

## **The Advisor – Fall 2011**

### **The Acquisition Proposal**

This newsletter continues our recent discussions on the steps involved in acquiring a business. Assuming an acquisition strategy has been developed and followed and a target has been identified, it is now time to take a second “sober look” before proceeding. A detailed, objective analysis of the target should be executed before expressing an intention to purchase. This analysis would ideally be prepared by the CFO and/or the corporate development team of the buyer. Outside M&A advisors can add value in vetting the analysis or in assisting in its compilation where internal resources are inadequate. As a minimum, an outside advisor can provide an objective, third party opinion on the merits of the potential acquisition.

Some of the items that should be contained in an acquisition proposal would include:

#### **1. Benefits of the Acquisition**

This would be a high level discussion outlining the strategic motivations of the deal as well as a rationale of why senior management should spend valuable time and incur significant out of pocket costs in attempting to acquire the target.

#### **2. Organizational Fit**

Items to discuss in this section would include:

- Is the corporate culture of the target complementary to the buyer's?
- Is the target's organizational structure similar to the buyer's? (e.g. centralized vs. decentralized decision making; functional organization structure vs. profit centres etc.)
- Are there desired competencies and capabilities inherent within the target that are absent within the buyer?

#### **3. Synergies Analysis**

A detailed financial model should be prepared showing the value accruing to the buyer and quantifying potential synergies. For example:

- Elimination of redundant head count, overlapping office locations and other surplus overheads;
- Redundant assets that can be sold;
- Horizontal or vertical integration;
- Revenue enhancements due to access to markets or product lines not accessible in the past; and
- Tax reduction strategies (e.g. acquiring net operating losses to reduce the buyer's taxes payable).

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#### **4. Preliminary Valuation of the Target**

This would be based on the preliminary financial information provided at that time and would be fine-tuned during the due diligence stage. Similar companies should be discussed and compared to the target. Ideally, some would be public for ease of comparison. Various valuation methods should be presented generating a range of values with a recommended value within the range. Key value drivers (consistent with the strategic motivations discussed earlier) should be highlighted as part of the valuation calculations and conclusions. A reservation or walkaway price should also be presented if negotiations on deal terms become difficult.

#### **5. An Estimate of Transaction Costs**

Hard costs such as accounting, legal, due diligence and advisory fees should all be estimated. Soft costs such as hours spent on the transaction by senior management would also be projected. This analysis would represent the worst case scenario of what costs would be spent in the event that the decision to pursue the target is made but a deal cannot be reached.

#### **6. Deal Design Terms and Hypothetical Term Sheet**

In this last section, an outline of the key components of how the deal will be structured would be provided including:

- Whether it will be an asset or share purchase;
- How the deal will be paid for (cash, shares) or financed;
- The timing of the payment (percentage paid up front vs. deferred via an earnout); and
- Any tax exposure resulting from the acquisition.

A hypothetical term sheet or letter of intent can be presented for senior management review and modification.

Aries Advisory Group can assist you with the preparation of an internal acquisition proposal to be reviewed by senior management. We will ensure that all required components are covered and key issues are identified. We will also ensure that the recommendations reached in regards to valuation, suggested offer price and term sheet components are sound and valid. Please contact us at [info@ariesag.com](mailto:info@ariesag.com) or at (416) 467-7878 to see how we can help.