

WHY TRANSACTIONS FAIL TO CLOSE

What is a Seller to do?

It's difficult to know for certain what percentages of transactions fail to close, because investment bankers don't like to disclose their failure rate. However, it's estimated that as many as one in three deals will fail to close after executing a letter of intent ("LOI"), and that roughly four of every five deals that do successfully close take much longer than expected.

The most prominent factors that result in failed transactions and suggested steps a seller can take to mitigate against such an outcome are summarized below:

1) New issues uncovered during due diligence:

- a. Ensure full disclosure of major issues prior to the LOI, be they known or contingent in nature; e.g. a threatened lawsuit
- b. Undertake an audit or review level engagement of your annual financial statements. Implement audit recommendations, particularly those that relate to establishing systems and internal controls and creating a sufficient audit trail; and
- c. Stay current with all necessary regulatory approvals, permits, certificates, licenses etc.

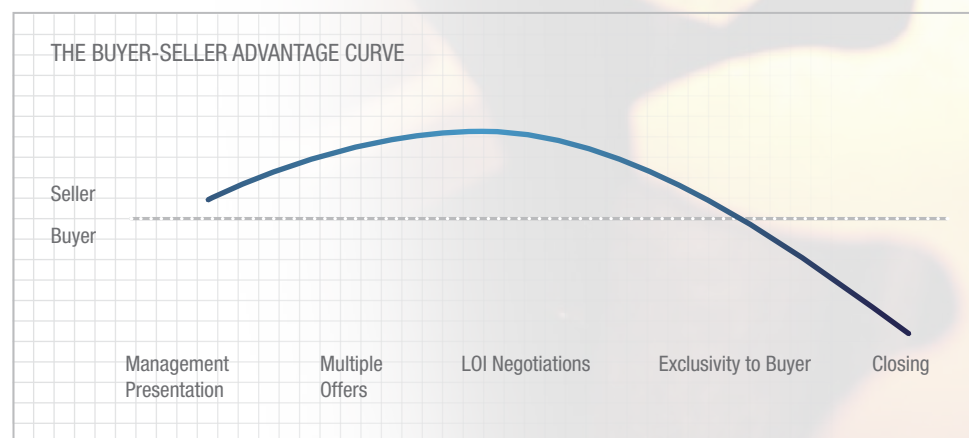
At some point prior to closing, a buyer is likely to have access to key management, suppliers, and customers. A prudent buyer will be in a position to seek clarity concerning identified key risk areas. For example, if the business is dependent on the owner and the owner still maintains key relationships with customers, this will come to light at some point during due diligence.

2) Diverging expectations between buyer & seller:

- a. Secure a comprehensive, unambiguous LOI. It is in the sellers' best interest to include as much specificity as possible in the LOI despite the fact that the document is non-binding; and
- b. Take the time to understand the prospective buyer's initiatives, motivation, priorities, strategy, etc. This is critical for selecting the right buyer and can help facilitate negotiations. Selling a business should not be a one-way exchange of information.

The seller maintains negotiating leverage until the time exclusivity is granted to the buyer, which typically coincides with the execution of an LOI. As demonstrated in the figure below, essentially, the buyer/seller advantage curve shifts in favour of the buyer at this time. Generally, a prudent

buyer will not proceed with detailed financial and legal due diligence without exclusivity because of the high cost involved in undertaking such analysis.



Note: This newsletter is meant to encourage general best practices only and is not intended as a substitute for professional advice. Specific situations or circumstances may warrant alternative approaches.

3) Diverging expectations among the selling group:

- a. Set and agree on objectives (financial and personal) in the planning phase of the process, revisit these expectations periodically; and
- b. Seek independent advice to determine if expectations are properly aligned and realistic. Business owners sometimes perceive that their company is worth much more than its market value, and risk turning down a good offer as a result.

4) Retain qualified advisors you can trust– i.e. lawyer, Investment banker, tax accountant:

- a. Retain counsel with a proven track record for closing transactions. Establish expectations at the outset and avoid attempts to renegotiate the business deals as agreed between the parties. Keep legal counsel focused on the legal risk/exposure and relevant implications;
- b. Create a barrier between the principals during stringent negotiations so as to not hinder the relationship between the parties. Your advisor can wear the “black hat” if necessary as you may have to continue working with the buyer post closing i.e. throughout the transition period; and
- c. Seek tax advice during the planning stages to maximize potential tax savings and to avoid any surprises at closing. There are three parties to every transaction; the buyer, the seller and the government. Through mutual cooperation and proper planning, the buyer and the seller can legitimately minimize the government’s interest.

5) Available capital:

- a. Deal with any financing conditions as early as possible, ideally prior to granting exclusivity; and
- b. Be selective when choosing the prospective buyer. Weigh your alternatives by carefully assessing the proposed conditions attached to any proposal.

6) Material adverse change in your company’s operations:

- a. Adopt a “business as usual” approach throughout the sale process and during closing. Don’t get distracted by the process and the demands it will command on your time. The business must come first; and

- b. Be conscious of risky endeavors / investments that have too long of a payback period as a buyer is not likely to pay for unproven initiatives.

7) Regulatory approvals:

- a. Take necessary steps to obtain preliminary indications of approval in advance whenever possible; and
- b. Review all contacts with change of control provisions, exit penalties, etc. Identify any cost and conflicts of interest that may result and take whatever steps necessary to alleviate these risks.

8) Vendoritis:

- a. Take the time to contemplate and know the answer to the question “what do I want to do with my life?”, particularly if you selling by choice and not necessity (e.g. health complications). There will be a time when you wake up in the middle of the night and wonder if you are doing the right thing. The sale process is an emotional one, and can be fraught with challenges. Often, it is the single largest monetary event in an entrepreneur’s life.

9) Deal fatigue:

- a. Set time deadlines, milestone targets and revisit progress regularly. Stick to the plan as much as possible and maintain deal momentum. For the most part, the timing of the sale is under the seller’s control up to the signing of the LOI and granting the buyer a window of exclusivity. Beyond that, it can become more difficult to keep things moving along, particularly when dealing with larger multinational corporations whose internal legal departments can often dictate the ultimate timing.

10) External circumstances:

- a. Negotiate a relatively short exclusivity period to minimize the potential for outside influences to cause the deal to falter. External events are beyond management’s control and cannot be avoided. If the economy takes a turn for the worst you may be forced to put the process on hold.

In the end, adequate pre-sale preparation and effective execution of the sale process are critical. These things will not only dramatically improve the odds of a successful closing but should result in a transaction that meets both the personal and business goals established at the outset by the shareholders.

VERACAP IS PLEASED TO ANNOUNCE ITS MOST RECENT TRANSACTIONS



TCH[®]

acquired the assets of

rush
electronics

*Veracap Corporate Finance
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B
Premium Brands

acquired the assets of

Piller's[®]

Piller Sausages & Delicatessens Ltd.

*Veracap Corporate Finance
Limited acted on behalf
of the seller*

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In August, **Veracap** acted on behalf of Rush Electronics, in its sale to TCH, a hardware distribution company. Rush Electronics is a Canadian-based distributor of electronic components used in a variety of applications.

In September, **Veracap** acted on behalf of Piller Sausages & Delicatessens in its sale to Premium Brands, a publicly held food company (TSX: PBH), in a transaction worth \$115 million. Piller's is one of Canada's leading manufacturers of deli-style meats sold at retailers and food service establishments throughout the country.

We are actively engaged in several other transactions, buoyed by an active market for M&A activity throughout Canada.

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