Article

Surviving The M&A Nuclear Winter: Key Success Factors To Getting Deals Done In Troubled Times

Many M&A professionals are glad to have 2009 behind them, but who knows whether the "M&A nuclear winter" will thaw in 2010 — will valuations rise, and will credit start to flow? Additionally, who are the firms that were able to get deals done in this tough economic environment?

I focus my practice on "middle market" transactions ($5M to $250M deal size) and have been noticing a recent uptick in deal activity. But since there's less margin for error in the current environment, I'd like to share some key success factors I've observed that often separate the successful deals from those that fail. I will also share the success story of Ancor Capital and their ability to get five deals done in the past 15 months.

- **Smaller can be better.** Smaller transactions are less dependent on bank financing and are therefore easier to close in the current environment. Many buyers are looking to do less risky add-on acquisitions that broaden product penetration, add customers, and so on. Smaller companies are also typically more thinly capitalized, and therefore adverse business conditions may be more likely to drive them to sell all or a portion of their business.
- **Look for deep pocketed buyers.** Larger transactions are better suited for well financed buyers. Additionally, certainty of closing is often as big an issue for the seller as the sale price. Larger buyers with cash hoards also have an advantage in the acquisition of troubled or bankrupt companies since cash is king in those deals.
- **Be flexible with financing.** Because the credit markets are so difficult, consider alternative forms of financing, such as buyer stock or a promissory note. But be careful - you will need to consider several "what ifs". What if the buyer defaults on the note? Can the buyer reduce the amount of the note if it has claims against the seller? What if the buyer's stock doesn't turn out to be worth as much as the seller had hoped? And so on. This is where an experienced, professional deal advisor earns his or her keep.
- **Creatively bridge any "value gap."** Many sellers believe that 2009 was an anomaly, but buyers may not be so sure. Will the seller's business return in 2010? Earnouts, or deferred payments based on the performance of the business after the closing, are commonly used to bridge the gap between the sale price the seller wants to receive and the purchase price the buyer is willing to pay. Because earnouts are often the source of post closing disputes, I often advise clients to seek the advice of a knowledgeable accountant to help them structure earnouts. After the business terms are understood and agreed by the parties, the attorneys are able to draft an earnout provision that is less likely to be challenged. It is also important for the parties to consider whether a dispute resolution mechanism other than a lawsuit will be used to resolve disagreements over earnouts.

Additionally, deals can often be structured to reduce taxes in order to increase the portion of the sale proceeds that the seller actually pockets. The key here is to engage tax advisors well in advance of a potential transaction since the seller's flexibility to engage in tax planning transactions decreases as the sale transaction draws closer.

- **Minimize surprises.** In an M&A transaction, time is typically the enemy of the seller. If word of the deal leaks, then customers, suppliers, and employees can get nervous. Also, the longer the time period to closing, the greater the opportunity for the seller's business to experience a hiccup that may jeopardize the deal or result in a reduced purchase price. Since surprises often trigger delays, it's imperative that the seller use maximum effort to limit surprises. And when the seller becomes aware of a surprise, it's usually best to immediately inform the buyer. Surprises are rarely like fine wine; they don't get better with age.

- Discover the golden handcuffs. Because acquisitions are often as much or more about people than about products, customers, and markets, smart buyers will often look for monetary or non-monetary considerations that will motivate key teams to excel for their new bosses. But make sure to first consult your tax advisors, since the form and structure of different compensation arrangements can have dramatically different tax consequences.

One firm who was able to get deals done in this challenging market was Fort Worth based Ancor Capital. In a 15 month period the Ancor team was able to close five transactions beginning with the acquisition of Care 4 Kids in October 2008, followed by Tom Cat Bakery in January 2009, FCA Packaging in March 2009, Spencer N. Enterprises in August 2009 and finally Tri Trax Healthcare Services in January 2010. According to Brook M. Smith Managing Director at Ancor, “we were able to close on these acquisitions as a result of focusing on quality companies and relying on the long-term relationships we have built with our investor base.” Ancor focuses on the lower end of the middle market in manufacturing and distribution with a particular strength in food and health care and as a result of their strong operational expertise they were able to accomplish what others were not able to during the tumultuous market environment.

As M&A transactions revert to the "new normal," deal execution will become even more critical. Those buyers and sellers that keep their focus on these key success factors will have a greater likelihood of achieving the outcomes they expect.

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