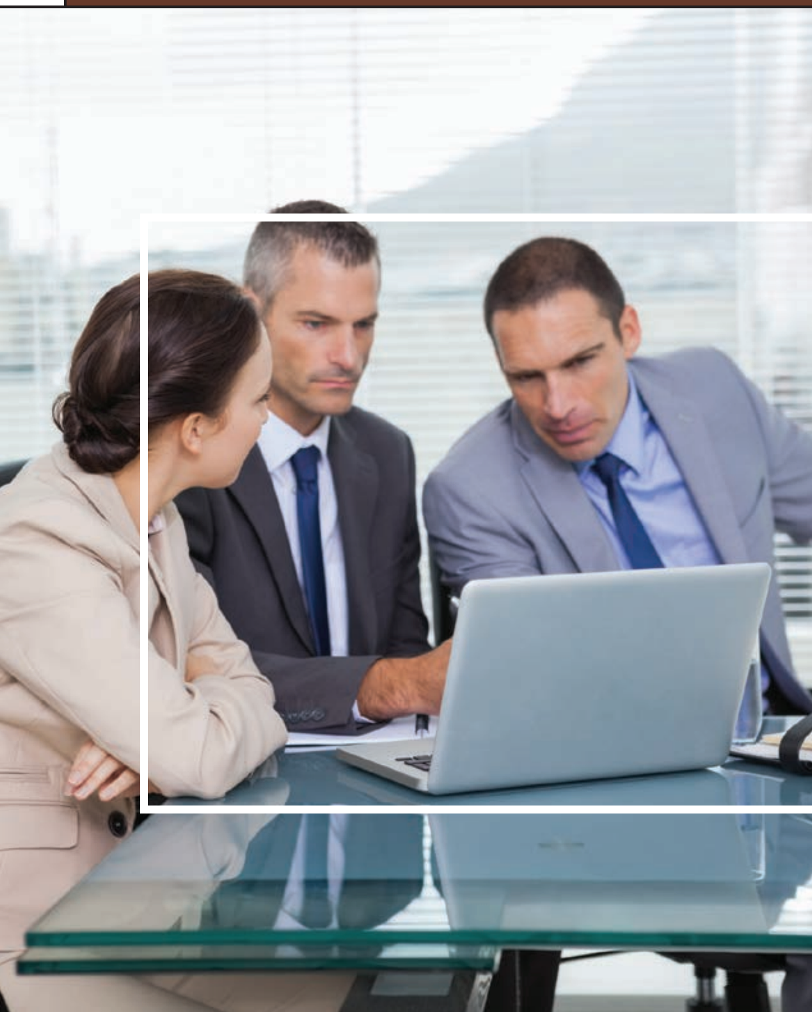
Merger & Acquisition Focus



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Celebrating Over 25 Years

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Tax issues remain long after the deal closes

For most business buyers, taxes are a priority when negotiating a purchase price. However, if they neglect tax issues during the integration phase, the negative consequences can be serious. To improve the odds of a successful merger, it's important to devote resources to intensive tax planning before — and after — your M&A deal closes.

Complacency can be costly

During deal negotiations, you and your seller are likely to discuss such issues as whether and how much each party can deduct their transaction costs and how much in local, state and federal tax obligations the parties will owe upon signing the deal. Often, deal structures (such as asset sales) that typically benefit buyers have negative tax consequences for sellers and vice versa. So it's common for the parties to wrangle over taxes at this stage.

Just because you seem to have successfully resolved tax issues at the negotiation stage doesn't mean you can become complacent. With adequate planning, you can spare your company from costly tax-related surprises *after* the transaction closes and you begin to integrate the acquired business. Tax management during integration can also help your company capture synergies more quickly and efficiently.

Before you start integrating products, personnel and facilities, examine the tax implications of your actions.

You may, for example, have based your purchase price on the assumption that you'll achieve a certain percentage of cost reductions via postmerger synergies. However, if your taxation projections are flawed or you fail to follow through on earlier tax assumptions, you may not realize such synergies.

Merging accounting functions

One of the most important tax-related tasks is the integration of your seller's and your own company's accounting departments. There's no time to waste: You must file federal and state income tax returns — either as a combined entity or as two separate sets — after the first full quarter following your transaction's close. You also must account for any short-term tax obligations arising from your acquisition.

To ensure the two departments integrate quickly and are ready to prepare the required tax documents, decide well in advance of closing which accounting personnel you'll retain. If you and your seller use different tax processing software or follow different accounting methods, choose between them as soon as feasible. Understand that, if your acquisition has been using a different accounting method, you'll need to revise the company's previous tax filings to align them with your own accounting system.

Boosting synergies

Another facet of postmerger tax planning entails digging through possible operational synergies. Before you start integrating products, personnel and facilities, examine the tax implications of your actions. Major areas of concern include:

Supply chain integration. Combining your seller's logistical operations with your own may make fiscal sense on paper, but there could be tax consequences. Say, for example, that you're planning to shutter your seller's main warehouse and fold operations into your company's existing warehouse facilities. But what if the acquisition's warehouse is domiciled in a more favorable tax locale than your warehouse is?

Divestitures and sell-offs. Buyers often spin off unwanted divisions or products when they acquire a business. But from a tax standpoint, such moves can be costly. For example, selling a segment could eliminate certain tax write-offs or protections. And you need to plan for the tax consequences of selling newly acquired assets.

Global implications. International acquisitions can be a tax minefield. What kinds of new exposures, such as value-added taxes (for example, if the company is in the European Union), does the deal carry? And how might a foreign purchase affect your company's effective tax rate? Be sure your M&A advisory team includes people who are knowledgeable about the tax laws in your seller's country.

Enterprise resource planning (ERP). If the two companies' ERP systems aren't merged and synchronized, data collection could slow or you could even lose tax data. Such changes could affect the accuracy and speed of the combined organization's financial reporting.

Tax traps associated with employees

With M&A deals, it's not just major strategic decisions that have costly — or beneficial — tax implications. Routine integration tasks, such as those related to employees, also can harbor serious tax issues.

For example, does the deal promise "parachute" payments to departing executives, such as the selling company's CEO? In such cases, buyers need to determine whether the parachute payments will be subject to excise taxes and adjust accordingly. However, buyers also must consider whether the IRS will deem them excessive.

Employee stock options also have the potential to cause tax problems. Because these plans can be merged in myriad ways — each carrying different tax implications for employees — make sure you ask a tax expert to identify solutions to protect your most valuable assets.

Taking precautions

When you acquire a company, your to-do list will be long, which means you can't devote all of your time to the deal's potential tax implications. However, the tax consequences of M&A decisions may be costly and could haunt your company for years. So if you don't have the necessary tax expertise in-house, work with outside advisors who do. ■

To innovate or merge: That's the strategic question

Many companies reach a point in their development where they have to make an important decision: Innovate or merge? Either they devote resources internally — for example, to develop new products or new logistics practices — or they look for business acquisitions that can provide such innovations "ready-made."

This isn't always an either/or decision. Companies *can* grow both organically and through business combinations. But given recent economic volatility and financial stresses, many business leaders are finding that they must deploy their resources more strategically.

Defining innovation

Innovation is a broad term that encompasses several strategies — all of which are intended to improve a company's cash flow or diversify its risk. The most common strategies are:

- Research and development of new products, from ideation to manufacturing; market testing to full-bore rollouts,
- New market penetration via geographic expansion (such as opening offices in new cities) or with enhanced product or service offerings, and
- Productivity increases resulting from employee- or department-level improvements, new management strategies or workflow enhancements, and executive realignments.

What do these three have in common? Each takes time, manpower and capital. Understandably, business leaders can be gun-shy about devoting such vital resources to innovation initiatives.

A recent Accenture survey of 519 CEOs in the United States and Europe found that, while half of the respondents had recently increased funding for innovations, only 18% believe that such investments pay off. Slightly less than half of the survey's executives revealed that their companies have become more risk averse about spending capital on further innovations.

The M&A alternative

For companies that don't want to bet the farm on internal development, mergers can be appealing. If you're looking to expand a product line, for example, it might be more time- and cost-effective to acquire a competitor that already offers the goods you want.

Your acquisition target has already done the hard work, including funding, testing and manufacturing the product and building a client base. By buying this competitor, you may incur less risk than you would by investing your own capital and building the

product from scratch. The same holds true for geographic expansion and productivity improvements.

Making the call

If acquisitions are easier and cheaper, why would any company pursue internal innovation? For one thing, business combinations come with their own risks. To fully benefit from any business acquisition, your company needs to "stick the landing" — efficiently integrate operations and retain divisions and employees capable of ensuring that innovations continue to pay off. For many buyers, that's a tall order. And in some industries, internal development is necessary because there are no other companies offering the innovations you want.

Access to capital is another potential obstacle to a winning M&A strategy. Some companies are more successful in getting financing to make an acquisition than in raising capital for internal investments. But others, particularly public companies, often encounter the opposite: Investing in innovation may be an easier sell to stockholders than the great unknown of an acquisition.

There's also the question of timing. Is the new product your company spent all of its available resources developing entering a still-growing market? Or are you simply playing catch-up to competitors that are already onto the next big thing? If innovating isn't your company's strong suit and you're always playing catch-up, a merger probably makes more sense.

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Consider Yahoo's recent purchase of social media platform Tumblr. Rather than spending millions to create a competing microblogging service, Yahoo instead bought one of the sector's biggest, fastest-growing players.

Ideal world

In an ideal world, companies would devote resources to innovation and also make the occasional small acquisition to bolster their standing in particular markets. But most companies don't have the luxury to do both simultaneously. To best deploy your limited resources, spend time examining the risks and potential rewards associated with each option. ■

Meet the buyers

GETTING AN M&A OFF ON THE RIGHT FOOT

Like many important business transactions, M&A deals often owe their success to amicable and trusting relationships. If you (or your prospective buyer) make a bad first impression, it could sour the deal. To ensure you get off on the right foot, put some thought into your initial deal meeting and determine well in advance the attendee list, meeting place and agenda.

Who should attend?

One of the first decisions you'll need to make is who will attend the meeting. Do you want to keep it small and confidential, including only your owner or CEO and your M&A advisors? Or do you wish to invite senior managers representing your company's various departments? Early meetings typically require fewer participants.

culture. If this is the case, be sure your facilities are clean and organized and that employees dress and act appropriately. If you're concerned about fueling the employee rumor mill, hold your meeting after hours.

What will you cover?

Even if you typically conduct casual, impromptu meetings, it's essential to draft an agenda for your initial buyer meeting. This includes a detailed time frame and a set of discussion topics. For example, you'll want to introduce your company with a brief history that covers its inception, growth over time, any ownership changes and how it stands today, including its general financial health and future prospects.

You don't need a script, but it's important to know what you'll say and how it relates to the larger message about why your company is an attractive acquisition target. Most buyers will be interested in knowing why you're selling and how the sale aligns with your long-term vision for the company. Similarly, you should ask about the buyer's interest and their plans for your company. You might also discuss how the management structures and cultures of the two companies compare.

Unless your meeting follows informal talks that have already laid the groundwork for the deal, you likely won't discuss a specific purchase price or method for valuing the company. Deal structure — including whether it will be a cash or stock transaction and how the buyer plans to finance it — is another topic best tackled during the due diligence and negotiation stages.

Minimizing mistakes

The initial buyer-seller meeting is an important step in the M&A process, so be sure you're well prepared for it. You can minimize potential deal-killing mistakes at this stage by working closely with your M&A advisor. ■

Each configuration offers certain pros and cons. A meeting limited to owners and CEOs will likely move faster and be more candid. But its success will rely on the impression made by only one or two individuals. Involving a team of managers, on the other hand, enables you to provide more information and expertise. However, it also increases the chance that the meeting will get bogged down with too many — or even mixed — messages.

Also consider that the more managers privy to confidential deal information, the more likely your plans will leak before you choose to disclose them.

Your M&A advisor can help you decide what's appropriate under the circumstances and how to protect the confidentiality of discussions and any documents reviewed during the meeting.

Where will you meet?

Although it may seem like a minor detail, your meeting's location can have major repercussions. A third-party site such as a hotel conference room is ideal because it eliminates the "home field advantage" for either party and helps both concentrate on the issues without distraction.

However, it's likely that your potential buyers will want to meet at your office so they can look around and get a feel for your operations and business

Ask the Advisor

Q. As a business owner involved in a merger transaction, what's the best use of my time?

A. If you're the owner or top executive of a company in the midst of an M&A transaction, you probably wish you could be everywhere at once. For most business leaders, the merger process involves an endless number of details to get right, strategic questions to answer and people to keep on task.

However, there are only so many hours in a day, and you probably have other day-to-day business matters demanding your attention. The key is to focus on facets of the transaction that benefit from big-picture knowledge.

Get ready to delegate

Owners and executives usually handle significant discussions at the beginning of a deal — proposing the merger, meeting with advisors and serving as the first point of contact with the other side — and they lead the transaction through closing. But that doesn't mean you need to be the dominant player throughout the entire M&A transaction.

A team of managers — including representatives from finance, marketing and sales, operations, information technology and human resources — should be capable of steering your company through the myriad stages of a deal. Don't hesitate to delegate authority to these managers or to your financial and legal advisors.

Moving in, staying out

The best tack is to think of yourself as a strategic representative and sounding board for other deal team members, stepping in and making decisions as needed. Suppose your deal negotiations stumble over a matter such as employee compensation or the postmerger location of the company's head office. You and your counterpart on the other side of the deal should get negotiations back on track and moving forward.

That said, be careful about butting in where you may not be wanted. There's nothing more frustrating for deal team members than to come to terms with managers on the other side, only to have their decision vetoed by a CEO who hasn't participated in earlier discussions. Once you've charged team members with deal responsibilities, act as a monitor and advisor, but try not to override their decisions.

Omnipresence isn't necessary

At the risk of your health and sanity, you may feel the need to be omnipresent during an M&A transaction. But you — and your company — probably are better served if you take a step back. Let your managers do some of the heavy lifting, and for complex issues (such as deal structure) or burdensome tasks (such as due diligence preparation), ask your M&A advisors for help. ■

Celebrating Over 25 Years

Everingham & Kerr, Inc.

Merger & Acquisition Advisors focused on the Lower Middle Market

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 nearly 200 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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