

VIEWPOINT

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CHOOSING THE RIGHT INVESTMENT BANKER WHEN SELLING YOUR MIDDLE MARKET BUSINESS

By Elliot Williams

This month's Viewpoint focuses on one of the most important business decisions an entrepreneur ever makes: selecting an advisor for selling your middle market business. Choosing the right M&A advisor is important for any business, but middle market companies have unique characteristics that must be considered when selecting an M&A advisor. These differences make "fit" with your advisor critical.

WHY THIS MATTERS:

- Middle market companies encounter different challenges from those of larger companies when engaged in a sale; having an investment bank that understands these differences is vital.
- Choosing the right M&A advisor can have a major impact on your company's valuation, as well as the probability of closing a transaction.
- Asking the right questions when interviewing banks can help you better gauge the true fit and capabilities of potential advisors.

COMPANY DIFFERENCES IN THE MIDDLE MARKET

Middle market companies are relatively small in size, ranging from \$10 million to several hundred million in revenues. Organizational charts in middle market companies are driven by practical day-to-day operational needs, and they tend to lack the bench depth needed to support an M&A process. Management teams typically are stretched already, and adding a highly demanding process such as selling the business can quickly cause management teams to lose focus on the company.

Middle market management teams must hit their numbers during a sales process. Missing stated financial goals can have serious ramifications for value and probability of close. Buyers can lose confidence in a management team's capabilities quickly. Missing the numbers also raises fundamental questions about management's visibility into the future performance of the company. When budgets are missed, buyers may start to wonder about

other possible problems that may exist in the business.

This pressure to perform is exacerbated by the fact that middle market businesses are generally more susceptible to monthly and quarterly financial fluctuations due to their size. Losing a major customer when you generate \$20 million in revenues has a much bigger impact than if your revenues are \$500 million. Your team needs to be more focused than ever on making the numbers during a sale process.

Regardless of which advisor you choose, the M&A process will put serious demands on your middle market management team. Due diligence, document preparation, management presentations and preparation, strategy, and negotiations are just a few topics that will require management input and time. Also, the type of information that needs to be collected, analyzed and tracked in a sale process can be very different from the day-to-day operating and financial reporting used to manage the business. Technical skills matrices, employee longevity and turnover statistics, product margin and mix analysis, deeper sales pipeline analysis and many other analyses may be required to properly position your company for maximum value. Some advisors are better than others in positioning a company for sale – asking the right questions during interviews will help you make the right choice.

Because of the size of middle market companies, the buyer universe available to these companies is often much larger than the potential buyer pool that exists for large companies. In many cases, hundreds of companies can fit the financial and strategic buyer profile for a middle market business. This drives the need for a highly-managed process for communicating, managing and negotiating with multiple suitors. We speak to a relatively large number of potential

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acquirers on any given transaction. The number is situation-driven, but Mirus typically reaches out to between 50 and 300 companies on a given transaction. Managing confidentiality is critical when engaging numerous companies. How this process is managed should be a key

consideration for selecting an advisor.

Another important difference when working with middle market sellers is that, generally speaking, owners and management teams lack M&A experience. Many middle market owners are selling a business for the first time, or have only been involved in M&A in some tangential way. Executives and owners with deep M&A experience still require help and independent advice when selling a business. Lack of experience inevitably leads to a variety of challenges during a sale process. Your advisor should be sensitive to this fact and have both the ability and inclination to walk you and your team through each step. Preparing each team member for buyer interactions is imperative when working in the middle market. Buyers are typically more versed in M&A process and strategy than sellers. A strong advisor should level the playing field for you.

IMPORTANT TOPICS TO EXPLORE WHEN INTERVIEWING ADVISORS

How do you decide which advisor is right for your firm and the opportunity you have before you? Incorporating these considerations in your decision making will help you make a good choice:

- **STAFFING** Staffing can be a tricky discussion when working with investment banks. The bottom line is that you should demand and receive senior level attention when selling your business. You

FIRMS THAT SERVE THE MIDDLE MARKET

One of the most important criteria for selecting an advisor is choosing what type of firm is going to represent you and your company. Here are your choices:

- **BUSINESS BROKERS**

The vast majority of firms serving the middle market fall into the business broker category, typically firms of approximately one to five people that focus on smaller deals in the \$2 million to \$50 million range. These firms emphasize senior-level attention as a primary differentiator but often lack much of the infrastructure (research, information systems, etc.) that larger firms have integrated into their services.

- **MIDDLE MARKET BOUTIQUES**

Middle market boutiques are larger firms with up to 25 people, and focus on transactions between \$10 and \$200 million in value. These firms (Mirus Capital included) position themselves as striking the right balance between senior-level attention, technical capabilities in middle market finance and M&A, and a process geared to middle market companies that has been informed by middle market experience.

- **BRANDED MIDDLE MARKET INVESTMENT BANKS**

Branded middle market investment banks typically employ 50 to 150 people and focus on transactions valued between \$100 and \$500 million. These firms tend to position themselves based on their industry and financial connections, along with comprehensive technical knowledge in finance and M&A. Each firm has different philosophies on process, with some using processes that are more similar to middle market boutiques, while others use processes more similar to those of full-service investment banks. Be sure to understand their process when interviewing these firms. One approach may be more appropriate than the other for your business.

- **FULL SERVICE INVESTMENT BANKS**

Full service investment banks are large institutions that provide a variety of financial services, including mergers and acquisitions advisory. Names in this category are well known, including Merrill Lynch, UBS, CIBC, Morgan Stanley and many others. These firms tend to focus on large deals ranging from \$250 million to multi-billion dollar transactions. These firms position themselves based on their industry and financial connections (having a relationship with the "right" five buyers) and highly developed technical expertise (such as situation-specific financial instruments used to close a transaction).

deserve nothing less given the investment you have made in the business, not to mention the fees you will be paying to an advisor.

Avoid the "bait and switch" tactic that has become well known in the investment banking trade. Do not assume that the person delivering the pitch is the person who will handle your transaction. Many advisors use senior partners to secure business but more junior staff to actually manage the transaction. Be sure to ask about the continuity of the team – will the team that starts your transaction be there until the end? Also, ask tough questions about the role of each team member.

- **CAPABILITIES** These are the intangibles that are difficult to gauge in a simple pitch meeting. We recommend that you reference check to gauge capabilities. Reference checking allows you to dig into the individual banker's capabilities as well as the firm's capabilities. How were the communication skills of the bankers? Writing skills? Negotiation skills? How did reporting work? How was their advice throughout the process? Any surprises? References provide firsthand accounts and insight that may raise additional questions to ask a perspective investment bank.

- **PROCESS AND TIMING** Prompt each advisor to discuss the timing and logistics of their recommended process, focusing in on each step of the process. Be sure to understand exactly how each banker will approach up-front due diligence, writing the Descriptive Memorandum and Executive Summary, building and maintaining a data room, creating a buyer list and contacting potential buyers, managing the Letter of Intent process, creating management presentations for Buyers, managing ongoing buyer due diligence, managing the Purchase and Sale Agreement process, and managing closing activities. Which process is optimized to meet your transaction objectives? Which approach fits best with your firm's culture and capabilities?

- **CONFIDENTIALITY** Dig into the communications strategy each firm proposes to use to reach out to potential buyers. We have seen firms employ fairly indiscrete tactics for marketing companies. Some firms will "mass-market" your company to not only strategic buyers and private equity firms but to other investment banks, attorneys, and accountants through email marketing campaigns. The downside of this approach, of course, is that your advisor quickly loses control over who is reviewing the Executive Summary on your business. We have also seen investment banks send the Executive Summary to strategic buyers via general corporate fax numbers in a "fax-blast." Ask detailed questions about the process for reaching out to buyers.

- **VALUATION** Any good advisor should manage owner

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expectations up-front regarding timing, process and, of course, valuation. While you are interviewing investment banks, keep in mind that they are selling to you. Don't fall victim to being told what you want to hear. Challenge each banker's position on valuation (particularly on higher valuations) and force them to justify the valuation.

Keep an open mind during these discussions, particularly with those bankers who are expressing a lower valuation. You

should be able to learn a lot about the market for your business, as well as distill the most likely scenario for your business. Although it's appealing to hear that your business is worth three times revenues or 15 times EBITDA, it's better to deal with facts. Entering a sale process with inflated expectations can lead to poor decision-making and broken transactions and could force you to wait several years for the next exit opportunity.

- **INDUSTRY KNOWLEDGE** Hiring an advisor with strong industry knowledge can be a great asset during the process. Mirus has built expertise within many segments of business services, software and manufacturing that we find very helpful when selling a company. Industry specialists can bring several things to the table, including industry contacts, more refined positioning ideas, and they may get up the learning curve more quickly with your company given their familiarity with the industry. All of these characteristics are valuable and should be weighed when hiring an advisor. However, in our experience, too much emphasis is placed on industry knowledge when hiring an investment banker. Owners often say that they are only interested in hiring an "industry expert," but this limits your options, and may lead you to hire a banker with the right industry knowledge who is the wrong banker for your business or situation. Be sure to weigh all of the relevant facts when hiring a banker.

IN THE END, CHEMISTRY COUNTS

Don't underestimate the importance of chemistry and trust on your selection of an investment bank. Selling a company is a long, emotional and stressful undertaking for owners and managers alike. Entrepreneurs spend years building their businesses and the decision to sell is a difficult one. Add to this that the process has its inevitable ups and downs and can create a great deal of stress in the process. Your advisor may be accustomed to the M&A roller coaster, but you may not be entirely ready for the ride. Hire an advisor who will be sensitive to how the process may impact you and your team. Also, keep in mind that all communications coming from buyers will pass through your advisor. Trust is paramount.

Elliot Williams is president of Mirus Capital Advisors, Inc. Mirus is a middle-market investment bank that specializes in advising companies in strategic mergers and acquisitions. By combining a proven process, industry and transactional expertise, creative thought, and personalized service, Mirus has completed hundreds of transactions for both public and private companies. Mirus is a registered broker-dealer and NASD/SIPC Member. For more information, visit www.merger.com.



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QUESTIONS TO ASK WHILE INTERVIEWING M&A ADVISORS

Here are specific questions that we recommend you ask any investment banker you're considering hiring to conduct what could well be the most important business transaction of your life:

- VALUATION**
What is my company worth? Why do you believe it is worth this amount? What specific transactions and analysis would you point me to that justifies this price? What is the worst-case scenario on valuation for my business given the current market environment?
- POSITIONING**
How would you position my business in the marketplace? What critical success factors do you see? What assets would you highlight in my business? What have you found in my business that may have a negative impact on valuation or probability of closing a transaction? How would you position these weaknesses?
- STAFF**
Can you identify the entire team that will be working on my transaction? In your experience, how often does this team change mid-transaction? Who is going to work day-to-day with me, my investors and my management team? Who will be the project manager? How many transactions is each member of the team currently working on?
- DOCUMENTATION**
Who will prepare the Executive Summary and Descriptive Memorandum? Will you be preparing these documents? How much work will be required by me and my team? Are these documents created in-house or outsourced? Can you provide me with samples of documents that you have created?
- MANAGEMENT PREPARATION**
Who will prepare management presentations used for meeting with buyers? Can you provide me with a sample of a previous presentation? How will you prepare me and my management team for buyer interactions? Can you show me preparation materials you have used in other transactions?
- REPORTING**
What type of client reporting do you do? What is the frequency of reporting? Could I review a sample client report?
- CONFIDENTIALITY**
How do you screen buyers to be sure they can consummate a transaction? How do you ensure confidentiality in this process? How do you contact buyers? Fax? Email? Direct phone?
What happens if there is a breach of confidentiality during the process? Have you experienced this situation in the past? How did you handle it?
- TIMING & PROCESS**
How long will this process take? I realize that it is somewhat premature, but can you give your thoughts on the right sale process for my business? Will buyer meetings happen before or after buyers express valuation and terms? How many buyers will we meet with? Who should create the purchase and sale agreement?
Who will handle negotiations on my behalf? Can you take me through the typical market terms right now in terms of escrow percentage, indemnification caps, baskets? What do you expect in terms of deal structure and timing of payments? What should my management team members expect in terms of employment agreements (timing, non-competes, etc.)?
- PREPARING FOR A SALE**
Are there any issues I should work on/resolve before starting a process? What areas should I explore in my business for typical "trouble spots" during transactions?