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LEGAL ALERT

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Successful Techniques in M&A Auctions

The last several years have seen the investment banker-led auction become a common method of selling businesses. Many interested buyers participate in auctions, and follow the rules dictated by the lead banker and the seller, only to find themselves failing to be the successful bidder. For many companies, the same techniques used in failed bids are tried over and over again, resulting in repeated failures and frustration with the M&A auction process.

The following outlines some techniques implemented by successful bidders in recent auction settings.

1. Bear in Mind the Seller's Goals – Price, Terms and Certainty. Buyers, of course, evaluate an acquisition candidate based upon what is best for the buyer. However, bear in mind that it is the seller making the decisions as the auction process progresses, so emphasize the buyer's advantages with respect to the seller's priorities – price, terms and certainty of closing.

2. Bid High. While other factors are important, the high bid generally carries the day, and the winning bidder is sometimes referred to by the others as "the one who overpaid." Bidding high, of course, puts pressure on the winning bidder to realize greater value from the target company, but it may be a simple necessity to win a desirable asset in an auction setting.

3. Be Selective and Pursue Aggressively. Successful bidders will limit their interest to those targets that they really want, and pursue them aggressively. A common feature of repeated failed bids is a bidder that continually submits low bids to test the waters, and then finds itself pulled into a diligence process (and related expense), while serving merely as a stalking horse to generate interest from other bidders. Repeated success is more likely a function of a prospective buyer limiting its efforts to those companies that it is interested in pursuing, and then pursuing them aggressively.

4. Find Value in Creative Structuring. Bidders frequently will attempt to bridge valuation gaps by proposing an initial amount of cash plus an "earn out" or other contingent additional consideration. Another alternative structure is for the bidder to propose an acquisition of a majority interest (51% to 80%) of the company, rather than the whole company, leaving a remaining minority interest with the seller. The retained interest is then valued at the higher transaction value, thus enhancing the overall bid value. Other techniques (such as tax strategies and synergies where a strategic buyer is involved) may yield additional value, which can be used to justify a higher bid based on the particulars of the deal.

5. Complete Due Diligence and Submit an Actual Mark-up. Bidders sometimes test the waters in an auction by doing partial due diligence or submit an issues list rather than an actual mark-up of the seller's proposed purchase agreement, as a means of avoiding the expense associated with a more substantial due diligence effort and a full mark-up. While

more economical to the bidder, this approach also sends a message to the seller that the buyer is not committed to the deal or is just looking for a bargain. It is better for a buyer to embark upon the process only for targets it is very interested in acquiring, and then to commit fully, and invest in due diligence and an agreement mark-up as evidence of this commitment.

6. Keep Agreement Comments Focused and Reasonable. To some extent, the amount of redlining on an acquisition agreement will signal to the seller how hard or easy it will be for them to work with the buyer. While there is no reason to accept the seller's proposed draft if it is extremely weighted toward the seller, the bidder should take a measured approach in marking up the seller's proposed draft. Doing so is likely to require some prioritization, such as identifying areas of greatest concern, and perhaps scrutinizing those areas heavily, while letting language go in other areas, if the language is adequate for the buyer's purposes.

7. Enlist the Services of an Investment Banker with Expertise in the Relevant Industry. Most auctions are led by investment bankers, so having an investment banker on the buyer's side can open a window into the process that may not otherwise be obtainable. Sometimes, an internal corporate development professional can serve the same role, in effect serving as an in-house investment banker. It is important for the buyer's banker to have relevant industry experience, which will help the buyer to develop a rational valuation of the target and also to navigate the auction process.

8. Be Ready to Make Decisions Quickly. Auctions tend to move quickly (at least in spurts), so it is necessary for a buyer to be prepared to do the same. An inability to respond quickly to a seller's proposal or request may make the difference between a winning and losing bid. A buyer should involve appropriate senior management and brief them regularly so that it can respond nimbly when decisions need to be made.

9. Consider Preempting the Auction. Where a highly desirable property is involved and an aggressive price can be offered upfront, consider making the offer contingent upon the seller terminating, or at least suspending for a period of time, the auction and negotiating exclusively with the buyer. Note that, at least where public targets are involved, if the auction has been preempted, the seller is likely to insist on a "go shop" period during which the seller can solicit superior proposals and pay the original buyer a breakup fee if one is selected.

10. Have a Game Plan. Have a plan for the auction; this may or may not involve simply following the rules laid out by the selling company and its investment banker.

11. Be Prepared to Commit the Necessary Resources. Be mindful of the commitment of resources necessary to effectively pursue a target company in an auction setting, which is substantial. Prioritization is critical so that adequate focus can be placed on those deals that really matter to the buyer.

12. Evaluate the Seller's Particular Circumstances and Tailor the Bid to Them. For instance, where a family-owned business is being sold, and the owner is rolling over a portion of

his equity, consider bringing operating talent and demonstrating an ability to improve the business.

13. Demonstrate to the Seller a Track Record of Successful Deals. Be prepared to demonstrate a track record in terms of successfully integrating acquired companies and fostering their success. Be prepared to provide references to a seller from successfully completed prior transactions.

14. Keep Your Commitments. Successful bidders demonstrate to the seller that they are reliable. Be prepared to follow through and keep commitments.

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