LAZARUS RESOURCES GROUP, LLC

Selling Your Company

A Guide to the M&A Process from the Seller's Perspective

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Special Report

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The Sell-Side M&A Process

Introduction

Due to the number of baby boomers reaching retirement age, it is estimated that in the next ten years over $11 trillion of personal wealth will change hands. Of that, about 70% is in the form of ownership in private companies.

Many of those companies will change hands through the M&A process rather than through inheritance.

This is an overview of the Sell-Side M&A Process. While each transaction has its own peculiarities, this report covers the most typical type of transaction.

First of all, let us address the different types of players one may encounter in deciding the most appropriate advisor for your situation:

Business Brokers

A business broker typically sells business opportunities such as smaller business (typically deals under 2 million), franchises, and single store retail operations (restaurants, etc.). In many states such as California brokers are regulated by the Department of Real Estate and must have a real estate license.

A broker typically takes a listing agreement similar to that which is used for a property sale and charges a commission upon completion of the sale. They generally prepare limited marketing materials and list the business for sale with a multiple listing service and on websites created to offer such business opportunities.

Transactions are closed through an escrow, usually involving a bulk sale of assets. Business brokers are not licensed to sell securities such as corporate stock, and most seller-financing (which is considered a security in many situations).

M&A Intermediaries

Intermediaries may be either sell-side or buy-side representatives, sometimes both. Intermediaries are in the business of bringing buyers and sellers together through the M&A process we will be discussing here. While some act only as "Finders", introducing buyers and sellers, most will prepare extensive offering materials, identify potential buyers, make the approach, and assist in the sale process.

It is typical for advisors to charge a retainer for the preparation of materials and doing the ground work, and a commission, or success fee, upon closing. In the past, most of these advisors have been unlicensed and acted as "consultants". Recent changes to the SEC regulations require that anyone who deals with the sale of stock or other securities be licensed through the Financial Industry Regulatory Authority (FINRA). If they are unlicensed, they may not be involved in the transaction after a buyer is located, and may not charge a success fee.

Investment Bankers

While Investment bankers perform all of the services that an M&A advisor does, there are some differences in practice between the two. While both may be licensed Broker/Dealers, investment bankers typically offer a wider range of services, such as alternative types of deal structures, valuations, and financing. They are typically also involved in such activities as IPO's, Private Placements, and Secondary Market transactions.

An Investment banker might also assist in arranging the financing for M&A transactions.

Once you have determined the type of advisor that is best for you, it is time to begin the process.

Preparing the Company for Sale

Let me state here that many owners never plan beforehand. They prefer to jump into the sale process, usually driven by a need or an event which creates a need to sell.

Most intermediaries prefer to be engaged after exit planning is done, and do not care to be involved in the longer process of preparation. Lazarus prefers to be involved in this process from the beginning. This sets us apart; it is the key value proposition of our firm. This to me is one of the differences between M&A intermediaries or finders, and an investment banker.

Exit Planning

The first step in preparing a company for sale is preparing for the owner's exit. This should involve a review of the strategic alternatives based on the needs of the owner and the company, such as a complete sale, partial recapitalization, a strategic alliance, roll-ups, or spin-offs, etc.

Once the alternatives have been analyzed and discussed, the exit planning process can begin. Exit Planning is offered by several types of professionals:

- Financial Planners
- Estate Attorneys
- Accountants
- Insurance Agents
- M&A Advisors

Not all professionals approach exit planning from the same direction. Each has services that tie into the process and this is typically what they focus on. Lazarus prefers to take a holistic approach, working with the owner's advisors to ensure that all facets of planning are addressed.

For our firm, exit planning involves all of the steps below to ensure a successful exit and sale of the business:

- Establishing Owner Objectives
- Establishing Business Value
- Building Value and Cash Flow
- Family Wealth Preservation Planning
- Tax and Estate Planning
- Choosing Counsel, Accountant, and Financial Planners
- Business Process Improvements (and in many cases, turnaround or renewal plans)
- Situation Forecasting and analysis
- Succession Planning
- Retention of Key Employees
- Identifying Key Players Involved in the Process
- Stakeholder Management

Collection and Preparation of Due Diligence Materials

Due Diligence is where many deals fall apart or are re-valued. It is important that the seller be prepared for due diligence. This provides an opportunity to find and fix deficiencies.

It is a good idea to have documents ready and separated, to avoid delay and keep the buyer focused on the key issues of due diligence.

Value Enhancement

Value enhancement means identifying and implementing actions which can enhance both profitability and the multipliers used to value the business at sale.

Identifying Value Drivers

Value Drivers are the features, or characteristics necessary to make a business saleable and valuable. They are characteristics that either reduce the risk associated with owning the business or enhance the prospect that the business will grow significantly in the future. Value Drivers include:

- Management Team
- Operating Systems
- Maximized Business Processes
- Well Documented Policies and Procedures
- Established and Diverse Customer Base
- Appearance of Facility Consistent with Asking Price
- Realistic Growth Strategy
- Effective Financial Controls
- Stable and Increasing Cash Flow
- Tax Efficient Business Structure

Recasting Financials

The owner who views his business as a lifestyle “consumption vehicle" is not thinking ahead or planning for the future. Using business revenues as a source to support personal spending undermines the long-term value and growth of the business. The same operating principles and accounting methodology that minimize tax liability also minimize the overall business valuation.

Have your accountant prepare re-casted financial statements for at least three years, adding back all non- necessary owner benefits and costs, and adding in what is needed to replace the owner. This will give potential buyers a truer picture of what the company can do under new ownership.

As you can see there is a lot of preparation to be done; no wonder owners and brokers don’t want to do it. However, according to recent studies, good exit planning can increase the net value received by a seller by as much as 60%.

Engagement of an Advisor

Once the company and its owners are ready to begin the actual sale process it is a good idea to engage a professional advisor to assist you in the process. If you have chosen Lazarus Resources Group, of course, we will have been involved in the planning process from the beginning.

The selection process may include interviewing and obtaining a proposal from several advisors. Once an advisor is selected, the seller will typically negotiate an engagement agreement. I cannot stress enough the importance of properly executed agreement to mitigate conflicts later on.

While engagement letters vary from firm to firm, there are some items that should be in any properly executed agreement. Think of the phrase "**I SET A FEW**" terms.

Indemnification
Scope of Services
Exclusivity
Tails and options
Activities of Advisor
Fees & expenses
Exit clause
When the fee is earned

Preparation of Materials

Executive Summary

Working with you and your accountant, the advisor will typically create a one or two page executive summary for general distribution. The main purpose of this summary is to gain indications of interest from potential buyers. The key facets of this document are:

- It does not identify the seller
- It describes the business
- It contains selected financial highlights
- It provides sufficient information to gain interest
- It describes the sale process

Information Memorandum or Confidential Business Review

The next document that your advisor will help you prepare is an Information Memorandum, or Confidential Business Review. There are several names for this "book" but they all serve the same function: provide a prospective buyer with enough information about the company in specific to allow them to make the buying decision and price their offer.

The book is sent out to qualified buyers who have indicated interest, and have signed a non-disclosure agreement, which we will address in a following section.

This book usually contains a detailed description of the company, its business operations, structure, financials, and projections, along with other information necessary to make the buyer familiar with the company.

Marketing the Company

Having prepared the materials for distribution, the advisor will work with you to determine the best approach for your sale. The two most common strategies for a private sale are:

The Targeted Offering or Negotiated Sale

A target offering usually involves just one or two buyers. It is the most appropriate strategy when there is a clear buyer (or at most two), and speed of execution and confidentiality are of paramount importance. The potential buyer is typically a strategic acquirer that expects to realize substantial synergies in the combined business.

The negotiated process is also advisable in highly engineered transactions involving financial, tax, and other structural complexities. The negotiated sale process can be less disruptive to the target's business and employees, because the process affords greater confidentiality and less disclosure to third parties, such as suppliers and customers.

Auction Process

The other strategy, which is most often used by M&A professionals, is the Auction. There are 2 types of auction processes:

Broad Auction

A broad auction employs a competitive bidding process designed to achieve the highest value for the seller(s) of a business. The ideal candidate for a broad auction is a business that will attract many buyers. This could include financial sponsors or strategic buyers seeking to expand their existing markets or enter new ones. This process is most effective in a strong merger market.

However, a broad auction may deter potential bidders because some financial buyers refuse to participate in auctions to avoid overpaying for a business.

Targeted Auction

This process is most effective when there is a clearly identifiable universe of likely bidders. It provides more flexibility in terms of timing, since there are fewer bidders with whom to coordinate.

The general auction process can be broken into two stages:

- Stage 1 – Solicitation / First-Round Bids
- Stage 2 – Due Diligence / Second-Round Bids

Identifying Prospective Buyers

Another aspect of the sale process that an advisor will help with is the identification of prospective buyers. There are different types of buyers and each type of buyer has a specific motive for making an acquisition. We break buyers down into three types:

- Strategic Buyers - often a direct competitor or a company operating in the same space but in a different geographic market.

- Industry Buyers - usually a company operating in a synergistic or related space but perhaps not currently a competitor. An example might be a company wishing to integrate upstream or downstream in the supply chain within its current market, or acquire specific expertise or capability.

- Financial Buyers - firms that exist are in the business of buying, growing and exiting companies (i.e.: PE Firms.) To the extent that a financial buyer already holds a complementary company in its portfolio, a financial buyer may also appear to be a strategic or industry buyer. This is where PE's might be interested in smaller deals for a "bolt-on" to an existing platform company.

The Approach

Once the potential buyers have been identified and selected for solicitation, the advisor will make the approach to the buyers to gain an indication of interest. This is usually done without identifying the company for sale. If the prospect is interested, the advisor will send out the Executive Summary to gain a level of interest. If the prospect is truly interested in pursuing the possibility of an acquisition, the process will move to the next step.

Non-Disclosure Agreement

At this point, the advisor will send out a Non-Disclosure Agreement (NDA), for the prospective buyer to sign, agreeing not disclose the identity of or information about the company it receives. The agreement may vary in some matters, but most are fairly identical. It is a good idea to have your attorney draft one, or at least approve the one used by your advisor.

Presenting the Memorandum or CBR

When the potential buyer has returned a signed copy of the NDA, the advisor will send a copy of the CBR to the buyer. The document is usually numbered and logged to control the circulation of information.

Letter Of Intent

When a prospective buyer expresses interest in making an offer for the company, the advisor will request that the buyer submit a Letter of Intent (LOI). This letter is usually a non-binding agreement which spells out the terms and conditions of the contemplated purchase and the requirements for closing the transaction.

In an auction process there are often more than one LOI submitted and the advisor can assist the seller in selecting the winning bidder. Due Diligence is often performed with multiple buyers prior to final offers.

Due Diligence

A competent advisor will provide guidance and assistance during the due diligence period, arranging site visits, setting up data rooms and maintaining communications with the buyer to ensure the integrity of the information and providing a smooth process.

The decision needs to be made whether to create a virtual data room or a physical one.

Being prepared ahead of time adds value, speeds the process, and identifies weakness for correction prior to marketing.

The Purchase and Sale Agreement (PSA)

Once the due diligence is completed and the sale is to proceed, attorneys will draft the PSA and closing documents. An important factor to consider is which side will write the first draft of the agreement.

While every deal is different, and therefore every PSA is different, there are several key points that should be addressed to everyone's satisfaction for the deal to go forward. Main deal points to include (Think "**TIPTOE**", because parties often must tread carefully around each point.):

Terms
Indemnity
Price
Timing
Optimum Structure (taxes, etc.)
Escape Clauses

Another key factor is the deal structure. Will the transaction be an asset sale, a stock sale, or a stock for stock merger? Will there be seller financing or earn-outs, etc.? The deal structure will also determine license requirements of the advisor you choose.

Closing

Once the documents are drafted and all of the conditions are met, the deal will close. At this point the work of transferring ownership and control begins. The seller will often be required to stay on for a period of time to ensure a smooth transition.

The process of selling your business can be complicated and sometimes seem daunting. Hiring the right advisors, accountants, and attorneys can make the process much smoother and more successful than attempting to sell your company alone and unprepared.

If selling your company is on the horizon within the next three years, you should begin the process now. Contact **Lazarus Resource Group, LLC** for an initial consultation to determine the best steps to take on your journey.

About Lazarus Resources Group, LLC

Lazarus Resources Group, LLC provides management advisory and investment banking services to business owners and investors of middle market companies with revenues of $10 to $150 million.

We bring a unique approach to serving our clients, providing effective solutions to their business planning, succession and exit planning, mergers & acquisitions, and corporate finance needs. We have particular expertise in assisting under-performing and troubled companies return to profitability and increase shareholder value.