Merger & Acquisition Focus

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Still points at the center of chaotic acquisitions

Treat salespeople like the valuable assets they are

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Ask the Advisor

Celebrating Over 25 Years

Everingham & Kerr, Inc.

Merger & Acquisition Advisors focused on the Lower Middle Market

1300 Route 73, Suite 103, Mt. Laurel, NJ 08054
Phone: 856.546.6655, Fax: 856.546.2806
Email: EK@everkerr.com, Website: www.everkerr.com

Integration managers

STILL POINTS AT THE CENTER OF CHAOTIC ACQUISITIONS

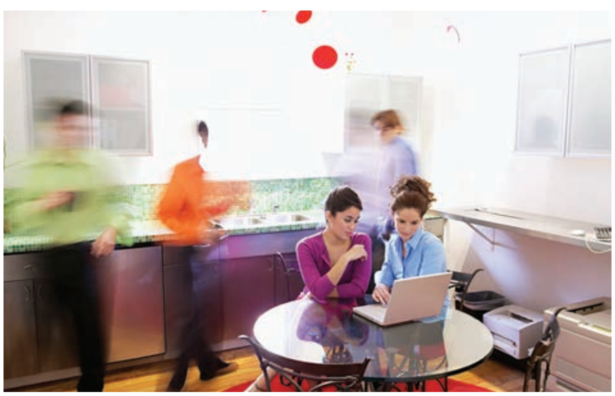
Acquiring a company requires enormous time expenditures — more than most inexperienced business buyers realize until they're in the middle of a deal. If you're contemplating an acquisition, consider doing what many other buyers do to manage the myriad details involved: "Hire" an integration manager (IM).

A critical job

Typically, an IM is a current employee who's responsible for scheduling tasks and helping deal team members accomplish theirs. Your IM will be the point person for the period between the successful close of deal negotiations and the completion of integration, which could span a period of several months to several years. Understandably, finding someone capable of this challenging role — and who actually wants to perform it — can be difficult.

But it's critical that you assign a highly competent individual to the role because integration generally is where M&A deals succeed or fail. Longer- and costlier-than-expected integrations can erase the projected financial savings from synergies (for example, from merging facilities or consolidating suppliers) and turn what seemed like a bargain into a burden.

Part of preserving synergistic advantages is monitoring customer and vendor relationships. If these stakeholders are unhappy about deteriorating service or communications during integration, your IM may need to slow down or change the process to appease them.



Your IM should have high-level managerial experience across several different disciplines.

Your IM also needs to be sensitive to the needs and concerns of employees in both companies. Culture shock, new compensation and benefit packages, and competition for positions in the merged organization are issues that frequently arise during integration. Your IM needs to ensure that the best performers aren't alienated during the process and decide to leave the company.

Attention to hotspots

To get off on the right foot and gather all relevant information, your IM should meet with managers and deal team members at both companies. These meetings provide opportunities to ask questions about timelines, priorities and other scheduling-related issues. Armed with this information, your IM can outline how integration should proceed. The key here is flexibility. Certain tasks are particularly resistant to scheduling and the IM may need to adapt integration timelines around them.

For example, if the acquired company outsources functions to third-party service providers, reconciling and integrating these functions could take time. Your IM should review all outsourcing agreements and determine which functions can be combined (for example, if both your company and the acquired one outsource accounts payable to the same agency), which ones should be brought back in-house and which ones can remain as they are.

Such issues may seem relatively minor, but these are the types of things that can blow up and become integration nightmares. Payment hiccups due to delays in integrating accounting systems, for example, could cause confusion and strained relationships with key customers and vendors.

Important traits

To ensure you assign the right person to the IM role, look for the following skills and experience:

A big-picture perspective. Your IM should have high-level managerial experience across several different disciplines and at least a working knowledge of how information technology, supply logistics, marketing and sales function. It also helps if your IM is generally well respected and has good working relationships throughout the company.

Real-world experience. This individual should be familiar with current federal and state regulations and tax policies — or be able to work closely with advisors on these matters. If your company is making a cross-border acquisition, the IM should be aware of political factors and cultural traditions in the target company's country or hire someone with foreign market expertise.

Outsourcing skills. Your IM can't do everything during integration him- or herself, so someone with micromanaging tendencies would be a poor fit for the role. A far better choice is an individual who's capable of spotting talented employees and communicating what needs to be done.

A tough task

Whatever the size of your deal, your IM will assume a tremendous challenge. He or she needs to manage expectations of external and internal stakeholders while keeping the deal on course and preserving projected cost savings. Don't wait until the last minute to find a competent person for this important role. ■

Where the candidates are

Finding an integration manager (IM) for your M&A is easier said than done. Employees with the skills and experience to serve as an IM generally are rare. What's more, your best candidates may already be too busy managing other aspects of the merger to assume additional responsibilities.

One place to start looking for candidates is in your company's strategic operations or administration areas. Leaders in these departments already juggle multidisciplinary projects and have forged working relationships with employees in other divisions. Or consider offering the job to a retired CEO or COO. Such an individual could devote his or her full attention to the integration — plus, this type of IM would likely be considered a more "neutral" party than an executive who's been embroiled in deal negotiations.

Are there any candidates you should avoid? Individuals who have spent much of their careers in a single job or field may not be the best qualified. For example, a longtime information technology manager may be ill equipped to handle employee morale issues or the smooth transfer of sales relationships.

Treat salespeople like the valuable assets they are

Knowledgeable, experienced salespeople with strong customer relationships are worth their weight in gold — or perhaps the premium paid to acquire their company. So the last thing you want to do as you integrate your acquisition is alienate this valuable group of employees. Instead, focus on convincing sales staff of your merger's merits and involving them in the planning process.

Thwarting the competition

As soon as your deal is announced, competitors are likely to contact your target's customers to persuade them to jump ship, claiming that your combined organization will be too big or bureaucratic to effectively serve them. Competitors will also attempt to recruit your best salespeople.

Even the most loyal employee will consider a competitor's offer if the price is right.

Act quickly to thwart competitors' efforts and reap the benefits that attracted you to the transaction in the first place. Help salespeople communicate the deal to customers by preparing a script that explains expected changes and how customers will benefit. Include FAQs and provide the name of a person in the organization who can answer questions your sales staff can't.

Face-to-face meetings

Also be sensitive to the morale in the sales department. It's not enough to communicate upcoming events via e-mail. CEOs of both organizations need to meet face-to-face with their salespeople as soon as possible to address rumors, reassure employees of their job security and discuss potential opportunities within the merged organization. Keep these presentations short and spend time listening to employee concerns.

Salespeople will — above all — want to know how the deal will affect them. For example:

- Will the sales forces of the two companies be combined?
- Will salespeople now be expected to sell the other company's products or services?
- Will compensation and benefits change?
- How will the new sales department be structured, and who will manage it?

If you don't know the answer to a question offhand, promise that you'll respond as soon as possible — then keep your word. Following these meetings, salespeople can return to their work and communicate a consistent message to existing and potential customers.

Financial incentives

Even the most loyal employee will consider a competitor's offer if the price is right. So consider financial incentives, if you hope to retain top sales producers (and their customers) and encourage staff to cooperate with new colleagues and share knowledge.

Offering retention bonuses and rewards for maintaining and increasing sales — in addition to existing compensation plans — can help. Make such incentives easy to understand and clearly achievable. While interim bonus programs may be expensive in the near term, they can prevent sales from dropping off during the merger process. And they will help you generate far more long-term revenue to offset the immediate cost.

Ask the real experts

Because they work in the trenches, salespeople may have cross-selling and other ideas. Create a temporary sales leadership team to evaluate possible downside risk and increased sales potential. The team should include two to four seasoned salespeople who focus their efforts on retaining customers and maintaining sales during the integration.

There are many ways the team can help accomplish these goals. It can serve as a clearinghouse for customer concerns and employee confusion over the future of product and service offerings. Team members also might have ideas for new product and service offerings or combinations. Sales leaders further can be valuable in identifying and monitoring at-risk accounts.

A fragile link

Although all personnel affected by a merger deserve honest communications and an opportunity to voice their concerns, it's particularly important to keep salespeople in the loop. Your sales staff is your direct link to customers, and this link can be broken if it's not handled with care. ■

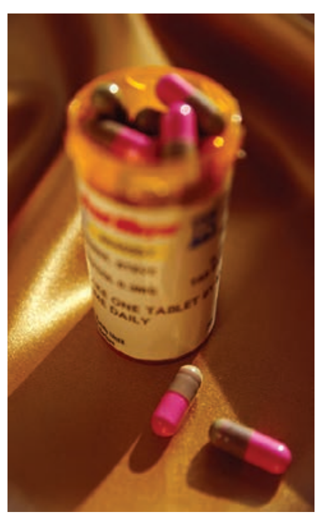
Why sellers shouldn't go to their M&A deal "sick"

If you think that selling your troubled company will solve issues such as entrenched employee conflicts or a deteriorating market position, think again. Going into an M&A deal "sick" can lead to all sorts of transaction problems — which easily could cause the deal to collapse before closing.

It's true that some buyers specialize in acquiring financially or operationally ailing companies to turn them around for a profit. But if you hope to receive a fair price for your business, it's better to get your internal affairs in order *before* going to market.

Stress fractures

Some buyers are willing to overlook minor dysfunction, particularly if they're buying your business to



eliminate competition or for other strategic purposes. But extreme stresses and conflicts will turn off many buyers. Most generally fall into one of two broad categories: internal or external conflicts.

Even if a company looks attractive from the outside, a "rotten core" eventually will lead to its collapse. For that reason, most buyers are wary of severe organizational instability. For

example, longstanding compensation disagreements between top salespeople and management could lead to an en masse departure — with the salespeople taking valuable customer relationships with them. Or continual battles between divisions or departments for capital resources could create an entrenched culture of distrust and disunity.

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Not only do external conflicts cost time and money that could be better spent growing the business, but they also create public relations problems. Examples include disagreements between a company and government agencies over underpayment of tax or regulatory violations, or outstanding litigation between a company and former customers or employees.

Mending a broken strategy

Selling is an opportune time to examine your company's health and value. Remedying underlying issues strengthens your rank as an acquisition candidate and helps you avoid a potential downward spiral into a distressed sale or bankruptcy. Take the following steps to present a more positive image:

Perform a triage assessment. Identify the most dangerous financial and legal situations that your company currently faces. Which ones could cost you the most in terms of lost revenue or tax exposures? Which problems are the most complex to address or require the most parties to help resolve?

Prioritize actions. Once you've determined the extent of your problems, prioritize which ones *must* be fixed. For example, you might decide you have to replace an executive responsible for internal conflict and who you believe will project a negative image to potential buyers. Or you might want to sell underused equipment to pay down debt on your balance sheet. Also prioritize problems that can be resolved fairly quickly and easily, such as settling a wrongful termination lawsuit out of court.

Craft a recovery story. You're probably not going to solve all of your problems before selling, so focus on crafting a positive narrative. When you speak to buyers, you'll want to acknowledge obvious bad decisions, but explain how you've revised faulty strategies. Highlight problems you've addressed successfully to turn them from value detractors to value enhancers. Emphasize areas where a buyer could profit from further improvements. For example, if your marketing department is short-staffed and inexperienced, a buyer might bring in its own seasoned marketing team.

Position of strength

It's tempting to look at a sale as an escape from deteriorating market conditions and management that no longer knows how to fix its problems. But if you go into the M&A market in critical condition, you're likely to be disappointed by any offers you receive. The bottom line: The more problems you can fix today, the stronger your position will be at the negotiation table tomorrow. ■

Ask the Advisor

Q. Will the new reporting method for goodwill affect my company's merger?

A. In January, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) that provides private companies with an alternate method of reporting goodwill under Generally Accepted Accounting Principles (GAAP). Adopting FASB's standard could reduce the cost and complexity of preparing financial statements for private companies following business combinations. However, this alternate method may prove troublesome if your business is subsequently acquired by a public company and the event triggers revised accounting rules.

Simpler method

When a company's sale price exceeds the fair value of its assets and liabilities, the buyer records goodwill on its balance sheet. According to ASU 2014-02, *Intangibles — Goodwill and Other (Topic 350): Accounting for Goodwill*, private companies can now elect to write down goodwill over a 10-year period — sometimes over a shorter period if circumstances warrant.

By contrast, public companies must run annual impairment tests to determine whether the carrying value of goodwill exceeds its current "fair value." If so, the company must reduce the carrying value of goodwill on the balance sheet and report an impairment loss on the income statement.

Regardless of whether a company is public or private, all businesses must test for goodwill impairment if a triggering event — such as the loss of a key person or an unexpected increase in competition — occurs.

Worst-case scenario

Electing this alternate reporting method may appeal to private businesses hoping to save time and money. However, if a private business is acquired by a company that's required to include its acquisition's historical financials in a new SEC filing, the accounting can get complicated.

Under current rules, a public buyer has to revise all of the acquired private company's previous goodwill amortization, which could require a major accounting expenditure. So if you adopt the new accounting standard, it might make your private business less attractive to certain public company buyers.

Hard decision

FASB currently doesn't offer a transition plan for private businesses that adopt the new accounting standard and are subsequently purchased by public companies. However, many analysts expect that FASB will extend the alternate reporting method for goodwill to public companies (as well as nonprofits) in the future.

If you're considering selling your private business, discuss with your financial advisors the benefits of adopting the alternate reporting method for goodwill against the potential headaches of retroactively undoing it. ■

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Everingham & Kerr, Inc.

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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 over 350 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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