Stay Tuned
The M&A Sector of the
Building Services Industry:

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STAY TUNED – *Periodic Update For The Building Services Industry's M&A Sector*

The state of the M&A sector of the building services industry is alive and well (almost). There remain some uncertainties as a result of the world economic downturn in 2008, but living with that uncertainty has now become the new normal, so some sellers that held off selling their businesses have now decided that it may be the time to proceed with that effort. As in the case of any transaction that has significant importance to the parties involved, selling or buying a business that is engaged in the building services industry can encounter some bumps along the way. This issue of STAY TUNED will address some of those bumps and suggestions about how to avoid, or to deal effectively with them. Additionally, some basics about the closing process will be discussed.

THE M&A PROCESS; SOME PITFALLS TO EXPECT

In The Beginning there was a seller and a buyer. Each has interest in what the other has to offer, so the process that can end with a successful transaction begins with great expectations and a mutual confidentiality agreement in place. Here we go.

The usual sequence of events that will lead to a closing is:

1. **The Initial Discussion** between the parties is usually an overview and the opportunity to take measure of the other side. Frequently, this initial meeting can reveal whether or not one's initial prior perception was correct, or not. It will certainly reveal things about the other that were not known and may change one's perception of the other, either in a positive or negative way. There can also begin to develop a view of the other in a personal sense. Will one enjoy working with the other person? Is there mutual trust? A second and third meeting may follow, during which more detail is discussed. Copious notes taken by each party is a good idea to be referred to throughout the process. At this point, a transaction is still in the distant (probably months) future, if there is to be one at all. After the initial

meetings have taken place and both parties are still interested in taking the next step, it will be time to take that next step.

2. **The Term Sheet** is an informal, non-binding document that, in written form, presents the highlights of what has been discussed and agreed. Usually, the Term Sheet development is a joint effort and may go through several revisions. In some cases, it may be skipped, going directly to a Letter of Intent (LOI). By this time, advisors on each side are advising their clients, so they too have a hand in the Term Sheet development. It is wise to remember that the Term Sheet is important in that, when developed, it will reveal more about the other side. In final draft form, there should be a meeting to make sure that there is clarity. If conflicts arise, it is usually at this stage. When completed and agreed upon, it is time to go to the next step. (Remember; the process is still at the stage where only those that need to know, should have any knowledge that discussions are taking place.)

3**. The Letter of Intent (LOI),** like the Term sheet**,** is non-binding, although there may be certain parts that are binding (confidentiality is one example). It is usually written by the Buyer's attorney. It will be sent to the Seller's attorney for review and comment. Working together, the attorneys will provide a final draft to their clients for approval. The LOI will often describe a price, a transaction structure and dates for the due diligence process and closing. There may be additional confidentiality requirements for each party, including a non-solicitation provision for the Buyer who will now have access to the Seller's individual account information during the due diligence process. Agreement on the terms of the LOI is a significant step, and one that, in most cases, is a sure sign that the transaction will proceed to a closing. It is at this stage, if not before, that advisors, both internal and external, will necessarily be brought into the process, although if the Seller or the Buyer is represented by an *M&A* intermediary, they will likely have been involved from the beginning of the process. It may be wise to discuss the importance of confidentiality to all at this point. In some cases a confidentiality agreement may be a wise precaution for all that are involved in the process. The Buyer must, at this point, provide information about their ability to finance the transaction, including their cash contribution, the lender's cash contribution and a letter of commitment from the lender stating that the financing will be provided and, under what conditions. Now; it is time for due diligence.

4. **The Due Diligence Process** begins after there is total agreement as expressed in the LOI. The process will be the buyer's effort to confirm what has been purported by the Seller with regard to all financial records, performance, operations, management infrastructure and more. In short; it is the time when the Buyer has the opportunity to see and be made aware about all aspects of the Seller's company. If the Seller and advisors have done their job well, there will be few, if any, surprises. Sometimes, the Buyer's internal staff performs the due diligence; other times, the Buyer may elect to outsource some of the task, usually to an accounting firm. If not provided before, now is the time for the Buyer to produce final arrangements for financing the project including a formal commitment from the lender. A concurrent effort will be underway for the Buyer's attorney to develop all of the closing document drafts. Due diligence is not only for the Buyer to make sure that what has be purported about the Seller's company is verified, but it also a time for the Seller to verify that the Buyer will have the financing to complete the transaction in the form of a lender commitment letter and any other sources of funds that will be required to complete the transaction.

5. **The Purchase Agreement and Other Closing Documents**, usually after some minor revisions, are ready to be signed by each party. When signed, there is one more important step: *funding.*

6. **The Closing** is complete when the funds have been distributed according to the Purchase Agreement. *Let the fun begin.*

Looking at these six steps that will lead to the transaction's closing appears to be easy enough; right? ***No****; it is never easy. However; it can be less difficult when the Buyer and the Seller anticipate possible areas of conflict, giving it thought and developing their own plan for resolution as needed. Conflicts, differences of opinion are bound to occur. Usually, when dealing in good faith and appreciating the other's perspective, the problems can be worked out to each party's satisfaction. The differences can become evident at any time, but it is much better for the major differences to be worked out early in the process, even during the initial meetings. Some of the more common areas of disagreement include:*

1**. Valuation: Not Exact Science**. One person's view of value may be different than another and each can be correct. Value is perceived, based on one's own experience, need, and the perceived effect on the individual or entity. There are, of course, comparable transactions that have taken place, or *rules of thumb* for any given industry that can be cited to support one's valuation, that is, if you can believe what you hear. They may or may not be a reliable indicator of value for another entity. The trick it to have two valuation scenarios that are close and to negotiate from there. Valuation methodology is important too. Is value determined by averaging the past three or four years, or is a better valuation based on a *Trailing Twelve Month (TTM)* calculation? There can be good arguments for these and other methods too. Past financial performance is not the only consideration when assigning value to an entity. Thought has to be given to the likelihood of the past performance continuing, so management depth and their continuing under new ownership has to be weighed too. Other things to consider include: market sectors in which the company operates, customer retention rate, opportunity for growth within the market sectors and market areas served.

2. **The Price Components** can be another area of difference between a Buyer and a Seller. The Buyer may want to use less cash than the Seller wants to receive. Again, there are comparable transactions and rules of thumb to gauge what is usual. Sometimes the percentage of the purchase price that is guaranteed (cash, promissory note) can influence the purchase price, either up or down. Certainly, a cash transaction will have a lower price that one with less cash or a guaranteed promissory note.

3. **Working Capital** is sometimes misunderstood and can be a source of problem. A Seller can look at accounts receivables as being part of their proceeds and a Buyer will consider that the purchase will be of a going concern, *including* the working capital. Each scenario can work, but there will be an effect on price. It usually works out that the Buyer keeps working capital as calculated and agreed by both groups; however, the Seller keeps all cash and retains all debt too. As usual; each transaction is unique, so this is not written in stone.

4. **Notice of the Impending Sale to Customers** can be a source of disagreement. Frequently, as part of the operational due diligence, a Buyer will want to be introduced to a selection of the company's customers, making the Seller somewhat uncomfortable because the closing has not yet occurred. There are ways around this that will satisfy both the Buyer and the Seller, one of which may be for the seller to secure a letter of good standing from the customer.

5. **Key Employee Interviews** by the Buyer group before closing is another possible source of conflict. The Buyer wants to make sure that key managers are onboard, plus it provides a one-on-one time to assess the depth of management. Sellers may be reluctant to reveal their intention to sell, perhaps because there is still a chance that the transaction will not happen. Sometimes the interviews are conducted with both the Buyer and the Seller present. Most of the time, whatever the format and whomever is present, interviews will need to take place.

6. **Feeling, or Evidence of Dealing in Bad Faith** can develop in either group at any time during the process; and when it does, no matter at what stage the process is, ending the process should be considered. It doesn't happen too often, but when it becomes evident, it is often too risky to proceed. Integrity and good faith deliberation should always be expected. There will always be other opportunities.

7. **Too Much Elapsed Time** can have a negative impact on the possibility of completing a successful transaction. If the process is slowed due to principal or advisor schedules or becoming bogged down with trivial (*one can argue that there are no trivial matters when buying or selling a company*) matters, it is quite possible that one or the other will become less enthusiastic about going forward. Priorities can change. One side may get the impression that the other is stalling for some reason. The effort needs to be thorough and deliberate, but taking too much time can cause unnecessary delays, confidentiality leaks and in some cases, lead to the disintegration of the process. Momentum lost; the deal languishes and may not close.

8. **Look Out For The EGO Effect**. Everyone has ego, but in the matters of mergers and / or acquisitions, it's better to check one's ego at the door. Winning or conceding a point can sometimes make or break a deal. Usually compromise on both sides of the table is necessary for the completion of a successful deal. If one's ego gets in the way, even when common sense dictates compromise, it can cause a deal to crash. Many speak of wanting a *win-win* deal, but hyper-egoism makes a *win-win* deal far less likely.

9. **Greed Can Become Evident** at any time. Sometimes it can be related to egoism, but it usually is the case when one side or the other acts or makes demands that are unreasonable, without concern about whether or not it is fair or reasonable to the other. A sign of greed is when one side makes such a demand near the end of the process, calculating that the other side has come too far to not go forward with the transaction and that the demand will be met. The other side needs to breathe deeply and look at the big picture, to agree, or simply say; *no*, letting the chips fall where they will.

10. **The Standoff** refers to a situation in which one side or the other refuses to take the next step unless the other takes a step *first*. Usually, this is an indication that there is a problem between the parties. It may be mistrust, or it could just be an indication that each party is looking for a way to end or alter the transaction features that have already be agreed upon. It may also be the result of one party feeling that their side has done most of the compromising and that the other side needs to compromise more. The *standoff* is not a good sign and, unless someone can break the log jam, the project will likely falter and die.

11. **Going Dark**. In other words, one side or the other side, ceases to communicate. This is not a good sign. Even if traveling, or there has been some unexpected crises that prevents active communication, there is always a way to send a short email to indicate when the process will resume. *Going dark* often means that one or the other side is beginning to back out for some reason, or, at least, is reevaluating whether or not to proceed. That can happen, but *going dark* is not the way to express it. One can always be direct and truthful.

12. **Finally, The Closing Crazies** happen. This refers to a plethora of small, often inconsequential issues that seem to appear out of thin air. Perhaps it is because of pent up fear or reluctance about the impending sale by each party. It is sometimes referred to as, *Buyer's remorse*, or *Seller's remorse*. It usually passes, but has been known to cause a delay in closing. The usual cure for this is to take a little time out, thinking through all options.

Looking at these twelve pitfalls that can occur does not necessarily mean that they will occur. However, if you are a prospective buyer or seller, these and others are things for which one should be prepared.

Most of the time, the process will continue to closing after the *Term Sheet* milestone has been reached. Not all, if any, of the pitfalls shown here will happen, but it is better to be on the lookout in case they do occur. The process, even if terminated at some point, can often be resumed. If the acquisition has merit, but ended for some reason, one or both parties may, upon second thought, want to resume. It has happened more than once.

Merger and acquisition activity is a business fact of life in all industries, including the building services industry. For a buyer, it can be a good way to grow; for a seller, it can be the means for a company's legacy to continue as well as a means for shareholders to realize the fruits of their daring, sacrifice and work over many years.

*I invite your comments, questions and criticism for this issue of **Stay Tuned**. What is written herein is based on my personal experience in the M&A sector of the building services industry over many years and before that, as a building service contractor that experienced the sale of his own business. Your comments, questions and criticism will be appreciated. Thank you. Stay Tuned.*

Regards, Gary
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STAY TUNED!

Gary

PS See the attached list of a few of the companies that GPA is currently representing. Please contact us for further information about these offerings or, if you have interest in exploring the sale of your company.