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SELLING OR FINANCING YOUR COMPANY: 10 STEPS TO A BETTER DEAL

By Bill Capps and Gordon Schaller

Bill Capps chairs the Corporate Department and Gordon Schaller is a senior tax partner at Jeffer Mangels Butler & Mitchell with lawyers in Irvine, Los Angeles and San Francisco.

1. Painting the house before putting it on the market.
We are surprised how frequently a business owner will go to the market with his company without first taking steps to fix problems and enhance its value.

For example:

- resolve or quantify environmental issues so that they do not become an excuse for buyers to unreasonably reduce the purchase price;
- diversify suppliers or customers;
- improve the quality and quantity of financial reporting;
- obtain trade secret or non-compete protection from valuable employees.

The owner's lawyer can suggest aspects of the business that would benefit from pre-deal due diligence. Getting in front of a problem shows buyers that the company is being skillfully managed.

2. Tax and gift planning can maximize after-tax results.
Selling a company may present unique opportunities to transfer wealth within the owner's family at valuations substantially lower than the final selling price. This must be considered and accomplished before any letter of intent. In addition, there are several techniques by which the taxes payable from the sale of the company can be reduced or deferred if there is sufficient time to properly plan and an adequate business purpose. It is what the owner and his family keep, rather than the selling price, that is most important.

3. Serendipity is not the game of choice.
Selling a company should not be an accident that happens, but a process which is carefully managed. Although we hear anecdotal stories about great deals that came up on the golf course Saturday morning, we always wonder how much better the deal would have been if the company was properly packaged and marketed.

4. Drafting the right team.
Not every lawyer or accountant is suited to clear the path for a deal. For example, lawyers who specialize in M&A work every day with the investment banking community. They can be very useful in selecting bankers for the owner to interview and in vetting potential buyers. Accountants who are familiar with M&A issues can help recast financial statements in formats which are better appreciated by the buyer (for example, adjusting historical earnings to show what the future is likely to bring for the buyer).

Likewise, there may be professionals who are likely to become redundant as a result of a sale. It is dangerous to assume that their prompt cooperation can be taken for granted.

5. Winning the support of your employees.
In many sales, the owner wants to reward long term employees. This can be done in a way which not only maximizes the after-tax benefit for the employees, but also helps align the interests of the employees and the business owner. Techniques that are used for this purpose include "stay bonuses" and equity incentives.

1900 Avenue of the Stars, 7th Floor
Los Angeles, California 90067
310.203.8080—(fax) 310.203.0567

Two Embarcadero Center, 5th Floor
San Francisco, California 94111
415.398.8080—(fax) 415.398.5584

3 Park Plaza, Suite 1100
Irvine, California 92614
949.623.7200—(fax) 949.623.7202

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6. Designing earn-outs to maximize value.
Sellers who accept some risk of the future performance of the business will usually get a higher price than those who sell for an "all cash" price. Part of the skill of an M&A lawyer is carefully designing and drafting these "earn-outs" so that the business owner has a reasonable chance of hitting the target.

7. Why the letter of intent is so important.
A letter of intent ("LOI") typically outlines the price and structure of the deal. The LOI, however, also serves some unexpected functions. For example, a carefully drafted LOI can lower the cost of documenting the deal by giving better direction to the lawyers drafting definitive documents. Likewise, the LOI can incentivize the parties to close sooner by establishing benchmarks and price adjustments based on delay. "No shop" provisions which protect the buyer's due diligence expenditures can be made mutual so as to prevent the buyer from simultaneously pursuing two competing target companies.

Because the letter of intent is so important, the M&A lawyer will have a major role in preparing the LOI.

8. Protecting yourself from minority owners.
Not surprisingly, the fact that an individual owns 10 percent of the equity of a company does not always mean that the individual expects to receive only 10 percent of the sale proceeds. Owners should carefully evaluate what rights they have (or do not have) in the sale of a company. For example, many "buy-sell" agreements in closely held companies contain "bring along" provisions which specifically force the minority to sell on terms approved by the majority.

9. Why that agreement is so long.
From the perspective of a buyer, lengthy representations and warranties in sale documents help "smoke out" issues that sellers might not otherwise disclose. For example, a representation will be requested about pending or "threatened" litigation. This forces the business owner to think about potential disputes that might ripen into litigation after the sale. Usually, the business owner sits down with his M&A lawyer to go over the representations and warranties in order to make sure that the owner knows what information is being requested.

10. What happens after the closing is important, too.
If the deal contains an "earn-out," it is important for the owner to stay in touch with his M&A lawyer to make sure that the company is staying on a course to reach the target. If the company is off target, it is important to know whether or not this is due to the fault of the buyer (for example, improperly burdening the business with unexpected expenses or reducing resources necessary to increase earnings). If these failings are not properly and timely documented, it can be very difficult later on to ascribe blame.

In the sale of many businesses, the owner has traded great earnings from a single company (the one he owned) in exchange for less earnings from a diversified pool of debt and equity investments. M&A lawyers spend a lot of time with professional money managers and can help the owner interview and select among them.

About the Authors

Bill Capps is partner and chairman of the Corporate Department at Jeffer Mangels Butler & Mitchell LLP. He represents business entities and individuals in a wide range of business matters, including mergers and acquisitions, securities and corporate finance, executive and other compensation planning, and international and cross border transactions. He represents significant families in Southern California in business succession and personal planning. Contact Bill at 949. 623.7245 or WCapps@jmbm.com.

Gordon Schaller is a prominent Orange County tax and estate-planning attorney and partner at Jeffer Mangels Butler & Mitchell LLP. Gordon focuses his practice on taxation issues, domestic and international estate planning, business succession, charitable and wealth management services and trust and estate litigation. His 30 years of experience in wealth management, and his intimate knowledge of financial, estate and tax structures, helps him add value to every client's unique situation. Contact Gordon at 949.623.7222 or GSchaller@jmbm.com.

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