Jon Siebers:

I think the market is the biggest timing issue. Once you identify that you want to do a strategic acquisition and you've identified that it's a good market for you to do that acquisition in, then it's a question of vetting your potential targets. And when you're vetting potential targets, things that you want to look at include the brand name, how well they're known in the marketplace, how good their reputation is, how their customer relationships are, how their vendor and employee relationships are.

Jeff Large:

That's Jon Siebers, a shareholder and attorney at Rhodes McKee. Jon is focused on mergers and acquisition. You might remember Jon from the last episode where we discussed selling your business. On today's episode of Conversations with a Business Attorney, we discuss growing your business through acquisition. I'm your host and fellow business owner, Jeff Large.

I want you to listen for a few key topics/ big ideas in today's episode. One is understanding the ways to know if a business will be a good fit for yours in the acquisition and what forms to do the merger in. Another thing is how to do your due diligence when looking at a strategic business deal and finally, what team members/lawyers you need to achieve a successful acquisition and the potential risks that come along with one going badly. Now, there's lots of reasons why you might want to acquire another business. Jon starts our conversation by listing some of the common strategic reasons.

Jon Siebers:

Usually in a strategic acquisition, the primary goal is to increase revenue. That's not always the case, but that's usually if not the driver, a driver. Other goals in strategic acquisitions would be to obtain qualified employees. Right now, there's a huge shortage of qualified workers throughout the country, not just in West Michigan. And we're seeing deals where people are actually acquiring companies just to get good people. That's another reason. You may have a client or a company that has what we call customer concentration issues where their revenue is not allocated among enough customers, and so you have a high risk that the company is going to go under if a customer leaves.

Jeff Large:

Just like a all eggs in one basket, whatever say. What is the normal percentage for that? I hear different things. Like if you, say, for example, your largest client makes up X percent of your business, when should you begin to be concerned?

Jon Siebers:

I think different buyers look at that differently, but I would say if you have more than, say, 30% of your revenue, 40% coming from one customer, it's probably going to start to make buyers nervous. Having said that, if you're looking at buying a company that has 70% of their revenue coming from one customer but when you buy that company, that revenue is only going to account for 10% of the revenue generated by the post-closing, the combination of the two companies, then it's not an issue. What may be an issue for the seller may not be an issue for the buyer.

There could be a reason you want to break into a new market or you want to keep a competitor out of your market. Maybe you're buying a friendly competitor in your market because you don't want an out of market competitor to come in. It could be because you're going to increase cost

savings substantially by combining two companies, or it could be that you're trying to go after some proprietary product or process procedure, IP, something like that.

Jeff Large:

For the one you just said regarding cost savings, what are some typical examples of that?

Jon Siebers:

Well, if you have two companies operating similar manufacturing operations in two buildings and you can combine the two companies into one building, you're going to see savings. At least in theory, those synergies are going to create more revenue or more earnings for the combined company than either of the two companies was experiencing alone.

Jeff Large:

And then just for the sake of focus too, are we strictly talking about existing businesses or companies acquiring other ones? Or-

Jon Siebers:

Yes. Yep.

Jeff Large:

Okay. We're not talking about acquiring a business to start?

Jon Siebers:

No. No. And usually what we're talking about there is what we call a financial buyer. It could be a high net worth individual, it could be a family office, it could be someone else, some other buyer that doesn't currently own a company that wants to own a company. That would be a financial buyer as opposed to a strategic buyer where you have an existing operating company buying another existing operating company.

Jeff Large:

With some of these different reasons like increasing sales, enter new markets, gaining certain proprietary information, those types of factors. What are some indicators for the owner/owners that maybe now is a good time to consider acquiring another company?

Jon Siebers:

That's going to depend on the rationale. If you're trying to increase revenue but doing it at a price that's not inflated, acquiring another business in a market that's really seller friendly is going to be a difficult time to purchase because you're probably going to pay an inflated value for the company. If you can wait until there's a downturn in the economy and valuations start to slide, that's one factor to look at. Am I paying something for this that really makes it sense? Because obviously if the revenues aren't going to change that you generate from a company after you buy it but the price you pay for that company is going to be more in one market than in another market, you're probably going to want to wait until it slows down if you can.

Jeff Large:

Maybe use a basic analogy, think of a guitar pedal. You have different knobs on it that you can tweak or just any sort of thing that has different knobs. It feels like there's elements of this where it's, like you said, the actual evaluation of the company or considering itself, but then there's also how the market is responding to the company. One, could you dive into that? And two, are there any other of those types of variables that you need to be paying attention to on the on front?

Jon Siebers:

I think the market is the biggest timing issue. Once you identify that you want to do a strategic acquisition and you've identified that it's a good market for you to do that acquisition in, then it's a question of vetting your potential targets. And when you're vetting potential targets, things that you want to look at include the brand name, how well they're known in the marketplace, how good their reputation is, how their customer relationships are, how their vendor and employee relationships are. Some of those are difficult to determine during due diligence because most sellers are very cautious about letting a potential buyer approach their customers, their vendors, their employees prior to closing a deal because they want to make sure if the deal doesn't close, nobody knows that you were thinking about selling. Some of those can be difficult to determine, but there are ways to look at those during due diligence.

Others would be from an operation standpoint, is it a good fit? I was involved in a deal where a company purchased company that made very, I would say, craft type, high quality, high workmanship products that took a long time to make. And they were all custom and they were very expensive. They bought a company that created high volume, low margin, off the shelf type products, and those two weren't consistent. You have different types of employees that want to work on one and not the other. Your typical crafts person that really enjoys creating custom products is probably not going to thrive in an environment where they now also have to create all these identical, low margin, high volume products. That's another thing to look at.

Culture is certainly something that should be considered. It's one of those soft side items that buyers should consider. If you have an environment where you give your employees a lot of leeway to do their jobs and you're going to buy a company where the owner has absolute strict control over every decision made in the company, it could be a challenge because now the employees of the seller are going to come in and say, "How do I make decisions here? I've always just relied on the owner to make decisions previously." Those can be challenging issues to resolve, and ideally you identify those prior to closing.

Jeff Large:

Interesting. Do you feel like is it a matter of proper research, proper due diligence of understanding what you're getting into? Or would you typically advise somebody otherwise of it's better to find both, say, a cultural fit, a strategic fit, those kinds of things? How do you weigh those two, I guess, tensions against each other?

Jon Siebers:

If you have other options out there that are, but for culture, they're identical, I would go for the company where the culture is a better fit. And I'm not a consultant that advises companies on culture, but I've seen it enough to know that culture can take a long time to change. And so if you buy a company and say, "Well, it's not a good fit culturally, but we'll change that," well, not without a lot of growing pains.

Jeff Large:

Yeah, yeah. It's one of those things where it's like there's so much of... You see a lot of trends, I think, in business regarding minimum viable product or trying to roll things out as simply. And I've been able to witness it and start thinking about it, I guess, more in different areas that you wouldn't normally apply it to. And this feels like one of them. Do you really want to jump into an acquisition that is going to just cause more tension for you or bigger hurdles to get through versus something that can more seamlessly fit into what you got going or align just better? Like we're saying with some of these strategic reasons.

Jon Siebers:

Right. I think there would have to be other factors, other pluses that significantly outweigh a cultural disparity between the companies in order to go forward.

Jeff Large:

Yeah. Interesting.

Jon Siebers:

Maybe one of them, maybe you're getting a really good deal, maybe you really need their employees. Even though there's a cultural issue, you have to have those employees and there's nowhere else you can get them, so you don't have many choices.

Jeff Large:

How do I find a company to buy?

Jon Siebers:

There are a lot of different ways that my buyer clients source their targets. One is if they're in trade groups or peer groups with other similar... Usually they're friendly competitors outside the market where they get together and they share market information and industry information. Those can be good sources of potential acquisition targets. A lot of times it's, hey, we've been friendly competitors for years and we've always talked about, hey, if one of us wants to get out, the other should buy. That can be a source, just the buyer itself having discussions over the course of many years with other people in the industry.

If you're in a franchise or dealership type of a setting, a lot of times the companies that oversee your franchise or dealership arrangements can be good sources of potential targets. Another good source is to hire an investment banker or a business broker. Now, a lot of investment banks and business brokers specialize in sell-side engagements, so they're really working primarily with sellers. But there are quite a few that also do buy-side engagements. And they can be a great source of potential targets. Bigger companies often have their own corporate development team that does that work internally; will go out and source companies for the business to buy.

Jeff Large:

To recap, you probably want to consult a couple different kinds of professionals before considering an acquisition: an investment banker, franchise management, industry members, and trade or peer groups. Let's say you found a business that you want to acquire. How should you structure the deal?

Jon Siebers:

In most cases, as a general rule, buyers want to do asset sales. An asset sale is when the buyer forms a company or has a company and buys the assets from the other company. If you've got XYZ Manufacturing is the seller, and A B, C Manufacturing is the buyer, XYZ Manufacturing transfers all of its assets, which would be your physical assets, your IP, your contract rights, your goodwill, all of that over to ABC Manufacturing. And a stock sale, ABC Manufacturing would buy the stock own of XYZ Manufacturing that the shareholders of XYZ Manufacturing own.

And in an asset sale, typically buyers want an asset sale for tax reasons. It deals with the ability to allocate the purchase price among the assets that you're buying and then depreciate the cost over time, depreciate the basis in those assets. And there are also legal reasons why buyers typically like to do an asset sale, because it tends to cut off most of the successor liability of the seller. Typically when we're looking at a strategic acquisition, we want to do an asset sale. The question then becomes is the existing company... Again, let's say ABC Manufacturing is the buyer. Is ABC manufacturing itself going to buy the assets or should ABC Manufacturing set up a subsidiary company to buy the assets? And there are tax and legal reasons why in certain circumstances one may be better than the other. And it's really a case dependent or fact dependent decision. But what I typically tell clients is if you are concerned at all about liabilities from the seller tainting the assets of your existing company, then we should set up a subsidiary affiliate and put those assets into a separate company so that if any liabilities come over with the company we buy, they don't taint your existing company.

Jeff Large:

When you say taint, what do you mean?

Jon Siebers:

Let's say you've got a great operating company that's worth $10 million and you buy a company that has a liability for $5 million. If your existing operating company, again, ABC manufacturing is the buyer, that $10 million value is now offset by the $5 million liability. Whereas if you parked the assets of the company that you bought into an affiliate of ABC Manufacturing, that liability doesn't ever touch the operations of ABC Manufacturing.

Jeff Large:

And to further explore that, why should I care? Obviously, we're making this purchase as a strategic move, so there's some bigger reason behind it. Why would that matter?

Jon Siebers:

Because if you can structure it so you don't poison the existing well, that's why you would do it. And it could be too, I had a client that was an existing business in a declining industry, and their sales were declining year over year. And to offset that decline, they wanted to purchase another business in a growing industry. They did it, but they put the new business into an affiliate so that any liabilities associated with the decline in the one industry didn't taint the assets and the revenue and the profits of the operations in the growing industry.

Jeff Large:

Interesting. They almost did it for the reverse reason.

Jon Siebers:

Yeah. Yep. Yep.

Jeff Large:

That's cool. That's clever. Anything else there?

Jon Siebers:

When you're talking structure, it needs to be... M&A is a team sport so when you're talking structure, you need to be including all of the advisors at the table. From a buyer's perspective, you need to have your CPA, your attorney, your bank, your insurance advisor, anyone else, any other trusted advisors, your business broker or investment bank, all those people should be at the table talking about the structure.

Jeff Large:

Does anything change in terms of your advisory board from, say, our last episode when we were discussing selling versus now with the strategic acquisitions? Or does it typically have the same lineup of people that you're consulting with?

Jon Siebers:

Well, from an accounting and legal standpoint, it typically doesn't change. You want experienced people. If you have a good attorney that handles just basic day-to-day contract matters for you or has handled your estate planning but has never done an M&A transaction, that's probably not the best pick for you. Same with an accountant. If there's somebody that just does tax returns for you and nothing else, they don't have that strategic focus and that transactional focus, you probably need to get a different CPA.

When you're dealing with the buy-side, your bank is probably going to be far more heavily involved than they would be if you're selling. The rationale is if you're selling, you're going to pay off the bank debt and you're not going to be a customer of the bank anymore, typically. Whereas on the buy-side, in order to make the acquisition, you're going to need financing that works. And so your banker is probably going to be far more actively involved in buy-side decisions.

In the sell-side, typically your personal financial advisor is going to be more actively involved than on the buy-side because on the sell-side, if you're selling your one and only business and retiring, your personal financial advisor needs to make sure that you're going to net enough proceeds from the sale to be able to retire. On the buy-side, that's not typically an issue.

Jeff Large:

That makes sense. It's not all legal considerations when it comes to a strategic acquisition. It helps when companies are an operational fit, a customer fit, and a cultural fit. And you don't need a lawyer to figure out those variables. But what about once you do get to the legal and financial side of things? Jon explains.

Jon Siebers:

Ease of closing is probably something to be considered, especially if you're a fairly small company. If the buyer is a fairly small company that doesn't have a full-time, corporate development M&A team, it takes a lot of time and... Just like it takes a lot of time and effort to

sell a business, it takes a lot of time and effort to buy a business so you need to make sure that if you're serious about acquiring another company, you think through how are we going to handle all the due diligence? How are we going to handle all the negotiations and continue to run our business? The last thing you want to do is take your eye off your existing business and see declines because you were so focused on this acquisition. In those scenarios, ease of transaction really can come into play as a factor to consider. If you've got two deals you're looking at, one is going to be a company that you know a lot about already or you know a lot about the people and you have a good working relationship with them and you feel like it's going to be a fairly easy deal to put together, that may trump any other deal simply because you're not going to take your focus away from your existing business as much.

Jeff Large:

It feels like just the actual strategy behind it, situations that we can do this. I'm curious from your point of view, what is it really like at the ground level for the owners? With you pointing out the ease of transaction, it just reminded me of a situation of a client of mine recently sold. And for a good month, it was just hell for him. He went through a lot of just turmoil internally with sorting stuff out with his own team. And it didn't sound like it was so much from the other company that was acquiring him, but going through that process was just a very stressful time for him for a lot of different reasons. I'm curious, just as someone who is potentially going to acquire, make a strategic acquisition like this, what can I expect on a day-to-day level?

Jon Siebers:

It really depends on the deal. Really what you're talking about is post-closing integration. What does it look like for the buyer to integrate this new company into the existing company? And it really depends on what resources you have. If you have a full HR team and a full finance department and a full IT team, it's probably going to be fairly smooth, especially if they've done deals before, because you've got people that are experts in those areas that can help make sure that you do things right. If it's a small company buying another small company and you don't have a solid management team in place, it can be a lot more challenging.

And it depends, again, on the company you're buying. If they have good systems in place, good policies and procedures in place, good accounting system that works, maybe you get in there and you don't change anything at all for a year and you just let it run as is, and then you start looking at, well, what can we do to make changes? Again, it really depends on the deal and what resources you have available at your disposal from a buyer's perspective.

Probably one of the bigger headaches that I see from a buyer's perspective is getting in and trying to figure out what inventory they bought, because usually inventory is part of a deal in an asset sale or a stock sale. Usually it's part of the networking capital adjustment. We talked a little bit about that in the last session. You've paid something for the inventory maybe above and beyond the purchase price that you've got in your LOI, and now you're trying to figure out, all right, did we overpay for the inventory? Did we underpay? Do we have inventory that's been sitting in the warehouse for 10 years and nobody's ever going to want it? Those issues can be a real headache for buyers to work through.

Jeff Large:

Can you think of anything specific?

Jon Siebers:

If you manufacture only one type of product and it's all done with aluminum, most of your raw material inventory is probably fungible and can be used for any of the products you're going to produce. But if you've got very specialized products and maybe some of them have been custom made products for particular customers and you've got a bunch of material that you acquired 10 years ago to produce 5,000 products and the customer has only put in a purchase order for 500, you've got a lot of extra raw material inventory sitting around that you probably shouldn't have paid for or-

Jeff Large:

You started digging into those details. That doesn't come through in the due diligence? You would typically do that after?

Jon Siebers:

Some of that does come through. And again, it depends on the deal. But depending on the size of the company and the amount of inventory they have and how willing they are to let the buyers' representatives come in the company and do a full-blown inventory prior to closing, considering that they don't want their employees to know that they're selling the business, a lot of times they don't want you coming in and doing inventory prior to closing, if at all possible. Yeah, in a lot of deals, an actual physical inventory is taken prior to closing. In some deals, it's just not possible.

Jeff Large:

Even that alone I find interesting where it just seems like there's aspects of this process where the buyer and the seller have such drastically different desires, and you have to reconcile that. And a lot of the times for somebody like yourself, you're in the middle. What is a realistic expectation for me in the shoes of buyer of what to expect in this process of, like we're saying, doing this due diligence, this inventory? How can you help me be reasonable? Still get what I want, but also be understanding of the other side.

Jon Siebers:

Well, there are what we call market terms that we try to follow in most deals. And by market terms, what I mean is there's a publication that the ABA, which is the American Bar Association, puts out a publication on M&A deals every maybe 18 to 24 months. And they look at deal terms from sales of private companies. And in that publication, there's probably 150 pages of statistics dealing with different provisions in the purchase agreement, how you structure the purchase agreement, what risks the buyer is taking, what risks the seller is keeping. Really, when you say you want to be reasonable in a transaction, what you're really looking to is are we within the range of values in that ABA study? And M&A attorneys constantly talk about, "Well, that term isn't market." Well, why isn't it market? Show me the statistics that say it's not market. We use that as a tool to keep each other in check.

What I typically tell a buyer or a seller is, "If you're a seller, you shouldn't be taking on any more risk with any particular buyer than you would with any other buyer." And the vice versa is also true. If you're a buyer, you shouldn't be taking on any more risk with seller A than you would with seller B, C, D, or E. And again, that comes to how do we structure it? What's in the asset purchase agreement?

You talk about inventory issues. If you can't get in to do an inventory, how are you protected as a buyer? Well, there's going to be a representation and warranty in the purchase agreement

that says, "I'm selling you inventory that's saleable and usable in the ordinary course of business." And if it's not, then the buyer has a claim for indemnification against the seller.

Jeff Large:

Okay. Interesting. I'm hearing that it just sounds like almost probably somewhat moving standard.

Jon Siebers:

It is. The market terms shift over time. And with the rep and warranty insurances is an insurance product that oftentimes is used in M&A deals. And it's been around for a long time, but it's come downstream in terms of the deal size that people are using it in. And rep and warranty insurance has had a fairly significant change on market terms since it's expanded in the marketplace.

Jeff Large:

That makes sense. How do I reduce my risk when acquiring another company?

Jon Siebers:

You reduce your risk by trying to put as much of the risk as possible back on the seller, but the seller's trying to do the same thing. It's what's good for the buyer is bad for the seller, and vice versa. And that's true in a lot of different things in M&A, and particularly in certain tax provisions. For instance, in an asset sale, the buyer and the seller have to allocate the purchase price among the assets that are being sold. And the IRS has guidelines on how you do that, but the buyer and the seller have to use the same allocation. And an allocation that's good for the buyer is typically bad for the seller, and vice versa. That's a fairly common theme in M&A.

Another thing that I always recommend for buyers is... And this would be true not just in a strategic acquisition, but any acquisition. Even if you don't need seller financing to close a deal, I recommend trying to have the seller agree to seller finance a portion of the deal; maybe it's only 5% or 10% of the purchase price. But when you do that, the seller is not going to collect the full amount of the purchase price until after closing, and it's going to depend on how smooth the transition goes and how well things perform after closing. It gives the seller some skin in the game if you have seller financing involved.

Jeff Large:

Yeah, yeah. It sounds like it keeps the other party accountable maybe a little longer. That makes sense.

Jon Siebers:

Or a lot of times in certain deals, the seller will roll over some equity. They may own 100% of the seller entity, but they're going to own 10% or 15% of the buyer buyer entity. And that too helps to keep them honest because at some point they're going to want to cash out that 10% or 15% that they bought in the buyer, and it's going to depend on how well that transition goes, just like if they had seller financing. It helps keep the seller honest and invested in the process.

Jeff Large:

Yeah. Is there anything that I should just straight out avoid or red flags when it comes to this strategic acquisition process?

Jon Siebers:

It's tough to answer that because what I always tell people that are looking to buy a business is before we start looking at all the legal issues and the tax issues, it first needs to make sense from a business perspective. I think that's probably the biggest cautionary note is you need to make sure that there are fundamental business reasons for doing a deal before you go down any road towards drafting documents and doing full on due diligence.

Usually in an acquisition, the buyer and the seller have negotiated a purchase price, and a lot of the due diligence is simply to confirm that the value in that purchase price is there in the company. It's a business transaction before anything else. And you need to make sure it makes sense from a business perspective. My role, I feel, is not to tell a buyer, "Don't buy this business," it's to tell the buyer what the risks are if they do buy it and help to try and mitigate or avoid those risks.

Jeff Large:

Yeah, that makes sense. What do you feel like you get asked most? Are there any questions that you find that frequently come up that maybe we haven't covered yet?

Jon Siebers:

A lot of times, people want to know how long it's going to take to close a deal, they want to know what the legal fees are going to be for a deal. And it's really hard to answer either of those questions until we know how much work is going to be involved. In a deal where there's real estate involved, it's probably going to take longer because you're typically going to go through environmental due diligence, get a survey. You're going to get all the title work. That can take time. Usually timing, if there's no third party due diligence requirements, in other words, you don't have to hire an environmental consultant or a surveyor, you don't have to bring in a title company, you don't have to bring in a quality of earnings report, when you're not relying on third parties to provide their due diligence reports, then it's just between the buyer and the seller to determine what the speed is going to be. Same with bank financing. If there's no bank involved, the bank isn't going to have any say in how quickly we close a deal. But the more third parties you add to a transaction, usually the longer it's going to take because you have to work through all their timelines and all their processes before you can get to a closing table.

The cost is deal dependent too. Usually there are two factors that drive legal fees in an acquisition. Same with a sale. One is negotiation. How long are we going to have to negotiate to get to a deal that we feel is appropriately risked to the buyer? The more complicated, the more due diligence, the more negotiated the deal is, typically the more expensive it's going to be and the longer it's going to take to close.

Jeff Large:

What do you wish more sellers either thought about or perhaps had ready before they approach their attorney, before they approach somebody like you with something like this?

Jon Siebers:

Probably a couple things. Number one, most sellers think their businesses are worth more than they actually are. When I deal with sellers who have realistic opinions of the value of their business, it tends to be easier to get a deal done because you're not constantly dealing with the pressure to respond to their inflated value. Now, that's not a legal issue, it's just a bigger picture deal issue, but that can be a big issue. Usually though, a deal where the seller has unrealistic

expectations of their value, you're not going to get past the LOI phase. You may not even get to an LOI phase because the parties can never agree on price.

Another would be having a seller understand what is market in terms of how we shift risk between the buyer and the seller. Usually if they have good counsel, that's not an issue because their attorney is going to explain that to them and walk them through it. But if they have inexperienced deal counsel, it's going to be an issue. I guess that's another thing is having sellers come to the table with experienced deal counsel makes my job a lot easier because I'm not having to educate the other side on what's market and what's not, they already know it just like I do. I think networking capital, understanding the role of networking capital in an acquisition setting, that it can be very complicated for people who have never really paid any attention to networking capital and what it means to their company. If they're learning it for the first time in a transaction, it can cause headaches for all the advisors, including the seller's counsel and tax advisors.

Jeff Large:

Is there an opportune time to get my attorney involved? Should it be I'm thinking about selling and I give my attorney the heads up? Or is it something that maybe I find a couple of different companies that perhaps I'm thinking about acquiring, then I get them involved? Where's the opportune time for that?

Jon Siebers:

I usually suggest that if you're thinking about doing an acquisition, let your attorney know. And you can have at most a brief chat about what it is you're looking for. Maybe the attorney has potential seller prospects for you. Letting the attorney know that you are looking at doing an acquisition may help you find companies. The attorney's probably going to start asking some questions that are about things that you need to be thinking about during the search process. The last thing you want to do is go a long ways down a road and then find out at the last minute just when you're ready to negotiate an LOI that for some legal reason, this is a really bad fit. The sooner you can have your attorney involved in those discussions, the better. Same with transaction structure. If there's a really big issue with structuring it as a stock sale versus an asset sale or vice versa, the earlier the attorney can be involved in that discussion, the better because you can avoid problems that you've got a lot of time sunk into.

Jeff Large:

It's all the time saving. It's all the whole preparation versus dealing with post issues.

Jon Siebers:

Yeah, and a lot of times I don't get actively involved. I may have a chat here and there with a client who says, "Hey, I'm looking to buy another company. I'll keep you posted." We'll talk generally about what they're looking to accomplish, how they're sourcing their potential targets, things like that. And then they may keep me up to speed every couple of weeks or every couple of months depending on the timing on where they are and what they're looking at, and then I can ask a few questions and just make sure we're tracking in the right direction.

Usually, I don't get actively involved until there are documents to review. A lot of times, if the seller is represented by a business broker or a investment bank, the business broker or the investment bank will provide a nondisclosure agreement for all prospective buyers to sign prior to getting any confidential information about the target. Seller clients need to understand this

too, but buyers really need to understand that all NDAs are not the same, especially if you're competitors in the same market. If you're looking at buying a competitor in your market, you need to be very cautious about what's in that nondisclosure agreement because some nondisclosure agreements have non-solicitation provisions. I've seen non-compete provisions. They have all sorts of things that can impact your ability to continue to do what you're doing today. You want to make sure that signing and nondisclosure agreement as a buyer doesn't prevent you from operating your business in the ordinary course. But some NDAs could do that, so it's critical to have your attorney review an NDA before you sign it. A lot of people think all NDAs are the same, but it's just not the case.

That's usually a fairly short scope of work to review and negotiate an NDA. Usually I get far more actively involved when there's a letter of intent being negotiated. And then I'm either drafting it or reviewing the other side's LOI. And that's where the rubber hits the road from my perspective, because now we're going to start spending time and money on due diligence and drafting documents.

Jeff Large:

That makes sense. Is there anything that we haven't covered yet that you want to make sure our listener knows about strategic acquisitions?

Jon Siebers:

I think the biggest thing is just to make sure that you understand that if you do a strategic acquisition the right way, it can add a lot of value to your existing entity, but if you do it the wrong way, it can take away a lot of that value too. In a strategic acquisition setting, you really need to make sure that not only are you vetting this company the same way that any buyer would look at any company, but you're also looking at what's the fit going to be after closing? Is this going to help me achieve my strategic goals? And how certain are we that we're going to get what we think we're going to get out of this deal? Because the last thing you want to do is go into a deal where you think you're going to increase the value of your company by 40% by doing a strategic acquisition only to find out that you lost 40% of value in your company because it was a bad deal. It took your focus off things. There were liabilities you took on that you didn't realize, operationally it wasn't a good fit, et cetera.

Jeff Large:

It's important to remember that acquisitions do come with risks for both parties. Jon is reminded of some deals that negatively affected both the buyer and the seller.

Jon Siebers:

I have had a number of deals where after closing... And I've seen this from the buy-side and the sell-side, where after closing, the parties realized that this was such a bad fit that the only real option at that point was to undo the deal. Now, putting together an M&A transaction, putting together an acquisition is a lot of work, and it's a lot of time and a lot of effort. Breaking up a deal is even worse because once you put these two webs together, they're all completely intertwined and tangled, it's really hard to break those up depending on how you structure the deal. Now, if you run it as a subsidiary, you didn't combine any operations, you didn't combine any employees, you have no customer crossover, things like that, maybe then it's not so difficult, maybe then you just spin off the subsidiary that you bought. But if you essentially merge

the target into your existing business and then find out it doesn't work, that can be a real challenge.

And that's why I tell people that if you can hold off on combining the two companies together... And I don't necessarily mean legally, but just operationally for some period of time after closing, just to make sure it's a good fit, to make sure you understand what you've got, what you bought, the better off you'll be. Because if it's not a good fit, it's a lot harder to undo it once you combine the two.

Jeff Large:

A big thanks to Jon Siebers for sharing his time and expertise on today's show. If you have a question about growing your business through an acquisition, consider reaching out to Jon or one of his peers. You can learn more at rhodesmckee.com. That link will be in the show notes.

Conversations with a Business Attorney is a project from Rhodes McKee, and it's produced by Come Alive Creative. Thanks to Rachael Workman, Isadore Nieves, Elaine Moore, and everybody who helped make this show possible. I'm your host, Jeff Large, and please do me one favor. If there's someone else in your life who is going through an acquisition or just could use some legal advice on their business, please share this episode with them. Your shares go a long way.