Merger & Acquisition Focus

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8 first-time seller mistakes

Looking up
An economic recovery can be your selling opportunity

Initial steps to integration success

Ask the Advisor

8 first-time seller mistakes

If they're not careful, business owners selling their first company can make serious mistakes that jeopardize the deal or result in a lower sale price. Selling successfully requires extensive advance preparation and strategizing. It also demands the same level of personal attention and commitment that it took to build the business.

Fair warning

To avoid making mistakes that could kill your deal or result in a lower-than-fair price, be sure you don't:

1. Fail to use an experienced intermediary. Owners who made ill-fated attempts to sell their own business often confess that they wish they had used an experienced intermediary. Without professional help from advisors who understand their company, industry and M&A market conditions, sellers are prone to take the wrong advice from the wrong people.

2. Under- or overestimate your company's value. Companies rarely have a current or accurate business valuation, and too often their asking price is unrealistically high or low. Buyers tend to value current performance while sellers value future growth, so be sure to find industry sales comparables.

Many business owners neglect to plan for their personal financial and estate needs after the sale of their company.

To limit tax exposure, many closely held businesses suppress profits. As a result, their financial statements may not reflect the company's value to a prospective buyer. Ask a financial expert to review your financial statements and adjust them to eliminate

discretionary and nonrecurring expenses, and other items that artificially reduce your company's value.

On the other hand, don't assume buyers will be willing to pay what you consider your company to be worth. When setting a price, be as objective as possible and take into account such factors as the current M&A market and general economic conditions.

3. Misunderstand buyers' motivation. Buyers seldom buy what sellers think they're selling. Sellers may focus almost exclusively on numbers when their buyers are actually looking at intangible assets, such as reputation, brand, intellectual property and management skills. Buyers also usually look for improvement opportunities. By highlighting areas that could benefit from the buyer's greater financial or staff resources, for example, you could enhance your company's perceived value.

4. Reveal too much to the wrong buyer. Selling companies often assume that the most appropriate buyer is a competitor, customer, supplier or employee. But if the deal falls apart, a great deal of confidential information may have been disclosed. When working with these types of buyers, keep financial and operational information confidential until you're confident that the transaction will close successfully. Break-up fees can also help protect your company and its confidential information.

5. Assume the best buyer is local. Many sellers assume that the market for their business is their own city. But today, the best investor may be across the country or, as is increasingly common, halfway around the world.

6. Neglect to prepare financial statements. When buyers perform due diligence on acquisition targets, they often want to know what the business would have looked like if it had been a public company. In addition to adjusting financial statements, prepare three- to five-year pro forma projections that are backed by solid market research.

7. Mention price first. A cardinal rule of negotiation is never to be the first one at the table to mention price. Value is subjective, and an experienced buyer who sees your company's potential may have a higher price in mind. Your advisor, who has no emotional stake in your company and is, thus, better able to view its value objectively, can be particularly helpful at this stage of the deal.

8. Forget to plan for the post-sale future. Many business owners neglect to plan for their personal financial and estate needs after the sale of their company. If you're retiring from the work world, discuss your income requirements and tax-efficient strategies for passing on your wealth to your heirs with a financial professional.

If you don't need cash from the sale of your business and are willing to defer some of the sale proceeds, you may realize a higher price. If, on the other hand, you need an all-cash deal, buyers are more likely to lower their offer.

Careful deliberation

Unfortunately, the previous eight mistakes are only some of the most common first-time seller pitfalls. To ensure you don't make other ones, take your time when deliberating major decisions such as when and to whom to sell and at what price. Also, make sure you retain an M&A expert to help you execute your decisions. ■

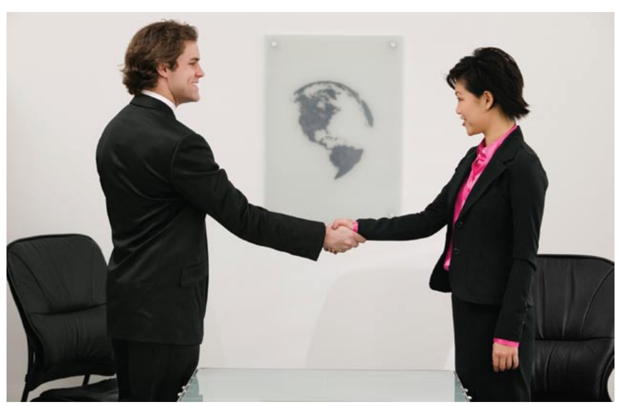
Looking up

AN ECONOMIC RECOVERY CAN BE YOUR SELLING OPPORTUNITY

Although there's some disagreement over whether the country's recession is over — and even more over how long a full recovery could take — the future is finally beginning to look brighter for the M&A market. Selling a business in a still-fragile economy may not be ideal for some owners. But if you've been waiting to sell and are well positioned, now may be a good time to start strategizing. That way, you'll be ready to strike when the iron's hot.

The fever breaks

Several recent economic indicators have provided reason to hope that the economy is recovering.



According to the U.S. Commerce Department, the nation's gross domestic product grew at an annual rate of 3.5% in 2009's third quarter — the first positive quarter in a year and the largest increase since late 2007. Retail sales appear to be on the upswing, and even Ford Motor Co. posted a surprising $1 billion profit in the third quarter.

Assuming the economy suffers no additional severe shocks, corporate buyers and private equity funds that have bided their time building cash reserves are expected to re-enter the M&A market. A couple of big deals that made headlines toward the end of last year may serve as good omens. In November, Stanley Works announced it would acquire Black & Decker for $3.5 billion and Berkshire Hathaway announced its purchase of Burlington Northern Santa Fe for $26 billion.

Your transaction will likely be smaller than these, of course, but deal participants of every size can expect several common constraints. Most buyers will be more gun-shy than they were before the recession, and therefore more focused on risk. Sellers should expect greater balance sheet scrutiny, a longer due diligence process and possibly more price haggling.

Overcoming financing barriers

Most deals also will face financing difficulty. Banks have adopted more stringent lending criteria and stricter covenants, and private equity lenders — whose money was instrumental to the last M&A market boom — have yet to emerge in force from the sidelines.

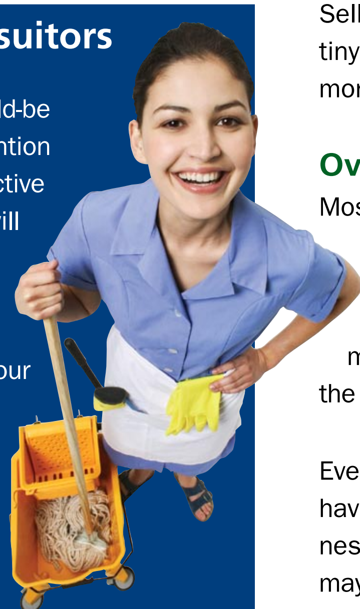
Even companies with strong balance sheets may have trouble raising enough capital to buy a business. Therefore, owners determined to sell this year may need to “help” their buyer by compromising on price or deal structure. If, for example, you’re ready to retire and you’ve already spent several years preparing your business for sale, consider:

Accepting equity. Instead of an all-cash deal, accept a portion of the price in stock options. This reduces your buyer’s financing needs and signals your confidence in the company’s future value.

Financing the deal yourself. In a seller-financed transaction, the buyer makes a “down payment” when the deal closes and pays you the rest in installments over a set time period.

An earnout. Instead of paying the full amount asked, buyers make part of the purchase price contingent on their ability to meet future earnings targets or agreed-upon performance milestones after they’ve absorbed your company. Be sure,

Scrubbing up for suitors



Currently, a surplus of would-be sellers is vying for the attention of a limited pool of prospective buyers — which probably will be the case for some time. Stiff competition means that, if you haven’t done much recently to prepare your business for the market, you need to get cracking!

Start with simple, but important, tasks such as cleaning up the physical appearance of offices and production facilities. Then focus on cleaning up your balance sheet, paying particular attention to liabilities. Buyers that have waited out the recession by building their cash nests aren’t going to be interested in acquiring a pile of new debt. To reduce debt, consider making a strategic divestiture of a unit or selling real estate that isn’t likely to boost your market value.

Because buyers won’t look only at your numbers, determine your company’s strategic value and how you can communicate it effectively. For example, would acquiring your business enhance a buyer’s product line or regional presence? Do you offer valuable intellectual property or management savvy? These are the factors that make a company stand out.

however, that you maintain a management role in the company, so you have some control over the final sale price.

Confident, not delusional

Just because conditions appear to be improving doesn't mean the economy or the M&A market is out of the woods yet. Before becoming overly optimistic, remember that countertrends such as weakness in the banking sector or continued high levels of unemployment could hinder a recovery. And some industries are likely to recover more slowly than others.

On the other hand, financially healthy companies that have adequately prepared and made themselves attractive to potential buyers often can find a good offer in any market. You enhance your chances of successful sale by remaining confident — and flexible. ■

Initial steps to integration success

M&A deal participants usually focus their energy on such activities as pricing, due diligence and negotiations. Numerous studies and ample anecdotal evidence suggest, however, that poor integration is the most common reason that mergers fail to meet their objectives.

Integration should begin early — earlier than you might think. In fact, buyers need to get the process rolling before they tell employees or publicly announce the deal.

Philosophical thought

Before you devise a plan and put it into action, take a moment to consider your "integration philosophy." Think about whether the combined organization will aim for a "best of both" situation in which the contributions of the two companies are valued equally, or whether the acquired business will be asked to assume your company's culture.

Also weigh short- vs. long-term thinking. Sometimes buyers focus on short-term "boosts." They might, for example, quickly close a weaker unit to reduce costs or combine former rival divisions to achieve cost synergies. Such hasty decisions can alienate employees and customers and hurt the company's long-term success.

On the other hand, a slow or unambitious integration plan can be just as harmful. If, for example, you want to equitably distribute management roles, your goal shouldn't come at the expense of promoting the best employees or dragging out the task.

Team approach

An integration team can be particularly helpful in the early stages of the process. Assemble this team from executive-level personnel representing such areas as human resources, accounting, technology, sales and public relations from both companies, and be sure one or more members also work on your merger's deal team.

The team should map out an integration timeline, with tasks, responsible managers and deadlines, and meet regularly to monitor progress toward these goals. Inevitably, some tasks will take more or less time than expected and others will become more or less important as time goes on. Give the integration team leeway to change priorities as the deal progresses.

Discrete parts of the whole

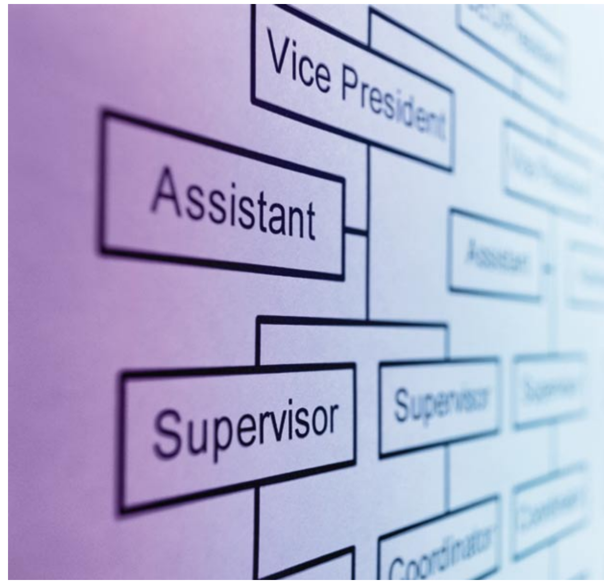
As you approach integration, understand that it isn't a monolithic task, but instead a collection of smaller, but critical, activities. Early-stage considerations include:

Employees. Buyers often decide to buy only certain units or divisions, and employees may be laid off or required to relocate as a result. If you plan to combine, close or sell units, inform employees as soon as you're reasonably sure how the action will affect them, rather than letting rumors circulate. Also start evaluating your target's benefit plans and determine whether employees will keep their old benefits or move to your plan.

If you want to equitably distribute management roles, your goal shouldn't come at the expense of promoting the best employees.

Consider holding orientation sessions for both your and your target company's employees to introduce them to the different management styles or office cultures they're likely to encounter. Throughout the process, work with your seller's human resources department to communicate your plans and provide support.

Management. This is often the most political integration task; you'll need to decide who will



report to whom in the combined company. Evaluate members of both management teams fairly and consider what each person brings to the table. Giving preferential treatment to your own company's team could result in the early departure of your target's valued managers.

Information technology. There's only one rule when it comes to IT integration: It will take longer and be harder than you anticipate. Start the integration process immediately by putting your IT department in touch with your target's so they can determine compatibilities and redundancies.

Product and client integration. Many mergers involve combining similar product lines and eliminating some products. As you make these decisions, consider your current customers and whether cutting a product, introducing a new sales representative, or implementing a different customer service process might lead to contractual disputes or lost business.

Biggest deal-killer

For most merging companies, integration is a long and complex process, and procrastination only makes it more difficult — if it doesn't kill the deal altogether. Begin as soon as feasible by determining your integration philosophy and forming an integration team to carry it out. ■

Ask the Advisor

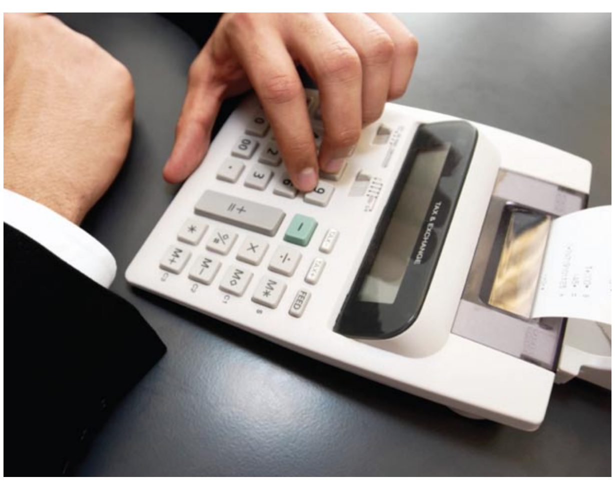
Q. What does it mean to "buy a balance sheet"?

A: In an uncertain economic climate, bank financing for strategic growth initiatives can be hard to find — even for financially healthy companies posting regular profits. Companies having trouble attracting lenders could consider "buying a balance sheet," or acquiring a cash- or asset-rich company it has little strategic use for to use as loan collateral.

Buying a balance sheet may be a viable option if you have the means to make an acquisition. Your target company should have ample cash or liquid assets, but be relatively small compared with your own so that you don't need to seek outside financing to complete the transaction (which would defeat the purpose of such a deal).

Balance sheet at work

To understand how the strategy might work, consider BioSante Pharmaceuticals' recent acquisition. The company had $6 million in reserves but needed an additional $35 million for upcoming clinical trials for a new, potentially profitable drug. Unable to raise capital through banks or even private equity funds, BioSante instead bought Cell Genesys, which is expected to show as much as $23 billion in additional cash on the balance sheet.



BioSante admitted it had no strategic need for the nine-person Cell Genesys staff or its prostate-cancer drug products. It bought Cell Genesys primarily because it promises to produce additional cash. BioSante offered the seller an all-stock deal, which enabled it to preserve its existing cash holdings.

Does the shoe fit?

BioSante's growth strategy highlights the fact that buying a balance sheet is likely to work for only select companies able to make a stock deal. If your company undertakes such a transaction, be sure that your target shares enough similarities with your company — such as those of industry, location and company culture — that integration and consolidation won't be overly difficult or time-consuming.

You also need a seller with good incentives to accept the deal. A small startup whose owners are willing to move on in exchange for a stake in your company's long-term growth, for example, could make a good acquisition target.

Sellers also benefit

This strategy doesn't benefit only buyers. Sellers with a decent cash reserve or significant liquid assets can negotiate for a higher-than-market price and favorable deal terms, such as consulting arrangements for the selling owners or an agreement to keep the business intact for a period of time. But as with buyers, the balance-sheet deal will appeal to only a limited group of sellers — typically to entrepreneurial owners in high-cash-generating sectors. ■