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Notes

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Corporate Seminars - Management Education oriented - seminars and workshops
30-35 subjects in portfolio of program
Started 1966 - 5000 people attended in 1969, 10,000 in 1970

Malcolm Rowe - Biomedical Resource Company - Put 25 small medical testing companies for hospitals, nursing homes, etc. 5 - 6 in sales.

Nick Salgo, Chairman, Bangor Punta
When to make a proposal
How to make a proposal

Negotiation is a people battle strategy

Never make a proposal unless you clearly define your interest and seller's desires, hopes, expectations. Is seller serious or on a "gratis appraisal"?

Not for sale - means he is. "Will listen" - more honest.

Owner's family situation - know it well.

Assuming we get together - what are you going to do with - time?
Money?
Next day?

How far can you count on man you're dealing with?

Took the man to Nedicks for good talk - big restaurant would have killed it. Man had been "told" what to do, how much.

Make sure what the owner really wants - Is Gummy or Sig calling shots.

Tie him in with stock - not money.

Single or more people involved? Make sure you know.

Gamblers to ultra conservatives - have to sort out.

Determining price - Don't shoot from hip - need background

Value concept of the seller -

Appreciate how much worth to him versus how much to you. Watch out if too far apart.

Don't bother with written proposal unless confirming talks.
PAPER creates an impression that he owns something.

Seller's mind - 100 units cash
Your mind - not worth it

Can counter with your cash unit - \( \text{\$100} \)
but invent alternators that equals \( \text{\$100} \) but he may interpret as a lot more, ie: stock, options, etc., tax free exchange, giving a shot at what he wants.

$100 borrowing at prime with 20% in bank = 10-3/4%

"Build a bridge" thru all the devices.

Decision making is very tough on both sides.

Once decision to purchase is made, decisions become much tougher for seller - biggest decision in life.

Use all empathy possible!
"Merger" is a euphorism - someone has to be boss.

Break-off timing

Acquirer - as long as in ball park, keep pecking - suggest go elsewhere for try.
Seller - walk out and let him follow

Individual interests cannot be bought part cash, part stock but different people can be handled in different ways.

Jim Robinson - Indian Head Chairman

Both sides must be better off after the deal.

Negotiating strategy

Start with Corporate strategy

1. Need specific and aggressive seat of power
   an individual leader totally committed
   backed up by board who will act and back.

Never has been the perfect deal.

Takes a lot of good staff work to set up and get information but in the end, top man must do it.
Leader needs high threshold of frustration.
Most deals won't go through - 10/1 or 20/1

Indian Head policy - increase intrinsic value of common stock
properly run and managed - more resiliency
opportunity
economic use of money
need not to get head in sand in one area.

Current climate

The bloom is off the rose today. Too many extreme actions have been taken which cause extreme reaction.

Over sold - too high prices, too creative accounting practices. Funny money.
Weak top management structures.

Reaction - falling earnings - falling stock prices a long way.

Pace will slacken - negotiations will be more sensible due to expense of money. Borrowing money for buying is going to be different.

Negotiations

Atmosphere must be good
Difference between style & policy
Don't take minority position

Willing seller - tightly held situation
estate problems
liquidity
need for capital to maximize growth. Management or technical lacks - family firms run out of management talents.

Small deals are harder to do than big ones because individual seller is more closely involved.

Be close mouth in discussion stage with outsiders and friends.

Concern for employees.

Fringe Benefits by joining

Contract for seller and limited number of people worked out beforehand.

Employing in "an exemptive capacity" for 3-5 years for $ ______ or better for full time and averaging at any time on 60 or 90 days notice by either side can be switched to consultant capacity at 1/3 to 1/2 of above for ______ time.

Drastic reorganization should be spelled out beforehand.

Autonomy must be clearly understood beforehand.

Lay all the cards on the table beforehand. No cuties, holdbacks.

In serious meetings - not too many people Client, attorney, accountant - few associates, if any.

You'll see and miss a lot of opportunities but don't seize the first or 2nd opportunity to tell a man to go to hell.

In making buy proposal, be decisive with well explained reasons.

Financial aspects

John Castle - Investment Bankers MIT - HBS

See Outline attached #1

Each deal is different because people are different entrepreneurial vs professional. Emotion vs economics.

3 packages depending on individual seller.

1. Stockholder's financial package - least important
2. Business synergy " - 2 + 2 = 5 economic-advantages
3. Seller's management " - roles & status

Good job on 2 can save a lot of money in final price. Clarifying 3 can be big plus.

2 = detailing the joining of 2 firms advantages production facilities, economies convertible debentures convertible preferred synergy package

Conglomerate benefits in business synergy package
1. Opportunity for cash for growth
2. Common stock
3. Spread risk for future product development
4. Attracting excellent people
5. Geographical spread

Express this package verbally but have it well thought out.

3 = Most important because urgent vital - detailing what the top group get

Responsibilities - for young more or less for old
Challenge
Generate enthusiasm to satisfy felt needs
Face saving devices if necessary
What happens if earnings decline - try to envisage
  Company owners may feel company peaking out
  Shield
Security & comfort packages
  Options, salary, titles, Board of Directors
  Clubs, reaction of friends

1 = Price, tax aspects, down side protection, increased eps,
  Analyze financial package. Parameters
  What multiple of earnings does he want.
  Cash vs cosmetic goal
  Cash is easy, clear deal
  Tax free, taxable, tax deferred
    30% cash - 70% paper
    being changed bylaw
  Dividend objective - 0 vs a lot
  Liquidity objectives Piggy back rights
  Registration Rights
  Down side protection - because of stock market decline people think about this.

Guarantee a certain stock value 5 years from now or make up difference with more stock or cash. This may reduce multiple from 15 to 10 because of surety.

See attached #1

Sources of information on closely held companies
directly from principles
  then confirm with thorough investigation by outside auditors - Arthur Young is excellent - before signing.

Establishing a Price Range for bargaining
Harry Keidan - Accountant for either side of acquisition

Foundation of objectives and relative weight of cash objective
  (Goal formulation)
  Increase of eps - for public companies may warrant higher price
  Acquisition of personnel
  Improved cash flow - for private companies
  New markets
  New products
  Use of idle cash

Analysis of sellers earnings & cash flow
  Condition of inventory, equipment etc.
  How were earnings arrived at
  Financial statement review for past several years
Auditor's statement - qualifications?
Footnotes - study them - interest rates on loans
Existing lease terms - study carefully
Maximum equity adjustments due to outstanding options, price
Contingent liabilities
Comparative statement schedules annually
Ratio analysis - yearly plotted
Expense to sales

Maintenance, advertising, selling; separately

Ratio of receivables to sales
Ratio of sales to return of sales - poor quality

Ratio study raises questions - puts seller on defensive.

What accounting principles are used re ours so what effect will it have on new owners.

Depreciation-useful lives
Inventory evaluations

Pricing Concepts

PE ratios of similar businesses
Use above ratio studies
Above based on many facts and assumptions
Buying public company, market price + a bit usually but basic intrinsic value must be established.
Book value - not usually too helpful
Liquidation value

Maximum Price
Public Co. - effect on EPS - does not dilute
dilution may be if future looks great
After Tax economics
Premium for buying good will is non deductible
Solid assets are deductible
Capital cost to buyer is vital
Cash flow is more important than book earnings
Return on investment

If earnings of company have to be used to retire existing debt, not much benefit to return on investment.

Look at new combined net cash flow - should be commensurate with buyer's financial goal.

See Example #2 attached.

Methods of Buying
Stock
Buy current assets for cash, lease other assets long term
If loosing money - loan money against purchase contract for stock
Contingent payout based on performance

Above paper is the type of homework that has to be done.
Acquisition is like courtship
How to initiate talks with prospects
be introduced
stumble into
classified ads

Study industry
standing in trade
customers

Mutual trust between key people - confidential
Maintain reputation as hard but fair bargainer

Don't scrutinize records to confirm what's been said until after handshake understanding.

Most important asset in any company is the management not the book assets themselves. Know how - technical and keeping pace with future.

Sources
Commercial Bankers
Investment bankers
Brokers
Ads

One out of 10 is good ratio for serious talks. 1/10 of this get to handshake. 1/10 of these fail.

Guideline criteria for Kidde are not written
Lots of intuition involved.

Contingent payout works well in small company deals.
Make sure whose responsible is clear.

H. Corbin Day - Goldman Sacks - Investment Bankers
Participants - Negotiation
Role of Investment Bankers
Represent buyers or sellers as financial advisor to complete a specific objective.

Sometimes an intermediary - impartial professionals trying to play constructive role

Explore all alternatives

Seller - Private - goes to G.S.

G.S. tries to get basic objectives of seller
Where do you want to be 2 or 3 years from now?
G.S. separates wheat from chaff.
Then outlines alternatives
stock offering
loans
merger
estate tax problems
debt situation
timing
need for product or financial diversification
Decision-merger

Evaluation & preparation of Company - books & people
Full understanding
Recommend price and structure of deal
Compare industry P/E rations + premium for control
Publish brochure - facts

There is a merger market in each industry
Tax free transaction is tax postponement - not necessarily the best deal. Capital gains on cash may be better.

All this homework by G.S. takes 3 months

If tax free - what is investment value of stock received
Select buyers - make presentation to key man
Negotiate - look at big & little items carefully, don't pull surprises at the end.
A deal must be good for both parties

PEOPLE

G.S. fees - 5% for 1st mo, 3% for 2nd mo, 1% for 3rd
Exclusive agent - obligation of seller but can be handled in wide variety of ways
If a finder only gets paid if the deal goes through, won't this generate a shot-gun marriage? - Yes but not if intermediary is highly reputable.

G.S. does not recommend continuing payments generally.

Because of present money shortage and low value of stocks - prices for acquisition will be lower. Good companies that were 17 and 18 to 1, now 14 to 1.

12/4/69 - Shad - Hutton - Investment Bankers

Financial Realities of Mergers - #3 - Prices in today's market

Past - public

1/2 only financial in nature - no other benefits
3/4 tax free 1/4 debt, securities and cash. Convertible
Preferred very popular

Average deal does dilute the buyer's EPS even though this is known to be a poor situation. Reasons below.

Prices are high - justified below. Most competitive market in history.

1. Competition among buyers
2. Cynergistic aspects
3. Seller's growth prospects better than buyers
4. 531 problem companies - some companies get bought with own assets
5. Debt capacity availability
6. Putting buyer's stock into friendly hands

Tactics for Sellers

Reconstruct 5 year operating record to clarify unusual expenses or situations.
Reconstruct balance sheets to show fair market values, real estate, inventory, etc.

Capitalization of expense

These reconstructions are to illuminate - not deceive

Work up study showing comparable companies in industry
Schedule of actual deals in industry for past 2 years

Conglomerates make more deals because they're good at it and can move quickly with confidence. New Buyers are apt to be much too ponderous and this lose out.

Use full time experienced lawyers and accountants to keep matters moving and assure covering right points.

Read article by Shad attached, #3

Sophisticated buyers agree on price before through study

<table>
<thead>
<tr>
<th>Price</th>
<th>Taxable or no</th>
<th>Management continuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>get these agreed</td>
<td>early - in principle</td>
<td></td>
</tr>
</tbody>
</table>

Memorandum signed by both parties
Then contract - 30 to 90 days

This automatically gets into the details

Chief Executive Officer should barge into prospective deal, get principles established, then turn it over to others.

Disclosure requirement comes after agreement in broad principles are established and at time of formal action.

Stephen Snyder - Greyhound

Timing - very personal thing - no set pattern

Solving estate problem is usual reason for selling - how strongly does he really want to solve his problem.

Seller must believe his future will be worth less or he is not satisfying his reasonable objectives.

Warding off unwelcome take-over

Final count down to signing is the crucial timing area where full communications are in effect.

Set finalizing date, which can be postponed, but it puts pressure on signing. Pressure is necessary because the high decision is more easily postponable.

Contingent payout should not exceed reasonably foreseeable goals. Greyhound has used them well as incentives and in new areas for Greyhound. Proteus on
downside and will assure payback for long term - 5 year, maximum - maybe 2 or 3 better.

Truth serum. Allows possible higher price.

How does seller protect himself in contingent payout that buyer will will cooperate on expansion goals, overhead assigned, etc.

Greyhound agrees in contract to advance monies at specified rates, to not charge overhead during period, to cover as many as possible of these areas. Have not spelled out actual loan amounts, but have said will loan if payback criteria are met. Mutual trust is still of major importance.

Wesley Marple - Observations of a negotiator - Northeastern

Case Study

A 75 in Company 10/1 PE 3,000 after taxes NYSE - dividend larger than earnings

B 12 in Company 26/1 PE 300, after taxes Over the counter

Silence can be as misleading as misstatements in keeping channels open on regular basis.

Private companies offer much more imaginative deals than public.

Optimum negotiating team size - 3 or 4. One chap is leader and consistently there.

Style and rank equivalents important.

Price Get at early and make reasonable - therefore well backed up. Doesn't matter who mentions first.

Opinions weighing risks vs opportunities can vary 4 times minimum. 25M to 100M.

Likes discounted cash flow analysis technique - others are important.

Value of an acquisition in the future but not the hereafter.

A bastard in a negotiating team really doesn't help. Situation is already stressed enough.

Team - Chief Executive
Financial officer
Top accountant
Top Lawyer
Consultant who knows the area

In final talks - only 2 of above

Follow up verbal understanding with memo - not necessarily signed.

Charles Scharf - Structuring the Merger Agreement - Closing the Deal

The deal is really being structural from the first meeting onward. Important to cover the details that come up from the beginning.
Get good experienced lawyer in the act early.

Agreement fixes rights of both parties. In private deal, representations and warrants in agreement tell whole story - go back 3 - 5 years in finances, land, equipment, patents tie-ups, agreements, etc.

Closing is the time that the legal effect takes place. May or may not be the same day as contract is signed. The real deal is signing the contract, but closing must be explicit.

Paul S. Morgan

PSM/eh
10 December 1969