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The Design Professional Roundtable

An Overview Of The Acquisition Process For A Private Company Transaction

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Before the Process

- Develop a business plan for the Company
  - What is the current Company situation
  - Where does management want the Company to be
- Can the Company achieve the business plan alone
- If not, consider the following:
  - Merger (could be considered a sale of the Company or a merger of “equals”)
  - Acquisition

Before the Process (Cont.)

- Determine what is the Company requirement that the merger or acquisition will address
  - Strategic reasons
    - Increase rate of growth
    - Increase geographic presence
    - Add service capabilities
    - Acquire management expertise
    - Acquire a competitor

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Before the Process (Cont.)

- **Internal reasons (closely held companies)**
  - **Ownership succession not feasible**
  - **Family succession not possible**
  - **Dispute among principals**
  - **Retirement**

The Process

- Determine a list of targets or merger partners
- Initial contact of targets or merger partners to determine interest
- Confidentiality agreements
- Valuation and structure
- Letter of intent
- Due diligence
- Develop an integration plan
- Prepare the transaction agreements
- Negotiate the transaction agreements
- Close transaction
- Implement integration plan

List of Targets or Merger Partners

- Use your market knowledge or an advisor
- Companies on the list should address the Company's strategic reason for the transaction
- Similarity of "company cultures"
- Contact listed companies directly or use an intermediary

Confidentiality Agreements

- Enter into confidentiality agreements with selected targets or merger partners on the list

- Confidentiality agreements

    - Allow for an exchange of information on a protected basis
    - Prevent solicitation and hiring away of employees
    - Prevent interference with existing and potential client relationships
    - Allow for preliminary due diligence before letter of intent
    - Permit the target-merger partner list to be narrowed to a primary candidate

- Initial meeting of the principals of the companies

Valuation and Structure

- Based on preliminary due diligence, including: financial statements, accounts receivable aging report, backlog, projections, and compensation
- Determine the amount of consideration to be offered in the transaction based upon the fair market or transaction value of the target or merger partner

Valuation and Structure (Cont.)

- Comparable market analysis
  - Publicly traded guideline companies
  - M & A guideline transactions
- Expected earnings analysis
  - Financial performance (historical performance creating projected future cash flow estimates after adjustments)
- Appropriate premium and discounts

- Determine the structure of the transaction
  - Asset
  - Stock
  - Merger

Letter of Intent

- Outlines principal terms and conditions of the transaction
    - Structure
    - Consideration (cash, stock)
    - Post-closing management structure
    - General terms of employment and consulting agreements
    - Conditions to closing
    - “No shop”
    - Transaction timing
- Determines whether there exist fundamental differences before the transaction proceeds too far
- Not binding, except for “no shop”

Due Diligence

- In depth investigation of the target or merger partner to validate the valuation and the strategic fit
  - Financial
  - Management
  - Operations
  - Employee matters
  - Clients
  - Litigation (pending and potential)
  - Insurance coverage and history
  - Confirm necessary permits and licenses
  - Compliance with laws

Due Diligence (Cont.)

- Determines if “problems” exist and whether they can be resolved
- Provides information for use in the development of the integration plan
- May lead to a renegotiation of the transaction consideration

Develop Integration Plan

- Don’t wait until the transaction closes to develop the plan
- The plan should address how the two companies will operate following the closing of the transaction
  - Determine potentially redundant areas and address their post closing status
  - Management
  - Identify expense reduction opportunities
  - Are there potential conflicts regarding clients and how will these be resolved
  - Determine who will be responsible for the implementation of the plan

Prepare Transaction Documents

- **Acquisition agreement**
  - **Acquired assets, assumed liabilities**
  - **Consideration**
  - **Representations and warranties**
  - **Conditions to closing**
  - **Indemnification**

Prepare Transaction Documents (Cont.)

- **Depending upon the transaction, potential ancillary transaction agreements include**
  - **Employment agreement**
  - **Consulting agreement**
  - **Non-competition agreement**
  - **Seller financing promissory note**
  - **Escrow agreement**
  - **Stockholders' agreement**

Negotiate Transaction Agreements

- **The negotiation process will typically focus on the following to the extent they are in the transaction**
    - **Post closing adjustments to the transaction consideration**
    - **Terms of any “earnout”**
    - **Representations and warranties**
    - **Terms of the indemnification**
    - **Terms of the seller financing**
- **Experienced advisors make the negotiation process more efficient because they know the range of what is considered “reasonable” in the process**

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Close Transaction

- Either sign the acquisition agreement and close on the same day or sign the agreement and close when the conditions to closing are met
- Closing typically occurs by electronic exchange of signed agreements
- Make any necessary public announcements based upon mutual agreement (employees, clients)

Close Transaction (Cont.)

- **There may be post closing actions**
  - **Adjustment to transaction consideration based upon validation of financial statements**
  - **Earnout payments**
  - **Transition service obligations**

Implement Integration Plan

- Initiate the integration plan
- Monitor the implementation
- Revise the plan, if necessary, to achieve integration

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