Merger & Acquisition Focus

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Ask the Advisor

Exercise caution when wading back into the M&A market

If you're hoping to sell a business, you know just how challenging the past two years have been. According to Bloomberg, total 2009 M&A deal values fell by 32% to $1.7 trillion, making it the weakest year for mergers since 2003. However, several key economic indicators suggest that the U.S. economy finally is turning a corner — which likely bodes well for M&As. Indeed, fourth quarter 2009 total deal values increased 54% compared with the third quarter.

For many sellers, 2010 could be the best time to find a buyer since the mid-2000s. But caution is warranted. Before jumping at the first reasonable-sounding offer, be sure you know your company's value in the current market and have explored all your options.

Same as it ever was?

Perhaps you spent years preparing to sell and were ready to find a buyer when the credit markets tanked in 2008. That doesn't mean you can now pick up where you left off. Most U.S. companies became less profitable during the economic downturn and your current financial profile may not look as rosy as it once did. If you do business in a sector that's particularly vulnerable to economic troughs, such as manufacturing or retail, your financial statements may show signs of distress.

Business buyers in 2010 will almost certainly be more risk-averse than they were before the economic crisis, and what they might have overlooked in 2007, such as a moderate debt load, won't pass muster now. So before you put your business on the market, ask an M&A professional to review your financials and operations and suggest ways to improve your marketability — and, ultimately, your sale price.

Depending on the state of your organization, fixes could be as simple as cleaning up your facilities and organizing financial and legal documents. Or they could be as challenging as reducing expenses, restructuring debt and selling off major assets — projects that could take a year or more to complete.

Bargain hunters on the prowl

As the economy recovers, some buyers are likely to be on the hunt for bargains, particularly companies that have taken a beating in the bad economy and those owned by individuals anxious to retire. Private equity funds, for example, may be looking for higher-growth companies that can be bought cheaply and resold at a profit after a couple of years.

While you may be able to get a good deal from such a buyer, it's smart to be wary of bargain hunters and shop around before you agree to a deal. Financial buyers focused on shorter-term gains may be faster out of the gate than strategic buyers and initially make lucrative offers. However, they're also likely to play hardball at the negotiation table, where that original offer could turn into something less satisfactory.

On the other hand, being pursued by opportunistic buyers can enhance your market value. Competition drives up bids, and knowing other buyers are interested in your company can get corporate buyers that have been eyeing you for several years to finally get off the sidelines and make an offer.

Recognize opportunities

Although caution can be a virtue when wading back into the M&A market, don't let opportunities slip through your fingers. Deal financing is still difficult for many buyers to get — and is likely to remain so for some time. If you're approached by a buyer with the cash or bank backing to meet your asking price, it's probably not a good idea to hold out for a better offer.

Once you find a serious suitor, move quickly to close the deal. It's critical to remain flexible and be ready to offer incentives — such as partial seller financing or a deal structure that provides the buyer with tax benefits — to keep your transaction from unraveling. And don't be surprised if your buyer refuses the seller protections you propose. (See "Are deal protections worth the fight?" above.)

Diving in vs. standing back

Many factors will affect your ability to get a fair price for your business this year, including your industry, financial health and preparedness for sale. Even if you're ideally positioned, you'll need to walk a fine line between pouncing on what appears to be a good offer and hanging back to mull over your options. ■

Are deal protections worth the fight?

During the M&A salad days of the mid-2000s, seller protections were a common feature of sale agreements. Buyers outnumbered sellers and generally had little choice but to concede to them. Now the shoe's on the other foot.

A recently released American Bar Association M&A Committee survey found that in 2008 not a single public M&A transaction included a "go shop" provision, a feature which enables sellers to actively solicit third-party bids. By contrast, 97% of surveyed deals contained a "match right" provision which gives buyers the right to match third-party bids.

In the current environment, you're unlikely to get all (if any) of the protections you request, so it's important to concentrate on those that you really need. Aside from a go-shop clause, you might, for example, negotiate for termination fees in the event your buyer backs out, or consider asking for a "fiduciary out," which enables your company's board to accept a better offer while negotiating with your original bidder.

Combine and conquer

THE BIG ADVANTAGES OF ROLL-UPS

Even the best-run middle-market companies eventually face size-related obstacles — including difficulty raising cash for strategic initiatives and an inability to negotiate better prices and terms with suppliers. A roll-up, where several smaller companies in the same or similar industries combine to form a larger company, can provide a solution.

Among the possible advantages of a roll-up are access to economies of scale and improved efficiencies, higher sales and profitability, low-cost capital, and simpler exit strategies.

Ready to roll

Roll-ups generally are implemented in one of two ways:

1. Several businesses band together in a "loose federation" without consolidating operations in any meaningful way. Each participating company continues to operate as an independent entity in its particular market, keeping its own brand identity and management team.
2. Companies aggressively consolidate operations and actively seek synergies among all participants. By combining operations and cross-selling products and services, the combined entity can reduce costs and grow revenue internally, resulting in widening margins and accelerating earnings.

Although there are costs involved in the consolidation and IPO processes, roll-ups can result in an immediate increase in value. But to achieve such benefits, all participants in a roll-up must be financially sound. And if the roll-up is to follow a loose federation approach, each individual management team needs to be highly competent — not to mention able and willing to collaborate.

Head off trouble

Unfortunately, roll-up success is the exception, not the rule. Too often, participants focus more on getting the deal done than on postintegration challenges. And inattention to consolidation issues can lead to disaster.

During the bull-market years of the late 1990s and early 2000s, "poof" roll-ups — in which several smaller companies combined to create the appearance of greater size, with no real integration strategy — were common. Typically, the goal was a quick windfall. And almost invariably, these transactions failed because either their IPO would tank or the management teams were unprepared to integrate and run the combined company.

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If you decide to participate in a roll-up, develop a detailed plan for every aspect of integration, including employees, facilities, sales channels and IT. And if the smaller companies' former CEOs will lead divisions of the larger entity, you must clearly define performance measurements and incentives. The decision to centralize control or operate divisions as largely autonomous entities also will be critical.

If your goal is to go public, be sure you understand the costs involved. Public entities must submit to SEC scrutiny and adhere to the provisions of the Sarbanes-Oxley Act of 2002, which typically means increased marketing, accounting and legal costs. And regardless of the fundamentals, your company's value may fluctuate based on general market conditions and the opinions of investment analysts.

Value and opportunity

Even more than standard merger transactions, roll-ups require serious strategizing, the right partners and experienced professional advice. But if you can make it work, a roll-up may greatly enhance your business's value and provide it with otherwise out-of-reach growth opportunities. ■

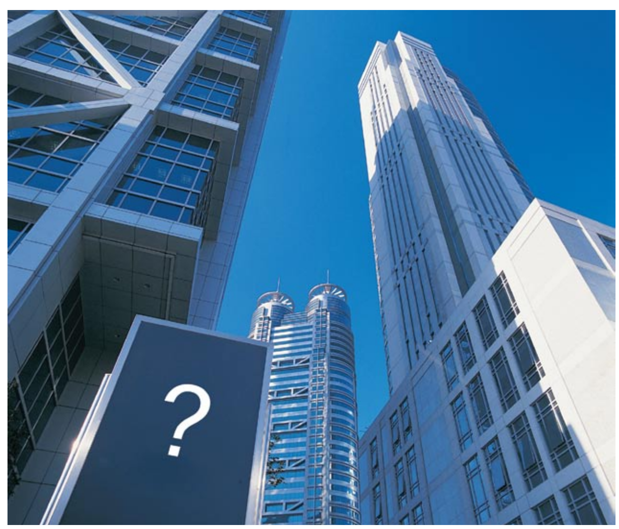
The name game: A critical acquisition decision you shouldn't neglect

Among the many decisions buyers must make after acquiring a company is the fate of that company's name. The potential fallout from a name change — or, conversely, from keeping the name — means that careful thought and a sound strategy should go into the choice.

Menu of options

Naming decisions are never a simple "yes" or "no" choice. Depending on your situation, you may want to:

- Change all of your acquisition's operations to your company's name. Pfizer, for example, currently is in the process of renaming all of Wyeth's operations and products.
- Keep the acquisition's name for specific units or the entire operation. For example, although Smith Barney was acquired by Primerica Corp. (and later by Travelers Group), retail brokerages continued to operate under the Smith Barney name.
- Combine your acquisition's name with your own company's. This often is a necessary compromise in a "merger of equals" scenario, as with AOL/Time Warner and DaimlerChrysler.



- Create an entirely new name for the merged company. Examples include InBev (from Interbrew and AmBev) and Chemtura (from Crompton Corp. and Great Lakes Chemical).
- Change your company's name to that of your acquisition, especially if the acquisition has better name recognition. This is a rare situation, but it occurs occasionally, as when NationsBank acquired BankAmerica in 1998, changing its own name to Bank of America.

Sometimes the advantages associated with a name change are fairly obvious — for example, when a well-known and respected national company purchases a small regional business. And if you intend to fully incorporate the acquisition into your existing operations, it usually makes sense to rename it.

You'll need to change office signs, stationery, the Web site, packaging and employee uniforms.

The case for change

Buyers have many good reasons for bestowing their own name on an acquisition. These include: to signal a major cultural shift; to present a unified company image and unambiguous brand identity to the public; or to replace the damaged name of a distressed company with one that carries more credibility.

Creating a new name for both companies, on the other hand, can help them form a post-transaction "culture of equals." Without the historical implications of individual company names, employees are more likely to recognize the need for change. And a fresh identity can reduce the prevalence of management "fiefdoms" that might have stifled growth, innovation and new ideas in the past.

Any name change, however, can negatively affect customer and employee loyalty and damage brand effectiveness. So be sure you weigh the pros and cons of changing your acquisition's name.

The case for continuation

Name changes don't always have strategic appeal — for example, if you're purchasing a business primarily for your seller's trademarks, customer base or marketplace cachet. There's no good reason to discard a name you paid good money to acquire.

The logistics of renaming can be costly and time-consuming as well. Consider what it will take to hire a branding consultant to come up with possible names and then research copyrighted and trademarked names to ensure you don't encroach on another company's name. You'll also need to change office signs, stationery, the Web site, packaging and employee uniforms, and market the new name.

Further, you run the risk of alienating and confusing customers. Federated Department Stores learned that the hard way when it rebranded many of its retail acquisitions with the Macy's name and met with customer anger and resistance — notably in the Chicago area, where some former Marshall Field's customers organized protests and boycotts.

An imperfect decision

Start thinking about your acquisition's name well before you close the transaction, and include a variety of executives and department heads in the discussion to ensure you've considered it from every angle. Keep in mind that, no matter what your decision, you'll never make everyone happy. Your goal, however, is to determine which name offers greater advantages than disadvantages. ■

Ask the Advisor

Q. How should I handle compensation-related disparities in my merger?

A. Compensation may seem like a minor detail when you're buying or selling a company, but it can cause major headaches — particularly when the two companies' compensation practices differ.

Compensation practices can differ in several ways. Merging companies may pay different base salaries or salary ranges for the same position or offer dissimilar performance-based incentives.

For example, one company may pay out annual bonuses to all employees based on company performance and the other may give bonuses to only select employees who meet specific goals. Or one company may offer executives a nonqualified deferred compensation plan, and the other a basic retirement savings plan. Such scenarios often lead to employee dissatisfaction and poor integration.

Act quickly and decisively

The worst compensation mistake you can make during a merger is to leave current compensation structures alone. You may think employees won't find out what their new colleagues are getting, but they will — and probably sooner than you anticipate.

Head off conflicts between the two employee groups — those who perceive themselves as undercompensated and those who worry they have something to lose — by acting quickly and decisively. If you don't, rank-and-file staff could make the critical integration stage difficult by acting uncooperatively. And key employees, instrumental to your company's future success, could jump ship.

Cost vs. growth

Compensation decisions can be tricky because they usually require some tradeoff between cost savings and the pursuit of growth objectives. If, for example, your target's sales force earns much of its compensation via commissions and incentives, moving them into your more cost-effective, salary-based plan could prompt the best salespeople to defect to your competitors. When changing compensation structures, be sure to provide an accounting of how newly proposed structures can be more lucrative for employees. Transparency is key.

If you're having trouble making decisions, consider hiring a third-party compensation consultant. This expert can review existing plans, compare them to those of others within your industry, and draw up a new plan that balances cost with fairness. Your employees are more likely to accept the research findings and plan of a third party.

Once you have a plan, use your human resources department as your compensation command center. These staff members already are knowledgeable about compensation structures and are likely to have their ears to the ground and know employees' concerns. They can work with you to devise the best communication strategy and troubleshoot individual employee issues.

Decisions are final

Whatever the new plan, be sure to stick with your decisions. In no way should you give the impression that compensation will be negotiable again in the near future. This perception could undermine the cohesiveness of your fragile new organization. ■