Divestiture: The Marketing Process ©

Selecting Investment Bankers

Having made the decision to sell, the first major decision you'll be faced with is selecting an investment bank. You will want to meet with several teams of investment bankers. Look at the experience level of the people who will actually do the work on your transaction, not the pitch guys. Try to determine which team gives you the greatest comfort level: you're going to be working with this team for a while.

Each investment bank will have its own form of engagement letter. Ask to see a form of one early on. Feel free to have your attorney review it as well, since it is a contract. The engagement letter will contain key components of your relationship with your bankers: their fees, their requests for indemnification from your company, your rights to terminate the relationship for nonperformance and the like.

Make sure your engagement letter gives you a right of termination for nonperformance. It won't always be the banker's fault: market conditions can change rapidly. Your deal, which looked so attractive yesterday, just isn't saleable in current market conditions. Then again, sometimes your relationship with your banker won't pan out, and you will need to find another firm with which to work. Include a written right of termination with at least 30 days' notice.

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Your bankers will ask you for certain indemnifications. You will be giving them a great deal of information about your company to present to potential buyers. The bankers are relying on you for the accuracy and completeness of that information. That is the reason for the indemnification request. If you were to fraudulently, purposely or negligently present false information to your bankers, who then pass such information along to potential buyers, the liabilities will be great.

Assuming that you have chosen not to follow an auction process (a subject for a different article), you will likely follow an orderly sale process. Your newly retained investment bankers have a lot of work in the first thirty to forty-five days.

Valuation

The bankers will be working with you to finalize a valuation for your company. Often direct marketing companies are valued as multiples of EBIT (earnings before interest and taxes) or EBITDA (earnings before interest, taxes, depreciation and amortization). Those numbers may be adjusted by your bankers for higher than usual salaries to owner/managers or for certain perks.

Valuations are not static. If your numbers start to deteriorate during the sale process, expect your valuation to decrease. Conversely, if your company is blowing through all of its upside projections, make sure your sale transaction gives you an opportunity to get paid for those numbers!

One of the key features bankers will examine closely for valuation purposes will be the ability of direct marketing companies to give their clients "real time" information about inventory, order fulfillment, customer purchasing information and even profitability by client. This reporting component will be a critical divider, enabling more sophisticated direct marketers to give their clients valuable information that will improve the client's profitability and performance. Successful direct marketers will have to provide this level of service to their customers. Valuations will be effected.

Make sure you and your bankers are in general agreement on valuation before you start the sale process. Unfortunately, some bankers tell prospective clients what they want to hear. That's the advantage of interviewing several firms: as a seller, you should have a fairly good idea of where your company will sell, assuming your numbers materialize as expected.

Potential Buyers

With the assistance of your bankers, you will develop an initial list of potential buyers your bankers will contact. You will both give each other names. You may also give your bankers a "Do Not Contact" list. You may want to eliminate any consideration of certain buyers for a number of reasons: competitors, poor ethics, bad business practices, difficult personalities, etc. Now is the time for this discussion with your bankers: not when such a buyer is walking through the door for a site visit. Competitors should not be summarily excluded: sort carefully.

You will also discuss with your bankers certain types of buyers: industry buyers, financial buyers, consolidators and others. You may have a preference for one over the other. This should be thoroughly discussed with your bankers.

Likely you will also discuss a preferred deal structure and may make mention of the same in the memo referred to below.

Your bankers will also discuss a timetable for the transaction that may also be included in the memo described below.

The Confidential Memorandum

During this period, you will be assisting the bankers in putting together a confidential memorandum (the "Memorandum") that describes your company. I have seen a lot of poorly written Memoranda. On the other hand, I have been in meetings where potential buyers asked a lot of questions which were answered in the Memorandum.

At the date of this writing, I would err in favor of a well-written Memorandum. The Memorandum should cover the material aspects of your company accurately and succinctly. It should include an executive summary in the front and an appendix with three years of financials in the back. The Memorandum should include a company description, salient sales points, a description of the business, a description of sales and marketing, an analysis of the business, a description of the market the business is in, a description of key management (with an organization chart) and a discussion of clients. You will need to include information about key equipment and IT systems. I personally like to include a discussion of risk factors. Material litigation, a breakout of the ownership of the company and any unusual items currently in process, like a Phase I environmental study or an ISO certification, should also be included. Include any material item about the Company.

Some Memoranda include a company's marketing materials; others do not. At a minimum, don't forget to point the potential buyers to your company's web site!

Some owners are uncomfortable identifying their clients in a Memorandum. Clients can be alphabetically or numerically coded in the Memorandum for later identification by name. I would plan to include at least three years of information about revenues per key client, even if a code is utilized. Some buyers want to see gross profit by client or at least gross profit by business segment.

In an industry where personnel are key and competitors pilfer personnel from each other, management names may also be coded.

Company counsel often drafts the Memorandum. Sometimes the bankers draft the Memorandum for review by Company counsel and the Company's accountants. What's important is that key personnel (who are aware of the pending sale) and professionals review the Memorandum for accuracy and completeness. Ideally the Memorandum will be deliverable in hard copy or by email. It should be ready within the first thirty to forty-five days.

The Confidentiality Agreement

Counsel, or your bankers with counsel's assistance, will prepare a Confidentiality Agreement or a Non-Disclosure Agreement ("CA"). In the course of a sale transaction, you will disclose a great deal of information about your Company to third parties. The purpose of the CA is to make sure that the information you have disclosed is only used for the purpose of considering an acquisition of your Company. The CA prohibits other uses. Specifically, the CA:

a) limits the use of the information provided to determining interest in the acquisition;
b) requires that confidential information be treated as such by the parties who have access to such information;
c) precludes advising others that your Company is for sale;
d) precludes the signer from contacting your clients or vendors;
e) prohibits contacts with or solicitation of your employees;
f) sets forth the duration of the CA; and
g) requires a return of all materials and destruction of copies once a party determines that the acquisition is no longer of interest.

The CA usually has a term of one year or longer. Your investment bankers will require each party that expresses an interest in your Company to execute a CA before receiving the Memorandum or any other information.

During the first thirty to forty-five days, your investment bankers, on a "no name" basis, will contact potential buyers: your company will be described, but not named. The bankers will be screening such potential buyers for their level of interest, ability to pay, synergies with your Company and other factors that you have determined are important to a successful sale. Companies that pass the screen receive a CA. Once that is executed, a Memorandum is sent.

The Golden Rule

Never, never take your eyes off your company's business while you're going through the sale process. The sale process can be seductive to those who have never been through it. It's easy to get distracted by the investment bankers, the potential buyers, the attorneys, the accountants and everyone else that gets involved in the sale process. Don't! Often the result of taking your eyes off the business is that your numbers start to deteriorate. There's nothing sadder than chasing a declining valuation toward closing because the company's numbers are deteriorating through the sale process.

Most company owners are multi-task pros. Like all other multi-tasking opportunities, the amount of time devoted to the sale process must be finite. The amount of time that you normally spend running the business is sacrosanct and can't be invaded by the sale process. If your numbers start to decline during the sale process, consider stopping the process. Immediately address the issues causing the downturn in your numbers. Don't restart the sale process until you feel the company can get through the entire sale process with a bit of upside surprise built in for the buyer.

The goal of the sale process is not to sell your company: the goal is to sell your company when it's continuing to show upside momentum which increases the buyer's perceived valuation.