A SAN DIEGO BUSINESS JOURNAL SPECIAL REPORT

MERGERS & ACQUISITIONS

Stephen Whalen

Paul Johnson and David Boatwright — co-chairs of mergers and acquisitions for Procopio, Cory, Hargreaves & Savitch LLP — said preparing your business for sale needs careful planning and advice.

Smooth Selling

SALES: M&As Bring Up Legal, Financial and Even Emotional Issues

■ By EMMET PIERCE

Selling a business is a complex undertaking that requires patience and careful planning to maximize your company's market value.

One of the first steps owners should consider taking is "an internal exam" to make sure they are emotionally prepared for a sale, said **Paul Johnson**, partner for the regional law firm of **Procopio, Cory, Hargreaves & Savitch LLP** and co-chair of its mergers and acquisitions practice group.

"If you have been the principal owner of an organization for any number of years and you want to sell your business, you have to be ready for a change in how you are viewed," Johnson said. "A friend of mine said you have to go from everyone laughing at your jokes to being third in line at Starbucks. Now you are no longer the boss. It really is a lifestyle change."

Lawyer **David Boatwright**, co-chair of mergers and acquisitions and strategic joint ventures and one of Johnson's colleagues at Procopio, said it is very difficult to run the business while involved in the sales process.

The process requires stepping back from day-to-day operations to look closely at the internal operations of the business, the two said.

Steps to be taken include making sure contracts with customers are signed and that employees have signed nondisclosure documents.

"When an acquirer walks in, he'll have 20- to 50-page document asking about everything that could possibly be wrong with your business," Johnson said. "They're going to expect straight answers about what is wrong."

Johnson said it is best to have a lawyer review company documents and recordkeeping to eliminate surprises.

"Take care of things first," he said, such as having audited financials prepared. "It's important to organize your operations and records so a new owner can easily take over."

Fully Consider Terms

Boatwright, who has taken part in

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Acquisition Is All About Getting the Price Right

BUSINESS: Determining Value Can Involve a Variety Of Factors and Approaches

■ By EMMET PIERCE

If you're planning to buy a business, it's essential to establish its value before making an offer.

Many factors must be considered in order to get a good return on your investment and minimize your risks.

Three basic things to weigh when setting a value are the company's assets, income and market value.

Despite the risks involved, buying a business can be a satisfying experience, said **Paul Johnson**, a partner in the regional law firm of **Procopio, Cory, Hargreaves & Savitch LLP.**

"You end up being your own boss, which is great for a lot of people, and it really does help the economy to grow," he said. "San Diego is a great entrepreneurial community."

The Asset Approach

The asset, or cost, approach to establishing a business's worth looks at all its individual parts, said **Matt Bradvica**, tax partner at the San Diego office of accounting firm **McGladrey LLP**.

"It is a really basic approach," he said. "Here is the minimum value of the company."

Wade Hansen, CEO of **Cabrillo Advisors**, a business valuation firm, said the asset approach is based on the premise that a prudent investor would pay no more for an asset than its replacement or reproduction cost.

"To put it in a nutshell, what is the stuff worth?" asked **Ken Oppeltz**, managing principal of **VR Business Brokers** in Rancho Bernardo.

Wade Hansen

Ken Oppeltz

"When you have a manufacturing company, what is the value of the fixtures and equipment, the tables and chairs?" Oppeltz said. "It is valuing the tangible assets of a business at a fair-market valuation. We call it orderly liquidation. There are also things like cash and accounts receivable. You are trying to figure out the value if you had to shut this thing down."

The Income Approach

With the income approach, you're valuing the business based on the income stream or the earnings it is likely to generate over time, Oppeltz said.

You are trying to determine a company's ongoing ability to remain profitable.

This can be a good method when a company has a stable cash flow that is growing at a constant rate.

If you don't think you will be able to match the current income stream after you buy the company, you should factor that into your offer.

"You project what it will earn in the next five years," Bradvica said. "What return do I need? What are my risk factors? You are buying a stream of cash flow."

THREE VALUATION APPROACHES

Asset Approach:
The sum of the fair-market value of the tangible assets, including cash and accounts receivables as if the business were to shut down.

Income Approach:
The value of the net present value of the benefit stream generated by a business, which generally falls into three categories: direct capitalization, discounted cash flow, and gross income multiplier.

Market Approach:
A subjective value that compares the business to others in the same industry, of the same size, and within the same area. Consideration of market conditions, the goodwill associated with customer connections, brand visibility and team experience can be some of the variables.

The Market Approach

The market approach to setting a value looks at recent sales of similar businesses, Oppeltz said.

"That's looking at the company against others that have been transferred and sold, and trying to compare the two," Oppeltz said. "You try to get enough comparable sales to see a trend and develop a price-to-earnings and a price-to-revenue comparison."

For example, if you wanted to buy a company that designs T-shirts, you would discard the businesses that are much larger or smaller than the one you want to buy, he said. "You try to get as close to the subject company as you can."

No matter what approach you use, "at the end of the day, fair value is what an interested buyer would pay for the company," Bradvica said.

UPCOMING SPECIAL REPORTS

April 21	Top 50 Public Companies
April 28	Health Care
May 5	Commercial Real Estate
May 12	Accounting & Management Consulting
May 19	Banking & Finance
May 26	Energy & Clean-Tech Innovation
June 2	South County & Tijuana
June 9	Structures
June 16	Small Business Succession Planning
June 23	Manufacturing & Exports
June 30	Attorneys
July 7	Women-Owned Businesses
July 14	San Diego Venture Capital
July 21	Talent & Staffing
July 28	Commercial Real Estate
Aug. 4	Office Design

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Business:

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sales, mergers and acquisitions, and strategic joint ventures ranging in value from a few million dollars to over $1 billion, said some owners decide to sell too quickly, without fully considering the terms of the sale.

"Our worst nightmare is when a client walks in with a signed letter of intent and asks you to review it quickly to see if there are any major problems with it," he said. "The great clients, when they are thinking about selling, call you up and ask you: 'What should I be thinking about? What should I be doing?'"

Matt Bradvica

Matt Bradvica, a tax partner in the San Diego office of accounting firm **McGladrey LLP**, said sellers should market their companies strategically to buyers who are likely to pay the most.

"Don't sell your company to the first guy who approaches you," Bradvica said. "This is your most valuable asset, in most cases. Get as many interested buyers as you can."

Put Your House in Order

Before businesses contemplate sales, it's very important that they diversify their client bases, said **Wade Hansen**, CEO of **Cabrillo Advisors**, a business valuation firm. The idea is to ensure the bulk of your business is not concentrated with a few clients. A company with a diversified client base is viewed as less risky to buy.

As you get ready for a sale, make sure you have solid accounting records available for at least the past two years. It's also important not to make significant operational changes that could impact the performance of your business at a time when the company is being watched by potential buyers.

One of the challenges business owners face is keeping their minds on their company's operations while they court potential buyers, Boatwright said. It's important to keep your management team focused on running the business rather than getting deeply involved in the details of a sale.

Another important task for sellers is to keep the news of a possible sale private until they are ready to make the announcement.

"You don't want a lot of people in the company to think they are being sold," he said. "They may look for work elsewhere. It's important not to create the appearance of a sale taking place until it's ready to happen."

Bradvica agrees. If key employees think you are planning a change in ownership, they may leave for other jobs, which could devalue your business.

"It really can cause a toxic environment." Bradvica said.

Timing Is Important

Boatwright said business owners should keep an open mind when preparing for sales. After you've weighed all your options, you may decide that it's not the right time for you to let go of your business.

"Timing always is important," he said. "You don't want to sell when there are bad economic times, if you can avoid it. Ideally, you want to sell when your company has really very positive earnings trends. It has been a very uneven transactional market since 2008."

He said 2007 was "an off-the-charts good year" for selling businesses and that "we have not come close to those levels."

Johnson said things are improving, however.

"I have seen a slight uptick in businesses being bought and sold," he said. "That means people are confident about the economy. Things are getting done. Investments are being made. It's not at the point yet where I would say it's a frothy market where people are bidding up companies."

Tom York contributed to this article.

Notable Recent Acquisitions

San Diego County's merger and acquisition activity is starting to heat up, but it still is not near 2007 levels.

Company	Buyer	Industry	Value
Life Technologies Corp.	Thermo Fisher Scientific Inc.	Medical devices	$13.6 billion
Leap Wireless International Inc.[1]	AT&T Inc.	Prepaid wireless service	$4 billion[1]
Cymer LLC	ASML Holding NV	Lithography equipment for making semiconductors	$3.7 billion
Santarus Inc.	Salix Pharmaceuticals Ltd.	Diabetes and gastrointestinal drugs	$2.6 billion
Cadence Pharmaceuticals Inc.	Mallinckrodt plc	Pharmaceuticals	$1.3 billion
Mitchell International	KKR & Co. LP	Software for auto repair and insurance	$1.1 billion
The Active Network	Vista Equity Partners	Online event registration	$1.05 billion
Websense	Vista Equity Partners	Security software	$906 million
Accelrys	Dassault Systemes SA	Biotech software	$750 million
Aires Pharmaceuticals Inc.	Mast Therapeutics Inc.	Pharmaceuticals	$5.2 million
Barney & Barney	Marsh McLennan	Insurance	Not disclosed
National Interstate Corp.	Great American Insurance Co.	Insurance	Tender offer at $30

[1] Includes assumption of about $2.8 billion in debt; deal will close in March if regulators approve the transaction.

Source: Staff research