LEARNING MADE EASY

Mergers & Acquisitions

for dummies®

A Wiley Brand

Strike the right type of deal

Navigate the entire M&A process

Integrate employees, policies, and procedures

Bill Snow

Noted authority on mergers and acquisitions

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by Bill Snow

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Contents at a Glance

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Introduction

In every job — whether it be sales, managing retail establishments, raising capital, crunching numbers, writing, working with venture capitalists, creating online ventures, or working investment banking deals (I've done all these, by the way) — you quickly discover that you need a whole new set of rules, lingo, conventions, and nomenclature. And more often than not, what you need to know to excel at your job can be distilled into just a few salient points. If you're lucky, you bump into a wise old sage who, upon experiencing your questioning, utterly confused face, and dispirited body language, simply says, "Forget all that other stuff; here's what you really need to know." Enter *Mergers & Acquisitions For Dummies,* an inside look at the process of buying and selling companies.

Although companies change hands every day, buying and selling can mean many things and take many forms. Who or what is the Buyer or Seller? What kind of transaction is it? How will the Buyer finance the deal, and what does the Seller receive? These are only a few of the considerations in any given mergers and acquisitions (M&A) deal. It's so confusing!

As a result, business owners, some of the main participants in M&A, are often completely befuddled when the time comes to sell their businesses or make acquisitions. They don't know anything about M&A because they've been focused on their own businesses and not on the business of buying and selling companies.

That's why I wrote this book — to serve as your wise old sage as you jump into the wild M&A world.

About This Book

Although the M&A process, like any sales process, involves a step-by-step approach, I've written this book so you can simply refer to whatever section you need to read. Scan the index and table of contents and then go directly to the information you need.

When a Buyer and Seller are negotiating a deal, they're on opposite sides of the table. The Buyer wants to get the best (that is, lowest) price, and the Seller wants to get the best (that is, highest) price. This book isn't slanted one way or another. It's not pro-Buyer or pro-Seller. Deals get done only when Buyer and Seller find common ground and agree to price and terms.

During the M&A process, many of the steps and techniques I discuss in this book apply to Buyers, Sellers, or both. I highly recommend Sellers read the Buyers' information and vice versa. My hope is that this book provides some insights for both sides by helping each side see things from the other's perspective. Understanding the other side's motivation and rationale is key to getting a deal done. If you know what the other side is seeking or why she's asking for something in a particular way, you're in a better position to provide an answer that helps move the deal to a close. And closing deals, ladies and gentlemen, is what M&A is all about.

Conventions Used in This Book

I use a few conventions throughout this book to help make it more accessible:

- I format new words in *italic* and accompany them with definitions.
- **Bold text** highlights the active parts of numbered steps and signals the keywords in bulleted lists.
- Web sites appear in `monofont`. In some cases, Web addresses may have broken over more than one line during the book's printing. Just type the address exactly as you see it; I haven't added any characters to mark the line break.
- Because "mergers and acquisitions" is kind of an unwieldy phrase, I often use the abbreviation "M&A." You see it in the field all the time anyway, so why not use it here?
- One challenge in this book is that two distinct yet related groups of people (Buyers and Sellers) may read this title. When I use "Buyer," I'm referring to the individual or executives in a company seeking to acquire another company. When I use "Seller," I'm referring to the owner of a company or the owner's representatives (executives or advisors). I also use "you" to address you, dear reader, directly, even though the text in question may not apply to your specific situation. In those cases, I clearly alert you to whether I'm talking about Buyers or Sellers.

What You're Not to Read

My goal for this book was to write an easy-to-read, introductory look at the world of mergers and acquisitions. At times, however, some of the text may be a bit technical and in-depth, so turned those parts into sidebars (those shaded gray boxes) or marked them with a Technical Stuff icon. You don't need to read those parts unless you really, really, really, really want to know more.

Foolish Assumptions

I assume you bought this book for any number of reasons:

- You're a business owner or executive of a middle market or lower middle market company and are interested in selling a division, subsidiary, or entire company.
- You're an executive of a company and are interested in acquiring middle market or lower middle market companies.
- You're a business student who is interested in discovering more about mergers and acquisitions.
- You know a lot about your specific business but little or nothing about the business of buying or selling businesses.

You may be asking yourself, "Why the specific delineation of middle market and lower middle market companies?" Those two market segments, defined roughly as companies of $250 million to $1 billion in revenue (middle market) and $20 million to $250 million in revenue (lower middle market), are often overlooked by larger banks. The deals aren't as large, the companies aren't as famous or "sexy," and when you have a plethora of top-tier MBA grads all clamoring to make a million bucks a year, the smaller fees from these smaller deals just aren't of interest.

Although the lower middle market deals aren't front-page headline blockbusters, the fact is the middle market and lower middle market are comprised of many more companies than the Fortune 500, which, when you think about it, is exactly 500 companies. The owners and executives of many, if not most, lower middle market companies are wholly unfamiliar with the business of selling a business and are therefore the perfect audience for this book. But although middle market and lower middle market company execs may be this book's target audience, the information here is applicable for just about any kind of business sale transaction.

How This Book Is Organized

I organized *Mergers & Acquisitions For Dummies* in five essential parts. These parts cover the main facets of doing deals, from an introduction to the basics to the courting process to the documents and meetings involved to integrating Buyer and Seller.

Part 1: Mergers & Acquisitions 101

Part 1 gives you the lowdown on M&A's foundations. Chapter 1 introduces you to some of the basic building blocks in the M&A world: words, phrases, decorum, players and their motivations, and generally accepted steps to buying and selling companies. Chapter 2 analyzes the rationale and motivations of Buyers and Sellers so that you can better understand the folks on the other side of the table (and maybe get some insight into your own goals as well). In Chapter 3, I provide an outline of the generally accepted M&A process; you have a much better chance of making a successful deal when you know what steps to follow.

Part 2: Taking the First Steps to Buy or Sell a Company

When you actually want to do deals, as opposed to merely thinking about doing deals, Part 2 gets you started on the first steps. You need money (or seashells, cigarettes, or some form of consideration that the Seller finds acceptable), and Chapter 4 offers some thoughts about financing M&A deals. Every deal-maker needs a little (well, a lot of) help, so Chapter 5 lays out the advisors you need in order to successfully buy or sell companies. M&A is really a form of dating, except with meetings, boring documents, and grueling travel. Chapter 6 provides you with colorful tips for successfully approaching Buyers or Sellers and explains why M&A is one of the few industries where selling is easier than buying.

Part 3: Starting the Deal on the Right Foot

In this part, I show you how to get going on a deal. Chapter 7 quietly discusses the cloak-and-dagger world of confidentiality. Chapter 8 deals with the offering document, which is basically the story a Seller tells a Buyer about the company, as well as how to write it and what to look for when you review it. M&A requires a certain level of discretion, and that level is high! In Chapter 9, I introduce you to the form and function of the indication of interest (IOI — this field loves its initialisms) that Buyer offers Seller when Buyer's ready to move from talking about doing a deal to providing specific thoughts on an actual deal. (What can I say?

M&A loves crafting documents, too.) The next steps are the management meetings between Buyer and Seller; Chapter 10 helps you navigate these meetings, which don't have fancy abbreviations but can be tricky.

Part 4: Firming Up the Deal

When Buyer and Seller agree to do a deal, what's next? Part 4's topics, that's what! First, Buyer and Seller have to agree to terms; M&A deals involve layer upon layer of complexity that you can and should negotiate. Chapter 11 takes you to the smoke-filled back rooms where deals are made; all cigar-chomping is figurative.

Chapter 12 plows the fields of valuation for you and reaps an answer to that most nagging of questions: What the heck is this company worth?

When Buyer and Seller want to stop playing the field and get married, they move on to the letter of intent (LOI). Chapter 13 takes you through the ins and outs of this key document. Due diligence is the next key phase; it's where Buyer and Seller confirm certain facts from the other side just to be safe. Chapter 14 fills you in on what to expect during the confirmatory due diligence phase. Chapter 15 provides insight about converting the LOI and the results of due diligence into a final, binding purchase agreement.

Part 5: Closing the Deal . . . and Beyond!

Part 5 helps you successfully conclude the deal. In Chapter 16, you get the insider's look at that important day. Chapter 17 details all the sordid adjustments one side or the other makes after the closing. After the deal is done and a new day has risen, Buyer and Seller must integrate and learn to live together. Integrating Buyer and Seller can be a difficult proposition that many people don't think about, so Chapter 18 tackles this hidden issue.

Part 6: The Part of Tens

The Part of Tens is a *For Dummies* classic, so of course this book includes it as well. Chapter 19 clues you in to important questions to ask before signing an LOI. In Chapter 20, I warn you against mistakes that can sink a deal, and Chapter 21 offers ways to come to an agreement on valuation. I also give you an appendix full of resources such as a due diligence checklist, helpful online sources, and some sample M&A documents.

Icons Used in This Book

I use the following four icons throughout this book to help draw your attention to particularly important or salient bits of information (and let you know what bits aren't essential):

TIP

This icon denotes info that can save you time and/or hassle as you work through a deal.

REMEMBER

The Remember icon flags important points and concepts worth searing into your memory banks.

TECHNICAL STUFF

The text next to this icon is useful but not vital to the topic at hand; you can skip it if you're in a hurry or just want the need-to-know information.

WARNING

I use this icon to highlight potential M&A disasters you want to avoid.

Where to Go from Here

No matter your immediate interests or needs, I highly recommend reading Chapter 3, which provides an overview of the process. An understanding of the typical steps involved in a business sale can help you as you read other specific sections. From there, you can dive in and out of this book as you please. You will also find a handy "cheat sheet" for this book on `dummies.com`. Just search for Mergers and Acquisitions For Dummies Cheat Sheet from the `Dummies.com` home page.

Beyond this book, the best advice I can offer for anyone who wants to buy or sell companies or work as an advisor in the M&A industry is to get off your duff and get in the game. Books are great, and I certainly hope you find *Mergers & Acquisitions For Dummies* to be an extremely valuable resource, but the fact remains that the best way to learn something is to do it yourself. The only way you can truly get a handle on buying and selling companies is to actually buy and sell companies.

I'm a big believer in "ground up" learning. No, I'm not talking about deli meats; I'm talking about getting your hands dirty and learning business from the ground up. You're going to make mistakes, but finding out what doesn't work is the best way to learn. If you want to be successful in M&A (as a Buyer, a Seller, or an intermediary), you're best served if you can talk from a level of actual experience. Those experiences should ideally include successfully selling a product or service, interacting with customers, hiring and firing employees, merchandising, marketing, working in human resource compliance, banking, making a payroll, filing taxes, and bookkeeping. (Mopping some floors and scrubbing a few toilets won't kill you, either.) You don't want to be the only one at the table who hasn't dealt with real-world business issues and problems. Being the least-qualified person in the room is never a good thing!

One of the big ironies for the investment banking world is that most people who do what I do didn't start their careers with the plan of being an investment banker. I'm often asked how to get into the investment banking industry. I always say the same thing: "Most of us who do this didn't choose this career. Go do something else. Get involved in a business first, and then segue into investment banking."

One final thought: One of the keys to M&A is accounting. If your accounting skills are suspect (or nonexistent), you need to take a class, stat! Most community colleges offer accounting classes, and you can probably audit the class instead of taking it for credit.

1 Mergers & Acquisitions 101

IN THIS PART . . .

This part delves into the basics of M&A: The players, their motivations, the terms, the nomenclature, the conventions of the industry, and the rules and regulations. I also discuss reasons to buy or sell a company, and I walk you through the generally accepted process of buying or selling a company on a step-by-step basis.

IN THIS CHAPTER

- » Becoming familiar with the main vocabulary of mergers and acquisitions
- » Understanding the rules of the road
- » Opening your eyes to potential costs
- » Figuring out where your company fits

Chapter 1

The Building Blocks of Mergers and Acquisitions

Mergers and acquisitions is a complicated field, so this chapter provides a basic overview: an introduction to the basic terms and phrases, a discussion of decorum and the basic M&A process, a look at the players and the category of deals, and my handy-dandy guide to helping business owners determine what kind of businesses they have.

Defining Mergers and Acquisitions

Mergers and acquisitions (or *M&A* for short — the M&A world is rife with acronyms and initialisms) is a bit of a catchall phrase. For all intents and purposes, M&A simply means the buying and selling of companies. When you think about it, mergers and acquisitions aren't different; they're simply variations on the same theme.

In the strictest sense, a *merger* is a combination of two or more entities where each merging entity has an equal stake in the new enterprise and each merging entity has a very clearly defined role in the new entity. This ideal is the vaunted *merger of equals.* Daimler's 1998 combination with Chrysler was a merger of equals. In a more practical sense, so-called mergers of equals are rare; one side usually ends up controlling the enterprise. For example, the years following the Daimler-Chrysler merger showed that Daimler executives planned all along to control the combined entity.

Although actual mergers do occur, most of the activity in the M&A world centers on one company buying another company, or the acquisitions category. I like to think using the word *merger* keeps the uninitiated on their toes; plus, talking about combining two companies as equal partners rather than about committing a hostile takeover sounds much more egalitarian.

Mergers are far less common than acquisitions. An *acquisition* is when one company buys another company, a division of another company, or a product line or certain assets from another company. Actually, an acquisition is when any kind of business purchases another part (or all) of another business. Although some companies grow *organically* (from within by creating and selling products or services), an acquisition allows a company to bypass the growth stage by simply buying existing sales and profits. Starting up a new product line may be less expensive than buying an existing one, but the market may take a while to adapt to the new product, if it does at all. For this reason, buying other companies rather than relying on organic growth may make sense for a particular company.

The fact that one can transfer a company's ownership through a sale often comes as a bit of surprise to many people (including many business owners, believe it or not). Business owners, especially owners of middle market and lower middle market companies (with revenues between $250 million and $1 billion [middle market] and between $20 million and $250 million [lower middle market]), have spent their careers building a company, so the process of selling a business is often something new and foreign to them.

In addition to being an activity, M&A is an industry. As this book illustrates, the steps to doing a deal, the names of documents and processes, the conventions, and the sundry tips and insights I provide are all based on de facto industry standards that have developed over time, and my humble hope is that this book helps introduce you to those standards and conventions.

Introducing Important Terms and Phrases

Like any topic, M&A has a language that you have to get a handle on to understand the field. Although I introduce many more terms and phrases throughout the book, the following words are part of the basic building blocks of M&A.

REMEMBER

The *lingua franca* of M&A is an amalgam of accounting and banking terms sprinkled with initialisms, acronyms, and words and phrases adjusted and twisted to suit certain needs at certain times. Pay close attention to the terms I define throughout the book. Although some are tricky, I use them all for a reason.

Buyer

You can't sell something unless you have a buyer for it. Although Buyers (both potential and actual) are typically companies or entities, I often refer to them as individuals for clarity.

REMEMBER

In documents and contracts and agreements, you usually see *Buyer* as a defined term, which means it's capitalized. When you read those documents, *Buyer* looks like the name of a person. In fact, to make it seem really formal, M&A professionals often drop the word *the* from *Buyer.*

"Buyer" isn't a one-size-fits-all category. A Buyer may acquire all or part of a company, the stock of the company, or certain or all assets and even assume some of the liabilities. Despite this wide variety of possibilities, Buyers typically fall into four broad types:

- **Strategic Buyers:** These Buyers are other companies planning to combine operations of the two companies to some extent (as opposed to buying strictly for financial reasons). For example, when Oracle buys a company, Oracle is considered a strategic Buyer because it buys companies that have some sort of synergy to its business.
- **Financial Buyers:** *Financial Buyers* are funds of money that buy companies. Financial Buyers of middle market and lower middle market companies are typically private equity (PE) funds, which are essentially large pools of money (see Chapter 4 for more).
- **Other companies backed by PE funds:** The company will be the new owner of the acquired company, but another entity (the fund) is providing the dough to do the deal.
- **Individuals:** Although it happens, an individual buying a middle market or lower middle market company is rare. When individuals buy companies, those companies tend to be small retail shops, consulting firms, or construction companies. Typically, these companies have revenues of less than $1 million.

REMEMBER

As a Seller, know that who's on the other side of the negotiating table may change the way your M&A process works. Are the Buyers experienced deal people, or are they new to the process? For example, if your Buyer is a PE firm, rest assured that the people you're negotiating with know exactly what they're doing.

Seller

You can't buy something unless you have a Seller. Like Buyers, Sellers usually aren't individuals, though I often refer to them in the singular here for clarification purposes. *Seller* is a defined term, meaning it's capitalized for the purposes of documents and contracts.

Here's a quick look at the types of Sellers you may find in the world of M&A:

- **The spinoff:** A company may be divesting a division, a product line, or certain assets.
- **The change of control:** This company is selling enough of itself (more than 50 percent) to result in a change of control. In these cases, the owner or owners most likely receive the money. Colloquially, this approach is called *taking some chips off the table.*
- **The recap:** Sometimes an owner wants to take some chips off the table without giving up control of the company. This situation is called a *recapitalization,* or *recap* for short.
- **The growth capital:** A Seller may issue more stock for the purposes of raising capital to invest in the business. In this case, the owner isn't actually selling the company but rather selling more stakes in the company. The money from the sale doesn't flow to the owner; instead, the company retains the money to fund growth.

REMEMBER

Remembering why the Seller is selling the company, how much of the company he or she is selling, and where the money goes is key. Follow the money.

M&A PERSONALITY TYPES

Regardless of whether you're buying or selling, one helpful trick for getting deals done is to assess the personality of your negotiating counterpart. Based on my experience, you're liable to run across the following types of people:

- **The highly motivated:** This person has to get a deal done or he's doomed. He's so desperate to do a deal that he may — strike that, *will* — leave dollars on the table.