

The Role of the Investment Banker In the Sale of Private Companies

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Investment bankers help buy or sell companies and raise capital. They are members of a team with attorneys and accountants. The investment banker's value added comes both from specific technical knowledge as well as from hindsight from the number of times they have been through the process. This article can be an effective way to explain the often incompletely understood role of an investment banker

As a financial advisor to numerous middle market private companies, I have been asked many times: "tell me again, exactly what does an investment banker do?" Well, about 30 things come to mind in the context of a sale or merger engagement. The same process applies to financing and acquisition assignments.

1. Obtain Concurrence Of Expectations Of Value And Terms.

The investment banker's first task is to determine that they and their prospective client concur on value, which need not be a firm number - it may be a range or ratios pending future performance, and will depend on terms. Since no asking price will be used, the market will ultimately determine value, but expectations need to be mutual.

2. Help The Client Understand How A Potential Buyer Will View The Company.

Most companies are sensitive to how they are perceived by customers, suppliers, employees and the community, but haven't focused on the unique perspectives of potential buyers. The investment banker and their client must develop a mutual understanding of why and where a potential buyer will see value.

3. Candidly Assess The Prognosis For Future Challenges.

The investment banker must drill down to unearth any issues that could emerge at an inopportune time. If there are any potential problems related to the company and its business, they need to be discussed candidly and early in the process. Even a relatively minor issue can kill a good deal if it crops up at a critical point in the process.

4. Develop, Validate And Document Historical And Projected Financials.

The investment banker will help the company recast historical numbers to add back discretionary expenses and model future performance. Projections should be optimistic but realistic - a buyer might predicate his price on them - and must include underlying assumptions as to what capital and other resources will be needed.

5. Assist In Recruiting Other Members Of The Team Not Already On Board.

A sale transaction requires attorneys and accountants with experience commensurate with the anticipated transaction. Mistakes or oversights can be expensive and/or kill deals. This is not where to cut costs, and you don't want to wait until there is a deal on the table. The investment banker can help in recruiting or selection.

6. Identify And Evaluate Potential Categories Of Buyers.

The first task is to determine who is likely to buy the Company at the desired price and terms. There are financial buyers (investment groups) and strategic buyers (companies in related businesses). The “right market” depends on the type, size and location of the business and the desired terms. A lot of time can be wasted chasing the wrong market.

7. Develop Marketing Strategies.

There are three basic M&A marketing strategies: tightly focused to a select few; strategically focused to a limited number; or broadly to a large audience. The selection depends on the type of business, confidentiality and the type of buyers targeted. The investment banker’s goal is to create an auction, or alternately obtain a pre-emptive bid.

8. Identify Specific Potential Buyers

The investment banker’s next task is to identify and prioritize specific potential buyers. A strategic buyer 5 to 10 times your size is optimal, but smaller divisions or subsidiaries of even very large companies are often virtually autonomous and should be included, as should financial buyers with other investments in the same industry.

9. Obtain Firsthand Introductions To Potential Buyers Wherever Possible

The investment banker’s ideal goal is to obtain personal introductions to senior management of potential buyers. Auditors, attorneys or banks whom they know often will have direct or indirect (e.g. through board members) relationships that can get past the gatekeepers, which is especially useful in approaching large organizations.

10. Prepare Documentation To Market The Company.

The investment banker will prepare two marketing documents: a concise summary containing enough to arouse interest without revealing identity; and a comprehensive **book** or **memorandum**, which should cover the same ground as a public company “prospectus”, but at the same time must be a marketing document.

11. Initiate Contact With Potential Buyers

The investment banker’s initial approach to potential buyers is critical. Once the prospect has said no, it’s hard to go back. Initial contacts require tenacity and skill. Whether by phone, letter or email, they need sizzle to get attention but also cover the essential facts. The “pitch” must be well honed and get the message across in 30 seconds or less.

12. Obtain Signed Confidentiality Agreements

The investment banker’s ensuing objective is to obtain a signed confidentiality or non-disclosure agreement (“CA” or “NDA”) so the next step can be taken. The simpler the CA, the easier it is to get signed. If truly sensitive information is to be disclosed later in the process, a more detailed one can be executed.

13. Provide Prospective Buyers Detailed Information

The investment banker’s next step is to send prospects the “book”. Confidentiality agreements notwithstanding, the book should not contain anything truly proprietary and

not even identify the company by name. Also, even in this day and age it is preferable to send hard copy. E-mailed documents tend to be disseminated, raising the risk of leaks.

14. Obtain Indications Of Interest And Arrange Site Visits

The investment banker's follow-up starts a week after the book is received. Common responses are requests for more information and/or referrals to other people. After a few rounds the investment banker needs to get the prospective buyer to commit to visit the Company. If they won't, they are probably low priority prospects.

15. Research and Qualify Interested Potential Buyers And Principals

Before a visit the investment banker will dig into the backgrounds of the individuals and the company, its culture and its history, particularly with respect to prior transactions. Such information enables the Company to ask the right questions and understand why the buyer might be interested. If it doesn't look like a fit, better to find out sooner than later.

16. Prepare the Company For The Buyers' Visits

The investment banker will obtain the buyer's schedule and checklists in advance so as to be prepared and not to take time on issues on which they are not focused. The Company's participants must be selected and a plan formulated and rehearsed as to what will and will not be said, offered or provided, and how to handle sensitive questions.

17. Orchestrate the Buyers' Visits

Don't assume they have read the "book". Start with an overview, but most of the time should be spent answering questions, and listening. Requests for information should be noted but not necessarily filled on the spot. The CEO should not dominate the visit. They need to see a team. The investment banker can be active or passive, but should be there.

18. Create The Infrastructure For Maintaining Momentum.

Deal momentum is critical. The investment banker must assure that the visit end with a definitive schedule of next steps and agreement as to who is responsible for what. The buyer should designate one accessible point person, ideally either a decision maker or champion. The Company's CEO should be above the fray and saved for global issues.

19. Police The Flow Of Further Information Between Company And Buyers

Assuming continuing interest, the next thing that happens is requests for more information. The investment banker should serve as control for incoming requests, which will help identify emerging negotiating issues. Careful consideration must be given to what is provided, especially projections, and records kept as to everything provided.

20. Obtain Indications Of Value And Terms Or Alternately Definitive Declines.

Requests for more information can be an un-ending fishing expedition. Within 30 days, the investment banker needs to tell the buyer that the Company needs some form of proposal - term sheet, letter of intent - with at least an indication of value. If more information is required, it should be reduced to a manageable list and timetable.

21. Evaluate Alternative Proposals

Proposed payments come in all different forms – cash, stock, notes, non-competes, earn outs, etc. Some may offer to buy assets, others stock. Some may want to leave behind some assets (e.g. real estate) or liabilities. The investment banker's job is to help evaluate the different deal structures in the context of the seller's needs and tax circumstances.

22. Negotiate A Term Sheet Or Letter Of Intent (“LOI”)

The investment banker will interface with the buyer on an LOI, but the attorneys also need to be involved. Traps to avoid are 1. Agreeing to a no-shopping clause without milestones; 2. letting an LOI turn into a mini-agreement and 3. going directly to a full agreement without an LOI or at least a term sheet.

23. Prepare Company For Due Diligence

Deals die because due diligence drags out. The investment banker should orchestrate the preparation. 90% of what will be needed is predictable and should be located in advance, which is never as easy as first thought. A common practice is to create a “war room” where documents are accumulated and organized for inspection.

24. Organize The Due Diligence Process

Due diligence can be disruptive and unproductive. The investment banker can serve as either the quarterback or coach. There must be a program identifying who is responsible for what and sequencing sensitive issues (e.g. talking to customers and discussing retention with management) until after the buyer has signed off on all other items.

25. Manage The Due Diligence Process

A key to managing the process requires understanding the buyer's needs and clarifying what is really required. In addition to seeing documents, buyers want to talk to managers in human resources, IT, production, Q/C, purchasing, marketing, engineering as well as administration and finance. Such managers must be briefed and prepared with answers.

26. Continually Track Progress and Open Issues

As due diligence proceeds, additional issues arise which should be tracked and the authority for concessions clearly defined. Significant monetary and legal issues can be allowed to accumulate, but secondary issues should be settled in real time to maintain momentum and avoid deal fatigue resulting from “numerous unresolved issues”.

27. Help Compile The Disclosure Statement.

A disclosure statement is a compilation of documents, e.g. contracts, leases, deeds, patents, asset schedules, shareholder records, insurance policies, orders, etc. Compiling these documents is never easy. Since they are part of the contract, the sellers are warranting that they are correct and complete. An error or omission can be expensive.

28. Help Compile Other Closing Deliverables.

The investment banker will also assist in obtaining the numerous other “closing deliverables” from outside sources, e.g. consents of shareholders, lenders, landlords, leasing companies, insurance carriers, customers or government agencies; lien releases; good standing and tax clearance certificates, etc. One missing document can kill a deal.

29. Assist Negotiating Business And Financing Issues In The Definitive Agreement.

The definitive purchase contract and related documents (notes, security agreements, consulting or employment contracts, non-competes, licenses, leases, etc.) are the purview of the attorneys, but also include personal or financing and deal structure issues on which the investment banker can help their client evaluate options and make decisions.

30. Stay Until The End.

A professional investment banker will remain on the scene, on duty, until the deal finally closes, even if it's midnight New Years eve. There are many things that can be missing or go wrong at the last minute, and, having been there numerous times before, the investment banker may be just the person to help.

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