Merger & Acquisition Focus

Year End 2017

An asset sale *can* be to your company's advantage

Shifting gears
Be flexible about changing M&A objectives

M&As aren't personal — don't let them become so

Ask the Advisor

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

An asset sale *can* be to your company's advantage

Even if your company offers strong growth potential, a business buyer may actually be more interested in something more tangible. For some buyers, an acquisition's value lies in a specific set of assets.

Companies with valuable assets are in a strong position when negotiating a potential sale. Both parties, however, need to ensure that the deal preserves asset values for the buyer while providing fair compensation for the seller.

Hidden assets

For some buyers, hard assets, such as real estate, are the main draw. Many business owners don't realize that office or production facilities or investment properties peripheral to the business have appreciated significantly since they were purchased. If your region is experiencing a real estate boom, such assets could raise much-needed cash. Large equipment is another potential source of value — particularly if it's already operated by trained personnel who can run it without significant downtime during an ownership transition.

In the technology, media/communications and other sectors, intellectual property (IP) can be extremely desirable. If you own patents and copyrights, even inactive ones, a buyer may want to pay for them.

Finally, consider the value of your ownership stakes in other businesses. Yahoo's merger with Verizon was driven in part by the latter's 15% stake in China's massive online retailer Alibaba.

Framing the jewels

Before you put your company on the market, review your assets and rank them in terms of potential value to buyers. A third-party appraiser or providers of asset-based lending or sale leaseback capital can help you arrive at reasonable market values. It's important to be vigorous in your assessment, as some assets that may initially seem insignificant could be precisely what a buyer is looking for. To that end, research recent acquisitions in your industry to gain an understanding of the kinds of companies and assets that seem to be in high demand.

If, when you're ready to sell, a prospective buyer expresses interest only in certain assets, don't reject the proposal out of hand. Buyers often keep their acquisition strategy private during deal negotiations. But you can probably gain insight into a buyer's motivation by the types of questions asked and where its deal team devotes due diligence efforts.

If selling just assets doesn't appeal to you, you can still push for a full acquisition by demonstrating how your company's assets are connected to those of the larger company. For example, the value of a trademark may depend on your research and development staff's continuing involvement. Or a real estate holding that benefits from tax breaks

Make reps and warranties ironclad

The representations and warranties document is a heavily negotiated aspect of any M&A deal agreement. But when asset transfers are core to a business buyer's strategy, the wording of this document must be ironclad.

Say that a seller wants to use a particular trademark postmerger. The reps and warranties document would need to guarantee this option and lay out exactly how the trademark can be used. For example, the buyer would be instructed to license the trademark to the seller after the transaction closes.

Other issues to address in a reps and warranties document are:

Ownership status. Does the seller fully own the assets it's selling? Do other stakeholders need to be part of the transaction? Are there liens on these assets?

Protections. Are all copyrights and trademarks legally secured? Does any intellectual property infringe on the rights of a third party?

Seller obligations. What obligations does the seller have to help the buyer ascertain and secure asset ownership? What are the buyer's rights in the event of lawsuits or other indemnification related to particular assets?

negotiated between the current owner and a municipality could become void if the property is transferred to another company.

Potential hurdles

The transfer and sale of a company's assets can be complex and should be worked out in detail with professional advisors. (See "Make reps and warranties ironclad" above.) Among the issues you'll need to address are:

Document transfer. This can be a particularly contentious subject because IP might have been developed jointly with another party no longer affiliated with the selling company. So there may be restrictions on the transfer of such assets.

Taxes. Asset sales usually impose a heavy tax burden on sellers. It may be worth negotiating a deal for stock in your buyer's company instead. Also watch out for unanticipated local and state taxes that may be triggered when you sell real estate.

Antitrust obstacles. State and federal regulators may treat the transfer of asset ownership as a red flag and decide to investigate your deal. That's because acquiring new IP can give a company too great a competitive edge in a particular sector — for example, if a buyer acquires software that's essential to many of its competitors' products.

Working out assets

Asset sales can be a good deal for sellers, depending on your objectives. But such transactions are different from full company M&As, particularly from the perspective of minimizing taxes and transferring ownership. So be sure to work with advisors with experience in this area. ■

Shifting gears

BE FLEXIBLE ABOUT CHANGING M&A OBJECTIVES

Sometimes an M&A deal ends up not only in a different place from where it started, but in a different guise. Whether it's due to shifting market conditions or other unforeseen factors, a buyer's acquisition strategy may change during the course of deal negotiations. For example, a transaction initially intended as a full company sale might become a division spinoff or strategic partnership. The key to success when objectives change is for deal parties to remain flexible.

Evolutions happen

What makes a prospective buyer change its acquisition objectives midstream? Due diligence might reveal that the selling business, which seemed like an ideal fit, would in fact be difficult to integrate. Or a seller may have more debt obligations or unprofitable product lines than its potential buyer realized.

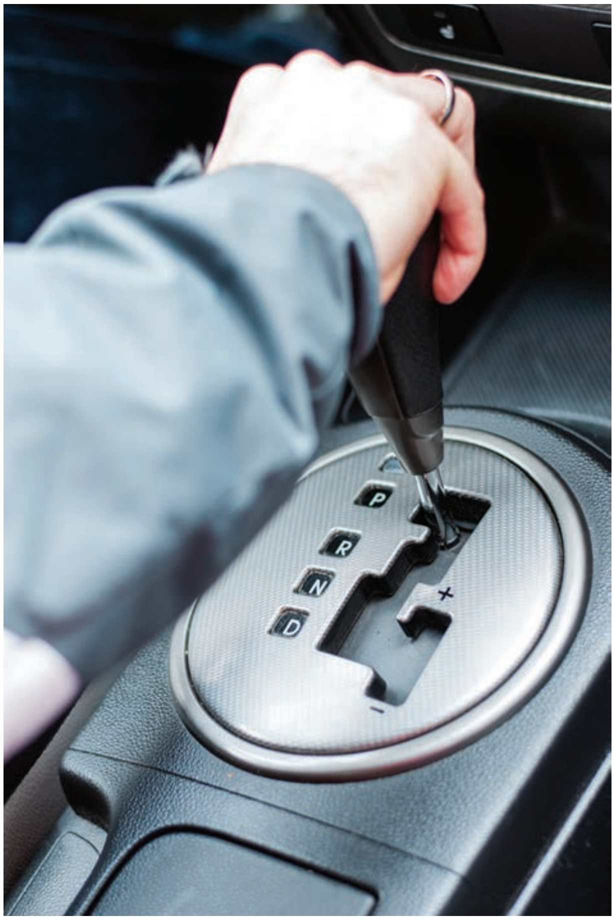
In many cases, such issues can be worked out before or after the deal closes. But it may make more sense to recalibrate the deal — particularly if the buyer is primarily interested in one particular division. In that case, a spinoff of that division might be in everyone's best interests. The buyer would pay only for a unit that suits its strategic model and the seller would receive a cash infusion and retain its core business.

When partnerships make sense

Here's another scenario: After initial discussions with a buyer about a full sale, a seller gets cold feet or simply prefers a slower integration. So it proposes a strategic partnership instead of an acquisition. Forming such a partnership can provide a structure for potential buyers and sellers to learn how to work together. The two may share common principles, such as administrative resources or raw materials. More important, their collaboration enables them to work out any cultural integration issues.

Strategic partnership agreements often contain a clause allowing the buyer to make an ownership bid after a specified period of time. Agreements can also be informal and allow the relationship to evolve and possibly dissolve at a certain point.

Trouble coming up with the funds to make an acquisition also occasionally forces buyers to recalibrate. If the financing it needs isn't available, a



buyer might take a minority stake in a company as part of a longer-term acquisition bid.

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Scaling up

Changing objectives don't always result in a more limited deal. In some cases, buyers and sellers discover during early discussions that there's more potential value in a transaction than they thought. What originally was intended to be a partial acquisition or a strategic partnership may become a full sale.

If this occurs, the parties may need to restart the deal, either because the buyer has to secure additional financing or the seller needs its board's approval to make a full sale. But if the price is right and the value proposition is clear, such obstacles usually aren't difficult to overcome.

Greater good

Although M&A transactions with clear, unchanging objectives often close faster and with less hassle, they aren't always possible. Both buyers and sellers can benefit by entering into negotiations with an open mind. That way, if issues arise, the participants will have the flexibility to make the best deal — regardless of how much it differs from their original conception. ■

M&As aren't personal — don't let them become so

It happens sometimes. Weeks of planning and a smooth due diligence stage are followed by several tense, even hostile days at the negotiating table. At this point, it's obvious to everyone involved that personality conflicts are likely to kill the deal. Maybe the two owners are like oil and water, or the founder and first-time seller feels insulted by the buyer's experienced acquisition team.

Although personal dislikes or disagreements shouldn't prevent solid M&A deals from going forward, they can if you're not careful. Selling — and even buying — a company can be an emotional process, so it's critical for owners to remain as objective as possible and rely on the cooler heads of their professional advisors.

Just business

You're more likely to get what you want from a deal if you know what that actually is. Take time to identify your goals, and your tactics for reaching them, before you put your company on the market or start looking for an acquisition target. If you remain focused on these goals as the transaction proceeds, your deal is less likely to become sidetracked by your emotional responses to the topsy-turvy M&A process.

If, for example, sellers hope to realize an above-market price, they need to be able to speak confidently about their business's strengths and address any perceived weaknesses. Buyers gain negotiating leverage by highlighting an acquisition target's weaknesses, so sellers should prepare good arguments and not allow themselves to take offense at any perceived criticism of their leadership.

By the same token, buyers should focus on specific weaknesses — supported by numbers and facts — that affect value, and avoid blaming the company's owners or executives for poor management. Diplomacy is essential in such situations.

Cordiality counts

You don't have to become your buyer's or seller's best buddy, but a cordial relationship can go a long way toward a satisfactory deal outcome. Dinner or another social outing can help break the ice. If you're talkative by nature, speak less and listen more, and express interest in the other party's opinion. Retaining a good sense of humor further helps build a working relationship.

Going back on your word, exaggerating points or misrepresenting facts in an attempt to strengthen your position, on the other hand, can damage goodwill. And don't try to box the other party into an untenable position during deal negotiations. It could backfire with the other side walking away.

The principled process

A principled negotiation process also can mitigate conflict. Don't think of the deal as a game you need to win, but as something that can result in *both* parties walking away satisfied. To achieve such an outcome, consider:

Separating style from substance. Different communication styles (for example, analytical vs. emotional) often lead parties to believe they've reached an impasse, when in fact the substance of what they want is similar.

Focusing on interests. Taking extreme positions for leverage can make negotiators lose sight of their true goals or interests.

Seeking win-win solutions. Compromise and a show of good faith are critical if both parties are to "win."

Relying on facts. Founding, long-time owners, in particular, often are emotionally attached to their company and may feel insulted when a buyer doesn't agree on its value. By sticking to industry standards and other objective measures, you can avoid personalizing what is, after all, a business transaction.

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Finally, if you reach the point where you feel you can't communicate with the other party and are ready to give up, remember that you can always lean on your M&A advisors. These professionals lend a degree of detachment to the deal process that interested parties obviously lack and they have experience negotiating in adversarial situations. If necessary, empower your advisors to make decisions for you.

Be sensible

No one benefits when personality conflicts prevent closing a deal that otherwise makes sense. Before you enter the negotiating room, discuss your strategy with your advisors and be prepared to turn the controls over to them if discussions become hostile. ■

Ask the Advisor

Q. How might international volatility affect my foreign acquisition?

A: These days, U.S.-based companies planning overseas acquisitions need to prepare for regulatory snags. Political flux in Europe and Asia won't necessarily make cross-border deals more difficult. But you need to be aware of how regulations have — or might be — changing and keep on top of them.

Before attempting a foreign acquisition, make sure you're familiar with all M&A enforcement authorities and know which ones require approval before you proceed. This means identifying every country or region where your target has a business presence, even if the company isn't domiciled there.

Shifting perspectives

The global merger enforcement landscape is different today from what it was five years ago, and will be changing in years to come. In particular, pay close attention to:

Brexit. When the United Kingdom leaves the European Union (possibly by 2019), Britain will need to establish new M&A enforcement rules with requirements potentially different from those of the EU.

European Union. The European Union has a reputation for being more aggressive than the United States when it comes to deals it believes have monopolistic potential. Google's recent record-high antitrust fine may signal that the European Union is planning to take a harder line in the future on what it perceives as competitive abuses.

China. As recently as a decade ago, the Chinese government imposed only minor regulatory restrictions on M&As. Since then, the Chinese Minister of Commerce (MOFCOM) has become more assertive. China is known to delay deal approvals by requesting extensive information and documentation. Transparency about MOFCOM's decision-making process has also become an issue.

Local advice

To execute a foreign acquisition successfully, you should have knowledgeable sources in the target company's country or region. Consider hiring local advisors or an international law or investment banking firm with extensive global operations and a proven record of obtaining approval for acquisitions made by U.S. buyers.

If antitrust issues arise, your legal and financial advisors can provide you with inside information on the type of divestments that might be required. They can also warn you about potential cultural miscommunications with regulatory officials and give you a sense of how long the approval process might take.

Being prepared

Cross-border M&As are challenging enough during times of relative stability. But when regulatory regimes are shifting, it's all too easy to make deal-delaying or deal-killing errors. Establishing local contacts and hiring legal advisors in the target company's country can help prevent serious holdups.

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 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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