DENVER BUSINESS JOURNAL
TABLE OF EXPERTS
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MERGERS & ACQUISITIONS

If you plan to sell your business some day, you should start preparing now –- not one year before the sale, no matter how far away it is.

The panel of experts offered many solid, practical suggestions about how best to prepare your business so that it's highly attractive to potential buyers. They offered some surprising answers to questions about funding, finding expert advisors, mistakes they've witnessed and more.

The "Best Practices in M&A" panel: Reid Godbolt, attorney at law with Jones & Keller in Denver; Amy Kane, vice president, senior wealth planner, US Bank in Denver; Emily Maier, group leader, transactional solutions, Woodruff Sawyer & Company in Irvine, Calif.; and Dan Roth, managing director, IBG Business, Denver. The event took place February 23 at the Wellshire Inn.

Publisher Pete Casillas conducted the question-and-answer session.

Q: How is the M&A market looking in 2017 compared to recent years?

GODBOLT: I think there is a renewed sense of spirit and optimism. People that can find deals can move them forward. What I see is that there is a lack of sellers. There's a lot of money on the sidelines, looking.

I think a positive factor for people that are thinking about selling is that you've got three types of buyers: strategic buyers, the private-equity crowd and the public companies. Strategic buyers are a little bit more reserved. Private-equity funds and the public companies, they're in the business of getting return back to their owners on a fairly quick basis. So they've got this pressure; it is always there. They've got to get a deal done. And those buyers will typically be the ones that pay the highest prices, and there's a lot of unused gunpowder out there right now.

Q: A best practice in M&A is to form the right advisory team. Who should be on the team and how do you choose advisors?

ROTH: It is important to build the right advisory team whenever you're going to sell a company or work on an acquisition.

Attorneys are absolutely critical to getting a successful transaction done. Select an attorney that is a specialist in M&A transactions, not a generalist. You want a specialist representing you, because it's very likely when you sell your company that the buyer is going to have an excellent M&A attorney on their side. The last thing you want is to have their M&A attorney completely out negotiate your attorney, which we see happen all too often.

Avoid attorneys who think their job is to argue as much as they possibly can with the other attorney to make you think they're justifying their existence. Those attorneys will just charge you a lot of money and your deal will probably never get done.

Second is accounting. You're going to need help on the accounting side, most likely, in the due diligence process, whether you're buying or selling. Most importantly, I think you want an accountant on the team who's a specialist in M&A tax structure. Larger accounting firms usually have a team that specializes in M&A tax law. This type of tax specialist knows how to save you money, because you're going to be amazed how much the IRS is going to try to take out of your deal.

Insurance is third. You may want to have an insurance firm on your team that knows how to use M&A insurance products, like representation and warranties insurance. These are evolving in the marketplace to manage your risk, especially if you are buying a company.

Fourth is a wealth management advisor if you are selling. Why? Because you want to make sure when you sell your company that you have a place to park your money. Don't start spending it right away. You want somebody who manages the proceeds of your sale to

enable you to enjoy the lifestyle you deserve.

Finally, you're going to need somebody to quarterback the deal. For a smaller deal, you want a broker. For a larger deal, you want an M&A advisor or investment banker who is properly licensed.

How do you select that person? I would avoid dealing with people that want to charge you large retainers.

You want to have competition for your business by attracting multiple buyers; that's how you drive up your price. If you're on the buy side, the last thing you want is competition. Work with an advisor that knows about those deals that nobody else knows about.

Make sure your M&A advisor is excellent at negotiating and he or she understands all possible components that can be used to structure a deal. When you sell your business, or buy a business, a lot of what you do is structuring the deal. Also, you should be confident in their ability to tell the story of your business in a compelling way.

For all advisors, pick people who tell you want you need to hear, not what you want to hear. Folks that tell you what you want to hear are not going to get your deal done in the right way, and you're going to have issues, so pick people who tell you the truth.

Q: Should business owners think of a particular set of questions that might be helpful to let them know they're getting in with a great partner?

MAIER: Experience, specifically in M&A is vitally important. You really want to get a feel for: Does your Advisor have long-term relationships with the kind of people that you want to work with during the deal., If it's insurance how good are their insurance market relationships? Does your banker have access to, and the trust off, the right potential buyers does your advisor have the long-term experience of pulling deals together and perhaps know a few tricks that some of the young'uns don't?

KANE: It's important to make sure that the advisor team is going to educate and advise the client. A lot of times, it's not necessarily the questions that the business owner is going to ask; it's about the questions the advisors are going to ask the business owner.

Q: What steps can a business owner take now to position itself for a successful sale in the future?

ROTH: As a business owner, you should always be planning for the sale of your business, whether you're going to sell this year, five years from now or 30 years from now. The decisions you make now will pay off handsomely down the road.

Think of it this way: For most business owners, selling a business will be the most important financial transaction in your life. Hopefully, it's the largest payday you'll ever have. Why not plan for it properly? The first step we advise is to start with a valuation. This helps you understand where you sit today; allows you to benchmark your company, and understand what drives value for your type of business.

From a value perspective, look at your business through the eyes of a buyer. One factor that scares buyers away routinely is customer concentration. If you have 60 percent in revenue from one customer, it's a big red flag for buyers. As part of your planning process, work on having a breadth of customers so you do not have any customers representing more than 10% of your revenue.

Also, focus on developing your management team. If you're the kind of business owner that has everything coming through you – meaning nobody can make a decision without you – that is a very hard business to sell. A business is attractive to a buyer if the business runs well without the owner.

This is basic, but clean up your books and records and make sure your inventory is properly represented.

Finally, drive recurring revenue. Businesses that have consistent monthly recurring revenue are the companies pushing valuations to high levels.

Q: What kind of legal preparation do I need to do to put my business in a position to sell?

GODBOLT: What you want to do when you are looking at buying or selling is to try to put yourself on the other side of the table. If you're looking at selling, put yourself on the other side of the table and think like you are buying. What is it you would want to see in your business?

Look at your organizational documents. Keep records. What are your books like? What litigation do you have, if any? How are your books? How is the accounting going? How are your tax filings? What's critical to your business?

Q: What is a good strategy for finding and completing strategic acquisitions?

ROTH: The first thing we recommend before you start is to build relationships with banks and line up your funding sources. Who's going to provide capital? Because when you get to the point where you're going to make offers to potential sellers, the first thing they're going to ask is, "Do you have the money?"

Have the lenders educate you about how you can leverage a balance sheet from the target that you're buying. You can actually borrow money against the balance sheet of the company you are going to acquire. Understand how that works so you can lower your cost of capital and increase your rate of return.

Second, establish your criteria and then stick with these parameters. Say, "I want to buy this kind of company, in this industry, with this kind of revenue and this kind of profit." Then, go find those companies. Don't stray from that.

And finally, ideally you want to find companies that are not on the market. If a business is already on the market, the seller will likely have a certain mentality about how the

business deal should go. Better to approach a business that's not on the market yet. You will have a better chance of negotiating a better deal for yourself and potentially structuring the deal with more of a shared-risk, shared-reward model.

GODBOLT: If you stray from what you're really trying to do, you're going to be the new player at the table, you're going to be the new player at this card game, and guess who's going to lose? You're going to lose. So you really want to stick with your strategies in what you're looking for.

KANE: I'm going to echo what Dan said about having the financing ready. If a business owner is planning for an acquisition, make sure they are working with an organization that can give them access to lending or partners with private equity. A lot of times, business owners will find the opportunity to purchase and don't have the lending established.

Right now, financing is very attractive from a term and an interest-rate perspective.

Additionally, make sure you have a plan in place to retain key executives and key employees, especially if you're going through some kind of transition. It's really important to make sure the people that you want on your team stay, whether it's with the existing company or the new company.

Q: How do underwriters judge or approximate the risk?

MAIER: With reps and warranties, what they're doing is diligence on the diligence. What they're going to want to see is a thorough and robust process. This speaks to some of the things we've heard about prepping for sale: So let's say the buyer is the insured. About 90 percent of the policies written right now are buy-side insured. The underwriter –will want to go into the data room. They will want to see that all the documents that are purported to be there are there. They will look at the warranties and look at the data provided and check for gaps. They will want to see all of the third-party diligence, or internal memorialized diligence that has been done. They will want to talk to the buyers' team and find out how they went about the process.

Q: What does this cost?

MAIER: There are two numbers to think about. One is retention, the other is premium. Retention is like the deductible on your car insurance; it's the pain the insured has to feel before the underwriter feels pain. There's multiple ways to set it up. But assume that 1½ percent of the overall transaction size is going to be the retention. So, in the case of the $100m transaction the retention is $1.5m. The retention can be borne by the seller; it can be borne by the buyer. It can be borne by a combination of the two.

If the object is to walk away completely free and clear, the buyer will have to take all that retention.

In terms of premium, it's also a percentage, but it's a percentage of the limit that you buy and is not tied to the transaction size. So last year I would have said 3 or 4 percent, so for a $10m million-dollar policy limit, that's 300 or 400 grand. It will last six years. You only pay off once.

In the last two months, I'd say 2 1/2 percent to 3 /2 percent.

Q: What are some of the biggest mistakes business owners make?

GODBOLT: I've got so many scars on my back from situations where things were not looked at closely. I'd say the biggest thing when you are looking at these companies, from a legal perspective, really do your homework and be prepared. Learn as much as you can, and if you see something that doesn't sound quite right, or you're not sure about it, make sure that you really flush that out. A lot of times when deals get momentum, and there's something that's not quite right, there's something that gets pushed to the side and never really gets flushed out until the deal is done. And then it's, oh my goodness, what happened?

If it absolutely has to be done tomorrow, don't do it, because there's a reason that people are pushing you into a corner to try to get something done.

KANE: Remember to plan from the personal perspective. Give yourself time to be educated, time to minimize tax payments, maximize value, and time to plan long term.

Like a business, you need a personal strategic plan. Know what your goals, objectives and legacy are going to be, and create a plan that maximizes that.

I ask business owners, "Visualize your life post transaction. What's it going to look like? Are you going to start another business? Are you going to focus on a hobby?" I have heard my clients say: "I'm going to do all the things I haven't been able to do. I'm going to go golf, I'm going to go skiing, I'm going to go on these trips." But that's probably going to wear off after a few months. So what is it

going to look like after? How are people going to contact you?

One of the biggest mistakes I see is that people still use their business email for personal talk. If you sell your company, that information goes with that new company. You don't want the new company to have that personal information.

MAIER: Take plenty of time to get prepped. Different buyers have different kinds and levels of concern. If they're a private equity buyer, they're going to go through everything with a fine-tooth comb. They want to see a very tight ship. Make sure your corporate governance is well documented, that your contracts are in order, that your books and records are clear.

If it's a strategic buyer, they're going to be very interested in the coverages you have for the key risks in your industry.

What you don't want is gaps in coverage, or a poor loss history in key areas.

Although it's a sellers' market you don't want to be penalized for easily fixable issues or even put out of the running.

ROTH: I've seen quite a few. No. 1 is a seller selling to a single buyer. I can't tell you how many times I've been told, "Oh, I have a buyer for my business. I don't need to have a marketing process. I've got a buyer."

That buyer -- you are their dream right now. That means you don't have a good advisory team, you don't have any competition on your deal, you don't have much ability to negotiate a better deal because you do not have leverage. You're not going to get a great deal when you sell to a single buyer.

The second mistake I hear is when a business owner decides to sell to an employee. That means you're not going to have a liquidity event. They don't have the money; that's why they work for you.

Third, if you're a buyer, falling in love with a deal that doesn't fit your parameters.

Fourth, not understanding who the buyers are. Sometimes I'll talk to business owners, and I ask, "Who do you think is going to buy your business?" "Oh, Joe down the street, or some other local competitor."

Think more broadly. Deals get done with international buyers. Large companies are buying small companies. Private equity is extremely active right now and they have lots of money they need to invest. Understand why these types of buyers would want to buy your business. Geographic expansion. Product line expansion. Selling your products or services through their existing sales force.

Perhaps the biggest mistake is thinking that the right time to sell your business is up to you. You do not decide when the market is right to sell your company. The best time to sell your business is dictated by the market. Avoid artificial time frames like your age, or getting to a certain revenue or number of employees. Your business will be the most valuable if you sell when the market is most interested in acquiring a business like yours.

Q: What are the timing factors to be considered when buying or selling a company? When is the right time to start?

ROTH: Now. I don't care if you're selling in 2017 or 2040. You should always be planning for the sale of your company, making decisions now that will make the most important asset you have as valuable as possible and then listen to the market.

Work backwards. Stephen Covey said, "Start with the end in mind." I want to be an attractive company to buyers, I want to drive a high valuation, but I also want to think about other factors, like making sure whoever buys my business will take care of my people and the legacy of the company I have built.

Earlier, we talked about having clean books. If you do not have that, change your accounting processes now. Buyers love backlog and they love long term contracts. Try to build your business so you have contractual relationships with customers that buyers can inherit. Build your backlog. Buyers feel a whole lot more comfortable when they see a six-month or a 12-month backlog and they can count on that revenue post-acquisition.

KANE: If you give a business owner a list of 10 to 15 things to do, it usually goes off to the side and does not get done. The more time you have, the more you can set small, more manageable tasks and goals. If I give them one or two things, those get accomplished, and then we move on to the next items.

Even though we are spending much time focusing on what happens during a transaction, it's important not to forget about a contingency plan. Life is going to happen. Transition is going to happen, regardless of whether you want it or not. Understand and plan for what happens in the event of death, divorce, disability. We've had a couple of unfortunate incidents where a business owner is going through a transaction, and something happens to the key owner. With a contingency plan in place, owners have a plan B ready. I think it's really important that you do not lose sight of that.

MAIER: If you are looking for an exit, you really want to minimize your liability, and you want to consider things like reps and warranties, and tax opinion at the very beginning., You want to set the stage for the buyer. Let them know that, that is your expectation. Let them know you know how much it costs, and you know what's a bad deal. Have that in your back pocket., so you can highlight the issue at the beginning of the negotiation.

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Reid's 36 years of experience has been representation of issuers and underwriters in public and private offerings in several industries including energy, insurance, technology and pooled investment vehicles such as hedge funds, private equity funds, mutual funds and municipal finance.

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