

[illegible]

et's think on a small scale here as in SMB rather than Fortune 1000-type mergers and acquisitions. After all, that's what most *Mercer Business* readers can relate to. On the other hand, Michael Mann, an attorney with Pepper Hamilton who specializes in mergers and acquisitions says the size of the company isn't necessarily the reason one might engage in a merger or acquisition.



Dan Kerrigan



Michael Mann



Shawn Neufeld

"It depends on your situation," says Mann. "Sometimes it's better to do a merger, sometimes it's better to do a stock acquisition, and sometimes it's better to do an asset acquisition. There are a slew of reasons from taxes to liability to simplicity where you might choose one over the other. That's why you have attorneys and accountants."

There are a couple of reasons for doing a merger.

"You might want a tax-free exchange so all the shareholders of all the companies become the shareholders of the combined companies, in a typically tax-free way," states Mann. "Number two, it allows you to do the transaction without getting 100 percent of the shareholders' approval."

Shawn Neufeld, managing director and head of Mason, Griffin & Pierson's business and banking practice finds acquisitions are more common in the SMB space.

Acquisitions More Prevalent

"Generally [an acquisition] is a more typical transaction. There are instances where related companies merge for specific reasons, but I'm certainly seeing more acquisitions than mergers."

If you're looking to sell your company or merge with another the place to start is with an investment banker or a company that will get you ready for sale or merger.

"They will help make sure all your ducks are in order and help you hire your professionals, which could be getting your accountant on board, making sure your attorney is on board, and making sure all your assets are in place, and there aren't any things that are going to raise issues," says Mann.

They'll also help prepare marketing materials, perform a financial analysis, and depending on how big the company is, prepare a bid package and send it to prospective buyers. What one finds in the market, according to Mann, are different types of buyers.

"There's strategic buyers who would buy a company in a similar line of business, which brings with it the product lines and customers. Or they might buy one of their parts suppliers, for example, in effect acquiring the middleman. That's a strategic purchase."

Then there's an investment purchase such as when private equity investors buy a company, splits it up, maybe bring new management in to run it for awhile, buy other companies, then roll them all together and sell it.

"An investor is going to look for a return based on the cash flow and the earnings of the company," says Mann. "Maybe the company is struggling so they're going to inject new capital in the company."

Get Professional Advice Early

When does an attorney like Mann get involved?

"I like it when my clients bring me in while negotiating the letter of intent," he responds.

The questions to ask at this point are what am I selling and how am I

going to structure it (stock sale, asset sale)? It's also wise to get some tax advice at this point too.

"We might help them on the RFP process finding the right buyer," adds Mann. "When a company I'm not currently representing hires me they're usually hiring me just before or just as they're negotiating the letter of intent."

What should one think about when drafting a letter of intent? Tax considerations are at the top of the list and will differ depending on the type of corporation.

"If you're a C Corp and sell your assets you're going to be taxed on the sales price twice," says Mann. "If you're an S Corp or C Corp there are tax consequences. If you're an LLC the question is are you going to sell your assets or stock? From the buyer side every tax advantage for the seller is a disadvantage for the buyer. That's part of your negotiation."

Is this ever a simple process? "Yes," laughs Mann, "it sounds more complicated than it is, but that's why you

need good counsel and professionals around you."

Dan Kerrigan, CFA, managing director with Management Planning, Inc. also believes the discussion should be more focused on acquisitions rather than mergers for the *Mercer Business* reader.

What's the Difference?

"When you're talking about deals in the size range that attaches to your readership often they are structured as acquisitions and assets," he says. "When you're doing a merger, generally what you're doing is exchanging some of the buyers stocks with the seller's stocks. That usually doesn't happen very often in the lower to middle market. Usually it's a cash acquisition, perhaps with an earn-out component. It's really, give me your stock and I'm going to hand you cash. Or, give me your assets and I'll hand you cash. It's a bit of a nuance but when people think of mergers and acquisitions they don't necessarily distinguish between a pure acquisition and a merger."

For his firm, the best case scenario is when they are brought into the sales process when a sale is not imminent. "We always want to come in before our client engages in any discussions with the buyer because we have a specific viewpoint of how the process should go," says Kerrigan.

Kerrigan's company will also make sure any problems are addressed before the seller gets into any discussions with the buyer.

"The earlier we get involved in the process it optimizes it from a transaction standpoint as well as an ultimate negotiation standpoint," notes Kerrigan. "Invariably we will think of more buyers and find more prospective buyers than the seller just because that's what we do for a living."

Neufeld likes to get involved early on as well. "I usually get involved after a target has been identified whether it's a purchase, sale or merger and then I meet with the client and [discuss] the deal.

Confidentiality Agreement First Priority

"Generally, the first step is drafting a confidentiality agreement—starting the exchange and flow of certain information," says Neufeld. "Then we'll start negotiating a stock purchase agreement or an asset purchase agreement depending on the transaction."

Mann also recommends a good confidentiality agreement, especially if you're negotiating with a competitor. "Think about it, your competitor comes in finds out everything about you—pricing, they meet your key employees, find out who your customers are, who your suppliers are," says Mann. "Depending on how they do the initial diligence, I give them more and more information, but not all at the same time."

Nobody wants to fail in an acquisition or merger and Neufeld identifies the key to success.

Due Diligence

"The key to any successful acquisition is adequate and detailed due diligence. Undertaking a thorough [review] of corporate documents, financial documents, tax documents, and benefit issues is critical so there are no surprises afterwards that people would want to litigate about."

Due diligence is certainly the obvious tact to take and as Neufeld points out the purchaser needs to understand the business they're acquiring.

"If it's a new market they don't understand I encourage my clients, before they get too deep into due diligence, to understand the business. Then you have to understand the tax consequences of the transaction and understand potential unexpected liabilities and employee severance packages. I'd segregate them into classifications of financial and tax issues, benefit issues, employee matters, and then dealing with any contracts you're now going to be responsible for fulfilling as a purchaser."

Have an Accountant Prepare the Books Beforehand

Kerrigan recommends having an outside accountant prepare the books in advance. "You'll learn more before you start negotiating with the buyer, which is always good, and two, it gives the buyer a bit more comfort in the type of data he sees."

There are universal stumbling blocks that businesses anyone—seller or buyer—looking to do a merger or acquisition should be aware of from the start.

"Understanding the tax consequences and valuation issues are two stumbling blocks that are nice to avoid if you can," states Neufeld. "Valuation of the business is an art not a science. It's important that both parties understand the value of what they're buying and selling. If that expectation isn't managed up front you can waste a lot of time in the negotiation of the contract to the point of after due diligence the buyer doesn't think the business is worth what the seller is asking."

"They underestimate the amount of time the seller is going to have to spend on this acquisition," adds Kerrigan. "The less prepared they are going into it, the more time they're going to have to spend with buyers answering questions and so forth."

Have Management in Place for Strong Transition

Another mistake is not being prepared from a management standpoint, especially with private equity buyers.

"They'd rather not buy a company when the sole owner, sole CEO, or sole everything is going to walk away after the deal," states Kerrigan. "They'd like to know there's a management team in place that's going to stay and help make a strong transition from one owner to the next."

Buyers have a different perspective on the acquisition. "They know despite the level of diligence they do before an acquisition there will still be unknowns or items that were open during diligence that were not technically closed," says Kerrigan.

A company doesn't have to be struggling in order to do a corporate merger or acquisition. It can simply be to infuse capital to help it to grow and reach the next level. "If the company is in trouble, maybe it's a different kind of search, you're looking for investors maybe to come in and buy you and infuse capital, or if it's a sale, somebody to run this company and make it successful," notes Mann.

"No matter how well a company is doing and growing at some point it's going to need some capital to grow," says Kerrigan. "So when you see a smaller company doing really well at some point there's going to be a decision point for that owner, do you bring on more money, do you bring on capital to continue this growth or perhaps at this point it's time for someone else to take on that growth path?"

As far as Kerrigan is concerned this is an excellent time to sell and buy, acknowledging that there's a lot of private equity money available even if there's a little less on the lower end of the middle market. "Companies on the market have come through a recession and are a lot stronger and more attractive acquisition targets," he says.

Favorable Capital Gains Rate Ends in 2013

The capital gains rate is also an important factor.

"There's a favorable capital gains rate which sunsets at the end of this year," states Kerrigan. "Beyond 2012 there's a lot of uncertainty at how much you actually net after tax upon selling your business."

With all that said and done, how can one gauge success?

"A successful transaction for the buyer is buying a company that addresses a very important need for their broader business whether it's a product extension or lets them offer additional products and services to their client that would be more expensive for them to replicate so it allows them to continue to grow and feeds within the core competency for the buyer," says Kerrigan. "That's a win for the buyer. For the seller it's selling your business to a party that will continue to employ the capital to feed growth."

"When it's all done, the buyer got what they thought they got and they never called the seller or selling group again," adds Mann. "And the sellers got what they wanted and they never heard from the buyer again."

Is that realistic?

"It happens all the time," concludes Mann. ■