A BASIC BUYER'S GUIDE TO SUCCESSFUL ACQUISITIONS

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Bob Cohen and Sam Sacco operate R. A. Cohen Consulting,
a trusted industry M&A advisory service. We have advised on
more than 100 successful industry transactions.

Contact us at (416) 229-6462 or (910) 509-0691, respectively.

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When you want to grow your business, your options are building or buying. Often, the fastest and easiest path is buying, provided you have access to capital at a reasonable cost. Many great businesses today became dominant players in their fields through acquisitions.

Most acquisitions are driven by the desire to increase shareholder value. Bigger usually is better, or at least more valuable.

Before you set out on the acquisition trail, it is important to have a flexible but clear strategy for your acquisitions. You need to know what fits and what you are looking for in a target firm.

Buying Considerations

The challenge in making an acquisition work is managing each step of the process very carefully.

You need to review a number of areas prior to seeking acquisition targets. Taking time to do this in advance can save you valuable time and resources down the road by serving as a template for your acquisition opportunities.

Define your goals for acquiring

Companies decide to expand through acquisition for a broad variety of reasons, such as increasing market share, entering new markets, taking advantage of economies of scale, offering new services, or acquiring management talent.

Define clear-cut goals and present them to your current employees. Because they will perceive your decision as affecting their future opportunities, it is essential that you take the time to get key employees to buy into the larger future you are creating. Clearly defined objectives can also serve as a guideline at several stages of the process.

Define your acquisition criteria

Probably your first decision will be what sector(s) of the industry you want to look at. Then you may identify particular geographic markets; this choice may be determined by your firm's present location(s) or by areas you have identified as having particularly strong potential.

You should also define financial criteria. This will include the annual sales range you are looking for in a candidate firm.

And you will need to define the financial performance goals you're seeking in the target firm (e.g. gross margin / EBIT / average bill rates / sales history growth rates, etc.).

Determine how the acquisition(s) will be funded

You can fund acquisitions in several ways:

- Internally.
- Using borrowed money. If this is your choice, you'll have to ensure that funds are approved and in place before you make an offer.
- Through private equity or venture capital. This can take a while to arrange. Start early, preferably six months in advance of requiring the funds.

Decide what you are looking for

Are you looking for top-drawer, well-run companies or distressed properties? The decision is more or less like a house-hunter deciding whether to buy a fixer-upper, a middle-aged home in good working order or a brand new home. Your decision may be determined by the resources you are best equipped to offer – financial, operational or human. These factors will also influence the type of business you can integrate most successfully.

Identify how a target firm can help you create value

- Increase market power by spreading your brand over a wider customer base.
- Increase market share in existing markets. Sometimes the best way to reduce or eliminate competition in a particular market is to buy a competitor.
- Enter new markets that fit or complement your service strength and have an attractive potential client base or a large pool of appropriate talent.
- Offer existing customers additional services that you cannot provide through existing expertise, staff and resources.
- Lower unit costs through economies of scale, by spreading infrastructure costs over a larger revenue base, and better cost management. For example, your back-office (accounting) operation could handle another $200,000 per week in sales and the related payroll activity without adding much additional staff expense, thereby lowering your cost per unit for processing the additional business and making that extra volume incrementally more profitable business for you.

25 SUGGESTIONS FROM THE PROS

1. Develop a clear, thorough plan in advance to avoid fighting fires later.

2. Communicate your intentions and your plan regularly. It's virtually impossible to give out too much information on this subject.

3. Keep the information clear, concise, direct, honest and inclusive.

4. Repeat messages and themes. It takes time for others to buy into your agenda.

5. Start with the general outline and move on to the details.

6. Allow employees time to assimilate the information.

7. Solicit, receive and respond appropriately to feedback. Get it, use it and feed it back. If employees feel that you aren't listening, they will find an employer who does.

8. If you want real feedback, don't ask for it to come to you publicly. Make time to meet with each individual privately, and be prepared to explain the anticipated impact on that person.

9. Communicate from your audience's viewpoint. Put yourself in their position. What is very lucrative for and exciting for you is probably very anxiety producing for them.

10. Remember that everyone's favorite radio station is WIIFM: What's in it for me?

11. If staff cuts are inevitable due to redundancy or other reasons, figure out which positions are vulnerable and deal directly and quickly with the affected staff.

12. Help employees who are leaving,

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but don't forget to support the employees who remain. They are fearful and uncomfortable, and they are watching you.

13. Re-recruit your best players. Court them as you would any strong new hire that you know has talent and can produce results.

14. Don't leave staff in an uncertain state. If you do, they will leave, and you will lose your strongest staff first because they usually have more options. You don't want to be left with just the ones who have nowhere to go or no drive to get there.

15. Tackle transition planning early in the process. This is always one of the greatest challenges.

16. Open two-way discussions to build trust and forge clear agreement on goals. Change goes more smoothly with a buy-in from all involved.

17. Communicate your agenda to the newly acquired staff. And keep communication lines open. You need a dialogue, not a monologue.

18. Sell newly acquired staff on the benefits of committing to your organization.

19. Seek out the leaders and influencers among your new staff and enlist their passionate support.

20. Be on the lookout for disgruntled, negative staff and deal with them swiftly. Turn their attitudes around or point them toward the door before they destroy any chance for a successful integration.

21 Be personal. DVDs, CDs and videos are great tools for distributing large amounts of information quickly,

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- Create synergies so that 2+2 will equal at least 5
- Gain new technology
- Acquire management talent
- Bring in fresh ideas

Decide what you most want to see in a target opportunity

Many elements would be nice to have, but it's important to prioritize. Companies, like people, are rarely perfect.

Factors you will want to consider and rank are:

- Strategic fit – how acquiring this business will further your corporate strategic (business direction) objectives.
- Compatible culture – whether the target firm's prevailing style of doing business fits your firm's approach. This can take many forms. One item would be how and on what level decisions are made. Another is compatibility of compensation programs: your firm might have a commissioned staff solely dedicated to outside sales, while the target firm might have salaried sales personnel who work inside and outside.
- Talented management – experienced, entrepreneurial and savvy managers to help you continue the growth of the acquired business. Sales and service staff continuity can help ensure a smooth transition.
- Sustainable growth – a relatively young target company that is experiencing 30% to 50% annual sales growth may be able to continue that growth in dollar terms, but it will be very hard to maintain that percentage increase.
- High gross and operating margins
- Operating focus – single or blended management and operation of temp/contract and direct hire. These two service delivery styles are so philosophically disparate that very few firms have been successful in merging them in the same location.

Identify target firms

Use industry directories to develop a target list, then call or write to contacts on the list. Ask your staff to identify the best independent local competitors and what they regard as their strengths. Contact respected industry M&A advisors and intermediaries to find out what's available (and what might be coming on the market). Engage an intermediary (your M&A advisor, an investment banker, a venture capitalist, a private equity firm, a CPA or an attorney) to bring you suitable targets.

Decide what you want to buy from the target firm: assets or stock

Your decision will probably be based in part on the income/capital gains tax issues for you in each of these acquisition structures.

Choose the deal structure that best suits your needs

This is a good area to be flexible in order to address a broader group of sellers.

- If you want to offer only a percentage of the purchase price as cash on closing, decide what percent that will be. Typically, the less cash you put down at closing, the higher the total price you will pay. However, using less cash gives you greater leverage on your liquid (cash) assets that can be applied to buy another business. Combined with an earn-out, the amount of cash you offer can serve as a risk transfer determinant.
- If you are willing to use promissory notes, decide what interest rate you will offer. Using notes is a way of controlling your cash flow and creating cost certainty over that portion of your acquisition expense.
- If you choose to offer earn-outs, or payments based on the future performance of the business with an opportunity for the seller(s) to stay on, decide what period of time you want to offer. Establishing earn-out payments contingent on some measure of future performance, such as sales volume, gross profit dollars and percentages generated, bottom line profits or some combination of these items, is a way of sharing the risk between buyers and sellers going forward. Be flexible; sellers have varying levels of risk tolerance.

  If you are going to make substantial investments in the acquired company, you may want to limit or eliminate the earn-out portion; you don't want to pay the seller for benefits derived solely from your impact. On the other hand, if you plan to let the acquired business continue under its own steam with some relatively minor investment on your part, a longer earn-out scheme may be appropriate.

  Having said that, keep the entire acquisition cost in perspective and make sure that your approach to earn-outs is both competitive in the marketplace and supportive of corporate objectives. Sometimes the faster the acquired firms' systems are aligned with yours the faster you'll obtain the intended synergies.
- Decide whether you want to offer stock as part or the entire total purchase price. This decision is often influenced by your view of the inherent value and/or the mar-

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however they are not the best tools for your first contact with anxious new employees, fearful for their jobs and their future with your organization.

22. Take nothing for granted. Make no assumptions that your new staff is aware of your long record of stellar integrations of prior acquisitions.

23. Vary your methods of communication – face-to-face, small groups, written and electronic – and tailor them to each situation.

24. Learn from your experiences and the experiences of others.

25. Stick with your program. It will get easier. Successful integration can mean the difference between success and failure. Initial and early communication (in both directions) is often the key to winning in M&A transitions.

ket price of your stock. Today, many buyers feel that their stock is undervalued; consequently, they are reluctant to use it to pay for acquisitions. Using stock will also dilute your individual share value because more shares become outstanding. Many sellers are uncomfortable accepting stock; others want a portion of the purchase price in shares, hoping for a shot at another brass ring down the road. This can be a great built-in motivator.

Select the members of your acquisition assessment team

They may include internal staff members and/or outside experts. These teams are often multi-disciplinary and include experienced representatives from senior management, accounting/finance, operations, legal, and experienced outsourced M&A advisors.

All team members must be fully conversant with the corporate objectives for acquisitions. Often, these teams are part of the initial process of developing the acquisition goals and criteria for target companies. Legal participation, other than in a broad sense, often is not required until a decision to make an offer is reached.

Decide who will negotiate your transactions

This should be someone who is familiar with current deal pricing, various deal structures, tax consequences for buyer and seller, how best to negotiate with future employees of your firm, and how to work with the seller's professional advisors. Often it will be your M&A advisor or an experienced financial or senior manager because of their knowledge gained over many years in the industry, your firm and the market.

Determine what you will need to review during your due diligence process

Your financial and legal advisors should be able to help you develop an appropriate list of items to examine. These will include:

- A complete set of financial statements for the last three years
- Tax returns covering the same period
- The most recent month's balance sheet
- Property leases
- Equipment leases
- Staff personnel records and an organization chart
- A description of all employee benefit plans

- A detailed accounts receivables listing and client bad debt history
- Schedules of furniture, office equipment, computer hardware/software and telephone systems
- Budgets for current and future years
- A variety of schedules detailing assignments/projects with clients
- Reports from outside accountants/auditors
- Review contracts to ensure transferability

Establish your timetable

Determine a planning schedule for significant events to occur. Often this is achieved by working backwards from when you hope to acquire. Your schedule needs to remain flexible as actual opportunities develop on their own timetable that may or may not fit your original plan. Keeping your timetable fluid enables you to adjust to market circumstances while still providing a framework to follow. These are some of the areas you may want to consider to keep energy in a deal in order to be as prepared as the experienced buyers you are competing for the best companies with:

- When you will begin searching for targets?
- When a target appears suitable how quickly can you assess it?
- How quickly can you make an offer?
- How quickly can you close a transaction?
- Once a offer is accepted how quickly can you provide your due diligence requirements to the seller?
- When will you prepare a template for your Purchase and Sale Agreement?
- How long do you anticipate due diligence will take to complete?

Decide how you will integrate the acquired business

Integration is usually the most critical area in an acquisition, and blending cultures is often the key to a successful transition. You need to decide how you will integrate the acquired business.

- Fully, with your brand name. This can be the least expensive approach, because it creates mass purchasing power. It also can strengthen your brand awareness in the marketplace.
- Partially, as a (your brand) company, i.e., ABC, a XYZ

firm company. This approach is a bridging mechanism that is sometimes used for 6 to 12 months, sometimes indefinitely. It is not unusual for the acquired company to have a higher profile and/or a better recognition level and reputation in its local area.

- Autonomously, as an entity appearing to be independent. This approach preserves the feeling that the employees and customers of the acquired firm remain independent and will continue to provide seamless service.

Why Deals Fail

There are many reasons deals fail. Common reasons we see include:

- Unrealistic market valuations. An overpriced business, like a perfectly good but overpriced house, will sit on the market for so long that potential buyers will assume that something is wrong with it.
- Attempting to renegotiate the price or change the terms or meaning of terms after the initial agreement, effectively changing the deal. Be sure that you understand and are comfortable with both the price and the terms of the deal before you agree to them in the first place.
- Rigidity or arbitrary stubbornness about terms or structure. Buyers want sellers to be their partners going forward. They typically don't want to absorb all of the risk from day one, so they are very interested in earn-outs. A lot of owners initially aren't interested in earn-outs because they're leaving or being asked to leave and they don't have any control over the earn-out, but buyers are saying, "If you don't believe in your business, how can I?" The reality today is that 99% of all transactions have an earn-out component. A buyer may say, "if we buy your business today for 100% cash, you've effectively shifted 100% of the risk overnight. Therefore, in terms of a risk: reward ratio, we're going to pay you much less – perhaps below your perceived market value, so much so that you may not find the deal attractive. So they then may say, let's go forward together and share some of this risk. We'll give you 60% of the value we believe your business has in cash today and the remaining 40% over the next three years. If the business grows, you'll get more, and if it shrinks, then we both share in that shrinkage."
- Professional advisors attempting to function beyond their areas of expertise. Attorneys should protect you on legal aspects, financial advisors should give you tax advice and structure information, and the business advisor or M&A

intermediary should advise you on the reasonableness of the offer, the terms and structure, etc. The M&A advisor is best suited to coordinating the disparate parts and professionals on both sides and affecting appropriate compromises.

Clients have told us on many occasions that a lawyer's adversarial training can often hamper the process and that some CPAs get so focused on the detail that they may lose sight of the overall objective, which is usually to make the deal work.

- Landlords looking for a windfall. Typically, a buyer will want to take over the lease responsibilities of the seller. In most cases, the buyer's covenant is stronger than the seller's because it is a larger company, so from the landlord's perspective, he is getting a bigger, stronger richer name added to the lease. It's reasonable for a landlord to charge a minimal amount for the administrative cost of affecting the change, but in some areas, depending on the real estate market at the time, landlords may ask for a $5,000 or $10,000 fee or an extension of the lease rather than a more appropriate $50 to $200.
- Sellers not keeping bankers fully informed, particularly if the bankers are owed money. They want to be sure they will be paid at the time of closing or whenever money changes hands. If the proceeds of the sale are insufficient to repay a bank, the banker will want to know how and when he will get the money owed. The loan agreement the owner signed when he took out the loan probably calls for him to advise the bank of any material change in the firm's assets or stock, but many owners forget about this provision; the result is that the deal comes to a halt while the bank reviews the Purchase & Sale Agreement.
- Buyers looking to steal a business. It's not worth the time or expense for a seller to try to negotiate with a buyer that makes an unrealistically low offer and will not increase it when appropriate.
- The seller's senior staff members holding the seller ransom. Sellers are getting a lot of money from the deal, and their senior employees in particular want to know what they're going to get out of it, such as a significant bonus in recognition of their role in helping to build the business or a stay bonus to help achieve an earn-out.
- Seller's spouse not committed to a deal. In many situations, the spouse – in the staffing industry, that's often the husband – is not very involved in the business and doesn't appreciate the mental and financial state that leads the

owner to want to sell but instead urges the owner to "hang in there."

- Poor current financial results. One of the most important things knowledgeable M&A advisors do is present the seller's figures, no matter what they may be currently, in an acceptable and realistic form for the buyer to review. Nothing causes a buyer to lose confidence in a seller faster than inconsistent or unreliable numbers.
- Unrealistic projections of future financial performance. Knowledgeable buyers are familiar with market conditions and aware of what reasonable future expectations should be for your business.
- Overly onerous sales, margin or profit levels required to achieve an earn-out. An unrealistic earn-out offer, whether the seller will be there or not, will affect the total value the seller receives and his ability to compensate senior staff in order to encourage them to stay and help achieve the objectives.
- Lack of attention to or ambivalence about the transaction. We commonly see this when the buyer's or seller's business starts to decline – the person is "away," doesn't answer phone calls, etc. It's usually an indication of a more fundamental problem, resulting in inertia and delays, or the loss of the deal.
- Inexperienced buyers with poor internal communication. Many new buyers – private companies – don't have targeted M&A departments or business development departments focused on acquisitions. Consequently, the CEO, CFO and COO all may tend to have their hands in the process, looking at it from different aspects. This can result in a lack of coordination, with contradictory messages being sent to the sellers or their representatives, which creates confusion.
- Seller's remorse, usually occurring just before the sale is completed.
- An inexperienced buyer trying to take all the risk out of a transaction.
- Unrealistic adjustments of certain expenses by the seller going forward. Typically, in addition to the cost of sales and SGA expenses, in M&A there's another section called adjustments. When we're adjusting earnings, that's when we see add-backs. An add-back is where the buyer determines what he would have to spend to replace the function the seller has eliminated. For example the seller may remove his own compensation and minimize his contributions to the business in an attempt to jack up the EBIT-

DA, but the buyer will need to pay someone to perform those general management functions, so only the difference in cost should be adjusted. Another seller may say he had a couple of top employees who were ineffective and actually cost the company money, but they've been fired, therefore that expense should be deleted going forward. That may or may not be realistic. Or a seller may say he had a dot-com client go out of business, leaving him with a large amount of bad debt, but he's not going to deal with that kind of firm again so that expense should be deleted. If the firm's bad debts have been running at half a percent of sales, which is about the industry average, and they shoot up in one year to 2% to 3% because of specific, identifiable customers that went out of business, yes, there might be some justification for that add-back. But ordinarily, if the bad debt goes up to 0.75% or even 1%, how does the buyer know that's not just a lack of good internal controls on issuing credit? The rule is: When adjusting your earnings, keep your add-backs of expenses realistic.

Transition and Integration Issues

Finding an acquisition target that meets your criteria and negotiating the Letter Of Intent (LOI) and the Purchase and Sale Agreements, while complex, are often the easier steps for a buyer to navigate in an acquisition.

The real measure of success of an acquisition is how well it is integrated into the buyer's firm. It's easy to change a company's name but much harder to change old work habits, ingrained attitudes and values.

Over the past several years, some buyers have acquired excellent companies only to see their investment stumble and fail. Often, this can be traced to the buyer's inexperience with acquisitions and the inadequate provision of appropriate resources. It can be very challenging to convert an entrepreneurial landscape to an intrapreneurial environment without some casualties.

Acquirers need to think carefully about all transition issues, such as whether to bring the new company under the buyer's umbrella partially or totally, the timeframe for integration, and who on the integration team is responsible for each change. Successful integrators have the answers to these and other questions ready before the questions arise, and arise they will.

The Human Impact

We are essentially a people business. If we treated our customers with indifference, our businesses would surely fail. Likewise the way we treat the staffs of both the acquiring and acquired firms determines the success or failure of most acquisitions.

More than one acquisition has been torpedoed by lack of adequate communication between upper management and the people on the front lines. Management must ensure that the right messages are being conveyed. If the larger vision from the corporate suite is reinterpreted at the branch level, where activities are often geared to the current month's profit and the branch manager's bonus, the result can be a disaster.

Larger companies typically buy smaller companies for their expertise, local presence, management, contacts, creative methods of doing business and the innovative service offerings they bring to the marketplace.

Unfortunately, it's not uncommon for a buyer to inadvertently damage or destroy much of the goodwill it is acquiring by erasing the seller's identity and imposing its own culture prematurely. This is the primary cause of decline in the acquired business – and it is usually self-inflicted.

Small companies have a lot to offer large companies. Owners and key staff are usually proud and somewhat proprietary about the way they do business. For years, they have sold their clients on the very fact that they are small, local, flexible and always available, unlike the giant firm that may have acquired them. It can be especially risky to impose changes before understanding all the elements that made the acquired company successful and attractive to the buyer in the first place. The culture and processes of a tightly focused small company may be complementary to or even superior to those of the acquiring firm.

Since acquirers are typically larger, they may believe that they have greater corporate intelligence and expertise in support systems, advertising, marketing, infrastructure and the overall methodology of delivering services. They may be right. However, it can be very costly for buyers to impose their "corporate systems" arbitrarily or faster than the plan can be communicated clearly to sales and service staff on the front line. People often need time and repeated exposure to new messages and themes before they buy in.

■ The Letter of Intent

Signing an LOI is an important initial commitment between a buyer and a seller. While LOIs are typically non-binding documents, they do form the basis of the Definitive Purchase Agreement, which, when executed, is a contract binding all parties to the agreement.

Some of the areas that an LOI addresses include the purchase price, the terms and structure of the transaction, and the currency to be used in the transaction.

There are only four types of currency that can be used in any transaction:

- Cash on closing.
- Notes – unconditional promises of payment at some time in the future, e.g., $100,000 on the first anniversary and $100,000 on the second anniversary, at 6% interest per annum. Regardless of whether the business goes to heck in a hand basket or skyrockets, the seller gets the predetermined amount.
- Stock.
- Earn-outs – contingent future payments, contingent on performance metrics that are determined at the time of the transaction. They may be based on generating a certain level of sales, gross margin dollars or bottom line profits over a period of years. If the agreed-upon level is achieved, the seller earns the amount specified during that period. In a typical earn-out the buyer might say, "If you generate the same gross margin dollars as you did in the first year after closing, I will pay you $1,000,000. If you're 10% below that, I'll pay you 10% less."

  Typically, the seller can get more or less than the stipulated amount. A buyer may say, "If the gain is less than 50% [or 75%, or whatever the buyer has factored in], you get nothing," or he can cap the earn-out gain at 125%, but some just let it run according to the amount gained. A few years ago it was like a cliff; either you got the agreed-upon increase or you didn't, and you were paid or not as a result. In the last few years we've been able to convince buyers that it's to their advantage to use a graduated scale so as not to discourage sellers' initiative if the primary goal seems out of reach.

Other areas covered by the LOI are:

- A proposed closing date, or the maximum number of days until closing – typically 90 to 120 days.
- A description of what is to be acquired: stock or selected assets. Buyers can purchase one of two things: stock (which is the entire company, lock, stock and barrel, or some portion thereof) or (more commonly) selected assets, which may include the fixed assets used in the business, goodwill, customer lists and other items such as the balance sheet, current assets and current liabilities (including accounts receivable, current government remittances and taxes due, typically as of the closing date).

Usually, buyers don't take the cash or securities that belong to the owners and they won't take any of the owner's long-term bank debt. Some leave the balance sheet completely alone and just purchase the stream of earnings, i.e., the tools, equipment and materials required to generate sales and profits – customer lists, desks and chairs, phones and computers, etc. They're buying it as a going concern.

The type of corporation the seller is functioning under often dictates whether he wants to sell stock or assets. Most times buyers prefer to buy assets because there's less due diligence – they're not buying everything hook, line and sinker, so they don't have to worry about the seller's unknown or undisclosed liabilities.

- A Confidentiality Clause, which will survive the LOI. A standard confidentiality clause or a non-disclosure agreement will indicate for a period of time, up to indefinitely, that any information the buyer learns as a result of the evaluation process will be used only for the purpose of making the investment or acquisition and not for market purposes. The seller agrees not to divulge the information to anybody, call on the seller's clients, try to hire the seller's employees, and vice versa. So even if the deal collapses at the LOI stage, there is still protection for both parties.
- An Exclusivity or No-Shop Provision forbidding the seller or its representatives from discussing a possible transaction with anyone other than the (LOI) buyer until the agreement terminates.
- A No Public Announcement Clause in which both parties agree not to disclose any details about the transaction (unless required by law) until its conclusion.
- A Preservation of Business Clause in which the seller agrees to continue to conduct business in his accustomed manner and to use his best efforts to maintain customers, margins, staff and employees.
- An Expenses Clause indicating that each party will bear its own costs to complete the transaction.
- An Access Clause permitting the buyer reasonable access to the business premises and/or business information to assist in conducting due diligence. The term "Buyer" refers to the entire corporate entity, including accounting staff, audit people, some of its operational people, and sometimes outside auditors hired for the transaction. (The Big Five accounting firms do very well with private buyers

because they coerce banks into making their reviews a necessary part of the lending process. The cost is absorbed by the buyer but is reflected in the pricing, as are M&A fees.)

- A Jurisdiction Clause indicating the location of the prevailing law under which the agreement is to be adjudicated, if necessary. Typically the location will be in the State/County/Province where the buyer is based.

Letters of Intent may address the following additional items:

- A list of assets/liabilities specifically included or excluded. Items included might be current accounts receivable (sometimes defined as “outstanding no more than 60 days”), items excluded might be paying off long-term bank debt. This only pertains to an asset deal; in a stock deal, you get the good, the bad and the ugly. In a stock deal there’s a benefit to the buyer because there’s usually equity on the balance sheet: retained earnings or surpluses, in an S corporation they are the seller’s “triple A (AAA) accounts.” In other words, if you were to pay off all of the liabilities and collect all of the assets, you would typically be left with a surplus of money. That’s an advantage to the buyer for all of their trouble, and sometimes it is reflected in the purchase price.
- A clause contingent on the buyer obtaining Employment Agreements and/or Non-Compete Agreements with key employees of the seller.
- Proposed employment terms for key personnel the buyer wishes to retain.
- Definitions of Gross Margin and/or EBITDA, if appropriate.
- Finally, given the investment of time and resources, some buyers may include a Break-Up Fee clause, in the event the seller decides to sell to another party or not to go through with the deal, even though he signed the LOI with the intent of selling. The break-up fee can be a nominal amount or a more significant (punitive) amount ranging anywhere from $10,000 to hundreds of thousands of dollars. It usually depends on the size of the transaction.

Many of these clauses are designed to clarify certain issues and items for both buyer and seller before they embark on a costly due diligence process. Buyers view an LOI as an inducement to them to expend the significant resources required to conduct due diligence and to prepare the many legal documents required to complete the transaction.

Typically, due diligence is a multi-part task. It should be conducted in a way that protects the seller from unnecessary or premature disclosure to his staff and limits the resources expended by both parties until the likelihood a deal is fairly certain.

A letter of intent is generally contingent upon the following terms and conditions:

- The signing of a Definitive Purchase Agreement containing the usual Representations and Warranties for agreements for transactions of this type. In the staffing industry, those representations and warranties might include: "to the best of your knowledge, all employees have been paid; all workers compensation claims settled; there are no outstanding liens or litigation against the business; the financial picture of the company is as it has been presented; and there has been no material change in the business, the customer base or the employee base since the LOI."
- A satisfactory due diligence examination by the buyer.
- Approval of the transaction by the buyer's board of directors.
- Sometimes, approval of satisfactory lending arrangements by the buyer, who may say the LOI is subject to his obtaining satisfactory financing for the deal.
- Sometimes, satisfactory transfer or cancellation of leased premises.

At times, a buyer will be content to begin negotiations with a Term Sheet. This is a less all-encompassing document that, as its name implies, purports to identify the key terms of the deal. It most often focuses on purchase price, terms and structure, currency to be used, and what is being purchased.

Term Sheets are most often used when a deal is expected to be very large and complex and the buyer wants to be sure there is agreement on the basic elements of the deal before drawing up an LOI. Perhaps surprisingly, if the opposite set of circumstances exists – that is, if a deal is expected to be very simple or imminent, some buyers will prepare a simple Term Sheet then go right to the Definitive Purchase Agreement. Often it is just a question of what makes sense for the proposed transaction.

As you can imagine, since there are no firm rules as to what comprises an LOI or a Term Sheet, the details provided in this document will depend on the individual seller and buyer.

At this stage, the Term Sheet or LOI is non-binding for both parties. But it is important to keep in mind that the document will be referred to and relied on in preparing the Purchase Agreement and other important documents. An LOI is always a compromise document that tries to balance the interests of both buyer and seller, and your wishes need to be heard. Be sure to negotiate or have your representatives negotiate to include all items of importance to you. Due diligence is a two-way street.

Settling basic terms is one of the most valuable aspects of the LOI. If you take issue with any of the items mentioned, this is the time to address it. If you can't agree at the LOI stage, proceed only if you can live with the issue as is. If an item is a deal breaker, it's best to cut your losses and move on. Buying a business is too important to leave to chance.

Sources of Trouble

Following are some areas to watch out for:

(The following case studies are not drawn from a single situation but are actual experiences that we have combined here for editorial convenience.)

- Unclear integration plan. A buyer had built its business through low margins and few, if any, service frills to attract and retain volume accounts. The buyer's corporate officers delivered a rousing speech to the acquired firm's employees, saying how pleased they were to have their expertise and business style on board and how much they hoped they would lead the buyer's firm to the promised land of high-touch, value-added service and higher-margin business.

  Unfortunately, the message was not conveyed to the buying firm's area, regional and district managers, who pressed the acquisition's employees for large gross profit dollars, with no particular regard to the gross margin percentage or the quality of the business. Confusion about the stated goals and the day-to-day reality was more than several staff members could endure, and within a year three key employees and four others left the acquired firm.
- Unclear transition timelines. In another acquisition, the buyer did not pay enough attention to the selling firms' existing payroll procedures. Most business operators are very sensitive to employees' need for a seamless transition in this area, because first impressions of the new owner are often formed at this time. In this case, within two weeks, the buyer and seller were running parallel payroll systems one printing just a payroll register and the other a duplicate payroll register plus paychecks for employees.

  So far so good. However, the seller produced and issued invoices to customers as usual – and the buyer's sophisticated accounting software automatically printed and issued invoices for the same services, creating double billing, extra work, unnecessary distress and apprehension in established clients' accounting departments – not exactly a morale booster for the acquired staff.

- Unclear levels of authority. The solution devised to resolve the payroll/invoicing problem was almost as damaging as the original problem. Corporate management instructed local staff to offer each double-billed client an 8-hour credit for service as a peace offering. The staff followed these instructions, and relationships seemed to be improving – until those same clients received an attractive gold-sealed certificate from the corporate marketing VP offering the clients "FOUR FREE HOURS OF SERVICE AT ANY TIME," further eroding confidence among both staff and clients. However they were able to turn this into a positive as now affected clients received twelve free hours of service.
- Weak communication links between the corporate office and the new firm's staff.
- Indecisiveness.
- Confusing directives from the corporate office.
- It's when times are unsettled that staff members need the greatest amount of clarity.
- Frustrated employees.
- Loss of key staff and founders.
- Flat or declining sales, often followed by...
- Decreasing margins and...
- Increased resignations.

Any of these situations can stymie integration and require a major investment to get back on track toward profitable growth.

Most mergers and acquisitions are won or lost in the immediate post-merger period. Careful planning prior to acquisition and disciplined execution of the plan, clearly communicated in advance to the affected personnel, is essential for success.

Steps to a Successful Integration

1. First, create your integration strategy. Then determine and assemble your integration team, get their buy-in and be sure field management is on the same page as senior management. Part of your planning should center on the human impact of these changes. Human aspects should take precedence over systems.

2. Plan the integration in a way that makes sense for all affected individuals. Your first concern may be to communicate the changes you will make, when and how you'll make them and whose jobs are at risk. If you don't deal with this up front, you may lose your best staff before you get started. No one you want to keep will be happy waiting for the other shoe to drop on his or her future. They'll take quick action and pursue other opportunities.

3. Ensure that you retain the seller's key staff members, and get them on your side as soon as possible. Your success is dependent on your ability to put this intellectual capital to work on your customers' behalf.

4. If there are redundancies, deal with them quickly; lame ducks and fearful staff rarely make productive employees. It may mean more work for your corporate staff, but you will be keeping these people's worlds from turning upside down.

5. It is relatively easy and painless to reduce redundant costs and create revenue synergies. The real challenge is to manage the anxiety of the acquired employees and foster a new, stronger team that sees great opportunities and success for all parties. It's not easy, but the payoff can be outstanding.

6. Try to populate your integration team with top performers who can engage the new staff; don't rely solely on back-office types. This will help to liberate the combined organization. Sticking stubbornly to ingrained ideas and rigid adherence to the "tried and true" is the first step toward corporate stagnation. Be open to new ideas or different ways to approach an old familiar issue. Your window to capitalize on the new is relatively short. Focus on excellence.

7. Many buyers pay lip service to incorporating "best practices" but never get around to implementing them. Successful integrations identify the best people and the best ideas and work at helping them succeed.

8. Many buyers talk about infusing more entrepreneurial spirit in their managers, then they sustain practices that destroy that spirit and chase good people away. Successful integrators listen to the seller's key people and act on their best suggestions.

9. Successful integrators also know that good people need a high degree of operational autonomy. Create a business plan with them, then get out of their way and let them succeed.

10. Early in your integration plan, lift some headaches from the acquired firm. A good start could be taking over unpopular administrative activities such as payroll, billing, credit, collections and the creation of financial statements, government filings and reports.

11. At this stage, it is also common practice to add the acquired firm's employees to the buyer's benefit programs.

12. Follow this by making your corporate resources, such as advertising, human resources, marketing, database access, and other systems and support available to your new field operators. This is often the largest and one of the most productive steps in integrating an acquisition successfully.

13. Ideally the final stage will include identifying shared cross-selling opportunities and executing action plans to integrate the buyer's customers with all the service offerings of the acquired company, and vice-versa. This combination of marketing capability and distribution channels can yield significant economic benefits for the entire enterprise. Handled properly, two and two can equal five or more. Poorly handled, a buyer will be lucky to make two and two equal three.

Successful integrators focus on creating value, not cramming the acquired firm and its employees into their cookie cutter.

The First Ninety Days Are Critical

Balance your need to think things through thoroughly with the urge to move quickly. It is often wiser to take advantage of partially effective solutions that can be implemented completely rather than wait for perfect solutions that may never come.

Integrating newly acquired firms doesn't have to be like pulling teeth. Use caution, wisdom, sensitivity and a well-communicated plan. These are the key ingredients for making your integration – and your acquisition – a smashing success. Don't rush the process. It will take less time if you do it right from the outset. It is up to you as the acquirer to make integration work for everyone.

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CONTACT

Sam Sacco
R.A. Cohen Consulting

6241 Chalfont Circle
Wilmington, NC 28405

910.769.4057 voice
910.262.5326 cell
910.782.2777 fax

sam@racohenconsulting.com

Brian Kennedy CPC
R.A. Cohen Consulting

8 Pine Avenue North
Mississauga, Ontario L5H 2P8

416.229.6462 voice
416.222.0177 fax

brian@racohenconsulting.com

www.racohenconsulting.com

r.a.cohen
consulting