

# Expert opinion

## Valuation

# Preparing for a sale: what's new?

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**Amid great caution in M&A, transaction support professionals should move towards detailed, targeted, critical analyses.**

**Deviations from certain VDD standards, observed between 2001 and 2007, must leave room for alternative analysis tools.**

The current M&A market conditions have been profoundly changed by the deteriorated economic environment. Since July 2007, there have been almost no more large LBOs for lack of funding; the near-impossibility for a bank to syndicate debt from other institutions, and therefore share the risk, has considerably reduced abilities to obtain credit; the extreme volatility of the stock markets has paralysed everyone involved. In many sectors, the unforeseeable decrease in business in recent months makes it impossible to develop reliable forecasts of turnover and therefore earnings. This lack of visibility on cash flows forecasts is a true obstacle to any attempt at valuation. Thus, buyers or potential sellers are delaying many transactions as they wait for clear benchmarks. However, relative activity remains under the effect of several factors:

- Modest-size LBOs (small & mid-caps), which consume less debt, are still active;
- "Alternative solutions" have permitted and continue to permit deals without traditional financing (such as the case of Converteam);
- New players are positioning themselves to buy unlisted companies ("turnaround" funds, sovereign funds, etc.);
- The restructuring of debt can result in movements in capital of the companies involved (entry of new equity sponsors, transformation of mezzanine debt into capital, debt to equity movements, etc.);
- Certain listed groups are examining or considering the disposal of assets that are underperforming or lie on the periphery of their core activity;
- Many listed groups are on the lookout for potential "good deals" from LBO fund portfolios or even companies under court-supervised reorganisation.

In this climate, the services of consultants who prepare the transactions, grouped under the label "transaction support" (TS), are bound to grow.

## **Making sense of numbers**

Vendor due diligence (VDD), practiced on the English market since the end of the 1990s, and in France a few years later, still used on large operations, is no longer always suitable for the current situation. This work, often burdensome and costly, fit with the standards imposed by financing bankers of the London market during the LBO boom years. The settling of demands and the escalation of service providers during this period often led to the production of reports of hundreds (or even thousands) of pages, in which compliance with "standards" sometimes prevailed over the relevance of analyses and the volume of which and the lack of a summary, in certain cases, prevented comprehensive, effective use. During these years of extreme competition among capital investors and financial bankers, in many cases, this document guaranteed uniform treatment among competitors and quickened the conclusion of the transaction. Prepared at the initiative of the seller, it was sometimes the only analytical document of reference for the transaction, with the buyer being limited to a careful and, if

possible, critical reading. According to many stakeholders – capital investors as well as listed groups – the current environment for M&A transactions and, probably, how it will change in the coming years will require much more critical, thorough analysis work. The priority is no longer to provide "standard" documents, but to give true meaning to the numbers, allowing a decision to be made with regard to a sale or investment. There are fewer potential buyers, who are less bound by time to beat the competition and are more cautious. At the same time, the few providers of debt are much more cautious and require more advanced analyses on items deemed truly sensitive. All stakeholders are also fussier with regard to acquisition costs.

### **Preliminary parameters**

This trend seems conducive to the emergence of less burdensome documents, in which the presented information targets the specific characteristics of the object to be sold and is analysed in more depth, showing proof of a true healthy scepticism of genuine worth. In order to support a sale, there are more targeted, alternative solutions to VDD. In an upstream phase, the pre-sale analysis should allow a group planning to buy a business to define a large number of preliminary parameters. Prepared in the greatest confidentiality by TS professionals from a limited number of interviews and the examination of targeted documents, this analysis should be able to answer the following questions in particular:

What are the accretive, or dilutive, effects to be expected from such a sale?

Under what conditions, and after what preparatory financial work, is this scope saleable?

How should it be presented to potential buyers (financial statements, forecasts)?

What work should be planned and at what cost?

What are the points that must be examined in more depth, possibly resolved, before the transaction?

## The Financial Facts Book (FFB) is a document prepared by TS consultants at the seller's request.

In this context, the involvement of transaction support professionals is purely technical in nature and complements the work performed by corporate banks.

### **Standards that are sometimes unnecessary**

In the implementation phase, a true VDD light, the Financial Facts Book (FFB) is a document prepared by TS consultants at the seller's request for examination by potential buyers. Ignoring certain VDD standards that are sometimes unnecessary (for example, presentation of the company's business, generally redundant with the info memo, thorough description of the accounting principles used, very detailed analysis of certain balance sheet accounts), this document focuses on the financial aggregates and the important elements for the potential buyer. Among these elements, examples of what can influence buyer interest or vary the target's value include:

- The recurrence of operating earnings
- The availability of cash
- Real net indebtedness, including off-balance sheet items
- The ability to achieve the objectives, taking past achievements into accounts, etc.

Similarly, the FFB should be focused on thorough analyses allowing buyers to correctly understand certain specific features of the target, for example:

- In activities based on long-term contracts (public works, mechanical construction, or aeronautics): recognition of business earnings, methodology for business end forecasts, and cash profile over the term of the contracts.
- For a chain of stores under development: modelling of the financial consequences of a typical opening (investments/increased activity/earnings/cash).
- For an audiovisual production business: analysis of pre-sales, methods for compensating

copyright holders, risks on minimum guaranteed, methods for calculating the producer's share of net receipts, etc. This therefore involves offering less extensive, more focused analyses making it possible to understand the intimacy of the target's financial model in detail.

### Real advice

Lastly, in the current economic environment, vendor's assistance work can support the seller in preparing forecasts and any "non-accounting" financial documentation necessary for presentations to buyers. The TS consultant prepares the information and analyses with the help of the seller. These items (for example, a detailed and supported business plan, analytical income statements by income lines, costing of a restructuring plan, etc.) can be prepared in advance. Often, the work occurs during the buyer's due diligence phases in order to provide updates and additional items. During these various phases and for these various types of work, it is essential for TS professionals to be able to assist their customers and their consultants without regulatory constraints during negotiations of the price, terms for adjustment of the price, definition of reference aggregates, and the drafting of the agreement. In conclusion, in the current climate, there are limits to the conventional, standardised work: it is necessary to use specific, pragmatic work adapted to each situation, utilising as much expertise as it does experience and innovation. As such, TS is real advice.

### For each situation, there is a corresponding assignment type

Type of work	Definition	Advantages	Limits/disadvantages
<b>Vendor due diligence</b>	Analysis work performed upon request	Document meant to be exhaustive. Responsibility of the TS professional towards the buyer and the seller.	Document often very long and burdensome. Sometimes difficult to use. Costly work.
<b>Pre-sale analysis</b>	Analysis work performed at the seller's request according to "market" standards.	Good decision-making tool. Flexible and inexpensive.	No formalisation in order to send the information to the buyer.
<b>Vendor's assistance</b>	Analysis work intended to identify the interest of a sale and the future work to be implemented in order for the sale to go smoothly.	Work that is adapted to the situation and the negotiations.	No report signed by the TS professional: the information is communicated to potential buyers under the seller's banner.
<b>Financial Facts book</b>	Analysis work performed jointly by the seller and its TS consultant.	Not as demanding as VDD. Focused on the important points. Provides information adapted to the buyer's needs.	No responsibility of the TS professional transmitted to the buyer. Does not correspond to a "standard"; the nature of the work actually performed must be assessed by prospective buyers each time.