



## Keeping M&A Deals on Track: Managing The Killers

By Andrew J. Sherman, Esq.

Deal Killers. We have all seen them and had to manage through them. They come in all shapes, sizes and varieties with different reasons, justifications and rationalizations. They can emanate from the buyer, the seller or any number of third parties, such as lenders, investors, key customers or suppliers, professional advisors ... or all of the above. Some deal killers are legitimate for deals that deserve to die and some are emotional, financial or strategic in nature. They can be very costly to all parties to the transaction, especially when significant costs have already been incurred and for certain advisors and investment bankers, it means not getting paid. Clearly, deal killers inflict a lot of pain along their path of destruction of a transaction.

Most “deal killers” can be put into one of the following major categories:

- Price and Valuation
- Terms and Conditions
- Allocation of Risk
- Third Party Challenges

### Communication and Leadership

The first step in keeping a transaction on track (and greatly increasing the chance of deal killer avoidance) is to have strong communication and leadership by and among all parties and key players to the transaction. As in football, each team (e.g., buyer, seller, source of capital, etc.) should appoint a quarterback, who will be the point person for communication and coordination. Too many lines of communication, like too many chefs in one kitchen, will create confusion and misunderstanding — which are fertile conditions that allow a deal killer to pollinate. The more that the quarterbacks coordinate, communicate and anticipate problems with the various members of their team and promptly discuss key issues with the quarterbacks of the other teams, the greater the chances that the transaction can and will close.

Some of the key tasks of the transactional quarterback and each team to keep the transaction on track towards closing include:

- Putting a master strategic plan in place (with realistic expectations re: financial and post-closing objectives)

- Building the right team
- Communication and teamwork
- Orchestration and leadership
- Momentum and timetable accord
- Avoid emotion/don't call my baby ugly syndrome (sellers) and buyers must avoid falling in love with a given transaction
- Early start on governmental and third party appeals
- Creative problem solving
- Cooperation and support from financing sources
- Facilitate agreement on the key value drivers of the seller's business/intellectual capital issues

Diagnosing the Source of the Problem

When a potential deal killer does arise, each quarterback should first diagnose the source of the problem. Where is the issue coming from and what can be done to fix it? A deal killer for one party may not be a deal killer for another party. Take a look at Box A below. The old adage “where you stand often depends on where you sit” clearly applies here. For example, a lender to a buyer coming at a higher lending rate than anticipated may significantly alter the attractiveness of the transaction from the buyer's perspective but may be viewed as a non-issue for the seller.

| Box A  |   | The Source of the Problem Will Dictate the Solution   |  |
|--------|---|---|--|
| Seller | <u>Stakeholders</u><br><input type="checkbox"/> Minority shareholders<br><input type="checkbox"/> Key employees<br><input type="checkbox"/> VC investors<br><input type="checkbox"/> Family members | <u>Third Party Approaches</u><br><input type="checkbox"/> Regulatory<br><input type="checkbox"/> Lenders<br><input type="checkbox"/> Lessors<br><input type="checkbox"/> Unions           | A<br>L<br>L<br><br>P<br>A<br>R<br>T<br>I<br>E<br>S |
|        | <u>Sources of Capital</u><br><input type="checkbox"/> Debt<br><input type="checkbox"/> Equity<br><input type="checkbox"/> Mezzanine   | <u>Professional Advisors</u><br><input type="checkbox"/> Lawyers<br><input type="checkbox"/> CPA's<br><input type="checkbox"/> Investment Bankers<br><input type="checkbox"/> Consultants |  |

## Understanding the Types of Deal Killers

Once the source of the deal killer has been analyzed, the respective quarterbacks should focus on the specific type of deal killer. Most deal killers can and should be resolved — either with creative restructuring, effective counseling or precision document redrafting. Some deal killers cannot be resolved (they are just too big and hairy) and other deal killers should not be resolved (like trying to squeeze a square peg into a round hole).

Deal killers come in a wide variety of flavors, and include the following:

- Egos clashing
- Misalignment of objectives
- Inexperienced players
- Internal and external politics (board-level, executives, venture investors, etc.)
- Due diligence red flags/surprises
- Pricing and structural challenges (price vs. terms)
- Valuation problems (tax/source of financing/in general)
- Third party approval delays
- Seller's/buyer's/source of capital remorse
- Employee and customer issues
- Overdependence on the founder/key employee/key customer or relationship
- Loss of trust/integrity during the transactional process
- Nepotism
- Failure to develop a mutually-agreeable post-closing integration plan
- Shareholder approvals
- Accounting/financial statement irregularities (post-Worldcom)
- Sarbanes-Oxley post-closing compliance concerns

- Breakdowns in leadership and coordination/too little or too many points of communication
- Too little or too much “principal to principal” communications
- Crowded Auctions
- Impatience to get to closing vs. loss of momentum (flow and timing issues)
- Incompatibility of culture and/or business systems (e.g. IT Infrastructure, costs and budgeting policies, compensation and reward programs, accounting policies, etc.)
- Force-feeding deals that don’t meet M&A objectives (square peg/round hole) (Bad deal avoidance/good deal capture — systems and filters)
- Who’s driving the bus in this deal? (M vs. A)
- Changes in seller performance during the transactional process (upside surprises vs. unexpected downside surprises)
- Loss of a key customer or strategic relationship during the transactional process
- Failure to agree on post-closing obligations, roles and responsibilities
- Environmental problems (buyers less willing to rely on indemnification and insurance protections)
- Unexpected changes in the buyer’s strategy or operations during the transactional process (including a change in management or strategic direction)

### Curing the Transactional Patient

Although a detailed discussion of the tools available to “kill a deal killer” is beyond the scope of the article — and is probably as broad as the number of tools available to the Orkin® man to kill the hundreds of different insects and rodents — some of the more common tools are listed below. The first step is for each quarterback to ensure that the transaction can and should be fixed. If so, these tools can be very valuable in mending a broken deal:

- Earn-out’s/deferred and contingent post-closing consideration
- Representations, warranties and indemnities (tools to adjust allocation and assumption of risk) (weighting of priorities issues)

- Adjusting the post-closing survival period of R&W's
- Holdbacks and security interests
- Closing date audits
- Third party performance guaranties/performance bonds/escrows
- M&A insurance policies
- Restrictions on sale by seller of buyer's securities issued as part of the overall consideration
- Recasting of financial projections and retooling post-closing business plans

### Conclusion

Bad deals deserve to die a peaceful death. Not all transactions are meant to be closed: (a) at this time; (b) at this valuation; (c) between these parties; or (d) under these terms and conditions. But if a transaction can be saved, then it should be saved. The quarterback on each team must have the transactional experience, the business acumen and the communication skills to diagnose the source and nature of the problem and enough familiarity with all of the tools available to get the transaction back on track towards closing.

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### ABOUT THE AUTHOR

ANDREW J. SHERMAN is a Partner in the Washington, D.C. office of **Dickstein, Shapiro, Morin and Oshinsky**, a prominent law firm with over 350 lawyers in Washington D.C. and New York City. Mr. Sherman is a recognized international authority on the legal and strategic issues affecting small and growing companies. Mr. Sherman is an *Adjunct Professor* in the *Masters of Business Administration (MBA)* program at the *University of Maryland and Georgetown University* where he teaches courses on business growth, capital formation and entrepreneurship. Mr. Sherman has been General Counsel to YEO since 1987. Mr. Sherman is the author of twelve (12) books on the legal and strategic aspects of business growth and capital formation. His most recently published books include **The Complete Guide to Running and Growing A Business**, published by **Random House** in November of 1997 and **Mergers and Acquisitions: A Strategic and Financial Guide for Buyers and Sellers** published by AMACOM in March of 1998 and **Parting Company** published by Kiplinger's in May of 1999, as well as **Raising Capital** published by Kiplinger's in Spring of 2000. **Fast Track Business Growth**, was published by Kiplinger's in January of 2002. Mr. Sherman can be reached at (202) 833-5000 or e-mail [andrew@growfastgrowright.com](mailto:andrew@growfastgrowright.com).