JAHANI & ASSOCIATES

A Step-By-Step Process Guide to the Sell-Side M&A Process

How to Perform a Disciplined Sell-Side M&A Process to Maximize Results

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The sell-side M&A process, facilitating the sale of a business, is long and complex. Bringing a company to market does not guarantee the company will achieve its M&A goals. The M&A process is challenging for three reasons:

1. It is difficult to build consensus among a large number of stakeholders.
2. Gathering relevant, transparent, and adequate data is complicated, particularly in private markets.
3. The M&A process contains many steps, and within each step, there are many opportunities for things to go wrong.

This report contains the step-by-step guide Jahani and Associates (J&A)—an NYC-based professional services and advisory firm—uses to maximize results for its clients. Each step in the sell-side M&A process is driven by activities, deliverables, and solutions.

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STEP 1: Preparation to Solicitation

Preparation for solicitation requires the company and their investment banker to generate the artifacts buyers need to make an offer for the company. This information includes but is not limited to financial information, the growth history of the company, intangible asset information (e.g., customer relationships and proprietary technology), and the reasons the owners are selling the business.

Industry-standard deliverables, such as a confidential information memorandum (CIM) and audited financial statements, are used in this phase to market the business to potential buyers. This phase is vital because any delays while in market can impact the outcome of a transaction.

Figure 1: A typical M&A Process

	PREPARATION	SOLICITATION	RECEIVE IOI*	RECEIVE LOI**	CONDUCT DUE DILIGENCE	SIGN PURCHASE AGREEMENT
ACTIVITIES	• Conduct valuation • Build confidential information memorandum (CIM) • Build buyer prospect list, including warm and cold connections • Create data room and due diligence package • Build and finalize financial models and business documents	• Solicit buyer with a request for an indication of interest • Give buyer a commitment timeline when appropriate • If prospect passes, ask for a referral • Rebut objections based on preparation	• Create and negotiate valuation range, earnout, and acquisition terms • Share information needed for buyer to create valuation, such as growth story and customer information	• Negotiate and refine deal terms, such as valuation, earnout, and equity rollover • Determine due diligence needs and exclusivity post LOI execution	• Due diligence activities including but not limited to legal, operational, financial, vendor, working capital, organizational structure, facilities, and advisor items	• Updating valuation, earnout, equity rollover, and other related items based on material due diligence discoveries • Conditions to close • Representations and warrants • Covenants and indemnification
DELIVERABLES	Confidential information memorandum Objection-handling script Prospect list Projections and audited statements	List of FAQs List of expected objections and	List of open items for an LOI Formal IOI	Due diligence list Executed LOI	Completed due diligence list Data room containing artifacts	Signed purchase agreement Money transferred
STAKEHOLDERS	Seller, Banker, Lawyer	Seller, Banker	Seller, Banker	Seller, Banker, Lawyer	Seller, Banker	Seller, Banker, Lawyer

* IOI: Indication of interest (nonbinding) **LOI: Letter of Intent (may be binding)

STEP 2:

Solicitation to IOI

Reaching a sufficient number of solicitations to find an interested buyer is difficult and crucial, particularly in the lower-middle and middle markets. J&A recommends only sending detailed material during the preparation phase to potential buyers after they have signed an NDA.

Common sources of buyer solicitations include direct connections from an investment banker's network, direct solicitations of qualified buyers determined from research (e.g. PitchBook), and targeted emails to qualified lists of buyers.

IOIs (Indications of Interest) contain valuation ranges and general expectations of earn-out, which should be negotiated as necessary to have a smooth transition from an IOI to an executable letter of intent (LOI). IOIs are non-binding.

PREPARATION → **SOLICITATION** → ***RECEIVE IOI**** → ***RECEIVE LOI***** → CONDUCT DUE DILIGENCE → SIGN PURCHASE AGREEMENT

STEP 3:

IOI to LOI

A site visit usually occurs while transitioning an IOI to an LOI and is an opportunity for the buyer and seller to meet and conduct a deep dive into any outstanding items that need to be settled before executing an LOI. Since LOIs are legally binding, many buyers will require exclusivity after an executed LOI, which is also referred to as a "no-shop clause." This means the seller will not be able to conduct sale-related conversations during the no-shop period and must ensure the upcoming due diligence will be satisfactory, in order to close the deal.

STEP 4:

LOI to Purchase Agreement, Including Due Diligence

Due diligence is the process of affirming the information the buyer has used to make his offer and determining whether or not the company is in good standing with all relevant information in its possession. It is often the longest part of the sell-side M&A process, as it may take up to 120 days.

Once due diligence is complete, executing the purchase agreement, where ownership changes hands, is the final step in the sell-side M&A process. Agreements can be asset purchases or stock purchases. If due diligence went as expected, which is vastly important, this step should be relatively simple. Changes that may affect purchase agreement negotiations are material discoveries in due diligence, economic forces, material alterations in business operations, and management changes.

Problems and Solutions: Quickly Resolving Challenges Requires Deep Thinking and Preparation

Jahani and Associates has collected common challenges that exist in each step of the sell-side M&A process and the best way to resolve them. In order to avoid disruptions or delays in the M&A process, it is important for M&A stakeholders to plan ahead and know where weaknesses may rise, and also imperative that the investment banking team has a plan to resolve these challenges before they even arise.

Preparation to Solicitation

Companies most often do not go from preparation to solicitation when seller management teams are not aligned or properly prepped for the sell-side M&A process. This can occur when multiple stakeholders are involved, particularly in companies boasting a significant capital raise. If a business undergoes a change that materially reduces the company's desired valuation, management often decides to postpone the process.

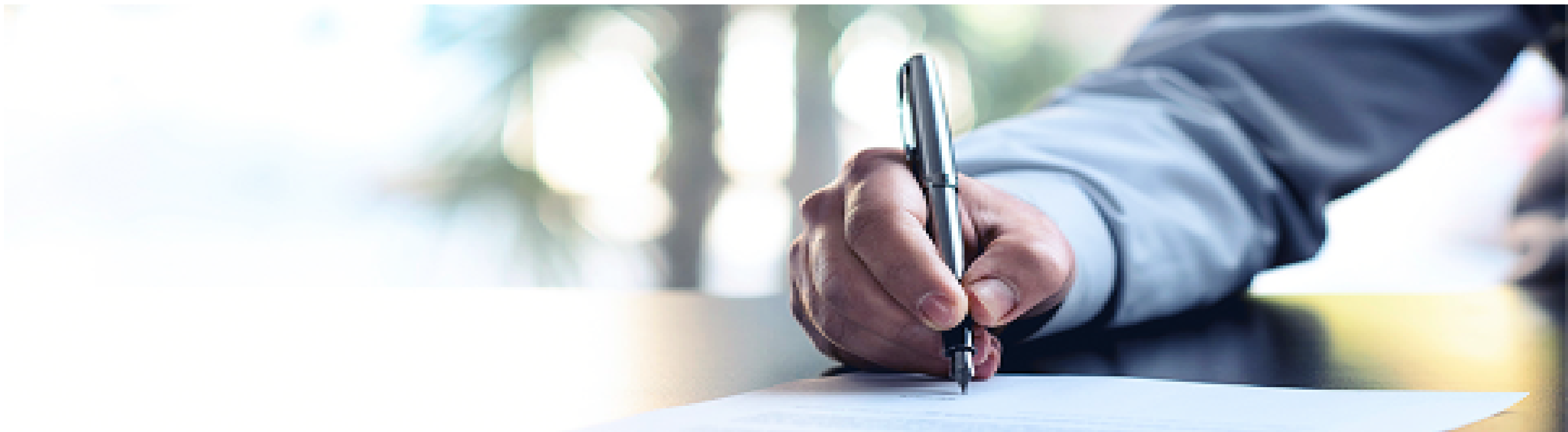
Solicitation to IOI

As a solicitation to IOI is fundamentally a sales process, sellers and their teams are most prepared when they view this as a sales exercise. This is often the most difficult step in the process for unprofitable companies in the lower-middle market.

Figure 2: Solicitation to IOI

COMMON REASONS FOR FAILURE	J&A'S SOLUTION	KEY PERFORMANCE INDICATORS (KPIs)
Poorly segmented potential buyer or investor list	Have a pre-scripted reason why each buyer would buy or invest based on their past acquisitions or investments.	Number of reasons per buyer
Not enough prospect follow-up	Follow up four times before moving a prospect to not interested. Follow up seven times if a buyer responds as interested but then goes dark.	Number of follow-up attempts
Weak or uninformed pitches	Solicit twice, after the CIM is created and then after the teaser is created. Do not solicit too early.	Number of pitches that result in a next step
Inability to qualify buyers and investors resulting in wasted time	Ask qualifying questions, such as: • Do you have cash to meet the desired payout? • Do you want to buy this company?	Number of qualifying questions answered
Low volume of solicitations	Solicit at least 100 buyers with a blind teaser	Number of solicitations
Poor objection handling	Collect objections in a central database that can be shared by registered representatives. Craft objection-handling responses.	Number of objections handled
Poorly coordinated buyer outreach	Clearly assign roles and responsibilities within each team assigned to the client project.	Internal project management tools such as RACI,*** project plans, and status reports

*** RACI Matrix – A responsible, accountable, consulted, and informed (RACI) matrix is used to determine the roles of various stakeholders, such as a senior executive, and their requirements for information.



IOI to LOI

Moving from an IOI to LOI is a matter of negotiation and mutual understanding between the buyer and seller. A site visit is often used between the IOI and LOI to develop a relationship between the buyers and sellers.

LOI to Purchase Agreement, Including Due Diligence

Due diligence is the process of confirming the buyer's understanding of the business at the time they made their offer. Due diligence is time-consuming and material information that changes the valuation, and earn-out identified in the LOI may be discovered during due diligence. This will be negotiated as part of the purchase agreement, which may be made for either cash or stock, each of which has its own tax, legal, and strategic considerations.

Figure 3: IOI to LOI

COMMON REASONS FOR FAILURE	J&A'S SOLUTION	KEY PERFORMANCE INDICATORS (KPIs)
A poorly communicated story or vision	• Qualify IOIs before passing to the sellers • Give the seller reasonable time to review the offer before a face-to-face dialogue or meeting • Subtly communicate other IOIs that are on hold	• Number of IOIs that are accepted and passed • Number of face-to-face meetings
Inability to manage multiple IOIs	• Keep building up sales funnel • Settle up timeline to push current IOIs to LOIs • Always set an expiration date for LOIs • Use multiple deals in IOI stage for comparison and avoid fixating on a single transaction	Number of IOIs pushed to LOIs while working on an LOI
Financial fundamentals from sellers are not final	• Set a fixed price rather than a multiple of the EBITDA • Strictly control add backs or inadequate reserves for bad debts, inventory, or warranty claims	Thresholds set for financial adjustments
Overly aggressive negotiation by denying bids too early	• Avoid "repricing" or "retrading" while under LOI • Help sellers understand working capital adjustments, escrow holdbacks, owner compensation during the transition, lease or buyback options, and the legal wrangling around reps/warranties	Number of financials stayed unchanged through due diligence
Failure to reach valuation range agreements	• Conduct thorough up-front valuations to set seller expectations • Socialize valuation with warm buyers to align expectations	Valuation comparables delivered to and reviewed with client
Insufficient follow-ups with buyers	• Follow up seven times with an equal mix of email and phone calls before moving to a close	Number of follow-ups including type

Deloitte, "Cultural issues in mergers and acquisitions," Leading through transition: Perspectives on the people side of M&A, last modified 2009, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/mergers-acqisitions/us-ma-consulting-cultural-issues-in-ma-010710.pdf.

Figure 4: LOI to Purchase Agreement

COMMON REASONS FOR FAILURE	J&A'S SOLUTION	KEY PERFORMANCE INDICATORS (KPIs)
Inspection failure	A team of CPAs delivers a client-focused approach to financial due diligence that mitigates risk and identifies key value drivers, while avoiding conflicts of interest • Keep the pace of weekly calls • Strictly perform interviews and site visits as stated in contract	Checklist
Over-reliance on inorganic growth	Make clear plans for how to utilize any new intellectual property or assets to enhance their existing operations Ensure functional groups are aware of goals, responsibilities, and deadlines to avoid poorly executed integration	Checklist
Lack of functional risk management	Analyze the risks associated with competitor developments, innovative solutions, and new technology that could replace your offering	Checklist
Misguidance on strategic consulting	Agree on objectives and expected results at the LOI stage Team of experienced strategic consultants from J&A provide tailored advisory services and drive the deal to the client's desire	Checklist
Noncompliance with regional laws and regulations [4]	Establish the complete picture of laws applicable to the business and industry of operation	Checklist
Undeclared information [4]	Disclose any information that may cause a red flag, such as onerous customer contracts, ongoing litigation, and problematic receivables	Checklist
LOI terms are not acceptable (e.g., no-shop clause) [4]	Pre-sell terms to sellers and buyers by communicating the strategic advantage of each followed by trade-offs [4]	Number of terms communicated to the seller before officially receiving the LOI [4]
Terms such as payout and earnout are not agreed upon [4]	Have multiple competing offers at similar stages in the process	Number of offers in similar stages of the process
Assets to be acquired contain potential material liabilities [4]	Ensure hidden assets, such as debt, property, goodwill, and intellectual property, are revealed and disclosed	100 percent of items on due diligence list checked
Failure to agree to necessary financial adjustments [4]	Set up threshold on financial adjustment in the LOI stage to minimize reconciliation payment	Number of financial adjustments in question
Postpone closing date due to valuation dispute [4]	Make sure the parties agree on valuation methods and resulting valuation prior to negotiating the actual purchase agreement	Prediscussed valuation models and assumptions
Failure to protect against competition [4]	Be transparent in drafting confidentiality agreements, non-solicitation agreements, noncompete agreements, and IP protection overall in APAs	Timeline of the signed acknowledgement from sellers
Failure to change signatories [4]	Include provisions that require the sellers to assist the buyer with transition items for the first three to six months	Provisions written in purchase agreement
Essential parties are not part of the purchase agreement	Avoid shell company becoming the essential beneficiary	Stakeholder involvement driven by the capitation table, not only the active managers

[4] Corporate Finance Institute, "What is the No Shop Provision?" No Shop Provision, accessed November 22, 2019, https://corporatefinanceinstitute.com/resources/knowledge/deals/no-shop-provision/.

The sell-side M&A process is challenging, but the seller's success will be maximized when a disciplined process is followed.

The challenges, solutions, and KPIs in this paper are not exhaustive, but they provide an overview of the way to maximize success in sell-side M&As. It is important that all stakeholders understand the challenges they will face and how to alleviate them as quickly as possible. Establishing a consensus among stakeholders and then focusing on a problem-solution-KPI framework gives transparency to the client and allows the investment banker to increase the size of their team while preserving client service and information sharing. Experience in dealing with these issues is paramount to successfully delivering M&A results, and that experience must be coupled with actionable outcomes.

Any business owner seeking to sell their business must carefully consider all these factors and be aware of expected obstacles in order to significantly increase the likelihood that their company successfully completes a sell-side M&A transaction. The analysis contained herein is based on decades of experience and is included to support business owners across the world as they achieve a maximally successful exit.

In 2019, J&A surveyed hundreds of business owners about successful and failed M&A deals, why they failed, and how those failures could have been avoided. J&A then compared these stories with its own processes and tools to determine the best way to anticipate and avoid these failures in any M&A scenario. The resulting analysis is this document that outlines common reasons for failure and how to avoid them. This document is meant to serve as a resource to business owners and other service providers to give the best strategic advice and service for their business or clients.

SOURCES

1. Baird, Les, David Harding, Peter Horsley, and Shikha Dhar. "Using M&A to Ride the Tide of Disruption." Bain & Company, January 23, 2019.

2. Buesser, Gary. "For the Investor: Internally Generated Intangible Assets." Accessed November 22, 2019.

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4. Deloitte. "Cultural issues in mergers and acquisitions." Leading through transition: Perspectives on the people side of M&A. Last modified 2009.