Navigating the M&A Journey

The Role of the M&A Advisor as Guide

By Brian Deveaux

As the US economy seems to linger in its two and a half year hangover from the worldwide financial crisis that began in 2008, one of the symptoms of the "night before" has been a slowdown in merger and acquisition (M&A) activity. While logical to conclude that the slowdown in M&A activity is being driven solely by business owners concluding it is a bad time to sell, I believe there is a second factor at play—increased buyer scrutiny. In other words, there are business owners who want to sell but cannot do so successfully in the current environment due to the increased demands of buyers during the valuation, negotiation, due diligence, and documentation stages of the process. In an environment such as this, the right team of outside advisors can make the difference between a successful transaction and a failed one.

Ideally, the team of outside advisors should include the company's attorney and outside accountant, as well as an M&A advisor, preferably with experience in your industry. To the extent that the company's attorney and/or accountant do not have experience in M&A transactions, additional resources should be brought in to provide legal, accounting, and tax advice. While the roles of the attorney and accountant in a transaction are generally well understood, the role of the M&A advisor is often unclear.

There is a common misperception that M&A advisors simply "broker" deals. In other words, they connect potential buyers with sellers and step aside, or worse, they work both sides of the transaction, rather than zealously representing just their client. Anyone who has been through a sale or acquisition process knows, there is a lot more to a successful transaction than simply getting the parties together. A successful M&A transaction is not an event—it is the culmination of a lengthy process (some might say a journey). And one of the best ways to ensure a successful journey is to have an experienced guide that has traveled the same route before. The role of guide on an M&A journey is best served by an experienced M&A advisor.

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Living in Maine, I am surrounded by people who love to hunt and fish. If you ask them to describe the characteristics of a great hunting or fishing guide, they will tell you that the best guides:

- **Understand your goals** — Are you after lots of fish or the "Big One"?
- **Set realistic expectations** — If you want to fish for tuna in Long Island Sound, the guide must have the knowledge and fortitude to tell you that your chances aren't so good.
- **Prepare a detailed plan** — The guide should tell you in advance the route you will travel, how long it will likely take, what gear to bring, and what the potential roadblocks are.
- **Execute the plan** — The guide is effective, taking appropriate detours when necessary to successfully achieve your goals.

The best M&A advisors possess these same characteristics.

Understanding Your Goals

While maximizing the sale price is always an important factor in sell-side M&A transactions, it is not always the most important factor. There are often other, more important economic and non-economic goals that must be well understood by the advisory team.

For example, the buyer willing to pay the highest price might plan to relocate the business into its existing facility, thereby leaving you with an empty building or an on-going lease obligation. A buyer willing to buy stock (as opposed to assets) might offer a lower purchase price, but a purchase price that results in higher after-tax proceeds.

With regard to non-economic goals, is it your desire to continue working or retire? A strategic buyer might not care, but a financial buyer might insist on your continued involvement. Are there family members working in the business that will need jobs or other key employees that you want to "look out for"? How might customers be treated on a go-forward basis? Is use of the company or family name important? These factors need to be well understood by the advisory team so that realistic expectations can be set and a customized plan can be established to maximize the likelihood of achieving or exceeding your expectations. There should be *no surprises* between you and your advisors.

Setting Realistic Expectations

If maximizing purchase price (or after-tax proceeds) is one of the most important goals in a transaction, having realistic expectations in this regard is equally important. When it comes to valuing a business in order to sell it, valuation *theory* goes pretty much out the window. What determines how much a business is worth is the marketplace—in other words, a business is worth what a specific buyer is willing to pay for it in the current market. A good M&A advisor should be able to provide you with a realistic range of values within which your business will sell. While some advisors will simply tell you what they think you want to hear and hope they can achieve it, a good advisor will often tell you what you don't want to hear—that your business may not sell for what you were hoping for or expecting. Better that you know this before "going to market" than after.

Furthermore, a good M&A advisor should set realistic expectations regarding your non-financial goals and their potential impact on your financial ones. For example, your desire to have a relative or key employee remain employed at what buyers perceive to be above market pay, will likely impact the price that buyer is willing to pay for the business. This may be acceptable to you, but you should know this going in. Again, *no surprises!*

Preparing a Detailed Plan

While the general steps in most M&A transactions are similar, to achieve the best results, the process must be tailored and customized based on your specific goals, the attributes of your business, and the characteristics of the prospective buyer pool. This requires that a detailed process plan be established in advance, with input, involvement, and buy-in from everyone involved. As an overview, there are four primary phases of the process.

Phase 1—Preparation and Planning: Like most important and complex projects, the planning and preparation phase sets the stage for how well the execution phases of the project will go. During this phase of an M&A process, several things typically occur in parallel: a.) a prospective buyer list is prepared and reviewed; b.) an information memorandum and other information packages are prepared and reviewed; and c.) process documents such as a confidentiality agreement are prepared and reviewed. In connection with preparing the information memorandum, good M&A advisors conduct an internal due diligence review of the business and recommend preemptive actions to address areas of potential concern for prospective buyers in advance of "going to market."

Phase 2—Presenting the Opportunity to Prospective Buyers: Preserving the confidential nature of the potential sale is almost always of paramount importance to the seller. As such, the first step after making contact with prospective buyers involves negotiating a confidentiality agreement. Once a confidentiality agreement has been signed, a summary information memorandum is provided to the prospective buyer, which, in addition to disclosing the identity of the seller, provides an overview of the company, its business, operations, and financial performance. Financial statements are often adjusted or recast to remove unusual or extraordinary expenses that may be unique to the current ownership structure of the business.

While there is a definite balance between providing too much and too little information, I am a firm believer in prospective buyers being well informed when they submit their initial proposal. Initial proposals come in several forms (term sheets, expressions of interest, letters of intent), but each should address the key components of the proposed transaction. At a minimum, this includes: a.) what

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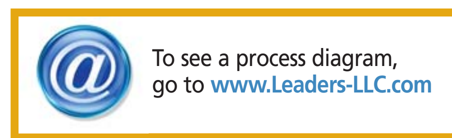
they are proposing to buy (e.g. stock, assets, all assets, partial assets); b.) the proposed purchase price; c.) the form(s) of consideration (e.g., cash, stock, earnout); d.) what liabilities they are proposing to assume; and e.) what their expectations are regarding real estate.

Phase 3—Evaluating Offers and Negotiating Letters of Intent: While on the surface two proposals might look identical, there are often subtleties that clearly distinguish one offer from another. For example for a company that leases its vehicles or real estate, the assumption of these liabilities by the buyer is always a critical component of a transaction. While real estate leases are usually addressed, assumption of vehicle leases is often left silent. If one buyer intends to assume the vehicle leases but the other does not, the two proposals that look identical on paper could result in very different net proceeds for the seller. A good M&A advisor will help to flush out important factors such as these, so that an "apples-to-apples" comparison can be made. After evaluating initial proposals from prospective buyers, a small number (sometimes one) will typically stand out. Negotiations with these prospective buyers will lead to each submitting a more detailed proposal in the form of a letter of intent. After careful evaluation (and further negotiation), a letter of intent will be signed with one buyer.

Phase 4—Due Diligence and Negotiating Transaction Documents: Upon execution of a letter of intent, two paths will typically commence, sometimes in parallel, sometimes in sequence, and sometimes iteratively. The two paths are the buyer's due diligence and the negotiation of the purchase and sale agreement (and other ancillary documents such as leases, non-competition, and consulting agreements, etc.). Both of these processes can be time consuming and emotional if not handled professionally by both sides. The M&A advisor and M&A attorney work closely together throughout this phase of the process to ensure the process flows smoothly and that emotions remain "in check." These two paths culminate with the closing of the transaction, when final documents are signed, money exchanges hands, and the parties shake hands and smile (hopefully).

I cannot over-emphasize how superficial this overview is with respect to the complexity of the four phases of the process. A series of future articles will detail each of the phases of the M&A process summarized above and will provide examples of how the process can be customized to meet the needs of different business owners. To download a detailed process diagram, visit the Leaders LLC website through the following link: *www.Leaders-LLC.com/media/documents/process diagram.pdf.*



This diagram provides a little more insight into the detailed steps involved, and my subsequent articles will examine more closely the importance of customizing the process based on your specific goals, the attributes of your business, and the characteristics of the prospective buyer pool.

Executing the Plan

All the planning and preparation in the world is virtually worthless if the plan is not effectively executed. Executing a successful M&A process requires the coordination of many different team members whose input, time, and expertise are often needed at different times throughout the process. The person who can most effectively coordinate these resources is the M&A advisor. The best M&A advisors are not necessarily experts in any one facet of transactions (e.g. legal, accounting, tax); rather, they have a solid foundation in each area and know when to call in the experts. Additionally, a good M&A advisor is one that can gain a solid understanding of the operations and finances of your business, so they can address questions that arise without having to consult you or a member of your management team every time one surfaces.

There is a saying in the M&A business that "time kills all deals." Our experience tells us this adage can be true, particularly in an environment of increased buyer scrutiny such as the present. The longer a transaction takes to close, the higher the likelihood that deal fatigue sets in and the prospective buyer decides to move on.

The most successful M&A transactions are those that are conducted such that momentum is maintained throughout the process. This is not to say that the process is conducted hastily; rather that the process is well thought out, planned for in advance, and executed with focus. This is done most effectively when there is a resource dedicated to managing the process. This is one of the critical roles of the M&A advisor.

The best laid plans . . . . Notwithstanding how well you plan for and execute the process, roadblocks will inevitably arise and detours will need to be taken. An experienced M&A advisor knows the back roads to take to get the process back on track, thus maximizing the likelihood of getting to your ultimate destination—a successful sale of the business.

Conclusion

The two-year extension of the Bush-era tax cuts has opened a window of opportunity for business owners who have decided the time to exit is near. If the economy can continue to show signs of a sustained recovery, the M&A activity level in our industry should steadily, if not rapidly, increase. What is not likely to change, however, is the level of scrutiny with which buyers will continue to assess acquisition opportunities. To maximize the likelihood of a successful M&A journey, assemble the right team, and hire a good guide. This is not a trip where you want to be telling tales about "the one that got away."

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General process overview of a sell-side M&A transaction