



Recent Experiences in Trade Sales

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Quarter 2, 2008

Detailed Preparation the Key in Trade Sales

A critical aspect of conducting an effective Trade Sale is the setting of a realistic timetable for the completion of work that is required ahead of the process beginning.

Lincoln Crowne & Company has been engaged in the buy side on a recent trade sale where the divesting party has clearly not prepared process materials in advance, and the timetable has been seriously mismanaged.

Extensive timetable blow outs in the release of information often have the effect of raising questions about the credibility of the process.

Whilst corporate clients

often feel that the detailed preparation can be overkill, the time spent has a direct benefit in the effectiveness and efficiency that will result once the process commences.

LCC suggests that clients ensure that the following matters are kept front of mind in the preparation for any Trade Sale process:

1. **Verification.** Ensure that all of the factual elements that the due diligence process will rely on are cross checked during the preparatory phase of work. This includes legal verification of facts. The risk that

is run if you do not do this is significant delay in waiting for the lawyers to bless the documentation.

2. **Convenience.** The divesting party should consider the use of online data rooms for both the presentation of information and the Q & A process. This is particularly important if there are international bidders.

3. **Make it a part of business planning.** A lot of time can be saved by ensuring data centralization is a part of operational procedures.

By maintaining documentation in a standard due diligence process format (or at least an index of where key documents are in larger organisations) considerable time will be spent if there is ever a requirement for a corporate initiative (including capital raisings, etc).

LCC's conclusion is that this simple matter requires considerable attention to present a professional divestment process.

Defending the Numbers

Financial projections are typically at the centre of any divestment process. The ability of a management team to defend its financial position is of the utmost importance.

The divestment process casts a much more caustic light on the financial projections than the annual budgeting process. Accordingly management teams should not make the assumption that just because

budgeting has been achieved all is well. Two of the critical aspects of the due diligence process will be to focus on:

1. **CAPEX.** With growth in financial projections typically comes CAPEX. Any bidder will not want to 'pay' for future performance where they will be footing the CAPEX bill.
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Therefore the ability to leverage the current resources of the Client without significant increase in capital expenditure is a major focal point for preparation.

2. **MARGIN.** Whilst many Bidders will focus one dimensionally on the ability of future revenues to be met, many will

embark upon a detailed exercise of understanding how margin pressure will likely effect the Client over 5 year horizon. In preparation, therefore, a detailed business case on both revenue and margin projections needs to be prepared.

LCC's view is for Clients to critically review projections as though they were the Acquirer. Pick holes in your own work. They will.....

'Busted' Auctions



The putting of a company 'on the block' is often seen as a definitive process which at the outset will always meet with success. Of course this is not always the case.

With the emergence of Private Equity over the last decade as a critical fuel for many organizations to develop their business model 'to the next level' the number of trade sales has also increased. Primarily due to the requirement of the financial investor to attempt to achieve an investment return over a typical 3 to 5

year time period. This deal pressure timetable, however, does not come without its risks.

The result of a failed, or busted, auction is that the asset in question will typically have to be taken off the market for a period of time. Given the rapidly changing corporate environment of today, however, this can result in material decay in the equity value of the asset in question—where margin pressures and increased competition are factors in that specific asset's sector.

For this reason Lincoln Crowne & Company is advocating market sounding activity for Clients that are contemplating a Trade Sale.

Under such activity preliminary activity is undertaken with a selected number of parties to establish the appetite for a divestment. Although the commitment of this style of activity being nothing more than 'price discovery' is often raised—with the abundance of capital and requirement for growth our experience is that the quiet initial approach works.

Post Earn Out Dilemmas

Whilst the structured purchase of a business has been a standard alternative approach to an 'all cash deal' for many years it is not without its problems.

Lincoln Crowne & Company has given clients advice over a series of issues that pertain to Earn Out situations including:

1. **Post Earn Out Period.** When the earn out ends the key ex-

ecutives subject of the initial acquisition will often leave. This is because the ongoing incentives are not there to retain them as they were for the earn out (*high performance multiples*). LCC recommends a strategic review of any acquisition 12 months ahead of its final earn out leg to en-

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sure integration has taken place.

Integration. Particularly in services firms there can be a resistance of the divesting party to hand over valuable information in the last year or so of earn out. This is particularly where no forward planning has taken place for the

post earn out period. Clients need to focus on such matters as the centralisation of IP, and contingency planning if key executives attempt to position themselves for exit following the earn out's completion.

LCC has seen many examples of issues of 'gaming' in earn outs, and advocates creative and strategic thinking being put into initial design to minimise the potential for later disruption.

Earn Out Operational Issues

In designing an earn out the Selling Party needs to be cognizant of the effect that the operational environment of the acquirer can have on the potential total earn out value.

LCC highlights 2 simple examples around cost base, which our Firm has had to deal with repeatedly.

There is an incentive on

both Acquirer and Vendor to optimize cost base. For the Vendor this means during the earn out period to run as lean as possible (*undercapitalize*), and for the Acquirer the loading of costs to spread corporate overhead. Whilst Vendor's get nervous about cost base load, this is controllable via Transaction Contracts. The most significant issue LCC

has found is the undercapitalization one. The acquisition's executive spends nothing on CAPEX during the earn out period to maximize profits and payouts. High CAPEX is then incurred following earn out period completion.

LCC recommends careful design of deal structures to overcome this occurring.





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- ◆ Trade Sales
- ◆ Mergers
- ◆ Joint Ventures
- ◆ Strategic Alliances
- ◆ Takeovers
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- ◆ Corporate Finance
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- ◆ Strategic Advice
- ◆ Corporate Governance

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- Kuala Lumpur
- Mumbai
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- Boston
- New York
- Sydney

Lincoln Crowne & Company has in the recent past executed engagements in numerous Asian economies, including Indonesia, Thailand, Vietnam, India, Malaysia, Singapore, Australia, Hong Kong and South Korea.

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Disclaimer

Lincoln Crowne & Company issues briefing notes on a periodic basis.

These notes are meant to provide the reader with an insight into a variety of issues that Lincoln Crowne & Company deals with in its professional capacity.

They are not meant to be definitive advice, and accordingly should not be acted upon as such. Although they highlight issues, they do not provide solutions which invariably need to be constructed on a case by case basis.

Lincoln Crowne & Company executives would of course be delighted to discuss any issues raised, and to that end inquiry is always welcomed.

Photos in this note taken by Nicholas Assef outside of Port Douglas in North Queensland.