

# Merger & Acquisition Focus



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Heading off purchase price disputes

Ask the Advisor



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# Put managers to work on your merger

**W**hen it's clear you've found a good match and your company begins the M&A negotiation process, consider how you can involve your managers. Leaving even lower-tier managers out of the loop is a waste of vital company resources — and a potential recipe for trouble.

Good frontline managers — for example, those who supervise product lines or sales campaigns — can help you accomplish the many tasks involved in closing a deal and making the merger transition. On the other hand, if managers are left out or undervalued, they're likely to become disengaged. They may defect to a competitor, negatively influence the opinions of rank-and-file workers or slow down the integration process.

*Employees are more likely to listen to and believe managers they know and trust than executives they've never met.*

## Look out below

Many companies in the process of selling or buying are reluctant to reveal that fact until the deal is all but settled. However, it's possible for owners and upper management to hold their cards too close to the vest. Consulting firm Towers Watson's 2010 survey of 700 lower-level managers found that many felt they had been underused in their companies' past mergers. Only 17% of respondents were included on integration teams, and 39% said they weren't involved in any integration activities.



So once you've settled on deal terms and know what major changes will be necessary, such as office or production facility moves and division consolidations, bring all of your managers into the loop. This will help prevent them from feeling isolated when rumors of the merger begin to leak. And managers' ground-level insights can help you make decisions regarding such critical issues as staff layoffs.

## Recognize leadership potential

Sellers in particular need to involve managers in the transition and integration process as soon as feasible. You may not want to entrust all of them with critical merger-related tasks, so be sure to:

**Establish a hierarchy.** Identify which of your company's lower- and midlevel managers have the best leadership skills and potential. (See "Where's the talent?" on page 3.)

**Open the lines of communication.** Once you've assembled your leadership group, require them to regularly attend integration meetings and solicit feedback about how they think the process is going.

Also provide managers with the information they need regarding such changes as layoffs and new reporting structures before they occur. This gives them time to plan for their own futures and how they'll communicate the news to their departments.

**Monitor performance.** Owners and upper management should monitor frontline managers to ensure they're making progress on their assigned integration duties and are properly managing employee expectations.

### On the ground

Aside from relieving owners and executives of some merger footwork, lower-level managers can provide critical communication services. Employees are more likely to listen to and believe managers they know and trust than executives they've never met. So consider appointing your frontline managers as first responders (along with HR personnel) when inaccurate rumors — such as a cut in salaries and benefits — begin circulating.

These managers can also be a valuable source of information for owners. For example, they can relate employees' opinions and concerns about the merger to those at the top.

### Don't neglect your base

You probably aren't going to involve your frontline managers in major M&A-related decisions. But you need to recognize how lower- and midlevel managers can help make your deal succeed. Assign them merger-related responsibilities and take advantage of their unique relationships with employees to ensure accurate messages are communicated and the merger receives staff buy-in. The odds of your M&A meeting its strategic objectives are much higher when you have all hands on deck. ■

## Where's the talent?

Depending on your company's size, you may have many lower- and midlevel managers who rarely interact — and may not be suited to work — with your executive team on high-level company business. So when assigning roles related to a sale, consider winnowing down the prospect pool.

Consider conducting a leadership workshop for managers. This will help you get a sense of each one's problem-solving skills, work ethic, efficiency and compatibility with their peers.

Enlist the help of your HR department to go over your managers' performance reviews, upward appraisals and other feedback, such as customer testimonials. HR should flag the files of managers who have been reassigned, demoted or subjected to disciplinary actions in the past. Depending on the circumstances behind such actions, it may not be appropriate for these managers to provide input on your company's future or be responsible for merger-related tasks.

As your buyer makes difficult organizational and personnel decisions, it also will appreciate knowing which managers show the greatest promise. As the two organizations consolidate, some managers may lose supervisory positions and others may be promoted to positions of greater authority.



# Deal do-over

## MAKE THE SECOND TIME A CHARM

**D**o you ever think about the deal that got away? Perhaps a buyer made an offer for your business that looked great on paper but fell apart when real world logistics, personalities and financing needs got in the way. If so, you'd probably be wary if that same buyer renewed its interest in buying your business.

It's wise to be cautious — even suspicious. But turning away a former prospective buyer without a fair hearing could be a mistake. Such buyers often are ideal merger partners because they've likely learned from their mistakes and are committed to making it work this go-around.

### Failure options

If your company's considering a second offer from a past suitor, it's important to revisit and analyze the original transaction to determine exactly what went wrong. Try to differentiate between the influence of outside factors and the buyer's mistakes and missteps.

*Ensure that the buyer has cleaned up its balance sheet and has adequate financing to meet your asking price.*

An example of outside factors might be the failed 2000 US Airways and United Airlines merger, which got tripped up by antitrust regulations. And in recent years, a frozen credit market has made it impossible for many interested qualified buyers to obtain financing — even when they were very serious about their acquisition intentions. If issues such as these no longer exist, there's no reason why you shouldn't entertain a new offer.



However, if the original deal crumbled due to buyer mistakes or incompatibilities between the two companies, you and your buyer should address them before moving forward. Common issues include:

**Financing.** Did the deal fail because the buyer was overleveraged and couldn't raise the necessary cash? Ensure that the buyer has cleaned up its balance sheet and has adequate financing to meet your asking price.

**Deal mechanics.** Was the original deal's process flawed? For example, did the buyer perform inadequate due diligence and then raise an overlooked financial or legal issue late in the game? Or did it poorly communicate its progress with you or move too slowly? Did the buyer use valuation methods that you consider inaccurate? If any of these are true, the buyer should provide you with a detailed description of how the process will operate more efficiently this time.

**Cultural mismatches.** Did the deal stumble over incompatibilities such as dissimilar management structures, compensation levels or company cultures? If so, what's different about the buyer's or your organization now that would prevent the same issue from rearing its ugly head?

### Positive signs

If you can resolve past errors and obstacles, consider some of the positive aspects of a second-chance deal. Original negotiations have likely already laid



much of the necessary groundwork and introduced you to the personalities and their negotiation styles. You can skip the meet-and-greets and get down to business relatively quickly.

And although both parties need to perform new rounds of financial and legal due diligence, you and your buyer will have a better idea of what to focus on and the types of information to request. What's more, when you're familiar with each other's business models, leadership structures and product

lines, you can begin planning for a smooth integration as soon as deal negotiations begin.

### Try, try again

It's natural for you to be wary of a prospective buyer who has disappointed you in the past. But if the buyer has improved its financial position, addressed compatibility and communication issues and made a commitment to pursue the transaction until it reaches a successful end, there's no reason why you can't make the second time a charm. ■

# Attitude adjustment

## HEADING OFF PURCHASE PRICE DISPUTES

**B**ecause most M&A deals are negotiated before closing-date financials are available, buyers and sellers usually have to make postclosing purchase price adjustments. These can lead to disagreements between the parties. Fortunately, your M&A advisor can draft purchase price adjustment provisions that reduce the likelihood of 11th-hour disputes.

### Mind the GAAP

Buyer and seller differences often are rooted in the fact that the parties may use different accounting methods to prepare financial statements. Carefully worded purchase agreements and procedural planning that define accounting practices to be used in the deal can save significant time and resources for all concerned.

Purchase agreements specify accounting policies by which the closing balance sheet will be prepared. They may state that the buyer is responsible for preparing the closing balance sheet but that it's prepared using the seller's accounting practices.

Generally Accepted Accounting Principles (GAAP) isn't always referenced in a selling company's

balance sheets. And even when GAAP is specified, the agreement may not provide a remedy for situations where the seller's historical practices and GAAP conflict. Buyers in particular will want the purchase price agreement to specify that, in instances of competing accounting methods, GAAP will win out.

### Accounts in doubt

Sometimes financial statements are prepared in accordance with GAAP but contain specific line items that improve the perceived value depicted in





the statements or reflect the seller's sole ability to liquidate such items. However, buyers view financials based on their ability to derive value from the line items. If they're not addressed earlier, items such as accounts receivable, outdated inventory and other unrecorded liabilities can become the subject of postacquisition disputes.

A seller, for example, may calculate the allowance for doubtful accounts and reserve for outdated inventory within GAAP guidelines, but not on actual operating cash value. The buyer, however, might consider its ability to collect receivables or sell inventory after the sale to evaluate the adequacy of the selling company's reported allowances.

The parties can avoid a dispute by indicating in the agreement whether the seller's practices or the buyer's actual results through a specified date after closing are the standard by which accounting estimates will be determined. The agreement also might specify a formula that calculates the allowance based on each account's payment history or on an agreed-upon measure, such as how long accounts receivable have been outstanding.

Other disputes may be triggered when a seller completes financial statements before receiving all outstanding invoices. The buyer may pay the invoices received after closing and determine that, for the financial statements to have been prepared in accordance with GAAP, the invoices should have been recorded as liabilities and expenses as of the closing date.

You can head off these kinds of issues by making sure your purchase agreement discusses how specific statement items that require judgment and estimates should be handled. Specify effective dates and set a time period after the deal's closing, during which the seller remains responsible for invoices that relate to liabilities incurred before the buyer assumed control.

## Buying time

Purchase agreements allow for at least a 90-day period after the deal closes for the buyer to prepare the closing balance sheet. Typically, the seller has 45 days to look over and comment on the closing balance sheet and supporting documentation, and the parties have another 45 days to negotiate any differences. Disagreements may be submitted to arbitration.

Buyers gain control of the books after the deal closes, so sellers should enlist the help of their accounting and M&A advisors in preparing initial balance sheets while they still have unrestricted access. This will better enable the seller's advisors to evaluate the closing balance sheet.

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Buyers, on the other hand, should be able to support conclusions — with detailed and specific information — reached in the closing balance sheet. And, to facilitate agreement, it's important for buyers to respond to the seller's inquiries as quickly as possible.

## Prevent conflict

Work with your advisors to specify the terms of purchase price adjustments in your sale agreement. Whether you're a buyer or seller, it could save you a lot of time, money and mental stress. ■

# Ask the Advisor

*Q. How should my company handle an unsolicited offer?*



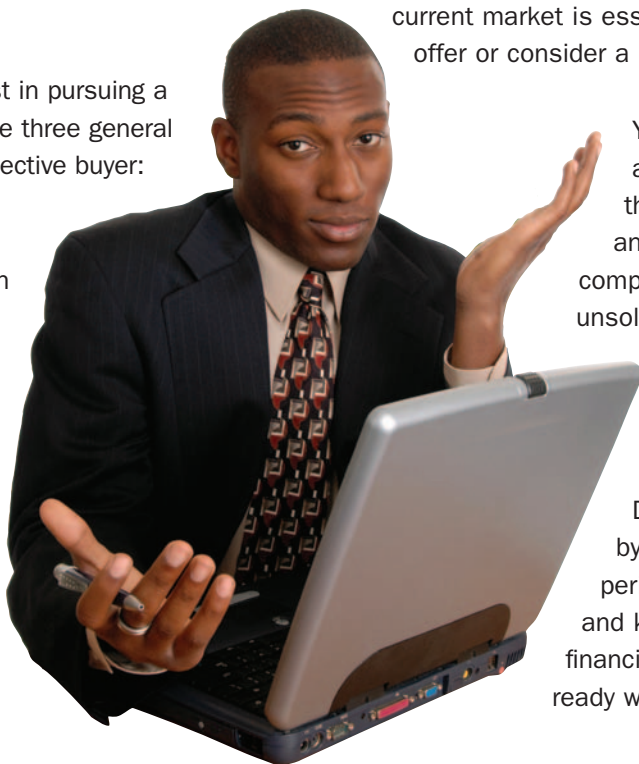
**A.** It's not unusual for business owners to receive unsolicited bids from buyers, even if they aren't planning to sell anytime soon. You may be skeptical initially, but an unsolicited offer can be a great opportunity if your potential buyer is offering a compelling amount and the companies appear to be a good fit.

The trouble with unsolicited offers, however, is that anyone can make them — and if you haven't considered selling before now, your company probably doesn't have a screening process in place to evaluate suitors. So it's essential that you enlist the help of an M&A advisor as quickly as possible. He or she can help you research the bidder, determine whether its offer is serious and decide whether selling now is in the best interests of you and your business.

## Get some answers

Before indicating interest in pursuing a deal, you need to resolve three general issues about your prospective buyer:

**1. Strategy.** Is the buyer's long-term growth strategy built on continual expansion via acquisitions? Or does it operate more strategically and pursue only those companies whose products and services complement its own and will likely provide cost synergies?



**2. Intentions.** Does the buyer have a history of trying to snap up businesses on the cheap or through hostile bids? If those targets declined the buyer's offers, has the buyer continued to aggressively pursue them? Is the buyer known for honoring its original term sheets?

**3. Financials.** Does the buyer seem well capitalized or overleveraged? If it doesn't have the cash to buy a business outright, is it capable of getting bank financing in what continues to be a tight credit market?

## Know your own value

While you're investigating the potential buyer, have your financial advisors appraise your company's value. Knowing what the business is worth in the current market is essential if you're to evaluate an offer or consider a sale right now.

You might also want to approach other companies that are in the market for an acquisition. The threat of competition could improve your unsolicited buyer's bid and scare off "bottom feeders" with bad intentions.

## Be prepared

Don't get caught off-guard by unsolicited bids. Obtain periodic business appraisals and keep your operations and financials shipshape so you'll be ready when opportunity knocks. ■



**Gilbert A. Herrera** founded Herrera Partners in 1992, a private investment banking firm that provides acquisition advisory services including allocation of purchase price and fairness opinions, SEC and FASB compliance services, impairment studies and valuations to our corporate clients; damage, proximate cause and expert testimony services to our legal clientele and restructuring services including the sale/disposition of non-core assets as part of debt restructuring and pre-packaged plans. He formerly served as director of Coopers & Lybrand's Southwest region corporate finance group. Previously, he was the senior investment banker for Underwood, Neuhaus & Co.

Mr. Herrera graduated from the University of Texas at Austin in 1978, where he is a member of the Dean's Council for the McCombs School of Business, MBA Investment Fund, Ex-Students' Association board of directors, Littlefield Society and Executive Committee of the Chancellor's Council of the University of Texas System. By appointment of the Texas Supreme Court, Mr. Herrera served two terms as a public member of the Commission for Lawyer Discipline from 1993 to 1999 and Chaired their Budget Committee. In 2001, Mr. Herrera was appointed by Governor Rick Perry as Chairman of the General Services Commission and its transition to the Texas Building and Procurement Commission. He currently serves as on the executive committee and board of directors of Neighborhood Centers, Inc., Chairman of CHRISTUS Health Gulf Coast, Chair-elect of the Houston Hispanic Chamber of Commerce, Vice Chair of Business and Financial Affairs for UTMB's Development Board and Chairman of the Investment Committee of the Texas Exes Scholarship Foundation. He is a past President of the Houston Chapter of the Turnaround Management Association, the leading education and advocacy group dedicated to the corporate renewal industry.

In 1995, he received the Outstanding Young Texas-Ex award from the Ex-Students' Association and previously served on the University of Texas at Austin's Commission of 125, *Planning for the Future*. In 2008, he received the Chairman's Award for Distinguished Service to the Houston Hispanic Chamber of Commerce.



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