SELL WELL

Understanding the M&A Process and Avoiding the Most Common Mistakes of Selling a Business

by

Rene Robichaud | Peter J. Kubasek | William F. High

WHAT PEOPLE ARE SAYING ABOUT *SELL WELL*

"Most owners of a private business grew the business over years and have years of experience. But these same successful owners will only sell their business once. It is hard to get experience selling your business in that setting. Rene, Peter, and Bill come at the subject with the experience of selling (and buying) businesses most of us will never have. They have explained the process in *Sell Well* in terms all of us can easily grasp. Give yourself the benefits of these three experienced successful authors."

David Dillon
Retired Chairman & CEO, The Kroger Co.

"ArkMalibu's technical expertise in our industry was instrumental in finding us a great deal and partner. From crafting a creative and compelling M&A story, to successfully negotiating with the sophisticated buyer community, and ultimately leading us through a rigorous due diligence process that included the wind down of a pension plan and ESOP, ArkMalibu quickly became our trusted advocate that surpassed expectations. I would strongly recommend any business owner consider ArkMalibu if contemplating an exit."

Dan Dungan
Executive Chairman of Springfield Electric

"*Sell Well* is a MUST READ if you are a business owner, especially if you are a baby boomer! Rene, Peter and Bill include everything a business owner needs to know, and more, about how to define and assure success in selling your business. Sell Well is written in a manner that immediately engages your interest and thought. I found myself underlining content, flagging pages, and applying the wisdom shared to my own situation. Anyone who reads this book will find it to be a valuable and often referred to resource!"

Jeff Holler, CFP®
President & CEO, The Capital Chart Room LTD®

"I've visited with dozens of business owners who have exited a company and in at least half the cases, the exit was overly painful, or the aftermath was a disaster. Rene, Peter and Bill have written the book every owner/CEO should read when that twinkle of an idea comes into their head that they might someday sell...if they do, it will make for a much more successful and pleasant exit."

Steve Grubbs
Serial entrepreneur & CEO, Victory XR

Sell Well is a carefully fashioned manual for any business owner who might be considering an exit. It comes directly from the real-world genius of Rene and Peter through their experience running one of the most premier boutique M&A firms in the United States. As an entrepreneur who ran a process through ArkMalibu, from the CIP all the way through the completion of the deal, our story was meticulously crafted, our deal was artfully negotiated, and our due diligence was smooth sailing. They possess a keen capability to create value-driven solutions out of challenges that might otherwise have been problematic for a potential buyer.
I would highly recommend the book and would most certainly encourage any business owner to engage with ArkMalibu if an exit is on the horizon.

Geneva Milne
CEO of Gunner Concrete

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DEDICATION

RENE ROBICHAUD

To Karen, Chris, Shannon, Grayson, Nicole and Zach, I am so grateful for having you in my life.

PETER KUBASEK

To my beautiful bride Maryam, who supports me and encourages me on the journey of life.
I will forever be thankful and to my awesome sons, Hudson and Luke; you are both a blessing.

BILL HIGH

To my wife Brooke who inspires me because of her example of love and service.

ACKNOWLEDGMENTS

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Amy Krueger and Maryam Kubasek, two great editors

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Jack Painter for thoughtful insights

Jon Reischel for coaching and insights

Ron Wheeler, our gifted cartoonist

Thank you all for your dedication to this project.

TABLE OF CONTENTS

FOREWORD

Selling your business can be either the capstone to a successful career or an outright nightmare. Having purchased and sold numerous businesses myself, both as the intermediary handling the transaction between buyer and seller and, later, as a principal seller, I have seen that firsthand. Too often, those of us with the entrepreneurial spirit assume we can accomplish anything we set our mind to, including a successful sale of that business we have so carefully nurtured over many years. But the challenges of selling that “baby” are numerous: emotional upheaval, taxes, giving considerations, family dynamics, unreasonable buyers, recast financial statements, representations and warranties, and the myriad of issues outside your control, such as bankers, interest rates, government regulations, etc. And perhaps the biggest challenge is trying to answer the question, “What will I do with my time now?”

As the investment banker in over 100 transactions, I often felt as though I were more of a psychologist than a dealmaker—more of a counselor than a financial analyst. The number of deals that blew up over insignificant items is unbelievable. I have seen transactions that didn’t close because of a conflict over the picture on the board room wall or the old pickup that the buyer thought he was purchasing. I have seen people pay enormous amounts in taxes rather than structuring the deal so that tax money could be transformed into charitable dollars. I have seen sellers turn down very good offers only to sell later at a substantially lower price—because they had failed to understand who was their best buyer and what was a fair offer.

And, later in my career, as a principal owner and, ultimately, a seller of several privately held companies, I found myself in the same shoes as many of the clients I had assisted in prior years. I have had the unfortunate experience of selling companies for the highest price instead of the best sustainable fit for the business and its employees. I have seen that large companies with substantial amounts of cash can close the transaction quickly, but can just as quickly decimate the values and culture that took years to develop. I have experienced the ramifications of seeing long-time employees laid off or demoted because their culture didn’t fit with the new buyer’s. I have had my professional counsel tell me I was foolish for giving away substantial amounts of the sale proceeds to fund causes I believed in. And had I not truly understood the tax savings and the ultimate benefit, I would probably have followed their advice.

Peter, Rene, and Bill have done a terrific job of writing this succinct guide to all the major points you need to consider before selling your business: choosing wise counsel, preparing yourself mentally and emotionally for the sale, preparing your business for the sale, choosing the right buyer, preparing to give charitably—and answering the big question, “What do I do now?”

Selling your business may be the biggest professional decision you will ever make. And it is likely one of the most significant stewardship opportunities you will ever have. This book will help take the mystery, misperceptions, and anxiety out of the process of preparing your business for market. It is a must-read if you are even thinking about that big liquidity event. I encourage you to read thoughtfully so you can truly sell well.

Pete Ochs
Entrepreneur | Investment Banker | Chairman, Capital III

With the flood of baby boomers planning to sell their businesses all at once, Bob was tempted to consider any young entrepreneur as a potential buyer.

INTRODUCTION

As the first wave of Baby Boomers headed into their early sixties, more than 70 million Americans were thinking about empty nests, disposable income, and at long last, retirement. For business owners, the time had come to think about cashing out. It was time to turn decades of hard work—through Vietnam, stagflation, Reaganomics, the dot-com bubble, the Great Recession, and the COVID-19 pandemic —into the Golden Years. It was time for the next phase of their American Dream. However, we all know how those best-laid plans turned out for many business owners who had to wait for better times following each of these economic disruptions.The buying and selling of businesses slowed to a crawl, and stagnation continued often for several years. This is the same American business reality that has repeated itself for generations.

We have been advising business owners on the sale of their companies for more than 30 years and have witnessed their struggles with market turbulence. This turbulence can have a crippling impact on their exit timing. When is the best time to sell? When does a merger or acquisition make the most sense? How will a deal today impact both short-term return and the future legacy of the business? Although we have worked hundreds of deals, we still can't predict the unknowable. We can't pick the next election winner, what the Federal Reserve will decide in its next three years of private meetings, or what your customers may or may not do and how that might affect your business. At least not exactly. What we do know from history, however, is that merger and acquisition (M&A) activity moves in cycles. It's difficult to predict how long a cycle will last. But the cycle always peaks, and a trough always comes.

Look past the uncertainty and confusion of the M&A cycle roller coaster and focus instead on the fundamental lessons that always apply.

Led by the Baby Boomer sell-off, the U.S. middle market is poised for transformational, generational change during the next ten years. Currently, acquisition demand is high. Many sellers continue to receive high multiples of trailing revenues and cash flow as buyers are flush with cash. However, there are more than 100,000 U.S. middle market companies led by CEOs who are in or near retirement age, according to Headwaters SC, who state that two-thirds of such companies are sold rather than transferred to a next generation of owners.

The large number of potential sellers hitting the market in a short period may cause a market change, where increased supply eventually drives down the average price and multiples for middle market business owners—all the more reason to be prepared and understand the tips covered in this book. We want to help business owners look past the uncertainty and confusion of the M&A cycle roller coaster and focus instead on the fundamental lessons that always apply. Using many actual examples with changed names, we i) discuss the biggest M&A mistakes private company owners have made, ii) give you go-to-market strategies for enhancing your understanding of the deal process, and iii) provide ideas to help maximize the market value of your business. We discuss everything from how to dig into the nitty-gritties of contracts and tax structures to how to prepare for the big ideas of future impact to your company and your life after the sale. We also let you in on some of the best innovations from our own experience, including the Art of the Possible, our way of thinking outside the box to find solutions that our clients never imagined were available.

If you have no destination, any road will do. This scary yet accurate piece of advice was offered by the Cheshire Cat in Lewis Carroll's classic, *Alice's Adventures in Wonderland.* Our goal in the following pages is to help business owners, particularly the one-time seller, who may be considering plans for management and ownership succession. Most M&A transactions are completed by experienced buyers. The one-time seller can be taken advantage of in this busy, professional marketplace. It is best to be well prepared. We want to help you create a clear definition of success (your destination) and choose a process that will maximize the odds for that success (your road).

For buyers, M&A is a knife fight.

Recent M&A data show approximately 20,000 transactions close annually in the USA and Canada. For every deal closed, estimates are that one deal failed to close. The estimated number of company sales attempted annually ranges from 30,000 to 50,000. The vast majority of the potential transactions are in the middle market and lower middle market. Full or limited auctions are the most common method for sellers attempting to achieve their goals of maximizing value and finding the best new owner. In such auctions, it is not unusual to invite 100 to 500 potential acquirers to consider the selling company's investment merits. Getting 10% to 20% of these professional buyers to read the formal confidential information presentation (CIP) would demonstrate good market interest and would be common in a hot market with an attractive target company. A good result would be to invite the top 3 to 10 buyers in for a management presentation. Several of these potential acquirers often end up working the acquisition hard enough to submit a thoughtful letter of intent (LOI). In a successful deal, one of these buyers will be selected to conduct even more due diligence for 45-90 days. Buyers often supplement their own management teams with professional consultants, bankers, lawyers and accountants. The opportunity and out-of pocket costs for any serious buy-side effort can easily range from $100,000 to $1,000,000 or more per potential transaction. Often, professional buyers work on ten buy-side opportunities before successfully closing on one.

The point of all the above numbers is to say that professional acquirers spend millions of dollars on potential deals that do not get done. That puts enormous pressure on buyers to focus only on acquisition opportunities that are professionally managed, as well as to seek any and all ways to maximize their chances to win an auction for control of an attractive company. This is why some buyers push the bounds of ethics to enhance their probability of success. See "Selected Games Some Buyers Play" on page 56.

> *"Our goals can only be reached through a vehicle of a plan, in which we must fervently believe, and upon which we must vigorously act. There is no other route to success."*
> - Pablo Picasso

A dear friend in the Midwest decided to sell a large division of his company, and he hired an investment banker to sell it. His investment banker went to work and showed the idea broadly to potential acquirers. The highest price came from an unknown financial buyer in New York. They closed the deal after a short due diligence period, and all seemed well at first. Soon after the transaction, though, the large division that had been sold off started to underperform.

The new owners had implemented cost cuts and eventually merged operations into another portfolio company based in a faraway state. Hundreds of employees lost their jobs. Our dear friend regrets his choice of buyers. He sees out-of-work former employees around town and feels he could have done better by them by selling for a little less money to a more capable and compatible buyer. Our friend's reputation in the community has been damaged. His employees in the company divisions he retained are worried that their jobs are at risk now, too. Operational effectiveness is down. Customers aren't as happy. And the company's financial results are well below plan. So, how did a seemingly straightforward process of selling one division go so badly for the business owner and the whole organization?

In this case, the missing piece was the development of a clear list of goals for the transaction. This is a strategic element that is just as relevant for any sale, but it's no easy task. There are dozens of transaction variables—from company size to ownership structure to geographic location—and dozens of owner profile types. This means there could be a long list of goals that any given owners will have for the sale of their business.

The maximum value could be the highest cash price offered, but not necessarily.

Below, we list several goals that most often rise to the top, based on our experiences working with hundreds of middle market company owners. The list is not exhaustive, but it gives a glimpse into the kinds of decisions that should be considered prior to undertaking the sale process.

- **Maximum value:** This could be the highest cash price offered, but not necessarily. Buyers can, and often do, offer several forms of valuable consideration that the seller must carefully evaluate—more on this later. People often talk

Destroying property, smashing guitars, and trashing hotel rooms are high on our list of goals as well. I'd like to buy your band.

about a given multiple of EBITDA (earnings before interest, tax, depreciation, and amortization) as their target value. Your target value should be tested early to make sure you have a reasonable probability of success in the sale process. This test can be done by financial professionals who have expertise in using business valuation techniques and who understand the current M&A market for companies in your industry. This test will generate a range of values for your company. If the entire range of values is acceptable to you as a seller, you are good to go ahead with starting the sale process from a financial point of view. If not, you should carefully consider either adjusting your value expectations or waiting for a better time to sell. (See page 10 on Why Some Buyers Pay More.)

- **Retain some upside:** You may not want to sell 100% today. Some or all of the owners may agree to sell a controlling interest (usually over 50%) and keep some equity for a second liquidity event. Private equity players generally want the sellers/management to keep a significant equity stake until the next sale, usually 3-7 years down the road. Alternatively, you may only want to sell a minority interest. In either case, your family and your management may want a significant role in the business going forward.

- **Outcomes for key leaders:** The new owners often want to keep the current senior management team and incentivize them to build long-term wealth. The seller may want the senior leaders to have a generous severance package in case things don't work out post-transaction. Certain investors may bring in their own people. Different types of buyers have different approaches to motivating key leaders. See the discussion below on types of buyers and their characteristics.

- **Employee motivation:** Some acquirers do not want to change the current corporate culture, while others expect employees to adopt a new (and potentially very different) culture right away. For some sellers, this may not matter. Other business owners may be willing to steer a transaction toward a buyer that offers fair value and embraces the current culture.

- **Support for the community:** What will happen to the jobs in the community? What will happen to the loyal local suppliers? Will the new owner grow the business where it stands? Will the new owner move its operations to another state or country? What about the charities, the schools, and the sports teams the business and employees have jointly supported?

- **Percentage of cash paid upfront:** Some acquirers will buy the whole company for cash paid at closing. That can be ideal, and it minimizes your risk as the seller. Often, however, the most economically attractive offers come from buyers who commit to payments over time (with some risk attached to potential future payments). How much cash do you need or want up front? And how much risk are you willing to take on future company performance and, therefore, future cash payouts?

- **Terms of earn-out payments:** Earn-out payments are contractual payments, usually made by the buyer to the seller at future dates, and contingent upon the company achieving a specified minimum level of financial performance (e.g., EBITDA or revenues). They are often used when buyer and seller have a large perceived-value gap. The terms of the earn-out may represent a large portion of the deal value. The more confidence you have in your financial projections, the more likely you are to accept earn-out payments as part of the total value offered. The terms should require the new owner not to stifle the chances of achieving the earn-out criteria.

- **Tax optimization:** Ultimately, the amount you get to keep after taxes is more important than the total sale price on paper. Structuring the deal for optimum tax efficiency should be considered very early in the process, if not several years before the actual sale.

- **Minimization of disruptions for management:** Your business does not stop just because you have decided to sell. Your senior management team (mostly your CFO) will be strained by the document collection, the fact checking, and the proofreading of new documents. A talented team of investment bankers can help minimize this burden. That being said, you are ultimately responsible for the quality and accuracy of the documents being presented to potential acquirers and for minimizing the business disruption that process might create.

- **Confidentiality:** No one should know anything about the possibility of a sale except those who need to be directly involved. Early leaks to employees, customers, key suppliers, or your competition can be damaging. **During an auction, no buyers should learn the number of competing bidders, their identities, their bids, or your reserve price.**

- **Minimization of the burden of escrows and holdbacks:** Most acquirers will ask the seller to set aside a portion of the sale proceeds in case any one of several things goes wrong. Your goal is to limit this amount, as well as the probability that the buyer can rightfully assert he was materially misled in the sale process. **Insurance companies now have products available to help manage selected M&A risks.** This is one of the reasons to hire good financial, legal, and accounting professionals. *(See Chapter 3: Choosing the Right Advisors.)*

- **Minimization of legal liabilities from representations and warranties:** Virtually all acquirers will want you to state for the record a long list of facts and beliefs about your business, which may haunt you legally in the future. Your goal is to limit these representations and warranties as much as possible. Again, insurance companies offer products that can minimize your legal exposure in exchange for a known premium amount. *(See Chapter 10: Deal Representations and Warranties.)*

- **Life after the sale:** Are you planning to retire in Singapore after the deal closes? If so, you can likely minimize your taxes and never worry about your business or its stakeholders again. For many, though, what life will be like after the sale is a big part of the decision whether to sell at all. Chapter 13 highlights how business owners have successfully managed their lives after the sale. Hint: Most did not move to Singapore and are very happy.

You should always be prepared to walk away from any deal that is not your best alternative. It is your job and your investment banker's job to let potential acquirers know that you have good alternatives. Without this threat, acquirers are more likely to change the price and terms of the deal negatively at the last minute, even after months of negotiations. This happens more often than you might think.

So, your first big step is underway. You've started to think about your goals, and now you can consider what kind of buyers are most likely to meet them. Chapter 6 will go into more detail about buyers, but here's a list of the four primary types, which may be helpful to keep in mind as you go through the next few chapters:

- **Strategic buyers:** Acquirers who operate businesses in or around your company's industry space
- **Financial buyers:** Acquirers whose primary concern is maximizing near-term financial returns
- **Family office buyers:** Private acquirers who are typically interested in long-term company growth
- **Employee buyers:** Employees who purchase ownership in your company

You should always be prepared to walk away from any deal that is not your best alternative.

WHY SOME BUYERS PAY MORE

- **They have a lower cost of capital**
- **They have a lower hurdle rate of return**
- **They bet your company can help their business**
  - » Revenue synergies (price, volume, mix)
  - » Cost containment synergies (fixed costs, variable costs, working capital, and capital expenditure requirements)
  - » Risk synergies (lower volatility of earnings, liability management, blocking competitors)
- **They bet they can bring resources (cash, technology, business practices, relationships, etc.) to your company which enhance your business prospects (revenues, costs, and risks)**
- **They believe your company has lower investment risk because:**
  - » Your company's corporate culture is strong (and they won't mess it up)
  - » Your management team is deep and talented
  - » Your cost structure is attractive and sustainable
  - » Your brand appeal is compelling
  - » Your line of goods and services is extraordinary
  - » Your leading technology is proprietary (IP)
  - » Your supply arrangements are top notch
  - » Your distribution channels are highly competitive
  - » Your customer potential to buy more is substantial
  - » Your customer relationships are world class (e.g., top customers never leave, always pay on time, and buy more from you every year)
  - » Your data is rich and analyzed to enhance your business
  - » Your plan to optimize for AI, IoT, & robotics is thorough
  - » Your competitors are weak
  - » There are no decent substitutes for your products and services
  - » Other potential competitors cannot easily enter your markets (barriers are high)
  - » Your positive financial results confirm all of the above advantages
  - » Your revenues and profits are not volatile
  - » You consistently grow revenues and profits
  - » Your margins are steady or expanding
  - » Capital expenditure and working capital needs are modest going forward
  - » Their expectations of continued growth are reasonable
- **They perceive your business and management team as a "platform" company for growth in your industry via organic opportunities, as well as through significant "bolt on" acquisition targets**
- **Larger deals get premium multiples**
  - » Smaller deal sizes receive discounted multiples (holding all else equal) because there is a greater supply of smaller deals, they carry more risk generally, and do not make a significant difference for larger investor portfolios.

SELECTED REASONS WHY SOME BUYERS BID LOW OR DON'T BID AT ALL

The CIP does not present compelling investment merits

The management team of the selling company is ill prepared to answer questions

The CEO of the selling company is overly dominant in the business (key person risk)

There are likely too many bidders (i.e., low probability of winning)

The terms of the seller's non-disclosure agreement are out-of-market

The company is too small (or too large)

The business risks are too high (opposite of list on page 10)

There is a culture clash between the buyer and seller

The selling company underperforms relative to its monthly forecast(s)

The seller's emotional outburst erodes buyer's confidence

The geographic area of business for the selling company does not fit the buyer

They sense potential fraud

CHAPTER ONE SUMMARY:
Setting Goals

Your goals in a sale transaction may include:

- Maximum Value
- Retaining some upside potential (equity)
- Negotiate outcomes for key managers (contracts)
- Maintain employee motivation (culture)
- Maintain support for the community
- Achieve a certain level of cash upfront (swim to shore money)
- Negotiate near-term bonus terms (earn-out potential)
- Optimize for taxes
- Keep management focused on the business during the transaction
- Confidentiality (need to know basis)
- Minimize burden of purchase contract terms (escrows, representations, and warranties)
- Plan for life after the deal

Consider what buyers seek and avoid:

- Reasons why they bid high
- Reasons why they bid low or walk away

CHAPTER 2 | Don't Cut Corners

> *"The purpose of life is not to be happy. It is to be useful, to be honorable, to be compassionate, to have it make some difference that you have lived and lived well."*
> - Ralph Waldo Emerson

Successful business owners are capable people. Many are used to doing things themselves, maybe with a little help from their colleagues and friends. This can save money and time. Besides, when capable business people do things themselves, the job gets done the right way—or does it?

For many owners, their business is the most valuable asset they own. They know it better than anyone else. But that doesn't necessarily mean they know how to sell it well. We have heard many regrets from owners who have sold their business on their own and are not happy for one or many reasons. The complaints may have to do with value received. Was it fair? Was it the most available at that time? Did the deal change negatively at the eleventh hour? Other complaints often have to do with the new owners. Were they hard to work with? Were they too demanding on things that didn't really matter? Did they have different values and beliefs? This is just a sampling of complaints.

Whether you do it yourself or hire professionals to help, the point is to make sure the hard work of properly selling your company—in all of its gritty glory—is completed right down to the last detail. The day after you close on the deal, you want to say that you have met all your goals. This is more likely if you follow the 5 Ps – prior preparation prevents poor performance.

So, how best to accomplish this task?

The day after you close on the deal, you want to say that you have met all your goals.

To begin with, you cannot cut corners for such an important transaction. For most situations, the best approach is a modified auction process. *(See Chapter 9: Deal Auction Process).* Step one: Make an exhaustive list of the buyers who would be most likely to meet your goals. Step two: Invite them into the strict process with a brief description of your company that hides the company's identity until such time as the potential acquirers sign a nondisclosure agreement (NDA) to protect you. Step three: Once the NDA is signed, have a phone interview with each potential buyer to disclose your company's identity and assess his or her level of interest and potential fit. Step four: If that call goes well, send a thorough presentation of your company that highlights the investment merits and alleviates the perceived risks buyers may have of investing in your company or industry. This presentation of your company is sometimes called a confidential information memorandum or presentation (CIM pronounced "sim" or CIP pronounced "sip"). It can also be referred to as a "marketing book."

He gave me his CIM on the back of a gum wrapper.
Yes, I'd say it was a bad meeting.

Go all in on the preparation of this critical document. If your management, accounting, and legal team is ready to go, a high-quality CIP can be developed in seven to nine weeks.

Depending on the company, a good CIP might be 40 to 70 pages long. All the pertinent facts should be outlined in this document, with detailed backup information included in a separate data room—usually via secure and confidential online file sharing.

Most investors in private companies are professional buyers. As you can imagine, some of these people see one to ten CIPs a week. They will quickly recognize whether it has been created professionally or not. Many buyers simply cannot afford the time to pursue an acquisition candidate that is ill prepared for the due diligence process. In other words, a poorly crafted CIP can eliminate some buyers who might otherwise want to invest in your company. Even if buyers stay in the process after seeing a poorly drafted CIP, the likelihood of them wanting to stretch their valuation parameters is diminished since they perceive the seller to be less than thorough.

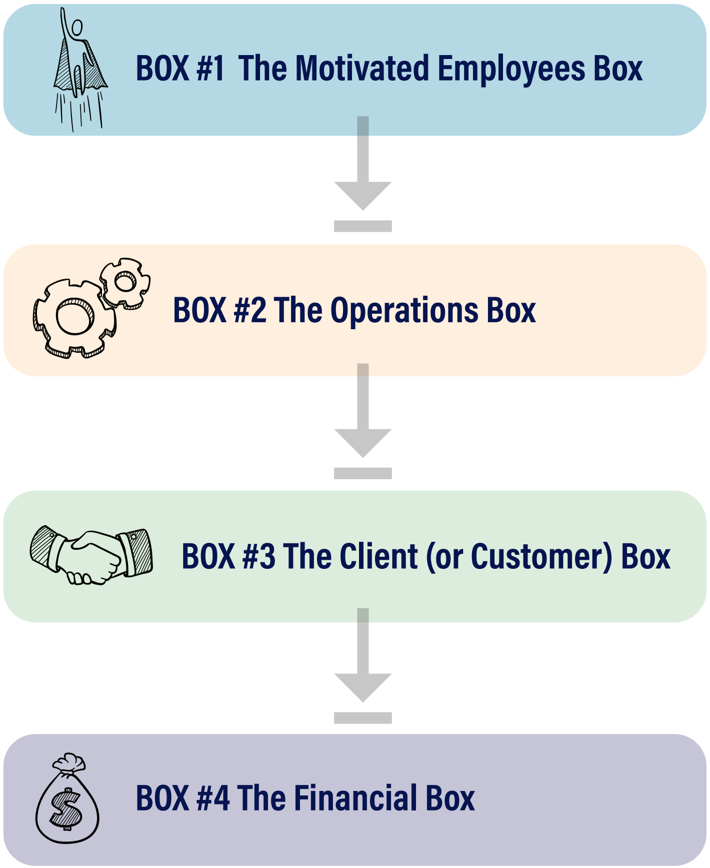
Go all in on the preparation of this critical document. If your management, accounting, and legal team is ready to go, a high-quality CIP can be developed in seven to nine weeks. Potential investors will appreciate reading about a compelling investment opportunity. After all, most investors get burned in the acquisition marketplace. In fact, many studies of acquisitions have been done over the years, and most conclude that 70 to 90 percent of all acquisitions fail to create wealth for the buyer. That is an awful failure rate, and it explains why good buyers often walk away from a deal any time they sense significant weaknesses in the investment story.

Why have so many acquisitions failed to achieve their cost of capital or better after a transaction? Three reasons explain most of the problem. First, the buyer paid too much. There is little chance of achieving a high return on investment if the denominator is too big. As a seller, you likely don't care about this reason. It's your job to get the most money possible for your business. You should, however, care a great deal about the other two reasons why so many deals fail for the buyers. Reason number two: The buyer's strategy failed to work as planned. The buyer was seeking to take advantage of certain synergies that would enhance revenues and control costs of the acquired company. With so many variables at play, too often the strategy fails to work as planned. Reason number three is probably the most important one of all: When the corporate culture of the acquired company does not fit well with the culture of the acquiring company, it can be like mixing oil and water.

Often, a poor cultural fit results in the employees of the acquired company losing their motivation. The best employees leave as soon as they can, and the normally smooth operations get thrown off their axis. Regular customers quickly see that things have changed for the worse and take some or all of their business elsewhere. The higher financial results that the buyer was banking on then fail to materialize. Another failed transaction is chalked up to culture disruption.

We recommend a transaction process that anticipates the needs of professional buyers so that they are more likely to want to pay full price. We have developed a method called the Four Boxes Analysis, which summarizes the world of almost any business into four distinct boxes that reconcile the soft elements of culture and people with the hard aspects of process and analytics. It takes a while to fully explain and about eight weeks for a team to analyze and document a company's investment merits and risks in order to clearly convey these, so each has its own section of the CIP. However, here's a primer on the Four Boxes approach.

THE FOUR BOXES APPROACH



Box #4 The Financial Box

This section of the CIP is made up mostly of revenues (volume, price, mix), fixed costs, variable costs, and capital expenditures. In our graphic, this is the bottom box, but most investment bankers focus on it, as they are trained to see a deal mostly in financial terms.

The financial section summarizes the company's financial results so buyers can quickly grasp historical growth rates, profitability, and cash flow. It should give the buyer confidence in the accuracy of the financial statements and the believability of forward-looking projections. Clear, clean financial statements are helpful, and they should be supplemented with detailed supporting analytics as needed and available. Often, financial statements are adjusted to remove aspects that would not be appropriate under new ownership.

The financial section also shows a credible three-to five-year forecast that gives potential investors a view of the future from the perspective of current management. It should include projections built from the bottom up that maximize value and help to manage buyer expectations. These projections include the following:

- **Price, volume, and mix:** These drive top-line growth.
- **Profits:** These are driven by revenue projections and cost assumptions.
- **Net income, cash flow, EBITDA (earnings before interest, tax, depreciation, and amortization):** The relative importance of each depends on the type of buyer.
- **Required capital expenditures:** Both capital to maintain the business and capital to grow the business profitability are shown here.

Box #3 The Client (or Customer) Box

This section of the CIP focuses on the segmentation of clients geographically, by size, by profitability, by market segments, and by a variety of other classifications. Since customers determine how much of the company's goods and services are bought (unit volumes) and at what price, the company's financial results and projections depend completely on this section. All the key customer segments for the industry are represented here, and it is important to highlight those customer segments where your company is particularly strong. This helps potential investors determine the possible synergies that may be achievable by enhancing revenues in these segments, controlling the costs in these segments, or entering new segments that could be rewarding.

In this client section, potential buyers appreciate a clear and concise overview and analysis of the industry, customer segmentation, and competitive landscape. Detailed customer analytics should include the following:

- Repeat business from strong, growing clients
- 80/20 revenue view

- Top ten customers
- Pipeline development, with an eye on the factors that could make your company better tomorrow.

An analysis of synergy opportunities should also be included. This allows potential buyers to understand the right mix of expecting more from the same clients, the company's ability to scale the client list in each segment, and the company's ability to successfully enter new markets.

Each box is mission critical, and each of the bottom three boxes is completely dependent on the one immediately above. Together, they create the foundation for the company's strategic direction.

Box #2 The Operations Box

This section of the CIP focuses on aspects of the company's basic operations. It is divided into three components: general and administrative operations (which often encompass a large portion of the fixed costs of the business), selling operations, and producing/delivering operations. It highlights the list of goods and services offered in the industry and those that the company is particularly good at producing and selling. Key supplier analytics and key performance indicators (KPIs) are well-established tools that should be included to communicate operating performance and overall value. This section is particularly important because the Four Boxes approach is based on the idea that the customers' likelihood of returning for more is completely dependent on this box: dependable and smoothly running company operations.

Ideally, the CIP includes elements from three key documents for potential buyers. The first of these key documents, the annual business plan, appears in this section.

The business plan should be clear and thorough. Buyers value smooth, consistent operations that build trust with clients and can be planned twelve to fifteen months ahead and beyond. Businesses without the ability to communicate this characteristic may be viewed as riskier. How to sustain any and all competitive advantages should be discussed in the business plan. Assembling and effectively communicating your business model is paramount to your preparation. You should answer these questions:

- What do you do well?
- How do you make money?
- What do you want and plan to do better?
- What could the best acquirer(s) help you achieve that you can't reach as quickly on your own?

Box #1 The Motivated Employees Box

This section of the CIP captures the shared values, beliefs, and habits of the company's employees. Since value is created through positively motivated employees, articulating these values, beliefs, and habits clearly is the precursor to establishing and reinforcing your corporate culture. After the business plan referenced above, the second of three critical documents is the well-written culture statement that describes how and why your employees stay motivated. Many acquisitions fail because of culture mismatch, so buyers are rightly concerned about the risk. Taking the time to fully define your culture and to put it in writing will give buyers a much better understanding of how best to integrate the culture and leverage its important impact. Strong corporate culture is a sustainable competitive advantage that can often be very attractive to potential acquirers.

In summary, these four unique areas of focus, the Four Boxes, should be clearly expressed in a professional CIP. Each box is mission critical, and each of the bottom three boxes is completely dependent on the one immediately above.

Together, they create the foundation for the strategic vision of how the company wants to compete and where it is headed three to five years into the future. A plan for this strategic direction is the third and final critical document that gives acquirers the confidence that investing in your business is likely to be a positive experience.

Pulling everything together is a considerable task, and the mere thought of it can be overwhelming for management teams of any size or experience level. A strong financial advisor can navigate the workload and ensure that you don't minimize or exclude any of these important elements so you don't risk settling for less than your company's full value. Execute the CIP well, and you are on your way to closing the best deal you can make for yourself and for your company. Cut corners and you risk failing to get any deal done and having your company become a "shopped" asset. This can hurt demand the next time you try to sell.

CHAPTER TWO SUMMARY:
Don’t Cut Corners

- **Develop a compelling marketing document (CIM or CIP)**

- **5 Ps: Prior preparation prevents poor performance**

- **Why so many acquisitions fail:**
  1. Price too high (sellers may not care)
  2. Strategy failed
  3. Culture integration failed

- **Consider the Four Boxes Approach:**
  1. Motivated Employees
  2. Operational Effectiveness
  3. Customer Strengths and Potential
  4. Financial Results and Expectations

CHAPTER 3 | Choosing the Right Advisors

"So don't go to war without wise guidance."
- Proverbs 24:6 (NLT)

Jerry launched his business 35 years ago. When he started, his wife did the books, and his close friend took care of the office. Jerry handled sales. To get rolling, Jerry found an attorney, Bob, from his local Rotary Club to handle the incorporation. His accounting work was handled by Mitch, the CPA who did his personal returns.

As the company grew, Jerry brought on other advisors. A financial consultant came on to handle the company 401(k), and a life insurance professional came on for "key man" insurance. Over the years, the advisory team responded to Jerry's requests and needs. Bob, the attorney, handled contracts, small acquisitions, a few small lawsuits, and even drafted a trust when Jerry and his wife went on an international trip. The financial advisors handled a small IRA for Jerry, but otherwise the bulk of Jerry's estate was tied up in the family business.

Jerry appreciated their loyalty in sticking with him in the building and growing of his business. So when a private equity firm approached Jerry about buying his company, he turned to his long-time advisors for assistance. Jerry pondered the idea of hiring a professional firm to market and sell his business but, when the initial purchase price came in, he soon forgot that idea. However, the potential sale brought new questions:

- How would the sale affect his employees?
- What would he do after the sale?
- What would the tax implications be?
- How would the sale affect his son, who was a mid-level manager?
- After the sale, how would his financial picture be altered?
- Could he afford his long-sought-after fishing cabin?

It is not safe to assume that your regular advisors are the ones best equipped to bring the transaction home.

As the transaction began to unfold, he found the speed dizzying. Worse, he found himself being confronted by a bevy of unfamiliar terms and countless decisions.

Among his advisory team, he sensed tension in working together. Bob, the attorney, asserted himself as the leader and blocked the other advisors from access to Jerry unless he was present. Mitch, the CPA, wanted and needed to address Jerry's tax implications. Bob, as a general practitioner, began digging into a charitable remainder trust as a tax reduction strategy, although he had never actually drafted one.

Thank you, but my advisors actually have their own way of handling their differences.

Jerry's life insurance expert was touting purchasing a new whole life policy as a means of sheltering income, and his IRA advisor was further suggesting a large, lump-sum contribution. Meanwhile, Jerry remained foggy about his future—let alone that of his son—and feared losing the opportunity for a big payday.

The deal closed and the reality of escrows, holdbacks, contingent liabilities, and earn-outs began hitting home. These were terms Jerry had heard as the deal progressed but had never fully digested. He questioned Bob, the attorney, about why these issues hadn't been negotiated harder and why these surprises were occurring. Bob was moody and defended himself. After all, hadn't he always been loyal to Jerry? Mitch, the CPA, also surprised him with a much bigger tax bill and when the premiums for the new life insurance policy came in, he second guessed himself about whether the policy had been a good idea. Jerry's son had stopped talking to him because it looked like the new management team was going to supplant the old one.

Jerry wondered what had gone wrong. He had the cash but not everything he had imagined.

Unfortunately, Jerry's situation is all too real. We have worked on too many transactions where the business owner concludes this most important sale using his day-to-day business advisors. It is not safe to assume that your regular advisors are the ones best equipped to bring the transaction home. While we are not suggesting that business owners should abandon those with whom they have built long-term relationships, we do strongly encourage owners first to assess the character and capability of their advisory team.

The first key trait in a qualified advisor is humility. An advisor with humility recognizes when he or she is not skilled in a particular aspect of a transaction. That same humility also gives the advisor the ability to recommend or bring in other advisors with specific skill sets for the transaction. A second key trait is the ability to collaborate and work with others. There are few advisors who can be the single point solution for a seller because of the complexities of a deal—let alone the human elements of a transaction.

For instance, a good advisory team may consist of the following:

- An attorney with specific M&A experience
- A tax accountant who has been involved in previous deals
- A wealth manager (as opposed to an advisor driven by product sales)
- An expert in charitable tax planning
- A life coach
- A family legacy coach
- A skilled investment banker or M&A advisor (whom some might call a "business broker")

90% of inherited wealth is gone by the third generation.

A few of these roles deserve special mention. It is a given that an attorney and an accountant with specific deal experience are preferred. The knowledge of sale transaction documents is invaluable. But the issue of tax planning is also essential. That tax planning often includes a wealth manager, who is typically expected to be involved in managing the financial wealth after a transaction. Business owners who are contemplating making any size of charitable gift from the sale should engage a charitable tax planning expert. Additionally, a charitable gift may make sense fiscally even for owners without purely philanthropic motives. While that expertise may reside in the attorney or wealth manager, in many cases it does not. Charitable tax planners—those engaged with charitable tax work—are likely to bring new and creative solutions to the table.

Sometimes, lawyers and accountants worry about losing a long-time client as a result of a sale transaction. That may cause some "biased" advice to creep in. We tend to favor bringing in M&A experts to support these advisors.

As part of the transaction, a gifted M&A advisor or investment banker is often overlooked. Some will consider this addition to the team only if they feel the financial terms do not make sense. But in truth, the best M&A advisors are ones who take the time to learn your company, your company's culture, your dreams, and aspirations—and who work to find the right partner for your business. They provide more than just advice on the sale. They research and glean market intelligence; uncover value drivers that differentiate your business; and help identify financial statement structuring, growth insights, and other business improvements. They really are part business coach, part psychologist, part salesman, and are all about getting the best possible partner for your family business. The sale process will be bewildering at times. Having a team member who is an expert at helping navigate these challenging waters is well worth the fee. A good M&A advisor or investment banker will drive many times his or her fee in savings and additional sale income.

Finally, a life coach and a family legacy coach are by far the most overlooked members of the advisory team. A life coach can provide valuable insight to a business owner on life after the transaction. Many owners are simply unprepared for their next phase. Similarly, for many, their next season may be largely unfulfilled if just left to the golf course. The business sale may provide their first opportunity for true reflection about their identity, their goals, and their dreams.

A good advisory team may consist of the following:

- **An attorney**
- **A tax accountant**
- **A wealth manager**
- **An expert in charitable tax planning**
- **A life coach**
- **A family legacy coach**
- **An investment banker**

A legacy coach provides guidance not just to the owner but also to the family. In the case of children, how can they be prepared to be heirs, and how can they live out their own dreams and visions? The statistics tell us that 90 percent of inherited wealth is gone by the third generation. A family legacy coach can help a family avoid these pitfalls.

While there's little doubt that the decision to sell is personal and confidential, the burden of the transaction should not be borne alone. To the contrary, those who bear the transaction alone often end up with not only a lower sale price but unexpected consequences as well. A great team of advisors will help maximize the sale proceeds and minimize the bumps along the way and afterward.

WHAT TO LOOK FOR IN AN INVESTMENT BANKER

Trust: The sale of your company is likely the single most important deal you will ever make in business. Find an investment banker you can trust who will keep your goals in mind throughout. The knowledge that you are considering a sale should be kept away from your competitors, your employees, and your customers. Your transaction should not be "steered" towards your financial adviser's favorite buyer(s). You cannot know everything that is said between the banking team and the potential buyers. It is critical that the banker is transparent with you throughout the process. There are two types of clients in the investment banking world: repeat customers and one-time customers. The former tend to receive better service and results.

> **Caution:** Recently we learned from a CEO that an investment bank was invited in for preliminary M&A advice. Months later, the CEO was told by the banker that his bank could no longer represent him. The CEO deduced that the banker was engaged by their local competitor. We cannot be certain if confidential information of a possible sale was misused by the banker, but it is a cautionary tale.

Expertise: Make sure that the team you pick has extensive experience acting as the project manager for the deal. It is most helpful that the team members be expert in business analysis with good writing skills so that they can get familiar with your business quickly and convey your company's investment merits compellingly in a CIP.

The vast majority of investment bankers specialize in an industry. This is both good and bad for you, the one-time seller. The positive aspect is that they have a good understanding of the industry dynamics and trends. The downside is that they make their living from repeat business with the strategic and financial players who are most likely going to bid to acquire your company. They often find themselves negotiating on your behalf and against their best clients. That conflict of interest has to be managed by you. It is important that you understand the relationship your banker has to the potential acquirers involved in the final stages of the auction process. To underscore this point, type the following five words into Google.com: "Wall Street conflicts of interest." You will get over 40 million hits.

For some multi-service investment banks, a mandate to sell control of a private company offers opportunities for additional revenues. Some investment banks will try to win the buyer's financing of the deal by introducing their commercial bankers or capital markets people. Developing a relationship with the buyer can generate follow-on M&A business for the investment bank. Others will try to win the wealth management opportunity from the selling shareholders.

Aggressive acquirers want to know the details of the auction such as i) how many bidders are in the process, ii) who are they and critically, iii) what is the needed clearing bid (the lowest bid that would win the auction). **This information should never be shared with a potential acquirer.**

WHAT TO LOOK FOR IN AN INVESTMENT BANKER

Production oriented investment bankers target total transaction manhours under 1,000 hours. It is not unusual for an “art of the possible” firm to spend 2-3 times that on preparing the company thoroughly and extracting maximum value from the market. This philosophy for success is based on the 5Ps – prior preparation prevents poor performance.

Entire Team: Get to know the entire team that will work on your deal for the six months or longer it will take to close. The team members should be highly engaged throughout the process and should include i) a senior banker, ii) an officer in charge of the transaction process on a day-to-day basis, and iii) 1-2 junior bankers who do much of the research and work.

Service: This means many things including the “chemistry” your management team has with the banking team. Said differently, you and your management team should feel good about your ability to work with and relate to your bankers because you will be together for an intense six months (or longer). Service relates to helpfulness in answering client questions.

Sizing: The M&A industry has large investment banks that are divided into industry specialty groups, specialist banks that work only in one industry, and boutiques that work regionally. The largest firms tend to avoid any transactions sized below $300 million. Medium-sized firms tend to shy away from deals valued below $10-$25 million. Business brokers and one-man shops usually work on smaller deals.

A few more thoughts:

- Meet confidentially with 2-4 firms
- Beware the low bidder
- Beware the firm that claims they can do the deal faster
- Ask your investment banker about its relationship with all the proposed buyers
- Ask your investment bank about the percentage of its total revenues generated by the private equity industry (Many firms are above 80%)

CHAPTER THREE SUMMARY:
Choosing the Right Advisors

Consider engaging experienced M&A advisors

- **Legal**
- **Tax**
- **Wealth**
- **Charitable Tax Planning**
- **Life Coach**
- **Family Legacy Coach**
- **Investment Banker**

"Financial advisors play an important role in M&A transactions. Private equity (PE) firms, in turn, are highly sought-after clients for financial advisors as they promise lucrative business due to their frequent engagements in acquisitions. We find that PE firms pay, on average, less for portfolio companies when their sell-side advisor has worked for the acquiring PE firm on the buy-side in past transactions. We refer to this as indirect relationships and argue that conflicts of interest between financial advisors and their clients are the main driver for our results.

"When examining indirect relationships (R2), we find that for our total deal sample, acquirers do not benefit from strong indirect relationships. However, a split-up of the deal types in PE and strategic reveals that PE firms benefit from relationships with target advisors, while strategic firms do not.

"Thus, the more often PE firms hire the sell-side advisors of a particular transaction in the five years prior to a deal, the lower the target purchasing price. Accordingly, **for an increase of one indirect relationship variable, we expect to see an 11% drop in the deal multiple."**

Conflicts of Interest and the Role of Financial Advisors in M&A Transactions: Empirical Evidence from the Private Equity Industry by Stefan Morkoetter and Thomas Wetzer, Swiss Institute of Banking and Finance (S/BF – HSG), August 2015 – this version: April 2017

"Helping others is the secret sauce to a happy life."
- Todd Stocker, *Refined: Turning Pain into Purpose*

As the Great Recession unfolded in 2008 and 2009, the board members and owners of a small regional service center in the Midwest were mapping a strategy to sell the business. The center was highly profitable, earning more with roughly 300 technicians than nearby competitors did with 15 times that many. In fact, the service center was consistently ranked among the best in the nation in its category, growing at 20 percent a year while keeping expense ratios at less than half those of competitive facilities. Technicians delivered success rates 40 percent higher than larger, more bureaucratic competitors. The approach was culture-driven but also soundly supported logistically with advanced equipment, processes, and facilities.

Company leadership went through their due diligence and began a formal search for a partner to help them get top dollar. Ultimately, they selected an out-of-state M&A consultancy with considerable industry experience.

The new partnership started well enough, but it soon became clear that the acquisition playbook used by the new advisors was standard issue and lackluster. The advisory firm's approach treated this small, profitable company like it was every other middling services organization. The consultants were spread too thin and easily distracted. They rarely came into town to meet face to face and, most importantly, they never invested in truly understanding what made the service center special—and the factors that made it such an earnings powerhouse.

In other words, the trusted advisors never understood the center's secret sauce, and they never pushed their client to fully understand it either. It's hard to get top dollar from a buyer when you don't really know what you're selling.

Almost all successful companies have a secret sauce, but many cannot readily quantify it and put it into words.

When the final bids came in, the best offer was just north of 60 million dollars, far below expectations. Disappointed and discouraged, the company's board rejected the offer and sought out a new firm to start the process from scratch. A new investment banking firm was selected. They amped up the face-to-face contact and accountability. They built an aggressive team to explore industry insights, trends, and triggers. Most importantly, they invested in understanding the center's secret sauce and pushed the new client to fully understand and articulate it. The next time around, they would have something clear and compelling to sell.

After months of study, who would have thought the secret sauce of our success would be … our secret sauce?

The point of the example is that almost all successful companies have a secret sauce, but many cannot readily quantify it and put it into words. Identifying that key competitive advantage so that it is clearly understood by investors can make a huge difference in successfully closing a deal and achieving maximum value.

What steps can be taken to identify your company's secret sauce? We recommend using the Four Boxes approach *(see Chapter 2: Don't Cut Corners)* to organize your business into its component parts, and using analytical tools to determine quantitatively what drives your company's success. The process should start with an analysis of the company culture. Peter Drucker, the prominent author and management expert, is famous for emphasizing that "culture eats strategy for breakfast." Our take on this statement is that a healthy corporate culture is more likely to produce above average financial returns than a good corporate strategy, holding all other factors constant. Employees of companies with a healthy corporate culture do the right things in a timely way without having to be told.

Although every company has a culture (and possibly many subcultures), not every management team can define exactly what the culture is.

There are management tools available to survey your key employees and get clear feedback from them regarding the three key elements of corporate culture: values, beliefs, and habits.

Values can be defined in many ways. We recommend the following definition, but some management teams may modify it to better suit their situation. Corporate values can be thought of as absolute standards of behavior that may not be violated by anyone for any reason at any time. For example, a mid-level employee might say to an incoming employee: "Do not do [this behavior]. Ever. If you do, you're fired. Go home. Don't even go to your desk to get your things. The boss will send your personal effects to your home." Well, that behavior would clearly be below the standard that is well understood in that company. It is so important a standard that everyone gets it. Sometimes these standards are referred to as "core values." To add clarity, let's say a company listed "integrity" as a value with the descriptive phrase "We underpromise and overdeliver!" If that is truly a company value, then the new salesman who believes it is okay to commit to an unrealistically early delivery date in order to win the business is unlikely to last in that company.

Corporate values can be thought of as absolute standards of behavior that may not be violated by anyone for any reason at any time.

The new salesman's attitude came from his experience at a different company where it was acceptable to stretch the truth to win the order and then make amends later using some odd excuse with the customer.

Beliefs are different from values. Corporate beliefs may be defined as those principles and premises that employees accept to make their business world work best. Some companies believe that customers come first. Johnson & Johnson is such a company. On the other hand, Southwest Airlines openly explains that it is profitable because it focuses on its employees' needs. With yet another perspective, Pfizer tells the world that it focuses on providing shareholders with a market rate of return or better on invested equity. [Note that the Business Roundtable now commits to "stakeholder" interests as a primary purpose]. These three large companies emphasize different fundamental beliefs. It's important to write down your company's cultural attributes and personality, and get employees to commit to it. Your workforce has a variety of relevant and significant beliefs. We recommend using management tools to survey your senior employees in order to understand what those beliefs are and where they, as leaders, stand.

Corporate habits are the third critical component of culture. Habits normally develop over time to meet the company's clear values and beliefs. There is a long list of habits that employees generally maintain. These habits include significant relationships inside and outside of the company. Some are more important than others, of course. It is up to each management team to write down the habits that truly matter in keeping employees highly motivated. For example, corporate habits include how people regularly dress, communicate, and meet with each other. These habits can vary quite sharply from company to company and from department to department. That's why it can be very important to know them in the M&A process.

Imagine, for example, combining the best people from the salesforces of two different companies.

Corporate beliefs may be defined as those principles and premises that employees believe make their business world work best.

The acquiring team's habits are highly professional, including buttoned-down dress and regular weekly meetings that always start and finish on time, and in which each item of a predetermined agenda is discussed with next steps clearly articulated at the end. The acquired team members are much younger and viewed as more creative. They are free flowing in discussing various sales agenda items before, during, and after regularly scheduled meetings. They do not necessarily start exactly on time nor end a meeting on time if the discussion is still quite active. You can see the management challenge here. How can management integrate these talented people with different habits without seriously diminishing the motivation of one side?

Corporate habits primarily relate to how people regularly dress, interact with each other, and are compensated.

As explored in Chapter 2, many acquisitions fail, from the buyer's perspective, because of cultural clashes. Buyers truly appreciate getting clarity on the culture of a company they may acquire. The more they understand the culture, the less risk the buyers perceive because they understand (or think they do) how to keep the culture strong post-transaction. For family office buyers, understanding the culture of a company they are considering for acquisition gives them greater confidence that the management team will not embarrass the family.

So, how can your unique differentiators and carefully evaluated market advantages—your secret sauce—be merchandised to drive maximum value for the business? It all starts with a team that is willing to get into the trenches together, to brush past preconceived notions, faulty perceptions, and misaligned goals in order to find and identify the best ingredients. It takes a spirit of collaboration and creativity to capture and define the secret sauce.

The secret sauce is different for every company in every industry. There are several key differentiators that are almost always found in the recipe:

1. **Identifiable and sustainable advantages:** For the service center described earlier, these included high quality of delivered service, motivated and incentivized employees, and nimble decision makers.

2. **Benefits valued and desired by customers:** From shorter wait times to improving the customer experience at every touchpoint, factoring in what makes the customer happy is key. We think of customer value as a ratio of Q*Q*Q*S/ P*R where Q stands for quantity, then quality, then quickness (or timeliness) of delivery, and S stands for service. If any of these factors increases, value to the customer increases. If any of these factors is zero, value to the customer is zero, as they are all multiplied together. On the denominator side, P stands for price per unit of goods or services received and R stands for risk to the buyer that something will go wrong with any other factor. If P or R increases, value to the buyer decreases. Buyers can often be segmented into groups that care most about one of these variables.

3. **Elements of the business model that are difficult to execute or replicate (protective "moat"):** In our example, the service center actively recruited top staff and techs, the administration and leadership were all aligned on a clear strategic plan, and the staff was well paid with low turnover.

4. **Level of technological advantage:** The center always accessed and provided the newest technology immediately, as long as it was used by staff. Leadership would routinely convince technology representatives to lend them the latest technology for testing, so investments were only made when technology was actively adopted and utilized.

5. **Disruptive supply chain or sourcing strategies:** Although the center bought a small fraction of the total dedicated software and hardware, they did it at a much lower cost than their larger competitors. Stronger negotiation as the industry innovator as well as aggressive blocking and tackling made all the difference.

6. **Continuous process improvement:** Everyone in the center was empowered to make process changes. Stories are abundant—from the accounts receivable clerk who figured out how to accelerate receipts, to the cleaning crew who suggested new ergonomic technology so that units could be cleaned and turned over with higher efficiency.

At its essence, the secret sauce is the very DNA of your organization.

The secret sauce, as described, is excitingly simple, yet it can be profoundly complex to identify. It might include a unique corporate advantage that everyone talks about, or a simple everyday process you've been doing so long that no one even notices anymore. At its essence, the secret sauce is the very DNA of your organization, the character traits that enhance your everyday performance. It's the sum total of the reasons your most loyal employees say they'll never leave and the reasons your fiercest competitors fear they'll never win. Professional acquirers always look to find these important differentiators.

The secret sauce comes to life when you ask questions and watch how and when the company succeeds. It often reveals itself through deep engagement with suppliers and customers and learning what competitors envy or need. Here are some steps you might take, in partnership with advisors, investment bankers, and consultants, to discover your own secret sauce:

1. **Interview owners and management**
   Always listen. Have multiple people taking notes and focus on what is actually being said (rather than what you expect to hear).

2. **Interview and observe line workers**
   Take the time to access the experts in this crowd and dig deep about what is truly unique.

3. **Research and interview suppliers**
   Experts are found everywhere: Don't overlook suppliers and the expertise they can bring.

4. **Research and interview competitors**
   We are always amazed at what competitors can teach us about our clients.

5. **Research and interview customers**
   The customer is not only king. He is also the "buying expert" who can deliver a constant drip of wisdom and value.

6. **Research and interview other industry stakeholders**
   These could include rating agencies, industry associations, and subject matter experts. Seek to understand their perspectives on what drives the most successful businesses in your category.

Take the time to determine the best questions and engage the right people. Whether they're buried in your processes or hiding in plain sight, every ingredient is worth finding and can deliver significant return when it's time to go to market. If you're willing to embrace what you learn, to make necessary changes, and to merchandise your strengths, you'll reveal a secret sauce that tastes just right.

$$\text{CUSTOMER VALUE} = \frac{Q \times Q \times Q \times S}{P \times R}$$

CHAPTER FOUR SUMMARY:
Your Secret Sauce

Clearly define your:

1. **Secret Sauce (sustainable key to your success)**
2. **Corporate Culture (values, beliefs, and habits)**
3. **Value Proposition (Q x Q x Q x S / P x R)**

> *"I can calculate the motion of heavenly bodies, but not the madness of people."*
> - Sir Isaac Newton in 1721

With sincere apologies to Sir Isaac Newton, we believe the phrase "and financial statements" could aptly and accurately be added to the end of his poignant quote from three centuries ago.

Here's the context. In 1711, the South Sea Company was founded in Britain to consolidate and reduce the cost of that country's national debt. The company was also granted a monopoly to trade with South America, and the public was encouraged to purchase company stock with expectations that vast wealth would spring from the exclusive deal. But with Britain embroiled in the War of the Spanish Succession—and with Spain in control of South America—there was no real chance any actual trade would ever take place. Despite never earning any significant profit from the monopoly, the South Sea Company's stock value spiked dramatically as insider trading, political bribes, and fiscal scheming produced gleaming financial statements.

The company's valuation peaked in 1720 before the house of cards came crashing to the ground. In what became known as the South Sea Bubble, the national economy took a major hit, and hundreds of individual investors, including—you guessed it—Sir Isaac Newton, lost their shirts. The vagaries of balance sheets, income statements, and cash flows were twisted so far that even an intellect of Newton's caliber was not immune to their madness.

Financial statements in the hands of an ill-willed master can wreak havoc. In the hands of someone well-intentioned but ill equipped, they can strike the wrong chord and stifle opportunity. But in the hands of a trusted expert, they can play like a Stradivarius—communicating a story in a beautiful and compelling way.

Building a great business typically involves relevance, timing, fearlessness, vision, and self-awareness. So does selling one.

A few years ago, our team started working with a successful, growing regional software company. Management had decided to seek out an equity partner in the market, so we immediately took to evaluating the financial statements with a fine-toothed comb. The audited financials failed to adequately highlight competitive advantages valued in the fast-moving software industry. The financials weren't wrong, but they lacked an expert's touch. We were dealing with a dynamic software company, but the financial statements could have just as easily described an ordinary manufacturing company or services firm—generic, clean, and unimpressive.

So, which financial report would you like … the one we wish we were, the one we used to be, or the one we send to potential investors?

The more we worked with the executive team to understand their software company, the more we found compelling evidence of a truly great and unique organization. The company served its clients with uncommon attention and expertise, which resulted in an extraordinary 98-percent year-over-year client retention rate. The client base and revenue had grown every year for decades, and profitability was consistently strong. More than 60 percent of the company's client contracts were evergreen; most were 24 months or longer and automatically renewing. With all that good news, very little of that compelling story jumped off the pages of the company's financial statements.

Building a great business typically involves relevance, timing, fearlessness, vision, and self-awareness. So does selling one—particularly when it comes to shaping the investment story told by the financials. Underwhelmed by the software company's statements, we recommended that company leadership tap its CPA firm to emphasize the performance metrics that best illustrated the company's success and long-term value.

The CPAs reworked the audited financials; when they did, a much more compelling investment profile emerged. Lines were added for recurring revenue. Key data—such as average length of client engagement, year-over-year client retention, total dollars of recurring contracts, and much more—was captured in footnotes across various statements. Rather than having functional, generic audited financials, the company now had a secondary source of credible information communicating its success. The seemingly perfunctory task of creating fundamental financial statements was transformed into a more complete and intentional undertaking—with a distinct narrative quality—that spoke volumes.

So, how does your organization turn the water of mundane financials into the wine of a validated success story? How can you bring your company's strongest performance metrics and details to the forefront? When buyers scour your financials, what exactly are they looking for and why? The following list is a good place to start. Any company preparing itself to go to the M&A market— assuming economic conditions and industry factors line up—is much better positioned when it can demonstrate all (or at least most) of these characteristics:

1. **Strong and consistent revenue and earnings for three to five years**
   The marketplace rewards consistency with higher multiples, better loan terms, and various other advantages. When doing due diligence, many buyers build their projection models from no less than the past three years of business performance. Having a positive upward trend line in historical financials gives potential buyers greater confidence in the projections for future growth, increasing valuations and enhancing the odds of a sale. The resulting financial picture is more likely to be one of a business that can survive a serious economic downturn, giving buyers more comfort in their investment decision.

2. **Upwardly trending monthly income for the prior twelve months**
   Growth and profitability drive lower risk and increase the chances of long-term success. Buyers gain confidence in seeing recent positive results and trends. Otherwise, they will be concerned that the decision to sell was triggered by nervous owners who saw recent negative results.

3. **Consistent ability to convert profits into cash**
Many financial buyers will place significant leverage on the company post-transaction. They are most attracted to companies that convert the bulk (say 90%) of their profits into cash available for debt service and distributions.

4. **Informed forecast for increased future profitability**
Few observers can keep a straight face when presented with hockey stick growth forecasts. But if you take the time to illustrate and build models on substantiated facts, those reviewing your forecasts will have a sense of comfort with the predictions. There are six core elements that need to work together logically: your pricing strategy, your volume expectations, your mix of goods and services, your fixed costs, your variable costs, and your capital expenditure plan. Not surprisingly, cash flow is another key factor for buyers. For most small business owners, cash flow is the number one measure that determines whether a business can meet their lifestyle needs. A company incapable of demonstrating a plan for continuing profitability and positive cash flow quickly loses its luster in the eyes of the investment community—even if it has had a history of healthy bottom lines. Ideally, be prepared to offer buyers a trend of profitability and cash flow improvement, as well as solid reasons why you expect that trend to continue for the next several years.

5. **Strong records and reporting systems to demonstrate financial health**
Earlier, we illustrated a software company that had a solid history of record keeping and converted the data into a compelling investment story. As obvious as it sounds to keep good records, many small companies forget that financial records are one of the primary tools buyers rely on to assess the health and viability of a business. In many cases, these records are also a crucial part of the valuation process.
In today's business market, computer-based accounting systems are the norm. If you haven't done so already, start transitioning your books to an electronic recordkeeping system, and contract for an outside review of your company's financials with an established accounting firm.

6. **Healthy and diversified client mix**
No company wants all of its eggs in one basket. If business is booming but your Walmart account makes up 80 percent of sales, your financial statements will tell a pretty limited story. If you can, make the effort to grow in new markets—with healthy, sustainable clients—and diversify your product/service mix to appeal to a wider range of potential buyers.

7. **Relevant and unique industry differentiators**
(See Chapter 4: Your Secret Sauce)
If your competitors are similarly sized companies that all look, feel, and sound the same, then you don't have much leverage. Identify the key factors—related to your people, culture, products or services, processes, technology, customer base, etc.—that set you apart from the rest.

8. **Intellectual property**
   Intellectual property (IP) can be attractive for buyers. The value of this property is always a subject of debate and will depend on the facts and circumstances. Some investors may say your IP is worth only the amount of money you are willing to spend defending it legally. It helps to proactively discuss whether management believes the company has extracted the maximum value of this IP from customers. If not, why? Also, be prepared to discuss what other potential IP could be developed and commercialized. Generally, this is buried in the footnotes, but it still should be something that is reviewed and highlighted.

9. **Consistent execution practices**
   Buyers will want to get a clear understanding of the operational practices related to managing key suppliers, sales and marketing, and production and delivery of goods and services. They will also want an understanding of the fixed costs embedded in the business and the variable costs of delivering the key goods and services offered. If the current management practices are indeed delivering consistently dependable results, buyers gain confidence and are more likely to offer top dollar.

10. **Staffing and a dynamic corporate culture**
    This is a big one. We've covered culture in greater detail in earlier chapters, but it bears repeating. Demonstrating how and why your dynamic corporate culture exists is a major part of your investment merits. Many business owners enjoy a special relationship with their employees, and that carefully crafted culture keeps employee motivation high. It is critical to make sure your culture is described well so that buyers can assess how best to work with your employees after the transaction. Professional acquirers have lived through many deals gone bad because the best people left the acquired company after the culture was materially changed. Your goal is to minimize the buyer's perceived risk that company performance will deteriorate post-closing. For example, low performers who are beloved by colleagues may not succeed with new owners. That may also be true of high performers who do not respect the new owners or their new management practices. There are management tools available that can help with a smooth transition, and these should be used to help meet your goals during a sale.

Identify the key factors that set you apart from the rest.

11. **Smart and dependable succession plan**
    Make sure you have a continuity plan in place that will ensure key employees can be retained to help run the business for the new owner. The business risk is high if good results depend on one or two key people. Managing this risk and discussing the deep bench of management talent within the company will help.

    In many cases, you will want to have a Quality of Earnings (QofE) assessment done by a reputable independent accounting firm early in the sale process. This practice has grown in popularity over the last 10 years. A well done QofE can help you enhance the investment merits of your company. Its main benefit is to minimize the chance that the ultimate buyer will substantially disagree with your financial presentation. It is also key in outlining adjustments made to EBITDA to recognize that some costs (e.g., shareholder/manager compensation) would not continue at the same level. It may also help shorten the time to closing when the buyer accepts your high quality QofE.

To summarize, all financial statements are not created equal. Some just list out the numbers. The best ones, however, tell a story. Take the time to proactively deal with business risks and to build up the factors that most convincingly position your business for success. Then make the most of your financial statements by highlighting every success. Now, that's a story even Newton would love.

All financial statements are not created equal. Some just list out the numbers. The best ones, however, tell a story.

CHAPTER FIVE SUMMARY: Financial Statements Are Not All Created Equal

- **Develop financial statements that convey a clear business story**
- **Create a credible forecast**
- **Demonstrate strong corporate controls**
- **Consider engaging an independent expert to analyze the Quality of your Earnings (QofE)**

> *"You can observe a lot by just watching."*
> - Yogi Berra

This nugget of wisdom from Yogi Berra is the perfect setup for a lesson on discernment. Fittingly, it all starts with the tale of a former minor league baseball player. When Marion Wade's playing career ended, he dabbled in life insurance and sold pots and pans door to door before starting a business in 1937 that focused on cleaning and moth-proofing carpets. In 1944, after several years of expansion, Wade was badly burned and nearly lost his sight in an explosion of cleaning chemicals. Thankfully, the accident never blurred Wade's vision for his business; and his company, ServiceMaster, would become one of the largest franchise-based service organizations in the country.

Pain comes in a myriad of packages—physical, psychological, emotional, and spiritual. In the business world, missing the warning signs that many others can see is a particularly destructive form of pain. That pain shows up often when business owners select the wrong buyers for their companies. The buyer with the seemingly ideal package and the trappings of a perfect partner may be revealed as spurious once the deal is done. The business owner's urgency, fervor, and enthusiasm for the sale can create blinders that mask flaws and red flags that almost everyone else in the room can see.

Building on the foundation established by Marion Wade, ServiceMaster became known the world over as one of the best places to work, with one of the best corporate cultures in any industry. It was driven by Judeo-Christian values that actively played out in the company's practices, beliefs, and habits. When ownership decided it was time to sell the business in 2007, they invited a slew of offers and explored a variety of potential partnerships.

What are we truly seeking to achieve?
What will we do next?
Who will be in charge after the sale?

A group of private equity sponsors emerged as the acquisition frontrunner, and it didn't take long before the dreaded red flags started to appear. It became clear that this deal would lead to the abandonment of the signature processes and value systems that created an unparalleled company culture. The strategic sales approach that delivered consistent double-digit percentage growth year over year would be shelved. The people-first management philosophy that attracted and retained key managers and employees would be scrapped to align with the new company hierarchy. Observers inside and outside the company could see the brewing bad fit, but the decision makers moved forward anyway.

And so, when you buy my china shop, will your bull be joining you in the operation?

By almost all accounts, the actual results were disastrous. The company's profitability tanked. Long-term managers and key employees left and opened competing companies to replicate the processes and culture they loved and thrived under at ServiceMaster. Thousands were negatively impacted, and the once-great organization has never been the same.

So, how do business owners avoid the crippling death-knell mistake of selecting the wrong buyer? They start by asking some fundamental questions:

- What are we truly seeking to achieve? *(Remember the goals from Chapter 1: Setting Goals.)*
- What will we do next?
- Who will be in charge after the sale?

Answering these and other basic questions of motivation and inspiration sets off the process of painting the most accurate picture of the ideal buyer. It's like the Treasury Department where agents train extensively on what real currency looks like so they can detect counterfeits immediately. It's critical to know who you are, what you want for your company, and the character traits you truly desire in a partner. These factors can make all the difference between a best fit and the clown who might destroy the company you have spent so much time building. In most cases, you'll want to avoid the extremes: The know-it-all buyer is just as bad as the one who is incapable or inexperienced. In all cases, don't miss the signals that are right under your nose: If your vision is that your company remain in the same town for the next 50 years and the potential buyer owns competing locations with excess operating capacity nearby, your dream scenario is likely just a mirage.

As you dig deep, take the time to understand the unique end-game vision for each current owner of your company. Find out their perceptions about what the company stands for, the factors that contribute to the company's culture, what each owner desires for the company and the stakeholders in the short and long term, and what the owners desire to accomplish with their lives now and in the future. Embrace and apply this knowledge, and it will become much easier to detect the counterfeiters when evaluating potential suitors.

Strategic acquirers can offer the highest price, in theory, because they benefit from the greatest deal synergies.

There are a variety of powerful tools that can unearth the deep learning you need. The Birkman Method, the LionsLead, and similar tools identify strengths, desires, styles, and other characteristics that allow us to know ourselves better. Owners spending time together allows an opportunity for agreeing on the most important company goals. Consulting experts can help activate these tools and align goals in order to identify a guiding consensus for the entire ownership group.

In some cases, we suggest you work with a culture consultant to capture the company's values, beliefs, and habits, and to make sure the prospective buyers take the Birkman or other profiles so you can compare your culture with that of the potential partners. If the potential partner or buyer refuses to take one of the personality profiles, there's an excellent chance your cultures will not be compatible. Employees do not need to hold hands and sing along, but it is fair to discover the management approach, staffing goals, cost-cutting expectations, and other business styles that may help identify trouble ahead.

Remember in Chapter 1 when we listed the main types of buyers? Buyers have broadly similar needs, but their characteristics can be very different indeed. Understanding what motivates the different types of buyers matters if you have specific goals beyond achieving the highest price. Here is an overview of four types of buyers:

1. **Strategic acquirers**
   These are the buyers who operate businesses in or around your company's industry space. They are often competitors, but can also be key suppliers or customers in some cases. Sometimes, they compete in different markets with a complementary line of products and services. These buyers generally have a significant focus on deal synergies and often will want to integrate your culture into theirs. These buyers are long-term investors. Some strategic acquirers are owned by financial acquirers (covered next) and therefore will have some of the positive and negative characteristics of both types of buyers.

Strategic acquirers can offer the highest price, in theory, because they benefit from the greatest deal synergies. Simply defined, deal synergies affect the combined revenues, costs and risks of the acquiring and target companies. Revenue synergies are derived from enhancing future prices, volumes sold, and the mix of goods/services delivered. Discussing price synergies can have legal ramifications (such as Department of Justice antitrust matters), so be sure to discuss this issue with legal counsel. Enhancing your unit volume sales is a potential benefit. Post-merger, you may find that your team can sell your goods and services to the acquiring company's customers, something you could not reasonably do before. Conversely, the acquiring company would want to look for opportunities to sell their goods and services to your existing client base. Enhancing the mix of business may also be a valuable synergy. If the new volumes sold by both parties are the more profitable goods and services, then the new mix of business has higher margins on average than before the deal— another good thing.

Other deal synergies come on the cost side. Putting two similar businesses together has the potential to eliminate certain fixed costs, enhance capacity utilization, and lower supplier costs through greater buying power. Using best practices and the best people from both sides can also result in higher quality as well as enhanced operational effectiveness and efficiency. Sharing proprietary technology and intellectual property can also add value to the company.

If you are selling, how can you benefit from potential deal synergies that will be generated by the new owners? Virtually all sophisticated strategic acquirers will say this during a deal process: “We don’t pay sellers for deal synergies we create.” Fair enough. An appropriate response from the seller is this: “We don’t ask you to pay us for these synergies. We highlight them for you so you know the potential economic power of this business combination. If your bid is better than all others, we will agree to sell to you.”

In fairness, most deals can have short-term negative synergies that include restructuring costs relating to people and operations in order to get the new (merged) business on an optimal footing. Strategic acquirers are the most likely to change your corporate culture. You will hear many of them say, “We paid for your company, so we expect your people to adapt to our culture.” The more sophisticated buyers in this space will have a professional and thoughtful integration plan that will carefully onboard their new employees.

2. **Financial acquirers**
   There are reportedly over 7,900 financial acquirers currently active globally. Most of these are known as private equity (PE) buyers. They are usually financed through capital commitments made by pension funds, insurance companies, endowments, and wealthy individuals. They normally commit to returning the capital invested within seven to ten years, the earlier the better. Many look to create wealth quickly by using maximum financial leverage (minimizing their equity commitment) and by making significant short-term changes to the company, with near-term positive financial returns being key. It is not unusual for a PE firm to sell its investment in any given portfolio company three years after its original investment. This is why Warren Buffett refers to these buyers as “resellers.” That said, trends show increasing hold periods. Also, many PE firms focus on achieving higher multiples on invested capital (MOIC) rather than internal rates of return (IRR). This focus relieves some pressure on the need to sell early. In general, PE firms have an industry reputation for being hard on a company’s corporate culture. With some research, you can determine the firms that have a positive track record of working with management.

Financial acquirers normally have an exit strategy mapped out before they agree to buy any company.

Financial acquirers normally have an exit strategy mapped out before they agree to buy any company. They’ve carefully calculated what near-term changes they can make to your business that will have the greatest payoff. These changes often involve more debt, lower fixed costs, lower operating costs, growth investments in sales and marketing, and capacity enhancements in selected markets. Time is of the essence for them, and they usually bring a keen sense of urgency to their plans. Management is expected to move fast and make decisions quickly. The great proportion of value added (if any) by a PE company is generated in the first two years of ownership. Therefore, many want to sell immediately after this period if they can. In this case, senior

Family offices actively seek to invest more in the business, so they are keen to understand all the possible growth opportunities.

management will be right back in the disruptive company sale mode like it had been two or three years earlier. PE firms are prone to say they don't want to change your company's culture. You should know that their mode of operation, as outlined above, will likely cause your management team to see things differently. Most PE firms want to use existing management, but will bring on several board members who will challenge management monthly or quarterly for progress and results. As you can imagine, relations go smoothly as long as the company is achieving projected results. Otherwise, not so much. Some PE firms will bring in their own CEO. That will almost certainly result in changes to the culture, sometimes significant ones.

PE firms may well outbid strategic acquirers. Just because financial acquirers may not have the opportunity to create the same strategic synergies does not mean that they bid low. They create wealth in several ways, as discussed above. Often, they plan to sell later to a strategic acquirer who will pay them, in part, for the potential strategic synergies.

On occasion, they will try to impress the selling shareholders by adding the upfront cash component of their offer to the potential value of the rollover equity five years later. This is financially misleading as it is like adding apples and oranges. Financially, it is appropriate to discount the future value before adding it to the upfront cash in the proposed deal.

3. **Family office acquirers**
   This is the newest significant category of buyers. There are reportedly more than 10,000 family offices operating globally, with investable assets exceeding three trillion dollars. Often, the investable wealth in a family office comes from the sale of the family's own business. Many of these family offices are keen to buy direct interests in superb private companies and see them grow for the long term. Unlike financial acquirers, family office acquirers don't need to have the invested capital returned to the family in any prescribed period of time. They are longer-term owners. Generally, a family office wants to keep the healthy corporate culture intact. These buyers often want to see management make a long-term commitment to the business.

   Family offices may have an interest in a minority investment, which is less likely in the case of strategic or financial acquirers. They may also have more flexibility on tax structures that can enhance the overall value of the deal. Often, family offices actively seek to invest more in the business, so they are keen to understand all the possible growth opportunities that management has developed but not pursued because of capital or other constraints. It is unusual for family office acquirers to bring in their own management. They are not generally in that business. They tend to prefer investing in growing businesses with bright prospects and with talented management teams that want to stay on for the long haul.

4. **Management buyouts and employee stock ownership plans**
   The last major buyer type is employee owners. According to the National Center for Employee Ownership, there are approximately 6,500 employee stock ownership plans (ESOPs) in place in the U.S., covering nearly 14 million employees. There are good tax reasons to explore the ESOP idea—and good cultural reasons for some owners, too. (To find advocates for this structure, visit www.esopassociation.org.)

   Achieving maximum value from employee buyers can be a challenge, and we advise you not to open this possibility with employees or management unless you are confident this is the best way for you to meet your goals because employees usually don't have much investable cash and the deals are usually heavily dependent on debt financing, which can limit the company's growth potential. In certain cases, however, investors have shown an interest in minority investments in ESOPs, making additional cash available for growth.

In summary, there are diverse types of buyers, and every single buyer within each category has a culture all its own. Learning about the buyers allows you to make smart and informed decisions. Too many organizations enter the process of finding a partner without spending the time to know who the potential buyers are or whether there is a good long-term fit. Trust Yogi. Spend time observing your fellow owners, your advisors, the market landscape, the potential partners, and your own motivations and desires. If you are watching closely enough, you will gather all the details you need to hit a home run and find the ideal match.

There are good tax reasons to explore the ESOP idea—and good cultural reasons for some owners, too.

CHAPTER SIX SUMMARY:
The Death Knell of Choosing the Wrong Buyer

Assess the "fit" of a potential new owner:

- Values
- Beliefs
- Habits

Profiles of different types of acquirers:

- Strategic
- Financial
- Family Offices
- Management and ESOPs

CHAPTER 7 | Games People Play

"Some infinities are bigger than other infinities."
- John Green

The unfortunate reality of searching for a growth partner or selling your business is that many people on the investing side look at your company as a conquest or a game. They keep score, they have goals we do not know or understand, and our actions might prevent them from achieving those goals. On many M&A projects, people on both sides of the deal have predetermined what they want out of the sale, and "more" can be a good enough goal for some players. Buyers may be motivated to play games for a number of reasons including career moves, the fact that it's just their job to bring in a better deal, or even relief from boredom.

When we worked with a cutting-edge technology company, most of the team members from potential buyers in the family office and strategic sectors understood that this particular acquisition opportunity was a potential career-making move for them. Unfortunately, one person with the strategic partner that ultimately made the acquisition knew that his chairman was closely watching this negotiation and he decided to take full advantage of this career move. He acted only in his own best interest. He lied, broke company promises, and defied all sides, trying to illustrate his negotiating prowess. The deal was completed despite him, but his behavior revealed his negative character. A few months later, the Fortune 500 company let him go. It was a great reminder that the games bad people play can affect the outcome of a good business combination.

Most of the people you'll meet on the buy side are really nice. They dress well, order excellent bottles of wine, and have endless engaging stories to share. But when you look across the table, remind yourself that their job is to buy your company for the least amount possible and with terms that are most favorable to their employers. That's just their job, and how their boss will evaluate them. The "other side" enters the fray of M&A frequently while, for many sellers, this is the only time they will ever be involved in a transaction of this magnitude.

Most of the people you'll meet on the buy side are really nice. They dress well, order excellent bottles of wine, and have endless engaging stories to share.

Like in most walks of life, whether as a lawyer, business owner, doctor, or librarian, sometimes we get bored; so, we keep score and play games to make the day or the deal move more quickly. If you do not remember that simple reality, when the other side plays games, it might cause you to react in ways that do not serve your best interests. Conversely, the person who calmly takes in all the action and wisely progresses is the person with the best opportunity for long-term success.

Don't bite on this one, Mr. Gill. I sense a bait and switch going on here.

Buyers know that the seller's negotiating power peaks just before the signing of the letter of intent.

Buyers who play games can be harmful to the company's future; but decisive, well-prepared sellers can offset this risk. For example, we worked on a project where the buyer's chairman was not a bad guy—he was just used to being in charge. He decided, at the closing table, to flex his muscle and call the seller "Dick" rather than by his given name, "Richard." Richard had communicated his proper name, but the buyer's chairman still called him "Dick." So, Richard decided life was too short to deal with someone who he felt was gigging him and would likely do that to his people going forward. Richard had no interest in being Dick, and the deal died. If Richard had not recognized the buyer's chairman as someone who played games, he might have sacrificed his goals for the company's future and regretted one of the most important decisions of his life.

Let's take a look at just a few of the games buyers play:

Game #1: Getting slick at the eleventh hour

Buyers know that the seller's negotiating power peaks just before the signing of the letter of intent (LOI). Your M&A advisor may have pushed the buyers quite hard by the time the LOI gets signed. (Actually, "should" is a better word than "may" here). But one of the games buyers play is to try to renegotiate, or "re-trade," your deal after the LOI is signed. Some will use every wart and blemish they discover during due diligence to grind you on the price and terms.

We finished a deal where it was discovered, right before the signing of the LOI, that the buyer had made a calculation error to the benefit of many millions of dollars in the seller's favor. When the error was discovered, there was extensive discussion, and it was decided the deal terms needed to stay as they were presented or the seller would consider other opportunities. The seller had peak leverage, and the buyer acquiesced. After three months of due diligence, however, the buyer came back to us right before closing. He requested—considering everything that had been discovered—that the "right and proper valuation," not the mistake-driven valuation, be substituted. We explained that this last-minute change would be unfair and that was not how the two groups should start their partnership. Again, it was quite tense, but the buyer realized that the seller was willing to walk and acquiesced.

Your best protection against a scenario like that? A veteran advisor and multiple bidders. If the buyer had not understood the clear position and opportunity, millions of dollars would have left the deal at the last minute prior to closing.

What you could be hearing is actually the other side working an angle against you.

Game #2: You're not quite as handsome as she is making you feel

The oldest and simplest approach to negotiation is building rapport. When it goes over the top, it is flattery. Many years ago, we were working on a large deal where the other side had perhaps the smartest, savviest, and most beautiful investment banker we had ever met. More importantly, she was also the smartest, savviest, and most beautiful investment banker our client had ever met. He happened to be the chairman of his company, and sadly, he believed every beautiful word that crossed her lips.

Everyone else within the company and all the advisors saw the train wreck that was coming—but the chairman, who owned 25 percent of the multi-billion-dollar enterprise, was willing to believe he was much more handsome than he really was.

Too often, we long to believe that what we're hearing is reality. But what you could be hearing is actually the other side working an angle against you. We always recommend that you surround yourself with advisors you can trust as well as "truth police," people on your team who are vested in the job and have the will to tell the truth. When millions or tens of millions of dollars may be at risk on the turn of a single decision, it is very wise to preemptively protect yourself.

Game #3: Good cop and really, really bad cop

We were working a deal with one of the largest companies in the world. It had agreed to pay almost 50 times EBITDA for our client's small but fast-growing company. The buyer had agreed to a carve-out of a significant portion of the intellectual property. They had given us everything we desired because our client was going to deliver some of the most advanced technology in the world. Three weeks prior to closing, the assistant general counsel of the buyer arrived on the scene, declared that he was now in charge, and gutted the carve-out (which happened to be worth a substantial sum of money). We argued, complained, and called them liars. The corporate counsel countered, "Take it or leave it." The lesson: Nothing promised is delivered until the deal has closed. This is a sad fact, but also a reminder that games are played throughout the deal by new and old players.

Ensuring that every decision maker or influencer on your team has a deep understanding of what is acceptable and what is not allows owners to determine what they are willing to live with and what is a deal breaker.

Look out for the players. Surround yourself with trusted advisors. And decide early on how far you are willing to stretch the boundaries. Then when the games begin, you will be ready to play.

Nothing promised is delivered until the deal has closed.

SELECTED GAMES SOME BUYERS PLAY

During the IOI phase, some may offer more than they ever intend (or can afford) to pay. Buyers may want:

- More confidential information for educational purposes or to help a portfolio company to assure they get invited into the LOI phase and work the deal terms down later

They may hide their true character during the buying process. Buyers may:

- Over-promise
- Behave more respectfully
- Act more empathetically

Buyers may lower the bid price or change the deal terms to your detriment because their due diligence uncovered "material" negative issues that they feel were not adequately disclosed

- Sometimes buyers do this the day before closing or even the day of closing when your other potential buyers have likely moved on.

Some acquirers may attempt to drag out the process

- During due diligence, they may want to wear down the seller (and the banker) and allow more time for competing buyers to move on and lose interest.

They may try to circumvent the auction process

- Some will attempt to open a direct line of communication with the CEO or owner to enhance their chances to win the auction on the best terms possible.

SELECTED GAMES SOME BUYERS PLAY

Buyers may attempt to have private conversations with more junior members of the management team who could soon be working for them

- They may try to develop a relationship with a susceptible manager or two in order to find out who the other bidders are, what the bids are to date, what due diligence matters warrant more focus, or just to have them try to influence the process in their favor.

Buyers may call in a favor with the CEO of your investment bank

- Many buyers are clients or potential clients of your investment bank. This conflict of interest can be managed, but you are responsible for managing it. Please know that the value of a "last look" to a buyer in an auction process can be considerable.
  - » Buyers always want to know the number of bidders in the final round(s), who is bidding, and what is the clearing bid. (Note: They should never learn this from your team members.)
- Some buyers will offer to pay the investment banker's "full fee" directly if they win the auction and do not beat the next best bid by too much. If you are a one-time client of your investment bank, the risk of this conflict of interest affecting your deal may be higher.
- Many buyers need active "deal flow" and will incentivize investment banks on the sell-side to steer potential transactions to them by offering follow-on M&A business or financing transactions.
- Some investment banks clearly point out in their engagement letters that they are not responsible for any conflicts of interest.

Buyers may make it difficult to get your future payments

- Some deals have considerable value derived from potential earn-outs. Some buyers may make it difficult for selling shareholders to earn these amounts.
- Some transactions have significant escrow amounts or holdbacks, and buyers can sometimes balk at releasing these funds.

CHAPTER SEVEN SUMMARY:
Games People Play

Be aware of potential "games"

- Last-minute changes to the negotiated deal
- Flattery
- Good cop, bad cop
- Inflated non-binding bids
- Over-emphasize minor negative issues
- Delay the process
- Gaining an "edge" through members of your deal team
- Using legal system to delay future payments

> *“We make a living by what we get, but we make a life by what we give.”*
> \- Winston Churchill

Taxes. Most people accept them as a normal consequence of a deal, but there is a better way.

Andy never intended to start a business, but when his sales position was eliminated after restructuring, he knew starting his own business was the best way to go. Although he made only $15,000 his first year, the succeeding years were a wild ride of managing growth and capital. After several years, the new company was providing millions in profit. The crazy growth of the company attracted several suitors, but especially the attention of a major retailer.

In a matter of months, Andy found himself at the negotiating table. As he contemplated the consequences, he asked his financial advisors for an estimate on how much tax he would pay. They calculated his number and presented him with the bill, much like an invoice.

It’s astounding there aren’t more companies that engage charitable tax planning experts, given all the benefits of addressing charitable tax issues before the sale.

Fortunately, we met Andy before he signed his purchase agreement. At that time, we made the offhand comment, “Before you sell, be sure to contact us.” Andy did indeed contact us and, with the transaction in progress, we counseled him to donate shares of his closely held corporation to a donor-advised fund in advance of the sale. He jumped at the chance to trade tax dollars for charitable dollars. He completed the donation well in advance of his purchase agreement. By donating before the sale, he saved one million dollars in tax liability. With his tax savings magically turned to charitable giving, Andy began funding education for those in underprivileged areas.

Andy’s positive outcome is one of the success stories. It’s astounding there aren’t more companies that engage charitable tax planning experts, given all the benefits of addressing charitable tax issues before the sale:

1. **Fair market value**
   The donation of closely held stock can occur at fair market value rates. A qualified appraisal will validate the value. The donation can be deducted against ordinary income.

2. **Capital gains avoidance**
   For all the stock that Andy donated, he paid no capital gains tax on those shares.

I can't take it with me so I might as well send it on ahead.

3. **Estate tax benefits**
   The shares that Andy donated were no longer counted in his estate and were thus no longer subject to estate tax.

4. **Partial donation**
   Andy only donated part of his shares. The percentage that an owner may donate is variable and determined by the owners.

5. **Charitable impact**
   By donating the shares to a donor-advised fund and the subsequent monetization of those shares, Andy was able to make contributions to charities of all kinds. However, he was not required to donate immediately. Instead, he was able to take his time vetting organizations and making gifts to charities as they crossed his path.

Andy's situation is just one example. There are other planning scenarios available. For instance, Andy could have used a charitable trust, achieving many of the same tax benefits while additionally creating an income stream for himself and his wife. A charitable trust could be thought of as a "charitable IRA." Other available tools include charitable lead trusts, charitable gift annuities, private foundations, and more.

For all of the options, there is much flexibility in timing. We see business owners who will make this kind of donation even five years before the sale. Often, the biggest value on an owner's balance sheet is the value of his or her company. The value is locked up, however, until there is a sale or disposition of some kind. So an owner of a closely held company pays income taxes on an amount of money he or she does not take home. The tax bill may turn out to be larger than the compensation actually received.

To mitigate these income taxes, wise owners, knowing that they may be moving toward an exit, will donate shares of the company on an annual basis. The value of the donation occurs at fair market value and can be written off against ordinary income. The income tax savings can be plowed back into the company or utilized for other purposes. For instance, assume Andy's company was worth 10 million dollars but that his adjusted gross income was 1 million dollars. Under this scenario, Andy's tax liability would be approximately 40 percent, or $400,000. However, if Andy donated just a three-percent interest in his company, he would have a $300,000 income tax deduction (three percent of 10-million-dollar value of the company).

At his tax bracket of 40 percent, Andy would have income tax savings of $120,000 (40 percent times $300,000). Think about getting $120,000 of money back as income tax savings simply by utilizing the latent value of the company. This situation is particularly enhanced if Andy's company is growing by 20 percent or more a year. His donation would be offset by the value of the growth of the company.

The key point here is that, in the context of the business sale, there are immense tax savings opportunities. Those tax benefits can be achieved even in advance of the business sale. Even for those people who are not charitably inclined, the tax savings make a contribution worthwhile. In one case, we worked with two businessmen who owned a strip-mall shopping center. They made a contribution of their interests to a charitable trust and received income for a ten-year period. At the end of the ten years, they allowed a close advisor to give away the remaining charitable proceeds.

From a process standpoint, the key point neglected by most business owners is that charitable tax issues must be addressed before the sale. Indeed, the donation of the shares must be completed prior to signing the purchase agreement. If the donation doesn't occur prior to signing the purchase agreement, then the opportunity to enhance the capital gains/fair market value deduction is lost, and only cash may be donated.

At the end of the day, the pending business sale represents not only a great payday for the owner, but it also represents the greatest opportunity for tax savings and charitable giving. The wise owner will maximize the sale, minimize the taxes, and still realize the opportunity to give away money. Similarly, the wise owner will surround himself with advisors who understand when and how to provide this kind of counsel.

CHAPTER EIGHT SUMMARY:
Don’t Give Away Your Tax Dollars: Be Charitable

- Dealing with taxes (income, capital gains, and estate)
- Opportunity to trade tax dollars for charitable dollars
- Donor Advised Fund (DAF)
  - » Provides charitable donations over time as you direct
- Charitable trust

CHAPTER 9 | Deal Auction Process

"Every election is a sort of advanced auction sale."
- H. L. Mencken

Several decades ago, the M&A market was first exposed to the power of the auction process as a vehicle for the sale of control of a business. In this market, auctions include full-on, all-comers-are-welcome invitations as well as limited processes where only prequalified acquirers are invited.

We participated in a transaction in which the initial buyer and seller were in agreement regarding the company's value. Wisely, the seller opted to hire an investment banker, terminate direct discussions with the initial buyer, and take the business to auction. The eventual sale price ended up being double the initial amount. Auctions keep everyone honest, and this experience was a reminder that the market most often sets maximum value. Auctions take a little longer and may not be the right vehicle for everyone, but it is worth the time and effort to understand the process in order to seriously consider whether an auction might be the right approach for you.

We've all heard the expression that "businesses should be bought, not sold." We disagree. Only on rare occasions do the best buyers knock on the door and offer to acquire your business at a full market price. Buyers want the opportunity to go direct—to simply approach a willing seller. They expect to save millions of dollars by avoiding an auction, as direct deals usually garner an average value or even a below-market value. The bottom line is that buyers much prefer the direct approach, whereas sellers are highly likely to benefit more from a formal auction process, both in value and deal terms.

Auctions keep everyone honest, and this experience was a reminder that the market most often sets maximum value.

Your investment banker is in charge of selling three things for you: i) your business, ii) potential synergies, and iii) non-core assets. The auction process helps find the buyer(s) that will offer maximum value for each of these three assets. Selling the business as a stand-alone entity is not the goal. A great deal of value can be extracted from the market by presenting the company as a platform for future acquisition growth, if this case can be made credibly. Also, the investment banker should focus on all of the opportunities for enhancing revenues and controlling costs for various buyers that can bring their own resources to the deal. These resources can involve a combination of factors including competing businesses or complementary businesses, best management practices, technology, intellectual property, and additional capital. We have seen transactions where, to a buyer, the value of the synergies exceeds the value of the stand-alone company. Such deals are more likely when the acquirer intends to reinvent its business model using the selling company's resources

I haven't a clue what Apex Amalgamated Inc. does,
but it sure is a good buy.

(e.g., technology). An auction process that canvasses many logical buyers will help you take advantage of the value of the potential synergies your company can help deliver to an acquirer. Lastly, certain assets on your balance sheet may not be viewed as core to the business by potential buyers. Your investment banker must advise you on how best to realize on these values, and that may mean that the non-core assets are retained or sold to a third party using a different process. *(See Chapter 4: Your Secret Sauce.)*

Optimal exits generally require strategy, planning, and an auction.

Some experts say this about selling direct: It is rarely optimal for the shareholder(s), as there is no built-in pressure on the buyers to offer their best terms. It is almost universally understood that lower sale prices are generated without competition, as everyone defaults to fair (to them) pricing and terms. Also, in a direct (nonauction) transaction, the chances of closing according to the original terms diminish as time goes by. Without the time pressure of an auction schedule, it is easier to submit an offer and then extend the due diligence process until the seller relents. In an auction process, however, significant portions of the due diligence are completed prior to a signed letter of intent (LOI). In a competitive auction situation, many of the key terms are agreed upon at the LOI stage, so fewer winning bidders back out in the middle of the due diligence process.

Optimal exits generally require strategy, planning, and an auction. Closing on an unsolicited offer (i.e., a single bidder) is almost always a lost opportunity for the seller. The benefits of having multiple bidders in a business sale include the following:

- **Maximizing the final sale price:** The market determines fair value. A good advisor acts as the auctioneer who provides the buyers with counterproposals and the opportunity to rebid, which can drive the price higher.
- **Increasing the probability of completion:** When everyone understands there is competition, fewer games are played, and everyone senses the pressure to perform.
- **Closing the transaction on time:** In an active auction, there is a scheduled beginning, middle, and end.
- **Demonstrating good governance to the board, minority shareholders, and other stakeholders:** You cannot reasonably be criticized if you have properly canvassed all the relevant possible players in the market.

There are several critical steps in the auction sale process: preparing for market, identifying the acquirers who will most likely be interested, preparing the CIP, inviting indications of interest (IOI), performing due diligence, LOIs or offer letters, navigating final negotiations, signing and closing. Though these steps do not always occur in this exact order, this is the general approach used during an auction process.

ILLUSTRATIVE AUCTION PROCESS SUMMARY OF STEPS

Illustrative Time Table

2 MONTHS +/- A WEEK

1 Preparing for Approaching the Market

- Decide what is for sale (i.e., up to 80% of the core business)
- Decide how long the CEO and other leaders will commit to working with a new owner
- Analyze the company, its financial results, and expectations
- Write a compelling CIP

2 MONTHS +/- A WEEK

2 Approach the Market

- Send a "teaser" (summary of your business hiding the company name) to potential buyers
- Send an NDA to potentially interested parties
- Send a CIP to potential buyers that execute the NDA
- Invite all parties with a CIP to submit an IOI outlining expected bid values and transaction rationale
- Invite the top 5-10 potential acquirers to meet management and explore the "digital data room." Management presents their investment merits for four hours to each party separately. Buyers are not supposed to know how many other buyers are involved or the identity of any other buyers
- Invite the parties to submit a detailed LOI outlining total consideration bid (value), important deal terms, and expected due diligence requirements
- Seller selects one "winner" after negotiations with players that submitted the most attractive LOIs

2 MONTHS +/- A WEEK

3 Close the Transaction

- Work with buyer's team to help them perform confirmatory due diligence on the business
- Answer hundreds of questions
- Schedule closing
- Sign the purchase agreement
- Close the transaction

As a side note, it is important for sellers to know beforehand that there may be negative emotions associated with some of these steps—and they are completely normal. Having support during the process allows sellers to do what they do best (i.e., manage the business) while this process is underway.

Preparing for market: This stage is often overlooked or pejoratively referred to as "perfuming" the target. Our view, however, is that this is the make or break time for the company—the time to find the secret sauce. It's when your company's true value should be identified via the economic value drivers and differentiation research that make up your secret sauce recipe.

Identifying the potential acquirers: Through our years of walking alongside business owners during the sale process, we have learned a few things about starting relationships with potential acquirers:

1. The work of identifying the best buyer or partner was, at one time, assumed to be the secret bastion of the industry insider or the Wall Street investment bank. Now, however, what was once owned by insiders is readily available via expensive subscription industry databases. Professional buyers want to know about your company. Deal flow matters a great deal to them and the buyers want to be found.

2. Thinking beyond the box is essential. This means taking a new look at the company and listing all the strategic, financial, and family office buyers that might benefit from a partnership with it. This means doing the necessary research to uncover those potential additional opportunities.

3. It is essential to present the company to the different potential partners in a way that is tailored to each type of buyer. The CIP document and meetings with the management should be customized to best meet the needs of each type of buyer.

To further clarify the first point, investment banking insiders once exclusively owned relationships and access to private equity (PE) funds and strategic buyers. Today, these buyers desire to be found. They make money by growing through acquisitions, and they have full-time people who network and ensure that any reasonable opportunity is reviewed. The 3,700+ active North American PE funds and thousands of strategic acquirers ensure that they are part of CapIQ (a subsidiary of S&P Global Market Intelligence), Bloomberg, Reuters, PitchBook, or other subscription databases that have virtually every strategic and PE buyer's profile and contact information. Thus, one no longer needs to work on Wall Street to access this important information.

Second, the concept of thinking beyond the box is simple, but the application is challenging. The idea is to stretch beyond normal processes and potential partners to consider new areas of growth, identifying entities that could benefit from research, relationships, contracts, technology, and anything else that might encourage a strategic partnership. This process, if done well, may move the company in dramatic new directions. It is a combination of stretching the bounds of who might be a good partner, researching to uncover what is valued by each type of buyer, and working hard to understand what needs are resident in the buyer pool in order to find the right cross-connect.

On a recent project previously taken to market by an industry-focused investment bank, less than ten percent of the new potential acquirer list overlapped with the previous list. Only ten of the 130 companies identified in the later process had been uncovered and approached previously. The buyers that had been identified by thinking beyond the box were dramatically different and ultimately drove the closing price much higher. Some investment banks tend to focus too heavily on their "regular" acquirer list. Often, many players on the regular list are repeat clients of the investment banking firm.

Finally, there are many types of buyers, and they are looking for different types of information. Expanding on the groups from Chapter 6, some groups that are active M&A buyers today include the following:

- **Large strategic companies:** These are public and private companies with revenues greater than one billion dollars. These buyers typically seek to acquire a 100-percent ownership stake in the target company and will most likely install their own senior management after the acquisition takes place. They typically pay in the middle to top end of the value range for the targets they acquire.

- **Middle market strategic companies:** These are public and private companies with revenues between 100 million and one billion dollars. These buyers typically seek to acquire a 100-percent ownership stake in the target company and will most likely install their own senior management soon after the acquisition has taken place. They typically pay at the high end of the value range for the targets they acquire if there is a compelling strategic purpose.

- **Private equity (PE) funds:** These are mostly institutional investor-backed professional buyers seeking to obtain a portfolio of companies from which they can earn a substantial multiple of invested capital (MOIC) in order to satisfy their investors and earn significant fees for themselves. They typically seek to acquire companies using considerable amounts of debt with a view toward reselling them to strategic buyers, to the public via an initial public offering (IPO), or to another PE firm within three to seven years of the acquisition.

Understanding and communicating the culture, operational expertise, and financial nuances of each potential buyer is painstaking work.

- **Individuals or small groups:** These are wealthy individuals or groups of individuals—often those who have previously sold a company—looking to acquire a company which they will subsequently manage. In contrast to PE buyers, these buyers are looking to obtain a market rate of return. Consequently, when seeking out a company, they will prioritize a strong cultural fit with the acquisition target and will be less likely to drastically streamline the company post-acquisition.

- **Family offices:** These are investment funds which are backed exclusively by a wealthy family or group of wealthy families. While these offices serve many functions for their backers—from providing tax advice to investing in public securities—they often primarily serve to avoid the high fees charged by PE fund managers and to invest (often with other family offices) directly in private companies. They are frequently driven by a desire to find cultural fits and seek partnerships with the current management of the target, and they may require that the management retain a portion of the ownership of the firm. It has been said the biggest sin in working with a family office is besmirching their reputation. They do not like to lose money, but they cannot replace their reputation. Therefore, they take great care in selecting acquisition targets with top quality management teams. Additionally, they often do not have a specific exit plan but, instead, anticipate holding their acquisitions for the growth opportunities and cash flows which they will generate over the long term.

- **Venture capital firms operating like private equity funds:** Some venture capital firms (VCs)—which traditionally have invested only in start-up companies—are seeking to acquire more mature firms to add to their portfolio of companies. Post-acquisition, they seek to run these portfolio companies in a manner similar to the traditional PE firms mentioned above.

- **International buyers:** These are large operating companies and middle market companies located in Asia, Europe, or MENA that are looking to expand into U.S. markets. These buyers typically seek to acquire a 100-percent ownership stake in the target company and will most likely install a member of their own management team soon after the acquisition has taken place. They typically pay at the top end of the value range for the targets they acquire, but may take longer than normal to close a transaction.

Having a trusted investment banker means the fairness of the offer can be considered by a seasoned expert in an objective manner.

Presenting the company's investment merits wisely is, unfortunately, not the norm in the marketplace. Sending the same marketing material to every buyer is easy, but creating materials customized to accentuate each potential partnership is challenging and much more time consuming. Understanding and communicating the culture, operational expertise, and financial nuances of the most attractive potential buyers is painstaking work. However, a cookie-cutter process delivers cookie-cutter results. Your company deserves the best possible result, which demands the best possible research and presentation.

Preparing the confidential information presentation (marketing book)

As discussed in Chapter 2, the CIP, also known as a "marketing book," describes the company so buyers can gain an initial understanding of the opportunity. Depending on the financial situation of the company, putting this book together may be relatively simple or unexpectedly challenging. This document thoughtfully presents the value components of the company to potential acquirers. During the initial discussions about the CIP and throughout the drafting process, sellers may feel apprehensive about revealing information about the company. However, when this marketing book is complete, they usually feel proud and encouraged. This document presents the company in the clearest and most positive light. All potential acquirers who want to review the CIP are required to execute an NDA satisfactory to the seller.

Inviting indications of interest

Soon after receiving the CIP, potential acquirers are invited to submit a non-binding indication of interest (IOI) that should outline at least the range of values within which they would consider paying, the broad deal terms they envision, and the reasons why they are interested in buying the seller's company. More thoughtful IOIs include a discussion as to why the seller should view the buyer favorably, including the buyer's i) financial capability, ii) success record, and iii) intentions regarding management of the business and the culture of the company going forward.

Performing initial due diligence

Initial due diligence is the process of giving potential buyers additional information beyond what is in the CIP. Buyers who have submitted attractive IOIs are given the opportunity to ask questions of the seller and its senior management in a face-to-face meeting. This process can be challenging, as the motivated potential buyers will continue to request additional information. Some sellers may feel a little threatened by the long list of questions and information requests. However, these inquisitive buyers are the ones who have a sincere interest in the company. Admittedly, it can be a frustrating process, and some sellers grow resentful of answering so many questions. This is one of several reasons why it is helpful to have an investment banking team that is on call to deal with this very detailed and labor-intensive part of the process.

During initial due diligence, it is helpful for the seller or the seller's advisors to perform some due diligence of their own on the acquiring company(ies) to ensure that they know the acquirer(s) and understand their intentions for after the sale. This is particularly important if the senior management is expected to remain at the company post-transaction. The fewer surprises, the better.

Executing the letter of intent (offer letter)

After the initial due diligence phase, a potential buyer will submit a non-binding LOI (or offer letter) to acquire the company. This letter indicates the price and the broad terms under which the buyer is willing to pay. When sellers receive the LOI, one of two things usually happens. Either they are surprised and excited by the unexpectedly high amount, or they are deflated and discouraged by an amount that is lower than expected. Even if the offer is on target with the asking price, sellers often still feel let down, especially when attorneys, friends, or co-workers are telling them they could get more money. Disappointment may lead to the assumption that the potential acquirer has not fairly evaluated the company. Having trusted advisors means the fairness of the offer can be considered by a seasoned expert in an objective manner. Transactions are normally "cash free and debt free" meaning the selling shareholders take home the cash on the closing balance sheet and receive the net transaction price after the debt and the transaction expenses are paid. Any escrow amounts will be withheld for the negotiated time period. The seller is responsible for delivering a negotiated amount of net working capital at closing.

Performing confirmatory due diligence

Confirmatory due diligence is the process of accumulating and presenting relevant company data, including financial reports, growth trends, revenue and profit, contracts and other information that was not included in the CIP or the initial due diligence. This is a challenging process in which the potential buyer will scrutinize everything material related to the business, including client/vendor agreements, licensing, trademark/patent registrations, systems, staff, benefits, facilities, and financial statements.

During this process, sellers sometimes assume the potential buyers do not trust them, or they grow frustrated by the time it takes to accumulate all the information. Some sellers even come to the conclusion that it is not worth it to continue the process. It may seem like the potential acquirer is asking the same questions repeatedly. It is important, however, for sellers to recognize that the purpose of the questions is to confirm the information that has been presented. The acquirer has the right to fully understand the details of the company and the potential transaction. Again, having an on-call advisory team to deal with these questions can reduce some of the stress on the seller.

There will also be pressure and stress during the confirmatory due diligence stage because the clock is ticking. Typically, offer letters stipulate that due diligence must be completed by a certain date so the closing can occur by another specified date. When the LOI expires, both the seller and the potential buyer are released from completing the transaction. The investment banker and the legal team help shepherd the process so that work is performed within the stipulated dates.

Navigating negotiations and the definitive purchase agreement

Negotiations will occur simultaneously with the confirmatory due diligence. At this point, the seller's attorneys draft and negotiate the purchase and sale agreement (PSA) with the buyer's attorneys. This document governs the proposed transaction, and if something is not stipulated in this agreement, it simply is not part of the transaction. Other documents are often included with the PSA, such as employment agreements, non-compete agreements, and operating agreements. The PSA will show whether the seller is selling i) selected assets or ii) the stock of the company. The tax implications are different and should be understood early so that negotiations take the tax impact into consideration.

Good negotiating is a skill. Therefore, it is particularly helpful to have a trusted and experienced investment banker and M&A lawyer who can advise you during this phase. Some battles are worth fighting, but others are not. Most times, some compromise is necessary in order to get a good deal done. During this phase, some sellers feel frustrated, angry, or taken advantage of by the acquirer. The goal is to come to a resolution where both seller and acquirer are satisfied with the terms of the agreement.

By the end of this step, you will have worked on this project for about six months. You may be tired. You may just want to get the deal done and move on to managing the business or the next stage in your life. Professional buyers know this happens. Too often, they will test you at this stage. A last-minute and substantial change may be demanded by the acquirer. You may feel disappointed or worse by this turn of events. This is the moment of truth. Will you walk away or take the new, tougher terms? Your experienced and trusted M&A team will have kept other acquirers motivated prior to the signing of the LOI, and can guide you as to the value of starting the process over again with buyer number two compared with finishing on less than the original terms with the first buyer. It is very hard to get good deals done if the buyer senses you do not have good alternatives to keep him or her honest.

When the negotiations on the PSA are completed, the parties will sign the agreement, but the closing may occur later. A deferred closing provides time for the buyer to complete its due diligence and for the parties to satisfy closing conditions, including obtaining necessary third-party consents, making government filings, and so on.

Completing the closing

The closing is a final meeting when the purchase and sale is completed. Additionally, if cash at closing is part of the transaction structure, it will be wired to the seller's bank account at that time. If the prior steps have been organized and well facilitated, the closing will go smoothly. When everything goes perfectly, most sellers feel great. However, there are often a few additional questions and issues that must be addressed during the closing. When this happens, some sellers feel confused or even misled. But once the issues are resolved, the seller feels relief and excitement that the process is over and life can move forward.

Moving on from the transaction closing—where to go from here: After the transaction is closed, sellers are ready to move on with the next phase of their lives and careers. However, this relief and excitement sometimes gives way to a sense of loss and grief. They are faced with the realization that something they built and put their lives into is no longer theirs. They may wonder if they made a mistake or if some areas of the transaction were mishandled. Ultimately, they will move through this phase and recognize that, although the process may not have been without problems, they are now free to move forward into their next endeavor.

The Five Ps: Prior preparation prevents poor performance.

In summary, the auction process is an extremely important part of the overall deal process that helps to enhance total value for the seller. Simply listing one's company with a business broker and being put into a listing or auction does not maximize value for the seller very often. The sale cannot be successful without the five Ps: Prior preparation prevents poor performance. Therefore, it is imperative to do the hard work of preparing the optimal buyer list and deeply understanding the company so as to be able to clearly present the investment merits and to alleviate any perceived risks in buyers' minds in order to take full advantage of the power of the auction process.

INVESTMENT BANKER COMPENSATION ISSUES

You want to achieve all your stated goals *(see Chapter 1: Setting Goals)* in the auction process. However, almost all engagement letters with investment bankers define success only in terms of dollars and cents. Below are some ideas to help.

- **Insert your most important goals in the engagement letter.** Have some financial reward (or penalty) associated with goals met (missed).
- **Lower the proposed retainer fee.** Investment bankers usually request retainer fees to offset the time and effort expended before any success fees are earned. This fee also means the seller has some financial "skin in the game." The retainer fee is almost always fully credited against any success fees paid. Sometimes, they will lower the retainer fee just to get the engagement signed. Sometimes, they will lower it in exchange for a higher success fee.
- **Stretch out the retainer fees.** Some investment banking proposals have the entire retainer fee paid upfront. Sometimes the bankers will agree to a monthly payment over three to six months. Sometimes they will agree to retainer payments made upon achieving certain auction milestones.
- **Lower the success fees.** Sometimes bankers will do this in order to get the engagement signed. Sometimes they will agree to this in exchange for higher retainer or bonus fees.
- **Adjust the definition of success.** You and your investment banker should be able to agree on a fair market value (FMV) for your company. A decent success fee is reasonable if the auction results in a deal done at FMV. If the deal gets done below FMV, the fee could be substantially less than first proposed. Sometimes the banker will agree to this downside in exchange for a higher upside in the event the transaction is completed above FMV.
- **Shorten the tail.** Most engagement letters will not let you fire the banker just before the deal closes just to avoid paying the success fee. If you do fire the banker, the terms usually require that the seller pay a success fee to the banker if a transaction is completed within 24 months of termination. Sometimes investment bankers will shorten this tail period.
- **We recommend a bonus structure for investment bankers who take the time and expertly analyze your company in order to effectively sell its investment merits.** The bonus structure tends to result in a better overall deal for sellers as the investment banker is more highly motivated to stretch for the best possible deal even if it is harder to achieve. *(See Chapter 12: The Art of the Possible.)* It is not unusual for the expert investment banking team to invest one to two man-years before any success fee is earned. Therefore, the seller wants to keep the banking team energetically engaged to get the most money reasonably possible at the end of the process rather than having them promote the easier and faster deal at or near FMV.

MANAGEMENT BUYOUTS (MBO): A Word of Caution

- Things change significantly if your management team wants to buy your company
- You cannot depend on your management team to present your company's investment merits well to competing bidders in this situation even though they still have a fiduciary duty to shareholders
- Other buyers who want motivated managers to continue working at the company may be reluctant to bid
- Managers who want to bid have an incentive to bid low and may allow expenses to creep up, and revenue growth to taper off in order to show more modest financial results
- The board or major shareholder should run the sale process in this situation
- Consult with your investment banker and lawyer as soon as possible if you sense management is a buyer

CHAPTER NINE SUMMARY:
Deal Auction Process

The auction process may be optimal for you because:

- Likely to maximize total value
- Enhances the probability of completion
- Auction timetable keeps the process moving smoothly
- Demonstrates good corporate governance to stakeholders

The auction process can be completed in 5-7 months:

- Prepare CIP (2 months)
- Talk to potential acquirers and select one (2 months)
- Due diligence and close (2 months)

Different types of buyers have different goals:

- Strategic buyers
- Private equity funds
- Family offices
- Management and employees

CHAPTER 10 | Deal Representations and Warranties

"You can avoid reality, but you cannot avoid the consequences of avoiding reality."
\- Ayn Rand

Seller representations and warranties are meant to protect the buyer. Most of these are meant to capture and document the buyer's understanding of your business and your commitment to honestly disclose all material information about your business. The boundaries of what might be covered can range from "fraud only" to everything under the sun. We worked on a deal where the buyers did such significant due diligence during the deal process that they simplified the seller's representations and warranties to just a few pages. Conversely, we've seen representations and warranties take up nearly 50 pages on a small project so that the buyers and their counsel could feel comfortable that they were protected. Some of our clients have been offended by the longer lists. We suggest that you recognize that market-based representations and warranties are normal. They are not personal. They are just business.

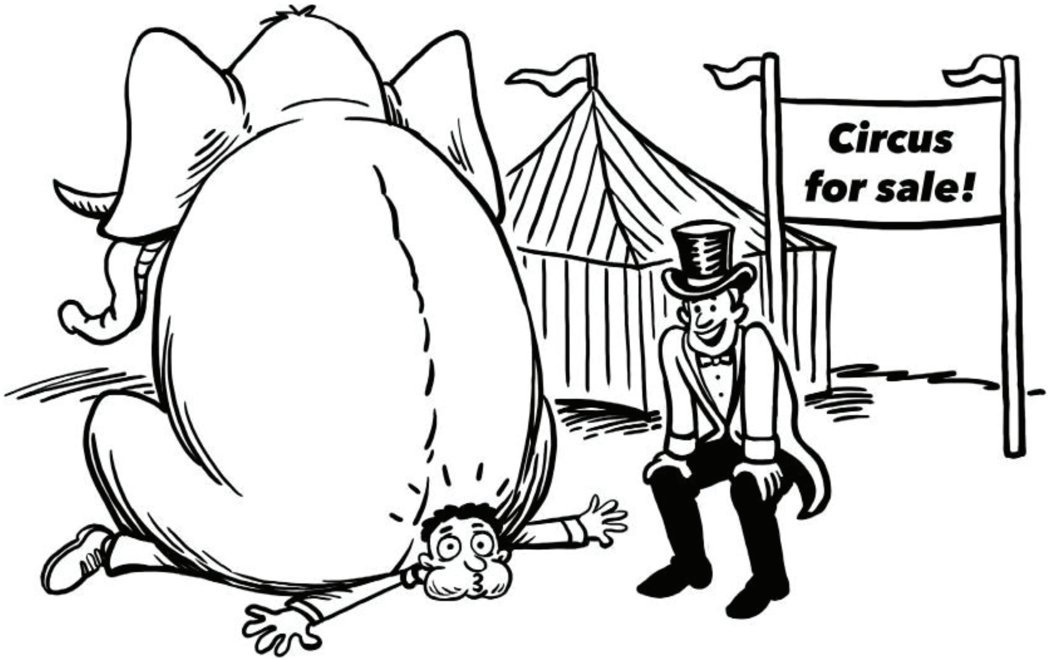
Once you have agreed on a price for your company, you are only halfway to a deal. The focus must shift to the terms of the transaction. An axiom in the M&A world says that, if they insist on setting the price, we will insist on setting the terms, so the deal will work for us. This underscores how important terms can be to your deal. Purchase and sale agreements (PSAs) involve numerous financial and legal definitions.

This chapter briefly touches on the major topics that are frequently included in PSAs. Each deal along with its detailed terms is different from other deals. The following summary of terms may not fit your situation, so we encourage you to obtain expert financial and legal help in negotiating any substantial sale.

Representations and warranties are not personal. They are just business.

There are many detailed issues to negotiate from a legal standpoint, which collectively bring clarity to the responsibilities of the parties involved and their contingent responsibilities should something go wrong. As a guiding principle for the seller, "the truth shall set you free" works very well as you put forth the salient information about the company.

The PSA will include i) representations and warranties, ii) obligations between the signing and closing, iii) closing conditions, and iv) post-closing obligations, including indemnification of the buyer for inaccurate representations and warranties or certain contingent liabilities (like the outcome of a pending lawsuit).



Now that we've settled on the price, we thought we'd bring in Missy to help us discuss the terms of the agreement.

The seller's representations and warranties serve three main purposes: i) disclosure to the buyer before signing; ii) allowing the buyer to walk away if they are untrue when made or at the closing; and iii) giving the buyer a post-closing indemnification claim for significant inaccuracies as of the closing that are discovered later.

The seller is always required to make certain representations and warranties, as well as to enter into certain covenants. Any or all of the following items may be included in a PSA:

- The financial statements are a "fair representation" or are "GAAP qualified."
- There are no undisclosed liabilities (in accordance with GAAP or not).
- The business has complied and is complying with the law.
- Before closing, the seller covenants to i) update its disclosures, ii) provide notice to the buyer of any breaches of its representations and warranties, iii) operate its business in the normal course, and iv) not talk with any other potential buyers.

There will likely be several important conditions that must be met at the closing, including the following:

- The representations must be accurate.
- There has been no material adverse change since the signing date or latest balance sheet date that would allow the buyer to walk away or avail itself of indemnification rights.
- There are no legal proceedings challenging or threatening to challenge the transaction.
- There are no appraisal rights available to eligible dissenting shares, if any.

An important issue is the standard of "materiality" that applies to any inaccuracies in representations and warranties at the closing. A common approach is to say that the seller's representations and warranties must be accurate "in all material respects" as of the closing. However, this potentially gives the buyer the right to walk away if there is a material inaccuracy in a minor representation. To avoid this, sellers often want to exclude inaccuracies that could not, individually or in the aggregate, be expected to have a "material adverse effect" (MAE).

In negotiating the definition of a MAE, it is important to be aware of market trends, and your legal counsel can advise on that. Also, a seller will want to include exceptions to the MAE definition (such as general changes in the economy) and will resist having a definition that is forward looking (covering "prospects") and focused narrowly on "liabilities" and "properties" opposed to "the business" or "financial condition." It is also possible to define a MAE with respect to a specific dollar amount.

The seller indemnifies the buyer in certain circumstances. The amount of indemnification and the circumstances can be contentious, but they are often limited according to the following:

- The buyer is limited to relying only on the listed representations and warranties, and nothing else.
- The buyer's ability to assert claims against the seller is limited for a certain period of time. (This time period is often twelve to eighteen months, and subject to certain carve-outs, like fraud, for example.)
- The buyer's types of damages or losses covered are limited, for example, to "out-of-pocket" damages only.

The PSA normally establishes baskets to deal with damages and losses incurred by the buyer. Each basket should have a threshold-to-access amount high enough to avoid having to deal with financially small amounts. For example, any and all damages aggregating to less than $250,000 are not to be paid by the seller. All losses above that amount are to be reimbursed by the seller to the buyer. There are alternative structures (e.g., first dollar) and carve-outs (e.g., fraud) that are often used, and your lawyer can be very helpful in negotiating these.

Sellers will want to avail themselves of any and all ways to reduce the amounts that may be payable to buyers in the event of any problems.

Sellers should set limits, or caps, on their indemnification obligations, subject to the survival provisions in the PSA. The caps are usually a function of the total enterprise value of the company, and rarely exceed ten percent of this amount and is often much less. Selected carve-outs from this cap are normal, including fraud, taxes owed prior to closing, investment banker's fees owed, or failure of the company to be duly organized or of the sellers to be duly authorized.

An escrow or holdback amount is often negotiated between the parties to give comfort to the buyer that there will be some money available in case of damages or losses. Whether or not the escrow amount is the exclusive remedy for the buyer is to be determined by the parties. Holdback amounts of three to ten percent of the total enterprise value are common. Sellers will want to avail themselves of any and all ways to reduce the amounts that may be payable to buyers in the event of any problems. Language in the PSA can offset buyer claims by any amounts available from tax benefits at the time of closing and related insurance proceeds regarding damages or losses. **In fact, some insurance companies offer very affordable policies to protect the sellers in M&A transactions.** The PSA should also include language relating to the buyer's obligation to actively mitigate any and all losses.

Disputes may happen. Defining a resolution process is normal. A few of the items for sellers to consider include the following:

- The express right for the selling shareholders to be represented in the dispute by the company's law firm

- A carve-out for any information from the buyer that is subject to attorney-client privilege
- A statement of whether or not to waive a trial by jury
- A statement of whether or not to allow for alternative dispute resolution processes like mediation and arbitration

From a financial standpoint, there are two important and frequently negotiated provisions involving payments to be made post-closing: i) adjustments based on working capital, and ii) earn-out payments. The former type is much more likely in any given deal, but the latter can be a much larger component of total value.

Virtually every company needs a standard amount of working capital to operate its business. The standard working capital amount can be established soon after the letter of intent is signed with the desired acquirer. The parties often agree to a balance sheet delivered at closing that is "cash free and debt free." In this case, the standard amount of working capital needed at closing is established assuming no cash and no current debt on the books as of the date of closing. It is usually agreed that any tax-related current assets or liabilities are excluded from the calculations. Buyers will sometimes demand an escrow to be set aside at closing for this adjustment.

Soon after closing, the buyer will prepare the opening balance sheet for the company as of the date it was acquired. This balance sheet will establish the actual amount of working capital that was delivered by the seller at the time. The working capital adjustment payments can go in either direction. If the seller delivered more working capital than the previously agreed standard amount, the buyer will make a payment to the seller for the difference—and vice versa. There is often an adjusting payment for working capital reconciliation.

Earn-out payments are very different and are dependent on performance. Therefore, they may or may not be earned and paid. Many deals do not have earn-out mechanisms. These payments can be included in deals to bridge a perceived value gap between buyer and seller. For example, if the seller's financial projections show aggressive levels of growth and profitability, the buyer may agree to make additional payments to the seller on the condition the acquired company achieves all or a substantial portion of the projected revenue or EBITDA in years one, two, or even three after the closing. Negotiating the detailed terms of an earn-out payment is critical. If the deal calls for an earn-out mechanism, it is important for the buyer to agree that the business will be managed fairly to enable the seller to reach the agreed-upon targets and secure the contingent earn-out payments. In certain circumstances, it may be appropriate to have the buyer commit to manage the business in a way that maximizes the probability that the company will achieve its projections.

The issues covered in this chapter have significant financial implications and can become very technical. It is always a good idea to consider these issues with your financial and legal team well in advance.

CHAPTER TEN SUMMARY:
Deal Representations and Warranties

- Sellers routinely are required to make representations and warranties to protect the buyer
- The purposes of representations and warranties include:
    - » Disclosure to the buyer before closing
    - » Allowing the buyer to walk away from the deal if these are material and untrue
    - » Giving the buyer a financial claim against the seller for significant inaccuracies
- Materiality standards are important negotiating points
- Insurance to protect the buyer is frequently used to substantially simplify these negotiations

CHAPTER 11 | The Great Failure in the Exit: Lack of Communication

"In the end, we will remember not the words of our enemies, but the silence of our friends."

\- Martin Luther King, Jr.

Randy was one of those guys who had an innate curiosity. He was always tinkering with things and coming up with new solutions to old problems. His company was like that, and it shouldn't have been any surprise to those who knew him when the company became very successful. In this case, we met Randy late in the sale process—when negotiations were well underway and moving to a close.

In the momentum of the company's growth, the days were fast paced, but Randy still made time at least to kiss his kids before they shuffled off to bed. But the company's whirlwind of activity soon caught the attention of some private equity (PE) buyers. Randy approached a potential sale just like he did the company—another problem to be solved.

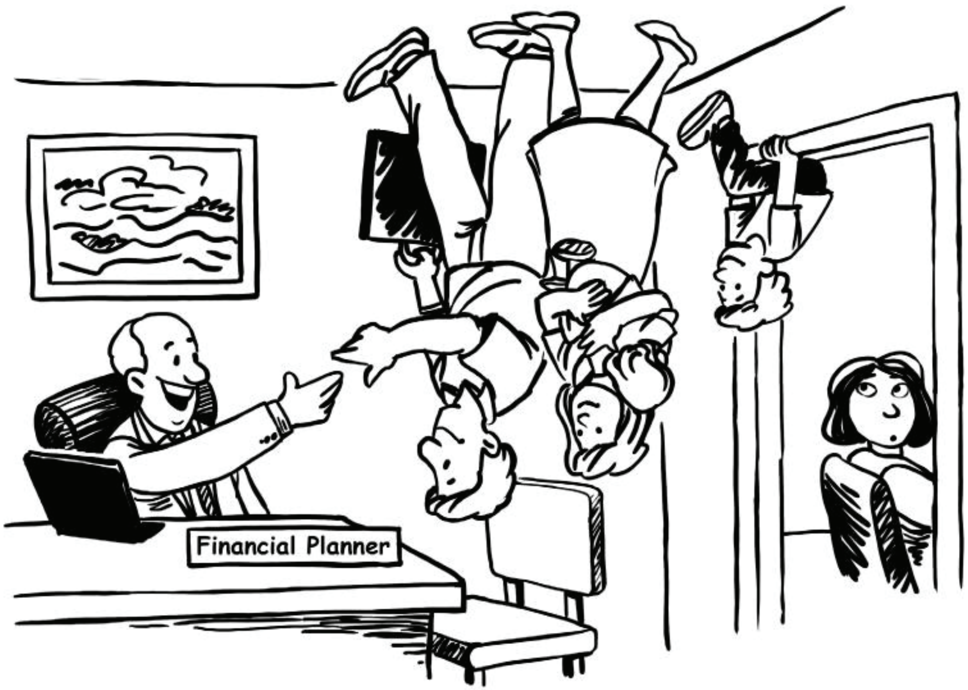
He met with a team of advisors who offered their opinions quite freely. There were plenty of advisors who auditioned for a lead role, as well. He listened to each—to some with skepticism and to some with intrigue but, in it all, he began to craft his own plan for exit. He chose advisors who could help him accomplish his plan.

Soon, he had it architected. He knew he could push off the sale until the next year, at which time the valuation would be dramatically higher. With the differing valuations, he created a family LLC and soon had shares in the names of his four children and his wife. At the same time, he'd kept a steady eye on the tax liability as well as the stockpile of cash he would need for the next deal.

Make no mistake. Randy was planning on a next deal, and perhaps a next. After all, these were problems to be solved. With the changes made, Randy dedicated himself to scaling the company, growing the numbers, and entertaining PE firms. The sale numbers began to grow and, even for a guy like Randy, they astounded him. He was going to be a millionaire many times over—and so were his children, and his wife.

Sometimes on the weekend when there was time for a pause, he would take his wife, Staci, out to her favorite restaurant, and they'd catch up. The children were growing fast. Their 16-year-old was already talking college. Their 14-year-old was already talking marriage, to Randy's chagrin. Their 8-year-old twins were fully immersed in soccer. Life was busy.

For Staci, life was all about the kids. She barely entered into the business ventures discussion, although she knew that Randy was planning to sell and that they'd be doing well financially. She had also been asked to sign some papers in between her family chauffeuring duties. It was all a blur—school, soccer, family, family vacation, Thanksgiving, Christmas, and a new year.



I understand the sale of your business has turned your world upside down.

With the New Year, the push toward a final sale arrived. A buyer was selected—offering a great price—and the race to closing began. Even for Randy with his boundless energy, he had had little anticipation of how much stamina it would take to sell the company. In the midst of moving toward a sale, he was also working at keeping the company growth numbers up. It was double duty, even triple duty.

The double duty meant longer hours, and he reasoned he could miss a few nights at home tucking the kids in. Soon they would all be doing well, and they'd have plenty of time (at least until the next venture started, for which Randy already had an idea). In the final two weeks, the pace was intense, and there was little more than a peck on the cheek of his still sleeping Staci. She stirred only to say, "I'll be glad when this is over."

When they crossed the finish line, Randy was surrounded by his key officers. Everyone applauded: job well done. To mark the occasion, Randy took his closing statement home and vowed to stay at home for two weeks to make up for lost time.

A few days later, Staci was in the kitchen and saw the handful of closing documents and the final disbursements. What she saw shocked her. For the first time, she saw that each of her children were millionaires. She was a millionaire. They'd never have to work again. She also saw figures for tax payments that she didn't really understand.

All of it frightened her. She thought they were living a nice, normal life. How could she ever tell her children they'd never want for anything? She had heard the stories and rumors about children who go astray because of money. Somehow the swollen bank account made her feel empty, and she wondered why Randy had never explained what was happening.

That Friday, Staci made sure they had their babysitter; and for the first time, she talked with Randy about what had really happened. She questioned the trusts, the family LLC, the kids' ownership interests, and the amount of money. She questioned how much was allocated to them. At first, Randy tried to be patient, but soon he was defensive. He had just tried to solve problems for them as a family.

They both ended the evening quiet, perhaps bitter. What happened to the dream? And what was next? For Staci, she discovered that the deal cycle wasn't ending: It was only beginning.

Unfortunately, the story of Randy and Staci is real—and too often repeated. There are variations on the theme, of course. Some owners do a better job of preparing their spouse and family and including them in the discussion, but Randy and Staci's story raises the right questions:

CHAPTER ELEVEN SUMMARY:
The Great Failure in Exit: Lack of Communication

Do I have transparency with my family about the sale of the company?

- Have I talked with my spouse about the transaction? Does he or she fully understand what is occurring?
- Is there agreement on what assets should transfer to children—or whether assets should even transfer to children?
- What is the next chapter for me? Will there be a period of respite? Does my family know and understand what is next?
- What about taxes? Do I understand the pre-sale ability to save money on taxes in favor of charitable giving? In this case, Staci was involved with two different charities and was disappointed not to learn about the opportunity to give more until after the transaction was completed and the opportunity had expired.
- If there are adult children, are they prepared to handle wealth? Would it discourage them from productive work of their own?

Of course, the fundamental issue behind all of these questions is this: Do I have transparency with my family about the sale of the company? This sale can lead to a domino effect upon those most closely associated with you. Make the domino effect one that everyone is prepared for.

Even with the right questions, the answers can be complex and difficult to discern. A competent advisory team including a life coach, a family legacy coach, and an expert in charitable tax planning can greatly help to clarify the answers and make one of your greatest moments of success also a success that can be shared by your family and those you care about.

CHAPTER 12 | The Art of the Possible

"The greater danger for most of us lies not in setting our aim too high and falling short; but in setting our aim too low, and achieving our mark."

\- Michelangelo

The "Art of the Possible" in this M&A context means successfully negotiating a business combination where the seller gets a higher price than expected or easier terms with a partner (buyer) who "fits" with his company culture.

One of our favorite stories about the "Art of the Possible" involves an analytical genius. People who are analytical do not normally think outside or beyond the box, but this fine gentleman listened and brainstormed and participated with the entire team to come up with one of the greatest Art of the Possible success stories.

A client's company had been to market recently, and everyone who was a natural buyer had passed on the acquisition opportunity or had provided lukewarm bids. During the process of discovering the company's secret sauce, however, the team came up with more cultural uniqueness, value drivers, and differentiators than expected. The analytical genius working on the deal—let's call him Steve—captured all of the hard and soft ideas, then did massive big data searches and converted the secret sauce into a thorough but complex financial model.

The model had drop-down boxes for each of the strategic buyer types, each of the additional services that the client would offer with each type of buyer, and many other variable factors. When a different strategic buyer type was chosen from the drop-down box, the entire pricing metric for every service changed to each different potential buyer's actual price list that included thousands of variables. Steve secured the model with leading encryption technology and a self-destruct mechanism in case it was tampered with by a near-time expiry date. The team was convinced of the value illustrated in the model. In this example, the economic model was provided to multiple potential buyers (not a normal practice). It was beautiful because all buyers were able to see their competitors' complete price lists and what they could afford to pay for the client's company, using thousands of variables.

The Art of the Possible: extracting the value you deserve by exploring the most extreme possibilities.

The client had recently exited a broken sale process, but this time he received offers from several potential buyers, and the highest bid was more than two times the amount of the valuation from the prior process.

I knew you could pull off the "art of the possible" selling my business, Frank. I wasn't sweating a bit.

Whenever we talk about exceptional value, we are talking about exceptional value for the business, for the potential synergies, and for other assets. *(See Chapter 9: Deal Auction Process.)* This chapter about the Art of the Possible is a how-to for extracting the value you deserve by exploring the most extreme possibilities. It truly is an art. Your investment banker should be asked to perform a dramatic high-wire act to capture your highest and best value.

You must ensure that whomever you hire is not a volume-oriented investment banker ("production banker") that is looking for a quick deal with "fair value" for both sides. A production investment banker will invest as little time and energy as possible in dozens of deals at any given time, playing the odds of closing the most deals by accepting offers that are within the seller's acceptable range but don't put the investment banker's success fees at risk. This also maximizes the chances that the production investment banker will keep a strong relationship with the buyer for future business. This is not necessarily in your best interest.

Let's go through some math together to illustrate how production bankers think about deals. Let's say you have an 80-percent chance of closing on a 100-million-dollar purchase price, which means that your investment banker would earn a 2-million-dollar success fee. Also, you have another buyer where there's a two-thirds chance of closing at 120 million dollars, which would mean a 2.4 million dollar fee to the investment banker. In the riskier choice, you could make an additional 19.6 million dollars. That is a sizeable sum. Would your investment banker want to work the larger deal or go with the easy deal? Five to six months into the project, production bankers will go for the easy 2 million dollar fee and move on. From an expected-value standpoint, the easier, smaller deal is more attractive to a production banker. Why? Because the expected value of the first deal is the same as the riskier deal, and the second deal is likely going to take more time (more cost to him). The production banker makes only a small additional amount if the higher, riskier deal closes, but you would garner many millions of dollars more in your pocket. If the higher value deal does not close, you still own your company. In this case, your banker's success fee is zero after investing say one to two man-years of effort. An investment banker that is an Art of the Possible player would be prepared to work with you to negotiate for the larger deal if that were the route you preferred.

Every day you should understand your BATNA (best alternative to a negotiated agreement).

WHAT DEAL TO CHOOSE

Easy Deal

SELLER:

Size . . . .$100 million

Probability of Closing 80%

Expected Value . . . .$80 million

BANKER:

Success Fee . . . .$2 million

Probability of Closing 80%

Expected Value . . . .$1.6 million

Bigger Deal

SELLER:

Size . . . .$120 million

Probability of Closing 67%

Expected Value . . . .$80 million

BANKER:

Success Fee . . . .$2.4 million

Probability of Closing 67%

Expected Value . . . .$1.6 million

A "production" banker will always encourage you to take the safer, faster deal. The "Art of the Possible" banker will shoot for more if that is your preference.

Normally, part of the deal for the investment banker, in order to motivate him or her to reach for the Art of the Possible, is a bonus, which usually comes in the form of a higher percentage of any monies received over a "fair market value." If you do not structure a bonus into the deal, we advise that you ensure that your investment banker has no conflicts of interest, at the very least. In our above examples, with an Art of the Possible investment banker, your chances of capturing the higher payday go up substantially, and you still retain the lion's share of the additional value.

In a similar scenario, Steven Levitt and Stephen Dubner's book *Freakonomics* details an analysis of property sales that contrasted houses owned by real estate agents with houses they sold on behalf of others. Not surprisingly, the results showed that houses owned by the selling agents commanded 3.7 percent higher prices than comparable properties they sold for others. The point? When you align your interests with those of your financial advisor everyone has more reason to play hard for a big win.

Courage is required to reach for more, and knowing when to try is paramount. This can be difficult when there are multiple shareholders and some want out immediately. You should understand your BATNA (best alternative to a negotiated agreement) at all times so you can convince your shareholders you are exploring all possibilities. If the deal on the table is not superior to or very close to your BATNA, you should walk away. BATNA routes include turning to the second or third buyer, approaching new buyers, putting the deal on ice for a while to focus on enhancing your business, or looking for alternative financial solutions like a recapitalization of your company.

If you enter the process believing that the first bid is your only option, you are likely shortchanging your potential.

Consider the deal where three of the four sellers voted to accept the provided bid from a respected acquirer. The president and the investment banker believed that a higher bid was possible from another buyer. The president convinced the three other shareholders to reject the first decent bid. The investment banker was able to convince the company president to continue negotiating for more. That single courageous vote of confidence earned each seller almost 14 million dollars in additional value—a total of more than 50 million additional dollars resulting from the Art of the Possible. Without wisdom and courage, your Art of the Possible investment banker cannot help you nearly as much as you wish.

Securing multiple capable potential buyers is very helpful to the seller for several reasons. Each buyer is likely to come up with unique deal ideas, and the winning buyer will often allow an Art of the Possible investment banker to consolidate all the great ideas into the winning deal terms. Many times, the creative ideas do not have a major economic impact to the buyer, so he or she is willing to add these ideas to the final purchase and sale agreement terms.

The ultimate goal is a walk-off grand slam home run for the sellers, which can be defined by reaching all or most of the goals that the selling team wrote down at the beginning of the process. The sellers and their team must practice the prior preparation which prevents poor performance. If you prepare creatively and execute courageously, you can win big.

CHAPTER TWELVE SUMMARY:
The Art of the Possible

Value terms:

- Reserve price: value below which you will not sell the company
- Fair market value (FMV): an average value when considering all factors
  - » Easier and quicker to achieve
- Maximum value: this is the art of the possible
  - » Harder and longer to achieve

Your risk tolerance: FMV bids usually occur earlier in the process

- Holding out for more requires a higher tolerance for risk
- Make sure your banker has the same risk tolerance

Always know your BATNA

Bringing the Art of the Possible to Life

The client was a Midwest-based business-to-business service provider with several large and many small clients based mostly in the United States. The company employed over 100 people, many of whom had obtained very high levels of education in their field. The company had plenty of investment merits but also carried some significant negative issues, including the following:

- Volatile revenue growth rates
- Declining EBITDA
- CEO approaching retirement age
- Failed attempt to sell the company 18 months earlier

The company's core revenues were increasing, but the rate of increase was dramatically different from year to year. This was due in part to having virtually no salesforce. The company's reputation was so good, however, that managers just handled incoming queries about services. The lack of focus regarding what kind of work to accept and how it was managed resulted in the choppy growth rates. The declining profitability was a direct function of the CEO's recent decision to substantially enhance the company's teams in management, sales, and project management together with materially improved operating and finance systems. The profitability per project was still strong, but the added expenses and delayed revenue growth expectations made the current year less attractive financially.

The CEO made a commitment to potential investors that she would manage the company for at least five more years. The investment banker hired previously (18 months earlier) was an industry specialist who had developed a standard but short CIP about the company and had only taken the opportunity to private equity buyers. The best preliminary bid in that process was simply too low for the client.

This time, the client was determined to find a strong new financial partner. At the client's request, the M&A team analyzed the previous sale process and the recent company changes, and discussed the owners' goals. The team's position was that this company's very strong market position would be attractive to strategic partners and select family offices. The team discussed the Art of the Possible, as well as the approach to promoting the company's investment merits based on the Four Boxes approach. The client's goals were realistic and included the sale of a majority stake, taking some risk off the table; a sizeable continuing investment; a growth capital injection; and a compatible partner that would not damage the culture. The team went to work for the next six months and closed a deal that vastly exceeded the client's expectations.

As the process began, the management team explained their historic successes, and it became clear that they needed to improve their sales approach and formally add a product that combined several of their individual services. The company's inconsistent earnings could be addressed by signing long-term, multi-stage projects that would provide years of contracted services. The management team hired additional sales leaders, and together they executed flawlessly, signing almost a dozen of these multi-year contracts over the next few months. This provided potential partners with robust confidence in the new sales projections, as much of the projected growth was already signed and being performed by the services team.

Together with the new COO and CFO, the team developed several critical documents that made the investment opportunity more compelling. The CIP went into great depth regarding the company's strong corporate culture (competitive advantage), its new operations and sales approach (which was showing immediate benefits), its broad appeal to a variety of customers, and its attractive project margins. In essence, it shined a light on the client's secret sauce that allowed it to generate margins well above industry average.

Using a proprietary survey, the team helped the client develop a written culture statement that resonated with the entire workforce. The CEO went on record stating that this clearly articulated culture statement helped make them "a better company."

Many acquisitions fail, from the buyer's perspective, because of a cultural mismatch, so giving potential investors an understanding of exactly what motivates your people helps to minimize the perceived risk buyers may have that your people will not perform well post-transaction. Also, family office buyers want to be proud of the culture they are buying into. Having it spelled out up front and having the opportunity to test it during due diligence gives them greater comfort. And lower perceived risk together with greater comfort maximizes the chances for a better deal.

The M&A team also worked closely with the finance team to help craft a detailed five-year plan to increase capacity to meet market demand better than ever before. This plan was the basis for the strategic direction document that outlined the company's goals for market position, added services, and added clients over the next several years.

Buyers really appreciate dealing with sellers that practice the 5 Ps: prior preparation that prevents poor performance. This saves them time and also gives them confidence that the company's management team is highly motivated.

Armed with a well-documented story regarding the company's investment merits, the M&A team introduced the opportunity to the best potential partners, with over half of these being family offices that have a long-term investment horizon. The other half was split almost evenly between strategic buyers and financial buyers. Each group gave very helpful feedback during the process.

Many acquisitions fail, from the buyer's perspective, because of a cultural mismatch.

The winning letter of intent was signed by an international billionaire family office that the client liked right from the start. The family office was the ideal partner, as the buyer respected the culture and was capable of bringing more capital to accelerate the company's growth domestically and overseas. The terms accepted by the client were more than twice the value offered in the first sale process, and the partner match was ideal.

This is one example of how the Art of the Possible can work—unleashing the creative powers of your full team to deliver an impressive result.

CHAPTER 13 | Is There Life After a Sale?

"To live is the rarest thing in the world. Most people exist, that is all."
\- Oscar Wilde

"The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of challenge and controversy."
\- Martin Luther King, Jr.

Life and joy come in many packages. In a few decades of helping business owners traverse the landscape of mergers and acquisitions, we've seen hundreds of different scenarios. One set of circumstances might constitute a dream career for one person, yet the very same circumstances could be another person's nightmare. One person's burden is another person's spark.

Take Tony, for instance. He is a dear friend and has been for a long time. He inherited a good business and made it great. He helped raise a brood of terrific kids, and he loves his wife more now than ever—but he's miserable about what he does for a living. He's approaching 60 years old and is really wrestling with the ideas of fulfillment, happiness, and "what might have been." All through his work-life journey, he never chased his dream. He only executed his family's holdings. He never fanned the flame of his passions, and it took nearly his entire career for him to understand the hole that choice was creating in his life.

Most professional people wrestle, to some degree, with the same feelings—whether they inherited a business or became an electrician, doctor, mortician, or comic. If they did it because it's what they were "supposed to do," then all they did was step into their mother's aspiration or their grandfather's business or someone else's dream. Martin Luther King, Jr.'s words were spoken in the context of the fight for social justice and racial equality, but they ring just as true in the business world. Dr. King exhorts us to become who we truly were designed to become—to stand up to injustices or challenges to that vision. Making the decision to exit a business and prepare for the next stage of life can take tremendous strength. It may mean standing up to the expectations of others, confidently straying from the pre-planned path desired by others for us, and boldly pursuing what we were created to do.

Making the decision to exit a business and prepare for the next stage of life can take tremendous strength.

I never thought that after running a major corporation for 30 years I'd end up working in the soup kitchen of a homeless shelter.

And I never thought it would be the most rewarding time of my life.

Oscar Wilde exhorts us to live and not just exist. Even the founding fathers, in the Declaration of Independence, exhort us toward “life, liberty, and the pursuit of happiness.” For most leaders and business owners, the lofty ideal gets wildly distorted over time, and they default to mere existence (not life), suppression (not liberty), and the pursuit of what the family or the shareholders want (not happiness). We hear almost weekly from business leaders who have not pursued what they desire and have only limited joy and happiness. Here in the land of the free, we are fortunate. We don’t need to throw off the shackles of an oppressive nation; we simply need to choose a potentially hard path to achieve our dreams.

So, what’s next after the sale? Emotions run the gamut, from fear and doubt to anxiety, confusion, and frustration. It is difficult for business owners to navigate that minefield and venture away from the familiar and comfortable. Dan Peters, a former executive at Procter & Gamble and a noted philanthropist and community leader, proclaims that “greatness is ahead, and there is a limitless potential of opportunities that await you.” Dan is a take-the-step evangelist who urges executives, lawyers, business owners, and others not to be afraid of exiting their current situation and to realize that greatness is ahead and available.

Staying unfulfilled in a current business or career can take a debilitating toll physically, psychologically, and spiritually.

Terry Plochman, another purveyor of hope, suggests that it is not difficult to discover what is next. It simply takes work. It takes work to make the time to do an inventory of joys, hopes, hassles, desires, and much more. It takes work to write down life themes and pursue why they make sense, why they are of interest, why they should be investigated, and why they might be set aside. It takes work to capture outside perspectives and understand what those who know you see and how that might surprise or enliven you. It takes work to analyze how you will measure your new-found ideas and begin to write your next chapter, but these tasks can make all the difference.

Staying unfulfilled in a current business or career can take a debilitating toll physically, psychologically, and spiritually. At a minimum, that decision provides us little to no pleasure on a day-to-day basis. At worst, it can drive us to drink, erode our marriages and family lives, and trigger health problems. Dan cheers us on to consider the possibilities of a life on your terms. Countless paths to pursue our original or new passions are available to us. For some, the opportunities to coach, to mentor entrepreneurs, to lead expeditions, to dream of and execute a plan are within reach. For others, the new path may be a need to slow down, relax, heal, and spend the time and resources to find what it is that gives us joy and peace.

We have worked closely with dozens of business owners and leaders who have successfully taken the leap. Each one wrestled with and made the decision to sell his or her company, to identify and pursue a dream, to embrace the idea that a fulfilling life after a sale is possible. Some made the difficult decision to face indoctrination and pressure from generations of investors, and begin the process of exiting and seeking what is next. Some of them took the time to take the Birkman or LionsLead profile in order to get a better glimpse into their strengths and gifts. Others read *What Color Is Your Parachute?* by Richard Bolles, or *Life Reimagined* by Leider and Webber. Each of these guides helped our leaders move through the hard emotions, potential rejection, and indoctrination—to steer away from the comfortable and toward that which they desired.

What is another common thread among our leading sellers? Finding partners for the journey. They sought out others who had ventured ahead of them and could help lead the way. They found colleagues who could add energy, perspective, and insight on the journey. They found supporters who made the journey more joyful, who picked them up when they stumbled, and who encouraged them to forge on. We never need to be alone in the midst of the journey, and we're certainly not alone in our need to transition, perhaps to exit our business, to sell what feels like our family legacy.

In reality, thousands of people are in that same boat. That family legacy that means so much to us is not bound up in a company, financials, or a bottom line. It's bound up in what we accomplish, the joy we help others to experience, and the joy we find in what we do and in ourselves. When you decide your legacy is about living, instead of just existing, you will have just taken the hardest step and made a decision to change the course of your life.

That family legacy that means so much to us is not bound up in a company, or financials, or a bottom line.

CHAPTER THIRTEEN SUMMARY: Is There Life After a Sale?

- The thought that “my work is my life” often keeps people from selling their company
- Many coaches are available to guide owners about the many opportunities that await the seller post-transaction
- Reading materials that help include:
  - » *What Color is Your Parachute?* – Bolles
  - » *Life Reimagined* – Leider and Webber

CHAPTER 14 | Considering All the Options

"The vision must be followed by the venture. It is not enough to stare up the steps – we must step up the stairs."

\- Vance Havner

So, now what? You've read through thirteen chapters that discussed avoiding the many mistakes committed by others and that suggested ideas to enhance the value of your company. You now have three fundamental choices: Do nothing, prepare, or go now.

There are many reasons to just stay the course, to do nothing (option number one). Perhaps things are going pretty well, and you may be comfortable being actively engaged in your prosperous business for the foreseeable future. You are busy. You are proud of your company and your employees. Why mess this up by selling it? Yes, you are attracted to the idea of one day capitalizing on a major liquidity event, but that can wait.

Keeping your business allows you the opportunity to add value and to keep that value for yourself. You have plans for profitable growth, and you are confident that you and your team can execute on these plans. You also have lots of energy and are focused on the business daily. If you're not, you have a competent successor in place who is actively working to replace you the day you say it's time to slow down. If this captures how you feel about your current situation, then the do-nothing option may well be the right choice.

We say "may well" because there are other issues that could derail the attractiveness of the do-nothing choice. The primary issue is maximization of value. Certain times are better than others to sell a business. The M&A market is not always accommodating. The marketplace for buying businesses goes through cycles. In a downturn, you may not attract any decent acquirers, or their bids may be disappointingly low.

Do nothing, prepare, or go now.

Since World War II, there have been four major waves of acquisition activity. During the late 1980s, we saw huge growth in M&A activity, fueled in part by the Michael Milken high-yield bond market innovation. The late 1990s saw another spurt of activity and high prices, this time fueled by the first internet boom—remember the "information superhighway"? From 2004 to 2008, we saw high prices and lots of deals resulting from historically low interest rates, strong bank lending, and the housing bubble. From 2014 to the time of writing, we have seen record activity levels, again driven by many thousands of buyers with record amounts of cash available. How long do these waves last? No one can predict for certain, but we do know that they eventually slow down and sometimes crash.

Do nothing, prepare and wait, or go for it! Criminy!
They are all good options, Ted. Just play!

For example, in 2013 to 2014, many owners of oil and gas businesses, oil field service-and-supply companies, mining operators, and mining service-and-supply companies, among others, were riding high with strong profits and a healthy business outlook. No one could convince these owners to sell when they were generating record profits and the M&A market was frothy. By July 2014, however, the market for most of these businesses fell off a virtual cliff. Many of our friends had businesses that became worthless at that point. The banks wanted out. The supply of great businesses available for sale vastly exceeded the demand to buy those businesses at anything but a highly distressed price. This is the worst-case scenario, of course. If you're not in a deeply cyclical business, this likely won't happen to you.

That being said, there are other scenarios that may hurt your business or the M&A market as the events of 2022 clearly demonstrated. During this period, the M&A market was not accommodating for SaaS and SPAC transactions, for example. Below are issues to keep in mind for most businesses:

- The level of demand for businesses can be negatively affected by higher interest rates.
- The desire for banks to finance mid-market acquisitions fluctuates considerably over time.
- A wave of competitors could make themselves available for sale at about the same time, which increases supply and thereby diminishes the value of your company in the market.
- An increased level of competition for your customers (by old competitors, new entrants, or substitutes) could negatively affect how buyers view your business.
- New technologies can emerge that damage your business prospects.
- Legislative and tax changes could materially affect your market outlook (for better or for worse).

These particular risks may never materialize for you. From our perspective, though, we encourage our clients to stay prepared (option number two) in order to be flexible and able to act swiftly when you decide the time is right to sell. The cost of being prepared is not immaterial, however. There are many issues to manage in order to be truly ready to go to market. Here are some of the major issues for your business that require a watchful eye when you are in preparation mode:

- Tax situation
- Legal structure
- Succession plan
- Valuation and potential
- Shareholder needs
- Strategic plan
- Business plan
- Corporate culture
- Legacy

To be ready to go to market, you should thoroughly discuss all of the above issues with your most important stakeholders (subject to confidentiality needs). All shareholders are part of this group, of course, but don't forget to consider your most senior business leaders and your family members as well as how a transfer of control of your company might affect the employees, the community, and the charities the company regularly supports. The benefit of being prepared means that you can pick the timing of your exit and thereby maximize the chances of meeting all of your goals in the sale of your company.

As you determine the right timing to move from preparation mode to full speed ahead, we recommend that you consider these questions that will help you identify the key indicators that signal a strong M&A market and will help you avoid the mistakes that regularly plague the deal process:

- What has been the volume of merger and acquisitions transactions in recent history, overall and in your industry sector?
- Are the acquisition EBITDA multiples fair given your current financial performance?
- What are private equity companies doing? Are they sellers or buyers? If the PE funds believe the market is so high that it's time to sell, we've likely hit the top of the market.
- What is the current availability of companies like yours?
- What is the current cost of debt?
- How much money is available for investment by strategic buyers, family offices, and PE firms? That number has recently been well over one trillion dollars per segment.
- How much are banks lending? If the average ratio is above 2.5 times senior debt to EBITDA, then the M&A market is likely active.

If you can answer these questions favorably, then it may be time for you to take the last of the three major options: to go. Act. Move. Do not delay. You must have laser focus because this is likely the most consequential transaction of your life. You must organize your most trusted team. Your senior managers, your accountants, your lawyers, and your investment banker will need to work together seamlessly to meet your objectives.

It is unlikely you will spend much if any time with your investment banker again after the transaction closes; therefore, trust is very important. The banker will be negotiating this critical deal. Often, he or she will be negotiating against very professional buyers. Investment bankers have two types of clients: repeat customers and one-time customers. Repeat customers tend to get better service and results. If you are a one-time client, it is critical that you be made aware of any conflicts of interest your banker has with potential acquirers of your business. Many production bankers will try to get 1-2 additional transactions for every sellside mandate, including financing the deal for the buyer and getting future M&A business from the buyer.

Your investment banker's role is to drive the process forward. He or she acts as the quarterback on the project, and you act as the general manager. The banking team should be made up of a senior person, a director or vice president, and one or two junior bankers (who never sleep). The vice president is in charge of the deal on a day-to-day basis and is in daily contact with your management team, lawyers, and accountants. The senior banker weighs in on all matters of judgment. Your investment banking team will set a timetable of tactical goals over the course of the next several months. Delays come too easily and add up to weeks, so your quarterback must be diligent to keep everyone on track.

Certain times are better than others to sell a business.

Your investment banker will prepare you and your team for the rigorous due diligence to come from the eventual buyer or investor. That means he or she will ask hundreds of questions about your business in order to present your company's investment merits in the best possible light. The investment banker's role is also to disclose the company's liabilities and risks up front and to crisply explain these in order to give the potential buyers confidence that the seller is fully disclosing material information. We can assure you that professional buyers truly appreciate reading well-written documents about a corporate acquisition opportunity. Remember the CIP? If it is not thorough and clear, many potentially good buyers will not pursue the opportunity. Based on your goals, you will decide what kind of investors to pursue and how many of them to invite into the process. As outlined in Chapter 6, the buying community is made up of four major groups: strategic buyers, financial buyers, family offices, and management/employee teams.

Some sellers will want to canvas a broad swath of acquirers. In this case, a one- to two-page teaser document can be sent to hundreds of potential buyers. In order to manage confidentiality, a teaser document does not mention the company name, but it does outline the business, a summary of the financials, and the company's investment merits. Confidentiality is critical, as you don't want to discuss a possible change of control with your employees, your customers, or your key suppliers until you know you are going to get a good deal done.

Other business owners may want to focus on just one buyer segment because of their situation. Also, it may be important, for competitive reasons, to limit which players in any segment get invited into the process. Helping you decide early on about whom to invite is an important value added by your investment banker. Your team can negotiate a final deal once you have identified the potential acquirer who best meets all of your objectives.

Selling your business may be the biggest professional decision you will ever make. For some businesses, it's the biggest moment the business will face in decades—or even generations. After decades of practice, the buyer market is very sophisticated. However, although the vast majority of business owners are experts in their businesses, they are not generally experts in the business of selling a controlling stake in their company. This book was designed to take some of the mystery, misperceptions, and anxiety out of the process of preparing your business for market.

In a nutshell, our advice to business owners considering a sale is simply this: few company sales are easy to get done. Set your goals. Follow the roadmap. Find experienced, savvy advisors. And when it's time for you to take the step, you can expect to find success.

The benefit of being prepared means that you can pick the timing of your exit.

CHAPTER FOURTEEN SUMMARY:
Considering All the Options

Timing matters for stand-up comics and in M&A:

- When your company's top performance and outlook coincides with a peak in M&A activity and prices, your chances of maximizing value in a sale are highest

You always have three basic choices:

- Do nothing: keep doing what you're doing indefinitely
- Prepare: confidentially discuss the possibility of a sale with your advisors well before you decide to sell
- Sell: make the decision and execute the deal with great focus

OUR THANKS

Thank you for taking the time to consider our thoughts around selling well.

As we considered writing this book, our goal was to share some learnings that we wish we had known many years ago. Rather than a tome or textbook, we hope this has been an easy read that provided you with valuable insights for the future, whatever that may be for you.

Selling well takes hard work, but it is worth it. We cannot overemphasize the importance of a good advisory team to help you through the detailed process as you define and pursue your goals—not only your goals for your company and employees, but also your hopes and dreams for what the sale could mean for your own future and for the charitable causes you care about.

We wish you the very best, and we hope you will take the time to share with us your thoughts about this book, no matter how brief.

Sincerely,

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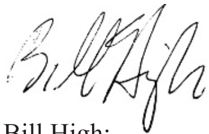

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ABOUT THE AUTHORS

RENE ROBICHAUD

Rene Robichaud is Chairman and Partner at ArkMalibu. He has helped hundreds of companies think strategically and become more successful. Rene has been president and CEO of two public companies for a total of 10 years. Most recently, he served as the president and CEO of Layne Christensen (a NASDAQ company). Prior to that, he served as president and CEO of NS Group (NYSE), which he helped grow from a $150 million enterprise to a $1.5 billion company. As an investment banker for 15 years, he has worked on capital raising and strategic transactions involving many industrial and natural resource companies around the world.

As Managing Director of Salomon Smith Barney based in New York, Rene held various corporate finance roles including co-head of global metals & mining practice, head of steel practice, and head of paper & forest products practice. He was also a Principal in Corporate Finance at Morgan Stanley based in New York.

He is a Magna Cum Laude graduate of the University of Ottawa, where he received his bachelor's degree in business administration. He also received his MBA from Harvard Business School. Rene has been married to Karen since 1984 and they have two adult children. Rene enjoys reading, travel, hockey, golf and is a PCA driving instructor. Rene is a member of the Young Presidents Organization, and CEO Network.

PETER KUBASEK

Peter Kubasek is Founder and CEO of ArkMalibu. Peter has been closely involved in more than 500 merger and acquisition projects ranging from $2 million to over $1 billion in sales representing billions in transactional value.

Peter brings a vast background of knowledge and understanding to every engagement in which he is involved. He has advised clients on preparing for exit, valuations, divestitures and financing options in a variety of areas including 3D printing, technology, services firms, communications, manufacturing, consumer packaged goods, and distribution. After earning an MBA from Pepperdine University, Peter began his career at Andersen Consulting in Los Angeles, later moving into Corporate Development roles at Nestlé USA and The Loewen Group. Peter obtained his undergraduate business degree Magna Cum Laude from John Brown University.

Peter is a member of the Young Presidents Organization, CEO Network, the Cincinnati Association for Corporate Growth and the Business Growth Alliance Affiliate Board. He is the former President of the Cincinnati ACG. Peter and his wife Maryam have been married more than 35 years and have two sons, Hudson and Luke. They live in Blue Ash, Ohio. Having grown up in Vancouver, British Columbia, Peter has a great love for the game of hockey and has coached his sons and other local youth.

BILL HIGH

Bill is the founder of 7 Generation Legacy, a consulting firm to families and family-owned businesses around the country. He helps navigate family and business transitions including leadership transition, succession, and generational transition. His unique focus is helping those families address 3 big areas: (1) relational health inside of their families and organizations, (2) structure and governance for long-term success and (3) next generation preparation and training.

He's also been the founder of several entities including a charitable foundation that helped facilitate over $5 billion in charitable gifts. Those gifts include business transactions at the point of sale.

He's a well-known speaker on the area of family, legacy and generosity. He's been voted one of the Top 25 Speakers on Philanthropy by Philanthropy Media and is a member of the Forbes Nonprofit Council. He's a published author with over 10 books including his most recent book co-authored with David Green, Leadership NOT by the Book (October 2022). You can find more out about Bill at www.billhigh.com.

GLOSSARY

Terms are included below because of their importance to the M&A process, although not all are referenced elsewhere in this book.

80/20 revenue view
The 80/20 revenue view is also known as the Pareto principle. When used in reference to a company's revenue, it describes the common scenario in which approximately 80% of a company's revenue comes from approximately 20% of its products, services, or clients.

Acquisition
An acquisition occurs when one company takes over another company via a controlling interest. In other words, Company A acquires a controlling interest in Company B.

Amalgamation
An amalgamation occurs when companies combine to form a new company for the purpose of greater synergy through pooled resources. In other words, Company A and Company B combine to form Company C.

Auction
An auction is generally the seller's best-case scenario—multiple buyers or investors bidding against each other for the opportunity to buy a company.

Backward integration
Backward integration occurs when a company acquires a supplier to ensure a dependable and affordable supply.

Birkman profile
A Birkman profile is an individual's personalized insights based on the Birkman Method, an assessment of behaviors, needs, and personality designed specifically for the workplace.

Black knight
A black knight is an entity that makes an unwelcome attempt to acquire a company.

Black swan
A black swan is an event that is unpredictable because it does not adhere to norms.

Bolt-on acquisition
A bolt-on acquisition occurs when a company is acquired i) to meet a particular need of or to create a more complete value proposition related to the acquiring (platform) company or ii) to create additional value for a private equity portfolio. In other words, Company A is the platform company that "bolts on" Company B for a specific purpose.

Capital gain
A capital gain is the profit above the cost basis of an investment. It is realized at the time of sale.

Charitable trust
A charitable trust is an entity that controls assets for charitable purposes.

Clawback provision
A clawback provision is a contractual agreement that would cause disbursed money to have to be paid back under certain circumstances. In M&A transactions, a clawback could occur based on poor post-sale performance of the company or based on a restatement of financial outcomes.

Competitive intelligence (CI)

Competitive intelligence is information a company gathers about its competitors and industry to help it perform well within its target market.

Corporate chemistry

A subset of corporate culture, corporate chemistry is how people within the company blend together. This is most important when a merger or acquisition takes place in which owners, executives, and/or employees from different cultures will be working and making decisions together.

Corporate culture

Corporate culture is the values, beliefs, and habits that are commonly understood and accepted within a company. It defines the ground rules of engagement that drive the company's synergies, decision making, and work styles. Regardless of what is said in employee manuals and human resource materials, the corporate culture is what is viscerally taking place within the company walls. What is rewarded? What is penalized? What is recognized? What goes unnoticed? These all shape corporate culture.

Cost of debt

Cost of debt is the amount a company pays to borrow money (i.e., interest).

Disruptive technology

Disruptive technology is new and innovative technology that alters the industry by causing significant changes in the way things operate.

Due diligence

Due diligence usually refers to the confirmatory phase of a deal wherein the buyer confirms that the seller is and/or has what has been advertised and that there are no unknown debts, obligations, or liabilities.

Earn-out

An earn-out is one or more additional payments made to the seller after the transaction closes. These payments are usually based on achieving certain revenue or profitability milestones by a certain date. The terms and conditions of the payment(s) are specified in an earn-out agreement.

Earnings before interest, tax, depreciation, and amortization (EBITDA)

EBITDA is a non-GAAP measure typically used as a proxy for operating cash flow.

EBITDA multiple

The EBITDA multiple is a ratio of total enterprise value to EBITDA.

Escrows

Escrows are documents, real estate, money, or securities deposited with a neutral third party to be delivered upon meeting certain deal terms.

Fixed costs

Fixed costs are company expenses that remain constant, as they are not dependent on the level of business activity.

Forward integration

Forward integration occurs when a company acquires a downstream company such as a retail outlet, or when a supplier company acquires a company that utilizes its product(s).

Golden parachute

A golden parachute is a large benefit package a company pays to members of management who are terminated as a result of a merger or acquisition.

Haircut

A haircut is a reduction from a previously discussed purchase price. This usually occurs as a result of a perceived value flaw uncovered during due diligence.

Hockey stick projection

A hockey stick projection is a forecast of dramatically increased revenues and profitability as compared to current trends. Like a hockey stick, the graph shows flat current results (the blade) followed by a rapid upward trend (the handle).

Holdback

A holdback is a portion of the purchase price that is deferred until conditions are met or information is known. A holdback is similar to an escrow; however, a holdback may simply be retained by the buyer rather than deposited with a third party.

Indication of interest (IOI)

An indication of interest is a non-binding document issued from a potential buyer to a seller, usually through advisors, that indicates a general range of an intended offer and makes a broad case for why the potential buyer is interested in the deal. A seller should seek multiple IOIs to determine which purchaser will make the best future partner under the best terms.

Intellectual property (IP)

Intellectual property consists of original concepts that may be protected by a patent, copyright, or trademark.

Letter of intent (LOI)

A letter of intent is similar to an indication of interest in that it is a non-binding document issued from a potential buyer to a seller, usually through advisors, that indicates a price or general range of an intended bid. It additionally outlines the buyer's price or desired deal structure and terms. An LOI allows the seller to determine whether the buyer's requested steps of due diligence are warranted. It behooves the seller for the LOI to be as specific as possible, with the intent that the buyer will respect the LOI terms unless there are material negative surprises in the confirmatory phase of due diligence.

Making a market

Making a market refers to the value-adding process that expert investment bankers use to identify creative opportunities regarding acquirers, terms, deal structure, and valuation for the seller to consider.

Merger

A merger occurs when a company absorbs another company(ies) for the purpose of greater synergy through pooled resources. In other words, Company A and Company B combine so that only Company A survives. Typically, shareholders of the merged company obtain ownership in and employees transition to the surviving company. There are three primary types of mergers: i) horizontal—combining competitors, ii) vertical—combining a supplier and buyer, and iii) conglomerate—combining companies with different markets for sake of diversity.

Middle Market

A company with total enterprise value of $25 million to $300 million. Some say the range can stretch to $1 billion.

Orphan
An orphan is a division within a company—or one of the businesses owned by a holding company—that has potential but is not getting the focus it would need to achieve maximum productivity and/or monetization.

Outlier
An outlier is a type of orphan that has an easily detectable path for dramatic growth and profitability, but needs a different owner or partner in order to achieve its potential.

Parent company
A parent company is a company that owns a controlling interest in one or more other companies.

Platform company
A platform company is a buyer's primary acquisition in a given market segment. It is often viewed as doorway to other "bolt on" acquisitions in that segment.

Reserve Price
The lowest price the seller would accept in a sale transaction.

Reverse takeover
A reverse takeover is the acquisition of a larger company by a smaller company. This method is often employed by private companies that wish to go public by acquiring a public company instead of going through the process of an initial public offering.

Roll-up acquisition
A roll-up acquisition is the consolidation of multiple companies by a private equity firm or platform company for the purpose of adding to its product or service offerings, geographical footprint, or client list to eventually drive a higher valuation and/or purchase price.

SaaS
Software as a Service

Sandbagging
Sandbagging is a strategy employed by companies to avert hostile takeovers by delaying a sale with the hope that a different buyer will emerge. The term "sandbagging" also refers to the unrelated practice of a buyer making an issue, after a sale, out of a piece of information it already knew to be false before the sale closed.

Senior debt
Senior debt is the company's top-priority debt. If the company were to close, this would be the first debt to be repaid.

Shell company
A shell company is a company that does not engage in normal business operations, but that may exist for any of a number of legitimate or illegal purposes.

Show stopper
Broadly, a show stopper is an event or condition that prevents an acquisition from being completed. Specifically, a show stopper often takes the form of legal or regulatory intervention to prevent a takeover.

Sleeping beauty

Named for the well-known fairy tale, a sleeping beauty is a company that has not yet been targeted for acquisition but that could readily add value for an acquirer.

SPAC

Special purpose acquisition company.

Succession plan

A succession plan is a company's strategy for how to transition leadership. Although this is often neglected in the urgency of day-to- day operations, it is essential to have in place. The succession plan should answer both the short-term hypothetical question of "What if the owner (or management) gets hit by a bus?" as well as the long- term question of "Who will lead us through the next few cycles?"

Takeover

See Acquisition.

Tender offer

A tender offer is an offer made to existing shareholders by an acquirer who wants to purchase their shares, typically for an over-market price.

Toehold purchase

A toehold purchase is the acquisition of almost five percent of a company's stock as a precursor to a possible subsequent larger purchase. (When five percent or more of a public company listed in the U.S. is acquired, the Securities Exchange Commission and the target must be notified.)

KEY M&A ABBREVIATIONS

Abbreviations are included below because of their importance to the M&A process, although not all are referenced elsewhere in this book.

BATNA: Best alternative to a negotiated agreement

CA: Confidentiality agreement

CI: Competitive intelligence

CIM: Confidential information memorandum

CIP: Confidential information presentation

EBITDA: Earnings before interest, tax, depreciation, and amortization

ESOP: Employee stock ownership plan

FMV: Fair Market Value

GAAP: Generally accepted accounting principles

IOI: Indication of interest

IP: Intellectual property

IPO: Initial public offering

KPI: Key performance indicator

LOI: Letter of intent

M&A: Merger and acquisition

MAC: Material adverse change

MAE: Material adverse effect

NDA: Non-disclosure agreement

PE: Private equity

PSA: Purchase and sale agreement

SEC: Securities and Exchange Commission

VC: Venture capital

"Rene, Peter, and Bill come at the subject with the experience of selling (and buying) businesses most of us will never have. They have explained the process in Sell Well in terms all of us can easily grasp. Give yourself the benefits of these three experienced successful authors."

David Dillon | Retired Chairman & CEO, The Kroger Co.

"ArkMalibu's technical expertise in our industry was instrumental in finding us a great deal and partner. ArkMalibu quickly became our trusted advocate that surpassed expectations. I would strongly recommend any business owner consider ArkMalibu if contemplating an exit."

Dan Dungan | Executive Chairman, Springfield Electric

"Sell Well is a MUST READ if you are a business owner, especially if you are a baby boomer!"

Jeff Holler, CFP® | President & CEO, The Capital Chart Room LTD®

"Rene, Peter and Bill have written the book every owner/CEO should read when that twinkle of an idea comes into their head that they might someday sell...if they do, it will make for a much more successful and pleasant exit."

Steve Grubbs | Serial entrepreneur & CEO, Victory Companies

"Sell Well is a carefully fashioned manual for any business owner who might be considering an exit."

Geneva Milne | CEO of Gunner Concrete