# Merger & Acquisition Focus

February/March 2018


The future is (almost) now
Blockchain makes big promises to M&A dealmakers

Winning the hearts and minds of your new sales staff

Tuck-in acquisitions take work to succeed

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

# The future is (almost) now

## BLOCKCHAIN MAKES BIG PROMISES TO M&A DEALMAKERS

Blockchain is a new database technology that enables users to share constantly updated documents across a network. It promises unprecedented efficiency and seems poised to make M&A negotiations and due diligence faster, more accurate and cheaper. Within a few years, blockchain code might even potentially verify and execute merger agreements. But does the reality of blockchain live up to the hype surrounding it?

### Authenticated data

Blockchain, also called “distributed ledger technology,” was first used in 2009 to support digital currencies such as bitcoin. Entries in each digital ledger are stored in blocks, and each block contains a timestamp and provides links to the previous block.

The financial industry quickly recognized blockchain’s potential: Users could transact business without banks and other third parties. A blockchain typically is managed on a secure peer-to-peer network with protocols for validating blocks. Once recorded, data can’t be changed without altering all other blocks — which requires approval by a majority of network participants. Blockchain proponents argue that this process essentially authenticates all information entered.

Since it was introduced, blockchain use has grown significantly. A 2016 IBM survey of 200 world banks found that 15% expected to have blockchain in commercial production by the end of 2017 and 66% said they would by 2020.

*With blockchain, merging parties would have more time to devote to integration matters that require a human touch.*

### Merger implications

The M&A implications of “smart contracts,” in which blockchain protocols verify and execute contract terms, are obvious. As blockchain’s conditional logic grows in complexity, it could become a means to verify and execute many kinds of contracts and deal agreements between buyers and sellers. Such capabilities promise mergers that are exponentially faster than they are now. Financial transactions conducted via blockchain can be executed within seconds — and without a bank intermediary.

Currently, due diligence is one of the more expensive and time-consuming phases of an M&A deal. But by shifting due diligence documentation to blockchain, financial and legal advisors wouldn’t have to spend as much time poring over

## Making earnouts work smarter

Earnouts — in which business buyers make installment payments to sellers based on the acquired company's postdeal performance — are one area where blockchain technology is almost certain to lighten M&A deal workloads. By using smart contracts built on a blockchain, earnouts can run faster and with little buyer oversight.

Where today's earnout provisions may stipulate payment at the end of an agreed-upon period, a smart contract can automate payments whenever agreed-upon conditions are met. Say, for example, that an earnout is structured to pay the seller a percentage of the buyer's revenues when the acquired retail business clears an agreed-upon sales goal. Any transaction that clears its point-of-sales system could, via a blockchain contract, trigger the transfer of a percentage of that purchase to the seller's bank account.

Earnouts can be a hard sell for some M&A deal participants. By reducing the potential burden of administering an earnout, blockchain could make them more appealing for both parties in a deal.

records. Both parties to the deal, therefore, could see major cost savings. And with a "self-driving" blockchain running the contractual end of the deal, merging parties would have more time to devote to integration matters that require a human touch.

### Pitfalls

That said, blockchain's promise to radically change the way dealmakers execute M&As is still just a promise. Even as the technology becomes more sophisticated, certain parts of a merger transaction are unlikely to be affected, including deal negotiations (where face-to-face meetings are preferred) and physical inspections of facilities.

There are also several unresolved issues concerning blockchain and M&As, such as:

**Legal and regulatory implications.** Banks and regulators still need to hash out what kind of access regulators should be allowed to have and reviewing processes they should follow with transactions executed via blockchain.

**Database security.** Storing sensitive information about a business in blockchain code could be risky in this era of heightened cybercrime. Hackers would need only a user's private key to infiltrate the blockchain.

**Need for emergency brakes.** Some experts wonder whether a blockchain transaction can be stopped if it becomes unnecessary or perilous. Deal parties may need to develop protocols for throwing the kill switch.

### Cultural changes

Blockchain technology sounds exciting, but the fact remains that it has yet to be used in an M&A deal. One obstacle is cultural resistance to change. Just as people have only slowly begun to accept the idea of driverless cars, companies tend to be wary of trusting significant transactions to a "driverless" process.

It could take many test runs before the average business buyer or seller feels comfortable using blockchain. But in the long term, the technology is widely expected to become a standard M&A feature. ■

# Winning the hearts and minds of your new sales staff

As soon as you announce an M&A deal, your competitors could be on the phone with your target's customers trying to persuade customers to jump ship. They may claim that your combined organization will be too big or bureaucratic to effectively serve them. Competitors will also attempt to recruit salespeople — spreading rumors that you'll fire staff, raise sales quotas and promote people from the new organization over them.

To thwart competitors' efforts and keep the customers essential to your deal's value, you need to win the hearts and minds of new sales staff as soon as possible.

## Making plans

If you've waited until the deal is announced to think about sales department employees, you may have waited too long. Ideally, you should develop a communications plan for salespeople in each organization early in the merger process. Among other things, the plan must explain the deal's rationale, its anticipated benefits for employees and changes staff can expect.

Even before the deal is made public, work with sales staff to prepare 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 sales staff can't.

## Providing answers

It's not enough to communicate upcoming events via email. CEOs of both organizations need to meet with their salespeople in the first week following the deal announcement. A face-to-face meeting is particularly important for the acquired sales force. As you talk to employees, focus on reducing fears

about layoffs and creating enthusiasm for new opportunities the merger will provide. You also want to ensure that everyone in sales will send a consistent message to existing and potential customers.

Make your presentation short, and spend the rest of the time listening to employee concerns and answering questions. 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 they now be tasked with selling 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 you'll respond as soon as you can — then keep your word. And if you plan to cross-sell or combine products or services, arrange to provide training. This helps salespeople more effectively present your offerings to customers and reminds them that you'll continue to provide them with sales support.

### Rewarding loyalty

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

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 and integration process. And they'll help you generate far more long-term revenue to offset immediate costs.

### Encouraging ideas

Because they work in the trenches, salespeople may have ideas for capitalizing on your expanded offering. Create a temporary sales leadership team to evaluate possible downside risk and increased sales potential of the deal. The team should include two to four top sellers who are taken off their regular responsibilities and tasked with retaining customers and maintaining sales momentum during integration.

The team should serve as a clearinghouse for customer concerns and competitor strategies and be available to other employees to clear up confusion over the future of product offerings. They might also develop new product and service combinations based on customer feedback and demand. And, if they spot at-risk accounts, look for ways to retain them. Finally, it's important that the team frequently update messages and strategies as the deal progresses and competitors' tactics change.

### Discouraging departures

When companies merge, some employee departures are usually inevitable. But if the success of your deal rests on customer retention — and most deals do — make sure you have a plan to win over and keep top-performing salespeople. Your M&A advisor can help you with integration challenges involving sales teams. ■

# Tuck-in acquisitions take work to succeed

"Tuck-in" acquisitions occur when a larger company acquires a smaller one with similar products and services and folds that business into its existing operations. Although popular, these transactions don't always run as smoothly as their name might imply. That's why buyers and sellers need to work together to ensure that the company is integrated fully and quickly following closing.

### Strategic impetus

Buyers in particular tend to regard tuck-in deals as being a simpler proposition than a merger of relative equals. Sellers may have a smaller operational scope or may be at an earlier stage of development, but they usually share other characteristics with their buyer. The strategic reasons for acquiring such targets are generally straightforward: to enhance the buyer's business model.

Here's a common scenario: A software manufacturer offering a line of enterprise solutions wants to expand its portfolio of offerings and its market reach. Instead of trying to develop niche software requiring specialist expertise and considerable resources in-house, it makes a series of tuck-in acquisitions of small software developers. Upon acquisition of these businesses, the buyer is ready to sell the new products.

## How, what and who

Although such acquisitions seem like they could be easier to integrate, there are likely to be plenty of postclosing challenges. Before committing to buying a particular company, buyers should ask the following questions:

**How quickly can the seller's product lines be adapted by your company?** Will you need to redesign products before putting them on the market with your own name? If the product is software, is it technologically compatible with your existing portfolio? Any incompatibility adds time and money to the equation.

*Anytime a customer sees the "joins" of a tuck-in deal, it's a potential danger point.*

**What factors have gone into the product's success in the past?** If location or a business owner's relationships have fueled sales in the past, you may have trouble duplicating the results unless you bring new value propositions to the table.

**Who will be responsible for the new unit?** If you plan to hand over control of the acquired business to your managers, how well will they work with the seller's employees during integration and afterward?

**Will the integration process be too disruptive to the future of the product?** Think about your deal from the perspective of a customer who might worry that sales and delivery transactions will be

less convenient or that prices will rise. Anytime a customer sees the "joins" of a tuck-in deal, it's a potential danger point.

Say, for example, that an acquired unit's customers and vendors will now have to work with your accounting department. You need to ensure that they won't experience greater delays or more bureaucracy than they have under previous ownership. Otherwise, they may start looking for a more reliable vendor or less troublesome customers.

## Team challenges

Consider the human factor, too. It's easy in theory to tuck in a smaller company's team and then resume business as usual. In reality, moving people into a new environment with a different culture can cause friction and discontent. For instance, new employees may resent having to adapt to a more structured work culture or greater staff/management barriers.

To head off such challenges, research your target's business culture during the due diligence process. How are the seller's products or services designed and implemented? Who makes the decisions? Are there existing conflicts between workers and managers that might carry over after the acquisition?

## Protect the deal's value

Once your transaction has closed and you begin integration, any possible deal flaws will become apparent. So take advantage of the negotiation stage and work through issues with the other party. The harder you look for potential problems, the better chance you have of containing them before they diminish the value of your tuck-in deal. ■

# Ask the Advisor

## *Q. Should I consider offering a prospective buyer a break fee?*

**A:** When a business seller isn't quite ready to commit to an M&A transaction but still wants to keep its prospective buyer interested, it can offer a break fee (also called a breakup fee). If the seller doesn't go ahead with the deal, the buyer is reimbursed for its time and deal-related expenses.

It doesn't make sense from a financial perspective to offer break fees to multiple prospects. But if there's a good offer you're concerned about losing, a break fee can be a strong enticement for the buyer to stick around.

### In the seller's court

A seller might have to pay a break fee if, for example, it backs out of a provisional agreement to sell to one buyer to go with a different one. (Reverse break fees, on the other hand, are paid by buyers that breach deal agreements or that can't consummate transactions due to insufficient financing.)

Break fee amounts, and the conditions under which they're paid, generally are worked out early in deal negotiations. Fees range between 1% to 3% of the deal's value, usually depending on the buyer's negotiation tactics and the seller's interest in keeping the buyer on board. If you're particularly worried that a buyer may look elsewhere, you might want to offer a higher fee.

### Strategic advantages

Break fees act as insurance for buyers concerned about the risk of an M&A deal. Some break fee agreements require a seller to pay a buyer if the buyer discovers information during due diligence that diminishes the company's value — or if there are other factors that endanger the transaction.

*If there's a good offer you're concerned about losing, a break fee can be a strong enticement for the buyer to stick around.*

At the same time, you can use break fees to your advantage. These fees have the potential to discourage other buyers from making offers. But they also can help you realize a higher purchase price if you stipulate that subsequent offers include the amount of the break fee you've already offered. Only serious contenders will consider paying more to stay in the game.

### Depending on circumstances

When does offering to pay a break fee make sense? It depends on the state of the M&A market, industry conditions and the details of your deal. So talk with your advisors to determine whether it's likely to work to your advantage to offer a break fee or other enticements to a potential buyer. ■

*This publication is distributed with the understanding that the author, publisher and distributor are not rendering legal, accounting or other professional advice or opinions on specific facts or matters, and, accordingly, assume no liability whatsoever in connection with its use. ©2017 MAFfm18*

# 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.


**Everingham & Kerr, Inc.**

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


**We encourage you to call us at (856) 546-6655 to discuss any of our services in greater detail or visit our website at www.everkerr.com to learn more about the company.**