

# VIEWPOINT

## ISSUE 19

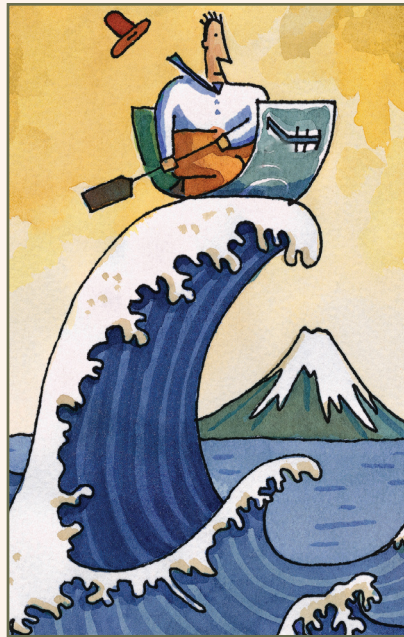
A Publication of  
Mirus Capital Advisors, Inc.

## SELLERS BEWARE: FIVE PROBLEMS THAT CAN SINK YOUR DEAL

By Peter Alternative

### WHY THIS MATTERS:

- It can be costly on many fronts to have a deal to sell your company crash and burn, so it's wise to be aware of common deal killers and takes steps to avoid them before entering the market.
- Wasting time on a deal that eventually sours can cause your company to miss its optimum window of opportunity for sale. The outcome could be a lower sale price when a deal finally does come to fruition.
- Deal killer situations soak up lots of management time, causing you to take your eye off daily operations and potentially harming company performance.



*Few experiences in business are more harrowing than having a deal to sell your company fall apart. While the ups and downs of a deal are inevitable, having your transaction get permanently derailed is not. If the deal crashes and burns, the repercussions on your business can be significant and long lasting. Company performance may suffer as management takes its eye off of day-to-day operations. Key employees get spooked and leave because of the anticipated change of control. The window of opportunity for selling your business may narrow, if not close all together. All of these outcomes can contribute to lowering the company's eventual sale price.*

*This month's Viewpoint looks at five common reasons why deals falter and provides advice on how to avoid these common deal breakers. Understanding these deal killers can help you take the necessary steps in advance to assure that your deal doesn't sink when it hits some rough waters.*

## DEAL KILLER 1: LOSS OF SELLER CREDIBILITY

The last thing you want to do during negotiations for the sale of a business is to lose credibility with the buyer. In the buyer's mind, the management team's credibility is directly linked to the probability of closing the deal, as contemplated in your letter of intent (LOI). More specifically, the implications of a loss of credibility can range from dropping the price a buyer is willing to pay to a figure that is below what you find acceptable to a buyer losing interest altogether.

One sure way to have your credibility plummet is to miss financial performance forecasts as negotiations unfold. Another is to provide forecasts with little supporting data. Be reasonable with your financial forecasts. Share achievable numbers that you can support with data about your sales pipeline, customer buying trends, quota attainment, historical close rates and all other key sales assumptions. Be sure any financial data given to the buyer is comprehensive, consistent, accurate and concisely presented.

"We tell clients to be realistic and not overly aggressive about their financials because deals take time," said William Andronico, CPA, MBA, MST, partner and practice leader of Corporate Advisory and Transaction Services at MFA - Moody, Famiglietti & Andronico, LLP, in North Andover, MA. "If you're projecting each month going forward and a few months into negotiations you haven't met a single one of your projections, that is not going to help close that deal."

Therefore, it's important to maintain your focus on day-to-day operations so business doesn't fall off and cause you to miss projections as the deal is underway. Deals are inherently distracting and buyers are going to want to spend as much time as possible with your team. This is where your investment banker should step in to shield your management team from as much "deal noise" as possible. The investment banker should also help you identify what is crucial to getting the deal done during due diligence and what is actually post-integration planning. While some post-integration planning has to take place in advance, you want to keep it to manageable levels so it doesn't sidetrack you from running your business.

Another way to lose credibility is by showing signs of incompetence during due diligence. "Even if you've never been through this process before, you don't want to convey the impression that it's amateur hour," said Ameer Ashok Ponda, an attorney with the Boston office of Sullivan & Worcester, LLP. "You want a prospective buyer to think you're on top of your game. If a buyer sees sloppy record keeping and sloppy options grants, for example, it's going to be off-putting. If you can't get your act together for a process that is this important, it makes the buyer

wonder how you run your company."

Certainly, how sensitive buyers are to credibility issues varies from deal to deal and from buyer to buyer. Public companies, for example, are going to have different risk profiles than private companies. However, for all buyers the momentum and excitement that has been built during the LOI stage can be quickly overcome by the number of red flags that emerge due to delays or haphazard responses during due diligence.

"If you know you're going to market, prepare ahead of time and consider what the due diligence process is going to look like," said Andronico, "Have the right people ready to be part of it and know what buyers are going to ask for so you're delivering the information in a clean, precise, consistent and quick manner."

Two suggestions regarding how best to ensure a smooth due diligence process include: (1) proactively build out an online data room before due diligence; and, (2) work with your advisors early on to assess whether you have adequate internal finance resources to handle due diligence. In the absence of a seasoned CFO, even the best controllers can be overwhelmed by due diligence. In that case, consider hiring part-time finance resources. While you will spend a few dollars, keeping your controller properly supported will keep him/her sane and will greatly improve the likelihood of a smooth due diligence process.

## DEAL KILLER 2: ERRONEOUS EXPECTATIONS

Many sellers, especially those who are selling a business for the first time, enter the process with naive expectations about a wide variety of issues that can eventually bring down a deal.

Perhaps chief among the faulty expectations first-time sellers bring to a deal is the price their company will fetch. Too often, sellers set a "walk-away" price in their minds and when the market comes back and says the real value of the company is materially lower, they balk.

"If you're putting your home up for sale, some brokers are going to tell you what you want to hear and other brokers will tell you how to price the house to sell," said Ponda. "Sometimes the news is sobering and many people will choose the person who tells them what they want to hear as opposed to what they need to hear. The same thing is true when you're selling a business." [See [December 2006 Viewpoint: "Choosing the Right Investment Banker When Selling Your Middle market Business"](#) for more information on this important topic.]

"When you have a first-time seller going into the process, they often do not fully understand all the nuances. For example, they may not understand what it means to make representations and warranties, the process of preparing and the need for

**"BUYERS CAN'T MAKE A FULLY INFORMED DECISION IF THEY DON'T KNOW ALL THE MATERIAL FACTS ABOUT A COMPANY. IF YOU TRY TO BE CUTE WITH DISCLOSURE, INVARIABLY IT WILL COME BACK TO HAUNT YOU."**

**-- SHANNON ZOLLO, MORSE, BARNES-BROWN PENDLETON, PC**

## MORE ON FAULTY EXPECTATIONS

Other problem areas that can sink your deal include:

- Failing to align managers' incentives before the sale process begins. Determine in advance of the sale process how to reward key managers who are integral to having a successful sale. Otherwise, you find yourself in the position of doing this at the 11th hour when key employees have increased leverage and may ask for things that are unrealistic from the shareholder's viewpoint.
- Having a dysfunctional board of directors. Investors on your board may have interests that differ from those of other board members or of your management team. Misalignment of objectives at the board level can be particularly acute when dealing with multi-generational family run businesses as well as at companies where there are both financial and strategic investors. As with incentives for managers, you want to think through in advance how to manage these opposing interests. If this isn't successfully done, you may not get the support you need to finalize your deal.
- Failing to thoroughly negotiate a letter of intent. Many things can go wrong at the letter of intent stage that later come back to haunt you. Rushing into an LOI without an adequate amount of buyer due diligence can cause you to sign a porous letter that leaves both sides with widely differing expectations that can only lead to disagreements down the road. Buyers, of course, understand that their negotiation leverage increases greatly once a seller is locked up in an exclusivity period. You, on the other hand, lose leverage and therefore are better served by having the buyer do more due diligence before the LOI is signed so that you have a better understanding of the buyer's position with respect to all key terms and conditions. This list should include understanding the buyer's approach to indemnification (survival, caps, baskets, etc.). You can encourage a buyer to see your perspective by saying that you want to make sure that before you effectively take yourself off the market, you're venturing in to a deal with a high probability of closing.

disclosure schedules and what their indemnification liabilities may be," said attorney David Barbash, a partner in the Corporate Department of Posternak Blankstein & Lund LLP, in Boston, MA. "These are topics that are not discussed in detail when someone is in the room saying 'I want to buy your company.'

"My first advice to a potential seller is get together with your attorney when you are contemplating a sale to discuss the process and the general terms of any purchase and sale agreement so you proceed with a solid understanding about the sales process," Barbash added. "Secondly, engage an investment banker early in the process to assist you as well. Having a strong team behind you as a first-time seller will make the process go much smoother and assist you to set reasonable expectations."

(See sidebar for additional areas where faulty expectations can cause trouble.)

## DEAL KILLER 3: DUE DILIGENCE DISCLOSURES

Due diligence can be a bumpy and sometimes terminal ride for sellers who either don't have their ducks in order to make the process flow smoothly or who make the bad choice of trying to shield potentially damaging information from a buyer as long as possible.

"Buyers can't make a fully informed decision if they don't know all the material facts about a company," said Shannon Zollo, a partner with Morse, Barnes-Brown Pendleton, PC, a business law firm in Waltham, MA. "If you try to be cute with disclosure, invariably it will come back to haunt you."

According to Zollo, at some point prior to serious negotiations with a potential buyer, the seller and his advisory team need to have a serious discussion about what the seller is trying to accomplish. "We need to find common ground between what the buyer is willing to pay and what the seller is willing to accept and that is going to be driven almost solely by disclosure. Sellers need to understand that full disclosure generally will resolve the majority of problems that partial disclosure creates."

"The worst thing is to have a major issue or liability be discovered during due diligence," said Barbash. "You want to get these issues out on the table early. In general, more often than not if something is going to cause a deal not to proceed early on, it will cause it not to be consummated later as well, so you might as well get sensitive issues out in the open early. If a seller waits and late disclosure causes the buyer to decide not to consummate the deal, then the seller has incurred costs, taken valuable time away from the operation of its business and generally weakened the company."

## DEAL KILLER 4: TAXING TAX ISSUES

Sometimes deals buckle because of tax situations that come to light during due diligence. Taxes of all sorts—state sales and use taxes, payroll taxes, state income taxes, taxes owed for doing business in foreign jurisdictions—can cause problems. This list of potential problem areas continues to grow, as issues such as IRS Section 409A come to bear in M&A transactions.

As Andronico reminds us, your company's corporate structure impacts your tax situation when you sell as does the tax laws of the state in which you do business. "For example," he said, "upon a sale of an S corporation, the shareholders are typically subject to one layer of tax at the individual level. However, there are exceptions to this that should be understood prior to entering negotiations. For instance, in Massachusetts, we have what is called the Mass. sting tax, which means that even if your company is an S corporation, if you sell assets rather than stock, you may still have to pay additional corporate level state taxes (and they can be significant). Also, if you changed to an S corporation from a C corporation within the past 10 years, you could have federal built-in gains taxes at the corporate level. These kinds of things really impact what people are willing to give and take in terms of the structure of a deal. Some

of these situations are deal 'complicators' and some are deal killers."

These issues vary greatly from company to company so we can only give the broadest possible advice, which is to consult with your tax attorney and accountant well in advance before entering into the market. [See February '07 Viewpoint: "338 – H – What? How deal structure can increase (or decrease) the sale price of your business."]

## DEAL KILLER 5: LOST MOMENTUM

"Deals are all about momentum," said Barbash. "When a deal drags on and on, people lose focus and move onto other things; this is especially true with larger buyers who are actively seeking to complete a number of transactions in the same time period. When the key decision makers on both sides of the table are focused, you need to take advantage of having their attention and move the deal along quickly. You need to avoid having due diligence take an inordinate amount of time or having numerous drafts of the operative documents go between the parties and their lawyers because you'll lose that momentum and once you lose momentum, deal fatigue kicks in and deals will not get done."

"You need a quarterback to keep both parties focused on key issues, not extraneous deal noise," said Andronico. "When you have either party focused on the wrong issues, that can be dangerous. The investment banker takes on an important role with this but the seller also needs someone who keeps things rolling. A buyer can come in during due diligence and just keep going down new roads that never end. The investment banker needs to keep things moving and know when to say, 'You don't really need that' and keep them moving to a conclusion."

Similarly, deals can fall apart if the deal champion at the acquiring company disappears, which is not an uncommon occurrence. "For example, if you're being acquired by a large public company and they have a corporate development professional who does the firm's acquisitions, there is a decent amount of turnover in those positions," said Andronico. "Sometimes deals can hit a

**"WE TELL CLIENTS TO BE REALISTIC AND NOT OVERLY AGGRESSIVE ABOUT THEIR FINANCIALS BECAUSE DEALS TAKE TIME. IF YOU'RE PROJECTING EACH MONTH GOING FORWARD AND A FEW MONTHS INTO NEGOTIATIONS YOU HAVEN'T MET A SINGLE ONE OF YOUR PROJECTIONS, THAT IS NOT GOING TO HELP CLOSE THAT DEAL."**

**-- WILLIAM ANDRONICO, CPA, MOODY, FAMIGLIETTI & ANDRONICO, LLP**

major road block because that person moves on or quits. To avoid this, sellers should make sure they have kept relationships with other key people in the organization strong, so that if one person isn't there before the deal closes, you still have momentum."

Similarly, in the case of financially sponsored deals where a platform investment company is doing an acquisition, make sure you have champions at both the acquiring company and the private equity group. In every case, whether it is a financial or strategic buyer, the board is going to have to authorize the deal, so make sure to maintain good visibility into the board's support for your deal.

## PSYCHOLOGY OF DEAL MAKING

This is by no means a comprehensive list of the deal killers you can potentially encounter that will sink your deal. As Zollo points out, the roadblocks you're most apt to encounter will vary based on the nature of the companies involved and deal size.

"The issues that are relevant to the buyer and seller when the deal is for a family owned or closely held business differ from those involved when a public company is acquiring another public company or acquiring a private company," Zollo said. "In fact, the number one deal killer we see among family owned or closely held businesses is having a seller who is not psychologically prepared to sell the company. Often times in these situations the company is more than just a business to the owner; it's like a child and they just don't want to give it up. But they sometimes don't realize this until they're already well into the sale process."

Being aware of the emotions that are driving your decision making during a deal to sell your business, then, is of critical importance.

Good will and a willingness to compromise are at the heart of every deal. With the help of a strong advisory team, even the worst deal killers we've discussed here can be overcome... provided you and the buyer are truly committed to completing a transaction that serves both parties well.

---

**Peter Alternative** is a partner at 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](http://www.merger.com).

WE DO  
THINGS DIFFERENTLY.



VIEWPOINT articles are archived at [www.merger.com](http://www.merger.com). Redistribution via e-mail is encouraged.

1987 **20** 2007  
YEARS