

Preparing Your Company for Sale

By Thomas J. Wilson

There are five action items that a board should consider to bolster its company's value and to improve the sales process.



Thomas J. Wilson

Debt is a vital component for most M&A activity and the rise and fall of M&A activity has been directly related to the vitality of

the credit markets. The availability of easy credit fueled the M&A bonanza from 2003 through the credit crash of 2008, just as the demise of Lehman Brothers froze credit markets and sent the M&A market into hibernation.

More than one year later, the credit market seems to be reawakening. Banks have de-levered their balance sheets and as a result of stimulus money and other liquidity provided by the Federal Reserve Bank, banks appear to be lending again. This development bodes well for future M&A activity. According to *businessworld.com*, worldwide M&A activity rose to \$520.4 billion in the first quarter of 2010 and the number of announced deals increased by 18% worldwide from the same period in 2009.

In addition, the *KPMG LLP and the Deal LLC Annual M&A Survey 2010* indicates that 61% of respondents believe that financial sponsored M&A activity will increase in 2010 and 30% believe it will hold steady. In the same survey, 70% of the respondents were more optimistic about the deal environment today than they were one year ago.

This data and other empirical and anecdotal evidence suggest that, absent a major global economic or political crisis, the year 2010 and beyond should see an increase in M&A activity. It is unlikely, however, that the hyperactive price bidding and manic auction process of the past will return soon, if at all. Therefore, any company contemplating putting itself up for sale or seeking to divest itself of a major division should consider taking certain actions that could enhance its attractiveness to a potential suitor and to optimize the M&A process.

There are five action items that a board of directors should consider to bolster its company's value and to improve the sales process. These actions are can be loosely categorized as financial performance, customers and suppliers, management, regulatory matters and contractual arrangements. Some of these actions require considerable planning and are not easily obtainable. The board of directors should weigh carefully the time and resources that could be devoted to any particular action against the deal-enhancing potential of any such action.

Financial Performance

To a large extent, it is all about the numbers: Has your company performed financially and what are its future financial prospects? Although this concern may not be as important in some strategic acquisitions (for example, eliminating a competitor),

it is certainly crucial in private equity transactions and is the prime factor in most deals. Most transactions are priced based on a multiple of a company's earnings before interest, taxes and amortization, or "EBITDA." However, companies in certain industries may be valued based on revenue, unique website visitors, order backlog or the uniqueness and/or value of inventory. Still, in most cases, an acquirer will carefully scrutinize a target's financial data and through pro forma adjustments ascertain the true EBITDA of the business. It is not uncommon for a buyer to attempt to renegotiate a purchase price after a letter of intent has been signed due to the buyer's "appropriate" adjustments to EBITDA. A company that can demonstrate increased operating income and reduced operating cost will find its business perceived more valuably by an acquirer. Acquirers generally will use the trailing twelve months data to determine an average historical EBITDA.

The multiple applied to a business is determined by many factors, including the attractiveness of the business, its prospects and sometimes by industry norms. Within an industry there may be a range of multiples that might apply and a good investment banker can help guide the board of directors through this process.

The future financial prospects of a business can be just as important as the historical financials. Most acquirers want to see a company with solid projections. If a company

cannot fully justify its projections, the purchase price for that business will suffer. It is also not uncommon for a buyer to attempt to renegotiate a purchase price due to the lack of solid projections. Projections can be highly subjective and therefore are often the subject of disputes between prospective buyers and sellers.

Customers and Supplies

A business' customers and suppliers are significant considerations in the discussion of projections. Most acquirers, particularly financial buyers, like to see that a target has a solid customer backlog. In industries where long term contracts are not customary and therefore a backlog is not feasible, a buyer most likely will focus on the company's future business plan compared to past performance and will scrutinize the company's capacity to execute its plan. Having solid, long term relationships with top customers that can be demonstrated during the due diligence process is extremely helpful. Likewise, demonstrating that your business has and can manage its costs through long term, favorably priced supply contracts may enhance a target's value.

Management

Solid senior management is the key to any well run endeavor. A strategic buyer may have its own senior management team in place, but most private equity acquirers will not. The board of directors should establish a development and succession plan to make certain that senior management is well equipped to develop and execute strategies for the long term growth of the business. A capable management team will be required to execute the company's existing business plan or the plans developed by the buyer.

In some cases a buyer will have an existing senior management team to take over the business. In those circumstances the board of directors should consider transitional issues and the adoption of a retention plan to make sure any deal does not fail due to the lack of continuity. These

for all of its commercial arrangements and these contracts will verify matters stated by the target company. Establishing and maintaining a system of orderly documentation can not only facilitate the buyer's due diligence process and save transactional cost for both parties,

Absent a major global economic or political crisis, the year 2010 and beyond should see an increase in M&A activity.

issues are particularly important when an earn-out or other contingent purchase price arrangement has been stipulated.

Regulatory Issues

Many acquisitions concerning targets that are subject to industry regulation are derailed or delayed due to regulatory issues. It is important for the board of directors to focus on the quality of the company's regulatory compliance. Lapses in compliance tend to persist unnoticed for many years and are not easy to discover or correct; and once discovered they can be very costly or impossible to correct. If a buyer decides to close a deal in light of regulatory compliance issues, the costs to correct these problems usually are borne by the seller, either through a specified escrow arrangement or strict indemnification provisions. A company's regulatory counsel should be engaged to review the company's current compliance regime to uncover any potential problems so that they can be rectified prior, or managed properly during, the sales process.

Contracts

Contracts are very important to an acquirer and its lawyers. The contracts of a business form the basis

it also reflects on the company and its management. Any company that has a concentration of key customers and/or suppliers should make sure that those contractual arrangements are in order prior to commencing the sales process. A buyer may insist on having complete copies of all major contracts. Obtaining these documents after the deal process has begun can be complicated; especially because a target usually does not want it publicly known that it is for sale. Accordingly, a buyer's reasonable insistence on having these contracts can delay and complicate a closing.

While there are many components of an M&A deal that will factor into its successful completion, the board of directors that focuses on the five action items above can position itself favorably in the deal market and can increase the odds for a successful conclusion. Credit markets are beginning to thaw, acquisition activity is heating up—the time to take action is now.

Thomas J. Wilson is a partner with Golenbock Eiseman Assor Bell & Peskoe LLP. His experience ranges from complex acquisitions and divestitures, middle-market private debt and equity financings to advising clients on a range of various day-to-day issues. He has represented foreign and U.S. clients in connection with the acquisition of businesses in Europe, U.K., South America and the Middle East.