The Acquisition Process

The following is the THIRD of a Series of three articles about the acquisition market sector within the building services industry. In the first article, I addressed issues associated with buying a company. The second article dealt with selling one's company. In each case, there was an effort to deal with the softer issues that both a buyer and seller will encounter. By softer, I mean the human side of acquisition. Certainly the technical side is important too, so in this article I will review some of the more technical parts of the process, but with some of the softer issues associated with those necessary technical aspects.–G.P.

There is a process that has developed during over the years that helps with the orderly acquisition of one entity by another. The process can be somewhat flexible, each transaction having its own uniqueness.

The Confidentiality Agreement (CA), or Non- Disclosure Agreement (NDA)

This is the document, agreed upon by each party, protecting the confidentiality that a seller is considering the sale of the company and that the prospective buyer is considering its purchase. The CA, or NDA, provides the mutual benefit of secrecy about the potential transaction. While there are legal ramifications if violated, it is rare for violation among professionals. It should never be entered into lightly and should always be entered into in good faith.

The Confidential Information Memorandum (CIM)

This is nothing more than a package of information that describes all aspects of the company to be sold. It does not have to be so spectacular that it dazzles the reader, but it should contain enough information and be well organized so that the prospective buyer, when finished perusing, will have enough factual information about the company to have some idea about whether or not it will be worth considering its acquisition. The seller, or the seller's representative, prepares the CIM. For it to be effective, the CIM should be well organized, accurate and complete.

The CIM should provide enough information, but not necessarily all information. For example, the CIM does not usually include customer identification. Neither does it include the names of key management employees. In the real world, of course, some of this information is known by virtue of the prospective buyer knowing this information through participation in the market place.

The CIM's purpose is to inform those who may have interest in the company with an in-focus snapshot of the business. It is essential for a serious seller and a serious buyer to have this point of reference for on-going discussions that may lead to a continuation of the acquisition process. As the acquisition process continues, sometimes for months, the CIM should be updated monthly to include a current trailing 12-month (TTM) financial report, plus any other noteworthy changes in the company and provided to all that have the CIM.

The Letter of Intent (LOI)

This formal document, sometimes referred to as a Memorandum of Intent, is the prospective buyer's expression of intent to buy the company, showing the price, price components, the transaction structure, anticipated closing date and other major aspects of the proposed transaction. Generally, the LOI is not binding, however, there may be certain aspects, such as confidentiality and the no shop provisions that are binding. Usually, each has a time limitation; the no-shop provision lasting only as long as the time limitation shown in the LOI. The confidentiality aspect may have a longer life as per the original agreed upon confidentiality agreement. While nonbinding, except for the exceptions noted, the LOI should always be entered into in good faith. The LOI is not the final closing document and can be amended by mutual agreement; however, if amended, it is usually because there have developed significant changes in the company's profile that warrant the change.

The LOI has a finite life which is usually 75 to 90 days after the terms have been agreed to by all parties. It can be extended by mutual agreement as necessary. The LOI is important in that it forms the foundation for the closing documents that are to come.

Due Diligence

Due diligence is the process by which the prospective buyer proves what has been presented as being factual information about the company, including (1) a review of at least three years of financial reports; (2) detailed analysis of all add backs to profit as presented in the CIM; (3) AR aging report; (4) determination of the working capital needs; (5) a complete customer analysis, including longevity, time to end of current contract, customer satisfaction; (6) size relative to the entire customer base and its individual performance; (7) inspection of office and warehouse facilities; (8) inventory of equipment and material; (9) the inspection of major customer facilities, sometime including the introduction to the customer, (10) interviews with key company managers, and; (11) any other matter deemed important to the

prospective buyer.

The time needed and the depth of information required will vary from buyer to buyer. It is important to each party that the process be completed in an orderly and complete manner. The process has changed during recent years in that much of it can be completed electronically, with minimal interruption to the on-going business activity of the company being inspected. However, sometimes there will be a need for onsite due diligence, often conducted by an outsourced accounting group hired by the prospective buyer.

It is during the due diligence process that, while confidentiality has been maintained up to this point, certain people within the company should now be apprised that the company is going to be sold. To not do so could be detrimental to those persons' relationship with the seller and could even have a negative impact on the transaction. Each seller will have to determine how to handle this and which, among the employees, should to be informed.

It is during the due diligence process that there is the concurrent effort by the prospective buyer to develop all of the closing documents, including the complete sale agreement, any promissory note, employee employment agreements and noncompete and/or nonsolicitation agreements.

In some cases the seller, upon revealing certain customer and key employee information, may require a nonsolicitation agreement from the buyer. A nonsolicitation agreement means that the buyer is barred from soliciting those customers and recruiting those employees for a period of time. Usually, it will not prevent the buyer from bidding on work offered by those customers if requested by the customer. It can be a very sensitive area, so a precise understanding by both parties is necessary.

It is customary for the prospective buyer to bear all costs for the due diligence process.

The Closing Documents

The closing documents are developed by the prospective buyer and will usually include the following:

The Agreement of Sale, which will reflect the original LOI, except that it will include significantly more detail. It will also include schedules, lists, contracts, leases and other documents pertinent to the complete transaction. Frequently, this and the other documents will circulate among the buyer, seller and their respective representatives several times before the document is finally approved by each group.

The Promissory Note is what the name implies. It represents the amount and terms of what the buyer and seller have agreed upon as to the amount, rate of interest and payment schedule that the buyer will pay to the seller. The Noncompete Agreement is the agreement is the agreement barring the seller, having sold the company will not, for a period of time, engage in that same type of business within a specified geographic area. Usually, the noncompete is reserved for shareholders of the company being sold, usually for a term of three to five years.

The Nonsolicitation Agreement is frequently reserved for key employees of the company being sold and may be part of their employment agreement. It provides that the person will not solicit customers or employees of the company being sold for a period of time. A non-solicitation agreement usually does not prevent a person from being engaged in or being employed by a company in the same industry or market area so long as the terms of the non-solicitation agreement are honored.

Employment Agreements are often included among the closing documents for shareholders and other key personnel that will be transferring to the new entity. Other agreements may be included in the closing documents, depending on the negotiations that transpired between the parties.

The Advisors

It is not likely for a company owner to possess all of the information and skill necessary to complete the acquisition transaction from start to finish, whether a buyer or a seller. Various advisor disciplines are required that include financial, legal, accounting and, for some, the M&A specialist.

A Legal Advisor provides a necessary function. It is that discipline that provides the seller or the buyer with legal advice about all of the closing documents. A CPA Advisor provides historical data, explaining the financial records and notes to the financial reports for the historical and current periods.

An M&A Intermediary Specialist is frequently called upon to assist either the buyer or the seller through the complexities of the entire sale process, from beginning to end. They work through and coordinate with their client's other advisors. They—at any given time—have the entire scope of the transaction in view.

It is customary that the buyer and the seller each bear their own costs for professional fees and other closing costs.

The acquisition process may or may not include each of the steps outlined here, but there really should be an organized path for the process. Of course, there will be a great deal of discussion leading up to and during each step of the process. The dialogue is the matrix for the steps coming together, resulting in a sound transaction that is good for the buyer and the seller. The ongoing dialogue is important also in that it

forms the basis of a relationship between the buyer and the seller. If the relationship is based on mutual respect and even, friendship, the transition to a successful transaction will have far fewer obstructions.

Acquisition is a business effort that is here to stay. It can provide positive results for the buyer and the seller if the entire process is entered into wisely, if the process is executed professionally and competently and if all parties act, using sound business judgment and act in good faith with one another. Transactions within the building services industry have often proven to be wise endeavors for buyers and sellers. The acquisition process within the building services industry has improved and matured as the industry has matured and improved; now standing among other viable industries within the world of commerce.

This is the last of a series of three articles dealing with the M&A sector of the building services industry. These articles have highlighted what is important for the buyer and the seller to know and what they need to learn if they choose to engage in the M&A sector. Each M&A undertaking is unique simply because each company situation is unique. One size does not fit all.

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