CAPITAL THINKING: TOP CONSIDERATIONS FOR SELLERS IN TODAY'S M&A LANDSCAPE

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From a seller's perspective, 2021 has begun with an extremely strong M&A landscape in the U.S. During 2H2020, the dollar value of mergers and acquisitions reached its highest level ever, by climbing to $2.2 trillion. This was largely due to pent-up demand, low debt rates, record capital availability, and concerns about changes to tax code under the Biden administration. We believe M&A is poised to remain robust in the near future.

Many companies that proved resilient over the past year, through flat or modest earnings growth, have seen a return to pre-COVID-19 valuations and beyond. As the U.S. economy recovers, albeit unevenly, buyers are aiming to participate in that recovery and capture the expected growth. Meanwhile public markets have persistently reached new heights, resulting in strong valuations on a comparable basis. Nevertheless, it is important for sellers to remember that the stock market is not the economy.

Even so, the record number of Special Purpose Acquisition Companies (SPACs) that conducted IPOs last year — 248 — also makes private companies of a certain size more attractive targets. M&A deals are becoming more competitive and generating higher valuations, in part due to the rise of SPACs along with an increasingly larger pool of typical buyers such as private equity firms, family offices, and strategic acquirers.

With the Fed expected to keep interest rates near all-time lows throughout 2021, the cost of capital continues to be historically low on a blended basis, which provides further support for M&A this year. Although strategic acquirers often have a cost of capital advantage and synergies, which make them powerful buyers, PE firms and family offices that can source capital at attractive rates and often employ aggressive growth strategies, also are able to pay premium valuations for acquisitions.

Sellers, therefore, have much to consider about every stage of the deal process.

Before Going to Market

Above all else, sellers who begin the M&A process with the sincere resolve to conduct a successful deal transaction are in the best position to accomplish their goals. Potential sellers who are merely "testing the waters" are less likely to obtain the best opportunities and therefore are more prone to failed processes.

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For many people, selling a business may be an intensely emotional experience. In general, those who are ready to act will be excited to do so. Years may pass between when a seller first ponders whether the time is right, and when that seller commits to moving forward.

Successful M&A deals can take many forms. It may involve sellers fully exiting the business, or keeping an equity stake after the buyers acquire minority or majority equity stakes, entering into a joint venture, or other deal types. It is essential for sellers to think through the pros and cons of each scenario before engaging with buyers, in order to protect the seller's long-term interests, which includes not only the valuation of the business today, but also their role and ownership post-transaction.

These early considerations tend to be more productive, when the seller works with a team of experienced M&A professionals. Investment bankers, accountants, and attorneys well versed in taxes and transactions should start collaborating with the seller as early as possible. Together they can help the seller clarify what to achieve, as well as what to avoid. These early discussions are sensitive conversations and provide "reality checks" to the seller as to what is possible and what is probable. Sometimes it involves how to implement operational or financial improvements for the business ahead of conducting a sale.

Along those same lines, the M&A team is likely to insist that a company undertake a Quality of Earnings (QoE) report, to be completed by an accounting firm unaffiliated with the seller's auditor.A QoE report enhances the objective analysis of a company's "normalized" earnings, and provides buyers with extra comfort about profitability and the necessary supporting documentation. A QoE report can also help minimize the risk of a future re-trade from a buyer.

The Art of Valuation

Maximizing the valuation of a company in a sale process is more art than science, because quantitative analysis is only part of what determines value. Combining a sound quantitative analysis with easily overlooked qualitative factors is the art of maximizing valuation, and it is where a strong M&A team can make all the difference for sellers.

Professionals with a comprehensive understanding of the art of valuation can positively influence the outcome of M&A deals in various ways, including in due diligence, positioning and financial presentation, deal and tax structure, competitive process tension, and negotiations. In addition, there is the great benefit of having a third party that can recognize how buyers will view the business from a fundamentally different perspective than the sellers.

Another crucial qualitative factor to address is the impact of a buyer on the seller's culture, employees, customers, reputation and legacy. Each seller will weigh these factors differently with the proposed purchase price when selecting a buyer.

Professionals who have worked on a wide variety of M&A deals will be able to anticipate these issues and advise sellers on them with precision. On the other hand, an inexperienced M&A team can negatively influence deal elements, the valuation of the company, and even the seller's perception of what will happen to the company after the transaction closes.

After the Transaction

Before the M&A deal closes, it can be difficult for sellers to envision circumstances that arise after the transaction. This is understandable. Prior to close, sellers may be so focused on the closing of the deal that what comes next seems too far away to contemplate. However, delaying those considerations may provoke suboptimal post-transaction outcomes.

Some of the biggest post-transaction considerations of a deal vary based on whether or not the seller is staying with the company. Sellers who continue with the company need to understand the buyer's expectations as a new owner, which may require the seller to take on new responsibilities.

Competent M&A experts will advise the seller to discuss these details with the buyer well in advance of closing. Buyers may not clarify stipulations ahead of time, especially if they are potentially controversial enough to derail the deal. This is all the more reason for sellers to understand what questions to ask and take the initiative. If staying on post deal, it's also important to know if any compensation and benefit package will change under new ownership.

Many private business owners utilize the company to cover expenses that will not continue under new ownership. This could include personal insurance needs. Gaps in life, property, and health insurance coverage — even for brief periods of time — should be avoided. Similarly, the company may have covered numerous other expenses that sellers will become responsible for after the deal closes.

In either case, before closing the deal, sellers should confidentially visit with others who have sold their business to the same buyer, for additional perspective on what to expect post-transaction. Last but not least, sellers need a sound tax strategy for maximizing their net proceeds. A strong M&A team will work to optimize the net proceeds and can further recommend private wealth advisors with expertise crafting solutions specific for your circumstances and future goals.

A Trusted Advisor

Stephens Investment Banking approaches the M&A process for all sellers as their trusted advisor. Deciding to sell a business is a major event that we treat with the utmost respect and care from start to finish. We understand how important confidentiality is to a family held business and is paramount in every conversation.

We attempt to be very proactive in thinking through the process and helping you understand what is needed and when it will be needed. In addition, we are on call 24x7 to respond to questions that you may have. In the role of trusted advisor, we listen to sellers throughout the M&A process. We listen to their wants, needs, concerns, and excitement.

Based on the information we gather by listening, we perform customized research and then impart informed and objective advice built upon our decades of experience working with both sellers and buyers. In some instances, this might be advice that sellers do not want to hear but that they need to hear. As an honest broker we believe we owe our clients unvarnished advice.

Most M&A bankers can run a process to sell a company. At Stephens Investment Banking, it's so much more than just a process, or a transaction. We endeavor to build a long-lasting relationship with and tailor our services for each client, with unparalleled perspective on the art of valuation and proprietary insight into the ever-changing M&A marketplace.

We always strive to deliver excellence, from the seller's first call, through the moment of closing, and thereafter. This is what makes Stephen Investment Banking the trusted advisor of choice.