Preparing your company for the M&A process

By Richard Andersen, Michael Bates and Brian Moriarty

When it’s time to exit your business, being prepared and having a well-planned exit strategy can be the difference between a good transaction and a great one. Exiting your business is just as important as how you started it, and planning is essential. Your goal is to maximize the value of your company, make a smooth and profitable exit, and minimize the time it takes to do so. Being prepared for an exit well in advance of the M&A process shows interested parties that you’re in control of your business, that you’re goal-focused, and that from the very beginning you’ve had a plan for an organized and smooth integration. Being prepared for the M&A process also significantly increases the efficiency and speed in which the transaction can take place and plays a huge part in its success.

Start early

Many times companies begin marketing themselves for acquisition too late. Often the growth curve has flattened out or competitors have entered the market before company executives perceive the need to sell and by then company value has diminished. The ideal time to exit your company is at the front end of the growth pattern or when beta product has hit the market. Sometimes the perception is that the company is too young at this point to be ripe for acquisition, but often the opposite is true.

Getting on the radar of serial acquirers

Keep in mind that startup companies are more often bought than sold. Acquirers usually make acquisitions when they’re ready to buy, not necessarily when the company is ready to sell. This means that putting up a “For Sale” sign on your company may not be the best way to look for prospective buyers. Much more effective is focusing on building relationships with companies over time. This can be done by establishing joint development agreements, joint marketing agreements, private label agreements, or reseller agreements. Sometimes the best partnerships are based on purchase orders. Remember that these agreements need to be mutually beneficial to both companies in order to make sense. Be a good partner, show that your company is fair and easy to work with, and these partnerships will have the potential to grow into acquisitions. Partnering relationships can take years to mature, so practice patience.

Prepare for due diligence now

Today’s buyers require more information for increasingly in-depth due diligence in order to mitigate the risks associated with acquisitions. Ideally, officers should begin preparing for the due diligence process on the very first day they join a company. This means having all relevant documents in digital form and organized in a secure “need-to-know” environment, which can be anything from a drive on a server to a virtual data room. The advantage of a virtual data room is that it can be tightly controlled by the managers of the information itself and not IT managers. With critical information organized in advance, it should be possible to have a virtual data room up and running over the
course of a weekend in response to a deal opportunity. When a buyer is ready, timing is everything, so be ready when they’re ready.

The virtual data room

Physical data rooms are a relic of the past and for good reason. A data room that is online, indexed, secure, and fully searchable increases competitive bidding, enables more informed and more competitive deal-making, and enhances optimal transaction outcomes. And frankly, it's what today's buyers expect.

When the due diligence process is automated and multiple buyers can review the same electronic documents at the same time, sellers can conduct simultaneous, fully confidential due diligence cycles and host unlimited numbers of bidders without extending transaction timelines. The result is a more competitive, better-informed deal environment resulting in higher bids.

A virtual data room allows buyers to easily locate and view the content that they need to perform due diligence and make an informed decision about acquiring the company, but this activity also has a very real advantage to sellers. Because buyer activity in the virtual data room is fully trackable, sell-side managers have the ability to analyze buyer behavior and gauge interest levels. Such intelligence can reveal important information about a buyer's concerns and interest levels and enable the seller to adjust negotiating strategies if need be. It can also inform the seller of key questions the buyer might raise when meeting face to face.

Compiling due diligence documents

A good way to begin compiling due diligence documents is to get a due diligence checklist from a lawyer or investment banker. Begin compiling those documents into a comprehensive data room. These documents can run in the thousands, even tens of thousands of pages, so preplanning is essential.

In addition to a due diligence checklist, employ a common sense approach by putting yourself in the shoes of the buyer. Ask yourself, “If I was a buyer interested in acquiring this company, what would I be interested in seeing?”

A good practice is to compile a CFO memo that addresses many of the basic items on the due diligence checklist, including the company’s legal structure, methods of distribution, board composition, key service providers (audit, tax, General Counsel, IP Counsel), status of tax years, and key consultants. For anything there is a lot of (distributors, consultants, etc.) it’s a good idea to do a summary spreadsheet that gives a macro view of that information.

Because due diligence information about your company is, by definition, the facts about your company, some of it will inevitably be negative. Prepare early on how to address these issues. If the issues are open-ended, provide documentation on how they are being addressed. If the issues have been satisfactorily dealt with (a settled lawsuit, for instance) show how they have been handled. Remember that it’s important for the buyer to understand the historical aspects of what the company has been through and how these issues have been resolved.

The objective, of course, is to avoid surprises late in the merger process. When preparing documents for inclusion in a virtual data room it’s essential that you work with other departments to ensure that all relevant information is available. Surprises late in an M&A process will generally result in a renegotiation at terms that are less favorable. If at any time during the due diligence process it’s discovered that important information is missing from the virtual data room, immediately supplement that material and make it available to all interested parties. By providing comprehensive due diligence materials to potential buyers you’re ensuring that the process for them is as easy as it can be. The easier the due diligence process is, the more likely it will result in a favorable offer.

Ensuring that the virtual data room is accurate and as comprehensive as possible can also have ramifications after the sale. For example, if an escrow fund has been set up and surprise expenses arise that relate to the prior ownership, they are most often charged to the escrow fund. However, if the matters in question were fully disclosed in the data room the seller can make the argument that the issues were known at the time of the sale and were therefore accepted by the buyer.

The role of corporate development groups

Corporate Development can refer to a wide range of corporate strategies designed to meet a variety of organizational objectives. In general, however, corporate development groups serve internal clients by identifying business gaps and proposing new areas of development. This can include everything from recruitment of new management teams, to establishing relationships with strategic business partners, to acquiring companies and increasing intellectual property. Usually corporate development groups are facilitators rather than decision makers and often have limited involvement after a deal has closed.

So, what are the signs that a corporate development group may be interested in your company? Typically, there are a series of events that may not always be obvious, but are generally at least detectable. You may begin to hear the word “acquisition” more often and in earnest. You will likely be asked for specific data as the buyer begins to build a business case and financial plan. There may even begin to be some
“price soundings” as the buyer begins to evaluate the worth of your company.

Your role as a seller is simply to provide the corporate development groups with the information they need in order for them to make an informed recommendation and to be ready when the buyer is ready. This means having due diligence data organized, secure and accessible.

The role of investment bankers

Not every M&A transaction involves a sellside investment banker, however, in many circumstances the right investment banker can add significant value. When selecting an investment banker it’s imperative to find one with expertise in your industry and one who has significant experience with similar transactions. Think of investment bankers as individuals. In other words, hire a banker first and a firm second. Like a good lawyer, it’s more about the individual than the firm you’re employing. If that person were to change firms, you would most likely follow them. Also consider the banker’s relationships with your list of possible buyers.

Another important factor to consider is the compatibility of your deal size with the size of the bank. If you have a small company and hire a large investment bank, your transaction could be assigned to a junior banker and you may not see much of the senior banker who courted your business originally. By picking a firm that’s appropriate for your size company, you’ll find that you’re an important deal to them and you’ll be more likely to get the kind of service you expect.

Two important things to consider when looking at investment bankers are how to structure the fee and the issue of how long a tail you should have in place on the relationship.

The fee structure can be a flat rate or can be tiered. A tiered structure is often preferred because it rewards performance. In a tiered fee structure you might start out with a lower percentage for a certain amount of value and then have higher percentages as value levels increase. This way the banker has a higher incentive to drive the deal to a higher sale price.

The length of the tail should be as short as possible while still being reasonable. Typically, bankers will start off asking for an 18-month or 2-year tail on the relationship. In the eventuality that no buyer comes forward you don’t want to be committed to that particular banker in perpetuity. So, keep the tail relatively short. It’s also a good idea to cap the banker’s expenses.

Sharing sensitive intellectual property

An important consideration when choosing a virtual data room is deciding to what extent and when you will share sensitive information about your company. Your goal is to empower the buyer to learn everything they need to know about your company in order to make an informed decision, however, not all buyers will enter the process with the same interest level and some documents shouldn’t be shared until later in the process when interest levels are more defined. Remember, some buyers may also be competitors, so giving away sensitive intellectual property indiscriminately could be very detrimental.

Your intention is to secure the highest price for your company, but keep in mind that it’s also imperative that the value of the company is preserved. Giving away too much information can jeopardize company integrity. Remember, you are the custodian of the company’s intellectual property and it’s your job to ensure that information is distributed responsibly. Exiting your company profitably is important, but it’s also crucial to ensure that the buyer comes out on the other side with substantial value. Buyers don’t always understand this and will sometimes request more information than is appropriate. If a buyer asks for information that is inappropriate for them to see at a particular stage of the process you may have to say to them, “I hope you win this transaction and...”
what we’re trying to do is preserve the ultimate value that you will realize when you acquire the company.” Buyers should understand that access to more sensitive information is earned over time and is often granted based on the seriousness of their interest in acquiring the company. Buyers should appreciate that by limiting access to sensitive information you are ultimately preserving business value. Top secret information is generally not made available until the end of the acquisition process when it’s clear that a deal is imminent. Because different documents have different levels of sensitivity being able to regulate access to those documents is essential. Your company has public information, or information that anyone doing their homework could find out without access to the data room. Then there are the more private documents—information you wouldn’t normally share without a non-disclosure agreement in place. And finally, top secret information, or information that has the potential to harm your business if a competitor got to see it. A quality virtual data room makes it simple to add users and the permissions to documents available to them on the fly. Remember, as the seller you control the process and get to decide who sees what and when.

The modern virtual data room allows you to manage all levels of document sensitivity with complete security. You will be able to decide which parties get to see which documents as well as whether the documents will be downloadable, printable, or have read-only access. In addition, these permissions can be changed or updated at any time during the due diligence process.

Management presentations
In addition to having a comprehensive data room in place for due diligence, it’s important that the various management teams of the company are prepared to give presentations to prospective buyers. Management presentations are usually done offsite, typically at law firms, where the firm provides a conference room of the appropriate size. These presentations don’t have to be elaborate, but should be planned well in advance and can even be rehearsed. Management presentations should focus on department functions, past accomplishments, future goals, and synergies that drive value.

Final offers become due
When final offers become due buyers may perceive this as the end of the process, however, if multiple buyers exist this can sometimes be the beginning of another phase of negotiations. At this time it’s still possible to get buyers to increase their offers. During this process you may enter periods of exclusive negotiation, which is a signal to other buyers that the company is in serious negotiations to be sold. From the buyer’s perspective, if bankers go silent and are no longer able to answer questions, it means that another buyer has entered an exclusive
arrangement and the deal is at very high risk of being lost.

When considering offers, always balance the certainty of value against the certainty of closure. A higher offer may end up being less attractive than a lower one if the higher one has to go through a lot of regulatory hoops. Ideally, you’re looking for more cash and the least amount of contingencies for receiving that cash.

Closing matters
Once your deal is cemented the buyer will most likely have some conditions to close. In other words, they will want you to fill some gaps and plug some holes.

It’s a good idea to spend the necessary money here and settle these issues quickly. It may also make sense for the sellers to set aside a small fund from initial proceeds to allow a shareholder representative to hire professionals, if necessary, to enforce the sellers’ rights under the merger agreement. This side fund can later be distributed to the selling shareholders once enough time has passed that all contingencies have been resolved. You may want to keep the virtual data room up and running to help facilitate some of these issues.

Conclusion
Remember that it's never too early to beginning preparing for the due diligence process. A comprehensive virtual data room is your best bet for ensuring that you're reaching the most appropriate potential buyers for your company and that you're providing them with the information that will help them make an informed decision that they're comfortable with. Today's modern virtual data rooms, like ShareVault, provide a due diligence platform that is intuitive, easy to use, completely secure, customizable to your needs, available 24/7, and will help ensure the optimal outcome for your company’s exit.

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Michael Bates
Mike Bates is the former CFO of four Life Science companies that all achieved successful and lucrative exits. Over a twelve-year period Mike has seen the evolution from the physical data room to the state of the art virtual data room and is an expert in what to look for when preparing potential buyers for due diligence. Mike is a CPA, serves as Audit Committee Chair for two medical device companies, and is an active angel investor.

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For the last twenty years Brian Moriarty has helped companies grow inorganically (M&A, alliances, licensing, investments) both as an investment banker and a corporate development executive. Most recently Brian was Vice President of Business Affairs at Sun Microsystems. In this position, Brian helped Sun acquire twenty companies ranging in valuation size from several million to multi-billion dollars, including such notable companies as MySQL AB, Storage Technology Corporation and SeeBeyond Technology Corporation. Brian also helped Sun sell itself to Oracle Corporation in a transaction that closed in January 2010.
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