

THE M&A ADVANTAGE

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Selling your distressed company

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Waves upon waves of economic shocks have negatively affected almost every business sector. Many companies, as a result, are hanging on by a thread these days. If your business faces an uncertain future, finding someone to buy it could be your best remaining option.

Selling a financially distressed company, however, isn't always easy. As a seller, you'll need to walk a fine line between making concessions to your buyer and standing firm to protect your employees and investors. Some factors, such as liquidity and market conditions, will be out of your control. So focus on those you can control.

PLAY FOR TIME

Distressed sellers have only so much time available to arrange a sale. How much depends on liquidity: The less capital you have, the less time you have to sell, and the lower the purchase price you'll likely receive. Consider, for example, that J.P. Morgan paid fire sale prices for Bear Stearns earlier this year after federal regulators indicated to Bear that it had only days to find a buyer.

Concentrate on showcasing your strongest assets and ensuring that your financial statements are as transparent as possible.

If you can buy some time through a short-term liquidity injection — such as a private equity investment — you might consider it. The cost of accepting a new co-owner, or even taking on additional debt, may be worth it for the extra weeks or months it could give you to find the right buyer.

Short-term cash infusions at this critical juncture also may provide you with an alternative to unappealing



"He says he's still not ready to sell his business!"

offers from "vulture" buyers. These buyers seek out companies in desperate straits, hoping the company will be so anxious to sell that it will accept a low price and unfavorable terms.

COURT YOUR BUYER

Your liquidity situation also will determine how you market your company to prospective buyers. If you're facing an imminent liquidity crisis, you may want to confine your efforts to a short list of prospective buyers that are willing to conduct abbreviated due diligence — often in exchange for pricing concessions or strong material adverse clause provisions that enable the buyer to pull out without repercussions.

Also consider which type of acquisition makes the most sense. If you have two or three distinct operations, it may be easier and more lucrative to sell each division to separate buyers. A buyer, for example, may anticipate synergies with one of your product lines, but have no use for another part of your business. Further, one of your divisions may be in a better financial condition than the others, meaning you may get a higher amount for that piece than you would if it were bundled with more-troubled segments.

SHAPE UP

There's only so much you can do to prepare a financially distressed company for the M&A market. Internal improvements alone won't resuscitate collapsing sales, for example. So concentrate on showcasing your strongest assets and ensuring that your financial statements are as transparent as possible. You want to make it easy for a prospective buyer to evaluate your company and, hopefully, determine that it still offers substantial value.

Knowing that prospective buyers will look closely at your numbers, make sure all your accounts payable obligations are current and reflect an accurate picture of your situation. So that all unaccrued payable obligations are accounted for, don't withhold or delay invoices. If possible, pay all outstanding vendor invoices as well. And be sure all of your employees' 401(k) plans are up to date so a buyer won't have to worry about underfunded company contributions.

RECOGNIZE BUYER NEEDS

Although due diligence often is considered the buyer's responsibility, distressed sellers must perform their own internal due diligence. Buyers considering your company will expect to find some problems, but try to reduce the chance of future surprises. This

means, for example, that you should tell the buyer if you expect a further deterioration of your customer base or a lower growth rate going forward.

Also, be prepared to provide the following to serious prospective buyers:

- Your historical financial performance numbers and a current, accurate tally of assets,
- Conservative future growth and performance projections, and
- Detailed analyses of any regulatory issues or outstanding litigation claims.

And provide up-to-date records of suppliers and customers, indicating those that have an outsized effect on your company's bottom line. Note which third-party agreements would most benefit from being renegotiated.

KEEP YOUR COOL

There are no hard-and-fast rules for selling a distressed company. But you should expect to make some difficult decisions on relatively short notice. Flexibility and pragmatism, therefore, will be essential. □

Are you giving IP its due?

Intellectual property (IP) is becoming even more of a critical factor in the success or failure of M&A transactions. IP can easily derail a deal if these assets aren't accurately valued and the seller can't prove that it owns them.

UNDERLINING THE IMPORTANCE OF IP

In many industries, a company's IP — including its trademarks, copyrights and patents — is at the heart of its value. Today's buyers are just as likely to acquire a company for its product lines and brands as its hard assets. But if a seller fails to properly research and vet its IP assets for potential problems, such as rival copyright claims or licensing restrictions, a prospective buyer could ask to



renegotiate the purchase price or even terminate the deal.

Buyers, too, need to be on their toes when it comes to IP. The annals of M&A are filled with companies that failed to perform thorough due diligence on their target's IP holdings and later regretted it. Anheuser-Busch, for example, bought Sea World in the late 1980s without realizing the name rights to its biggest attraction, the killer whale "Shamu," were owned by another licensing company. Busch eventually had to pay that licensor.

The importance of IP to overall value varies by company, but any seller with patents, trademarks and proprietary technology is at risk for IP-related complications. Even if you use open source software — which many businesses may not consider to be relevant to a prospective merger — your right to your own technology may be challenged (see sidebar).

SELLERS: KNOW WHAT YOU OWN

One of the first things sellers should do when planning to put their business on the market is itemize IP holdings, possibly with the assistance of valuation experts and legal advisors. Note which IP assets are the most important to profitability. If possible, provide a thumbnail sketch of their application and range — for example, whether your trademarks are valid in every state.

Consider naming an employee Chief Intellectual Property Officer (CIPO) to manage the IP component of your transaction. This can reduce the confusion that occurs when different people are responsible for such items as litigation risk, patent management and licensing.

The CIPO will be responsible for analyzing and managing IP assets and tracking any liabilities, so he or she should have IP and legal expertise. An IP counsel generally is the preferred candidate for this position, but smaller companies may need to appoint two individuals as joint CIPO.

BUYERS: BE DILIGENT

Prospective buyers should begin their IP due diligence as early in the transaction as possible. The value of these assets is likely to factor significantly into your offering price. A professional valuator will assess IP assets' value by:

Is "open source" an open wound?

Many owners consider the use of "open source" software (OSS) the sole province of their IT department. Unfortunately, your OSS could cause problems if you plan to sell your company.

OSS is any type of software whose source code can be altered by its users and then redistributed in a modified format. Companies use OSS because there's no up-front cost to acquire the code. Yet it remains unclear how much exclusive intellectual property rights companies can claim to software that uses OSS components. A business preparing for sale could discover that it has no right to prevent others from using or distributing its own code, simply because that code was developed initially via OSS.

Even with little clarity or legal precedent as to how OSS ownership should be managed, many open-source licenses exist that could, in theory, be applied to allegedly "open" codes. Cases where companies claim OSS license violations and patent infringements — often against businesses that didn't even know they had exposure — are on the rise.

- Performing cost analyses to determine the amount of resources needed to develop and replicate them,
- Comparing them with those owned by competitors, and
- Calculating cash flows — including royalties and production cost reductions (if, for example, the IP is used to improve applications) — generated by them.

As a buyer, you also should:

Know your rights. Research all IP assets to ensure your target actually owns them. Don't assume that just because the seller has never been legally challenged you won't either. Sometimes competitors don't act until they feel threatened. And when a larger company buys a smaller one, it can make the trademark in question more valuable.

Seek exclusivity. The fluid nature of IP means the seller doesn't necessarily have exclusive ownership of a trademark or copyright. The seller may have

only registered the trademark for specific products. International trademark rights also are a minefield. If the target didn't register its trademark in each country for specific products, a native company also may have rights to it.

Know when there are too many. If several other companies have any licensed use of a trademark copyright, it generally weakens the seller's claim to exclusive rights. Further, if the seller has been aware of trademark violations but didn't pursue the offenders, it may be difficult for you to pursue them once you assume ownership.

Keep in mind that, even if a seller notifies you of a potential IP challenge, your deal may still be viable. If you know your risks, you may be able to negotiate a deal with the rights holder before the issue becomes contentious.

KEEP ON YOUR TOES

Selling companies must recognize the value of their IP and thoroughly catalogue and appraise it if they're going to realize a fair price. Buyers should request proof of ownership for every IP asset. If you later become embroiled in an IP rights dispute, your acquisition could lose some — even all — of its value. □

How to sell your business to a foreign company

Given the shaky state of the U.S. economy and sluggishness of capital markets, more and more domestic companies are looking abroad for buyers. Many foreign buyers, in turn, are eager for U.S. acquisition opportunities. The dollar's decline over the past few years means cross-border deals are increasingly affordable for them.

These types of deals can be complex, opening the door for miscommunication. Anticipating challenges, however, can help smooth the way.

COMMON GROUND

Prospective foreign buyers may not only be unfamiliar with the ins and outs of your business, but also U.S. cultural customs, government regulations and labor relations. You can position your company as a more attractive acquisition candidate and smooth the process by assembling a group of executives to serve as an "ambassadorship" to a prospective buyer.

Charge this task force with explaining your country's traditions, work practices and regulations. This group might organize a series of meetings

in which managers from both companies can meet and discuss such topics as work hierarchies, distribution of power and responsibilities, and even office layouts. Informal meetings will help unearth any potential stumbling blocks long before the two organizations formally integrate.

LEND A HAND

Due diligence generally is a buyer's task. But foreign buyers likely will have their hands full trying to understand various legal and regulatory requirements. You can help keep the transaction moving forward by performing an extensive inventory of your assets. Draw up lists of tangible and intellectual properties and flag any potential





issues, such as machinery in need of repair or real estate with potential environmental exposure.

Also consider issues relating to human assets. Your HR department should compile a list of employees and determine if any of them might cause problems for an international buyer. For example, if you employ non-U.S. citizens, be prepared to explain their status — whether they're here on a work visa, or are in the process of obtaining U.S. citizenship.

Assess whether employee health and retirement plans will be ready to transition to a foreign owner. Benefits — particularly when you propose transferring them to a non-U.S. company — can be a regulatory minefield, so you should work with third-party payroll services with experience in this kind of work.

How employees transfer to new owners varies depending on the buyer's country of origin. In the European Union, for example, employees transfer to new ownership automatically. In Latin America and parts of Asia, the process can entail terminating the selling company's employees and then rehiring them.

REALISTICALLY SPEAKING

Sellers also can help facilitate a successful international acquisition by acting as the voice of reason in deal negotiations. If a buyer has overly ambitious goals, such as an accelerated integration timeline, it

may be in your best interest to argue for conservatism to prevent later disasters. If, for example, the buyer underestimates what it will take to transfer a database, ask your IT department to draw up a step-by-step chart of the process that includes realistic timelines.

Help keep the transaction moving forward by performing an extensive inventory of your assets.

Employee issues can flare up during international deal negotiations. An overlap between your and your buyer's organizations makes redundancies inevitable. But if your company is likely to bear the brunt of layoffs, be candid with your employees and, to the extent possible, assist them in finding new jobs. Otherwise, morale will suffer and employees will be more likely to leave en masse, or, if they remain, be uncooperative — making it very difficult for the buyer to achieve its strategic goals.

DOING YOUR PART

During the sale process, be respectful of your international buyer's culture and do what you can to ease a complex transaction. Your attitude and actions may determine whether you actually cross the finish line and realize a good price for your company. □

Dissident shareholders can make or break your deal



Whether you're buying or selling a business, you need to be aware of the power of minority owners or shareholders. Individuals who own only a small percentage of a company can still wreak considerable havoc on a deal if they don't approve it. However good a deal looks to you, be prepared to handle the objections and actions by activist and dissident shareholders — no matter how miniscule they may seem on paper.

THE MOUSE THAT ROARED

Recently, the news has been full of the ongoing dispute between Yahoo! and legendary financier Carl Icahn, who owns only 4% of the company's stock, but wields disproportionate power over its future. Icahn wants to depose the current Yahoo! board so that the board's replacements can accept Microsoft's buyout offer. While most minority shareholders are neither as famous nor as powerful as Icahn, they can play an outsized role in determining whether an M&A transaction goes forward.

Dissident shareholders come in all varieties, including hedge fund and other investment account managers, social activist investors, and risk-averse investors who don't trust management. And, of course, there are always investors who simply don't believe that a transaction makes strategic sense.

ADDRESS TROUBLE HEAD-ON

The best way to prevent dissenting shareholder trouble is to anticipate it. If, for example, you have your eye on a target company, research its shareholders and pinpoint those who have a history of aggressive or disruptive dissent. Open communications with these shareholders as soon as feasible so that they understand your intentions and are more likely to align themselves with your plan.

Indeed, both parties to a deal need to be proactive about communication. Unless you make a clear, compelling case for an M&A to minority owners early

in the process, you risk damaging rumors and unfounded suspicions spreading like wildfire. And once these stakeholders have their hearts set against the plan, it may be hard to change them.

If you discover objections to a deal, dig for their roots. Some minority shareholders don't actually want to block a deal, but only to challenge a particular point in the sales agreement, such as the sale of a particular asset or financing terms. If possible, try to reach a compromise with these owners before they get a chance to ally themselves with other dissatisfied shareholders.

WEAPONS IN THEIR ARSENAL

Minority owners can wield their power in surprising ways. When deals are subject to supermajority (67% to 90%) vote requirements, a single investor may be able to accrue enough small percentage votes to block it.

If you're a buyer, comb through your target's charter to see if a supermajority amendment has been enacted in the past. If you're a seller subject to such a requirement, you might want to try to remove supermajority-related language before putting your business on the market. Typically this involves a shareholder proposal at an annual meeting or a new amendment to the company's charter. Activist shareholders might also use litigation to disrupt and distract your plans, or, in some cases, to force you to go through with a deal.

EYES WIDE OPEN

While you can't fully prevent minority owner dissent, you can minimize the damage they cause. Reducing minority shareholder-friendly language in corporate charters, and making sure you have a good relationship with all of your shareholders, will certainly help. □