Index

Accountants, 73, 76, 167, 168, 258, 262, 265, 293, 294
Accounts payable, 257, 326
Accounts receivable, 147, 150, 162, 180, 257–259, 328
Accredited investors, 218, 228, 301
Accretion/dilution analysis, 35, 36
Acquisition agreement
provisions of, 161–163
representations and warranties, 162–164.
See also Representations and warranties
Acquisition costs, 186
Acquisition process. See also Asset
sale/purchase; Stock sale/purchase
advising clients on, 82, 83
approaching target company, 33, 34
bid, 38
case studies, 42–47
deal structure, 37, 38
deep dive, 34, 139, 255. See also Due
diligence
due diligence, See Due diligence
filtering targets, 32, 33
framework for, 31
integration of companies, 41, 42
iterative nature of, 31, 237
letter of intent, 34, 38, 39
lower-middle market versus middle market
deals, 34, 35
phases, 31
practical tips, 47–49
skill sets required, 49
sources of targets, 32, 33
strategic buyer’s valuation perspective,
35–37
timeframe for, 32
Adjustments
annual financial statements, 258
audits, 260, 268
balance sheet, 258
discretionary expenses, 141, 276
due diligence adjustments, 269
EBITDA, 21, 98, 140–142, 149, 275–279,
324, 325. See also Earnings before
interest, taxes, depreciation, and
amortization (EBITDA)
excess owner compensation, 21, 140, 141,
276, 277
income statement, 258, 269
interest expense and income, 142, 277
one-time expenses, 98, 141, 276, 277
partnership basis, 211
purchase price, 113, 145
unposted (waived or passed), 260, 268
valuation, 275–278
working capital, 43, 154, 258
Advertising, 77
Advisors
advertising, 77
attorneys, 151–153
audit accountant, 73
business brokers, 73–75, 132, 133
buy-side clients. See Buy-side
representation
Certified M&A Advisor (CM&AA), 134,
294, 295, 307, 308
client assessment and advising, 79, 81
coopervestment rights, 119
confidentiality issues, 83, 84
deal attorney, 73
due diligence consultant, 74
genagement letter/agreement, 84–88
ethics, 135, 136
expert status, obtaining, 78
fees, 86–88, 237
financial advisor/wealth manager, 73, 74
financial analysis, preliminary, 82
growth of industry, 131
integration manager, 73, 74
intermediaries, 73–76, 132, 133
Advisors (continued)
investment bankers, 73–76
licensing, 88–90
marketing, 76, 77
mores of clients, understanding, 78, 79
networking, 76, 77
operational consultant, 73
pretransaction consulting, 77
private business clients, understanding, 78, 79
process, advising clients on, 82, 83
professional standards, 134–136
role of, 73, 74, 113, 132, 292, 293
sell-side clients, 77, 78. See also Sell-side representation
services provided, 133
skills required, 133
strategic advisor, 63
success factors, 133, 292
tax professionals, 73
valuation, advising clients on, 82
valuation experts, 73
Affiliated person, 301
Agency costs, 242
Agreements and legal documents
acquisition agreements, 161–164
asset sale/purchase, 112, 113
assignment of third-party contracts, 113, 115, 160
attorneys, role of, 151–153
buy-sell agreements, 130
client engagement letter/agreement, 84–88
compensation agreements, 129
confidentiality agreement, 153, 154
consulting agreements, 161, 180, 181
contracts, due diligence, 263
disputed terms, 113, 114
employment agreement, 113, 115, 161
escrow agreement, 113
letter of intent. See Letter of intent (LOI) mergers, 129
noncompete agreement. See Noncompete agreements
non disclosure agreements (NDAs), 92, 95, 99, 101, 105, 106, 124, 186, 264, 324
partnership agreements, 129
schedules, 113
sell-side representation, 92, 112, 113
shareholder agreements, 129
stock sale/purchase, 112, 113
terms and conditions, changes in as deal killer, 114, 115
types of in M&A transactions, 113
Alliance of Merger & Acquisition Advisors (AM&AA), 134–136
Alternative asset class, 301
Alternatives to acquisition, 30, 31
Amortization
recapture, 185, 187, 188, 190
tax considerations, 172, 174–176, 178, 180, 183–187, 189, 190
Antidilution clause, 149, 302, 328
Antitrust laws, 221–223
Asset-based lenders (ABLs), 247, 248, 302, 314, 315, 329
Asset buyers, 21
Asset (Type C) mergers, 128, 202, 204, 205, 213
Asset sale/purchase
asset allocation, tax considerations, 173, 181–185, 189
balance sheet analysis, 148
buyout investors, 237
deal structure, 106, 107, 157–160
financing, 237–239
installment sales, 107, 193–196
I.R.C. Section 338(h)(10) election, 160
partnership doctrine, 197, 198
purchase agreement, 112, 113
purchase price allocation, 179, 180, 199–201
stock sale compared, 106, 107, 175–177
tax consequences, buyers, 172, 173, 185–188
tax consequences, sellers, 173, 174, 182, 183
third-party consents, 160
Assets
hot assets, 175
intangible assets, 149, 186–188, 257
mark-to-market gain on distribution of, 198
personal assets, 148, 150
unrelated, income from, 142
Attorneys, 73, 76, 151–153, 265, 293, 294
Auctions, 38, 39, 102–106
Audit adjustments, 260, 268
Index

Balance sheet  
adjustments, 258
cash, 149, 150
debt, 149
due diligence analysis, 257, 269
equity, 149
financial analysis, 142–150
fixed assets, 148
intangible assets, 149
in marketing book, 98
privately held companies, special considerations, 149, 150
working capital, 142–148
Bankruptcy  
described, 302
and special situation funds (turnaround funds), 250
type G reorganizations, 202, 206
Basis  
partnership, 211
stepped-up basis, 106, 160, 172, 173, 200, 203, 207, 260, 261
stock, 174
Basket provisions, 114, 164, 302, 303
Behavioral risk/return, 11
Belgium, 58
Benefit stream  
calculation, 273, 275
present value, 286–289
Blue-sky laws, 89, 215, 228, 229, 303
Book. See Marketing book
Book value, 20, 24
Boot, 201, 203–205, 303
Breakup fees, 111, 155, 303
Bridge financing, 247, 303
Broad (public) auction, 103, 105, 106
Broker-dealers  
FINRA Series 7 registration, 227
FINRA Series 62 registration, 227
FINRA Series 79 registration, 224, 227
registration under Securities Exchange Act of 1934, 90, 225, 226
regulatory compliance, 88–90, 219, 224–227, 229
Built-in gains tax, 208–210, 212
Bulk sales laws, 223, 224
Business bankers, 7
Business brokers, 7, 73–75, 132, 133
Business entities, 304, 305. See also specific forms of business structure
Business growth, 131, 132
Business plan. See Marketing book
Business ValueXpress™ (BVX), 299
Buy-sell agreements, 20, 24, 130, 306
Buy-side representation
attorneys, role of, 151, 152
co-investment rights, 119
decision matrix (filter), 119, 120
engagement, 119
fees, 86, 119
financing, 120
type of, 11–14, 94, 95. See also specific types of buyers
Buyout fund, 232, 306
Buyouts, 232–237
C corporations  
capital gains tax, 169, 171, 173, 174, 183, 189
described, 304
double taxation, 169–171, 173–175, 180, 183–185, 311
mergers and reorganizations, 127, 202–206
tax considerations, 168–175, 182–184, 198
tax rates, 169
CapEx. See Capital expenditures (CapEx)
Capital asset pricing model (CAPM), 282, 306
Capital expenditures (CapEx)  
described, 306
financial disclosures, 98
and growth, 48, 98
and IT due diligence, 265
INDEX

Capital expenditures (CapEx) (continued)
negative adjustments to EBITDA, 141, 142, 276, 277
tax considerations, 189
Capital gains tax, 169–175, 179, 181–184, 189, 190, 306
Capital markets, 3. See also Private capital markets
Capital providers, risk and return management, 7–11
Capital stock, 155, 306
Capital structure described, 239, 240
factors influencing, 243–246
and financing strategy, 239
optimal strategy, 240–243
Capitalization of assets, 189
Capitalization rate, 287, 288
Cash balance sheet, 149, 150
consideration, 108
working capital, 144, 145
Cash flow benefit stream, 273
and buyout deal structure, 234, 235
defined, 307
EBITDA. See Earnings before interest, taxes, depreciation, and amortization (EBITDA)
intangible assets, 149
and lending, 247, 250, 289
quality-of-earnings assessment, 121.
See also Quality-of-earnings assessment
shareholder objectives, 244
Certified M&A Advisor (CM&AA), 134, 294–295, 307–308
Change of control, 232, 263, 307
China, 56, 57, 61
Clayton Antitrust Act, 221
Client assessment and advising, 79, 81.
See also Advisors
Client engagement letter/agreement, 84–88
Clients for Life: Evolving from an Expert-for-Hire to an Extraordinary Adviser (Sobel), 292
Closings, 114, 115, 129
Co-investment rights, 119
Collateral value, 19, 20, 23, 26
Comfort letter, 120, 308
Commercial banks/bankers, 7, 8, 33, 76, 239, 247, 308
Common stock, 199, 208, 235, 308
Company profile. See Marketing book
Comparable company valuation method, 284, 289, 308
Compensation agreements, 129
below-market for related parties, 142
due diligence, 256, 262
excess owner compensation, 21, 140, 141, 276, 277
and mergers, 126
Confidential business report (CBR). See Marketing book
Confidential information memorandum. See Marketing book
Confidentiality agreement, 153, 154, 230
Confidentiality issues, 83, 84
Consents, 113, 160
Consolidated Communications (CNSL), 44–47
Consulting agreements, 161, 180, 181
Contracts. See Agreements and legal documents
Contributing mergers, 128, 201, 202, 210
Controlling interest, 231, 232, 234
Corporate capital gains tax, 169, 171, 173, 174, 183, 189
Corporate development acquisition alternatives, 30, 31, 47
acquisition process, 31–42, 49
acquisitions, reasons for, 28, 29, 48
case studies, 42–47
decision to acquire, 47, 48
overview, 27, 28
practical tips, 47–49
sale of business, reasons for (Dismal Ds), 29, 30, 55. See also Motives
Cost of capital, 6, 7, 11, 17, 35, 36, 235, 241, 250, 282, 283, 310. See also Weighted average cost of capital (WACC)
Cost of equity, 282, 283
Cost segregation studies, 185, 188, 189
Index

Credit boxes, 9
Current ratio, 259, 310

Data collection, 91–94, 129
Data room, 94, 102, 105, 112, 299, 310

Databases
acquisition multiples, 284, 285
of buyers, 100, 101
online resource, 299, 300

Deal flow, 76, 77, 310

Deal structure
acquisition agreements, 161–164
asset sale/purchase, 157–160
attorney’s role, 151–153
confidentiality agreement, 153, 154.
See also Confidentiality agreement
consideration, 160, 161
consulting agreements, 161
earnouts, 164–166. See also Earnouts
employment agreements, 161. See also Employment agreement
I.R.C. Section 338(h)(10) election, 160
letter of intent, 154–157. See also Letter of intent (LOI)
mergers, 127–128
overview, 37, 38
purchase price, 160
regulatory compliance. See Regulatory compliance
representations and warranties, 162–164
sell-side representation, 106–109
stock sale/purchase mergers, 155, 157, 158, 160

Debt
financial analysis, 149
leveraged buyouts. See Buyouts
personal guarantees, 149, 150, 251–253
ratios, 9, 241, 252, 310
recapitalization, 232, 237, 328
risk, 10
sources of lending, 247

Decision matrix, 119, 120
Deep dive analysis, 34, 39, 139, 255.
See also Due diligence
Defense Production Act, Exxon-Florio provision, 223
Deferred consideration, 107

Depreciation
accelerated, 301
recapture, 181, 190, 194, 198, 207
tax considerations, 172, 174–176, 181, 182, 185–186, 189, 190
disclosures, 21, 84, 86, 97, 98, 113, 139, 163, 220, 229
discontinued operations, 141
discount rate, 6, 7, 18, 286–288, 311
discounted cash flow (DCF), 6, 35, 289, 298, 299, 311
discretionary business practices, 276, 277
discretionary expenses, 141, 276
dissenting shareholder cases, 22
dividends and distributions, 169–171, 173–175, 180, 183–185, 311
dissocative D reorganizations, 205, 210
dividend valuations, 22
dodd-Frank Act, 226
double Lehman formula, 87
double taxation, 169–171, 173–175, 180, 183–185, 311
due diligence
attorneys, role of, 151, 152, 265
compensation and benefits, 256, 262
consultants, 74
contracts, 263
deep dive analysis, 34, 39, 139, 255
described, 312
employee benefits, 256, 262
equity structure, 263
financial matters, 255, 257–259
financial statements, 258, 268, 269
GAAP compliance, 259, 260
global mergers and acquisitions, 51–54, 56–61, 63, 67, 69, 70, 267
industry issues, 256
information technology, 256, 264, 265
intellectual property, 263, 264
international operations, 267
inventory, 147
key employees, 264
legal compliance, 256, 263–265
liens, 264
litigation, 264
mergers, 128, 129
process, 258, 266
public versus private companies, 266, 267
quality of earnings, 268
reliance on, 267
Due diligence (continued)
sell-side, 111, 112
strategic, 38–40
tax impact and compliance, 255, 260, 261
team members, 49, 265, 266
timeline for, 266
traditional, 38, 39, 255–265
transaction life cycle, 256, 261, 266
working capital, 146, 147

Earnings before interest, taxes, depreciation,
and amortization (EBITDA)
basis calculation, 143
debt ratios, 9, 235
defined, 312
due diligence, 259
financial disclosures in marketing book, 98
negative adjustments, 141, 142
normalization adjustments, 21, 98,
140–142, 149, 275–279, 324, 325
normalized calculation, 144
positive adjustments, 21, 98, 140, 141
quality of earnings assessment, 268
recast EBITDA, benefit stream calculation,
275–279
valuation multiples, 6, 13, 284

Earnings before interest and taxes (EBIT),
279, 312

Earnouts
benefits of, 37, 165
deal structure, 108, 109, 116
described, 164, 165, 312
disadvantages of, 165, 166
installment sales, 194–196
parameters, 165
representations and warranties, 163
use of, 10, 37, 160, 161, 164, 194, 195, 237

EBIT. See Earnings before interest and taxes (EBIT)

EBITDA. See Earnings before interest, taxes,
depreciation, and amortization (EBITDA)

Economic costs, 23
Employee benefits, 126, 256, 262, 264
Employee stock ownership program (ESOP),
20, 312
Employment agreement, 113, 115, 161, 262
Engagement
buy-side representation, 119
letter/agreement, 84–88

Entity structure, tax considerations,
168–171
Equitable distribution, 22
Equity
balance sheet analysis, 149
debt provisions, 149
defined, 312
due diligence, 263
shareholder debt versus equity, 150
Equity kicker, 250, 320
Equity risk, 10
Escrow, 83, 105–108, 113, 164, 194, 195,
210, 237, 312
Escrow agreement, 113, 210
Estate planning
family businesses, 132
preparation for business transfer, 80
and purpose of valuation, 18, 19
Ethics, 135, 136
Evergreen funds, 36, 248, 313
Exit
buysouts. See Buysouts
and long-term shareholder objectives, 231,
232
recapitalization (partial exit), 232, 237,
328
strategy/planning, 68, 77, 78, 248, 292,
293, 313
Expert status, obtaining, 78
Experts, valuation, 73

Failure, reasons for, 115
Fair market value, 17–20, 22, 25, 26,
185
Fair value, 20, 22, 185
Fairness opinion, 76, 313
Family businesses, 131, 132, 267
FAS 141R, 185
Fees
advisors, 86–88, 119, 237
breakup fees, 111, 155, 303
Filters (screens)
buy-side, 119, 120
corporate development, 32–34
private equity groups, 100
Financial Accounting Standards Board (FASB),
described, 313, 314
FAS 141R, 185
valuation authority, 20
Financial advisor/wealth manager, 73, 74
Index

Financial analysis
balance sheet, 142–150
EBITDA. See Earnings before interest, 
taxes, depreciation, and amortization
(EBITDA)
financial performance, 139, 140
financial ratios, 259
and motives for financial reporting, 139,
140
overview, 139
preliminary, 82
working capital, 142–148
Financial buyers, 12–13, 21. See also Private
equity groups (PEGs)
Financial Industry Regulatory Authority
(FINRA), 224, 226, 227
Financial matters, due diligence, 255,
257–259
Financial ratios, 259
Financial reporting, public companies, 229,
230
Financial risk/return, 11
Financial statements. See also Balance sheet;
Income statement
annual adjustments, 258
audits, 268, 269
due diligence, 257–260, 268–269
normalization adjustments, 140
Financing
acquisitions, 237–240
asset-based lenders, 247, 248
buyers, 120
buyouts, 232–237
and capital structure of company,
239–246
commercial banks, 247
contingencies, 107
debt, 247, 248
and long-term shareholder objectives, 231,
232
mezzanine financing, 249
personal guarantees, 149, 150, 251–253
private equity groups. See Private equity
groups (PEGs)
recapitalization, 232, 237, 328
seller financing, 249
sources and types of, 246–250
Fixed assets, 148
Flow-through tax entities. See Limited
liability companies (LLCs);
Partnerships; S corporations
Form BD, 226
Form S-1, 228, 315
Form S-3 (short form), 228
Form S-4, 228
Formal auction. See Public auction
France, 58
Free cash flow, 21, 235, 315
GAAP. See Generally Accepted Accounting
Principles (GAAP)
General acquisition selling multiples, 281,
282, 284–286
General investor return, 281, 284
Generally Accepted Accounting Principles
(GAAP)
compliance with, due diligence analysis,
259, 260
described, 316
FAS 141R, 185
and financial analysis, 140
Germany, 289
Global mergers and acquisitions
advantages of, 52
best practices, 63–66
cultural understanding, 51–65, 68–70
Defense Production Act, Exon-Florio
provision, 223
due diligence, 51–54, 56–61, 63, 67, 69,
70, 267
factors for success, 70
failures, 52, 58–63
Fellowes, Inc. joint venture in China, 56,
57
Foreign Corrupt Practices Act (FCPA), 60,
67, 69
InBev acquisition of Anheuser-Busch,
58
intellectual property, protection of, 68
labor issues, 53, 59, 67–69
language barriers, 57
legal issues, 53, 58, 59, 62, 63, 66–68
middle market transactions, 14–16
and national security, 223
negotiations, 55–57, 59, 66
overview, 51
tax issues, 68
Going concern, 21, 121, 146, 316
Going private, 230
INDEX

Goodwill
   in asset subworld valuation, 272, 273
   balance sheet analysis, 149
   and Section 1031 exchanges, 196
Governance documents, 263
Gross margin, 98, 108, 109, 121, 275, 280, 316
Gross profit percentage, 193
Growth, financing. See Financing
Growth equity funds, 245, 249, 250
Haircut, 36, 316
Handbook of Financing Growth: Capital Structure, Strategies, and M&A Transactions, 247, 283
Hart-Scott-Rodino Act, 221, 222, 317
Hedges, 9, 68, 317
Hockey-stick forecast, 99, 317
Holdbacks, 194
Horizontal integrations, 12, 21
Hospital Corporation of America v. Commissioner, 188
Hot assets, 175, 317
Hurdle rate, 35, 36, 317
Income statement
   adjustments, 258, 269, 275–277
   due diligence analysis, 257, 269
   example, 143
Incremental business value, 20, 23
Indemnification provisions, 83, 107, 113, 114, 152, 163, 164, 317
India, 61
Individual buyers, 12, 13
Individual capital gains tax, 169–171, 173–175, 179, 181, 182, 184, 190
Individual tax rates, 170, 171
Indopco v. Commissioner, 186
Industry considerations
   benefit stream calculation, 273, 275
   capital structure, 246
   due diligence, 256
Industry research, 94, 95
Informal valuation, 78
Information technology (IT) due diligence, 256, 264, 265
Initial analysis, 123, 124
Installment method, 193, 194, 210–212
Installment sales, 107, 193–196, 210, 211
Insurance on collateralized property, 252, 253
Intangible assets
   balance sheet analysis, 149
   due diligence, 257
   tax considerations, 186–188
Integration
   acquisition process, 41, 42
   and operations, differences in, 125, 126
   planning, 122, 127
   postmerger, 41, 130, 265
   postmerger, global M&A, 51, 54, 59–66, 70
   postsale, 92, 115, 116
Integration manager, 73, 74
Intellectual property
   due diligence, 263–264
   protection of in global mergers and acquisitions, 68
Interest
   defined, 318
   in EBITDA calculation. See Earnings before interest, taxes, depreciation, and amortization (EBITDA)
   expense and income, adjustments for, 142, 143, 277
   imputed, 195
   mezzanine financing, 250
   promissory notes, 161
   seller financing, 249
   tax considerations, 233
Intermediaries, 73–76, 132, 133
Internal rate of return (IRR), 35, 319
Internal Revenue Code (I.R.C.)
   Section 338(h)(10) election, 160, 201, 206–208, 212
   Section 351, 201
   Section 368(a)(1) transactions, 202–206
   Section 382, 211
   Section 374 election, 200, 211
   Section 761, 211
   Section 1060, purchase price allocation, 179, 180
Internal Revenue Service (IRS)
   fair market value, 185
   fair value, 185
   Form 1099-MISC, 180
   Form 8594, 179, 180
   Revenue Procedure 2011-29, 186
   Revenue Ruling 59-29, 22
International mergers and acquisitions. See Global mergers and acquisitions
Inventory, 147, 148, 319
Investment Advisers Act of 1940, 224, 226, 229
Investment advisor registration, 226, 229
Investment bankers, 73–76
Investment banking, 76, 319
Investment Company Act of 1940, 227, 229
Investment criteria, buyers, 118
Investment value, 19–21, 23, 26, 103
Islamic law (sharia), 57
Japan, 57, 61
Joint ventures, 30, 123, 128, 199, 200
Key employees, 109, 110, 115, 121, 154, 155, 161, 165, 262–264
Key performance indicators (KPIs), 130
Labor issues
global mergers and acquisitions, 53, 59, 67–69
union approvals, 115
WARN Act, 223, 224
Large companies, 5, 6
Leases
assignment of, 113, 115
capital leases, 248, 249
lease financing, 248
operating leases, 248, 249
personal guarantees, 253. See also Personal guarantees
Legal compliance due diligence, 256, 263–265
Letter of intent (LOI)
binding provisions, 111, 155–157
contingent conditions, 154, 155
and due diligence, 39
exclusivity (no-shop) provision, 155, 157
issuance of, 120
nonbinding provisions, 110, 111, 154, 155
preparation of, 153, 154
public companies financial reporting requirements, 229, 230
seller receipt of, 109–111
terms, 154
timing of, 38
Letter of interest (LOI), 109, 110
Leveraged buyout. See Buyouts
Leveraging, 88–90
Liens, 264
Like-kind (Section 1031) exchanges, 107, 196, 212
Limited liability companies (LLCs)
described, 304, 305
joint ventures, 128
membership interest, sale of, 198, 199
membership interests, levels and classes of, 199
tax considerations, 168, 170, 171, 175, 181, 182, 190, 196–200
Limited liability partnership (LLP), 196, 305
Liquidation
basis of value, 13, 321
C corporations, 169
described, 321
S corporation, 195
structured liquidation, 81
value of assets and personal guarantees, 251, 252
Litigation due diligence, 264
Loan guarantees
personal guarantees, 149, 150, 251–253
Small Business Administration (SBA), 247
Lower-middle market segment, 5–8, 10, 11, 34, 35
M&A advisors. See Advisors
Management
buy-in, 13, 81
effect of on capital structure, 244, 245
Management buyout (MBO), 13, 75, 81, 97, 234
Marginal cost, 6, 322
Mark-to-market gain on distribution of assets, 198
Market segments, 4–10
Market value
asset subworld, 271–274
benefit stream, 273, 275–281, 285–289
financial buyers, 272, 273
financial subworld, 271–279, 281, 282, 288, 289
global perspective, 289
overview, 20–23, 26, 271
private return expectation (PRE) calculation, 281–285
range of values, 271
reason (purpose) for appraisal, 272
INDEX

Market value (continued)
strategic (synergistic) buyers, 272, 273
subworld determination, 272, 273
synergy subworld, 271–275, 279–282, 288, 289
value calculation, 285–289
value worlds, 271, 272
Marketing
M&A practice, 76–78
sell-side process, 99–102
Marketing book
blind summary (teaser), 95, 100, 101
book summary, 95
contents of, 96–99
data collection, 92
distribution list, 100
distribution of, 101, 102
financial disclosures, 97–99
follow-up with recipients of, 102
forecasts, use of, 99
industry research, 94
motives of seller, 97
preparation of as step in selling process, 91
target market, defining, 94, 95
terminology, 95, 96
timeline for providing, 85
Martin Ice Cream v. Commissioner, 185
Memorandum of understanding, 230
Mergers
agreements and documents, 129
asset mergers. See Asset (Type C) mergers
closing, 129
contributing mergers, 128, 201, 202, 210
cost structure, operations, and culture differences, 125, 126
deal structure, 127, 128
due diligence, 128, 129
initial analysis, 123, 124
integration plan, 127
LLC joint ventures, 128. See also Joint ventures
negotiations, 125, 127
non disclosure agreement, 124
overview, 123
post merger integration, 130
process, 124
statutory (Type A). See Statutory (Type A) mergers
strategic rationale, 124, 127
tax considerations. See Tax considerations
triangular mergers, 203, 204
valuation, 125. See also Valuation
Mezzanine financing, 10, 234, 235, 239, 249, 250, 323
Middle East, 57
Middle market segment
capital, access to, 5–7
described, 5, 323
global transactions, 14–16. See also
Global mergers and acquisitions
lower-middle, 5–8, 10, 11, 34, 35
market activity, 14–16
middle-middle, 5, 6, 8, 11
reasons for selling (Dismal Ds), 29, 30, 35.
See also Motives
size of, 131
upper-middle, 6, 8
valuation multiples, 6, 9, 10, 13, 14
Miller, Merton, 240
Minimum fee clause, 87
Minority shareholders, 115
Modigliani, Franco, 240
Motives
for acquisition, 3, 4, 28, 29, 47, 48
of clients, understanding, 78, 79
for selling/valuing business, 3, 4, 19, 29,
30, 34, 35, 78, 79, 97, 139, 140, 267,
325
Multiples. See Valuation multiples
Name change (Type F) transactions, 202, 206
Negotiations
global mergers and acquisitions, 55–57, 59, 66
and letter of intent (LOI), 38. See also
Letter of intent (LOI)
monters, 125, 127
negotiated sale, 102–104
sell-side representation, 102–106
tax considerations, 177–179, 181, 182
Net operating loss (NOL), 201, 206–208, 211, 324
Net present value (NPV), 35, 324
Networking, 76, 77
No-shop provisions, 230
Noncompete agreements
amortization and allocation of, 176, 180,
182–184, 186, 190
defined, 324
Index

- drafting, 152
- due diligence, 262, 264
- enforceability, 54
- nonbinding provisions of LOI, 110
- as part of M&A transaction, 113
- Nondisclosure agreements (NDAs), 92, 95, 99, 101, 105, 106, 124, 186, 264, 324
- Normalization adjustments
  - balance sheet, 98, 148
  - EBITDA, 21, 98, 140–142, 144, 149, 277, 324, 325
  - income statement, 275–277
- North Pittsburgh Systems, Inc., 44–47
- Offering memorandum, 95, 96. See also Marketing book
- One-time expenses, 98, 141, 276, 277
- Operational consultants, 73
- Operations
  - differences in and integration, 125, 126
  - operating efficiencies, 130
- Opportunity cost, 23, 242, 282, 325
- Options, 37
- Organizational culture, 125, 126
- Owner value, 20, 23, 26, 103
- Owners. See also Buy-side representation;
  - Sell-side representation
    - advising, 78, 79, 81–83. See also Advisors
    - motives for selling/valuing business, 3, 4, 19, 29, 30, 34, 35, 78, 79, 97, 139, 140, 267, 325
    - preparing to sell, 79, 80
    - readiness to sell, 79
- Partnership doctrine, 197, 198, 211
- Partnerships. See also Joint ventures agreements, 129
  - basis adjustment, 211
  - built-in gain, 200
  - described, 304
  - gain tracking, 200, 211
  - interest in, purchase/sale of, 200, 201
  - limited liability companies, 196. See also Limited liability companies (LLCs)
    - limited liability partnerships (LLPs), 196
    - ownership flexibility, 199
    - partnership allocations, 211
- partnership doctrine, 197, 198, 211
- S corporation compared, 197–199
- tax considerations, 168, 170, 171, 175, 190, 196–201, 211
- Payment terms, deferred, 107
- PEG. See Private equity groups (PEGs)
- Personal goodwill, 182, 184–185, 190, 209, 210
- Personal guarantees, 149, 150, 251–253
- Planning for growth and exit, 292, 293
- Portfolio risk, 9, 10
- Portfolio theory, 9
- Postmerger integration
  - global mergers and acquisitions, 51, 54, 59–66, 70
  - internal team, 265
  - overview, 41, 42
- Post-sale integration, 92, 115, 116
- Practice management. See Advisors
- Preferred stock, 199, 208
- Premise of value, 13
- Present value, 286–289
- Pretransaction consulting, 77
- Private auction (limited auction), 102–105
- Private business clients, understanding, 78, 79
- Private Capital Market Line, 282
- Private capital markets
  - buyers, types of, 11–14
  - capital providers, 9, 10
  - market activity, 14–16
  - public markets compared, 3, 4
  - risk and return, 6, 7, 9–11
  - segments, 4–10
- Private Capital Markets, 246
- Private cost of capital (PCOC) survey, 282
- Private equity groups (PEGs)
  - buyouts. See Buyouts
  - as financial buyers, 12, 13
  - growth equity funds, 245, 249, 250
  - investment horizon, 36
  - mezzanine funds, 249, 250
  - overview, 249
  - sale of controlling interest to, 231, 232
  - special situation funds (turnaround funds), 249, 250
  - valuation multiples, 9, 10, 13, 14
  - venture capital, 249, 250
- Private investment bankers, 7
- Private placements, 216, 217, 228, 327
INDEX

Private return expectation (PRE) calculation, 281–285
Professional advisors. See Advisors
Professional organizations, 134
Professional standards, 134–136. See also Ethics
Profitability, increasing, 293
Promissory note (seller note), 113, 161, 194
Prospectus. See also Marketing book
Psychological risk/return, 11
Public auction, 103, 105, 106
Public companies
due diligence, 266, 267
financial reporting requirements, 229, 230
going private, 230
Public markets versus private markets, 3, 4
Purchase price
adjustments, 113, 145
allocation, 179, 180, 185
Purpose of appraisal, 18–20, 24, 25, 272
Qualifying assets (installment method), 212
Quality-of-earnings assessment, 120, 121, 268
Range of values, 24–26, 37
Ratchet provisions, 149, 303, 304, 315, 328
Rate of return
discount rate, 18. See also Discount rate
fair market value, 17
and risk tolerance, 18
Recapitalization, 202, 206, 232, 237, 328
Redemption, 212, 329
Registration of securities, 215–219, 227, 228, 329
Regulation D, 217, 218, 329
Regulatory compliance
airline industry, 222, 223
antitrust laws, 221–223
blue-sky laws, 89, 215, 228, 229, 303
broker-dealers, 88–90, 219, 224–227, 229
bulk sales laws, 223, 224
Defense Production Act, Exon-Florio provision, 223
Department of Labor, 262
financial reporting for public companies, 229, 230
going private, 230
Hart-Scott-Rodino Act, 221, 222, 317
Investment Advisers Act of 1940, 224, 226, 229
Investment Company Act of 1940, 227, 229
labor laws, 223, 224, 262
public companies, 229, 230
Securities Act of 1933, 215–219, 227, 228
telecommunications industry, 223
Williams Act, 220
Worker Adjustment and Retraining Notification Act (WARN), 223, 224
Relative value, 125
Representations and warranties
buyers, 162, 163
defined, 329
due diligence, 266, 267
indemnification, 163
limitations on, 107
qualifications, 163
sellers, 162, 163
topics covered, 162
Research, sell-side representation, 94, 95, 99, 100
Restricted securities, 217, 330
Retainers, 86, 119
Retirement plans, 129
Return on invested capital (ROIC), 36, 330
Return on investment (ROI), 53, 167, 330
Revolving loans (revolvers), 236, 247, 330
Risk allocation, 115
Risk and return, 6–11, 17
Risk management, 9, 10
Risk of forfeiture, installment sales, 107, 194, 210
Risk tolerance, 18
Rollups, 30, 94, 331
Rule 10b-5, 219, 301
Rule 144, 217
Rule 145, 216
Rule 504, 218
Rule 505, 218
Rule 506, 218, 228
S corporations
described, 305
mergers and reorganizations, 127, 202–206
ownership requirements, 208
partnership taxation compared, 197–199
shareholder criteria, 199
Sarbanes-Oxley Act, 59, 331
Schedule 13E-3, 230
Seasonal businesses, 146
Second-spreadsheet rule, 13
SEC’s Guide to Broker-Dealer Registration, 90
Section 338 election (stock/asset sale election), 160, 201, 206–208, 212
Section 754 election, 200, 211
Section 1031 (like-kind) exchanges, 107, 196, 212
Securities Act of 1933, 215–219, 227, 228
Securities and Exchange Commission (SEC) about, 332
broker-dealer registration, 90, 225, 226
Form BD, 226
Form S-1, 228
Form S-3 (short form), 228
Form S-4, 228
investment advisor registration, 226, 229
registration of securities, 227, 228
Regulation D, 217, 218, 329
Rule 10b-5, 219, 301
Rule 144, 217
Rule 145, 216
Rule 504, 218
Rule 505, 218
Rule 506, 218, 228
Schedule 13E-3, 230
SEC’s Guide to Broker-Dealer Registration, 90
Securities laws
blue-sky laws, 89, 215, 228, 229, 303
broker-dealers, 88–90, 219, 224–227, 229
private placements, 216–218
Securities Act of 1933, 215–219, 227, 228
Williams Act, 220
Self-employment tax, 197, 198
Sell-side clients. See Sell-side representation
Sell-side representation
agreements and documents, drafting, 92, 112, 113
attorneys, role of, 151, 152
buyer types, identifying, 94, 95
buyers, initial contact with, 100, 101
buyers, researching, 99, 100
closing process, 92, 114, 115
data collection, 91–94
deal structure, 92, 106–109
due diligence, 92, 111, 112
industry research, 94, 95
letters of intent (LOI), 92, 108–111
letters of interest, 92, 109, 110
marketing book, 85, 91, 92, 94–99
marketing the company, 99–102
negotiations, 91, 103–106
nondisclosure agreements, 101
overview, 91, 92
postsale integration, 92, 115, 116
term sheets, 92, 109
Seller financing, 160, 162, 163, 237, 249, 332
Series 79 license (FINRA), 224, 227
Shareholder agreements, 129
Shareholders
long-term objectives and financing issues, 231, 232
minority shareholders, 115
motives for full or partial exit, 232
objectives of, influence on capital structure, 244
Shell companies, 172, 173, 206, 332
Sherman Antitrust Act, 221
Skill sets required for advisors, 133
Small Business Administration (SBA), 5, 247, 250, 332, 333
Small Business Investment Company (SBIC), 250, 333
Small businesses
capital, access to, 5
lending to, 9
market segment, 4, 7, 8
risk and return, owners’ perspective, 11
Soft commitment letter (comfort letter), 120
Sole proprietorships, 170, 201, 202, 305
Special situation funds, 249, 250
Specific industry return, 281, 284
Specific investor return, 281–283
INDEX

Spinoffs, 205, 333
Spinouts, 205, 333
Stand-alone value, 37
Standards of value, 18–24
State laws
bulk sales laws, 223, 224
securities laws (blue sky laws), 89, 215, 228, 229, 303
Statements of Financial Accounting Standards (FAS) 141R, 185
Statutory (Type A) mergers, 128, 202–204, 212, 213, 224
Stock-for-assets (Type C) transactions, 128, 202, 204, 205, 213
Stock-for-stock (Type B) transactions, 202–204, 213
Stock options, 129, 262, 264, 333
Stock sale/purchase
deal structure, 155, 157, 158, 160
I.R.C. Section 338(h)(10) election, 160
membership interest in LLC, 175
purchase agreement, 112, 113
See also Tax considerations
Strategic advisor, 63
Strategic buyers (strategics)
corporate development teams, 27. See also Corporate development
described, 12, 13, 27
investment horizon, 36
and market value, 21. See also Market value
synergies, 21, 22, 28
types of, 28
valuation multiples, 13
value perspective, 21, 22, 35–37
Strategic planning and decision making, 291–294
Strategic rationale for mergers, 124, 127
Subordinated debt, 108, 234, 235, 249, 250, 333. See also Mezzanine financing
Success factors for advisors, 133, 292
Succession planning, 132, 231, 232
Synergies
and acquisition multiples, 13
defined, 333, 334
and market value, 21, 22, 279–281
negative, 36
positive, 36
and postmerger integration process, 41
and strategic buyers, 12. See also Strategic buyers (strategics)
Synergistic buyers. See Strategic buyers (strategics)
Tax considerations
acquisition costs, capitalization of, 186
amortization, 172, 174–176, 178, 180, 185–187, 189, 190
asset allocation, 173, 181–185, 189
asset sale/purchase, 172–188, 261
built-in gains tax, 208–210, 212
C corporations, 168–175, 182–184, 198
capital expenditures, 189
capital gains, 169–175, 179, 181–184, 189, 190, 260
capitalization of assets, 189
consulting agreements, 180, 181
corporate capital gains tax, 169, 171, 173, 174, 183, 189
cost segregation studies, 185, 188, 189
depreciation, 172, 174–176, 181, 182, 185–186, 189, 190
dividends, 260, 261
due diligence, 260, 261
divisive D reorganizations, 205, 210
entity tax characteristics, 168–171
importance of understanding, 167, 168
individual capital gains, 169–171, 173–175, 179, 181, 182, 184, 190
individual tax rates, 170, 171
installment method, 193, 194, 210–212
installment risk of forfeiture, 107, 194, 210
installment sales, 107, 193–196, 210, 211
intangible assets, 186–188
I.R.C. Section 338(h)(10) election, 160
limited liability companies (LLCs), 168, 170, 171, 175, 181, 182, 190
mark-to-market asset distribution, 198
mergers and reorganizations, 127, 202–206
mergers and reorganizations, 205, 210
negotiations and deal structure, 177–179, 181, 182
net operating loss (NOL) limitations, 201, 206–208, 211
noncompete allocation, 180, 182–184, 190
partnerships, 168, 170, 171, 175, 190, 196–201, 211
personal goodwill, 182, 184–185, 190
purchase price allocation, 179, 180, 185
qualifying assets (installment method), 212
Section 338(h)(10) election (stock/asset sale election), 201, 206–208, 212
Section 1031 (like-kind) exchanges, 107, 196, 212
self-employment tax, 197, 198
stepped-up basis, 172, 173
stock sale/purchase, 174–179, 260, 261
tax-free deal structures, 202, 203
type A statutory mergers, 128, 202–204, 212, 213, 224
type A triangular mergers, 203, 204
type B stock-for-stock, 202–204, 213
type C stock-for-assets, 128, 202, 204, 205, 213
type D (divisive D reorganizations), 202, 205, 206
type E recapitalization, 202, 206
type F name change, 202, 206
type G bankruptcy, 202, 206
Union approvals, 115
Unposted (waived or passed) adjustments, 260, 268
Unrelated assets, income from, 142

Valuation
adjustments, 275–278. See also Adjustments
advising clients on, 82
authorities, 19, 20, 272
book value, 20, 24
buy/sell agreements, 24
and buyers, types of, 11–14
changes in as deal killer, 114
clients, advising, 82
collateral value, 19, 20, 23, 26
dissenting shareholder cases, 22
divorce, 22
dissenting shareholder cases, 22
dissenting shareholder cases, 22
equitable distribution cases, 22
experts, 73
fair market value, 17–20, 22, 25, 26, 185
fair value, 20, 22, 185
and financing strategy for acquisitions, 237–239
global perspective, 289
incremental business value, 20, 23
informal, 78
intangible assets, 149
investment value, 19–21, 23, 26, 103
in M&A deals, 26
and market segment, 7
market value. See Market value
and marketplace efficiency, 133
mergers, 123
multiples. See Valuation multiples overview, 17, 18
Valuation (continued)
owner value, 20, 23, 26, 103
and purpose of appraisal, 18–20, 24, 25, 272
range of values, 24–26, 37
relative value, 125
risk/return relationship, 6, 7
second-spreadsheet rule, 13
standards of value, 18–24
tax and legal matters, 22
transaction valuation. See Transaction valuation
value worlds, 20, 24–26, 271, 272
Valuation gap, 38, 237, 238, 332
Valuation multiples
databases, 284, 285
described, 323
EBITDA, 6, 13, 284. See also Earnings before interest, taxes, depreciation, and amortization (EBITDA)
financial buyers, 13
general acquisition selling multiples, 281, 282, 284–286
market segments and types of buyers, 6, 9–10, 13–14
middle market segment, 6, 9, 10, 13, 14
private equity groups (PEGs), 9, 10, 13, 14
strategic buyers (strategics), 13
and synergies, 13
Value, definitions of, 18
Value investors, 12, 13
Value kicker, 88, 320
Value proposition, 125
Value worlds, 20, 24–26, 271, 272
Venture capital, 226, 249, 250, 335
Vertical integrations, 12, 21, 22
Villepin, Dominique de, 58
Weighted average cost of capital (WACC), 282, 283, 336
WIIFM (What’s In It for Me?), 125
Williams Act, 220
Worker Adjustment and Retraining Notification Act (WARN), 223, 224
Working capital
accounts receivable, 147
adjustments, 43, 154, 258
balance sheet analysis, 142–148
calculation of, 144, 145
cash, 144, 145
components of, 146–148
defined, 142
due diligence, 146, 147, 257, 258
financial analysis, 142–148
inventory, 147, 148
negative, 146
ongoing company versus acquisition, 143
pegging (working capital target), 145, 146, 148
seasonal, 146