



viewPOINTS

SELLING YOUR BUSINESS

10 CRITICAL STRATEGIES
TO MAXIMIZE VALUE IN
A DIVESTITURE





In a vibrant health care service merger and acquisition environment, selling a business is easy. If your goal is maximizing value, however, that's an entirely different story. It takes planning. Strategy. Execution. Not unlike what was necessary in building the business in the first place.

There are a multitude of stratagems that sellers can employ to ensure they reach their goals and objectives. But there are 10 strategies in particular that – with virtually no room for error – must be initiated to maximize value in a divestiture.

1. Perfect the timing. For every company, there is a unique and ideal time to sell – and rarely is it when a buyer happens to pop the question.

Rather, the perfect timing arises (1) when a business begins to shift from “hyper-growth” to “mature growth” in its growth cycle; (2) when factors such as reimbursement, operating strategies, supply and demand and others contribute to favorable M&A market dynamics; and (3) when passion turns to burnout, alternative investment opportunities become attractive, the psychic value of incremental equity becomes marginal and other personal goals and objectives are consistent with a sale.

The best-prepared sellers continually monitor these three “decision spheres” to determine when they are in optimal alignment: the point at which both financial and intangible value can be maximized. The importance of this approach can't be emphasized enough. Without question, more value is lost by mistiming a transaction – and more value gained by right-timing a transaction – than by any other miscalculation in a divestiture.

2. Determine the Components of Value. Quite simply, you can't maximize value if you don't define its components. Sure, you want cash. The more the better. But for virtually every seller, there are other tangible and intangible transaction elements that can create substantial additional value, value that can help distinguish one offer from another.

For example, for large, platform-sized entities with an owner or management team interested in developing the business further, extraordinary value can be created by selling to a private equity group and retaining a minority interest in the firm going forward.

With an influx of financial and other additional resources to support layer-on acquisitions and organic growth, PE-sponsored firms can grow so much that the value of a retained minority interest can sometimes exceed that of the initial deal. As such, value is derived not only by retaining an equity position but, more important, from partnering with the right private equity group.

Other examples: Many sellers assign a high value to divesting to a buyer that is likely to retain all of its key employees. This is often the case with hospital-based and not-for-profit entities. For others, timing is a crucial determinant of value, particularly when the seller wishes to pursue other business, personal or financial goals.

For C corporations, given the double taxation that occurs upon the sale of assets, extraordinary value can be created (or retained) by identifying a buyer willing to acquire stock.

Finally, while cash is king, sellers who want to maximize value will not limit their consideration to cash-only proposals. Buyers naturally want to leverage their cash on hand to complete as many, and/or as sizable, transactions as possible. Accordingly, many will bestow additional premiums to sellers willing to accept notes or stock.

Though non-cash remuneration certainly carries risk, the returns can be significant and, when carefully structured, large portions of this risk can be mitigated. Furthermore, when large gaps exist between buyer and seller regarding future performance, deferred compensation in the form of earnouts have the potential to be exceedingly valuable.

3. Recast Financials Completely and Credibly. On the surface, recasting financial statements to eliminate expenses a buyer is unlikely to incur seems quite simple. In fact, therein lies the problem. On the surface it is simple. Getting beyond the surface, though, is far more complex, yet essential in maximizing value.

Miss hard to identify add-backs buried in arcane accounting principles and you can substantially understate earnings potential, a miscalculation that is compounded when these figures are subsequently applied to valuation multiples. Overstate, inflate or unsubstantiate add-backs, and you compromise credibility, which buyers, in turn, often reflect by discounting those same multiples. So recasting financials must be done aggressively and delicately at the same time, a difficult balance to achieve.

Few sellers miss the easy add-backs: excess owner's compensation and perks, relatives on payroll, one-time expenditures and the like. Most sellers even pick up on the impact of expensing versus capitalizing equipment.

But the overwhelming majority miss out on the income statement impact of how financials are prepared (cash, accrual or modified accrual); how revenues are recognized; how billings on hold are treated; the impact of the direct write-off versus the allowance method for accounting for bad debt and uncollectibles; the impact on cost of goods sold of conducting (or not conducting) annual inventories; and the proper treatment of new start-ups, just to name a few.

It can be equally damaging to overstate add-backs by claiming adjustments that don't hold up or are simply unreasonable. Key personnel, incentive programs, promotional activities and the like – resource investments that support the sustained growth buyers crave – don't magically disappear post-transaction. Likewise with customer service and billing and collection overhead. While large strategic buyers have administrative infrastructures in place, it is somewhat overzealous to believe that these infrastructures



consistently have substantial excess operating capacity to absorb acquisition after acquisition without having to add such personnel and other supporting resources.

To maximize recast earnings and maintain credibility, adjustments of these types must be considered carefully. Moreover, sellers should not hesitate to include “negative” add-backs where appropriate – expenses the buyer will incur that they have not – as any “loss” of earnings will likely be more than offset by a valuation multiple unfettered by mistrust and increased risk.

4. Orchestrate Controlled, Multiple and Simultaneous Presentations. Far too often, sellers pursue what we call “sequential presentation,” a process by which sellers predetermine the likelihood that individual buyers will deliver maximum value, queue them up from best to least-best and approach them in order, one after another.

The theory is that best-fit buyers can be reasonably determined, and that limiting presentations to buyers one at a time reduces exposure in the market and lessens the chance that confidentiality will be breached. Interesting theory. But utterly and completely wrong.

First, with so many variables that have nothing to do with a particular seller and everything to do with a particular buyer, it is simply impossible to predict accurately which buyer will step up.

Second, rather than minimizing potential exposure, sequential presentation actually increases the likelihood that confidentiality will be breached. Unless the first buyer in queue submits and closes on the best offer (and how do you know if an offer is the best if you haven’t entertained proposals from others), time on the market expands as each new buyer is brought in. Counter to conventional wisdom, the greatest threat to maintaining confidentiality is more a function of time than a function of the number of buyers brought to the table.

Given this, the only way to identify the “right” buyer for the “right” seller at the “right” time in a compressed time period is to pursue a controlled, multiple and simultaneous presentation strategy.

5. Proactively Develop and Monitor BATNAS. Typically, once a seller has identified a buyer that they believe will meet their divestiture needs, all attention is refocused on this party, forgoing discussions – at least for the time being – with other potential suitors.

This is particularly the case when sellers pursue a sequential presentation strategy. In doing so, they forgo the opportunity to develop strong BATNAs (best alternatives to negotiated agreements) other than simply not selling. Absent these BATNAs, sellers give up negotiating leverage that can prove critical in moving from a letter of intent to closing at the price and terms initially agreed to, and under the most favorable definitive purchase agreement language.

In order to maximize value, it is vital that prior to signing a letter of intent – which typically contains “no-shop” provisions barring sellers from continuing dialogue with other buyers over a defined period – sellers proactively and strategically identify, develop and queue one or more back-up buyers. While this requires a deft and sensitive negotiation touch – no buyer likes to be in second place – the payoff can be huge, and it is not at all unusual for “secondary” buyers ultimately to close a deal.

6. Only Negotiate That Which Is Written and Complete.

While rarely used as a negotiation tactic, amidst a backdrop of excitement, anxiety and zeal to close a deal, buyers and sellers alike often find themselves negotiating a limited number of terms – typically price – the theory being that until price is nailed down, the details can wait.

Unfortunately, absent the details there is no way to assess the real value of an offer. An “expected value” net of taxes can be worth more or less than it initially appears based on structure (asset versus stock transaction), terms (cash, notes, stock, contingent payments, etc.), balance sheet considerations (liabilities assumed by the buyer or not; assets retained by seller or not), timing, financing contingencies, owner transition requirements, non-compete terms and other intangibles that may convey value to the seller (see No. 2 on the list).

When offers are put in writing, the ante is raised, and buyers typically include some or all of the details above in their proposals. Only then can a seller begin to negotiate a transaction that maximizes value.

7. Continue to Manage the Business as if You’ll Own it Forever ... You Just May. Perhaps the most common behavioral phenomena in mergers and acquisitions is that once a seller makes the difficult and emotionally gut-wrenching decision to sell, they immediately begin to distance themselves from the day-to-day operations of the business and focus entirely on completing the transaction as quickly as possible. Inasmuch as the principal shareholder(s) typically drive, facilitate and inspire performance, any reallocation of real or emotional resources can have a quick and deleterious effect.

Moreover, any unfavorable changes in performance between the time frame captured in the letter of intent and the final due diligence creates doubt in the buyer’s mind regarding the credibility of the original numbers as well as go-forward expectations, assumptions upon which the deal was originally crafted. Accordingly, price is often renegotiated, typically disproportionate to the downward trend. So a 10 percent reduction in performance can easily yield a 20 percent-or-more reduction in price.

As difficult as it may be, during the divestiture process, sellers can literally not afford to do anything other than continue to manage the business as if they were not contemplating a transaction.



8. Do Not Disclose Divestiture Plans to Key Employees for as Long as Practical.

This one can be very difficult, especially for owners who have developed strong bonds with key staff. Pursuing a divestiture strategy covertly feels like an act of bad faith, a violation of trust and disloyalty. In actuality though, keeping your plans to yourself is anything but.

The problem is that when a seller decides to divest, until they know that a potential deal is possible, who the buyer is and under what circumstances they are acquiring the firm (i.e., opening up a new market or folding into an existing operation), the seller simply has no idea what the future holds for key staff. Informing them of divestiture plans early in the process only serves to create anxiety for the very employees you care for most, anxiety that cannot be addressed or alleviated for many months.

Key employees may try to relieve their tension by confiding in others, seeking employment elsewhere or simply distancing themselves from the business, all of which can start a downward performance trend that can spiral out of control during a protracted period of the unknown. Given the impact of declining performance post letter of intent, this can destroy the opportunity to maximize value.

The above notwithstanding, buyers should recognize that in order to sustain revenue and profit streams, they must have a transition strategy in place prior to closing a deal, a plan that includes a clear identification of the employees they intend to retain post-transaction. To accomplish this, it is necessary to meet with and interview key staff at the very least prior to closing.

So how can a seller accommodate buyers' needs and minimize the risk described? The answer lies in a staged due diligence. When deals fall apart, it is generally due to problems in financial reporting and/or regulatory compliance. Accordingly, during initial stages, due diligence can be limited to off-site review of financial records and a random review of charts (typically accomplished via virtual data rooms).

Only after the buyer has indicated that they are comfortable with these findings do they begin to expand the scope of due diligence activities – including employee interviews – which are held off until as late in the process as reasonable. At that point, the likelihood of closing is high, mitigating the risk associated with employee notification.

9. Prepare for Due Diligence as if the Outcome of the Deal Depends on It ... It does.

After the difficult process of moving from preparation to presentation to negotiation through the letter of intent, many sellers begin to fade as they enter the due diligence stage, a laborious and detail-laden point in the M&A cycle that can either make or break a transaction. So, due diligence preparation often suffers.

Certainly, sellers can make up for this by scrambling to pull together information for buyers on an ad hoc basis. But in doing so, they give up the opportunity to create goodwill, confidence and trust with buyers, intangible elements that can be extremely helpful in working through the difficulties that inevitably arise between due diligence and closing.

Don't underestimate this point. To a buyer, sloppy due diligence raises all kinds of red flags regarding any business operations that require organization and attention to detail, notably billing, collections and regulatory compliance. On the other hand, well-prepared due diligence communicates just the opposite and inspires confidence.

As a result, some of the best-prepared sellers perform mock due diligence even prior to signing a letter of intent. Not only does this help in organizing the volumes of paperwork required in due diligence but it also gives sellers a preview of difficulties that may come up later on – and the chance to fix them before they can undermine a transaction.

10. Obtain Experienced M&A Counsel. If your first reaction to this point is that it is merely self-serving (we are M&A advisors), think again. Entrepreneurs are expert in building companies. Skilled intermediaries are expert in converting them to value. Very different skill sets.

That is why, regardless of their knowledge, experience and business savvy, no self-respecting CEO of a publicly traded firm would ever dream of entertaining an M&A transaction without the counsel of an experienced dealmaker, one that is well-versed in developing and initiating each of the strategies outlined here.

There is simply too much risk going it alone. Too much unfamiliar territory. Too much distraction. And most important, too much at stake – like financial security.



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