Business Transaction Marketplace

Information about Transition Planning, Business Valuations and M&A **March 2013**

Controlled Auction

Very small businesses are often marketed *with a price*. Buyers of very small businesses are many times first-time buyers who must know the asking price in making their decisions – often without the assistance of outside advisors. Larger small businesses and mid-market businesses are often marketed *without a price*. In other words, the *market* determines the price. Buyers of larger businesses are usually familiar with the buying process and/or they have the resources to obtain the assistance of outside advisors in making their decisions.

Sellers of larger businesses may decide to limit the marketing effort to negotiating with selected prospective buyers – under a *bilateral selling process* – as those prospects respond to the marketing effort. Or, sellers may prefer having broader market exposure by marketing those larger businesses under a *controlled auction* – the subject of this article.

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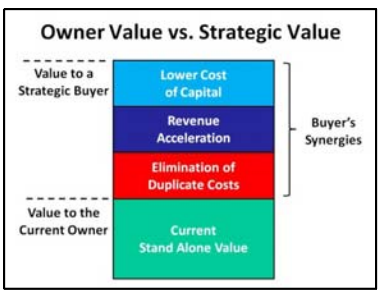
Buyer Motivations



Strategic buyers bring more than money to the deal; they bring additional *synergistic* opportunities. They're often referred to as *add-on buyers*. As the *Owner Value vs. Strategic Value* diagram shows, *strategic buyers* have the ability to increase the value of the acquired company by taking advantage of post-transaction synergies.

This *incremental value* creation opportunity is a prime motivator for a *strategic buyer*. From the viewpoint of any buyer, it's often cheaper to *buy growth* through an acquisition, than to *make growth* organically.

Obviously, buyers are reluctant to share this *incremental value* opportunity with the seller. The buyer's overriding objective is to pay as little as possible for a given opportunity.

The only sure way a seller can share in the buyer's *incremental value* is to create competition amongst more than one buyer. Fear of losing a particular value creation opportunity may motive buyers to compete – something they'd rather not do. But, the situation is thrust upon buyers to compete because the target company has chosen to be marketed under a *controlled auction*. The seller is controlling the process.

Controlled Auction Candidates

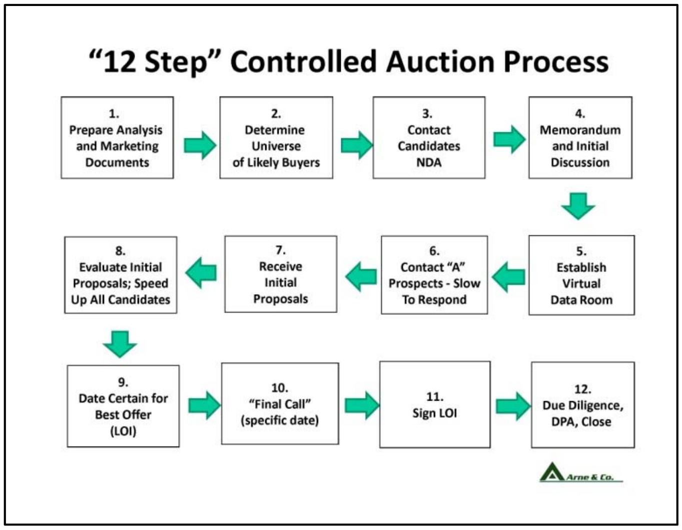
There are three situations where a company might be a candidate to be marketed and sold under the *controlled auction process*:

Owner Objectives. Often, a privately held business is the largest single asset in the owner's estate. To meet the owner's post-transaction financial objectives, it's important that the owner obtain the highest price and most favorable terms for the business.

Externally Positioned. The marketplace of *qualified buyers* (those with the financial capacity to quickly complete the transaction once an agreement is reached) is more likely to be interested in acquiring businesses with one or more of these attributes: a) has a market niche, b) has a particular product or service capability, c) has a large market share, d) owns an intellectual property asset (e.g. patent) that creates a barrier to market entry, or e) is operating in a growing market segment.

Internally Positioned. The Company has prepared itself for the in-depth due diligence that buyers will demand in order for them to commit to the transaction; and, to reach firm conclusions regarding value and deal structuring. This article speaks to this issue of preparing a business for sale.

Controlled Auction Process



Sellers of larger businesses typically hire an investment banker to develop the marketing plan and oversee the selling process. As shown in the diagram, there are twelve (12) steps to the *controlled auction process*. **Steps 1-3** are really no different than if the *bilateral selling process* was used.

Step 1. There are typically three (3) primary marketing documents prepared by the seller and investment banker:

Teaser. It’s an often used term for a 1-2 page abbreviated snapshot of the business that does not disclose the seller’s identity. Its purpose is to pique a potential buyer’s interest in the business.

NDA. A non-disclosure agreement accompanies the teaser. The NDA must be signed by the party receiving the information in order to obtain the confidential information memorandum (CIM) from the seller.

CIM. A CIM discloses the name of the seller, providing detail background information regarding the business. This would include an overview of the seller’s industry, and details regarding the Company’s management, products and services, distribution channels, customers and market share, and competitors. Also included are historical financial statements and sometimes projected financial statements.

Steps 2 and 3. The investment banker helps the seller create a list of potential buyers. With the seller’s approval, the list typically includes potential buyers that have natural synergies with the seller, along with the anticipated financial resources to complete the transaction. The transaction may also be presented to financial buyers – particularly if the universe of strategic buyers is small.

Steps 4 through 11. These steps are particular to the *controlled auction process* as shown in the above diagram. The objectives of these steps are to: a) control the dissemination of information, b) maintain the momentum of the process, and c) elicit the highest price and best terms from buyer prospects.

Step 12. The due diligence performed by the buyer, the negotiation of the definitive purchase agreement (DPA), and closing the transaction are virtually the same regardless of the marketing process.

Controlled Auction – Advantages and Disadvantages

Advantages

a) Designed to maximize price and terms, and to control risks, b) seller controls the process, c) takes place in stages, minimizing disclosure of proprietary information, d) definite time line speeds up the selling process, and e) provides for back-up buyers should the winning bidder back out.

Disadvantages

a) Best buyer may choose not to participate, b) difficulty maintaining confidentiality, c) marketing documents that differ from what’s learned in due diligence may derail the process, d) difficulty maintaining the competitive fervor when trying to coordinate buyer responses and due diligence requests, and e) long lead times getting third party consents and buyer financing commitments stymie the process.