Acquiring the Acquisition Mindset

How To Prepare for an Exit Daily

Nitin Khanna, CEO, MergerTech Advisors| May 2015

Introduction

What is the acquisition mindset? It is a mindset that says, “Whether or not I ever sell my company, I will run it as if it is going to be acquired tomorrow.” The acquisition mindset enforces a discipline, structure and rigor in your company that ensures you are running a professional organization that minimizes structural risk, maximizes work satisfaction and ensures the highest levels of income today and wealth tomorrow if you do sell. The acquisition mindset is a tool that helps you in all areas of your company, whether you are running a lifestyle company, a venture--backed company, a high growth company, or running a company on the side while you perform another day job.

The following tips will help you keep the acquisition mindset front and center.

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Running a Professional Company

Incorporate very thoughtfully. Spend a lot of time thinking through partnership agreements. Think through estate and tax planning issues right at company formation. Who owns the stock? Where does it reside? What would be the tax implications if you sold the company the next day? Should your kids own some of it now, before it has any value, so you avoid any estate taxes?

Create goals and metrics and strive to meet them. Analyze why you did or didn't meet the goal; refine, repeat.

Build a management team. A strong one. Could the business run a week, a month, a quarter without you?

Equity in your company is valuable. Treat it that way. Have really important and good reasons to give away equity to partners and structure it as a future incentive rather than a grant.

Be professional. Have a professional image, maintain an organization chart and be disciplined**. Be prone to candid conversations. The more difficult the topic the quicker you should have a candid conversation about it**. And remember, "fun" culture and "discipline" are not mutually exclusive.

Keeping Solid Records

It may be hard for you to see how record keeping contributes to value and wealth, but it creates a foundation that keeps you in control of your destiny.

Maintain solid financial records including getting reviewed financials once you get to $1MM in revenue and audited financials once you get to $5MM in revenue. Understand why you may or may not be using GAAP accounting. Use the accounting process that maximizes after--tax income but understand why you are using it and how it reconciles to GAAP.

Maintain solid legal records including articles of incorporation, regulatory and other business licenses, board meeting minutes (yes, these add a huge amount of value by increasing trust and demonstrating professionalism to a potential acquirer), and risk and liability records (environmental, various employment policies, insurance, etc.).

Invest appropriately in your IT and accounting systems. Investing appropriately means your systems are ready for the next 12--18 months of your growth.

Building a Network of Advisors

While you should rely on many experts as your company grows, the single most important relationship you want is with your bank. Constantly be communicating to your banker. Always have a line of credit that is 25% --50% larger than what you need for the current year. This relationship should be on the same level as the one with your largest client.

Develop a solid professional network of attorneys around you including tax and estate planning attorneys when you incorporate. Review these every $3MM in revenue. If you don't feel comfortable calling your attorneys at the first sign of legal trouble, you don't have the right relationship with them.

Always have an experienced accountant working with you from the very start. Consider hiring a controller at $2MM in revenue, a CFO at $10MM in revenue, and a General Counsel at $15MM in revenue.

Develop a relationship with a M&A Advisor around $3MM in revenue. He or she can apprise you of industry trends, valuations, and exit preparation and handle incoming offers for you.

Don't have an irrational fear of financial firms (VCs, PEs, bankers). Too many people give too much equity away to friends and too little to financial firms that can help them.

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Riding the Consolidation Wave

Now that you are running a professional company, keeping solid records and building a network of advisors, your company has become healthier and more attractive for acquisition. If you make the decision to sell, you'll want to generate the most return for you, your employees and stakeholders. Maximizing value is based on (1) understanding what buyers want, and (2) becoming an educated seller.

Many sellers confuse their view of their companies' readiness with the real motivations of buyers. The following questions, for example, show how easy it is to make that mistake.

> "I can't sell now. Last year was a down year and I want to show growth before I sell."
> "I can't sell now. I'm growing 40% a year. I want to make the company much bigger before I sell"
> "I can't sell now. I'm just about to get a very large contract and I'll sell after I get it."
> "I can't sell now. The actual value of my product is SO MUCH higher than my financials show."
> "I can't sell now. Because of the recession I'm sure buyers are not paying a lot."

All of the above reasons show a lack of understanding of the M&A process and why some companies get sold for so much more than other companies. Full and highest prices are paid by strategic buyers, which means your company, management team and product fulfill a strategic need of the buyer and suggest synergies between the two companies that go beyond financial performance.

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Riding the Consolidation Wave (Cont'd)

Being on the front end of a consolidation wave is essential to getting multiple offers, which is what generates the best price and terms. Once a buyer buys a company to meet a certain need, they will not replace that company by buying another one in the future, no matter how much better the newer one is. And while you are growing at 40% a year, buyers with money are spending it on other companies. Then, at the time your growth slows down, there is a potential for fewer or poorer buyers, thus driving down value even more. And buyers perceive a step down from 40% to 30% as a stumble, not as a sign of a maturing business; they tend to be wary of it.

Sell when you are growing to maximize cash at close value. You will have the best opportunity to have a great relationship after the close and maximize your earnout.

Becoming an Educated Seller

The other key to maximizing value is to become an educated seller.

Educate yourself on the strategic outcomes that are possible for your company; organic and inorganic (acquisitions) growth methods, recapitalizations, full or partial sale of the company, ESOPs, and IPOs.

Avoid the following mistakes:

- Overinvesting in one--off offers for your company. The surest way to maximize value is by running a process and having multiple offers.
- Using the wrong advisors, or no advisor at all. The correct advisors can add 10% to 100% or more to the value of the deal by bringing in additional buyers, minimizing due diligence mistakes and being a strong advocate on your behalf.
- Marketing your company multiple times.
- Not thinking about your employees and management team during the exit process.
- Sloppy due diligence practices.
- Legal risks and liabilities. Pay your taxes and vendors, keep a harassment--free workplace and deliver what you promise to your clients.

Understand that highest growth rates and higher revenue don't necessarily lead to highest exit valuations. Having an exit mindset and running the company that way from day one will give you a much better chance of being a strategic acquisition target – and converting your work into wealth.

Thank You

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