

# Rise Advisors

## Guide to Selling Your Business

### Abstract

This guide illustrates how a professional Mergers & Acquisition Advisor and a professional Tax Accountant work with business owners to prepare their company for a sale, target and qualify company buyers, contact buyers and communicate with them while maintaining confidentiality, lead the sales transaction process, negotiate selling prices and sales terms, and structure the sales transaction for tax efficiency and maximum cash flow back to the business owners.

# Rise Advisors

## Selling Your Business

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## Selling Your Business and the Role of a Mergers & Acquisition Advisor

Business owners are accustomed to selling products and services on a regular basis, but most of them have never experienced selling the company that they own. For a business owner, the sale of their company is likely going to be the largest, highest risk, most complex and emotional sale that they will ever participate in.

When a business owner sells their company, they are cashing out for the last time and they are putting the future of their company, its employees, customers and vendors in some one else's hands.

Unlike share redemptions, dividends, or recapitalization where a business owner converts a part of their shareholder value into cash, *a sale converts all of their shareholder value into cash*. The partial conversion of shareholder value through share redemptions, dividends, and recapitalizations are relatively low risk events with defined rewards.

At the other end of the spectrum, the full conversion of shareholder value into cash through a company sale exposes a business owner to the highest risk and, as you would expect, creates the opportunity for the highest reward.

The risk-reward trade off, the complexity involved, the resources required, and the time commitment it takes to sell a business is daunting. When a business owner who is motivated to sell weighs the risk and enormity of the task that lays in front of them, they recognize the need for the services of a Mergers & Acquisition Advisor.

The role of a Mergers & Acquisition Advisor starts before a company goes to market. Prior to initiating the sales process, the Mergers & Acquisition Advisor works with the company owners and managers to maximize shareholder value within the company. The objective of increasing shareholder value is to:

- Make the sales process smoother
- Generate higher proceeds from the sale
- Optimise the sales terms

The Mergers & Acquisition Advisor will assess the company's current shareholder value and identify opportunities to improve the value. There are many facets of the business that are measured and



benchmarked during this exercise. After opportunities for improvement are identified, action items are assigned to maximize shareholder value.

Ideally a company is always “Sale Ready”. The opportunities to maximize shareholder value have all been acted on and the company is in its best condition to go to market. Being sale ready is important because the timing of a sales initiative has a critical impact on the success of the sale.

The best time to sell a company is when the industry it operates in is experiencing a high rate of growth, the economy that it operates in is booming and there is access to low-cost debt financing. The challenge is that this “ideal alignment of business dynamics” can not be anticipated easily.

When the business dynamics do align the companies that have not enlisted a Mergers & Acquisition Advisor to assist them in maximizing shareholder value will be caught short. They can go to market to take advantage of the favourable business dynamics but they will not be as successful in their sales effort as they would be if they were “Sale Ready”.

Being “Sale Ready” places a company in the best condition to maximize its rewards when the decision is made to initiate the go to market stage of the sales process. The go to market stage of the sales process is complex. Tactical choices need to be made and a strategy developed to deploy those tactics. Every business sale has unique characteristics that dictate a tailored accounting, tax and legal approach.

In the go to market stage, the Mergers & Acquisition Advisor will work with the business owner and his team to design a sales plan. The sales plan has multiple objectives:

- ✦ Preserving the legacy and vision of the business
- ✦ Maintaining employment continuity for the staff
- ✦ Maximizing the sales value
- ✦ Negotiation of a favourable sale agreement and terms of payment
- ✦ Minimizing the tax bite into the sales proceeds

The successful sale of a business requires preparation, planning, and patience. A professional Mergers & Acquisition Advisor anticipates every step in the sales process and works with the business owner to ensure that these steps are executed efficiently.



## Is Your Company Sale Ready?

The process of selling a company can be initiated by the company owners or the catalyst can be an unsolicited buyer's interest in acquiring the company. Ideally, company owners are always in the position to trigger the sales process on short notice as either a pursuer of buyers or an entertainer of buyers. To be in the best position to initiate the sales process or respond to a buyer's solicitation, savvy business owners will engage their Mergers & Acquisition Advisor to assess the "Sale Readiness" of their company.

### Improving the factors that effect a company's valuation multiple

When sellers are deciding what they want to be paid for their company and buyers are deciding what they want to pay for the company, it is common to refer to a valuation calculation. The equations used in a company's valuation calculation will all include a multiple. The multiple selected will vary depending on what is being multiplied to arrive at a valuation.

For example, if the valuation calculation is a multiple of a company's revenues vs. a multiple of a company's after-tax cash flow; the multiple applied to revenues will be a fraction of the multiple applied to its after-tax cash flow.

Regardless of what is being multiplied in the valuation calculation, from the seller's perspective, the bigger the multiple, the better.

Early on in the "Sale Ready" stage the Mergers & Acquisition Advisor will assess the factors that have the greatest impact on a company's valuation multiple. The intent is to identify the factors that can be changed to improve the size of the multiple and recommend the actions required to make the changes.

Some of the factors that may need to be addressed to improve valuation multiples are:

- Concentration of sales to a small number of territories
- Concentration of sales to a small number of customers
- Concentration of key account relationships with a small number of employees
- Dependence on suppliers who can not be replaced in the event that they cannot fulfill their supply commitments
- Concentration of purchasing among a small number of vendors
- Concentration of vendor relationships among a small number of employees
- Concentration of key skills and a focus on training among a small number of employees
- A management team that lacks depth and experience
- Employment contracts with key management staff (Some types of contracts enhance the ability to sell and there are others that impede the ability to sell)
- Senior lender agreement that does not match the company's capacity for debt financing
- Working capital short fall that will need to be corrected prior to the sale or will be corrected using some of the proceeds from the sale of the business
- Facility lease agreements that may be too long or too short for prospective buyers
- Plant equipment, vehicle fleets, information technology expenditures required to support the company's business plan
- Dealing with redundant assets such as large cash reserves that are not required to fund the business operations



- Personal goodwill issues (The overdependence on the owners of a company in customer and supplier relationships, product and service development, and the day-to-day operations of the company)
- Miscellaneous skeletons in the closet that should be cleared out before the sales process starts

The primary objective of the “Sale Ready” process is to correct the factors that could depress the company’s selling price and limit its ability to meet all the non financial objectives of a sale. Another benefit of being “Sale Ready” is that the fitness assessment and correction exercises have a positive impact on overall company performance and profits that company owners will enjoy prior to triggering the sales process.

When the sales process is triggered the positive effect on profitability, cash flow and key financial ratios, translates into a higher measure that will be multiplied to calculate the company value. As a result, the company is that much more attractive to prospective buyers.

## Timing Awareness and Initiating the Sales Process

There are two categories of factors to consider when determining the best time to sell a company. There are those factors that are within a company’s control and those that are outside their control. Most of the factors both within and outside a company’s control are dynamic; they are in a constant state of change. All of the factors that are outside the company’s control are dynamic. Some of the factors that a company has control over are dynamic and the rest are static.

This mix of controllable, uncontrollable, dynamic and static factors makes predicting the best time to sell a company particularly challenging. The best way to deal with the challenge is to combine a “Timing Awareness” approach with a “Sale Ready” program.

### Timing Awareness

Timing Awareness involves monitoring the external factors, those outside a company’s control, to forecast when conditions will be the most favorable for a company sale. There are two steps in this process; being aware of the dynamic factors that create favorable selling conditions and monitoring the movement up or down for these factors.

Here are some of the dynamic external conditions that companies looking to sell need to be aware of:

- The rate of growth and stability of the economies that they operate in
- The rate of liquidity (low interest rates and access to funding) that is available for acquisitions in the regions where they operate
- The rate of merger and acquisition activity and the overall interest in buying companies
- The rate of revenue and profit growth in the industry that the company competes in
- The rate of consolidation that the industry is undergoing where private companies are being purchased and merged to create synergies and/or to package up for Initial Public Offerings

The dynamic internal conditions that companies need to be aware of are:

- Their history of positive performance and cash flow generation
- Their growth curve position (The most attractive companies are on a positive revenue and profit trajectory that is projected to continue into the future)



Timing Awareness is the combination of knowing what conditions to be aware of and monitoring the favorable and unfavorable rates of change in these conditions.

The overall economic conditions that are prevalent during a sale can impact the price a company sells for. Some conditions, like overall economic growth and low interest rates tend to promote higher selling prices for all companies. Lower interest rates translate into easier access to financing for acquisitions. When the industry that the company competes in is experiencing high growth rates and there is a high volume of merger and acquisition activity, there will be upward pressure on company selling prices. In these times, the most attractive companies to acquire are those that have room to grow and have demonstrated a history of profitability and positive cash flow.

Other economic conditions such as high or low foreign currency exchange rates can impact the performance of some companies.

## Sale Ready Program

Some of the most important *static conditions* that need to be addressed so that the company is best positioned to take advantage of favorable external conditions are:

- Owners that are motivated and prepared to sell their company
- Estate plans and corporate holding companies in place to mitigate the tax burden from a sale
- Shareholder agreements in companies with more than one owner that do not contain clauses that can compromise or thwart a sale (Clauses dealing with buy/sell situations, drag along & tag along, right of first refusal, or right of first offer)
- A strong management team in place so that the company can run without the day-to-day participation of the owners

In conclusion, the best course of action is to maintain a “Sale Ready” program combined with “Timing Awareness” and having a Mergers & Acquisition Advisor up to speed for the time when all of the dynamic factors are best aligned to generate the most favorable sales outcome.

## Targeting Buyers

In the “Targeting Buyers” stage of selling a company the Mergers & Acquisition Advisor works with company owners to compile a list of qualified buyers.

Qualified buyers are those who will gain a financial return, which may be combined with a strategic advantage, from buying the company and have the financial capacity to pay the owner’s asking price for the company.

The list of qualified buyers may include individuals, private or public corporations, managers within the company, and private equity groups. The list of qualified buyers may also include a combination of managers within the company who have teamed with a private equity group.





Buyers who stand to realize a strategic advantage can come from inside the company's industry or from outside the industry.

### Strategic Advantage

The strategic advantage that qualified buyers can gain from purchasing the company can be something that is new to the buying company such as access to markets in different regions, access to markets in different industries, access to customers, access to technical expertise, leveraging the company's brand, leveraging the company's overall competitive position.

### Special Interest Buyers

The potential for synergy is also taken into consideration when assessing the qualification of buyers. Special Interest Buyers, those with an existing operation that will be combined with the company operation, can realize synergies where the combining of the two operations generates a higher total performance than what is realized by the two companies operating separately.

### Financial Buyers

Buyers who do not have an opportunity to gain a strategic advantage from buying a company are attracted solely based on the financial return that they can make on their purchase of the company. The price that financial buyers are likely to pay for the company will not be as high as strategic buyers. Strategic buyers get a normal return on their investment combined with the return they get from exploiting the advantages from combining their existing operations with the company's operations.

### Financial Capacity to Buy a Company

Qualified buyers will have access to the resources required to pay a price for the company that satisfies the owners and have the capacity to structure a deal with terms that the owners can agree to.

There are going to be times when potential buyers who stand to gain a strategic benefit and / or realize synergies will not qualify as viable purchasers because they do not have access to the financial capacity to buy a company. There will be other occasions when potential buyers are identified who have ample means to finance a purchase but the strategic advantage of the purchase is not significant enough to get their attention. The most qualified buyers are those who will realize strategic synergies from the company purchase and have the financial capacity to fund the purchase with terms that are acceptable to the seller.

### Compiling the List of Qualified Buyers

A key role of the Mergers & Acquisition Advisor is to work with company owners to compile the list of qualified buyers prior to triggering the sales process. This role entails research, and research takes time. This is time in addition to the time that it takes to put a company into a "Sale Ready" condition.

One aspect of the research is to identify the strategic benefits that will accrue to each prospective buyer. This is an exercise in assessing each buyer's needs.

- Buyers who need to add new customers will be attracted to a company with a broad range of customers
- Buyers who need to expand their product offering to their existing customers will be attracted to a company that has a line of complimentary products and services



- Buyers who need access to proprietary technology will be attracted to the company that controls and deploys that proprietary technology
- Buyers who need access to a geographic region will be attracted to companies who are operating in the desired geographic region

Due to the day- to-day familiarity of dealing with companies inside a company's industry, it is easier to assess the needs of competing companies, suppliers or customers. At the same time, it is important to keep in mind that some of the most qualified prospective buyers can be found outside the company's industry.

## Buyer Priorities

During the compilation of the list of qualified buyers, it is important to keep their purchase priorities in mind. The purchase priorities vary between individuals, private corporations, public corporations, private equity investors and the managers of the company.

## Individual Buyers

In general, individual buyers have no strategic reason to buy a company and have a limited amount of cash and ability to access debt. Individuals do not consider strategic fit when they look to buy companies because they do not own an existing operation that they can combine with the company's operation, so there is no opportunity to generate synergies. Another general characteristic of individual buyers is limited cash and access to debt financing to purchase a company.

Individuals will not pay a premium for strategic benefits, so they tend to buy smaller companies that fly under the radar of buyers who are looking for companies that give them a significant strategic advantage. Because individuals have limited financial resources for a purchase, they tend to look for vendor take-back and earn-out deals as opposed to all cash offers.

Post-acquisition cash flow and efficient tax planning are other priorities of individual buyers. Individuals may also have limited executive and managerial experience which makes them a riskier buy candidate in a vendor take-back or earn-out scenario.

At the other end of the spectrum there are individuals with strong management credentials who have partnered with a private equity firm. This combination will pursue the purchase of larger companies. Individuals are at the quick end of the spectrum when it comes to the time required to make a decision to buy a company.

## Private Companies

Private companies are similar to individuals in that they need to use their own capital to finance the purchase of a company. They can combine the capital that they have allocated for a purchase with debt from a senior lender or a subordinate lender. They can usually raise a higher proportion of these funds than individuals can because they have the opportunity to make strategic purchases. Private companies are not as reliant as individuals are on vendor take-backs but they are attracted to earn-out terms when negotiating purchase deals.



Private companies will favour buying companies that are smaller than they are because they can finance them and merge them with their current operations without incurring too much risk. Positive cash flow is a higher priority than earnings for private companies. Private companies can make fast decisions to buy a company.

### Public Companies

Public companies, unlike individuals and private companies, have more liquidity options for purchasing companies. They have their own cash reserves, access to bank funding and they can raise equity in public markets. Public companies can also issue their own shares to buy companies.

As a general rule, public companies will make larger purchases than individuals or private companies. Public companies prioritize high profits over cash flow and tax deferral. This is because public companies need to manage their (P/E) share price to earnings ratio. When they are making the decision to buy a company, they calculate the price earnings ratio that will result when the purchase company's earnings are added to their earnings. They use the multiple that is inferred from their share price to earnings ratio to see if the earnings from the purchased company will be accretive – meaning that the share price to earnings ratio will increase.

Public companies are at the longtime end of the spectrum when it comes to deciding to buy a company. Acquisitions need to be reviewed and approved by a board of directors and sometimes require regulatory approval.

### Private Equity Companies

Dealing with Private Equity Companies is the most complex way to sell a company. The complexity notwithstanding, the sale to a private equity group can be a better alternative than a sale to an individual or sale to a private company.

The high level of complexity emphasises the importance of using a Mergers & Acquisition Advisor to manage a sale to a private equity company. Private equity companies use a pool of funds that are provided by their owners who can range from a group of individuals to pension funds.

When private equity firms are deciding to buy a company, they start with their exit plan in mind. They look at what their return on capital will be when they decide to sell the company. Their timeframe to sell is in the five-year range which is typically much shorter than strategic buyers who have a long-term investment strategy.

Private equity firms are focused on accelerating the growth of the compound annual growth rate of a company they acquire. They recruit all the help that they can get in this endeavor by stipulating that business owners and senior managers stay employed in the company after the company has been purchased. Consequently, existing owners often become minority shareholders in the company after it is sold. In this case, the Mergers & Acquisition Advisory team is tapped to negotiate shareholder agreement clauses that define the minority interest rights in the company.



Typical minority interest clauses include participation in special majority votes to approve; major increases in debt, major capital expenditures, management compensation and approving the sale of the company.

The goal of private equity firms is to get their original investment in the company back and make a high rate of return on that investment. A priority for the private equity firm is when the time comes to exit their investment, the minority shareholders fall in line and do not impede the sale.

When private equity firms exit their investment, they expect to earn a compound rate of return on their investment of 25% or more. To achieve this rate of return in the relatively short five-year range they will aggressively pursue organic growth and will also consider layering in more acquisitions. They are also encouraged to use more debt than is normal for the company to increase the return on equity.

### **MBOs - Management Buyouts**

In a number of ways, a Management Buy Out (MBO), the purchase of a company by a group of its managers is similar to the purchase by an individual buyer.

Both company managers and individuals both have limited equity to invest in a company purchase and they both have limited access to debt financing for a purchase. MBO deals often include some form of Vendor Take-Back so the company owner will assume more risk than they would in an all-cash deal to sell their company.

The other similarity between an MBO and a sale to an individual is that neither of these parties are strategic buyers. They do not have another operation that they will be combining with the company and they do not have the opportunity to create synergies. There will be no strategic buyer premium included in the calculation of the price that the manager's want to pay for the company.

MBOs can preclude a test of the full market value for a company. Some potential corporate strategic buyers may be reluctant to engage in discussions to buy the company when they know that they are competing with an MBO offer. This is due to the perception that the company management will not be cooperative if the company is sold to an outside party and not to the managers.

A fundamental difference between an MBO and a sale to an individual is that managements' commitment to the future of the company is a given under the MBO scenario. This commitment on the part of management is attractive to subordinated debt lenders and private equity firms.

The private equity firm is willing to see some equity owned by the managers because the firm wants the management team to be as engaged and incentivized as they would be under an MBO scenario. In larger MBO transactions, this works in favour of the managers because they are not likely to have the personal capital required to fund the full purchase of the company.

In the case of MBOs that include subordinated debt or private equity participation, the managers need to accept that they will be accountable to their new partners. The managers also need to understand that



subordinated debt lenders and private equity firms are, as a rule, short to mid-term participants. They both want to exit the company after five to seven years of participation.

As mentioned above, the positive for company managers is that private equity firms realize that giving up a slice of equity to company managers increases their incentive and fosters more commitment to growing the company. This is why MBO / Private Equity partnerships are most successful when the company being purchased is on a steep growth curve. When the company is on a steep growth trajectory private equity firms realize that having managers as equity partners improves the chance of realizing the organic growth potential and the growth from any acquisitions that are combined with the company.

## How Do You Respond to an Out of the Blue Offer to Buy Your Company?

The fundamental principle that an owner needs to keep in mind when they receive an unsolicited out of the blue offer to buy their company is that:

“They will be in a better negotiating position when they take their time to consider an unsolicited offer than they will be when they engage in sales discussions immediately.”

Company owners can have a strong temptation to overreact to an unsolicited offer and get sales talks going because they are so curious to know what the unsolicited buyer wants to pay for their company combined with a fear that the unsolicited buyer will rescind their offer.

Both of these emotions need to be held in check because responding quickly to the unsolicited offer puts the company owner in a take it or leave it position. A take it or leave it position for the company puts the unsolicited buyer in a strong bargaining position. Much stronger than they would be if the company had initiated the sales process and had approached more than one potential buyer. When the company has choice of buyers they are in their strongest bargaining position.

An out of the blue - unsolicited offer creates a situation where the company needs to decide whether or not to put their company into play. They need to decide if they are motivated and properly prepared to present their company for sale, not only to the unsolicited buyer, but to other companies who would benefit from buying the company.

During the time when the company is deciding on how to react to the unsolicited offer, the unsolicited buyer, knowing that they are in stronger bargaining position when they are the only one standing to make an offer, may press for an exclusive agreement and a short timeframe to negotiate the purchase of the company.

The company owner should not bow to the pressure to deal quickly and deal exclusively with the company making the unsolicited offer. They need to know that if the unsolicited buyer has a genuine interest in their company, they will be patient and wait for the company to go to market to solicit other buyers. If the unsolicited buyer will not be patient and threatens to rescind their buying interest, then



they were likely only interested in buying the company at a bargain price that is lower than the market price that other buyers are willing to pay.

Bargain shoppers can be smoked out with questions about why they are interested in buying the company and whether or not they are casting a wide net for acquisitions in the hopes that they will catch some companies that are willing to sell at a bargain price.

An out of the blue offer to buy a company can come at any time. Ideally, the owner of the company being solicited will not be caught off guard by the offer. They will be able to decide on their own terms whether to use the unsolicited offer as the triggering event to put their company in play because they have their company and personal affairs organized to reap the highest price from a sale.

## Do Different Businesses with The Same EBITDA Have the Same Values?

Do Different Businesses with The Same EBITDA Have the Same Values? The short answer to that question is – not likely.

On the surface it would appear that having the same EBITDA should equate to having the same value. EBITDA is a universal measure of company performance that gets a lot of attention, but there are other factors that come into play when determining a company's value.

EBITDA is one element in the valuation equation. The other element is the EBITDA Multiple. Two companies can have the same EBITDA but they will have different values if they have different multiples. This raises the question as to why companies with the same EBITDA would have different EBITDA multiples.

The following is a list of factors that distinguish a high multiple company from a low multiple company.

### Overall Industry Rating

A high multiple company operates in an industry that is higher rated than lower multiple company. The higher rating has to do with the positive trends in the industry combined with lower risk implications.

### Economic Environment

A high multiple company operates in stronger economic environments than a low multiple company. Stronger economic environments are more sustainable, have higher rates of growth, are more diverse and more politically stable.



## Market Competitiveness

A high multiple company is more diversified than a low multiple company because they sell in more markets and spread risk over a larger customer base. A high multiple company has a superior market position where they can sell products at a higher price and / or they can reduce their operating costs below those of a low multiple company. A high multiple company competes better than a low multiple company based on Key Success Factors (KSFs). There are 6 KSFs that are commonly used to measure Market Position.

### Price Influence

A high multiple company has more influence over the prices that they sell their products and services for than a low multiple company. They are not forced to follow the prices set by their competitors and they can change their prices at will.

### Competitive Position

A high multiple company has a better position in the market than a low multiple company. A high multiple company has better product and service features, better build quality and a better customer experience. A high multiple company is less threatened by new competition than a low multiple company.

### Vendor Relationships

A high multiple company has less risk of supply disruption and more influence over supplier pricing than low multiple company.

### Benefit Advantaged

A high multiple company's products and services have more features and benefits than a low multiple company's products. A high multiple company's brand has a more positive perception in customers' minds than lower multiple company's brand.

### Geographic Diversification

A higher multiple company is established in more geographic markets than a low multiple company. Accordingly, a high multiple company has diversified their exposure risk more than a low multiple company.

### Customer Diversification

A high multiple company has a broader customer base than a low multiple company. The negative impact from losing a customer is greater for a lower multiple company than it is for a high multiple company.



## Strategy and Business Plan

At a minimum, a company's strategy and business plan needs to align with standard Key Success Factors. To be truly effective the strategy will include a definition of the key activities required to deliver the company's value proposition. The business plan governs the execution of the key activities. High multiple companies will have a better track record and more management experience in strategy design and business plan execution than low multiple companies.

## Organizational Structure and Management Competence and Experience

In high multiple companies:

- ✦ The organizational structure is appropriate for the size of the operation
- ✦ The management team has the professional training and industry experience required to fill their position within the organization (The company has the right players in the right spots)
- ✦ The management team communicates effectively and there is an efficient process for decision making
- ✦ There is a history of low employee and key personnel turnover
- ✦ The management team has been effective dealing with growth and adverse situations
- ✦ The flight risk is low (If a key employee leaves, there is a succession plan in place that will mitigate the negative impact of the departure)

## Goodwill Pass Along

In high multiple companies, goodwill can be readily passed along to new owners. In low multiple companies, the pass along can be more difficult. For example, when too much goodwill is attributed to one person in the company, usually the owner. This occurs when the owner is overly involved in new product and technology development and customers and employees are more loyal to the owner than they are to the company.

When goodwill cannot be passed along easily, it not only depresses the multiple of EBITDA, but it can also negatively affect the terms of the company sale from the owner's perspective. The buyers of the company will defer some payments for the company in order to incentivise the owner to stay on with the company until a sufficient amount of goodwill is passed along to the remaining management team.

## Ability to Meet Financial Objectives

In high multiple companies:

- ✦ There is a history of consistently meeting financial projections
- ✦ There is a history of meeting debt servicing requirements
- ✦ The projected debt position supports the company's business plan and is sustainable
- ✦ The company's capital expenditure (CAPEX) program will sustain the current level of operations and support the projected level of operations defined in the company's business plan





## Financial Performance Analysis

High multiple companies have a greater capacity to repay or refinance debt or take advantage of growth opportunities than low multiple companies.

Specifically - High multiple companies will have better:

- |                          |  |
|--------------------------|--|
| ✦ Cash Flow Measures     | Higher Debt Service Coverage (DSC) <ul style="list-style-type: none"><li>▪ Higher EBITDA / Interest ratios</li></ul> |
| ✦ Lower Leverage Ratios  | Total Liabilities / Total net Worth (TNW) <ul style="list-style-type: none"><li>▪ Funded Debt / EBITDA</li></ul>     |
| ✦ Higher Liquidity Ratio | Current Assets / Current Liabilities   |

## Access to Funds

Companies that have access to funding when they need it for investments in new products or technology, production capacity, joint venture participation or acquisitions have more growth potential than companies that do not have the same level of access to funding. The higher growth potential translates into a higher multiplier and therefore a higher value than a company that has the same EBITDA but has less access to funding.

## Redundant Assets

A factor that can drive the value of one company higher than another in spite of them both having the same EBITDA is redundant assets. When a company has assets on their balance sheet that they are not using in their operations, the value of these assets will be added to the value calculated by the  $\text{EBITDA} \times \text{EBITDA Multiple}$  formula. When it comes time to negotiate the sales price for the company with the redundant assets, the buyers of the company are not likely to pay a market value price for the redundant assets. It is a better practice to sell the redundant assets prior to initiating the sale of the company in general.

## How Your Mergers & Acquisition Advisor Communicates with Qualified Buyers

One of the primary criteria when choosing a Mergers & Acquisition Advisor to sell your company is their proven ability to communicate and engage with qualified buyers.

The Mergers & Acquisition Advisor is the person who kicks off the selling process by making direct cold calls to individual buyers or to the senior executives of corporate buyers who have the authority to act on a sales offer.

Cold calls are notorious for failing to reach the person who has the authority to consider a sales offer. This is not the case when it comes to taking a call about a business that is in play.



It is hard to imagine a circumstance where a senior executive of a qualified buyer would not take a call about an acquisition opportunity. Even if it is only to satisfy their curiosity, most executives will take a call to learn about an acquisition candidate that a Mergers & Acquisition Advisor has determined to be a good investment for their company.

So, while it is relatively easy to get through to a prospective buyer, the onus is on the Mergers & Acquisition Advisor to make the most of that direct call. As the saying goes, there is only one chance to make a good first impression.

An effective first call is one where the person on the buy side who is taking the call knows immediately that they are talking to a credible professional who is presenting an opportunity that is worth exploring. The objective of the direct call is to have a discussion that makes the authorized person:

- ✦ Aware of the buying opportunity
- ✦ Piques their interest in the opportunity
- ✦ Instills a desire to invest their time to explore the opportunity

The initial call is also an opportunity to have a conversation with the prospective buyer about the state of the industry, their appetite for an acquisition and their criteria for qualifying acquisition candidates. The information gleaned in this conversation often proves invaluable in subsequent discussions. If this discussion reveals that the buyer is not in the market for a purchase, there is the possibility that they will refer the caller to another individual or company who are an appropriate buying candidate.

## Teaser

It is common during the initial contact call to present an abstract of the acquisition opportunity. The abstract is often referred to as a teaser. The teaser needs to disclose enough of the company's positive features to pique interest without disclosing the name of the company.

Teasers are only a few pages in length. They are most effective when they outline particular benefits and opportunities that the prospective buyer will enjoy after the sale is completed.

Teaser will include broad information on the company's industry, regions served and an abstract of the company's operations, financial position and sometimes a brief forecast of future operations.

## Entering Transaction Mode

### Non-Disclosure Agreement - NDA

The company for sale enters transaction mode when the direct call and presentation of the teaser leads to the prospective buyer wanting to learn more about the company.

Transaction mode starts with the signing of a Non-Disclosure Agreement or NDA. The NDA restricts both the company and the prospective buyer from using any information they receive for any purpose but the assessment of the buying and selling opportunity.



The minimum requirements of an NDA are:

- Only use the information that will be disclosed by the company for the purposes of assessing the opportunity to buy the company.
- Only disclose the confidential information to employees and representatives who will be bound by the NDA and will only use the confidential information to assess the opportunity to buy the company.
- Only communicate with the company's customers, suppliers and employees after permission is granted by the company.

## Offering Memorandum, Information Memorandum or Confidential Information Memorandum

The signing of an NDA is followed by the disclosure of a detailed insider analysis of the company that comes in the form of an Offering Memorandum, or Information Memorandum, or a Confidential Information Memorandum – CIM.

The CIM contains information about the company that allows the prospective buyer to estimate the profit growth and value that will accrue after the purchase. This CIM is sent to the prospective buyer by the Mergers & Acquisition Advisor.

The CIM takes the buyers past the curiosity stage that was established by the teaser. The CIM discloses the identity of the company to the buyer together with enough information for the buyer to assess the fit and synergies that a purchase will create when the company's operations are merged with the buyer's.

It is important to keep in mind that the CIM needs to be accurate so care must be taken to present the positive attributes of the company without exaggerating them. To this end, the Mergers & Acquisition Advisor drafts the CIM and the company owners edit it for accuracy.

### CIM Structure and Contents

Where the teaser was a two-page document, the CIM covers a broad range of detailed insider analysis.

A typical table of contents for a CIM is:

1. Executive Summary
2. Investment Fit
3. Market Overview
4. Company Overview
5. Organization Chart
6. Products and Services
7. Revenue Profile
8. Customer Profile
9. Supplier Profile
10. Employee Profile
11. Growth Opportunities
12. Historical Financial Information
13. Projected Financial Information



After the prospective buyer's team has had time to review the CIM, the Mergers & Acquisition Advisor makes a follow up call to determine the enthusiasm for proceeding to the next stage of the sale process. For some of the prospective buyers who received the CIM, the fit and synergies that come from buying the company will look substantial. These buyers will be motivated to estimate the value of the company, estimate what they are willing to pay for the company and estimate how much effort they will put into pursuing the acquisition of the company.

Not all of the prospective buyers receiving the CIM will see a good strategic fit and the opportunity for high synergies. The prospective buyer field narrows when these candidates drop out.

## Expressions of Interest

After the CIMs have been reviewed and analyzed, it is common for the Mergers & Acquisition Advisor to request an Expression of Interest from the prospective buyers.

The Expression of Interest communicates the degree of buyer interest in purchasing the company, specifically the buyer's interest in making a formal offer, their approach to valuation and their assumptions about the company's financial performance.

The Expression of Interest will cover:

- ✦ Purchase price considerations
  - ✦ The cash and debt components of the purchase consideration.
  - ✦ The right to change the terms of the payment consideration.
  - ✦ The fact that the document is only an expression of interest and therefore is non-binding on the buyer.
- ✦ Valuation Methodology and Financial Assumptions - Examples being:
  - ✦ The historical financial information in the CIM is complete and accurate.
  - ✦ The projections in the CIM are reasonable in light of the current competitive environment.
  - ✦ Working Capital as of the closing date will be normal and sufficient to operate the company during the ordinary course of business.
  - ✦ All facilities contracts, lease contracts, customer contracts, staff contracts, supplier contracts will transfer to the buyer without an extra payment over and above the purchase price.
- ✦ Due Diligence
  - ✦ The buyer's due diligence parameters. Due diligence parameters are usually broad and cover access to key personnel and all aspects of the business such as; all contracts, shareholder agreements, accounting and finance reports, intellectual property, and proprietary technology.
- ✦ Staff Retention Plan
  - ✦ The buyer sets out their requirements and plans for the company's management team and other key staff. The approach to achieving retention is also discussed.
- ✦ Transaction Structure
  - ✦ The buyers proposed transaction structure is explained along with how the buyer proposes to fund the transaction.



- ✦ Transition and support:
  - ✦ Buyers may list their requirements for transition support from the owner and senior management. They will also stipulate the compensation that will be paid if any, for this transition support.
- ✦ The Buyer's Transaction Approval Process
  - ✦ The buyer will explain the approval process for the transaction. It may be a straight forward approval by the owners or it may require the approval of a board of directors.
- ✦ Conduct of Company Business Before and After the Transaction
  - ✦ The buyer's expectation is that the company will carry on business as normal prior to the completion of the transaction.
  - ✦ The buyer will disclose their intentions to make any structural changes to the organization after the completion of the transaction.
- ✦ Transaction Costs and Fees
  - ✦ Costs and fees by either the buyer or the seller during their participation in the transaction are usually paid by each party on their own. Expenses such as those related to drafting documents, carrying out due diligence and legal support.
- ✦ Confidentiality
  - ✦ Buyer's will not want third party disclosure of their name or the purchase price and payment terms that are under discussion during the transaction proceedings or after the transaction in the event that the two parties do not complete the transaction. If the two parties do consummate the transaction, the price and terms of payment will not be disclosed to third parties without the buyer's consent.
- ✦ Expression of Interest is Non-Binding
  - ✦ There will be a clause stating that the expression of interest does not bind the buyer or the seller to sign to complete the transaction. Neither of the two parties can claim any damage by referencing the expression of interest.
- ✦ Buyers Contact Coordinates
  - ✦ The various ways to contact the buyer and the names and positions of the people on the buyer's team will be listed.

## Data Room and Management Presentations

A selling Company's response to buyers who have submitted an acceptable expressions of interest is to provide access to a data room and an invitation to a management presentation.

A data room and management presentation fills in the gaps in the confidential information memorandum. The data room and management presentation are designed to do more than generate interest in the company.

The data room and management presentation discloses information that the company anticipates the buyer requires to write a letter of intent to buy the company.



## Data Room

In today's world of selling and buying companies data rooms are virtual. virtual data rooms are more efficient and more secure than physical data rooms. Virtual data rooms reduce physical travel costs on the part of buyers and their advisors.

A representative data room table of contents may include:

- ✦ Company Structure and Corporate Governance
  - ✦ Incorporation documents
  - ✦ Bylaws
  - ✦ Board meeting minutes
- ✦ Contracts that the company is a party to:
  - ✦ Sales and purchase contracts
  - ✦ Senior bank agreements, including terms and conditions
  - ✦ Subordinated debt contracts
  - ✦ Insurance Contracts
  - ✦ Lease contracts
  - ✦ Management contracts
  - ✦ Consulting contracts
  - ✦ Employment contracts
- ✦ Finance and Accounting records
  - ✦ Externally prepared financial statements
  - ✦ Internal financial statements
  - ✦ Tax Returns
  - ✦ Insurance
  - ✦ Forecasts and budgets
- ✦ Strategic Plans and Business Plans
- ✦ Intellectual Property
  - ✦ Research and development projects
  - ✦ Trade Marks
  - ✦ Patents
- ✦ Human Resources
  - ✦ HR Policies
  - ✦ Benefit Programs
  - ✦ Employment Contracts
- ✦ Litigation
  - ✦ Outstanding Claims & Litigation
- ✦ Brand Promotion & Sales
  - ✦ Marketing Programs
  - ✦ Customer Account & Contact Listings
  - ✦ Sales Opportunities Under Pursuit
  - ✦ Operations & Facilities
  - ✦ Supplier lists:
    - ✦ Accounts
    - ✦ Contacts
    - ✦ Products and Services Supplied
  - ✦ Policies & Procedures



- Hours of Work
- Process Documentation
- Workflow
- Key Performance Indicators
- Facilities Specifications
- Equipment List & Capacity Profiles

### Management Presentations

The management presentation is the first occasion in the transaction process where managers of the selling company interact with the managers and advisors from the companies that are interested in buying the company.

There will likely be more than one qualified buyer who has submitted an acceptable expression of interest and is still interested after reviewing the company's data room. Accordingly, there will be multiple management presentations to schedule and facilitate. Management presentations take time to prepare, rehearse and present. Key managers from the selling company are required at every presentation.

Management presentations are challenging because they need to be made over a tight time frame to maintain the momentum of the transaction. They are also a distraction from running the day-to-day operations of the company because they take up so much of the senior managers' time and attention. They involve more interaction from people on both sides so there is more risk of confidentiality breaches.

The Mergers & Acquisition Advisor plays a key role in the Management Presentations:

- Setting the presentation agenda together with the company owners
- Preparing the information to be presented
- Rehearsing the management participants to ensure enthusiastic participation without revealing sensitive information such as who the other buyers may be
- Keeping the presentations on track and deflecting questions that are not appropriate
- Recapping with the selling company after each presentation
- Following up with the buying company after each presentation

The rehearsing for a presentation is tailored to the buying company participating in the presentation. Research is done on the buying company by accessing public documents if the company stock is traded, reviewing their website and social media profiles, and general internet inquiries. Much of this will be available from the research done in the buyer qualification stage.

The Mergers & Acquisition Advisor will review the questions that they anticipate from the buyers and rehearse the responses that the company managers will provide.

The Management Presentation can be a two-part affair; an offsite meeting between the management representatives of the two companies and a facility tour which may include product and service demonstrations.

Buying company managers usually prefer to attend management presentations at the selling company's facility, to see the operation in action during the presentation. On the other hand, the company management may be concerned that a string of on-site management presentations will raise the suspicion of the company staff.



The management presentations are scheduled after the buying companies have completed their review of the data room. So the buying company questions at the management presentation will be very specific.

The objective of the management presentation is to establish the degree of fit between the two companies. The meetings are very interactive and the meeting agenda includes in-depth questions and answer periods. The discussion of price and terms does not take place at the management presentation meeting.

The agenda for a management presentation is generic with the objective of facilitating a high level of open discussion.

The Mergers & Acquisition Advisor leads the Presentation. The presentation objectives are:

- Determine the degree of fit between the two companies and the enthusiasm to continue with the transaction.
- Meet and get to know all the attendees from both sides at the presentation. Each attendee will introduce themselves and give a description of their background and role they play at their company.
- Buying company profile - The buying company will outline their operations and why they are interested in the selling company. They will describe how they will integrate the selling company's operations into theirs and the performance expectations of the two companies operating as one.
- Selling Company Profile - The owners of the selling company will outline their history and achievements. They will discuss their future in the organization after a sale is completed.
- Selling Company - Managers Presentation:
  - This is the most interactive section of the presentation. The company managers from both sides will discuss tactics and strategy, and the performance potential of the merged companies.
  - The managers from the buying company will use this section of the presentation to ask specific questions that came out of their data room review.
- Facility tour and product demonstrations may be incorporated into the management presentation or they may come at another time.
- Presentation Summary:
  - The Mergers & Acquisition Advisor solicits feedback from the buy side as to continue interest in proceeding, and confirms any requests for more information.
  - The Mergers & Acquisition Advisor reviews the company's schedule of next steps with the buy side managers.





## Post Management Presentation Follow Up

The management presentation is set to be followed by letters of intent from buyers. Before letters of intent are issued, buyers may have more requests for information and the selling company may want to perform due diligence on the buyer. This may include meeting more managers from the buying company, reviewing their products and services, and touring their plant.

## Transaction Structuring

Transaction structuring starts in the “Sale Ready” stage with the implementation of tax efficient strategies that are designed to minimize the tax burden on owners when they sell their company.

### Tax Efficiency

Income tax efficiency is such an important aspect of a deal structure that a Mergers & Acquisition Advisory team needs to include a professional tax accountant who specializes in re-organizations of a company’s ownership and share structure.

The professional tax accountant will design both personal and corporate tax plans that will be implemented prior to initiating the sales process. Planning for tax efficiency is complex and it is one of the most important responsibilities of the Mergers & Acquisition Advisory team.

A tax efficient plan has two objectives:

- Minimize the overall corporate and personal tax bite on the sale proceeds received from a buyer.
- Accommodation of a variety of offers from different qualified buyers. Consideration needs to be given to how restrictive the tax plan is. An otherwise attractive offer from a qualified buyer can be excluded when the company’s tax plan is too restrictive. Excluding attractive offers reduces the number of competitive offers and that puts downward pressure on the selling price for a company.

While tax efficiency planning is the first consideration to be addressed in transaction structuring, there are three other structural considerations that come into play when ranking qualified offers that are presented by company buyers. These are:

1. The net amount of the buy offer
2. The portion of the net amount where payment is deferred until after closing
3. The degree of the risk that the deferred amount will not be paid and the reward that the buyer is offering to take on that risk

### Net Amount of the Buy Offer

There are two ways to purchase the operations of a company.

1. Buy the outstanding shares of the company
2. Buy some or all of the assets of the company

A share purchase from a buyer’s perspective means that they will own all the assets of the company and they will be party to all of the formal and implied contracts that the company has entered into. With a share purchase all of the company liabilities at the time of closing the transaction will be assumed by the buyer.



When a buyer enters into an asset purchase arrangement they are not automatically party to all of the formal and implied contracts that the company has entered into. Also, unlike a share purchase, the buyer does not automatically assume the liabilities that the company has at the time of closing the transaction. In an asset purchase the contracts that govern the company's day-to-day operations will need to be assigned to the buyer of the company assets. These will include vendor contracts, customer contracts, leases on property and equipment and agreements with employees.

As a rule, the gross amount of a buy offer will be higher for an asset purchase than a share purchase. This is because asset buyers do not automatically assume responsibility for the short and long term liabilities of the company the way that share buyers do.

The following example illustrates how an \$11,400,000 offer to buy the shares of XYZ Company is the equivalent (on a pre-tax basis) to a \$ 20,000,000 offer to buy the shares of XYZ Company.

**XYZ Company  
Balance Sheet (\$000)**

<b>Cash</b>	\$ 250	<b>Accounts Payable</b>	\$ 2,000
<b>Accounts Receivable</b>	\$ 5,000	<b>Accrued Liabilities</b>	\$ 1,000
<b>Inventory</b>	\$ 3,000	<b>Current Portion of Term Debt</b>	\$ 600
<b>Prepaid Expenses</b>	\$ 100	<b>Term Debt</b>	\$ 5,000
<b>Land &amp; Building</b>	\$ 4,000	<b>Share Capital</b>	\$ 1
<b>Equipment (Net)</b>	\$ 2,000	<b>Retained Earnings</b>	\$ 5,749
	<b>\$ 14,350</b>		<b>\$ 14,350</b>

**\$11,400,000 Offer to Purchase the Shares of XYZ Company**

The net amount (pre-tax) that accrues to the owner

**\$11,400,000**

**\$20,000,000 Offer to Purchase the Assets of XYZ Company**

The owners of XYZ Company receive an offer to buy the assets of their company for \$20,000,000. The book value of their assets is \$14,350,000, so the \$5,650,000 difference between book value and the \$20,000,000 offer price is allocated to Goodwill.

The company offering to buy the assets will also assume the \$2,000,000 of Accounts Payable and the \$1,000,000 of Accrued Liabilities.

The net amount (pre-tax) that accrues to the owner:

Asset purchase amount	\$20,000,000
Accounts Payable assumed	(\$ 2,000,000)
Accrued Liabilities assumed	<u>(\$ 1,000,000)</u>
Cash Amount	\$17,000,000
Current portion of term debt	(\$ 600,000)
Term debt	<u>(\$ 5,000,000)</u>
Net Amount to Owners Before Tax	<b>\$ 11,400,000</b>



### After Tax Proceeds that Accrue to Owners

The after tax amount of the proceeds that accrue to owners is determined on a transaction by transaction basis. In some transactions, owners will receive more after tax proceeds when they sell shares. In other transactions, they will be better off when they sell assets.

***The Mergers & Acquisition Advisor and Professional Tax Accountant play a critical role as they work in tandem to determine the tax consequences of the offers that are presented. They refer to the most current tax code and calculate the after tax proceeds that will accrue to the owners for each of the buy offers.***

Some of the factors that impact the tax consequences and choice between an asset sale or a share sale are:

- Owner's requirement to use the proceeds from the sale of their company for immediate personal needs – share sale is generally more favourable.
- The amount of capital gains exemptions available to the owner personally and through a family trust – share sale is generally more favourable.
- The amount of the proceeds from the sale that will be allocated to Goodwill – asset sale is generally more favourable.
- The availability of unutilized tax losses in the company – asset sale is generally more favourable.

### Payment Terms and Payment Risk

It is extremely rare for company buyers to pay the full amount of their offered price at the transaction close date. Some portion of the offer price will be deferred until a future date or a milestone in the future is achieved.

Cash that is not received at the transaction close date is at risk of never being paid. The company owner takes on this risk and they should be rewarded for taking on the risk. The reward that they expect to earn should correspond to the degree of risk that they are assuming.

There are four common types of cash deferral:

- Contingency Holdback
- Earn Out Clause
- Vendor Take Back
- Shares of The Buying Company in Lieu of Cash

### Contingency Holdback

A negotiated amount of the total purchase price for a company can be held back in trust to cover contingencies such as uncollectable accounts receivable, inventory write downs, liabilities that were not apparent prior to closing, and the settlement of legal issues that are unresolved at the closing date.

Both the amount of funds held back and the hold back period will be negotiated between the owner and the buyer of the company. For accounts receivable, inventory, and unrecorded liabilities, there will be a set time based on the company's historic rate of turnover for each of these items.



When some or all of the contingencies referred to in the holdback agreement are tax deductible for the buyer, the amount held back should equal the buyer's after tax liability. Typically for unsettled claims and lawsuits the related holdback amounts are not released until the matters are resolved.

The conditions for holdback release are negotiated prior to closing and written into the closing documents. Holdback amounts can be put in trust until they are released to the owner or used to offset contingencies that come to bare. Interest at a negotiated rate will be calculated on the holdback amounts. Any funds released to owners will include the principle amount of the holdback and the interest that has accrued up to the date of holdback release.

### Vendor Take Backs

Company owners may decide to sell to a buyer or group of buyers who do not have access to the funding required to settle the full amount of the purchase price on closing. In this case, the owners will negotiate a form of payment over a period of time that corresponds to the free cash that the company will generate and the availability of financing that the new owners will be able to raise after they take over the operations of the company.

The term of repayment and interest paid on the outstanding principle of the vendor take back are subject to negotiation between the company and the purchasing group.

Vendor take backs are most common in Management Buy Out purchases. This is for two reasons. First of all, the company owners have an existing working relationship with their managers and they will appreciate their likely inability to fund an all cash on closing offer.

Secondly, any Strategic Buyers or Private Equity Buyers who cannot make a high % cash offer or a share exchange offer are not taken seriously.

Vendor Take Backs expose the company owners to a high degree of risk that should be offset by a higher purchase price and / or interest rate on the outstanding principle. The Mergers & Acquisition Advisor and professional tax accountant will advise on the most tax efficient structure of the vendor take back.

Tax considerations are the timing of the tax on the sales proceeds vs. the timing of the principle payments from the buyers. The interest on the principle is treated as ordinary income to the company owners.

### Earn Outs

In an earn out agreement, the deferred portion of the buy offer is based on how the company performs after the closing date of the transaction.

Earn outs are particularly appealing when both the company owner and the buyer anticipate that the company is positioned to grow substantially after the closing date of the sale. In this circumstance, the buyers usually want the current owners and managers to stay in their roles to foster growth and the company owners want to stay involved for the same reason.



The earn out portion of the offer may be 100% or a lesser % combined with some cash paid on the closing date.

The Mergers & Acquisition Advisor and professional tax accountant play a key role in advising the company owners on how much cash they should negotiate for on closing, the basis for the earn out premium calculation and the tax treatment of the premium payments.

The cash paid on closing should be equal to the value of the company based on its historical performance. The earn out premium is for the increase in earnings over the earn out period which typically ranges from one to five years.

Company owners take on more risk in an earn out situation when the earn out period is longer and the basis for the calculation of the premium is based on an earnings calculation like EBIT or EBITDA. Earnings are calculated after the deduction of below the gross profit line expenses. These are expenses that the company owners have no control over after the sale of the company to new owners.

Company owners have the least risk when the earn out period is short – say one year - and the premium is calculated based on a top line measure such as gross revenue. Using Gross Profit to calculate the earn out premium serves the interest of both the company owner and the new buyer.

Because it is common for the company owners and senior managers to continue in their roles after the sale, the focus on gross profit encourages growth, but not growth at the expense of margins. The focus on gross profit also relieves any company owner's anxiety over a run up of below the gross profit line costs on the part of the new owners.

### Share Exchanges

An exchange of shares between a selling company and a buying company usually take place when the buying company is publicly traded or has plans for an IPO initial public offering.

The tax implications of a share for share exchange are complex so the advice of the Mergers & Acquisition Advisor and the professional tax accountant team is critical.

When the selling company and buying company are Canadian corporations and a share exchange makes up the full amount of the proceeds of sale, the tax on the sale proceeds is deferred until the shares exchanged are sold in the open market.

In a bull market, the expectation of a significant lift in the value of the shares that are exchanged combined with the opportunity to defer taxes can be very appealing for company owners.

Share for share exchanges agreements usually contain a clause that prohibits the company owner from selling their buying company shares for a period of time after the close of the sale. During this period – usually from three to six months – the shares can drop in value.

After the share for share exchange and until the buying company shares are sold, the company owners are minority shareholders of the buying company. The role of the Mergers & Acquisition Advisor is critical



during this period. The Mergers & Acquisition Advisor's defines and negotiates clauses that protect the minority shareholder's interest until the time that they sell their shares in the buying company. A company assumes the most risk in a 100% share for share exchange. They need to be compensated for taking on all this risk with a buy offer that includes a substantial premium over an all cash offer.

### Management Contracts

Some sale agreements will include a contract that engages the company owners to work for the buying company for a period of time after the closing of the sale. This stipulation is a consideration when the company owners are very active in their day-to-day operations. When the owners continue in their role after the sale, the upside for the buyer is a smooth transition of staff, vendors and customers.

The management contract can be for full-time commitment or a consulting arrangement. The compensation under the management contract can be significant and there may be an incentive clause for hitting performance targets. Advising on a Management Contract is another important role played by the Mergers & Acquisition Advisor and professional tax accounting team.

Management contracts are usually entered with the best of intentions, but they often prove challenging for the company owners who no longer exercise as much control and influence over the company as they did before they sold it.

### Negotiating Letters of Intent

Negotiations of purchase prices and terms start in earnest after prospective buyers have attended a company's management presentations and reviewed the company's data room. It is during this negotiation phase that the Mergers & Acquisition Advisor and their team prove their worth. In football terms, this negotiation phase is a "red zone" activity where the objective is to cross multiple goal lines. The goal lines are represented by Letters of Intent (LOI) that are received from buyers.

As in football games, it is the ability to perform in the "red zone" that results in a score or not. The negotiations that culminate in an LOI are led by the Mergers & Acquisition Advisor.

During these negotiations that the Mergers & Acquisition Advisor and their team draw on their depth of experience and skill set to:

- ✦ Prepare for negotiations on a company by company basis
- ✦ Keep up the enthusiasm for the sale by all parties
- ✦ Maintain objectivity and keep emotions in check
- ✦ Preserve credibility and consistency in communication between the buyers and the company
- ✦ Negotiate the best deal and fit that can be reached with each of the buyers who are working towards a LOI

### Preparation

Preparation for the LOI negotiation stage uses the information gained during the targeting buyers stage, the expression of interest stage, and the way each buyer used the information in the data room.



Effective negotiations start with an understanding of each buyer's needs and wants. Understanding the issues that will be resolved by buying the company. Understanding the benefits that the buyer will enjoy after they buy the company. Some issues and benefits will be the same from one buyer to the next. Some will be unique to a particular buyer.

In the preparation stage, the company owners on the advice of the Mergers & Acquisition Advisor and their team will determine the limits of how far they will go to accommodate each buying company's needs and wants.

Understanding each buyer's issues and benefits and knowing the limits of accommodation focuses the negotiations and makes them more efficient. It also makes them more effective because buyers appreciate that the selling company is addressing their needs and wants.

### **Credibility, Consistency and Objectivity**

The negotiations on the part of the company need to be led by one negotiator and this is the Mergers & Acquisition Advisor.

More than likely, the Mergers & Acquisition Advisor will be the most experienced negotiator of company sale transactions. They know how to keep negotiations progressing towards a good LOI all the while maintaining negotiation leverage for the company owners.

Having one person negotiating keeps the message consistent and eliminates the risk of someone on the negotiating team saying something that contradicts another member of the team. Contradicting statements between the same team members damages the team's credibility.

One of the key attributes that the Mergers & Acquisition Advisor brings to the negotiations is their ability to keep their emotions in check and not let them cloud their ability to think objectively. Maintaining objectivity is often difficult for owners because they find the process of selling their business to be very emotional.

A Letter of Intent (LOI) is a significant milestone document for both parties to the sales transaction. LOIs are important for the company because they reflect what the buyers want to see included in a contract to buy the company.

An effective LOI is a comprehensive LOI. The more comprehensive the LOI the more functional it is. For example, a letter of intent to buy the assets of a company needs to list the assets that will be purchased and the liabilities that will be assumed. The amount of consideration that will be allocated to each asset will be listed in the LOI.

Typical contract items dealt with in a comprehensive LOI are:

- ✦ The specific price that the buyer intends to pay for the company
- ✦ Whether the buyer wants to buy the assets of the company or the shares of the company
- ✦ The buyer's terms of payment dealing with such items as the:
  - ✦ Amount of cash that will be paid on closing
  - ✦ Amount to be held back to cover post-closing contingencies



- Amount of vendor take back and the terms and rates on the VTB debt
- Amount to be received by way of an exchange of shares
- Amount allocated to an earn out provision and the term and parameters of the earn out
- Conditions to the offer such as:
  - Approval by a board of directors
  - Approval by regulators
  - Approval by funding agents who will:
    - Finance the company's operations
    - Finance their capital expenditures
    - Be participating in the finance of the company purchase
- Financial Statement Requirements at the Closing Date
  - A section of the LOI will list the buyer's stipulated financial statement requirements on the date that the transaction is set to close - These can include:
    - Minimum Working Capital Amount
    - Debt to Equity Thresholds
    - EBITDA Threshold
    - Capital Expenditure Threshold
- Owner and Key Employee Agreements and Contracts
  - Details of management contracts that the buyer needs from the owners and key employees
    - Roles and responsibilities
    - Compensation and term of service
    - Non-compete, confidentiality and non-solicitation agreements

During the LOI stage of the transaction the Mergers & Acquisition Advisor is negotiating the best prices and terms and conditions from buyers. A certain amount of back and forth is expected as negotiations progress and it is normal for LOIs to be submitted and redrafted after a verbal response from the Mergers & Acquisition Advisor. The number of resubmissions is limited though because buyers will lose confidence in the process and the company will lose credibility if the buyers are asked to redraft their LOIs more than a couple of times.

Eventually the Mergers & Acquisition Advisor and the company owners need to decide on the buyer that has put forward the best offer and is in a strong position to close the deal that they set out in their LOI. When that buyer is selected their LOI is countersigned by the owner and the Buyer is granted a period of exclusivity.

### Exclusivity Period

The buyer who is granted exclusivity is in a high leverage position. They have leverage because the competitive aspect of the negotiation between multiple buyers is suspended during the exclusivity period. The Mergers & Acquisition Advisor and the company owners know that it will be hard to go back to the other buyers who issued LOIs if a deal falls through with the first buyer who was granted exclusivity.





During the exclusivity period, the buyer has the undivided attention of the Mergers & Acquisition Advisor and the company owners. This is the buyer's opportunity to run the table, to negotiate a deal that the company determines to be better than they can expect from any of the other buyers who submitted LOIs. In the exclusivity period, the buyer completes the due diligence that they started during the data room review. The exclusivity period is also the time when the pricing and terms that will be in the purchase contract are finalized.

## Due Diligence

The buyer's due diligence is performed during the exclusivity period. The due diligence is required to confirm that there is no reason for the buyer to adjust the offer that they set out in their LOI. This due diligence process is more in depth and involves more advisors and staff from both the company and the buyer than that leading up to the issuance of the LOI.

The Buyer will want to meet with customers, suppliers and employees that will be instrumental in the future success and transition to new ownership.

The buyer will use staff from their financial team or use an external finance team to review the financial records and plans for the company. The legal team that will be drafting the purchase and sale agreement will review the company's corporate records and legal correspondence and documents.

The buyer's tax advisors will review the company's tax filings and correspondence with the CRA. The buyer's management team will meet with their counterparts at the company. The meetings will involve facility tours and review of equipment, fleets, inventories, IT capability, back office functionality and other pertinent systems.

## Purchase and Sale Agreements

A business sale transaction culminates in the execution of a purchase and sale agreement. The buying company's lawyer drafts the purchase and sale agreement and the selling company's lawyer reviews it. The draft is then reviewed by all the key players acting on behalf of the selling company, the owners, the Mergers & Acquisition Advisor and the tax advisor.

The purchase and sale agreement needs to comply with the price and terms and conditions that have been negotiated to date. It also needs to be comprehensive and free of ambiguity.

Typical clauses included in a Purchase and Sale Agreement are:

- ✦ Price
- ✦ Terms
- ✦ Conditions, including any held back amounts
- ✦ Representations and Warranties
- ✦ Purchase Price Adjustments
- ✦ Non-Compete Agreements



## Representations and Warranties

In the Purchase and Sale Agreement each party may ask the other to make representations and warranties. Buyers will ask the company owners to warrant that there are no outstanding liabilities, legal claims, obligations or commitments that have not already being disclosed in the purchase and sale agreement and the documents attached to the agreement.

Owners will ask the buying company to warrant that they have the financing in place to fund the purchase in accordance with the stated purchase price and terms of payment.

## Purchase Price Adjustments

Purchase price adjustments arise when there is a stipulation that the agreed upon selling price be adjusted up or down if certain performance targets are exceeded or not met.

Common Purchase Price Adjustments include:

- ✦ Working capital thresholds
- ✦ Debt to equity thresholds
- ✦ Foreign exchange thresholds
- ✦ Fluctuations in share price in the case where shares are being exchanged as part of the purchase price compensation

## Non-Compete Agreements

It is common for buyers to have company owners sign a non-competition agreement that precludes them from setting up a competing operation or working for a competitor for a set period of time within a defined territory that corresponds to the current trading area of the company.



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