great importance since delays can be detrimental to the seller's reputation and confidentiality. Personal chemistry between the CEO and the M&A firm's deal maker is critical to the process, especially for conflict resolution between participants and when the M&A firm needs the CEO's support to move the process forward to a successful close.

Certification requirements for M&A firms can get confusing due to a lack of universal standards. Some states require business intermediaries to have a real estate license (WA state is an example) as the only qualification. Investment banks tend to hire associates with a Series 7 license, a qualification for selling public stocks and mutual funds. Organizations such as the IBBA (International Business Brokers Association) and AM&AA (Alliance of Merger & Acquisition Advisors) certify business intermediaries.

When selecting a M&A firm, a seller should look for a firm which has the appropriate certifications and experience, has the time to focus on your transaction (how many staff do they have, how many deals are currently being executed, commitment of their personal time to your deal, etc.), is able to close deals quickly, has a wide network of industry contacts and is able to conduct a confidential transaction.

Other Process Considerations

Various aspects of the process can impact the deal and the final price.

- **Buyer sophistication**: Buyers (usually larger companies or private equity groups) are generally more sophisticated negotiators than sellers of private businesses. This makes it all the more important for sellers to get a strong M&A firm in place prior to initiating the process. It is the M&A firm's responsibility to assess the value of the acquisition to the buyer and steer negotiations in this direction, while protecting the seller's interests.
- **Due Diligence**: This portion of the process can be trying for both seller and buyer. Buyers wanting to protect their interests will request a thorough audit of the seller to make sure there is no reason to abort the transaction and that they are not paying more than necessary. The seller should be prepared to provide the buyer with a lot of data to support these goals. Any issues

perceived by the buyer can trigger requests for additional data. Serious issues can negatively impact the sale price and the transaction itself. The process may continue for several months (especially for larger transactions) due to data demands from the buyer.

Confidentiality is another challenge during due diligence, if it is carried out on company premises. Employees may learn about the proposed transaction if they regularly see the due diligence team on site and start looking for jobs in advance of expected terminations. In order to avoid this, sellers sometimes rent an offsite location to store all the documents required. Modern technology improvements include electronic data rooms which allow online document storage, authorization and remote access to documents by buyer representatives over the internet.

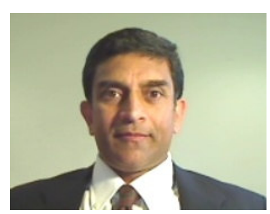
- **Structuring a transaction**: This is achieved through one of the following mechanisms: a) purchase of stock, b) purchase of assets or c) engaging in a statutory merger. Asset purchases are rare in comparison to the other mechanisms. Most sellers prefer a cash component, especially in uncertain times, or if the buyer's stock is not liquid. Lawyers and accountants usually come up with a structure which minimizes taxes for buyer and seller.

  Buyers typically minimize risks through legal clauses which ensure they are able to pursue the seller if undisclosed issues emerge after the deal is consummated. Buyers also like to retain the seller's services (using earnouts based on post merger performance) to make certain that the post merger transition is smooth.

SUMMARY

- Start planning for a divestiture a year or two prior to an intended sale and set targets for improving company performance and documentation prior to bringing in a M&A firm.
- The process has 4 phases, is complex and will require a dedicated team to shepherd it through. If you look for outside help, select a M&A firm based on experience (past transactions), certifications and knowledge of buyers in your industry.
- Buyer communications, due diligence and finalizing legal paperwork can be sources of delays in completion of the transaction. A good M&A firm will find ways to keep the process on track (with the CEO's help) so as to control both time and expenses for successful completion.

About the Author



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