financial executive
www.financialexecutives.org
April 2009

Buyers and Sellers Can Leverage the Economic Crisis

By William R. Hagaman Jr., CPA

Ask most professional athletes what determines winning results and they'll tell you it's about natural ability and hard work. Ask the same question of sports coaches, and get a different answer. Coaches talk about winning based on preparation and effective practice.

Like the athletes, in prosperous times — of not that long ago — many business leaders were able to nimbly navigate a wide-open playing field, leveraging abundant opportunities with their natural ability and vast resources.

By contrast, in today's chaotic economy, business leaders must now shift to the role of the coach, preparing the business for the times, focusing on preparation, honing the right talent in the right job and watching their competition.

Just two years ago, the mergers and acquisitions market reached a peak value of $4.2 trillion. Now, down an estimated 28 percent since last July, some speculate that an increase won't appear for at least another 12 months.

True, the mid-level corporate M&A landscape is quiet, but it is not dead. Though turbulent economic indicators make for a difficult M&A climate, this can be a good time for financial executives to assess their core business and explore positioning options.

If a company has reserved the necessary resources to seize buying opportunities, there are plenty of prospects that, if acquired now, can prove exponentially beneficial later.

A recent Boston Consulting Group study revealed that 13.5 percent of mergers in a weak economy produced two-year returns in excess of 50 percent, while only 7.4 percent of strong-economy mergers did so.

Conversely, 14.9 percent of strong-economy deals produced losses in excess of 50 percent, compared with only 6.7 percent of the weak-economy deals.

As turbulent economic indicators create a difficult M&A climate, this can be a good time for financial executives to assess their core business and explore positioning options — but incredible due diligence is essential.

For senior executives looking to sell, this is the time to prepare the company to be more attractive for purchase for when the climate improves.

A reasonable assumption would suggest that the ideal time to buy or sell a business is generally when all of the stars are aligned: strong economy; strong stock market; high business valuations; fluid lending availability; and growing revenues and profitability.

That is certainly not the case presently. Therefore, preparing the company now for a future merger or acquisition will put the firm in a position of strength when the climate does improve.

Thus, whether a buyer or seller, preparation is essential and the following guide should help:

■ **Critical Preparation**. Careful planning for the transaction is vital; preparation now can make or break the business.

Business valuations are at historic lows, making this a compelling time to buy. For buyers with ample resources, opportunities are there for the taking. Buyers that need to create resources to seize opportunities must do the preparation to free up resources.

The key areas of preparation to focus on include:

Streamline the Playbook. Sellers should take a close look at their balance sheets, clean up any related-party loans, review accounts receivable to be sure only collectable amounts are reflected and sell off nonoperating assets.

Review the business's normal monthly expenses and streamline them accordingly, keeping reserves available.

Most importantly, obtain a thorough audit of the books, preferably done on an annual basis. Having an objective third-party review of the firm's finances lends credibility and value to the business and also alerts management to potential exposure that can be addressed immediately. This can also serve as a preliminary mock due diligence for when a sale does take place.

On both sides of the deal, now is a great time to take inventory of all of the business assets on the books and attempt to liquidate any unused capital assets or excess, obsolete inventory.

For sellers, this exercise allows for a smoother scouting report and frees up resources. For buyers, liquidation can help generate the cash reserves needed to create the "war chest" required for strategic acquisitions.

Assess the Management Infrastructure. Both buyers and sellers will benefit from taking an objective look at their management infrastructure to optimize the deal.

For sellers, if the sale of the business is in response to the owner's desire to retire, the proper exit strategy should be planned years in advance. Identify the key management players — and secure their positions with employment contracts and noncompete agreements — to ensure the stability of the business after the deal is done.

The ability to deliver a strong management team at closing is a crucial factor in making a deal more attractive to buyers and will command higher multiples.

For buyers, creating a lean and nimble leadership structure enables cross-organizational agility. Have an efficient leadership model in place, free up resources needed to support the deal and have the right talent to execute and integrate the company in a post-acquisition environment.

■ **Establish a "War-Time" Adviser Team.** Establish a strong team of accounting, tax, legal and banking professionals who are equipped to counsel the firm through this preparation process. Also, be sure to fully understand the financial impact, tax issues and legal consequences of every transaction.

These "war-time advisers," need to demonstrate an aggressive, strategic mentality that can navigate the firm through the deal.

■ **Take a Harder Look at the Playing Field.** With business valuations and overall sales in a general downward and uncertain direction, it is a different playing field than it used to be. As such, it's a good time for financial executives on both sides of a deal to look around at competitors or vertical market players for potential synergies.

Committing the capital necessary to push through acquisitions may present a market advantage during a recession, and even greater positioning going out — something many businesses are currently doing.

On the other hand, for a struggling business, finding a buyer may be the best option and finding the right buyer is essential. Therefore for buyers and sellers alike, incredible due diligence is critical now.

William R. Hagaman Jr., CPA, *is a partner with WithumSmith+Brown PC, a top 35 accounting and consulting firm in the U.S. based in New Jersey.*