Merger & Acquisition Focus

August/September 2010

When it's time to sell
Internal and external factors can help you decide

Accentuate the positive
Revenues can drive postmerger growth

Hedge your bets with a hedge fund

Ask the Advisor

When it's time to sell

INTERNAL AND EXTERNAL FACTORS CAN HELP YOU DECIDE

One of the toughest decisions a business owner will ever make is to sell his or her company. Sometimes sales are forced, as in the event of financial distress, bankruptcy, or an owner's unplanned departure. But in most cases, owners must carefully assess their company's financial and competitive position and determine the best time to sell, given their own future plans. Success — a smooth transaction, good terms and a fair price — largely depends on how well you've prepared for this important event.

Plan if you can

Some owners are so financially and emotionally tied up in their businesses that they never retire. If this sounds like you, make sure you have detailed, comprehensive succession and estate plans. They can save your heirs and business partners major headaches and hefty tax bills.

Is your company the market leader in your industry or niche? Or are you consistently lagging your rivals?

But if you're like most people, you plan to retire and either live off the proceeds of your business sale or possibly invest in a new business venture. Both are good reasons for selling and are events you can plan for years in advance.

Unfortunately, business sales aren't always plannable events. Sometimes companies simply reach the end of their natural lifespan due to a changing marketplace, political or economic conditions, obsolete products or an inability to raise new capital. And owners caught up in the day-to-day running of the business may not recognize this dead end until they've hit the proverbial wall.

Leadership conflicts can also trigger a sale. If a company's two founding partners, for example, no longer agree on its long-term strategy, they should consider an ownership change. One partner could buy out the other partner's shares, or both partners could sell the business to an outside buyer.

Be prepared

Even if selling isn't in an owner's immediate plans, growing companies should always consider it an option. Ask yourself whether:

- Your business is competitive in the long term under your ownership,
- You have a strong enough appetite for risk to adequately grow it, and
- Current owners and managers are skilled enough to take the business to the next level.

If the answer to any of these questions is “no,” you’re probably hindering your company’s growth. A partnership with a private-equity fund or an outright sale to another company may be what your business needs to flourish.

Outside pressure

Internal factors play just part of the decision to sell a business. You also need to consider the state of the capital markets, interest rates, credit availability and industry-specific issues. For example, few deals were completed in early 2009 when market turbulence and frozen credit markets made it virtually impossible for buyers to complete M&A transactions.

Although external factors are important, don’t make the mistake of trying to “time” your sale to the market — you may miss out on a good deal. Instead, start preparing your company well in advance of any planned sale so that it’s an attractive target, regardless of market conditions.

Know your strengths

Begin the preparation process by making detailed assessments of your company’s:

Industry and competition. Is your company the market leader in your industry or niche? Or are you consistently lagging your rivals in terms of sales and market share, with little hope of catching up?

Growth potential. Do you anticipate strong sales growth in the next few years? Are you able to improve customer relationships and land new or larger contracts, or expand into new territories? Or has your business saturated its industry and exhausted opportunities for expansion?

Lifecycle. Are your earnings forecasts fairly stable several years out? Or does your company expect a significant sales uptick in, say, two years? That could be an auspicious time to try to find a buyer.

If you have the capabilities, an internal team might be able to perform these assessments. But you’ll likely get a more honest report and gain greater insight from an outside expert’s analysis. Knowing your competitive placement and growth potential will help you position your company for sale when it’s most likely to attract potential buyers.

For example, you may lead your market niche currently, but without a large capital infusion in the next year or two will likely lose ground to competitors. A buyer with the right resources and knowledge could see your business as a great opportunity — if you go on the market now.

Ideal conditions

A business sale can be a long-planned-for event or a sudden necessity. Obviously, you’d prefer to sell when demand is strong and your company is healthy. But even when conditions seem less than ideal, your company’s destiny is in your hands if you’re always prepared to sell.

Prioritize the personal

You probably think of a business sale as a financial transaction, but have you considered the *personal* ramifications of selling? Sometimes, getting the highest price must take a back seat to other priorities. Before you put your business up for sale, consider:

- Do you want to sell quickly or are you willing to wait for higher offers to come along?
- Do you need payment in cash or will you accept stock or even be willing to partially finance the deal?
- Have you made comprehensive retirement and estate plans so you know how much money you’ll need and where it will go?
- Have you planned for the tax impact of your sale?
- Will you only accept a buyer that’s willing to retain current employees or remain in the same city?
- Do you plan to continue working for the company after it’s sold? If not, what will you do?

Accentuate the positive

REVENUES CAN DRIVE POSTMERGER GROWTH

Almost all business buyers hope that their acquisition will lead to higher revenue growth in the future. Unfortunately, a significant percentage of deals won't. Almost half of the respondents in a 2010 survey conducted by Hewitt Associates reported that their past M&A deals had failed to meet financial and strategic goals.

One of the best ways to boost your acquisition's odds of success is to remember the saying "Accentuate the positive." No matter how aggressively you cut costs — a "negative" strategy — the real key to a successful acquisition is to continue growing revenues after consolidation has taken place.

Money where your mouth is

Growing revenues, of course, is easier said than done. It's much simpler to realize cost synergies than to deliver new products to new customers via new distribution channels. And although many companies have had no choice but to focus on the "negative" and trim expenses during the recent economic downturn, cost-cutting only takes a company so far.

It's not hard to understand why many businesses prioritize cost reductions. They're tangible and can be clearly quantified. Revenue assumptions, meanwhile, are ambiguous and depend on factors that are tough to anticipate — such as the company's future competitive position or its ability to continue providing the same level of customer service when it's a larger entity. Companies also may need to increase spending to achieve projected revenues.

Revenue in your sights

You must, however, try to keep revenue in your sights. Studies conducted by McKinsey & Company over the past decade have found that, when business acquirers ignore growth initiatives and plunge headlong into cost-saving programs following a merger, they can expect to lose ground to their industry peers. The key to success is to sustain current revenue and work to generate revenue growth during the integration stage.

In practice, this means that, in addition to turning your attention inward to address the many challenges of integration, your company also must maintain a strong customer focus. Customers already will be wary following the merger announcement and will likely look elsewhere if they sense that future dealings with your company hold higher prices, reduced service and the loss of key relationships. Be sure you provide customers with personal attention and clearly communicate how the merger will affect them specifically.

Other ways to promote future revenue growth and increase the odds of acquisition success include:

- Making the most of your newly expanded customer and prospect database by quickly identifying and contacting key customers and promising prospects,
- Improving your company's internal processes and providing better customer-service and sales training to your staff,
- Empowering employees, including your acquisition's employees, to identify new revenue sources, and
- Asking senior managers to contact your most important customers personally to discuss ways to better meet their needs.

A possibly more challenging, but essential, task is to ensure your employees are communicating a consistent message that reflects your merged company's values, strategic objectives and brand. Put in place a solid communication plan that's well understood by employees before you begin integration.

In addition to turning your attention inward to address the many challenges of integration, your company also must maintain a strong customer focus.

Fringe benefits

Focusing on revenue can help you realize other acquisition goals, including cost savings. Employees who are focused on what your company can accomplish, rather than on what it can eliminate, are more likely to be happy, motivated and productive. Organizationwide positivity should, therefore, help reduce staff turnover and limit costs associated with replacing employees. ■

Hedge your bets with a hedge fund

Hedge funds continue to play an important role in the M&A marketplace despite getting caught up in the financial market meltdown of the past few years. If you're planning to sell your business in the near future, finding a hedge fund buyer could be an appealing alternative to traditional buyers.

Financially distressed companies, or those with significantly undervalued stock, may have the most to gain from a hedge fund buyer. Even when your options seem limited, a hedge fund may be willing to make a satisfactory offer.

Different strokes

Depending on their investment objectives and target, hedge funds may make an acquisition in one of a couple of different ways. Commonly, funds purchase companies as the lead lender in a leveraged management buyout. The buyer obtains bank financing for the transaction using the acquired company's assets — and, potentially, some of its own — as collateral. Others act as direct buyers, as Bear Growth Capital Partners (a Bear Stearns hedge fund) did recently in its acquisition of bankrupt swimsuit company Everything But Water.

A start-up may get a better shake from a hedge fund that's attracted by its rapid growth rate.

Or a hedge fund may act as the majority investor or controlling shareholder of the company making the acquisition. This scenario can be tricky, and isn't always beneficial for sellers. A buyer controlled by a hedge fund is likely to have different priorities than would strategic buyers. The hedge fund may consider the acquisition of your company a device for beefing up your buyer's balance sheet — not a long-term commitment to your company's growth.

Other concerns

Indeed, many hedge funds have short-term investment goals and high-return benchmarks — between 15% to 20% annually. These types of funds typically spin off acquisitions after a few years. Some hedge funds, however, take a longer view of certain acquisitions. Ensure you understand a hedge fund's strategic goals before entering serious negotiations.

Sellers hoping to work with a hedge fund also need to keep their eyes on Washington. Congress has castigated some hedge funds for their alleged role in the 2008 financial crisis. Although no legislator has proposed specific reforms, new regulations could potentially place limits on risk levels, types of investments and sources of financing.

Some benefits

Despite these caveats, hedge funds can be a good alternative for some sellers. For example, such funds may provide their own acquisition financing, so they aren't constrained by credit crunches like the one that has derailed many corporate acquisitions recently.

Hedge funds also have fairly broad appetites, with many funds pursuing targets regardless of size or industry. A start-up, for example, may get a better shake from a hedge fund that's attracted by its rapid growth rate than by a strategic buyer that requires a solid financial history or specific product and service offering. Hedge funds also could potentially drive up your company's selling price if they sense an opportunity.

Minority is a major force

Hedge funds remain a minority in the ranks of prospective business buyers. But given their superior access to capital and healthy appetites for risk, they can't be ignored — and they can be the ideal buyer for some sellers. ■

Ask the Advisor

Q. Do I need a corporate development team?

A. Many companies are assembling "corporate development teams" to devise and implement strategies for growing their business — particularly through mergers and acquisitions. If your company plans to buy or sell in the near future, you might want to consider assembling such a unit.

Build your team

Traditionally, M&As have been initiated and executed by top executives and their financial and legal advisors. Given the increased complexity and volatility of today's economy and M&A marketplace, however, a diverse group representing various areas of your company can help improve your deal outcome.

Your corporate development team should be large enough to include financial, accounting, operations, legal and IT representatives. But it shouldn't be so large that it makes arranging meetings, reaching consensus or accomplishing objectives difficult. A 2010 Deloitte & Touche survey found that 77% of the 158 executives polled said their corporate development teams have 10 or fewer members.

Your company can choose team members through several means. A top executive, such as your COO, could serve as chairman and hand-select the team — typically members of upper management or department heads. Or your company could hold "elections" for team positions and ask prospective candidates to make their case for inclusion.

Responsibility for growth

Before starting the process, it's important to decide whether team positions will be full- or part-time and their term length. Also determine the team's responsibilities, which could include:

- Drafting an M&A strategy, which for buyers means defining ideal targets and, for sellers, ideal buyers,
- Identifying strategic plans to improve valuation,
- Performing or participating in the due diligence process,
- Ensuring legal and regulatory compliance, if required,
- Spearheading corporate valuation efforts, and
- Planning postmerger integration.

Keep in mind that a corporate development team is different from an M&A deal team, which is assembled to manage a transaction from start to finish. The corporate development team's responsibilities are broader, entailing the development of long-term strategies. But the two teams' duties will overlap during the deal process, so plan for how they'll work together. Of course, for some smaller sellers, the corporate development team also will serve as the M&A team.

The long view

For sellers, a corporate development team has a built-in expiration date. Once the company is sold, the team either disbands or is incorporated into its buyer's corporate development team. A buyer's development team has longer-term potential. If your company plans to expand market share via multiple acquisitions, your development team can be responsible for assessing ongoing risk, weighing acquisition opportunities as they arise and devising long-term growth strategies.

This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2010 MAFas10