Introduction

Corporate mergers and acquisitions ("M&A") represent a common and key strategic growth alternative for business owners in today's business environment. However, opportunities to acquire targets have become increasingly more difficult to come by and win, especially in an increasingly competitive climate with a growing number of strategic and financial buyers seeking to deploy available capital, and with investors applying increasing pressures on companies to accelerate growth.

A company that is seeking to grow through acquisitions (i.e., a prospective acquirer) is often disadvantaged in uncovering and accessing acquisition opportunities compared to buyers that are visible to sellers and have established connections to sellers directly or through intermediaries. Complicating the situation further, when a company gains access to attractive targets that are actively being sold, typically in a competitive managed sale process, a prospective acquirer is often disadvantaged in successfully bidding for the target due to limited insight into the business landscape, as well as into situational, legal and financial factors that provide an experienced buyer with leverage.

As a result, a prospective acquirer may not be able to move quickly enough in a transaction process compared to other bidders to successfully compete in an auction. Risks also exist for an acquirer to overpay for a target or to lose the opportunity altogether due to under-bidding or negotiation factors.

Because of these factors, engaging a qualified investment banker as a professional intermediary is usually the most proactive means for a prospective acquirer to successfully drive the acquisition of a target company. In these situations, an acquirer may exclusively engage the investment banker to execute a comprehensive "buy side" process for identifying, accessing and facilitating the successful closing of one or more M&A transactions. The investment banker will also act as a critical bridge to connecting with M&A opportunities while the management team can continue to focus on operations.

In other situations, an acquirer may choose to run its own buy side process without the assistance of an outside advisor.

Regardless of whether or not an investment banker is engaged, it is important for an acquirer to thoroughly understand the process of buying a company, collectively referred to as "the buy side process". This guide highlights the typical process of buying a company, with specific context for potential acquirers that may be new to the process.
Buy Side Process Overview

The buy side process is generally comprised of the following four phases:

| PHASE I | Target identification and engagement |
| PHASE II | Preliminary due diligence, valuation, and indication of interest |
| PHASE III | Further due diligence and letter of intent |
| PHASE IV | Final diligence, negotiations, drafting of the definitive purchase agreement, and completion of the transaction |

Each of the above phases is described in detail below.

Phase I: Target Identification and Engagement

The first phase of the buy side process is to identify and engage the acquisition target. The main objective of this phase is to uncover and pre-qualify an acquisition target as a potential strategic fit and as reasonably likely to be willing and able to consummate a transaction.

As described below, an acquirer will typically identify and engage an acquisition target in one of two ways: (1) by directly reaching out to the target or (2) by receiving an invitation to bid on a target, typically when the target is actively in a competitive auction process to sell its business.

1. Direct Reach-Out to the Target

This approach involves the acquirer researching the market for acquisition targets and then, once identified, proactively reaching out to solicit interest from the target to engage in exploring a potential transaction. The acquirer may reach out to the target directly or through an investment banker or other intermediary if the acquirer wishes to be anonymous.

Once interest is established, both the acquirer and target will typically submit, with the assistance of legal counsel, a Confidentiality Agreement ("CA") for the other side to execute, to enable in-depth bilateral discussions. The CA legally binds the parties from not disclosing confidential information regarding the target or the prospective transaction. At this point, once the CA is executed, the acquirer’s identity will be revealed if an intermediary is used.

For the acquirer, the main benefit of the direct reach-out approach is that the acquirer may pursue discussions with the target without the target necessarily being actively engaged in selling the company. Thus, opportunity exists to acquire the target outside of a competitive bidding situation, which may partially mitigate the risk of overpaying for the business as well as being forced to keep pace with local potential buyers in a formal managed sale process. Furthermore, the acquirer may have more flexibility and leverage in dictating the terms and pace of consummating a transaction.

For the target, a main benefit of the direct reach-out approach is a potentially shortened and more discrete transaction process, which may include minimal risk of confidential strategic or competitive information being leaked into the market. However, a challenge of the approach is potential concern from the target of lack of negotiating leverage and of "full" value potentially not being received since there are no other buyers actively competing for the business.

Often times, the target may engage the acquirer without strong intentions to sell the business. Alternatively, the target may simply be chiefly seeking to receive a “market check” on what the target’s business is worth in advance of potentially launching a formal competitive auction process to sell the business.

Given these factors, the likelihood of successfully consummating a transaction with a specific target through direct reach-out or on a direct one-off basis is usually considered lower probability compared to if the target initiates discussions with an acquirer and is actively undergoing a sales process. This is particularly the case if the acquirer does not have a relationship with the target before reaching out.

However, this risk can be partially mitigated by the acquirer by first developing a strong network of corporate executives and intermediaries – including of lawyers, accountants, investment bankers, private equity firms, commercial banks, wealthy investors and other capital providers.

Many of the most attractive target opportunities are often uncovered through such an established network. It is common for acquirers to be introduced to targets through individuals that are well-connected to local businesses and offer inside perspective on potential targets, including through direct or indirect key relationships within the target organizations. Developing such a network can play a critical role in uncovering high quality target opportunities that may not be readily found in the market. Such a network may also uncover situations where the target is a good faith seller with unique motivations to consummate a transaction with a specific acquirer.

In directing dialogue with such a network, it is value-added for the acquirer to first have conducted some research to determine the specific criteria that the acquirer desires in a potential target. Successful planning at this early stage can significantly increase the likelihood of a successful acquisition. Examples of certain criteria to consider include geographical preferences, industry or market niches, size of revenue, profitability, the stage and growth of the potential target and the nature of the potential target’s operations and facilities.

Importantly, the acquirer should have a clear understanding of its business objective and corporate strategy in pursuing acquisitions. While the acquisition criteria may be revised a number of times, it is often best to put it in writing as a formal benchmark to judge opportunities against as they become available. Such an acquisition criteria sheet (which many times may be just one page) can also be sent to the established network of trusted advisors and contacts.
2. Initial Discussions

In the event that the seller has engaged a sell-side investment banker to run a formal managed sale process, the acquirer may receive a phone or email solicitation to participate in a formal process to bid on a target. This is usually done through the investment banker that is acting as an exclusive intermediary to sell the target’s business on a confidential basis.

The investment banker will most likely be executing a competitive “auction process” on behalf of the target. In such a process, several-to-many potential strategic and financial buyers may be actively involved in bidding to acquire the target. For the target, such a process is beneficial as it helps ensure that full value is received for the company through a competitive process. For the acquirer, the process is beneficial in that the target’s interest and intention to sell the business is more certain.

In order to establish interest from the acquirer to bid on the target, the investment banker will provide a brief written executive summary to the acquirer that describes the target on a no-names basis, with the name and key identifying elements of the target removed. The summary, commonly referred to as a “teaser”, is reviewed by the acquirer and discussions are had with the investment banker to size up the target opportunity.

Once interest is established from the acquirer, the investment banker will submit a CA for execution to ensure that confidential information on the target is not disclosed by the acquirer during the transaction process. Upon executing the CA, the target’s identity is revealed to the acquirer by the investment banker.

Before executing a CA, it is important for the acquirer to have qualified legal counsel involved in reviewing and advising the acquirer on modifying the document. Executing CAs in relation to participating in a bid process is a standard process and often involves ambiguous legal language that is company specific and may be heavily slanted in favor of the target. Furthermore, the target will typically require that disputes arising from any potential breach of the CA be handled based on the current laws of the jurisdiction where the target resides.

Once the CA is executed, the investment banker will send the acquirer a Confidential Memorandum (“CM”), which describes the target and its industry and the investment merits and growth opportunities of the target in great detail. A summary of the target’s financial statements and forecasts will also be included in the CM.

Phase II: Preliminary Diligence, Valuation, and Indication of Interest

After the acquirer has engaged the target and the acquirer and target have executed a CA and receives the CM (if participating in a bid process), the second phase of the buy side process begins. This phase involves the acquirer conducting preliminary due diligence on the target and, if interest remains in acquiring the target’s business upon completion of the diligence, determining a value for the business and submitting a non-binding Indication of Interest (“IOI”) letter that outlines the acquirer’s intention to purchase the target. Each of these steps is described below.

1. Information Gathering and Preliminary Due Diligence

The goal of this step is to better understand the target and its investment merits, as well as to identify any deal-breaking issues prior to committing substantial time, resources and expenses in exploring an acquisition. If the acquirer is participating in a competitive bid process, the target will provide the acquirer with a specific bid date by which the acquirer must have completed its preliminary diligence and submitted its IOI. The bid date is typically set at three-to-five weeks from the day that the acquirer receives the CM.

Given this short timeline, only a limited amount of diligence can be reasonably conducted on the target. Furthermore at this phase, the acquirer is only provided with limited access to information on the target, most of which is contained in the CM. As a result, diligence should be executed quickly yet thoroughly and will typically focus on an “executive level” assessment of the business with a focus on uncovering key issues, opportunities, potential synergies and determining a preliminary valuation and deal structure for the target.

Issues that can immediately cause the abandonment of a potential acquisition may be based on how well the company fits the desired acquisition criteria previously outlined. Major items to be considered include size of the company, location, products, capabilities and customers; most of which can be garnered from the CM.

Other items to consider that this early stage include any materially negative trends in the target’s earnings and growth, pending legal litigation or potential lawsuits, lack of a sustainable and defensive competitive position, management retention or personnel turnover, customer concentration or retention concerns and other factors. The acquirer should also gain a reasonable level of comfort that the potential acquisition target is a strong strategic and cultural fit and that the likelihood of successfully integrating the company is high.

It is also important to look closely at the target’s financial statements and forecasts, typically found in the back of the CM. Most companies will provide a summary of their historical financial statements on a Generally Accepted Accounting Principles (“GAAP”) basis. The financial statement should be audited and include full income statements, balance sheets and statements of cash flows. However, smaller companies, or companies that are being sold as divested units of larger companies, may not have complete or fully audited financial statements. This can be a challenge for an acquirer and a lack of audited financial statements heightens the risk that there could be a problem with target’s quality of earnings.

As example, it is not uncommon for targets to not properly record all of their accrued expenses on a timely, consistent basis (e.g., payroll and vacation accruals, etc.). Furthermore, the target may not be fully expensing certain items as it would under GAAP, or it may use unconventional revenue reporting or capitalization methods.
Another market-based
Like the DCF method, the LBO
be acquired on a cash free (i.e., the seller keeps all the cash) and
Enterprise Value will be based on assuming that the company will
Value (EV) for the business. In the context of a transaction, the
the value arrived at using these methodologies will be the Enterprise
value is preliminary and based heavily on the limited financial information
acquirer believes the potential target is worth. It is important to
acquirer to layer in additional costs surrounding corporate overhead.
Given these potential issues and the limited visibility that the
acquirer has into the company at this stage, it is important for the
acquirer to properly consider these factors when it is submitting
its bid. It is also important to “normalize” the target’s historical
earnings, to adjust for certain non-recurring or owner discretionary expense items that may be flowing through the income statement,
but are not expected to continue or are expected to be eliminated
in the hands of a new owner. It is also important for the acquirer
to consider the degree of potential synergies that may exist in the
target, including potential redundancies of operations that can be
eliminated.

By proactively attempting to quantify such synergies and perform
a thorough “scrubbing” of the financials, the acquirer will be putting
itself in the best position possible to submit a compelling valuation bid while minimizing the risk of over- or under-paying for the business. During this preliminary due diligence stage, it is also
recommended that the acquirer actively engage with the target’s
investment banker and ask key financial and strategic questions to
uncover important information in preparing the bid. It is also highly
recommended for the acquirer to have familiarity with GAAP or
generate cash flow. However, unlike the DCF method, the LBO
method is income based and focuses on a company’s ability to

The value arrived at using these methodologies will be the Enterprise Value (EV) for the business. In the context of a transaction, the
Enterprise Value will be based on assuming that the company will
be acquired on a cash free (i.e., the seller keeps all the cash) and
debt free (i.e., seller is responsible for paying off any bank debt) basis. Additionally, it is typically assumed that all operating assets
are included in the purchase price as well as all operating liabilities
(i.e., accounts payable and accrued liabilities).

**DCF Analysis.** The discounted cash flow method is an income-based valuation technique in which the value of a company is
estimated based on the present value of its expected future economic benefits (i.e., distributable free cash flow). Distributable
free cash flow is a preferred measure of a company’s earnings
and dividend-paying capacity because it represents the earnings available for distribution to investors after considering the reinvestment required for a company’s future growth.

Distributable cash flow is the amount that could be paid to owners of a business without impairing its operations. To perform a discounted cash flow analysis, the available cash flow that a business can generate is projected into the future. The free cash flow is then discounted to the valuation date at a rate of return commensurate with the risk involved in realizing those cash flows. An investor would accept a rate of return no lower than that available from other investments with equivalent risk, and would value the investment accordingly.

**Comparable Public Companies Analysis.** This is a market-based approach focused on valuing a company by comparing it to similar public companies that have already established values. Criteria for comparability in the selection of publicly-traded companies include operational characteristics, growth patterns and relative size, earnings trends, markets served and risk characteristics. Each should be within a reasonable range of the subject company’s characteristics to make comparability relevant.

Once a guideline company is selected, pricing multiples are
developed by dividing the market value of equity or EV (equity plus interest-bearing debt, less cash) by appropriate measures of operating results such as sales, operating income or earnings. After analyzing the risk and return characteristics of the guideline companies relative to the subject company, appropriate pricing multiples are applied to the operating results of the subject company to estimate its value.

**Precedent M&A Transactions Analysis.** Another market-based approach with the primary focus on examining the terms, prices and conditions found in either actual sales of the subject company’s stock or sales of companies in the industry. After relevant transactions are identified, transaction valuation multiples (if sufficient data is publicly disclosed) are applied to the corresponding operating results of the subject company to estimate its implied value.

**Leverage Buyout Analysis.** Like the DCF method, the LBO method is income based and focuses on a company’s ability to
generate cash flow. However, unlike the DCF method, the LBO method assumes that the acquisition is being structured as a
leveraged buyout, with a substantial amount of debt being used to
finance the transaction (typically 65% to 75% of senior and subordinated debt).
Underlying Asset Value Analysis. An asset value-based analysis considers that the value of a business is composed of the value of its net assets. In contrast to the other methods described above that focus on valuing the entirety of the business, including intangible elements of a company, the underlying assets approach focuses on adjusting the net book value of a company’s assets and liabilities to their respective market values to determine the worth of the business.

Adjusted net book value is considered most relevant in situations where liquidation is imminent or ongoing; where a company’s earnings or cash flow are nominal, negative or worth less than its assets; or where net book value is standard in the industry in which the company operates. The adjusted net book value may also be used as a “check” when compared to other methods of valuation, such as the income and market approaches.

In the U.S., for the valuation of healthy going concern companies, the income and market valuation approaches described above are preferred because they best capture and quantify the intangible value of a target’s business. By relying solely on the underlying asset value method the acquirer is at risk of potentially undervaluing a healthy business and submitting a bid for the target that is too low and non-competitive.

In deriving a conclusion of value for the target at this early stage of the buy side process, it is recommended that the acquirer develop a valuation range based on a combination of the four methodologies (excluding underlying asset value approach, assuming the company is profitable) with more weight being placed on the specific valuation methods that are most applicable and conclusive considering the unique circumstances of the target being valued. As mentioned, the concept of synergies and other cost saving benefits and revenue enhancing opportunities may also play a part in establishing the value range.

Similar to the acquirer’s development of acquisition criteria, the acquirer’s conclusion of value may evolve and need to be revised throughout the buy side process as the potential target provides the acquirer with more information.

3. Submit Indication of Interest (IOI)

After the acquirer has satisfactorily conducted preliminary due diligence and determined a preliminary valuation for the target, a formal IOI letter must be submitted by the set bid date if the acquirer continues to seek to acquire the target.

Note that the IOI is non-binding and that a definitive proposal to acquire the target will be requested to be submitted later in the process when selected parties are engaged in full due diligence. The purpose of the IOI is to provide sufficient details for the target to assess the acquirer’s level of readiness, willingness and ability to consummate and finance a transaction. The IOI should also provide sufficient picture on valuation for the target to determine if the acquirer should be moved forward to the next phase of the process.

The below criteria, among other things, is typically considered by targets in evaluating IOIs and selecting acquirers to participate in the next phase of the acquisition process. Generally speaking, the more thoroughly written the IOI, the greater potential there is that it will be well received.

Typical criteria includes:

1. Maximization of value to target shareholders
2. Financial wherewithal of the acquirer to consummate a transaction
3. Amount and liquidity of the purchase price
4. Tax consequences associated with transaction structure
5. The speed with which the acquirer may close the transaction
6. The buyer’s intentions with regard to the target’s operations, in terms of both existing and future management team

In preparing the IOI, the acquirer should be specific regarding its intentions and rationale for pursuing a transaction. The acquirer should also provide a brief overview of the acquirer’s business, financial condition and financial capacity to consummate the transaction.

Phase III: Further Diligence and Letter of Intent

Shortly after the acquirer submits its IOI, the acquirer will be notified as to whether or not it has been selected to move forward to the next phase of the transaction process. This next phase typically involves being one of a small handful of acquirers to (separately) meet with the target’s management team, gain access to and diligence a greater amount of information, and submit a Letter of Intent (“LOI”) to acquire the target if interest continues. Similar to phase to, the target will provide the acquirer for a set bid date that the LOI must be submitted by.

The target will request and require the acquirer to meet with management in person, usually at the target’s main place of business. There, key members of the management team will conduct a presentation on the company and provide the opportunity for the acquirer to meet for several hours and ask and received answers to key questions that the acquirer may have.

Shortly after the management presentation is concluded, the target will typically provide the acquirer with access to an online information “datasite” where select legal, financial, operational and other information on the business can be found so that the acquirer can determine an appropriate valuation to submit a LOI.

The LOI highlights the acquirer’s intention to acquire the target and sets forth the proposed purchase price along with all relevant key terms, in much greater detail than did the IOI.
The LOI will also have an exclusivity clause, typically covering 60 to 90 days, so that the acquirer and its diligence and legal team has sufficient time to complete its diligence and consummate a transaction.

**Phase IV: Final Diligence, Negotiations, and Completion of the Transaction**

Shortly after the LOI has been submitted, the acquirer will be notified as to whether or not it has been selected as the preferred buyer to move forward with a transaction. If the acquirer is selected, the target will further negotiate the LOI with the advice of legal counsel. If the LOI is successfully executed, the next phase of the transaction process will begin – final diligence, negotiations and completion of the transaction. As mentioned, the LOI will typically provide for 60 to 90 days to complete the transaction. During this period, the acquirer has exclusive access to the transaction opportunity, as well as complete access to the online datashare. However, if the acquirer is unable to complete a transaction by the designated deadline, an extension must be granted by the target (at its sole discretion) or the transaction process must be terminated.

1. **Conduct Full Due Diligence**

With exclusive access to the target, the acquirer now undertakes the formal due diligence process, which generally serves to confirm the consistency and material accuracy of representations made by the target company. The signing of the LOI by both the acquirer and the target typically grants the acquirer access to financial statements, operating reports and other private and confidential company documents (both financial and non-financial in nature), allowing the acquirer to perform a detailed, in-depth investigation of the target company.

During this step of the process, the acquirer will typically deploy a full independent outside diligence team to lead in the diligence effort. The diligence team will usually consist of a public accounting firm; an M&A transaction law firm; and specialist diligence firms for certain financial, human resources and benefits, insurance, tax and other related diligence needs. Together, the financial diligence team members will rapidly work to complete its diligence so that there is sufficient time to deliver diligence findings, including the financial condition of the business and its quality of earnings.

Some key considerations that the due diligence process seeks to validate include: i) Should the acquirer make the acquisition? ii) How much should the acquirer pay for the target? iii) How should the acquisition be structured? iv) How should the Acquirer handle any post-acquisition operating, accounting and legal issues?

More importantly though, the due diligence of the business seeks to confirm that all of the information provided throughout the process is in fact true and correct. In order to effectively perform this detailed level of research the due diligence process is typically divided into functional areas and disciplines in order to answer certain questions, as follows:

- **Business/Operations:** What are the products and services offered by the target company? What is the nature of the target company's customers? Are the customers diversified or concentrated in certain ways? Does the acquirer's post-acquisition strategy line up with the target company's existing customer base?

- **Finance/Accounting:** Are the target company's financial statements accurate? What are the major internal or external factors impacting financial results?

- **Legal/Regulatory:** Are any legal issues anticipated in the post-closing process? Does the target company possess any potential legal threats? Does the target company maintain contracts with employees that will be impacted by the acquisition? Do any governance, regulatory, or cross-border issues exist?

- **Organizational:** Should certain management personnel remain in their positions? Will any issues arise in integrating the culture of the target company with that of the acquirer? Are there plans for retaining key employees? Is a plan in place for a successful integration after the closing of the acquisition?

As is evident, the due diligence process is no light undertaking, and it plays a vital role in the buy side process. Outlining strategic goals for the due diligence process is key and will lead to a better outcome. Additionally, enlisting the services of experienced due diligence professionals can help substantially ensure that this step of the buy side process is thorough and moves smoothly.

Often during due diligence, the acquirer will uncover information that will warrant the acquirer to revise its valuation (usually downward). In the sensitive situation where there is a downward revised valuation of the target, it is critical for the acquirer to consider all pertinent facts as well as cultural differences in order to determine how to best deliver the message. If the message is not well-received, the target or its advisors may suggest pursuing an alternative acquirer once the exclusivity period ends, which may jeopardize the entire transaction.

2. **Arrange and Secure Financing**

At this stage of the buy side process, the ability to finance the acquisition moves to the top of the priority list. Prior to the closing of the acquisition, the buyer must provide the target company with certain evidence that financing exists to complete the acquisition.

It is important to note that financing for acquisitions can typically be raised based both on the borrowing ability of the target (i.e., using the borrowing capability of the target company to help pay for the acquisition) and the acquiring company. However in certain transactions, securing debt on both the target and the acquiring company may be more difficult, thus creating the need for the acquirer to provide additional equity as part of the purchase price.
A transaction will usually be financed through more than one of the following means:

**Cash.** If the acquirer is actively seeking to make an acquisition, the acquirer may possess material levels of cash and cash equivalents on its balance sheet that the acquirer can readily utilize in order to partially or fully fund the acquisition.

**Acquirer Stock.** If the acquirer is publicly traded, it may opt to fund a portion of the acquisition by providing the target with stock in the acquirer’s business. Note that in accepting stock, the target shareholders will seek to closely assess the strength and financial performance of the acquirer’s business and the underlying growth potential and risk of the underlying stock, especially given that the stock is not readily liquid will be required to be held by the target owners for a certain minimum period of time. A target may opt to mitigate the risk of a fluctuation in the acquirer’s stock value by purchasing a collar on the acquirer’s stock through a broker. When the acquirer is a foreign buyer, the target will also consider volatility in foreign exchange rates and geo-political risk inherent in the acquirer’s business.

**Senior Bank Debt.** If the acquirer is not able or not preferential to fully funding the acquisition from its cash-on-hand or stock, it will typically seek debt financing. The two primary forms of debt are senior and subordinated. Senior debt from a bank, while less expensive than subordinated debt, may have more extensive covenants providing the lender with certain resolutions in the event the covenants are not satisfied. In addition, senior lenders often expect a company to have the debt collateralized by company assets such as accounts receivable, real estate, personal guarantees or another secondary source of repayment in the event the debt in unable to be serviced. In a liquidation event, senior debt obligations take precedence over all other debt obligations and equity positions. As senior debt generally proves to be the least expensive financing alternative, many acquirers may look to finance as much of their capital needs as possible using a senior debt facility, typically with a bank.

**Subordinated Financing.** Subordinated financing, often referred to as “mezzanine debt”, sits below senior debt in the capital structure and typically has both debt and equity characteristics. Unlike bank debt, mezzanine debt it typically unsecured. As such, the risk exposure is greater than senior debt warranting a higher interest rate and some form of equity “kicker” (i.e., an equity interest in the company, often in the form of stock or warrants) in order to drive acceptable risk-adjusted returns. Mezzanine debt typically requires the payment of related interest costs monthly or quarterly. Due to mezzanine debt’s high interest rates (which typically range from the mid to high teens) these payments can be significant. As such, subordinated debt is commonly used specifically for recapitalizations or acquisitions.

**Seller Financing.** Seller financing, also known as owner financing, involves the sellers of the target company financing a portion of the purchase price in order to bridge the gap between the other forms of financing (cash, senior debt, mezzanine debt, etc.) and the total purchase price. Seller financing encompasses several advantages to the acquirer. Specifically, it lowers the risk that the success of the business is tied to the involvement of the current shareholders, as seller financing provides the acquirer with the reassurance that the seller believes the target company can prosper without them. Additionally, seller financing may allow the acquirer to pay a premium for which the acquirer may not have otherwise been able to finance.

**Earnout.** Part of the purchase price may be negotiated to be paid as an earnout, resulting in the acquirer paying less cash to the seller at close. An earnout represent a contingent future payment dependent upon the achievement of as specific future performance event. With an earnout in place, the portion of the purchase price that is subject to the earn out will not be paid at closing, but rather will be paid later (usually after a year, as a single payment or in multiple payments), based on the target achieving a hurdle level of performance that is agreed upon between the buyer and seller at the time of closing.

Earnouts are typically based on the projections that the seller prepares as part of the sale and/or due diligence process and are structured as a percentage of a mutually agreed upon financial metric, most often revenue, gross profit or earnings before interest, taxes, depreciation and amortization ("EBITDA"). Similar to seller financing, an earnout aides in closing the gap in the valuation expectations between the buyer and seller and serves as a useful tool to facilitate the consummation of a transaction.

Determining the appropriate forms of financing to utilize in the acquisition can be determined by the overall market condition, the acquirer’s financial situation and the seller’s willingness to be exposed to the target company subsequent to the acquisition. While the acquirer may propose a certain financing structure, often may ultimately be determined in negotiations. If financing needs to be raise, an investment banker may take on the role of doing so on behalf of the acquirer, by leveraging the investment banker’s network and expertise in selling the M&A opportunity to qualified financing sources.

3. Deliver the Definitive Agreement

Typically around the same time that financing is being arranged for the transaction, the acquirer, with the assistance of its legal counsel, will submit a Definitive Agreement to acquire the company. If the acquisition is being structured as a purchase of assets, the agreement is referred to as an Asset Purchase Agreement. If the acquisition is being structured as a purchase of equity, the agreement is referred to as a Stock Purchase Agreement.

The Definitive Agreement is comprehensive and a binding legal document, and includes all details regarding the acquisition, including purchase price, target working capital and all other relevant details surrounding the deal. In addition to having the acquirer’s general legal counsel intimately involved in preparing the Definitive Agreement, it is also important to have tax counsel review the transaction and Definitive Agreement to ensure that all potential
domestic and global tax consequences are assessed and managed and that the structure of the transaction is optimal for the acquirer and considered in the transaction price.

4. Negotiate, and Execute the Definitive Agreement and Close the Transaction

In the final stage of the transaction process, the acquirer and target continue to negotiate the finer elements of the Definitive Purchase Agreement. If the aforementioned steps were taken thoroughly and properly, all that is left is to sign the appropriate documentation, wire the funds and close the transaction, completing the buy side process.

Conclusion

A well-executed and thorough transaction process of a target will typically take between six to eight months to complete. However, in certain situations, the transaction process may take longer due to potential required regulatory approvals and other hurdles that may be unique to the specific transaction at hand.

As example, if the target is operating within a highly regulated industry (e.g., aerospace-related sectors, etc.), certain federal, state or local laws may restrict the consummation of a transaction unless specific acquirer criteria and deal structuring is satisfied. In certain situations, the transaction may be disallowed altogether unless certain U.S. citizenship criteria is satisfied at the acquirer level.

Given these factors, it is highly recommended that the acquirer engage qualified legal counsel and other advisors with expertise in the target’s industry and regulatory environment, and do so early on in the process in order to identify and work to mitigate potential transaction issues. By being proactive in uncovering and addressing issues and hurdles, when the time comes for regulatory approval, the company will be best positioned to successfully execute the transaction in an expeditious manner.

In conclusion, by planning ahead, organizing the right team of advisors and being fully aware of the intricacies of the aforementioned buy side process, it is possible for an acquirer to not only find quality target opportunities, but also successfully win them. Even if the acquirer is participating in a competitive bid situation, with the right knowledge and team, a buyer can have an excellent opportunity to acquire the target, and at a fair price.

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