

The road to merger/acquisition

How business as usual can lead to a profitable exit **Interviewed by Paul R. Harvey**

Once the decision has been made to plan and implement an ownership exit strategy, much needs to be considered and accomplished well in advance of approaching a merger or acquisition (M/A) target.

M/A preparation may seem like a monumental and consuming project, but many of the core concepts involved are essentially best practices that all companies should have in place to maximize profit potential.

"Many of the ways that an inquirer will analyze a prospective target's business aren't that different from what the target should be doing all along," says Tom Gard, partner in charge, Armanino McKenna LLP. "Maximizing your profit potential on an ongoing basis will increase the sale price of any future M/A deal."

Smart Business spoke with Gard about how focusing on optimal business performance can help to put your business on track for a beneficial M/A outcome.

What are three preparation guidelines for a successful M/A?

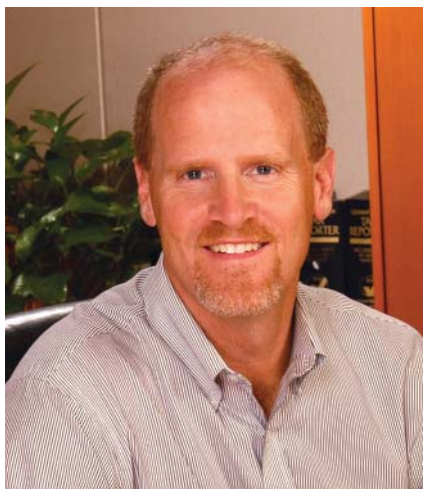
First, you'll need to attract a buyer. Your information has to be presented to convey a story.

Second, this story has to be supportable by facts. You might tell a story that sales are going to grow by 20 percent, but if it's not a plausible story, the buyer won't listen. Prepare the facts about where the company is right now based on current operating results.

Third, you should be critically evaluating your operation by product line and making the changes necessary to improve overall profitability — whether there's an M/A deal or not.

How do accounting practices come into play?

Economics will always drive whether or not the proposed merger or acquisition is a good strategic buy. However, accounting practices come into play when the purchaser starts analyzing the numbers. If things are not accounted for correctly or are not presented in a concise manner, the



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prospect may start to lose faith or question the numbers. If the numbers are straightforward and the reports are meaningful with no indications of any unusual accounting treatments, the buyer is more likely to be attracted.

When should a company seek assistance from outside resources?

Planning for an M/A deal should begin at least two to three years in advance. Companies can certainly benefit by drafting an experienced accounting firm early in the process that is familiar with how M/A deals are structured. Most CPAs can perform a critical evaluation of the historical numbers and help ensure that the company is correctly positioned prior to going into the market.

What categories can skew an M/A proposal, and how can they be recast?

Private companies often maintain substantial discretionary expenses. For example, a company may employ certain family members, offer extra-rich medical benefits plans or provide a large number of company vehicles. The prospective purchaser may choose to streamline these operations if they typically are not the industry norm.

This doesn't mean that a company should immediately eliminate these discretionary categories, but I advise my clients that these items need to be isolated and backed out of the numbers so the core profitability will look that much stronger.

How are accounting results best organized for critical analysis?

The buyer likely will request to see results of operation by distinct product lines or distinct divisions. For example, a truck dealership could present the numbers for truck sales, parts sales, service sales and other product lines. The buyer will want to understand what lines are actually driving the business, and which lines might be a drag on future profitability.

Additionally, prospective buyers will want to know how the company arrived at its current form. You'll need to prepare and provide many documents, including basics like articles of incorporation, minutes, capitalization tables and other statistics. Management should make sure it can run reports like these easily, even if not preparing for an M/A. Compliance documents, including four to five years of audited financial statements, tax returns and letters of recommendation from auditors — or internal financials if not audited — should also be prepared and organized for analysis.

How can negative results be mitigated before approaching a potential buyer?

It's rare when you find an organization that is running on all cylinders, and any legitimate buyer will drill down to the problem areas. This is where the critical analysis of your product lines comes into play. Once an area of concern is identified, a plan of action can be designed that illustrates how this lagging area can be turned to the benefit of the purchaser. You have to tell the story to the buyer about how this problem can be overcome and capitalized upon.

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