Fool Proof Mergers and Acquisitions

Acquiring or merging another firm has become one of the most popular ways to grow a practice. There are several reasons for this:

- Helps you rapidly expand into a new geographic region
- Lets you acquire much needed professional talent
- Permits you to obtain new service lines
- Provides opportunities to expand services (cross-serve) existing clients
- Takes a competitor out of the market
- Can secure your retirement by bringing in a younger firm
- Makes it easier to become a more dominate player in the market

Merging and acquiring also comes with some pitfalls, especially if you don't follow a proven process. In this article, I want to share with you the steps you need to take to make sure your merger or acquisition goes smoothly.

1. Why do you want to merger or acquire? Before you start down the merger or acquisition path, you need to determine why you even want to do it. How would a merger or acquisition help the firm fulfill its strategic vision? There are many different reasons to merge or acquire. (See the bullet points above.) You never want to acquire or merge a firm just for the sake of doing it. If a merger does not help you further your strategic vision, you usually need to walk away from the opportunity, because it really isn't an opportunity.

2. Who will lead the process? Depending on the size of your firm, you should have a dedicated M&A team take on the responsibility, or just one of the senior partners in the firm. The managing partner is usually the team leader and coordinates the effort. Firms also should select a lead negotiating partner, if this is not the managing partner.

3. What does the ideal candidate look like? The ideal candidate for your firm needs to have a culture similar to yours, unless of course your goal is to change your existing culture. Otherwise, you don't want to mix water and oil because they will always separate.

Most firms don't spend enough time examining culture. You won't want a firm that has a net income per partner that is significantly less then yours because they may have a more laid back or unaccountable culture. And, don't forget about technical ability and work quality. If the firm has several outstanding client issues or complaints, that's a

good sign of poor quality.

The more time you spend on identifying what the ideal candidate looks like, the smoother your process will be.

4. What are the deal breakers? Whether you are a buyer or a seller, there are certain issues or points that are non-negotiable. These are deal breakers. You need to identify what they are because a deal breaker does exactly what it says.

My advice is to get them identified and out on the table at the beginning of the process. Keep asking the other party what their deal breakers are. Some times people find them hard to articulate or just don't want to bring them up. It does no go to go through a lengthy M&A process only to have it killed at the end. Make sure you know what the other party's deal breakers are.

5. How to start the search? Once you have completed the above steps, it's time to start the actual search. Again, my experience has been that it is usually 9 to 12 months from the time you start the search to the time of closing the transaction.

While most firms already may have a short list of firms, you should use the following tactics to expand your list:

- Obtain potential names from partners
- Research firms on line with local CPA state society
- Advertise in state CPA publications
- Use professional advisors
- Send out direct mail solicitation letters
- Contact lawyers and bankers who may know of firms that are interested in buying or selling.

6. What to discuss at initial meetings? Usually the initial meeting is between the two managing partners. Before holding this meeting or any other potential M&A meeting, make sure that you and the other party have signed a mutual non-disclosure agreement (NDA). If the other party won't sign it, don't hold any meetings.

If the parties don't already know each other, this is the opportunity to meet and learn more about each of their respective firms. The best initial meetings are those that do not get into the topic of "what the firm may be worth." This is true whether you are the buyer or the seller. Determining the financial structure of a transaction is easy, once the two firms have agreed that they want to make a deal. Talking about money at this stage of the process is simply premature. Think of the M&A process as if you were dating. The first few dates are about getting to know the other person.

You will want to ask the other party the following types of open-ended questions about their practice:

- What types of clients do they serve?

- What is their service philosophy?
- Who are the other partners and what are they like?
- What kind of training do they provide staff?
- What is the firm's culture?
- Why are they interested in selling or buying?
- What do they know about your practice?
- Etc.

If you walk away from the initial meeting with good feelings then it is time to have further discussions and go to the next step.

7. What information to request? Before you even start due diligence, you will want to obtain from the other party as much information as possible about the firm. At a minimum you should ask for:

- Financial statements for the last three years and current year-to date financial statements (income statements and balance sheets)

- Number of individual and business clients (detailed client list can be obtained later)
- Accounts Receivable Summary by 30, 60, 90 and 120 days
- WIP Summary by 30 60, 90 and 120 days
- List of all employees and positions
- Payroll costs
- Productivity reports on partners and staff showing chargeable time, billable time, billing rate, utilization.
- Copy of employee manual
- Insurance claims history and any pending litigation

Once armed with this information you can begin to schedule follow up meetings and obtain answers to any questions that may arise.

8. What goes into a letter of intent? After several meetings with the other party you are able to begin the financial discussion. Some firms will have the discussion before issuing the letter of intent, while others use the letter of intent as the starting point for the financial negotiations. I don't think it makes a difference either way. It all depends on party making the offer.

The letter of intent is a non-binding document which outlines in general terms the nature of the transactions. It should include the following:

- The offer price for the goodwill of the practice and how it will be paid
- Asset or stock purchase
- The offer price for the tangible assets (if not included in the goodwill offer)
- How A/R and WIP will be treated
- Future purchase price adjustments (up or down)
- Firm governance

- Transition plans for any partners
- The assumption of any leases (equipment and real estate)
- Employment agreements and compensation terms for key people
- Admission to ownership of the surviving entity
- Non-compete and non-solicitation agreements

Some advisors will include a de-merger provision in the letter of intent. I personally believe that if one of the parties wants to have this, they are not 100 percent committed to the transactions. If a de-merger does happen, you can negotiate it later. Buying or selling should not be done without total commitment up front.

10. Negotiation. All things in life are negotiable except the deal breakers. I have found that the best negotiation is when you have two reasonable people who want to conclude the transaction and do not feel that they have to win each point. If, at the end of the negotiation, one parties feels it has loss that does not harbor for a good future relationship. Negotiate so it becomes a win-win and not a win-lose.

11. How to conduct due diligence. Once the letter of intent is signed, you are ready to conduct due diligence. I like to have due diligence done at this stage of the process since most of the negotiation has been done and the two parties are 99% sure the deal will transpire.

Assemble your due diligence team and provide each team member with a specific assignment. You basically want to verify that the information you received earlier in the process is accurate and true.

12. Getting the lawyers involved. I personally don't have anything against lawyers and they are critical in the process. I usually do not recommend that you get a lawyer involved early in the process. I have found that some of the best and easiest mergers or acquisitions are negotiated between the two parties. Once they have agreed on the terms, then it is time to bring in legal counsel to either draft or review the documents. Make clear to your counsel that you don't want them renegotiating the transaction.

13. Transition issues. It has often been said that a merger or acquisition is like an iceberg. The transaction is what you see above the water and that's 10% of the iceberg. The transition is what's below the surface and you can't see it, but it can sure sink the transaction.

You need to make sure you take care of the new clients, staff and partners, and don't forget about questions that your current staff and partners may have about the transaction.

For the new clients you will want to make sure that key clients are informed by a personal visit. Other clients need to receive a letter from the former and new managing partner.

Staff need to be informed as quickly as possible about their future with the firm. If you don't communicate with them they will create their own future. Everyone is asking themselves, "What does this mean for me?"

The due diligence process should help you identify a list of transition issues. For example, when and how will the transition to the new tax processing software be made? How will we physically integrate the two firms? When will we move?

There are a lot of steps in the merger and acquisition process and each one needs to be managed accordingly. Imagine yourself on a roller coaster, because that is what you will emotionally feel like when you go through the process. Just hang on and hold on to your seat!

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