Merger & Acquisition Focus

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Efficiency can be a persuasive selling point

Reducing risk

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A potentially faster, cheaper way to execute a deal

Ask the Advisor

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Efficiency can be a persuasive selling point

Business sellers are always well advised to highlight their strengths — such as experienced management, distinctive products or a strong brand — when marketing their company to prospective buyers. One potential key value driver that's often overlooked, however, is efficiency.

Efficiency-based sales pitches are attractive because they present buyers with opportunities to maximize profits. Because there are so many ways to showcase strength in this area, sellers like them, too. For example, you might publicize technology improvements, supply-chain efficiencies or continual improvement programs. (See "How to cut costs and reduce waste *now*" on page 3.) Just make sure to clearly describe how your efficiency efforts can boost the value of the M&A deal and save the buyer money over the long term.

Improving IT

Recent technology upgrades — even when they're relatively simple and inexpensive — make a positive impression on most potential buyers. Software packages that facilitate functions such as accounting and employee benefits management are good examples. So are inventory management systems or moving to the cloud. If, for example, you've adopted cloud computing, be sure to highlight the following:

Reduced storage costs. With company databases stored on an offsite server, the need for in-house facilities and maintenance drops substantially. This translates to lower physical storage space needs and less IT personnel labor.

Lower operational expenses. If you use cloud services, your company's chief information officer doesn't have to spend time planning and administering in-house infrastructure upgrades. Also, it's easier to budget for cloud services because they have fixed subscription rates, as opposed to the fluctuating costs associated with maintaining servers on-site.

Greater flexibility and productivity. Because they offer remote access to networks and databases, cloud-based systems easily accommodate employees working offsite — even as they travel. This means that employees can accomplish more in the same amount of time.

Minimizing manufacturing costs

Few businesses benefit from improved efficiency more than manufacturers. If your company has successfully lowered production costs without sacrificing quality, make it a key selling point. Explain to possible buyers how your investments in automation have reduced labor costs or your streamlined design process has virtually eliminated waste.

Because implementing efficiency measures can be costly and time-consuming, buyers appreciate manufacturing businesses that have already successfully completed the process. They may be intrigued by your systemic improvements — and plan to adopt many of them — but buyers may

How to cut costs and reduce waste *now*

Even if your company isn't planning a sale anytime soon, it probably can benefit from an efficiency upgrade. Depending on your business, one of several established and widely adopted programs can help you reduce errors and defects and increase overall productivity.

Six Sigma — used by many top manufacturers and service providers — is probably the best-known program that aims for greater productivity and quality. A typical Six Sigma project aims to produce less than 3.4 defects per million opportunities in a given process. The lower the number of defects, the further your company advances and the more money you ideally save. According to the Six Sigma Academy, companies that reach the highest level save about $230,000 per project and complete up to six projects annually.

Total quality management applies to several initiatives that seek high levels of customer satisfaction via continual, companywide improvement of specific processes. Your business might use a total quality management program to improve response rates to customer requests or shorten transportation time from production facilities to retail or wholesale sites.

Finally, lean programs help manufacturers reduce waste by first identifying what activities in the production process add value and then eliminating non–value-added activities. Your company might use a lean program to shorten production cycle time, reduce inventories and cut labor costs.

also be apprehensive about the expense of integrating a business that's too different from their own. So you'll want to communicate how easily your systems and processes can be integrated into your buyer's organization.

Taking advantage of outsourcing

Many businesses now use outsourcing to cut staffing expenses and focus on their core capabilities. Depending on your buyer, this can be an effective selling point. If you've outsourced product design functions or transportation needs to a third party, for example, make sure you can quantify your financial savings and productivity gains.

Note, however, that outsourcing can be a contentious issue in some cases. Buyers generally become responsible for contracts sellers have signed with vendors. If, for example, your buyer wants to bring certain services back in-house, canceling contracts can result in financial penalties or legal complications. So if you plan to sell your business in the near future, consider negotiating more flexible contracts with service providers.

Make your best case

If your company has pursued several efficiency initiatives, you don't necessarily want to trumpet all of them. Pinpoint which efforts have been the most successful and have had the biggest impact on your bottom line. Your M&A advisor can help you research efficiency program results and come up with data that will make the most compelling case to prospective buyers. ■

REDUCING RISK

A collar may fit your deal to a "T"

When a large diversified health care company announced its intention to buy a small, but highly profitable, nursing home chain, its stock soared. This may not sound like a problem, but it can be when deals are stock financed. In this case, the buyer faced the possibility that it would have to pay more per target share to make its acquisition. In other cases, post-announcement share price volatility can work to the seller's detriment.

Fortunately, it's possible to prevent the market from disrupting M&A plans with a "collar." Here's how it works.

Renegotiate or worse

Unlike all-cash deals, where the transaction value typically remains constant, deals financed partially or entirely with stock can decline in value as the buying company's share price fluctuates. This, in turn, complicates the deal because parties may need to renegotiate price as they approach closing.

Some collars are designed to limit risk by allowing the buyer or seller to walk away if stock fluctuations make the deal undesirable.

Typically, a seller's shares are exchanged for a fixed number of the buyer's shares in a deal structure called a "fixed exchange ratio." This arrangement, however, can work against the seller if the buyer's stock declines substantially before

closing. Conversely, a fixed exchange ratio can work against the buyer if its stock price increases, because it then will have a higher price-per-target share than it had originally negotiated.

Floors and caps

A collar sets floors and caps on the stock portion of an acquisition's price, giving both parties some assurance that the deal will retain its value. The one that's best for both buyer and seller depends on your priorities — whether you want to maintain a certain percentage ownership or secure a specified target price.

There are two major types of collars. The first is the "fixed-value collar," where the buyer and seller agree on an acceptable price range for either party's stock to remain within (known as the "collar width"). The exchange ratio adjusts within the set pricing parameters and won't fall below the floor or above the cap.

The second type is the "fixed-share collar." Here, the buyer agrees to give a specific number of its shares for each seller's share, and the parties agree on a pricing range for those shares. The deal's value fluctuates based on the price of the buyer's stock. A fixed-share structure lessens the risk of buyer overpayment because the exchange ratio decreases once prices exceed the highest price in the range.

Fixed and floating

Some collars are designed to limit risk by allowing the buyer or seller to walk away if stock fluctuations make the deal undesirable. Within a collar, there are two kinds of exchange ratios:

1. Fixed. The originally negotiated stock-for-stock exchange ratio doesn't change, but either party can cancel the deal if the buyer's share price moves above or below a specified level. Fixed-collar offers are most appropriate when sellers are willing to accept some uncertainty about the amount of the final sale proceeds.

2. Floating. Here, the exchange ratio may change within a specified range up until closing, but the price remains the same. The upper boundary protects the buyer from shareholder dilution if its stock falls between the initial agreement and the close of the deal. The lower boundary protects the seller from a reduction in ownership of the combined entity.

Although they can limit risk, collars have potential drawbacks. They may make a deal more complex and increase the time that management spends negotiating terms and price parameters. On the other hand, with a collar agreement in place you're likely to reduce time and costs at closing.

Perfect buyer and seller

Once you've found the perfect seller or buyer, you don't want to allow the market's reaction to the news to crush your deal. A collar is one price protection strategy to consider, but your advisor may be able to suggest others. ■

One, two, acquisition

A POTENTIALLY FASTER, CHEAPER WAY TO EXECUTE A DEAL

If your company is considering an M&A deal, you might want to look into a process called "the two-step acquisition." This type of transaction is fairly straightforward. The buyer makes a tender offer to acquire a majority of the seller's stock, and then it completes a short-form merger to acquire the remainder of the business.

Two-step mergers usually are faster to execute, with less paperwork, which reduces deal-related expenses. Whether one might work for you depends on several factors, including regulatory issues and how the deal is being financed.

Choose simplicity

What differentiates a two-step acquisition from a traditional single-step transaction is that buyers make the first move — the tender offer — without first seeking SEC review. After the buyer publishes a "tombstone" ad that announces its acquisition intentions, it sends approval documents to stockholders within 10 days. During the same period, the buyer files tender offer documents with the SEC.

It's a quick process. The tender offer is open for only 20 business days, and the SEC typically reviews it on an expedited basis. Once the offer closes, the buyer acquires all tendered shares (usually about 90% of total shares) to become the acquired company's new majority stockholder.

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Then it's on to the second step. Within a day or two, the buyer closes a short-form merger to acquire any outstanding shares. On average, two-step acquisitions take five or six weeks from start to finish, compared with the typical three-month to a year process for traditional M&A deals.

Note advantages

A key benefit of the two-step acquisition is its fast pace. Other strategic reasons to consider using such a deal structure include:

Less competition. A shorter negotiation period gives rivals less time to make a successful competing offer.

Reduced distractions. There's less opportunity for negative or distracting events — such as litigation or stock price volatility — to derail the deal.

Minimized shareholder resistance. Because two-step deals don't require a shareholder vote on the initial tender offer, hostile minority shareholders have less opportunity to block the deal. Also, the Dodd-Frank Act's "say-on-pay" requirement, which typically compels shareholders to approve executive compensation arrangements, doesn't apply.

Recognize obstacles

A two-step acquisition isn't the best solution for all companies. If a deal requires substantial regulatory review and Department of Justice approval, such as the recent AT&T/Time Warner merger, the process inevitably will take longer. If this is the case with your proposed deal, it may just be easier to choose a traditional, one-step merger.

Financing is another consideration. Two-step acquisitions work best when buyers pay with cash, not the proceeds from bank loans. In many cases, lenders aren't willing to provide the bridge financing buyers need to make the first-step tender offer. If your lender doesn't offer bridge financing, you would need to come up with the cash — possibly by accepting a private equity partner, which introduces other potential complications.

Another scenario unfavorable to two-step acquisitions is when a seller has outstanding debt obligations with rates that are scheduled to increase or loans that mature when there's a change in ownership. In such cases, the buyer needs to refinance the debt or pay the lender in full after it completes the first-step tender offer. If the buyer is obligated to assume substantial new debt, the cost could take a big bite out of cash reserves earmarked for financing the tender offer.

Consider the option

To be successful, two-step acquisitions should meet several conditions. If your transaction fits the profile, the two-step process can help you cut costs and expedite plans. But before you make a decision, discuss this and other options with your M&A advisor. ■

Ask the Advisor

Q. What role should social media play in my business sale?

A: As with other aspects of business, social media is changing M&As. Facebook, Twitter, LinkedIn and other platforms can be harnessed to help communicate your deal with stakeholders and the media. But using social media also poses certain risks.

As you begin to plan the sale of your business, consider the role social media might play. If nothing else, your company should have usage guidelines in place for employees to follow. All it takes is one careless tweet and your deal could be in jeopardy.

Indispensable tool

A 2016 University of Massachusetts Dartmouth Center for Marketing Research study found that, of Fortune 500 companies, 86% have a Twitter account, 84% have a Facebook profile and nearly all (97%) have a LinkedIn presence. Many smaller businesses are even more dependent on social media because it offers an inexpensive way to reach customers.

When you put your business on the market, social media can help you research potential buyers. Likewise, many buyers do the same when screening acquisition targets. For example, a buyer might look at reviews and comments posted by your customers — and your responses to them — to get a sense of your reputation and customer service capabilities. And if you have a particularly effective social media strategy, that may be an asset buyers consider worth paying more for.

You and your buyer might also use social media to respond to the questions and concerns of customers and other stakeholders. After the transaction is complete, your buyer might use your Twitter handle to announce potential cost or product line changes.

Potential havoc

Unfortunately, social media may also wreak havoc on an M&A. Both your employees and buyers' employees need to be extremely careful when representing their employers online.

A leak before the deal is announced could lead to media and analyst scrutiny, affecting your stock price (if your company is public). It's possible to arrange for representations and warranties insurance to cover such eventualities. But you may still have a problem if opponents of your plan use social media to try to derail the deal before it's hashed out.

Enhanced objectives

Social media should enhance, rather than undermine, your M&A objectives. So consider restricting access to your company's accounts to one authorized spokesperson until the deal is final. And be sure that, if applicable, you follow the SEC's Regulation Fair Disclosure rules about using social media to release material information to shareholders. ■

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Passing the Business Torch ... One Successful Transaction at a Time

Our Firm:

Everingham & Kerr (E&K) is a regional merger and acquisition advisory firm focused on implementing exit and growth strategies for lower middle market companies. Our client base includes private and publicly owned companies, investor groups, family businesses and entrepreneurs. Since 1988, the firm has successfully completed hundreds of transactions spanning virtually every industry sector.

Our Maxim:

Combining Experience, Teamwork and Persistence to Produce Superior Results.

Our Services:

Sales:

E&K provides representation to sellers of lower middle market companies including sales of entrepreneur and family owned companies as well as divestitures of business units of private and publicly owned companies.

Acquisitions:

E&K assists companies, entrepreneurs and corporate executives develop and execute customized acquisition strategies designed to result in successful transactions.

Transaction Consulting:

In some instances the parties to a transaction locate each other through informal industry or personal channels. These transactions include sales to unrelated third party acquirers, as well as management, family and partner buyouts. E&K is often engaged to structure these transactions and navigate the many issues requiring attention from the initial stages to the consummation of the transaction.

Business Valuations:

E&K provides a full range of valuation services to business owners for personal and corporate affairs. Supporting our belief that all owners should know the “real” value of their business, E&K offers the “Owner’s Planning Valuation”. This is an informal valuation that can be prepared in a cost-effective manner and updated periodically to assist owners with company and personal planning issues.

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