M&A Auctions: Are You Ready to Sell Your Company on eBay?

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Auctions seem to have taken over the world of middle market mergers and acquisitions in recent years. It's enough to make you wonder if eBay will soon advertise "slightly used high tech company/one owner/mint condition" along with its roster of books, appliances, and autographed baseballs.

Why the big push for M&A auctions? First, sellers are becoming increasingly sophisticated and investment bankers are increasingly targeting the middle market. But perhaps more important is the fact that there are simply lots of buyers competing for deals. Strategic buyers have strong balance sheets to back up their appetite for acquisitions. Private equity buyers have lots of equity capital and willing lenders.

Like other auctions, M&A auctions usually work best with many qualified, interested bidders vying for a desirable asset. But is an auction the right way for *you* to sell *your* company? That's a complicated question, and in this article, we'll help you answer it. We will first describe the M&A auction process. Then we will describe some of the pluses and minuses of an M&A auction for sellers.

The M&A Auction Process

In General. How does it work? In an M&A auction, the selling company hires a financial adviser (usually an investment banker) to design and orchestrate the sale process. With the seller's input, the financial adviser develops a list of potential buyers who can be expected to create a competitive process through various bidding stages. Generally the process takes anywhere from four to seven months from hiring a financial adviser to closing the deal (sometimes longer depending on regulatory issues or the buyer's closing requirements).

Hiring a Financial Adviser. Hiring a financial adviser is the first critical step in the M&A auction process. We always recommend talking to multiple potential advisers. Ask especially about the adviser's contacts in your company's industry. Investigate the adviser's track record and reputation, and check references (keeping in mind that this is challenging while trying to maintain confidentiality). When your adviser calls a potential buyer about your company, you need to be sure the call is answered.

Fees for financial advisers vary greatly. Financial advisers are usually paid as a percentage of the total sale price, customarily ranging between .5% and 1.0% for larger deals to 3% or higher for smaller deals. Sometimes a flat fee is used instead. But an adviser's fee is always very specific to the company and the deal, and there is no particular percentage or fee that makes sense based simply on the anticipated sale price. Interviewing multiple financial

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advisers for your deal is the only way to confirm you are paying an appropriate fee.

The Book. In a typical auction process, the company and financial adviser will prepare a selling memorandum (known as "the book"). This is a selling document that describes the company, its industry, its financial performance and prospects, etc.

The Data Room. Every auction involves due diligence, usually conducted through a "data room," which is a comprehensive collection of important documents, contracts and reports relating to the company's business and finances, corporate history and structure, ownership, taxes, employee benefit plans, material commitments, environmental and regulatory matters, etc.

Until a few years ago, the data room was typically a physical site. More recently, however, "virtual" data rooms, which are maintained online by outside providers (such as financial printers), have become common. Virtual data rooms have many advantages if appropriate security measures are in place, and they are relatively inexpensive as deal costs go (perhaps $15,000 to $30,000 for an average deal).

The Bidders. With the company's input, the financial adviser develops a list of potential buyers and contacts them. If a potential buyer is interested and signs a confidentiality agreement, then it receives the book. The number of potential buyers contacted can range from a handful to more than 100.

The Bidding. Most M&A auctions involve at least two rounds of bidding. In the first round, bidders submit a non-binding "initial indication of interest," which is usually a range of purchase prices based on available information. Bidders at this stage will also usually indicate whether they need to finance a deal, and, if so, provide some information about financing sources.

After receiving initial indications of interest, the company and its adviser select bidders for the next round. Qualifying bidders are allowed to conduct more extensive due diligence and to receive a presentation from company management (if not already provided). Bidders are then asked to submit a non-binding "definitive" bid, as well as further details about financing, timing, and any further approvals required to close the deal. Comments to a draft purchase agreement will likely be required with this bid, as discussed below.

Following this second round, the seller will usually choose a single bidder for final, detailed negotiations over a very short period of time and (the seller hopes) a successful closing. Due to the effort and expense associated with proceeding further, the winning bidder will usually require an "exclusivity" agreement, which precludes the company from dealing with other potential buyers for a limited time. Depending on negotiating leverage, this period will usually last 30 - 45 days, but is often later extended, especially in a financed deal, if satisfactory progress is being made.

The Purchase Agreement. Usually, at some point in the auction process (typically the "definitive bid" stage), bidders will be asked to provide a markup of a purchase agreement prepared by seller's counsel. In rare cases, bidders may be asked to submit their own draft purchase agreement (which we usually consider a mistake for a seller). The markup of the purchase agreement will reveal many important details of the bidder's proposed deal. Also, by sending out the same draft purchase agreement to all bidders, the seller is better able to compare proposed contract terms on an apples-to-apples basis (instead of receiving a completely different purchase agreement from each bidder).

Some Variations. Under the right circumstances, sellers may be able to change the typical auction process to their advantage. For example:

Single Stage Auction. In this scenario, a few potential bidders conduct extensive due diligence, mark up a draft purchase agreement, and submit definitive bids. Some further negotiation on price and other terms may occur, and then a winning bidder is selected for final negotiations and

closing. This single-stage process conserves time and energy.

Maintaining Two Active Bidders. To minimize the risk of a winning bidder trying to renegotiate the deal, financial advisers sometimes try to keep two bidders active until a definitive purchase agreement is signed. (The loser's out-of-pocket expenses are often reimbursed.) In our experience, this format is often discussed but rarely used. Even with expenses covered, the two bidders often feel that the additional due diligence and negotiations aren't worth the time and effort without exclusivity.

Negotiating Purchase Price Last. Experienced dealmakers know the devil is in the details and the purchase price is only the beginning of M&A deal negotiations. As a result, some sellers require bidders to negotiate a full purchase agreement and all ancillary documents *before* the bidders submit a purchase price. By doing this, sellers have all the other details worked out before accepting a bid and can move rapidly toward closing. It also precludes bidders from using a better purchase price to negotiate more favorable terms.

This process tends to work best in large transactions with a hot property. The transaction costs (legal, accounting, consultants, etc.) in this process are higher for both bidders and seller because of multiple negotiations. But, especially with large, competitive transactions, where the demand is high and transaction expenses are less important, this procedure can work very well for a seller. For example, Faegre & Benson recently represented Target Corporation in the sale of Marshall Field's and Mervyn's using this process in deals in which the ultimate purchase prices were $3.2 billion and $1.7 billion, respectively.

Pluses and Minuses of M&A Auctions

Intuitively, most sellers think an M&A auction will fetch the best price. That may or may not be true. Other considerations may also come into play that make an auction less desirable. M&A auctions involve trade-offs, which means that an auction may not be right for your company.

Based on our experience, here are some of the pluses and minuses of the M&A auction process for sellers.

Pluses

+ *Maximize Price* – under ideal circumstances, maximizes the sale price due to increased competition.

+ *Negotiating Leverage* – facilitates negotiation of key terms (in addition to purchase price) at a time when the seller has numerous options and greater leverage.

+ *Deal Momentum/Sense of Urgency* - creates a specific timetable and momentum for the transaction, and a sense of urgency for the buyer, which may increase the likelihood that the deal will close.

+ *Third Party Validation* – helps to validate the purchase price and other transaction terms, which is particularly valuable when the company has shareholders who are not involved in

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negotiating the transaction but will be asked to approve the deal.

+ *Unlikely Buyers* – increases the likelihood that unlikely buyers will be uncovered through the process.

Minuses

- *Risk of a Failed Transaction* – a company may be seen as damaged goods if the auction process becomes known and no acceptable offer is received, or if a winning bidder later backs out.

- *Deal Confidentiality* – auctions are very difficult to keep secret, which can adversely affect employees, customers and suppliers, among others.

- *Proprietary Information Confidentiality* – despite confidentiality agreements, it is very difficult to adequately protect sensitive proprietary or other confidential information (for example, financial results).

- *Complex Deals Are Tough* – it's tough enough to get bidders to spend time on a relatively straightforward auction. If your story or business is complicated, think twice. Auctions work best with a large number of prospects who think they understand the situation.

- *A Bird in the Hand* – sometimes the pressure of a *possible* auction is enough to get a great result from an interested, motivated buyer without an actual auction process. In many cases, a financial adviser can tell you whether the offered price is within a reasonable range based on financial analyses and comparisons, without running an auction process. Under the right circumstances, why jeopardize a bird in the hand for a few in the bush?

- *Demanding Process* – a full-blown M&A auction is a very intense process that is undertaken while management is still responsible for running the business. It's a major distraction and can even cause a downturn in your business (at the worst possible time).

- *Reluctance of Certain Buyers* - certain logical buyers may refuse to participate in an auction and will only negotiate one-on-one. You may lose these buyers in an auction process.

So is an M&A auction right for you? We can tell you with great confidence that ... it depends. You need to weigh carefully the pluses and minuses in the context of your specific situation. An M&A auction will never be as easy as selling on eBay. Depending upon the circumstances, conducting your company sale by auction may or may not be the right decision – you need to understand and accept the trade-offs.