



MERGER AND ACQUISITION BASICS

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This comprehensive eBook covers important subjects including the difference between an M&A advisor and a business broker, processes for selling, types of buyers, deal killers, and more. We begin by covering the basics.

WHAT IS AN M&A ADVISOR?

THE DIFFERENCE BETWEEN M&A ADVISORS AND BUSINESS BROKERS

Although the ultimate goal of both M&A advisors and business brokers is to help connect business owners with buyers, their services and processes are different. Many business owners are unaware of the variances between the two.

M&A ADVISOR	BUSINESS BROKER
Represent owners of businesses from a variety of industries valued from \$5 million and up.	Represent businesses valued below \$5 million. (Daycares, beauty salons, single location restaurants, etc.)
Operate more like an investment banker or consulting firm. They don't advertise their engagements through web postings; they work with targeted pools of buyers who have demonstrated an interest in opportunities of the type and size being presented.	Provide their services in a manner similar to real estate brokers, listing and advertising their businesses for sale through web postings or newspaper ads.
Buyers may occasionally be high net worth individuals but are more often other companies, private equity groups, and family offices.	Buyers are most likely individuals.
Typically have fewer engagements than business brokers. (Larger transactions tend to be more complex and require considerably more time.)	Tend to have more frequent engagements and smaller transactions.
Potential for company to be sold at higher valuation multiples.	Company rarely sells for more than four times cash flow.
Charge an upfront retainer fee (\$10,000 to \$50,000) and a success fee (ranging from 1.5% to 7% of the transaction value depending on transaction size and complexity).	Charge a commission ranging from 8% to 12% of the transaction value.

Lutz M&A is considered an M&A advisor. With an understanding of what an advisor is and is not, we move forward by providing some insight on different competitive processes for selling a business and how they can generate success in the future.

A COMPETITIVE PROCESS FOR SELLING YOUR BUSINESS

As a business owner, selling your company may be one of the biggest financial decisions you ever make. It is also no small undertaking. With those two things in mind it is best to do it right the first time. That means reaching out to as many potential buyers as possible to find the best fit. In other words, hiring an advisor to run a competitive process will typically yield the best outcome.

Unlike their publicly traded counterparts, private businesses are much less liquid. Public companies' stock is traded daily on an exchange through order books that track bid and ask prices to match up buyers and sellers. In a competitive M&A process advisors are hired to create a market for the private entity being sold.

COMPETITIVE PROCESSES HAVE A NUMBER OF BENEFITS FOR SELLERS.

1. PRICE MAXIMIZATION

At Lutz M&A we have worked with a number of clients who had received unsolicited buyout offers. Some decide to entertain these bids as a path of least resistance. Others chose to engage our team to run a process. In those cases the financial results were vastly different. In one example a Lutz M&A client sold for over 70% higher than a competitor's unsolicited bid.

2. ELIMINATING THE "WHAT IF" FACTOR

Selling to the first buyer that comes along without entertaining other offers can leave an owner wondering what may have happened if additional suitors were involved. After all, unsolicited bids are submitted for a reason. Buyers that see an attractive opportunity are most likely trying to acquire the business at a below market price or on unfavorable terms.

3. TALKING TO MORE THAN ONE BUYER

Most owners are concerned about the business and their employees' well-being post transaction. Having more than one buyer involved allows sellers to select not only the best price but also the suitor they feel most comfortable selling their company to. In a lot of cases selling shareholders remain owner-employees post transaction so selecting someone they can work with for the next handful of years is critical. Lutz M&A has had several clients choose buyers based on "fit" over price.

4. THE SAFETY NET

It is not entirely uncommon for buyers to back out of a transaction in the due diligence phase and/or attempt to renegotiate the purchase price. If issues that lead to the rise of these events are not able to be resolved, having other buyers that showed strong interest earlier in the process to go back to can save time and money compared to starting back at square one. At Lutz M&A we have been able to salvage transactions for clients by going back to other interested parties after the initial buyer backed out.

Competitive processes for selling businesses involve many steps and much time and work. However, for the reasons mentioned, we feel the cost to benefit trade off of using an M&A advisor weighs heavily into the seller's favor.

TYPES OF BUYERS: STRATEGIC VS. FINANCIAL

In the world of M&A, buyers tend to fall into two distinct categories: strategic buyers and financial buyers. We believe it's important to understand the differences among these buyer groups, so you know what to expect and who to approach about a potential sale.

STRATEGIC BUYERS

operate in the same industry, or perhaps a related or adjacent one • supplier or customer of yours that is looking to expand vertically within the supply chain • tend to acquire for a variety of reasons: growth opportunities, new product lines, and bigger scale to improve efficiencies • seeking to obtain skilled people that are in demand, intellectual property, technology, production capabilities, processes, customers, and suppliers • pay higher multiples, because there are often sales or administrative redundancies that can be eliminated post-deal after the two companies are combined

FINANCIAL BUYERS + PRIVATE EQUITY FIRMS

usually have funds with committed capital to be used for acquisitions • funds have defined criteria for the types of deals they will pursue • raise capital from high net worth individuals and institutions such as pension funds and endowments • typically have a track record of successful deals that enable them to raise such capital • some are more operationally-focused and “hands on” with their investments, while others are less involved in day-to-day matters • have specific industry expertise, knowledge, connections, and resources that can be highly beneficial to a seller's business • most would ask that existing management remain in place • not usually equipped to run the business, so a partnership with strong management team is critical • look at acquisitions in terms of returns on capital • they are held accountable for investment performance by their investors • may have a shorter time-horizon than strategic buyers because their funds usually have a defined lifespan, after which capital must be returned to investors

There has also been an emerging sub-set of PE firms that are known as “independent” or “fundless” sponsors. These firms don't have a fund, nor do they have committed capital. Instead, they depend upon their relationships and connections with capital sources which they approach to raise money when they find attractive deal opportunities. Because these sponsors can present more risk, we recommend learning more about them and their funding sources early in the process. These “fundless” sponsors also include family offices, which are established to manage money for high net worth families.

The alternative, a PE firm with a committed fund, offers certainty of close. Independent sponsors essentially raise money deal-by-deal. It's not uncommon for independent sponsors to seek capital from traditional PE firms, as these PE's are always seeking to expand their deal-sourcing network (beyond brokers and advisors).

Fundless sponsors tend to be smaller, but they have more flexibility with their deals because they are not constrained by a fund's specific criteria. They may or may not have specific industry skills and knowledge.

While on the topic of private equity firms, we next discuss the myths business owners believe regarding sales to these types of businesses.

THREE MISCONCEPTIONS OF SELLING TO A PRIVATE EQUITY FIRM

There are some misconceptions among business owners about private equity (PE) firms. Many feel that PE firms will pursue layoffs and cost cutting in order to boost profits and quickly sell the company at a higher price. While the end goal is ultimately to sell companies at a higher price, most PE firms place their bets on businesses with strong growth prospects in attractive markets in order to boost their returns. This often means additional investment, whether financial or human capital, to support an acquired company's potential. The goal is more often to grow and expand rather than cost cutting.

1. ALL PRIVATE EQUITY FIRMS ARE ALIKE

There is more than one type of private equity firm. Some are primarily sources of capital with dedicated funds. Some have their own dedicated funds but also have operating partners as part of their team. Others do not have dedicated funds and may or may not have operationally focused team members. In the majority of cases, all of these firms will be seeking to acquire businesses with an established management team and growth potential.

2. PRIVATE EQUITY FIRMS ASSUME OPERATIONAL CONTROL

Private equity firms are not staffed to run portfolio companies they invest in. This would require not only a much higher headcount but also a staff of team members with the ability and experience needed to manage complex businesses on a daily basis. Further, getting existing management to retain part ownership post transaction is typically required by most PEs. This aligns the interest of the investment firm with company management. It also displays confidence among the existing owners/management in the ongoing success of the business.

In many cases PE firms will seek to add their team members to the board of directors. These individuals are not running day to day operations. Rather, they are active in strategic planning and in the significant decision making processes. They are also available as consultants or for advice as needed. Firms with operating partners will bring these people into portfolio companies in executive level roles if needed. This would occur if any of the owner/managers of the business are selling because they wish to retire or if there are holes in the existing team such as the lack of a COO or CFO. However, PE's prefer to find adequately staffed businesses and keep existing management in place. After all, no one knows more about the operations of the business than its current management.

3. COST CUTTING IS INEVITABLE

Cases in which there are layoffs and loss of jobs occur in businesses that are overstaffed or have unnecessarily redundant operations or processes. It's not to say this does not occur with PE firms, however if it does it is likely in much larger businesses where there are multiple layers of management. Aside from the less frequent cases involving PE firms, restructuring and/or job losses occur more often when a business is bought by another company already operating in its industry, maybe a competitor (aka Strategic Buyer). In these transactions the two companies likely have duplicative operations that can be eliminated post transaction resulting in cost savings. These are typically referred to as operational synergies and can be a primary motivational factor in one company acquiring another.

In summary, selling to a private equity company often times is not what most business owners would expect. Post transaction the business continues to operate as it did under the prior ownership, just now with more financial and human capital to support the business' next growth phase.

DEAL KILLERS

THE MOST COMMON REASONS DEALS FALL APART AFTER SIGNING A LETTER OF INTENT

Not all M&A deals conclude with a successful closing. During the period between signing a letter of intent (LOI) and closing, the deal may break up for a number of reasons. Sometimes the reasons are unforeseeable, but many times these situations can be anticipated and potentially avoided.

	Getting a letter of intent signed is a critical milestone, but it doesn't guarantee the deal will close. Since the LOI is generally non-binding, both buyer and seller can pull out of the deal until a final purchase agreement is signed. Sometimes a seller will get cold feet, change his mind, and decide not to sell. Also, during due diligence buyers may uncover new risk exposures that lead them to reconsider a deal. Buyer financing also represents a critical item. Depending on market conditions and how much debt a deal requires, a buyer could have difficulty getting funding arranged and this might be a deal breaker. However, most larger strategic and financial buyers have well established banking relationships that lessen this risk.
	The probability a deal will close depends heavily on the buyer's due diligence findings. In particular, a key test is whether the Quality of Earnings report (prepared by buyer's advisor) findings matches buyer's expectations. It's critical to conduct a pre-deal financial review so that the business is marketed accurately with reliable information. Issues uncovered during due diligence may result in change of deal terms and may prevent the deal from closing. Sellers are often unwilling to accept a lower valuation than what was presented in the LOI.
	Most of the deals take on average between 6 to 12 months to close. Significant changes, either positive or negative, in the company's performance may occur during that time. Such changes can, and most of the time do, impact the company's valuation and the ultimate sale price leading to disagreements over deal terms which may kill a deal.
	The net working capital target / adjustment is another potential deal killer. A net working capital target is used to ensure the seller is not liquidating A/R or inventories, or slowing payment of accounts payable prior to close. In the case of a deficit of net working capital at close, the buyer may reduce the purchase price by the amount of the shortfall. As a result, the seller may end up with less cash at close than expected and walk away from the deal.

In summary, there are many potential deal killers when it comes to business sale transactions. Business owners should be aware of these key issues before entering in to a sale process. Consulting with an M & A advisor such as Lutz M & A and planning in advance of marketing your business for sale can help mitigate these deal killers.



ABOUT LUTZ M&A

OUR SERVICES, OUR PEOPLE, OUR RESULTS

Lutz M&A was born out of the recognition of needs owners of our accounting firm clients had to assist them with the complex world of selling their businesses.

Most business owners eventually recognize that selling their business to family members, employees or third parties is inevitable. But most struggle with how to properly assess the value of their business and how to most effectively complete a transaction taking into consideration all of the important factors specific to their business.

LUTZ M&A SERVICES

BUSINESS VALUATION: Assist business owners with understanding their business value, the specific value drivers for their business, and how to enhance the value of the business

MARKET ANALYSIS: Assist business owners with assessing the industry in which their business operates and the current market conditions

TRANSITION (EXIT) PLANNING: Assist business owners in developing a long-term strategy to create value along with defining and meeting personal goals

ACQUISITION ASSISTANCE: Assist with the process of making an acquisition of an operating business

BUSINESS SALE ADVISORY SERVICES: 3rd Party Sale – Develop a list of buyers, marketing materials, and manage the process of selling an operating business to a 3rd party buyer.

The business sale advisory services provided by Lutz M&A helps business owners tackle important issues and when ready, assists owners in finding qualified buyers for their businesses. We have significant expertise in this area specific to businesses with \$500,000 or more of annual cash flow, and this particular service is not widely available to smaller businesses.

FAMILY OR EMPLOYEE TRANSACTION – Assist owner in identifying the best method and type of transaction given the underlying goals of the business owner and their family.

THE LUTZ M&A TEAM

Lutz M&A is comprised of 9 highly trained, experienced professionals. There is no other firm in the region with our depth or breadth of experience.



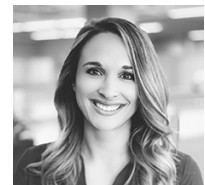
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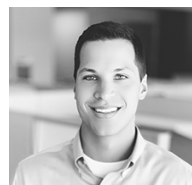
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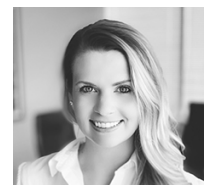
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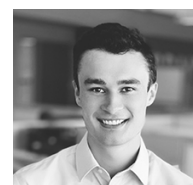
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Since 2015, Lutz M&A has helped dozens of companies with acquisitions, family and employee sale transactions, as well as business valuation and exit planning projects. Below are details of our recently closed M&A transactions . **TO LEARN MORE, VISIT WWW.LUTZ.US/SERVICES/MERGERS-ACQUISITIONS.**



**ACQUIRED BY
SUN CAPITAL PARTNERS**



**ACQUIRED BY
MCCARTHY CAPITAL**



**ACQUIRED BY
EVOLVE CAPITAL**



**ACQUIRED BY
PLATFORM CAPITAL**



**ACQUIRED BY
HELP/SYSTEMS**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



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**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



**ACQUIRED BY
CASEY'S**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER**



**ACQUIRED BY
EVANSTON PARTNERS**



**ACQUIRED BY
WAR HORSE GAMING, A DIVISION OF HO-CHUNK**



**ACQUIRED BY
CONSONUS HEALTHCARE**



**ACQUIRED BY
NATIONAL CONCRETE CUTTING**



**EXCLUSIVE FINANCIAL
ADVISOR TO SELLER FOR ESOP TRANSACTION**