

## FINANCE

### Make the Best Deal out of an Acquisition

Congratulations! You've decided to grow your company by acquiring another business. The question is: How are you going to finance this acquisition? What are the next steps to take? Here are some key questions and issues to consider in financing the acquisition.

#### Have the Right Advisors.

Do your advisors have extensive experience in dealing with mergers and acquisitions? Is that experience in your industry? If not, you risk undermining the ultimate success of the deal with their inexperience. Additionally, some industries are out of favor, so their knowledge counts here as well.

Ask as well if you will have the attention not just of the advisory firm but also of the right people there. Surrounding yourself with first-rate seasoned legal, accounting/tax and banking/financial advisors is essential in assessing the opportunity, the risks and the liabilities involved. Their advice will significantly impact the outcome from qualitative and financial perspectives.

**Leave Nothing to Chance.** Performing your due diligence before you commit to a deal is vital to the success of your acquisition. With your advisors, investigate all the facts and issues sur-



Mary-Laura Greely



Victoria Lazzell

rounding the opportunity.

First, know why the owner is selling. The stated reason may not be the real reason, so uncover any hidden or negative reasons prompting the sale.

Next, make sure you know what you are buying. Look for any encumbrances on the assets and make sure the purchased assets will include the core value of the business, such as intellectual property and key licenses.

Dig into the target's financial statements and verify and validate the seller's representations for any pro forma adjustments and potential cost reductions, including "non-recurring" expenses and insider salaries and transactions. Be conservative when estimating operating synergies, one-time acquisition and severance costs.

Now you are ready to determine what the business is worth. You may have your own ideas but

consult with a valuations expert who is familiar with the industry, the common multiples to apply in assessing value and the value of assets you would acquire.

#### Determine the Best Structure.

Whether you structure the purchase as an asset deal, a stock deal or a merger of two companies with one as the surviving corporation will have a significant impact not only on the net proceeds available to the seller from the transaction, but also the cost accounting for the transaction and the impact on your business going forward. Your advisors will help you balance the cost to you with your potential liabilities for each structure.

Think about the seller/management. Does it make sense for the seller to stay on with the business after the closing to help smooth the transition and integrate the business and customer base? Or do you not want the seller involved post-closing at all?

Likewise, are the parties in agreement on price? If this is a contested issue, there are other deal components such as earn-out based on future revenues, a seller note, reserves and other hold-backs to add a layer of protection from future liabilities. These will

# WOMEN'S BUSINESS

BOSTON

Covering Massachusetts, New Hampshire and Rhode Island

July 2005

THE PROFESSIONAL AND BUSINESS WOMAN'S JOURNAL

enable you to close the purchase price gap with the seller.

**Decide on Financing.** Now you can focus on the most appropriate and efficient sources of financing for this transaction. As you have identified in the deal structure above, the seller may be willing to provide some financing or agree to an "earn out" arrangement based on future revenues. Although a seller may be able to finance all or part of an acquisition, it can result in a higher price tag or in keeping the seller around after the transaction longer than you would prefer.

Next, look to your own business to see if you can leverage your company's existing assets and cash flow in the form of traditional bank financing to fund the acquisition. Then look to other sources of external financing, which can include acquisition loans from commercial banks, subordinated debt/mezzanine financing from various entities, and equity financing from private firms or individuals.

The lowest cost and least dilutive source is commercial banks that provide senior debt based upon tangible asset coverage and the reliability of the historical cash flow generated by both your company and the acquisition target.

Subordinated debt or mezzanine financing is a higher-risk, higher-cost debt. It is generally not covered by existing assets or cash flow but

instead is based on expectations for future cash flow generation and growth in the company's value. This source may also require an equity component.

Both commercial banks and subordinated debt/mezzanine providers will set specific financial targets for your company that measure ongoing cash flow generation, your liquidity and your debt burden. Make sure that these do not conflict with each other and that you have a comfortable cushion for any negative variance to your financial plan. Not adhering to these targets can be very expensive and cause your lenders to impose additional restrictions on your company.

Equity financing is available from venture firms and private equity sources who expect the companies they invest in to deliver strong financial performances that yield significant returns within a certain period of time. Equity providers and some subordinated debt providers expect to be directly involved with the management of your company, so you will have to "dilute" your ownership position in exchange for their investments. Make sure these providers are compatible partners who share your vision for the future and who can provide some strategic value in addition to their money.

**Perfect Your Pitch.** The outcome of your finance request depends largely on the effectiveness of your

pitch to debt and equity providers. Do your research on the lending and investment criteria of these potential providers to make sure that there is a good fit and that your assumptions are realistic. Document why you expect to achieve the results you are projecting and share all assumptions in your financial models. Make sure your presentation is accurate, consistent and brief.

**Summarize Your To-Dos.** Here's a quick checklist to help you avoid common pitfalls.

- Get the right advisory team together and involve them early.
- Get the right valuation for the target company. Don't lose the opportunity to a competitor because you failed to bridge the price gap with seller. But don't pay more than makes sense because you've been blinded by deal frenzy.
- Get everything in writing. Don't agree to deal with it later. This can be a recipe for disaster.
- Don't over-leverage the company. There are always unexpected bumps in the road. Make sure you have a cushion. Otherwise, you risk being unable to cover those unforeseen expenses and being in default with your lenders.

*Mary-Laura Greely is a partner at Mintz, Levin, Cohn, Ferris, Glouksy and Popeo P.C. in Boston. Victoria Lazzell is a commercial banking vice president at Citizens Bank.*