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How To Be A Solid Corporate Acquirer

Think how you want your acquisition to end up a year after closing. Most likely you would want to be the proud owner of a profitable growing company where all the employees, customers, suppliers and other stakeholders are happy with your ownership. And importantly, the company is handling its acquisition debt service just fine as your new company creates additional value every day. If this vision is your goal, the following points are the keys you need to know and do to be that successful corporate acquirer.

The Basics To be a Solid Corporate Acquirer, you must internalize and use an acquirer's inherently desirable traits. There are two basics for you to abide by:

- The first is to never overpay. Instead, buy it at a fair price with the proper structure.
- The second basic is to understand what you will do with it after you own it. How will you operate the company so that it creates the value-add that you contemplate when you make the decision to buy?

High Deal Flow How you get the right deal is to create options for yourself. Create acquisition options so that you select the right company to acquire. This concept is critical for the successful acquirer. A single acquisition opportunity is a binary decision. Buy it or pass.

You must have the option to consider many different companies in order to create choices and options to find the best opportunities. This process provides the ability to select only those businesses that are the best fit for you. Your acquisition needs to be consistent with your goals, financial capacity, industry knowledge, fit, culture and a myriad of other characteristics that make an acquisition "right" for you and your circumstances. Therefore, you must have high deal flow.

Synergies You owe it to yourself and all other stakeholders in a transaction to know what to do with a company you acquire. You should have, or get, experience in those industries or product types or markets in which the prospective target participates. Supplement what you do not know about the target company or its markets with the knowledge and expertise of others who can contribute, including possibly the selling shareholders.

Auctions Do not involve yourself in auctions! They are designed specifically to get acquirers to ante up more than they would otherwise without the benefit of in-depth discussions with the selling shareholders. Auctions violate the philosophical approach defined in the perspective of "The Basics" above.

Price and Value A seller can ask whatever price he wants to ask. So, as a savvy acquirer, you must become a quick study on company valuation. (See "How To Value A Private Company"). This knowledge is the key to obtaining a fair price. Possessing the understanding of value is critical for you in negotiations, because the issues and nuances about a particular company often impact value and, therefore, its price - up or down.

Earn-outs An earn-out is a common component of transaction structures in private company transactions. While the seller would normally prefer an all-cash consideration, it's rare. Earn-outs are used to facilitate the following circumstances:

1. It can bridge a price gap between the two sides during negotiations.
2. It can keep a seller interested in the company after the sale to ensure a longer-term transition.
3. It can help a less financially capable acquirer purchase a company with less cash up front. (See "Earnouts: When and How To Use Them").

Due Diligence All companies have warts. It is important for you to know all the imperfections, disclosed or undisclosed, before you close. (See "How To Conduct A Thorough Due Diligence"). Do not be surprised or dismayed by what you find. Most issues can be cured, resolved or handled operationally or in price negotiations. The due diligence process is a standard part of the acquisition process. So, become good at executing your due diligence with dispatch so as to keep your momentum moving.

Financial Analysis The language of business is the financial statement. When examining an acquisition prospect, get financial statements for the past three (minimum) to five years. Put the P & L Statement on a single spreadsheet. For an understandable comparison, show information year-by-year. Then show the percent of sales for the key line items. This process allows you to review the trends over time and for each year for:

- Sales
- Cost of goods sold
- Gross profit
- SG&A
- Operating profit
- Depreciation and
- Amortization

Develop EBITDA for each year. Take the same approach with the Balance Sheet making each item as a percentage of total assets. Also develop standard financial and operating ratios for each year. This process alone will probably tell you more than the seller knows about his company.

Consider the add-backs offered by the seller. Some are not real such as if the seller adds back all of his salary to get a restated profitability. (Somebody has to run the company). Some add-backs are valid, but it is your job to discern which are and are not. An experienced investment banker will have done this for his client, the seller.

Lawyers Most M&A lawyers do a fine job. But those few who do the wrong thing will kill your deal. The following behavior patterns are reflective of deal killing lawyers:

1. Some wish to play ping-pong with your transaction because by doing so, it runs up his billable hours. One tactic is to be overly adversarial in drafting or countering agreements or deal points presuming that the other side will do the same. The problem is that the principal on the other side takes the behavior of your lawyer and ascribes it to you.

2. Some lawyers focus on legal issues without a measured appreciation of the real business risk. So one of your jobs is to continue to assess the risk associated with your lawyer's definition of the legal risk involved in some matter. A good deals lawyer will describe the balance and tradeoffs.

3. Certain attorneys will assume more control than their role should permit. This happens more often when one of the principals is a neophyte at this type of transaction. So it may happen on the seller side more frequently but recognize that it may be happening.

The solution is to primarily maintain direct communication with the seller as principal rather than via lawyers or advisors.

Negotiating People sell their company to people they like. If the seller does not like the acquirer, the deal usually does not close, and the acquirer may never know why. So always treat the other side with respect. When you challenge, do so evenly and with facts. Try to understand why the seller holds a position with which you may disagree. Always explain your position clearly and objectively. Try to be solution oriented. Use your or the seller's investment banker to float trial balloons or deal structure ideas.

Momentum Deals close because the principal or each respective principal drives it to completion. Always, keep communications alive. Even when there are issues that require further exploration or evaluation, you keep the momentum going by regularly communicating with the other side.

Even though your work on your deal may involve more time to complete, refrain from inadvertently giving the appearance or perception of disinterest by not communicating. Most sellers have much invested in dealing with you. As such, always be aware that their parallel emotions can support or hinder your closing goals. Many things can happen on the way to the closing table. Manage the process.

Letter of Intent (LOI) After being involved in hundreds of transactions, your author is of the firm belief that it is important to draft a thorough and complete LOI. The first draft is your purchase proposal. The more clearly you document the transaction in the LOI, the more likely is your transaction to close. (See "How To Write A Letter of Intent")

There is discipline associated with writing, especially when documenting all the different issues that you and the seller addressed during verbal negotiations. It is better for you to debate the terms at LOI time than at Agreement time. A well-detailed LOI that has been agreed to by both principals significantly facilitates the final closing documentation. A good LOI will not only detail the price, how paid, terms and conditions, it will also include expected representations and warranties as well. This documentation process will avoid surprises and surprises are not a good thing.

Terms of The Agreement Sellers generally prefer a stock sale if the entity is a C-Corp in order to avoid double taxation. The acquirer generally prefers an asset purchase agreement in order to leave any contingent liabilities with the selling entity.

The tax impact of an acquisition has a significant impact on both you and the seller. Tax impact is one of those issues that can be a surprise to the principals as the time for closing approaches. The superior approach to dealing with taxes is to discuss tax issues as a part of the negotiations. It is important for an acquirer to have a good understanding of acquisition purchase agreements in order to smoothly propose an acquisition. (See "How Is The Acquisition Purchase Agreement Structured?").

In our experience, it is best to instruct the drafting attorney to get to the point of having signable documents as soon as is practical i.e. fewer iterations. This action helps avoid the adversarial environment that certain attorneys can create. "Adversarial" carries the risk of the deal falling apart. It is best to create documents presuming that both parties will have a positive relationship going into the future.