CHAPTER 6

MANAGING THE SELLING PROCESS

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6.1 SELLING PROCESS: SHOW TIME

Thus far, we have detailed an extensive process for planning and preparing for the divestiture transaction. In Chapter 3, we discussed planning activities such as the development of the board paper, organization plan, retention plan, and communication plan. We covered transactional preparation, which includes retaining advisors, drafting marketing materials, and preparing for due diligence, in Chapter 4. We then turned our focus to preparing for the operational separation of the divested business from its parent organization in Chapter 5. Here, in Chapter 6, planning and preparation culminate with the initiation of the selling process.

The public announcement of the selling corporation's intent to divest one or more of its business units signals the start of "show time" for the divestiture team. Leading up to the announcement, virtually all of the preparatory activities have been performed by a small team in a highly confidential setting. However, once the public announcement is made, the environment changes dramatically. Most of the process will now occur on a stage. From this point forward, the divestiture team's words and actions will be subject to scrutiny by an audience, and this audience's reaction can significantly increase or decrease the value of the deal.

As discussed in section 3.8, the audience of parties interested in the divestiture actually consists of several constituent groups, each having unique concerns. In order to inspire the enthusiasm and confidence of these groups, the selling corporation must adapt its messages to address each set of concerns.

For example, shareholders pay close attention to what is said about the selling corporation's strategy. This group wants to understand how the divestiture fits into the corporation's long-term plans. The shift in focus away from the divested business is expected to be accompanied by an indication of which segment(s) of the business will receive

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greater emphasis for future growth. Put succinctly, shareholders want to know how the divestiture will increase the corporation's value.

Potential buyers, however, are more interested in what is said about the divested business. They want to know why this is an attractive investment opportunity for them and may need to be convinced that the selling corporation is not just trying to rid itself of a troubled business.

Employees of the selling corporation, particularly those who are part of the divested business, have their own set of concerns. They will have many questions about how the divestiture will affect them personally, and the announcement may provoke a strong emotional reaction from them. As a result, employees of the divested business unit need both information and reassurance, delivered with empathy and respect. The divestiture team should not underestimate how quickly and easily employees of the divested business can become distracted after the public announcement.

Not only will the selling corporation's words be studied and evaluated, but so will its behavior following the announcement. The best way to continue to send a positive message about the divestiture is to follow the initial announcement with an efficient sale process, with speed and certainty of closing being the most important factors. Once the divestiture is announced, an extended period with no news from the selling corporation is likely to portend a problem. Knowing that the divestiture process is observed closely, the team needs to manage the sale process in a way that sustains momentum. A capable broker will make a major contribution toward this goal, utilizing its experience and savvy to shepherd potential buyers through a well-defined sale process and holding participants to tight timelines. The divestiture team will also see its extensive planning and preparation contribute significantly to a smooth selling process.

The public nature of the selling phase of the divestiture significantly raises the stakes for the transaction. An organization that delivers a positive initial message to its stakeholders and sustains momentum with a well-managed sale process has a much better chance of optimizing shareholders' value than one that suffers from a lack of attention, planning, and discipline. Consequently, we will emphasize two critical success factors in this chapter: effective, tailored communications, and an efficient, disciplined sale process.

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6.2 SELLING PROCESS STEPS

In section 4.6(b), we discussed the typical options for approaching the sale of a business unit. These options range from a preemptive process involving a single buyer, to a public auction, which could attract a large number of participants. While these approaches differ in the number of potential buyers involved, they are similar in terms of how the selling process is conducted. Specifically, most sale processes tend to follow a two-step format. In the first step, potential acquirers are solicited to submit an initial valuation, or valuation range, based on preliminary information that has been provided. If the valuation is directionally acceptable, the selling corporation invites the potential acquirer(s) to proceed to the second step, which consists of a closer look at the business leading to a definitive offer.

Even if the field of potential acquirers consists of a few organizations, or only one, a two-step process still makes sense because it prevents wasted time. Neither buyer nor seller wants to engage in an expensive and time-consuming due diligence process only to find that the parties' respective views about the valuation of the business are not even in the same ballpark. By providing for a preliminary offer based on summary-level information, both parties can quickly determine whether there is a basis for proceeding. If the discussions do move forward, the parties will enter the second stage confident that a successful deal is attainable and worth the additional effort. Conversely, if the valuation is not mutually acceptable, participants can walk away from the discussions without having expended significant time or money.

Since many sales follow this type of approach or some variant of it, we have modeled this chapter to follow a two-step sale process, which typically includes 10 elements:

1. **Final preparation.** Before publicly announcing the prospective divestiture, the team ensures certain key things have happened, namely: (a) approval of final marketing materials and communications plans, (b) completion of audits, (c) signing retention agreements with key staff, and (d) coordination of the timing of the announcement with corporate management.

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2. **Making the announcement.** When the selling corporation announces its intention to sell one or more of its business units, it implements its communications plan, directing targeted messages to specific internal and external stakeholder groups.
3. **Contacting potential buyers and distributing marketing materials.** This activity, when the broker approaches prospective acquirers and distributes offering materials, initiates the first step of the two-step selling process.
4. **Soliciting and evaluating initial indications of interest.** At a time specified by the broker, potential acquirers submit initial bids, usually in the form of nonbinding indications of interest. The broker evaluates the bids and reviews them with the selling corporation.
5. **Inviting bidders into the second round.** In this stage, the second step of the two-step selling process, a select group is invited to conduct due diligence, where prospective acquirers are provided access to more detailed information and then asked to make final, definitive offers for.
6. **Due diligence.** The due diligence process normally includes a management presentation, access to a data room, and the ability to ask follow-up questions, providing potential acquirers a level of access to the details of the business that is intended to be sufficient to enable them to finalize their valuations.
7. **Distributing the draft purchase agreement.** Sometime during the course of due diligence, the broker distributes a draft of the purchase agreement to the second-round participants. This draft agreement specifies the terms under which the selling corporation would be willing to close the transaction. Bidders are directed to mark up this draft with their proposed changes.
8. **Evaluating definitive offers.** In this step, the selling corporation uses the competitive nature of the auction to optimize offers, not only in terms of price but also in terms of proposed changes, or mark-ups, to the purchase agreement. Assuming two offers have a similar valuation, the offer containing fewer mark-ups to the agreement will be viewed more favorably by the selling corporation.

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9. **Negotiations.** In speaking to the bidders about their offers, the broker will normally focus mainly on the valuation. Although bidders usually are asked to submit their best and final offer, the broker can, and often does, ask them to improve their offers, especially if several are in the same price range. If a bidder has an attractive financial offer but an onerous contract mark-up, it is conceivable that it could also be asked to revisit its mark-up in certain areas. At this point, one or possibly two players are selected to perform the remainder of their diligence and to begin to negotiate the purchase agreement.
10. **Confirmatory due diligence.** Simply stated, confirmatory due diligence includes any activities the potential acquirer needs to complete in order to close the transaction. Brokers distinguish this element of the diligence as "confirmatory" because this work is expected to confirm or validate information that has already been factored in to the bidder's valuation. Accordingly, offers are not expected to change as a result of confirmatory diligence findings.

These steps can be categorized into four major groups of activity, which are discussed in detail in this chapter and are summarized in Exhibit 6.1.

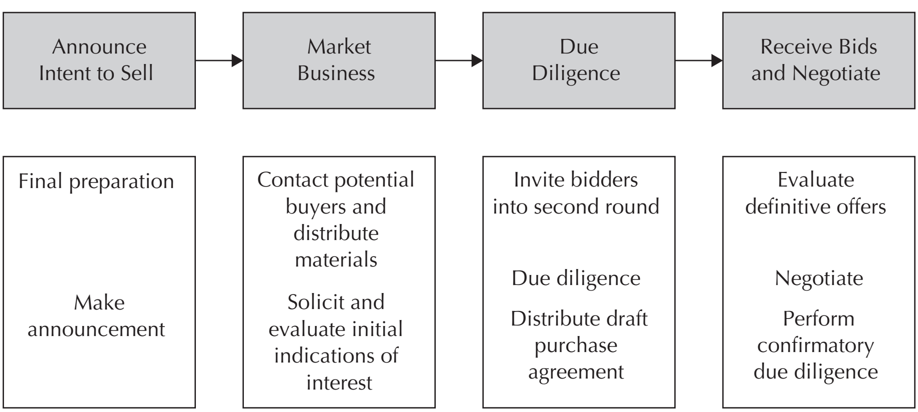

Exhibit 6.1 Selling Process Steps and Considerations

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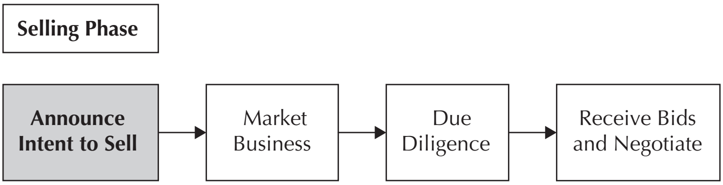
6.3 ANNOUNCING THE INTENTION TO SELL



(a) FINAL PREPARATION Once the corporation announces its intention to make the divestiture, the deal will begin to take on a life of its own. In the days and weeks following the initial announcement, the team's time can be dominated by interaction with various process participants and stakeholders, requiring its efforts to be largely reactive. This level of distraction is inevitable. Knowing this, the team should make sure its full attention is available for the postannouncement period. One good way to accomplish this is to methodically conduct a final review, designed to ensure that these key preparatory activities have been addressed before the announcement takes place:

- Announcement-day communication documents
- Marketing materials
- Audits
- Employee retention agreements
- Timing of the announcement

(i) Announcement-Day Communication Documents Require Final Corporate Approval. As discussed in section 3.8, the communications planning process generates a number of deliverables. Each of these deliverables, such as the internal and external announcements, question-and-answer documents, PowerPoint slides and scripts for live presentations, and employee information packages, should be reviewed and formally approved to ensure consistency with the core messages developed for the divestiture. Reviewers of the communications documents should include corporate communications, investor relations, executive management, employment counsel, and human resources. There will likely be many things going on across the corporation that may affect strategic positioning, requiring this group to place the

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divestiture announcement into the context of the overall public story the corporation wants to tell about its strategy and initiatives.

An important internal deliverable that the team should also include in this review is the employee information package, which details how employees' compensation and benefits will be impacted as a result of the divestiture. This package should include an individualized statement (e.g., calculations of vested retirement benefits, accrued vacation benefits, etc.) along with a question-and-answer document, which explains what is currently known about how employee benefits will be impacted by the divestiture and also noting items that cannot be determined until the acquirer is identified. Distributing such a package immediately after the announcement, even if some of the details cannot be finalized until later in the divestiture process, will go a long way toward alleviating employee concerns. Without such a proactive approach, the human resources group can expect to be besieged with employee compensation and benefit questions.

(ii) Final Marketing Materials Should Be Reviewed and Signed Off. The marketing materials (i.e., the teaser and offering document) form the divested business's first impression with potential buyers. As such, the marketing materials must have a persuasive, motivating effect. They should portray the business in the best possible light, demonstrating the upside opportunity of ownership to potential buyers.

At the same time, the marketing materials constitute the initial fact base against which due diligence activities will later be performed, and for certain transactions they will be examined by regulators as well. So the materials need to be both *persuasive* and *factual*. In order to achieve both objectives, the team should ensure that the marketing materials are positively positioned and have been reviewed and approved, and that the accuracy of all key facts have been verified.

The divestiture team should complete the review of the teaser and offering document before the announcement is made. Otherwise, team members may feel pressured to rush through their review, so that potential acquirers are not kept waiting once they start asking the broker for a copy of the "book."

While it is beneficial for the entire divestiture team to review and comment on the marketing materials, the most important reviewers are from the executive management, legal, and finance functions.

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- **Executive management.** Executive management should review and approve the offering document's rationale for the divestiture to ensure consistency with its planned announcement messages and that the document sufficiently highlights the value of the business (especially the Investment Considerations and Development Potential sections, described in section 4.5(c)). Management should also closely review how the market is defined and how competition is characterized, as this is the section that may receive regulatory scrutiny for transactions above a certain size. (See section 7.7(b) for further discussion of antitrust regulations.)

  As discussed in section 4.8, another area requiring management's judgment and concurrence is the amount of proprietary information divulged. Even in a limited auction, numerous parties will ask for and receive copies of the offering document, some with the objective of attaining a competitive advantage from the information revealed about the divested business. Although recipients are bound by confidentiality agreements, the selling corporation should nevertheless explicitly determine the level of information it is comfortable including in the offering document, withholding the most sensitive information (e.g., identity of customers, key employees, pricing) until a later stage in the process.
- **Legal.** As mentioned, transactions above a certain size are subject to regulatory review, making it essential in these instances for the internal and/or external legal advisors to examine all of the marketing materials before they are finalized. Even for smaller transactions, it is still prudent to have the appropriate members of the legal team review all key documents related to the divestiture, as they provide useful context and sometimes flag issues for later consideration when the contracts and agreements are being negotiated and structured. Moreover, while the offering document and teaser are essentially marketing pieces, and despite their inclusion of disclaimers, the legal team may still want to vet the supportability of certain statements made in these materials so that the selling corporation does not unwittingly create a credibility gap.

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- **Finance.** The finance representatives on the divestiture team can be useful as a quality control monitor for the marketing materials. Finance has primary responsibility for the accuracy of the historical results and forecasts as well as any financial facts quoted in the narrative sections of the document. Additionally, given its knowledge of the operations and relationships across the organization, finance can also serve as a liaison to managers within the divested business, having these managers verify information or operating statistics for areas within their responsibility. This review will minimize the possibility of any inconsistencies or conflicts between information potential buyers will see in the offering documents and the supporting information that will be in the data room.

(iii) Carve-out Audit Should Be Complete, or Nearly So. It is preferable for the carve-out audit to be completed before the announcement so that the audited financial statements can be incorporated into the marketing materials.

This, however, can create a timing problem, with the completion of the audit being the single event holding up the announcement of the divestiture. Consider a typical timeline. If brokers and accountants are engaged at approximately the same time, the broker usually can complete its information gathering and draft the offering document within a four- to eight-week time frame. A carve-out audit, however, normally requires a *minimum* of 12 weeks to complete, possibly much longer if the audit covers two or three years or if it does not proceed smoothly. This means that all other preparations for the announcement can be in place, ready to go, and then the team might have to wait for an additional month or more for the audit to be completed. This is the reason for our recommendation, in section 4.3(e), that the team arrange to have the audit initiated at the earliest possible moment—as soon as approval to divest the business is received.

If the audit is still in progress when the corporation is otherwise ready to make the announcement, the broker, in its zeal to get the selling process started, may recommend releasing the marketing materials using unaudited numbers and providing the audited accounts to potential buyers later in the process. This is because the audit does not

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technically have to be completed until later in the process, usually in order for the acquirer's financing to be finalized. However, the divestiture team should consider using unaudited financials in the marketing materials only if several conditions are satisfied:

- The team should be *highly* confident there will be no material audit adjustments. The existence of significant audit adjustments after distribution of the offering document can undermine bidders' confidence and potentially alter their valuation of the business. There is usually a point in the fieldwork when the auditors can inform the divestiture team that they have identified most of the major adjustments. The team should avoid publishing the marketing materials before this point.
- The team should be reasonably certain about how much additional time is required to complete the audit. If the audit is still in progress when the selling process starts, the audit's completion suddenly becomes a deliverable that will be monitored closely by potential acquirers. Any delay in the completion of the audit is likely to erode the confidence of the bidders, causing them to extend their other due diligence efforts and further slowing the sale process.
- The team must be comfortable with its capacity to support the remaining audit activities while also accommodating the potential acquirers' due diligence requirements. Once the offering document is completed, ideally all of the accounting and finance teams' energy should be focused on supporting the soon-to-come buyer diligence process. A financial staff that remains distracted by the completion of the carve-out audit has significantly less capacity to support the preliminary diligence, which could hamper the selling process.

(iv) Key Employee Retention Arrangements Should Be in Place. Key employees, typically the senior managers of the divested business who will be offered retention/incentive plans, should be signed up before the announcement is made. These managers must be counted on for their leadership, and they will be positively motivated by the knowledge that they are being treated fairly by the corporation. Other employees of the divested business will look closely at this group for signs of

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their support, or lack of support, for the divestiture transaction. Another reason this team needs to be signed before the announcement is they will be put to work on the divestiture immediately. Consequently, they should not be distracted and potentially demotivated by concerns about their own situation.

(v) Timing of the Announcement Should Be Coordinated with Corporate Management. Once the communications documents, offering materials, audits, and retention agreements are reviewed, approved, and completed, the final preparatory matter is coordinating the timing of the announcement with the parent corporation. Corporations normally prefer to orchestrate their public agenda, so there will likely be a specific viewpoint on the timing of the divestiture announcement. For example, there may be other acquisitions or disposals planned or under way, and the corporation may want to combine the several transactions into one narrative that emphasizes the execution of its strategy.

Another possibility is the corporation may wish to include the divestiture announcement into its scheduled release of quarterly earnings, utilizing an already-established mechanism for delivering the corporation's results and key messages to many of the same stakeholders (e.g., investors, analysts, and media). Doing this ensures that all investors hear the same message at the same time, and in the context of the corporation's broader narrative. Additionally, if the disposal is recorded as a discontinued operation (see related discussion in section 7.4(b)), the end of a quarter is a very convenient time to make the announcement and simultaneously disclose the operating results of the corporation's continuing operations, separated from the divested business.

(b) MAKING THE ANNOUNCEMENT Beginning with the announcement, the divestiture process transforms from a tightly controlled and confidential effort to one that is conducted in full view of a number of stakeholder groups. The divestiture team should think of its management of the logistics of the announcement as the first public demonstration of the corporation's ability to conduct a well-planned and smoothly run divestiture process.

(i) Managing the Announcement Logistics. A member of the divestiture team should be responsible for managing the logistics of the

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announcement and coordinating the involvement of executive management, corporate communications, investor relations, and human resources. This coordinator should prepare an announcement logistics schedule, specifying the timing of meetings, presentations, and release of the announcement documents. The schedule should cover relevant activities leading up to the announcement, those occurring on announcement day itself, and those planned for the days following. An illustrative announcement logistics schedule is shown in Exhibit 6.2.

In the several-week period leading up to the announcement, the primary tasks include securing venues and planning the communications logistics, such as webcasts or conference calls. Additionally, as discussed in section 6.3(a), the coordinator should ensure that all communications documents have received the required corporate approvals.

Announcement-day activities are divided between the external announcement to the public and internal communication with employees. The public announcement is fairly straightforward. If the transaction is small, the corporation can announce its intent to divest by issuing the press release. For a larger deal, the announcement can be made in a live meeting, often combined with other corporate announcements as discussed earlier.

The employee announcement, however, may require more detailed logistical planning. It is strongly preferable for employees of the divested business to hear the announcement directly from a senior executive. Employees' sensitivities will be quite high at this time, and they may take personally or misread what may well be innocent oversights in the announcement meeting logistics. While the employees may not be happy to hear the announcement initially, they will appreciate an executive traveling to their location and directly explaining to them the rationale for the divestiture. If it is not possible to have an executive present at every location affected by the sale, all employees, including those who are not in the office, should have the opportunity to connect to the live announcement through a conference call, video conference, or webcast. The divestiture team should not allow its members to become so busy with the transaction that they overlook the details that can shape employee perceptions.

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Date/Time	Task	Responsibility	Key Documents	Comments
X weeks prior to announcement	Arrange for venues, webcast, and/or video conference for external and internal announcement meetings	Corporate communications, operating management	Vendor contracts	
X days prior to announcement	Obtain all necessary corporate approvals of announcement documents	Corporate communications, HR management	All communications documents	
1 day prior to external announcement—late in day	Make internal announcement to employees of divested business	Senior executive	PowerPoint slides and scripts	Ideally, employees of the divested business should be informed prior to the public announcement by a senior executive, in person (if not prohibited by SEC or other guidelines)
Announcement day—at opening of business	Make internal announcement to employees of selling corporation	Senior executive	Internal announcements	Internal announcement to unaffected employees may be via a written communication

Exhibit 6.2 Illustrative Announcement Logistics Schedule (Continued)

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Date/Time	Task	Responsibility	Key Documents	Comments
Announcement day	Make external announcement	Senior corporate management, investor relations	Press release, PowerPoint slides and scripts	May be live or written, depending on size and importance of business
Announcement day	Follow-up meetings with employees of divested business	Business unit management, HR management	Question-and-answer documents, employee benefits packets	Departmental meetings and group meetings with HR, as required.
Postannouncement	Calls/visits with key customers and vendors	Business unit management	Customer and vendor communications	
Postannouncement	Receive external inquiries	Broker, investor relations, corporate communications	Question-and-answer documents	Potential bidders routed to broker: others to investor relations or corporate communications
Postannouncement	Receive internal inquiries	Business unit management, HR	Question-and-answer documents	

Exhibit 6.2 Illustrative Announcement Logistics Schedule

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Postannouncement activities include both outbound communications, such as outreach to important customers and vendors, and inbound communications, such as handling inquiries from potential bidders, or from employees. Clear accountability should be assigned for each area, and communications materials such as question-and-answer documents should be distributed to the relevant parties to ensure that the team's messages are consistent. It should be made clear in the various announcement-day materials where internal and external inquiries ought to be directed.

(ii) Delivering a Consistent Message: Message Triangle. Once the written communications are completed and the logistical details are in place, all that remains is to deliver the announcements. As mentioned earlier, the external announcement may or may not be done through a live presentation, depending on the size and importance of the business, while the internal announcement should be a live event. Even if the external announcement is done by means of a press release, however, the selling corporation should prepare its team to field follow-up questions.

An effective enabling mechanism for the corporation's spokespeople to deliver a consistent message and reinforce it after the announcement (whether in live question-and-answer sessions following the presentations, in interviews, or in follow-up conversations) is to use a well-established media training tool, the message triangle. A message triangle is a useful visual aid and an extremely shorthand way to distill the corporation's intended message about the divestiture into a few points on one sheet of paper. It normally contains three core messages, with supporting points aligned to support one of these messages. This allows the corporation's representatives to stay on message rather than get sidetracked by questions, which will hit them from a number of different perspectives. Separate message triangles should be developed for external audiences and internal audiences.

The key external audiences consist of shareholders, potential acquirers, customers, and vendors. Shareholders are fundamentally concerned with how the divestiture will increase the corporation's value, so they will want to know the selling corporation's strategic rationale for the deal and how the proceeds will be used (e.g., to make

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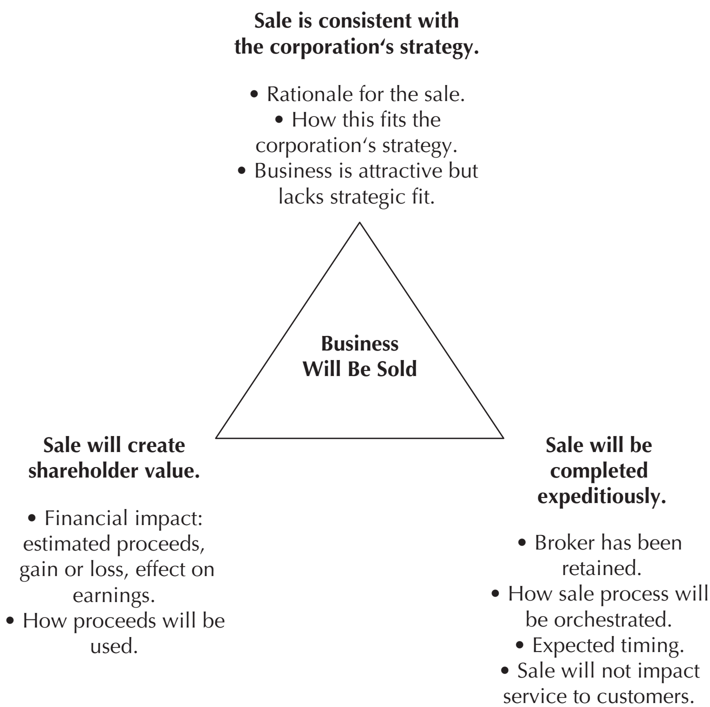

EXHIBIT 6.3 ILLUSTRATIVE MESSAGE TRIANGLE FOR AN EXTERNAL AUDIENCE

other acquisitions, pay down debt, pay dividends, or fund share repurchase programs). If the divested business is presented as unaligned with the corporation's strategy, shareholders will also expect the sale to be completed quickly so that the selling corporation can focus on its growth strategy. Potential acquirers, conversely, want to hear less about the selling corporation's strategy and more about the divested business, and whether this is a good investment opportunity for them. Customers and vendors mainly want assurance that the sale process will not cause an interruption or result in a change in the level of service to which they have grown accustomed.

A message triangle for external audiences, as illustrated in Exhibit 6.3, might address these concerns and interests through several core messages:

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- The sale is consistent with the corporation's strategy.
- The sale will create shareholder value.
- The sale will be completed expeditiously.

Note how the supporting points reinforce the core messages while addressing particular concerns, such as the attractiveness of the divested business and the expectation that customer service will not be interrupted.

The internal audience consists of the employees of the selling corporation, with the employees of the divested business being most centrally involved. The employees of the divested business are likely to receive the announcement of the intent to divest as a blow to their organizational pride, wondering if the sale signals a problem with the business. They will also have many concerns about their jobs and their benefits. In contrast to the external audiences, employees' questions about the divestiture will be much more personal in nature.

Another internal group not to be ignored is employees of the retained business units of the selling corporation. Although senior executives who are involved in the corporation's strategic portfolio analysis know whether any additional business units are being considered for disposal, most employees probably do not. Employees seemingly unaffected by the divestiture, therefore, will listen closely to the corporation's rationale for hints about whether other units might be considered for sale.

A message triangle for internal audiences, as illustrated in Exhibit 6.4, might address these concerns by developing core messages directly aimed at the employees' likely questions:

- Why is the business being sold?
- How will the employees be affected?
- What will the next steps be?

Note that the main message themes are similar to those for external audiences, but are framed in a much more personal way, addressing more directly what the internal audience really wants to hear. The corporation should point to the potential benefits of being owned by an enthusiastic acquirer, but should also be honest about the fact that many questions cannot be answered until the acquirer is identified.

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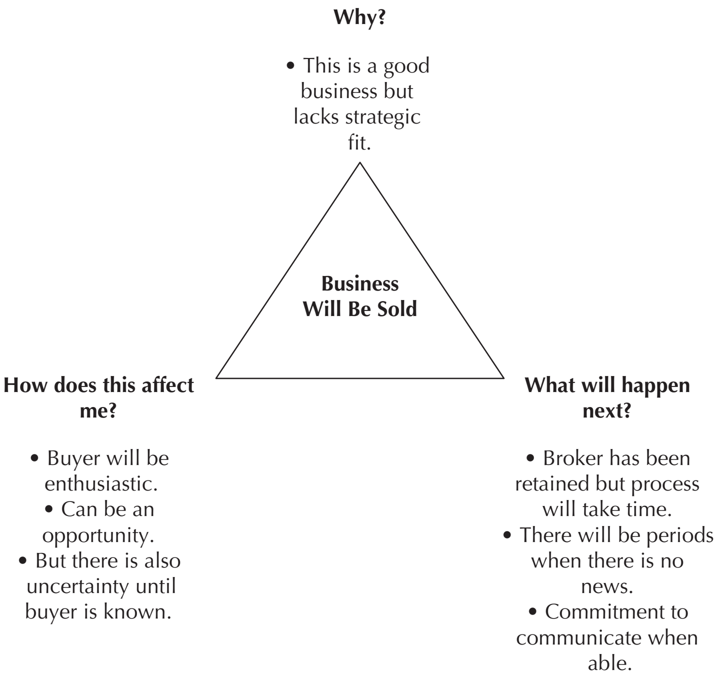
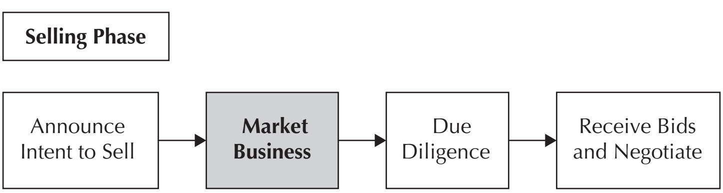


Exhibit 6.4: Illustrative Message Triangle for an Internal Audience

Another critical aspect of the message is to shape employee expectations about when and how they will receive updates about the sale as the process proceeds. Employees should receive a commitment that the corporation will keep them informed, but should also be told that the corporation will not be at liberty to speak to them during certain periods, as is usual during the sale of a business.

6.4 MARKETING THE BUSINESS



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(a) CONTACTING POTENTIAL BUYERS AND DISTRIBUTING MATERIALS The selling corporation and its broker normally develop a list of potential acquirers during the preparation stage. Once the announcement is made, the broker immediately approaches these prospective acquirers to gauge their level of interest. The broker and the selling corporation may also field inquiries from other interested parties who become aware of the availability of the business, supplementing their outbound marketing efforts.

Once an organization expresses interest, the broker sends out the first component of the marketing materials, the teaser, which is described in section 4.5(b). The teaser is a very brief document containing just enough information to generate interest, but which includes nothing that the selling corporation judges to be sensitive or proprietary. If the teaser accomplishes its objective and generates continued interest from the potential acquirer, the next step is for the organization to execute a confidentiality agreement, often referred to as a nondisclosure agreement (NDA). The NDA must be executed in order for the potential acquirer to receive more detailed, proprietary information upon which to base an initial offer.

(i) Nondisclosure Agreement. The selling corporation, depending on the scale of the process, may execute several dozen NDAs with potential acquirers as it seeks to establish a competitive auction. By definition, every one of these organizations except for one will not acquire the divested business. So there is a need to establish legal protection against the damage an unsuccessful acquirer can create by disclosing this information or by using the information or access to employees to compete with the divested business.

The NDA is the first legally binding agreement executed by the selling corporation and the potential acquirer. It requires the potential acquirer not to disclose any information deemed to be confidential as well as the existence and the contents of the deal discussions, and also prevents the potential acquirer from hiring or soliciting employees of the selling corporation (known as the no-poach provision.) These restrictions may endure for several years. Exhibit 6.5 includes an outline of the typical elements of the NDA agreement. Most of the terms of the NDA (such as the definition of, and the limitations on, what is

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Purpose

The purpose for disclosing the confidential information is the consideration of a possible transaction between the parties.

Information

The information being disclosed is nonpublic, confidential, and proprietary.

Access

The information shall be kept confidential and transmitted only to representatives on a need-to-know basis.

Return

Recipient agrees to keep a record of the location of the information, and to return it on request, destroying any analyses that incorporate the information.

Limitation

The confidential information does not include information that: (1) is or becomes public knowledge; (2) becomes available through a third party that is not bound to confidentiality; or (3) is independently developed.

Disclosure

A process is described for disclosing the information if the recipient is legally compelled to do so.

Confidentiality

This section specifies what is not to be disclosed. For example: (1) the existence of the contents of the agreement; (2) the fact that the information exists and has been made available; (3) the fact that discussions are taking place; and (4) any term, condition, or other fact related to the potential transaction.

No Liability or Obligation

The recipient recognizes that the disclosing company will conduct the selling process at its sole discretion and has no liability or other obligation as a result of signing the NDA.

Specific Performance

Monetary damages may not be adequate in case of a breach of the agreement and that the disclosing company is entitled to relief by way of injunction or specific performance.

EXHIBIT 6.5 NONDISCLOSURE AGREEMENT (NDA)—ILLUSTRATIVE OUTLINE (CONTINUED)

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No Contract

No contracts exists until, and unless, there is a definitive agreement.

No Representation

The disclosing company is making no representation or warranty about the accuracy or completeness of the information.

Governing Law

A specified state will have jurisdiction over the agreement.

Severability

If one provision of the NDA is invalid or unenforceable, it will not affect any other provision.

No Poach

The party receiving the confidential information will not solicit or hire [any, or a specified group] employees of the [disclosing company, or a specified division] for an [agreed period] of time.

Counterparts

Each party can sign a separate copy of the NDA, and each copy will be deemed an original.

Entire Agreement

The NDA represents the entire understanding between the parties.

EXHIBIT 6.5 NONDISCLOSURE AGREEMENT (NDA)—ILLUSTRATIVE OUTLINE

deemed confidential information, the restrictions on the parties, and the procedures if discussions terminate) are fairly noncontroversial. Where the difficulty usually comes is in the no-poach provision.

The no-poach provision is normally the first item that the potential buyer and seller have to negotiate. From the selling corporation's perspective, the no-poach provision should be written as broadly as possible—for example, covering any employee, whether involved in the sale or not, for as long as possible. From the potential bidder's perspective, the fact that it has entered into potential acquisition discussions should not impair its hiring practices, so it prefers as narrow a no-poach provision as possible—for example, covering only employees it meets or becomes aware of during the diligence, and for a short

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period of time. Also, the potential acquirer may want to provide for an exception, or carve-out, in case employees come to its attention as a result of normal, broad-based solicitations, such as job advertisements or company Web sites. Negotiations of no-poach provisions can become a significant impediment for some potential acquirers, especially for large organizations that may find such agreements cumbersome to internally administer.

(ii) Distributing the Offering Document and the Preliminary Process Letter. Once the NDA is executed, the potential acquirers can begin to receive what is classified as confidential information about the divested business. The first piece of confidential information is the offering document (described in section 4.5(c)), which is also known as the confidential information memorandum to underscore that this information is covered by the terms of the nondisclosure agreement.

The broker usually distributes a letter along with the offering document, the preliminary process letter, which describes the first round of the bidding process for the participants. In the preliminary process letter, the broker establishes a specific time deadline and other requirements for the initial round of bidding and describes how the remainder of the sale process will be conducted for the parties that are invited to participate in the second round. Exhibit 6.6 contains an illustrative outline of a preliminary process letter.

(b) SOLICITING AND EVALUATING INITIAL INDICATIONS OF INTEREST At the time specified, the broker will receive initial bids for the business. These bids are normally received in the form of a nonbinding indication of interest (IOI), which states the valuation (or range) at which the bidder would be willing to acquire the business. The IOI is signed by the bidder but is not countersigned by the selling corporation, since at this point there is no legal agreement between the parties, other than the nondisclosure agreement, which covers the confidential information evaluated in making the bid.

The exact form of the IOI can vary, since it usually is shaped to be responsive to the requirements contained in the bid instructions. Thus, IOIs can differ greatly in terms of how much detail they contain.

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Invitation

Broker has been retained as financial advisor to Selling Corporation for the potential sale of _______ business unit and is inviting recipients to submit a preliminary, nonbinding Indication of Interest (IOI), outlining the terms under which they would propose acquiring the business. IOIs should be submitted [when] [how] [to whom].

Indications of Interest—Required Contents

IOIs should address specific aspects of the offer:

- *Purchase price and consideration*. Provide an estimate (or range) of purchase price on a cash-free and debt-free basis and include the proposed form of consideration (e.g., cash or shares)
- *Financing sources*. Describe sources of funding, any commitments received, and any conditions to financing.
- *Due diligence requirements*. Selling corporation will conduct management presentations and provide a data room with customary information. Bidders are requested to identify any specific anticipated diligence issues.
- *Required approvals and consents*. Identify any required approvals (e.g., shareholders, board of directors) or consents (e.g., government) required to complete the transaction.
- *Timing*. Estimate the time frame within which due diligence will be completed, financing obtained, and any required approvals and consents secured.
- *Other*. Bidders may be asked to identify their specific plans for the business (e.g., management, employees, operating locations).

Description of Transaction Process

After receipt and review of IOIs, a group of potential acquirers will be selected and then allowed to perform additional due diligence and submit final bids. The selected parties will be provided access to due diligence materials and sent a draft purchase agreement to enable them to formulate their final proposals. Due diligence will include meetings with management and access to a data room which will contain customary financial, operational and legal information. [At the end of a defined time period], potential acquirers will be asked to submit final proposals including a copy of the draft purchase agreement marked up to show requested changes. A final procedures letter with further details will be sent to potential acquirers participating in this phase of the process.

Exhibit 6.6 Preliminary Process Letter—Illustrative Outline (Continued)

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Caveats

Broker and Selling Corporation may change or terminate the process at any time, for any reason. There is no obligation to accept or reject any offer. Selling Corporation can negotiate with multiple parties and enter into an agreement with one without prior notice to the others.

EXHIBIT 6.6 PRELIMINARY PROCESS LETTER—ILLUSTRATIVE OUTLINE

If any items are left open or are unclear, the broker will contact bidders for clarification before reviewing any offers with the selling corporation. An outline of points addressed in a typical IOI is shown as Exhibit 6.7.

(i) Indication of Interest versus Letter of Intent—Avoiding Exclusivity. Bidders customarily prefer that the preliminary offers they make to acquire the business be nonbinding, meaning that they are not legally obligated to pay the price they are quoting and they reserve the right to walk away from the transaction at any time. This is prudent because due diligence may reveal reasons to alter the valuation or to terminate discussions. As discussed, the document typically seen in bid situations is the IOI.

Sometimes bidders will choose to submit their offer in the form of a letter of intent (LOI). An LOI is similar to an IOI in that it is a nonbinding offer for the business subject to stated conditions. But the key differences are that an LOI typically provides more detail and

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Purchase price [range] and terms
Sources of financing
Due diligence process envisioned
Necessary approvals
Plans for the business (e.g., whether there are plans for employees, operating locations)
Material conditions (e.g., signing key executives to employment agreements)
Advisors (identity of bidder's financial and legal advisors)
Timing (how long does bidder anticipate to complete diligence and obtain required approvals)

EXHIBIT 6.7 INDICATION OF INTEREST—ILLUSTRATIVE OUTLINE

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asks the selling corporation to provide a stated time period during which the potential acquirer can pursue the acquisition on an exclusive basis; during this period the selling corporation agrees not to hold discussions with any other party. The exclusivity provision is legally binding, so both parties would execute an LOI.

From the bidder's point of view, it would be preferable to pursue an acquisition without the pressure of a competitive auction. Therefore, sellers should not be surprised to be asked for exclusivity. However, the selling corporation should approach this decision with extreme caution, since agreeing to exclusivity with one bidder can effectively undermine the leverage that might be gained from the auction. By putting the competitive dynamics of the auction on hold for the duration of the exclusivity period, the selling corporation loses leverage and may actually lose the option of selling to the alternative players if this one deal conversation breaks down.

Ideally, the selling corporation should not agree to exclusivity; instead, it should conduct negotiations with several organizations and sign a deal with the organization that can complete the transaction first. Competitive leverage would thus be employed to optimize speed as well as terms. If the selling corporation does agree to exclusivity, it should be done late in the sale process, when the probability of reaching a satisfactory agreement with one organization is judged to offset the loss of negotiating leverage.

(ii) Qualifying the Offers. Once IOIs are received, the broker qualifies the bids, evaluating the credibility of the bidders and weighing their ability to execute the transaction. Many bidders, especially those that are active acquirers, tend to develop reputations for certain patterns of behavior, and savvy brokers are well informed about these kinds of things. Some organizations are thought to be tire-kickers, looking at a lot of businesses but rarely pursuing acquisitions in earnest; others are believed to be finishers, being more selective, making bids only if they are seriously interested, and having a track record for closing transactions. Reputations are also considered when it comes to the valuations. Some bidders are known for submitting high valuations and then reducing them after due diligence, while others are known for presenting a more dependable initial valuation.

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The broker will also look at the sources of financing to determine the bidders' capability to close the transaction. An all-cash offer with no financing contingency is of course optimal but is usually unrealistic for larger transactions. In many cases then, the deal will be contingent on financing. If so, the broker must determine whether bidders have lined up specific financing sources, whether they have received preliminary financing commitments, and what types of conditions are connected to the financing. Opining on the financing arrangements is a critical aspect of the broker's role in the evaluation of the bids.

The bid is also scrutinized for conditions that might affect the certainty of the valuation, such as a stock (versus cash) offer, an earn-out, where part of the consideration is made contingent on future results, or conditional, based on a multiple of historical or forecasted results that are subject to due diligence scrutiny.

The broker will summarize the bids and their evaluation in a bid summary such as shown in Exhibit 6.8.

(iii) Selecting the Participants for the Second Round. The broker presents the bid summary to the selling corporation and recommends a certain number of qualified bidders based on agreed decision criteria, normally including price and financing. In making its decision about which bidders to invite into the second round, the selling corporation may apply some additional criteria to rule certain bidders into or out of the process, including:

- **Speed.** The more quickly the acquirer can complete its due diligence, the more confident the seller can be that there will be a transaction. The evaluation of a bidder's ability to move quickly through the acquisition process is based on what is said in the IOI but also on its reputation. As discussed, organizations develop reputations and track records, and brokers tend to be aware of them.
- **A good home for the business.** This is admittedly a far less tangible consideration than something like price, but it can be a real consideration for the selling corporation in forming the field of potential acquirers. The selling corporation, especially if it has owned a business for a long time, may be comfortable with an acquirer (this is especially the case for strategic

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Bidder	Valuation	Financing	Deal Structure	Conditions	Due Diligence	Timing	Other
	• Bid (or range) • Multiples of revenue/ EBITDA	• Sources (equity, debt) • Financing contingency • Sources • Conditions	• Specific form of transaction (e.g., cash for assets) • Tax assumptions (step-up) • Balance sheet assumptions at closing (cash, debt, working capital)	• Necessary approvals (e.g., board, shareholder) • Specified level of preclosing results • Employment agreements with management	• Subject to customary business, legal, tax, financial, and accounting reviews • Any specific requirement (e.g., management meetings customer/ vendor interviews, site visits) • Due diligence/ information request list	• Expect to be able to complete diligence review in [ ] days	• Plans for the business (employees, locations)

Exhibit 6.8 Bids Received—Illustrative Summary

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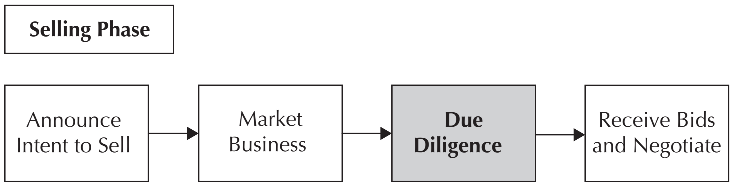
acquirers) that has similar standards for integrity, quality, and customer service. The selling corporation, if concerned that the actions of the acquirer would impact its own reputation, might want at least some comfort that bidders invited into the second round will be a good home for the divested business.

6.5 DUE DILIGENCE



(a) INVITING BIDDERS INTO THE SECOND ROUND Once the broker and the selling corporation reach consensus on which organizations to include, the selected bidders are invited to participate in the second round of the sale process: performing due diligence, and then making final, definitive offers to acquire the business.

The broker normally lets participants know if they have made it to the second round by a phone call to the bidders' principals, so that the selling corporation's rationale can be explained. Also, the broker may see these parties on either the buying or selling side of other transactions. Therefore, it is in the broker's interest to maintain good relationships with all of the bidders, delivering messages personally and in a way that demonstrates that the auction has been conducted in good faith. The broker may also choose, while inviting bidders into the second round, to inform them (without violating confidentiality) where they generally stand in the process. If, for example, a bidder has been invited into the second round but its valuation is significantly below other bids, the broker may say that to be competitive in the second round, the offer must be improved.

The call is then followed up by the final process letter, which clearly describes the process for the second, final round of bidding. Exhibit 6.9 illustrates a final process letter.

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Invitation

Broker is inviting recipients to participate in the second and final round of the process for the sale of [Selling Corporation's] _______ business unit.

Description of Transaction Process

The selected parties will be provided access to due diligence materials and sent a draft purchase agreement to enable them to formulate their final proposals. Due diligence will include meetings with management and access to a data room, which will contain customary financial, operational, and legal information. [At the end of a defined time period], potential acquirers will be asked to submit final proposals including a copy of the draft purchase agreement marked up to show requested changes. Final offers should be submitted [when] [how] [to whom].

Guidelines for Final Offers

- *Best and final offer*. Offers should be best and final. Bidders should not expect to have an opportunity to revise the offer, though the Broker may contact them to seek clarifications or revisions to the offer.
- *Purchase price*. Fixed price for 100% interest in the [assets or stock].
- *Purchase agreement mark-ups*. Offers should be accompanied by a copy of the purchase agreement that was distributed by the Selling Corporation, marked up to show any requested changes.
- *Financing*. State sources and confirm that the deal has been financed without any remaining contingencies.
- *Due diligence*. Identify any remaining confirmatory diligence to be completed. Any open items should not have an impact on the purchase price.
- *Conditions*. Specify whether there are any conditions to the offer (e.g., execution of employment agreements with key employees, receipt of key consents).
- *Authorization and approvals*. Confirm that all internal approvals have been obtained. Indicate any (external) approvals or consents to be obtained and timing expectations.
- *Timing*. Specify when bidders expect to be in a position to close the transaction.
- *Expiration*. How long the offer will remain open.

Caveats

Broker and Selling Corporation may change or terminate the process at any time, for any reason. There is no obligation to accept or reject any offer. Selling Corporation can negotiate with multiple parties and enter into an agreement with one without prior notice to the others.

EXHIBIT 6.9 FINAL PROCESS LETTER—ILLUSTRATIVE OUTLINE

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(b) PRELIMINARY DUE DILIGENCE Second-round participants normally receive a management presentation and access to a data room containing detailed information about the business. Additionally, depending on the number of bidders involved, the broker may allow bidders to request additional information or have follow-up meetings with management. These activities, collectively referred to as preliminary due diligence, are usually scheduled to occur within a fixed period of time established by the broker. After the time allotted for preliminary diligence is completed, potential acquirers are asked to submit final offers. The opportunity to conduct final, or "confirmatory," diligence is offered only to the bidder or bidders with which the selling corporation decides to pursue a definitive agreement, after consideration of the final offers.

There are two primary reasons why the selling corporation allows a fixed time for preliminary diligence and establishes a confirmatory diligence stage. First, it maintains momentum and efficiency in the sale process. By establishing a specific time when second-round bids are due, the seller forces bidders to look primarily at information that allows them to finalize their valuations and place a lower emphasis on all other diligence work, which by definition would not create additional value for the seller. Second, as discussed in section 4.8, the selling corporation can then withhold the disclosure of the most sensitive and proprietary information (e.g., customer lists, pricing details and strategy, employee-identifiable data) until confirmatory diligence, allowing only one or two organizations to see this information.

Despite these constraints imposed on the process, potential acquirers will often push to obtain as much information as they possibly can during the preliminary diligence phase. The acquirer's diligence objectives are much broader than simply finalizing the valuation, including, for example:

- Determining whether to proceed with the acquisition
- Validating key representations made about the business by the selling corporation
- Identifying any material exposures, liabilities, or vulnerabilities in the business
- Validating integration assumptions and formulating a high-level approach

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- Validating the historical financial results (e.g., audit work paper review)
- Legal review of key contract terms (e.g., assignability or change in control provisions)
- Discussions with key customers to ensure that there are no underlying problems or intent to cancel

Although several of these objectives are clearly confirmatory in nature, the potential acquirer needs to complete a good portion of this work in order to know the full extent of required mark-ups to the draft purchase agreement. For example, if a bidder becomes aware of a potential litigation exposure during diligence, it may want to ask for indemnification from the selling corporation. This may not be a headline valuation issue, but bidders will want to identify as many of these types of items as they can so that they can be incorporated into the contract mark-up. Therefore, many potential acquirers would be uncomfortable leaving major confirmatory steps incomplete until the last stage of the process.

The contrasting objectives can create a tension between the potential acquirers, which are trying to extract as much information as possible, and the broker, which is trying to enforce the preliminary diligence time limitation. This is an area where a good broker can bring the experience and sound judgment required to achieve the best balance, allowing bidders a sufficient level of access to the business while maintaining momentum and sale process discipline.

(i) Management Presentation: Focus on Salesmanship. The preliminary due diligence typically includes a presentation by the management team, which is intended to showcase both the business and the management team. It is a delivery of facts, but it is also a sales pitch with the objective of increasing bidders' enthusiasm. A lot of value can be created by a good management presentation, so the selling aspect of the presentation cannot be overemphasized.

In many cases, the management team that will go with the divested business may not have been part of a business that has been sold before. So, while the team may have strong knowledge about the markets, competitors, and operations of the business, its inexperience with divestiture transactions might lead it to approach the management presentation

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the same way it would an internal operating plan meeting. Buyers such as private equity groups, in contrast, are used to listening to road shows given by visionary entrepreneurs. In such a case, the divested business's management may come across as a bit conservative by comparison.

Consequently, in preparation, management should be coached to emphasize its vision for the business and the corresponding upside potential. It helps to keep in mind that the management presentation is in effect a job interview; that management will be measured not just on its factual command of the business, but also on its vision, energy, and enthusiasm. A fundamental objective of the presentation, therefore, is to convince the buyer to invest *in the management team* as well as in the business.

(ii) Approaching the Management Presentations as a Learning Process. As discussed in section 4.5(d), the best results are obtained if the management team is thoroughly prepared for the presentation. The presentation is typically scripted to ensure the message is delivered consistently and all key points are addressed by each speaker. Dry runs allow the speakers to internalize their notes so that they are not simply reading their scripts to buyers but are speaking naturally. These practice sessions also help the team to prepare for questions. The broker can be particularly helpful here because of its experience with the selling process; it can act as the bidder and help prepare the team by asking pointed questions. The team can then discuss and agree on the best way to approach these questions.

As the actual presentations approach, the broker can further assist the presenters by preparing a briefing document covering each of the organizations that will be in the second round. In this way, the team will be able to customize comments to point to the strategic fit with each potential acquirer. The broker should schedule the presentations thoughtfully, starting with a less important bidder or two to allow the team to refine its pitch. Presentations to the most important bidders should be reserved for the middle of the process, far enough along for the presentations to be smooth but not so far in that the team is liable to be fatigued and stale.

Typically the management presentation is a two- or three-hour meeting, with the presentation followed by a question-and-answer session or

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functionally organized break-out meetings. If break-out meetings are scheduled, the broker should coordinate them and get a list of the bidder's questions or agenda in advance. The broker should also attend every meeting to ensure it is aware of any issues that emerge, especially any that might impact the valuation.

The selling corporation may want to have a representative attend the management presentations, but this individual would not normally be very active in the discussion. There might be a question or two that are best answered by the selling corporation, such as why the business is for sale or what postsale transition services the selling corporation is prepared to offer. However, even if only as an observer, the representative from the selling corporation might be helpful in providing feedback to the presenting group.

No matter how much the team practices, it will face something unexpected during each presentation. Questions may be asked during the meetings that were not anticipated, or points may not come across as intended in tone or tenor. The team should conduct a debriefing session at the end of each presentation to review what went well and what didn't. This feedback should be used to make adjustments for the next day, to the presentation slides, the script, or the prepared answers. These adjustments can significantly improve successive presentations as well as the team's level of self-confidence as it interacts with the bidders.

(iii) Data Room. The other key element of preliminary due diligence, along with the management presentation, is the data room, which was discussed in section 4.7. Those with experience in mergers and acquisitions still visualize the data room as an actual room filled with attorneys and accountants, boxes of contracts and other documentation, and a junior broker or attorney sitting at the door logging people in and photocopies out. This scene is changing dramatically with the advent and increased use of electronic, or "virtual," data rooms over the last several years. Some estimates place use of electronic data rooms at 20% of all U.S. mergers and acquisitions.[1]

Although virtual data rooms are quickly becoming the norm, the team should still make an active decision as to whether a traditional

1 "The Data Room," *Boston Globe*, January 23, 2006.

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or a virtual data room makes more sense for its particular transaction. Some of the advantages of electronic data rooms from the standpoint of the selling corporation follow.

- **Ability to run concurrent sessions**. An unlimited number of individuals from multiple organizations can review documents simultaneously, resulting in a faster due diligence process. This allows for more bidders to be involved, removes geographic/travel constraints, and lowers venue costs.
- **Ability to measure usage.** The selling corporation can see metrics on which documents have been reviewed or which search terms bidders are using to search for documents. These metrics can act as a barometer of the process, both to gauge which bidders are most active and, therefore, most interested and to identify issues that might be potential areas of concern to buyers.
- **Control over access to documents**. The selling corporation can restrict certain documents from being seen by certain organizations or even individuals, allowing a level of control over access. This would be useful, for example, if the selling corporation wanted to restrict access to certain highly sensitive documents until a later stage in the selling process.
- **Security.** Most electronic data rooms are password-protected, encrypted, and offer other protective features to enhance security.

Conversely, there is only one major disadvantage to using a virtual data room: the effort and cost to set it up. The divestiture team will have to electronically scan any paper documents, plus pay the electronic data room provider a fee, which is normally based on the number of documents posted online. Therefore, a virtual data room may not be cost-effective in a process involving a small business unit or only a few bidders. But for a larger transaction, especially in an auction, the advantages are increasingly seen by many organizations as worth the effort and the cost of setup.

One last decision the selling corporation needs to make is when to open up the data room: before or after the management presentation. While opening the data room may seem like a way to accelerate the sale process, it can have an unintended consequence: derailing the

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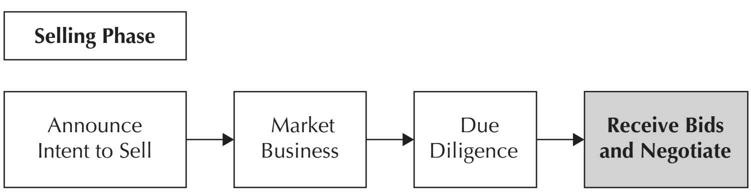
management presentations. If bidders have been through the contracts and documents before hearing the overall strategy and direction of the business, they do not have a context within which to place the details. They may then be tempted to drag the presenters into detailed questions during the management presentation, obscuring the bigger picture. Anticipating this pitfall, the broker usually announces the opening of the data room at the end of each management presentation. This is actually in the bidders' interest as well; understanding the business fundamentals and strategic direction can help bidders better understand and interpret items in the data room.

(c) DISTRIBUTING THE DRAFT PURCHASE AGREEMENT During the preliminary due diligence, the broker will distribute a draft of the purchase agreement to the second-round participants. This draft agreement contains the terms under which the seller would be willing to close the transaction; and bidders are invited to mark it up with their proposed changes. There will almost always be changes, because in an auction, the seller usually distributes a seller-friendly agreement, which it fully expects bidders to mark up. We discuss the structuring and negotiation of the purchase agreement in greater detail in Chapter 7.

6.6 BIDDING AND NEGOTIATIONS



(a) EVALUATING DEFINITIVE OFFERS At the time specified, the broker receives final bids for the business. These bids are normally received in the form of an offer letter, which fully addresses all items requested in the final process letter, such as:

- **Final valuation and form of consideration.** Bidders should not expect to have an opportunity to revise the offer, though the broker may contact them to seek clarifications or revisions to the offer.

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- **Financing arrangements.** This would include sources, conditions, and confirmation that the deal has been financed without any remaining contingencies.
- **Confirmatory due diligence items remaining to be completed.** Any open items are expected to have no impact on the purchase price.
- **Conditions to the offer** (e.g., execution of employment agreements with key employees, receipt of key consents).
- **Confirmation that all internal approvals have been obtained.** Additionally, this section would include indication of any (external) approvals or consents to be obtained and timing expectations.
- **Expected timing to close the transaction.**

Additionally, the final offers are accompanied by a copy of the purchase agreement marked up to show the bidder's requested changes.

The selling corporation, in evaluating the offers, certainly considers the price, but also looks very closely at any conditions the buyer is requesting and how extensively it has marked up the draft contract. Given a similar valuation, the offer containing fewer conditions and contract mark-ups will be viewed much more favorably by the selling corporation because it signals that the party will be less difficult to negotiate the contract with.

(b) NEGOTIATIONS The final process letter typically sounds one-sided: Bidders are told that they cannot expect to make another bid and, therefore, are asked to present best and final offers, but the broker and the seller reserve the right to go back to bidders to ask them to increase, or "clarify," their offers. This ability to dictate the terms of the process to bidders is the result of the negotiating leverage that an auction affords the seller. If only one bidder was involved, negotiations would proceed quite differently.

In speaking to the bidders about their offers, the broker will normally focus mainly on the valuation. However, if a bidder has an attractive financial offer but an onerous contract mark-up, it is conceivable that a bidder could be asked to revisit the mark-up in certain areas. This is a particularly important time during the sale process, and

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good brokers can create substantial value for the selling corporation if they artfully exploit the auction process to extract full value from the bidders.

At this point, one or possibly two players are selected to perform the remainder of their diligence and to negotiate the purchase agreement, which the seller will execute with one of the parties. While it may be viewed as simpler to select one bidder with whom to move forward toward a close, some negotiating leverage is surrendered once the competitive field is eliminated. For this reason, some sellers choose to keep two bidders in the process, right up until they sign the purchase agreement with one of them. Ideally, a bidder should never feel that it is alone in the process; there should always be a sense that there are other players involved.

Once the selling corporation and bidder reach concurrence on price and the contract mark-up, they are far from finished negotiating. Despite having submitted a mark-up, the terms of the offer made by the bidder are normally subject to the completion of confirmatory due diligence, which will likely raise additional issues the acquirer will want to incorporate into the purchase agreement. This has the practical effect of keeping the purchase agreement open for further negotiations. Additionally, in structuring the acquisition transaction and creating the final contracts and agreements, there are normally many details yet to be addressed by the parties, with one example being the finalization of agreements for transition services. We discuss the negotiations of the contracts and agreements further in section 7.6 because this activity tends to occur as a separate and much more detailed step after the total valuation and summary-level terms of the acquisition are agreed on.

(c) CONFIRMATORY DUE DILIGENCE As discussed in section 6.5(b), the bidder(s) with whom the corporation chooses to negotiate a definitive agreement are allowed to perform confirmatory diligence. Brokers refer to it as "confirmatory" because this work is expected to confirm or validate information that has already been factored in to the valuation; valuations are not expected to change as a result of confirmatory diligence. However, as mentioned, confirmatory diligence often does have an impact on the bidder's proposed mark-up to the purchase agreement.

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A common element of the confirmatory diligence is a meeting between the accountants representing the buyer and the auditors who performed the carve-out audit for the selling corporation. This is equivalent to a peer review, where the buyer's accountants review the audit work papers to ensure that appropriate audit standards were applied in the audit: sample sizes, audit procedures performed, materiality thresholds, results attained, and, in particular, understanding the resolution of proposed audit adjustments. Additionally, the reviewers can determine the detailed approach and application to any accounting areas subject to judgment, such as revenue recognition, so the work paper review can be quite useful for the acquirer. If any part of the purchase price is made contingent on validation of historical results, this step can be particularly important.

Other typical confirmatory diligence steps might include a legal review of certain contracts or a review of operational items that will help with integration planning. A review of any items the seller has held back to this point, perhaps including key customer contracts and pricing arrangements, or employee-identifiable information, also occurs. In practice, though, the line between preliminary and confirmatory diligence is not clear. Simply stated, confirmatory diligence is whatever the potential acquirer needs to do that is still open in order to close the transaction.

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KEY POINTS

1. Virtually all of the divestiture's preparatory activities are performed by a small group in a confidential setting. From the time of the announcement forward, the corporation's words and actions are scrutinized by an audience, whose reaction can significantly increase or decrease the value of the deal. (Section 6.1)
2. Final preannouncement preparation should include review of communications documents, marketing materials, audits, employee retention agreements, and coordination of timing. (Section 6.3)

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3. A good way to facilitate the reinforcement of a consistent message after the announcement is to use a well-established media training tool, the message triangle. (Section 6.3)
4. The nondisclosure agreement provides critical legal protection for the seller. It precludes disclosure of confidential information, including the deal discussions, and prevents the potential acquirer from hiring or soliciting employees. (Section 6.4)
5. Sellers should not be surprised to be asked for exclusivity. However, this decision should be approached with caution, since agreeing to exclusivity with one bidder can effectively undermine the leverage that might be gained from the auction. (Section 6.4)
6. Tension can exist between bidders, which are trying to extract information during preliminary due diligence, and the broker, which imposes a time limitation on the process. A good broker can help achieve a balance: allowing bidders a sufficient level of access to the business while maintaining momentum and process discipline. (Section 6.5)
7. Debriefing sessions should be conducted after each management presentation and adjustments made to the presentation slides, script, and prepared answers. (Section 6.5)
8. Nonfinancial factors are very important aspects of the final offer. Fewer conditions and mark-ups signal that the party will be less difficult to negotiate the contract with. (Section 6.6)
9. While it may be viewed as simpler to select one bidder with which to move toward a close, negotiating leverage is surrendered once the competitive field is eliminated. For this reason, some sellers choose to keep two bidders in the process, right up until they sign the purchase agreement with one of them. (Section 6.6)

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