

A Seller's Guide to Maximizing Proceeds in M&A Auctions

By committing fully to the process and thoroughly preparing for the sale, inviting the right potential buyers, knowing what's market, creating relationships with the bidders, and hiring deal experts, sellers can maximize their proceeds and get the best possible terms.

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While tightening credit conditions resulting from higher interest rates, inflation and economic uncertainty have culminated in reduced middle market activity, economists indicate that middle market valuations have demonstrated reasonable resilience in recent months. This is especially so for quality businesses (lead by industrials, business services and food and agriculture businesses) where financial sponsors and strategic corporates are looking to invest and acquire. Many buyers are looking to secure supply lines that COVID-19 exposed as overly dependent on foreign suppliers. Other potential buyers represent substantial amounts of deployable capital looking for investment opportunities. Some sellers, on the other hand, may lack liquidity or capital for growth given the current uncertainty and challenging interest rate environment, and some founders may simply be ready to redeploy their capital or retire.

The common wisdom amongst financial advisers, investment bankers and lawyers is that running an auction can enable a seller to maximize shareholder value and obtain the most favourable transaction terms.

This article sets out key strategies to get the best outcome when selling a business. These strategies include (1) committing to the sales process; (2) carefully preparing the business "to be presented", (3) addressing areas of risk, such as cybersecurity and privacy, and protection of intellectual property, (4) taking appropriate steps to mitigate risks associated with the business, (5) curating a list of prospective buyers to participate in the process, (6) knowing what's market, (7) building a relationship with the bidders, and (8) hiring strong advisers.

Commitment to the Process

Sellers must be prepared to dedicate significant resources to the process if they wish to sell their business by way of an auction. An auction is a robust process and often involves preparing a comprehensive marketing document such as a confidential information memorandum, and creating a well-organized, complete and up-to-date data room. Identifying a list of key issues or "must haves" will enable the seller to skillfully participate in the negotiation process and show that they are fully engaged, value the business, and are knowledgeable about the business. Business owners should avoid the temptation of putting a business up for sale "to see what we can get for it". If the business is for sale, ready it for sale, and be prepared to sell it when the process is complete. If there is a reserve bid that is not met, then that is another matter. Personal reputations can be enhanced or destroyed through the conduct of sales processes.

Prepare to "Present the Business" to the Market

Sellers should ensure that their business is prepared to "be presented" to the market. Much like preparing a residence for sale by addressing deficiencies, decluttering and making it look attractive, before a business

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owner puts a business on the market, they should first eliminate or minimize issues that may cause concern for potential buyers.

Sellers should work with their advisers to identify and address potential legal and financial concerns because a business that is subject to obvious issues (even if the seller believes them to be minor) can result in wasting management time quantifying each issue, delay in completing the transaction, and even discourage potential buyers from engaging in the process. There will likely be much less friction when sellers establish at an early stage in the transaction that their disclosure about their business is accurate.

A failure to heed this advice can be costly. In one case, a target had not fully resolved minor environmental issues prior to the start of due diligence, which resulted in lengthy discussions and the need to hire additional environmental consultants. This culminated in a request by the buyer for additional closing conditions, a purchase price holdback and a broad environmental indemnity, all of which could likely have been avoided with better preparation.

Diligence and Disclosure

The process of creating an electronic dataroom is an efficient way for sellers to ready the business for a sales process by allowing the seller and its advisors to do their diligence before buyers do theirs. Nothing potential buyers may identify should surprise the seller, as the seller should know the business better than anyone. The seller needs to ensure the business has available copies of all material agreements, ensuring they are complete and legible. These include agreements with key suppliers, customers and personnel, evidence of real and personal property interests, intellectual property licenses and any other agreements that may have a material impact on the organization's ability to conduct business and its valuation. Due diligence checklists are frequently used to tease out the applicable facts and supporting material.

If the documents and applicable searches raise any significant business or legal issues, sellers should consider the most efficient and effective method of disclosing these issues. This disclosure may be located in any or all of the confidential information memorandum, the materials that are posted in the data room and verbally in the formal management presentations. Outcomes are usually much better for a seller where the seller voluntarily discloses a material issue at an early opportunity rather than waiting for the buyer to discover it. Surprises, particularly once an auction is ongoing, tend to create a lack of trust, uncertainty, and other hurdles to concluding a transaction.

Cybersecurity and Privacy

Hot buttons these days include determining the business' approach to compliance with privacy legislation and its handling of personal information to ensure compliance with increasingly stringent applicable laws. Cybersecurity concerns are also front and centre. Confidential business information, including personal information, is also at risk of cyber attacks with ransomware and threats of disclosure. With increasing liability under these statutes, the potential for class actions, and the fact that buyers will be potentially liable for the compliance failures of the acquired business, there may be an additional set of diligence in these areas for which sellers need to be prepared. In addition, the diligence process and dataroom access must be carefully planned to protect the information disclosed to potential bidders and their advisors.

Protect Intellectual Property

If intellectual property is a competitive advantage of the business, be sure that it is also protected by contract and registration where applicable. Failure to do so can significantly reduce the value of the business. Every business should ensure that its employees and contractors have entered into legally enforceable agreements that provide that the business owns all rights to the intellectual property and is entitled to exploit the intellectual property in any way that it chooses.

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Properly documented intellectual property assignment agreements from employees and contractors are critical. In addition, if the business' intellectual property rights can be protected by registration, serious thought should be given to making these applications before the business is put up for sale. Buyers will be willing to pay a premium for a business that has been vigilant in protecting its intellectual property.

Consider Ways to Mitigate Risk

In assessing and seeking to mitigate risks that sellers typically accept as part of a sale process, such as by providing representations and warranties and associated indemnities related to the business in a purchase and sale agreement, sellers may wish to purchase (or have the buyer purchase) representation and warranty insurance. There may be circumstances where this “sleep at night” coverage reduces the risks on the seller over the period when the buyer can pursue the seller for certain claims under the purchase and sale agreement. Having this coverage may also offer the seller a “safety valve” if needed in the allocation of risk between seller and buyer in the sale negotiations.

Be Selective in Inviting Bidders to Participate

Sellers should carefully examine the marketplace in determining the bidders to be invited to participate in the auction process. Sellers should consider whether there is a preference for financial buyers or strategic buyers, as each presents unique advantages and risks. The financial buyer may be willing to pay a higher premium, but may be unfamiliar with the industry, leading to longer timelines for due diligence. On the other hand, the strategic buyer may raise anti-competitive concerns. Inviting the most likely parties to bid in the auction at the outset is key and a focused approach is likely to lead to a better result.

Having many bidders does not necessarily guarantee the highest price and can have a dampening effect. Serious contenders may be unwilling to dedicate the resources necessary to participate in the auction process if they are aware that there are many other potential bidders or that they are being used as a stalking horse without commensurate reward.

Know What's Market

Sellers should prepare and distribute a draft purchase and sale agreement and request that each prospective buyer provide a mark-up of the agreement to reflect the terms it is prepared to sign as part of its bid. Sellers should avoid the temptation to make the document too one-sided in its favour, as this may simply extend the process or turn off potential buyers. In addition, sellers should avoid imposing overly aggressive timing that may deter buyers, particularly strategic buyers who may have to complete longer approval processes. When reviewing buyers' comments, sellers should focus on what is reasonable in the circumstances of its business, its inherent risks and current market trends. If the seller has communicated to bidders that maximizing value is the most important factor in selecting the winning bidder, then the seller should try to avoid the temptation to focus on contract terms that do not have a financial impact.

Engage with the Bidders

Creating relationships with potential buyers is vital in selling the business for the highest price. People like to do business with people they know and trust. Being honest and forthcoming throughout the diligence phase will set the stage for the remainder of the transaction. While sellers will want to remain engaged with each bidder, sellers should be cautious about agreeing to exclusivity too early in the process, as it removes the competitive pressures that an auction is designed to facilitate.

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Hire Deal Experts

One of the main weapons of a successful seller is having in place a focused and experienced deal team of investment bankers, lawyers and other relevant subject matter experts. Investment bankers can open the door to potential buyers, and may advise on industry and market trends, valuation ranges, and potential deal structures. They will also assist in the preparation of a detailed information memorandum that tells the story of the business. Similarly, lawyers will assist the seller to navigate the auction process, identify and help ameliorate risks, negotiate transaction terms, draft agreements that appropriately allocate risk, and direct and facilitate the closing of the transaction.

The lawyers at Allen McDonald Swartz LLP have significant experience advising on corporate transactions of all types. If you are thinking about selling your business, email Jillian Swartz at jswartz@amsbizlaw.com, Eden Oliver at eoliver@amsbizlaw.com or contact any other member of our firm.

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