

Merger & Acquisition Focus



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Ask the Advisor

What to do when a buyer backs out

M&A transactions can fail to cross the finish line for a variety of reasons. A seller may not be able to substantiate earnings to the buyer's satisfaction, or the buyer may discover that synergies for long-term value just aren't there. Outside forces, such as environmental and regulatory issues, can also halt a deal, and some deals are postponed or abandoned because the buyer can't obtain enough financing.

Whatever the reason for a deal's demise, a jilted seller can become financially and operationally stranded. If this happens to your business, you need to act quickly to preserve its future.

Why are you selling?

Your options vary depending on the reason for your sale. If you're simply ready to retire or want to capitalize on your company's value, continue seeking suitors while you gear up to grow the business again.

Your original buyers may be willing to negotiate concessions to avoid a lengthy, disruptive and expensive trial.

If, on the other hand, your company is financially distressed, consider alternatives such as online business listings and asset liquidations and auctions to quickly recover as much capital as possible. Acting fast may help you avoid an exponential loss of your business's value — or even bankruptcy.

Salvage what you can

Even if your company is solid, in today's general economic and credit market environments, other viable bidders are unlikely to surface immediately to salvage an unsuccessful sale. And, by the time a deal falls through, you may have already lost major customers, star executives and your reputation for stability.

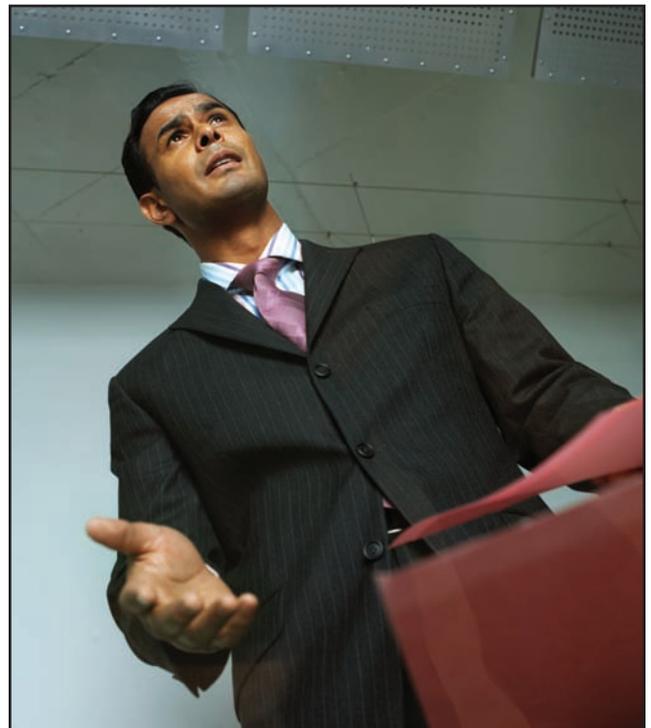
One option to recoup some of what you've lost is litigation. Or your original buyers may be willing to

negotiate concessions to avoid a lengthy, disruptive and expensive trial. In April 2007, Sallie Mae agreed to a \$60 per share buyout by an investor group led by J.C. Flowers. Sallie Mae also got the buyers to back a \$30 billion financing package in exchange for withdrawing a lawsuit and forgoing a \$900 million breakup fee.

Communication is key

Next, reach out to key constituencies affected by the misdeal. Personally explain the situation to investors and lenders. Also, deter rumors and boost employee morale with information meetings, and provide updates on your Web site and through an 800 hotline. Public companies should conduct analyst conference calls to manage market expectations and meet with credit-rating agencies to help prevent significant debt downgrades.

Owners and executives need to reach out to key customers to reduce their anxiety about the health and direction of the company. Frequent contact, in fact, can mean the difference between a customer base that provides recurring revenues for you and losing their business to your competitors.



A second chance

Although it's difficult to find any positives as a result of your failed sale, consider this one silver lining: It forces you to reevaluate your company and draft a new plan for growth and profitability.

Earnouts can appease skittish buyers

Increase the likelihood of closing a deal with a risk-averse buyer by agreeing to assume some of the risk yourself. An earnout clause in the purchase agreement reduces the initial purchase price, making additional, postclosing payments contingent on future sales, earnings or other performance measures.

A good earnout provision will provide for contingencies such as:

- ❖ Failed or excelled milestones,
- ❖ The buyer's future acquisitions,
- ❖ Changes in accounting practices,
- ❖ Allocations of overhead among affiliated corporate groups,
- ❖ Sale of the business during the earnout period, and
- ❖ Management changes.

You'll need to determine whether your plan will focus on cutting costs through layoffs and consolidation — for example, increasing efficiencies through improved equipment utilization ratios — or divesting your company of assets or even divisions. You'll also need a plan for securing necessary capital to stay afloat during your restructuring period.

Getting tough in a tough market

After immediate issues seem under control, take steps to enhance your business's appeal for future suitors. Without preliminary due diligence and remedial action, you could present an incomplete picture to potential buyers or leave a potential buyer with complex issues to deal with before or after the deal closes.

So before putting it back on the market, conduct due diligence on your company. Correct issues that caused concern for your first buyers, such as cleaning up financial statements, ensuring that your accounting is up to date, settling any litigation matters, and selling obsolete assets or stock not essential to running the business. Also, modify contracts and leases affected by changes of control.

Business as usual

A failed deal doesn't have to mean disaster. Reevaluate your company's strategic goals and rally the internal and external support necessary to secure a profitable future for your business — at least until another buyer comes calling. ■

Destination: M&A success

AN INTEGRATION MANAGER CAN HELP GET YOU THERE

The M&A process is rarely smooth sailing. Even the most strategically justified transaction can capsize if it's not well implemented. This makes the postmerger integration phase — with all the complex activities that must be conducted simultaneously, pressure from shareholders to produce rapid results and the looming threat of the deal failing — critical. To help guide them through this tumultuous period, many companies are using internal talent — leaders who already have employee respect — as integration managers.

Avoiding merger mayhem

Let's say that your deal has closed, but capturing its value is taking longer than anticipated. Your managers are still gathering information and developing plans for integrating the two companies. Meanwhile, your company is forced to operate two separate plans. As a result, millions of dollars in cost synergies remain unrealized. What's more, productivity throughout both organizations has fallen, and employees are seeking jobs elsewhere, where they might



just take their experience and product knowledge, not to mention your customers, with them.

Here's where an integration manager can make a difference. This professional can help steer you off the dangerous path toward merger mayhem by rigorously coordinating integration efforts and communications across all departments and business units until both organizations are fully merged.

Beyond project management

Even though the job primarily involves project management, effective integration managers do much more, including helping to set — and keep — the agenda for integrating the participating companies. Your integration manager and his or her team can be expected to help you:

Maintain or pick up the pace. Two time periods are critical to the success of most M&A deals: 1) between its public announcement and closing, and 2) during the first three or four months after closing. An integration manager won't make all the major decisions required during these stages, but he or she will keep things moving toward established goals. A manager might, for example, ramp up planning efforts or push for decisions to be made and actions taken.

By injecting speed into the process, the integration manager can help you start realizing the merger's expected synergies — such as lower production

costs or expanded sales territories — within the shortest amount of time. Although it could take years to determine if you've met your long-term objectives, a speedy integration is key to meeting your first year's financial goals.

Keep employees focused. Timely communications that address potential layoffs, changes in salary and benefits, and new roles in the merged company can mean the difference between organizational efficiency and chaos. Typically, integration managers help liaise between management and employees. They might field staff members' questions and concerns and also alert management to potential crises, such as labor union objections.

Your integration management may even enlist one representative from each company to address employee concerns. This enables management to defuse problems before they blow up.

Build structure. An integration manager can help a company draw up operations plans for departments and business segments such as IT, sales and administration. Depending on the circumstances, the integration manager may assemble and oversee small teams of employees and devise project timelines with deadlines for meeting certain milestones.

This professional can help steer you off the dangerous path toward merger mayhem by coordinating communications across all departments.

Shape company culture. One of the trickier challenges of integrating two companies is meshing their business cultures. Many owners and managers assume that all organizations share similar practices and values. In fact, most companies have distinct vocabularies, organizational structures and customs. An integration manager can help merging companies interpret each other's culture and decide which practices will be carried over, not to mention ensuring that everyone, in fact, follows them.

Go fishing early

When selecting an integration manager, start your search early and look close to home. The best person for the job should know your company and

its systems inside and out and be committed to the merged entity's future. For example, an experienced and trusted general manager with 15 or more years with your company (including frontline operating experience) is ideal.

Put your integration manager to work at least a month before you announce the deal. This gives him or her a chance to watch the deal's behind-the-scenes workings, particularly as management sets its goals. An early start also provides this manager with insight into:

- ❖ Pending business agreements and commitments,
- ❖ Written — and unwritten — understandings, and

- ❖ Internal decisions about sensitive matters, such as layoffs.

It will also enable the manager to learn which customers, personnel and projects will be the most important for the newly merged company.

Set your sights

Integrating two companies is a delicate and complicated process. By maintaining momentum and focus on the deal's objectives, managing peripheral issues and ensuring that performance targets are met, an integration manager can help navigate this turbulent phase to deal success. ■

Justifiable risk?

THE DANGERS AND REWARDS OF CROSS-BORDER ACQUISITIONS

International acquisitions can provide companies with many advantages, including a broader customer base, cross-selling opportunities, new distribution channels and improved access to rapidly developing markets. But even as overseas M&As offer these potential rewards, they also present serious risks. Before you venture across the ocean (or over the border), make sure you understand — and can manage — the potential pitfalls associated with a foreign deal.

Make your case

Companies make cross-border deals to meet a variety of objectives. You might, for example, wish to offer customers integrated global logistics, leverage

proprietary technology into new markets or strengthen your brand position. But having a good reason isn't enough. You also need to ensure that your proposed transaction is strategically sound.

To help make a business case for the deal, ask:

- ❖ Will an international acquisition help us achieve our larger growth plans?
- ❖ Will it increase our profits, and do potential profits outweigh additional debt and costs associated with the transaction?
- ❖ How long will it take after the deal closes before the acquisition becomes profitable?
- ❖ How well do the two companies' business and social cultures mesh?

Then compare the value and risks of an international deal with those of other initiatives, such as a domestic acquisition, strategic partnerships or various forms of internal growth.

Lay of the land

One of the greatest risks in a cross-border acquisition is failing to understand the target market's culture, government regulations or competitive environment. Don't assume that your knowledge of selling to U.S. customers will translate to the preferences of buyers



in another country. These kinds of misjudgments can be costly — perhaps resulting in overly optimistic projections of revenue growth or cost saving synergies.

Understanding the differences between doing business domestically and abroad can also help you minimize contractual risks. Your standard contracts and agreements may not be applicable in international transactions — not without certain modifications and clauses, anyway. Be aware, too, that tax treatment of business income varies widely by country and that these differences can have a dramatic impact on net profits.

Inflation and exchange rates in your target's country are another concern. Hyperinflation and currency devaluations are particularly common in developing countries. If your agreements are denominated in foreign currency, you could end up with a lot less than you bargained for.

Flies in the ointment

Getting an accurate appraisal and performing extensive due diligence on the potential acquisition is critical — even more so than with domestic deals. In addition to potentially exposing financial miscalculations and asset misrepresentations, your scrutiny could reveal costly challenges.

Don't assume that your knowledge of selling to U.S. customers will translate to the preferences of buyers in another country.

You might, for example, realize that hoped-for technology synergies are unlikely because the two systems are incompatible and the target company requires significant upgrades. This kind of challenge isn't necessarily a deal breaker, but it may suggest you need to negotiate a lower purchase price.

Hire a local business analyst to help evaluate subtle risks in reporting methods and standard operating procedures so that discrepancies don't get "lost in translation." And for complex situations, such as management disputes with local labor unions, you and your U.S. advisors may want to enlist the support of M&A and other types of advisors in your target company's country. These experts can help explain and bridge cultural, financial and regulatory differences.

People power

The success of your acquisition depends greatly on the market knowledge, customer and supplier relationships, and technical capabilities of your new employees. And the influence and reputation of local management with the staff are essential to the organization's stability and efficiency. In fact, employees are likely to continue to address and listen to the top manager who shares their nationality, so building relationships with new managers is critical.

You can help your combined staff get to know each other through social events, staff meetings and information exchanges. These interactions can help prevent or resolve conflict, improve decision making, build consensus, and facilitate employee adaptation. Clearly and quickly communicating structural, compensation or benefit changes will show your new staff that you're concerned about their well-being.

You'll also need to understand different pension, benefits and labor laws to ensure that you're in full compliance. Depending on the country, local laws may prevent you from altering current compensation levels and benefits. And in some countries, health benefits are provided by the government, not employers.

In addition, you'll need to be well versed in workplace condition standards, employment security laws, and the roles of unions and workers' councils. It's essential to research the quality and availability of local labor and accurately assess staffing requirements according to, for example, laws that regulate the length of work shifts.

Retain key value drivers

As with most acquisitions, integration planning should begin as early as possible, and long before the deal closes. Without careful preparation, retaining key value drivers such as customer relationships, distribution channels and key staff could become difficult.

Throughout the process, be sure to document the lessons you learn. Identifying internal experts and creating replicable processes will enable you to close and integrate future cross-border deals faster and more successfully.

A well-planned trip

Foreign companies add another layer of risk and complexity to a process that already has plenty of both. Nevertheless, cross-border acquisitions can be successful. Just be sure you know exactly where you're going before you start your journey. ■

Ask the Advisor

Q: What do I need to consider when acquiring a business in a regulated industry?



A: When buying a business in a government-regulated industry, you must think about any regulatory issues early in the transaction, and be prepared to discuss them when you draft your letter of intent. A detailed letter of intent is essential to every M&A transaction. When your target is subject to regulation, your letter must include additional information reflecting the laws, requirements and restrictions applicable to the specific business and its industry.

Capture requirements

When control of a business transfers to a new owner, the buyer most likely will be required to independently qualify for the transferred licenses (which may incur additional licensing fees). Describe the process under which you'll obtain the necessary licenses or approvals in your letter of intent.

Your future business development plans may be contingent on additional advanced or broader licensing permissions for which you won't qualify. So don't spend too much time and money on M&A negotiations until you've determined your license eligibility with the relevant regulatory agency.

Your letter of intent should also discuss any ongoing regulatory restrictions and requirements that could affect the business after the transaction is completed. If one or more of the business's officers or employees are required to be licensed and qualified (distributors



of pharmaceuticals, for example, are typically required to employ at least one licensed pharmacist), provide for the continued employment of that individual or his or her replacement. Also address any re-licensing or license transfers that may be necessary.

What's best for you

Depending on the industry, certain deal structures may be better suited to regulated companies. For example, asset sales of financial services firms, such as banks and insurance companies, can be complicated because these companies must submit notice to, and gain the consent of, customers before proceeding. In this case, it may be simpler to propose a stock deal. Other companies' forecasts may depend on future contracts, making earnout stipulations a good idea.

In addition to including standard closing conditions, your letter of intent should stipulate that the deal is subject to regulatory approval, filing or consent. This is essential to protecting deal participants from proceeding too far with a transaction that lacks necessary regulatory support.

Your letter should also include a right of parties to terminate if regulators refuse to consent. And don't forget detailed provisions regarding preparation of regulatory submissions. The letter needs to address deadlines for filing; specific responsibilities; consultation or approval rights; cost or expense sharing; and a list of assets to be transferred in the deal.

Players in position

Legal and financial advisors experienced with transactions involving regulated companies are essential for your M&A deal team. These advisors are likely to be well connected with industry experts from whom they can seek specialized information and may also have working relationships with regulators. Your advisors will continue to ensure you're in regulatory compliance through negotiations, closing and integration. ■