

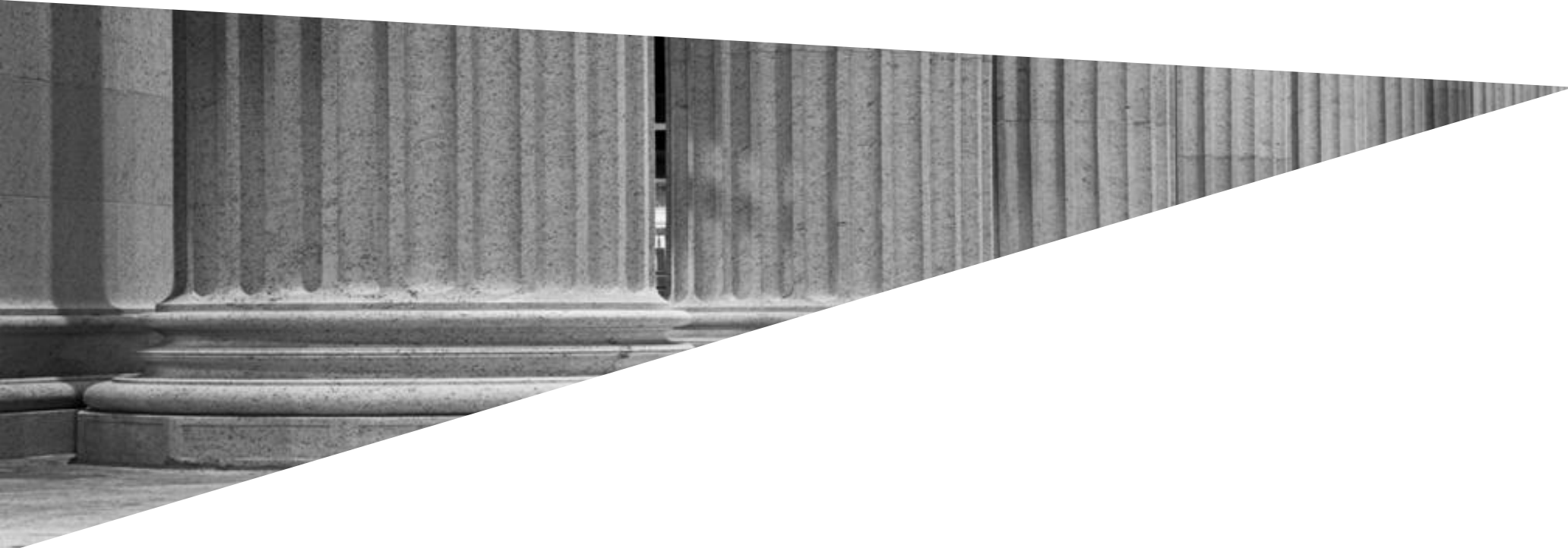
Ernst & Young

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Volume One

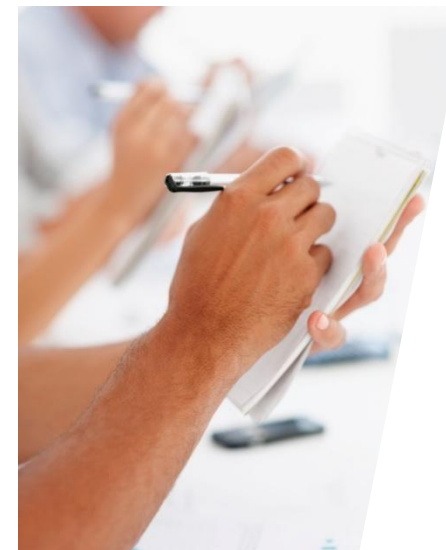


**Mergers & Acquisitions Best Practice**  
Preparation for Sale

 **ERNST & YOUNG**  
*Quality In Everything We Do*

## Ernst & Young Mergers & Acquisitions Best Practice Series - Volume One

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Dear reader:

We are pleased to present you with our first volume of *Ernst & Young's M&A Best Practice* series in Switzerland, outlining various *hot* topics around M&A transactions.

This booklet covers the main aspects in *Preparation for Sale* of your business and gives you an overview of the initial steps to be taken before entering into a formal M&A sell-side process. Well-structured pre-sale preparation is essential for concluding M&A transactions in a timely manner and will be outlined in this M&A Best Practice edition.

In each chapter of this edition, the theoretical framework on *Preparation for Sale* is depicted on the left-hand side and center section of our page layout. On the right-hand side of each sub-section, practical examples based on a case study will guide you through the relevant topics.

In addition, we will elaborate on common pitfalls and best practice approaches when it comes to preparing your business for exit. For definitions of M&A-related business terms, please refer to the glossary on page 22.

We look forward to assisting you with any questions regarding preparation for sale or any other issues revolving around M&A transactions.

Sincerely,

Your Swiss Ernst & Young M&A Team

# Importance of Preparation for Sale



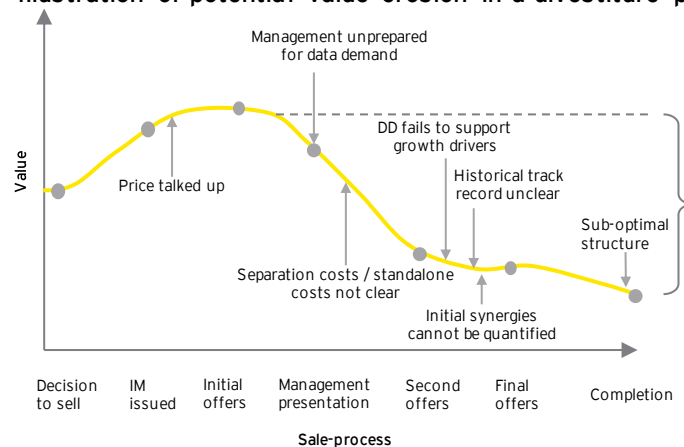
Pre-sale planning is essential to prevent value erosion during the divestiture process and to work towards maximum value.

*Preparation for Sale* is an important step to prevent value erosion of your business when entering into a formal sell-side M&A process. There are various reasons as to why this phenomenon, i.e. value erosion, can arise throughout the M&A process, such as an unclear historical track record, interim results that do not support communicated plan figures, the inability of management to provide potential investors with relevant data required to support price expectations or a suboptimal deal structure (see illustration on the right). Value erosion often occurs during the later phases of a formal M&A sell-side process and, hence, maximum value may not be realized any longer.

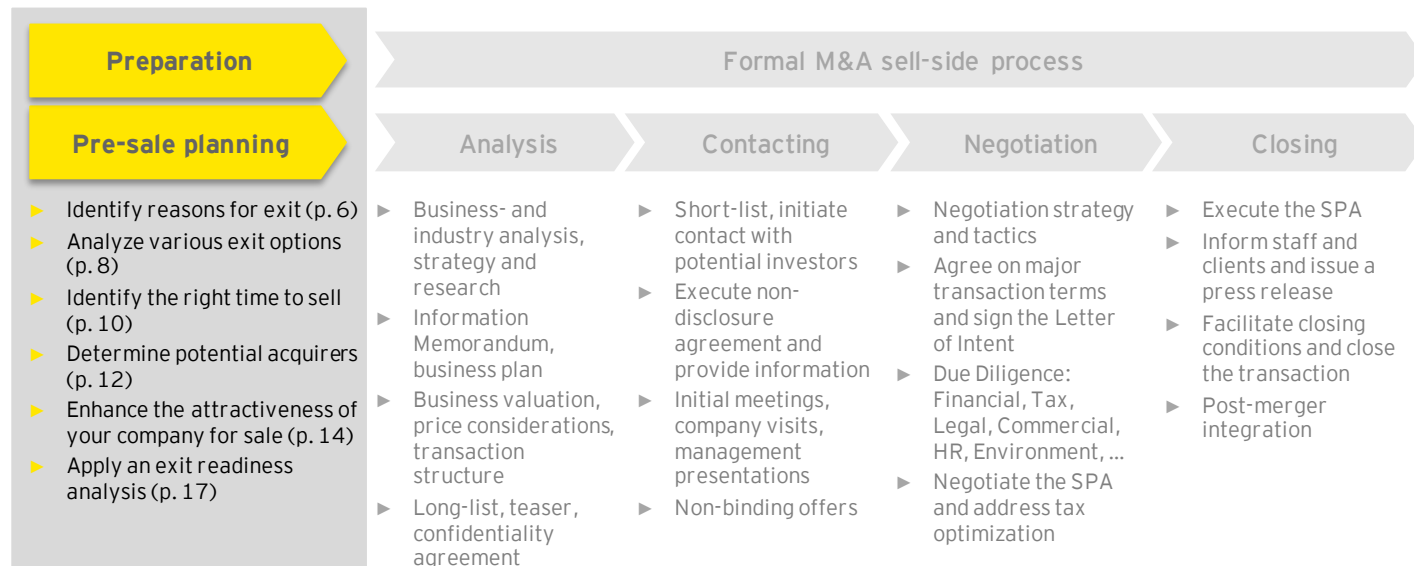
In addition, *Preparation for Sale* can unlock hidden values of the company, show transparency of the company's operations to investors and accelerate the sales process.

The following pages outline the theoretical framework of pre-sale planning.

Illustration of potential value erosion in a divestiture process



Pre-sale planning might take anywhere from two to ten months depending on the complexity of the entity to be disposed of.



# Pre-sale timeline: 1. Reasons for sale



## The underlying reasons for divestment build the foundation of the pre-sale planning process...

### Strategic reasons

- ▶ Concentration on core competencies
- ▶ Lack of strategic fit
- ▶ Holding period reached (private equity)
- ▶ Management time or resources no longer adequate
- ▶ Market saturation / consolidation
- ▶ Obsolete technology / brand
- ▶ Fast-paced market environment
- ▶ Below critical size

### Financial reasons

- ▶ Under performance
- ▶ Raising cash for remaining operations or other resources
- ▶ Opportunistic: market pays a premium
- ▶ Reduce financial debt

### Personal reasons

- ▶ Retirement planning
- ▶ Succession planning
- ▶ Financial resources

### Other reasons

- ▶ Third party offer
- ▶ Tax reasons

## Case study - Premium Furniture Holding AG

### Introduction

- ▶ Premium Furniture Holding AG is a Swiss holding company of two wholly-owned entities:
  - a manufacturer of modern office furniture and
  - a producer of classical premium priced dining room tables.
- ▶ The Holding Company is based in Cham and was founded in 1960.
- ▶ The Holding's core market is Switzerland with additional sales activities in Germany and the USA.
- ▶ Premium Furniture Holding AG's majority equity stake of 52% is held by two brothers in the third generation (at 26% each); the remaining equity stake of 48% is held by several other shareholders.
- ▶ Both brothers are on the board of directors, but not actively involved in executive management positions on the operational level.
- ▶ Revenue of the modern office furniture segment has significantly increased since its introduction 30 years ago while the dining room segment has stagnated.

- ▶ The office furniture division is currently the main revenue driver, contributing 80% of total sales.
- ▶ Premium Furniture Holding AG is considering selling its dining room table business in the imminent future.

### The following reasons for sale were considered:

#### Strategic:

- ▶ Concentration on core competencies (office furniture)
- ▶ No strategic fit between modern office furniture and classical dining room tables

#### Financial:

- ▶ Stagnating performance in the dining room table business in recent years
- ▶ Realizing cash for further acquisitions in the office furniture segment

# Pre-sale timeline: 2. Overview of exit options



... various exit options should be considered at the outset ...

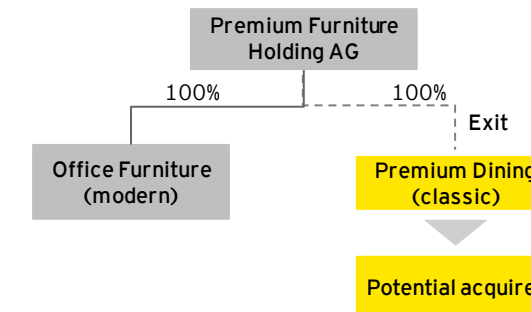
Divestment type	Frequency	Exit options		Payment structure			Deal structure	
		Majority	Minority	Cash consideration	Share consideration	Contingent payments	Share deal	Asset deal
Trade sale		✓	✓	✓	✓	✓	✓	✓
LBO		✓	✗	✓	✗	✓	✓	✗
MBO / MBI		✓	✗	✓	✗	✓	✓	✗
Carve-out / partial IPO / merger		✓	✗	✓	✓	✗	✓	✗
Liquidation		✗	✗	✓	✗	✗	✗	✓
Spin-off (share dividend)		✓	✓	✗	✓	✗	✓	✗
Split-off (share exchange)		✓	✗	✗	✓	✗	✓	✗
IPO		✓	✓	✓	✓	✗	✓	✗

Please note that alternative deal structures exist. The table above shows a basic cluster and understanding of the most common types of divestures.

## Case study - Premium Furniture Holding AG

### Preferred exit options

- ▶ The shareholders of the Holding Company decided unanimously to perform an exit of the dining room table division. Their objective is to achieve maximum value and a cash consideration for the sale of their business.
- ▶ In addition, the Holding would prefer to sell shares of the dining room table division in a share deal in order to avoid the payment of income taxes on capital gains with the closing of the transaction in Switzerland.
- ▶ The Holding would also consider an asset deal if preferred by the buyer. However, any additional tax burden arising out of the asset deal would have to be compensated for by the buyer.



# Pre-sale timeline: 3. Timing of sale



... finding the right time to sell is one of the most important cornerstones in the disposal process ...

It is a good time to sell your company if...

#### Internal factors

- ... you have a good track record to justify a high selling price.
- ... your business shows high growth potential in the coming years.
- ... you are outperforming your direct competitors.
- ... the company's accounts were consistently audited at the end of each fiscal year in a timely manner.
- ... you can sell it before you potentially have to.

#### External factors

- ... several potential purchasers are interested in buying your business.
- ... you can anticipate significant changes in technologies / market conditions / legislation in the future that could potentially have negative impacts on your company.
- ... there are favorable market conditions (period of growth / expansion) in M&A as well as the general stock market, which are expected to lead to higher valuations of businesses in your sector.

Please note that not all factors have to be applicable.

## Case study - Premium Furniture Holding AG

### Current market situation

- ▶ The global economy is beginning to recover from a downturn.
- ▶ General consumption is starting to increase; significant growth potential in the furniture market is expected due to rising demand for interior decoration and remodeling.
- ▶ Improved market conditions for M&A transactions are expected to lead to higher valuations due to increased trading multiples in the equity markets.
- ▶ Industry experts consider the furniture industry mature but yet highly segmented. Thus, market consolidation is expected to increase.
- ▶ Organic growth in the dining room table segment is, hence, assumed to be very limited.
- ▶ In addition, the company has been approached by a few parties in the recent past regarding the disposal of its dining room table division.

### Conclusion

- ▶ The current market environment indicates favorable conditions for the sale of the dining room table division.
- ▶ In addition, the company's classic dining room division enjoys a solid market standing in Switzerland.
- ▶ Strong interest from competitors reinforces the company's market position as an appealing target in its industry.
- ▶ Hence, it might be an attractive time to sell the premium dining room table segment, given current investor sentiment.

# Pre-sale timeline: 4. Potential acquirers



... identify potential investors that will unlock hidden values and maximize price...

If you consider selling your business, various buyers and their rationales for a potential acquisition need to be evaluated:

Buyer types	Strategic buyers	Private equity	Mgmt / employees	Private investors	Family members
Rationale for buyer	<ul style="list-style-type: none"> <li>▶ Local / foreign market share expansion</li> <li>▶ Diversification / synergies</li> <li>▶ Supply chain (forward-/ backward integration)</li> <li>▶ Enhanced product portfolio</li> <li>▶ Gain new expertise / new technology</li> </ul>	<ul style="list-style-type: none"> <li>▶ Improve profitability / market expertise</li> <li>▶ Financial engineering</li> <li>▶ Buy and build strategy</li> <li>▶ Hedging / diversification</li> <li>▶ Restructuring</li> </ul>	<ul style="list-style-type: none"> <li>▶ Awareness of business / market / products</li> <li>▶ Improving profitability</li> <li>▶ Personal challenge</li> <li>▶ Step-up from management capacity to shareholder</li> <li>▶ Building on personal relationships with the company</li> </ul>	<ul style="list-style-type: none"> <li>▶ New challenges</li> <li>▶ Capitalize on industry knowledge, network and business opportunities</li> <li>▶ Asset allocation strategy</li> </ul>	<ul style="list-style-type: none"> <li>▶ Maintain family tradition</li> <li>▶ Succession planning</li> <li>▶ Increase ownership</li> </ul>



## Case study - Premium Furniture Holding AG

### Potential acquirers

- ▶ **Strategic buyers:** This subset of investors includes other manufacturers in the same or similar industry, i.e. furniture producers or stores, who might want to build on or extend their portfolio of premium brand dining room tables or increase their market share mainly in Europe and the USA.
- ▶ **Financial investors:** Private equity firms might be interested in this opportunity to increase and build out their existing furniture company portfolio (buy-and-build strategy) or might use the carved-out entity as an initial platform investment for further expansion.
- ▶ **Current management** of the classic business unit: The dining room table segment is independently managed by local management. Current business unit management of the classic segment might potentially be interested in an MBO (Management buy-out).
- ▶ **Private investors:** Two minority shareholders (not related to the family) of Premium Furniture Holding AG mentioned an interest in the acquisition of the dining room table segment.
- ▶ **Family:** One of the two brothers is interested in acquiring a majority stake of up to 100% in the dining room table division. He would also be willing to dispose of his shares in the Holding Company to partially finance the transaction.

# Pre-sale timeline: 5. Attractiveness analysis



... and finally, "dress up the bride" before going to market.

Before entering into a formal M&A sell-side process, the following steps should be considered in order to enhance the **attractiveness** of the subject company for sale:

1. Identify your current market position and make sure you are clear on your company's competitive advantages.
2. Update your business plan for operational and recent changes in the market environment and ensure the completeness and coherence of company documentation as well as the availability of all shares.
3. Conduct analyses and vendor due diligence with respect to products, processes, geography and organizational structure to identify unknown issues.
4. Identify cost saving measures to improve profitability and remove redundant assets from your balance sheet.
5. Conduct a review on taxes and potential legal issues (e.g. shareholder agreements, intellectual property and change of control clauses).
6. Carry out property and equipment repairs, replacements and improvements.
7. Adhere to quality standards within your industry and get certified.
8. Request feedback through the execution of surveys on client and employee satisfaction.
9. Identify potential separation issues regarding employees (key people), corporate functions (HR, IT), manufacturing, suppliers, customers and knowledge transfer.
10. Make sure you have a clear communication strategy to justify a sale to stakeholders, clients, employees and the public.

## Case study - Premium Furniture Holding AG

### Attractiveness analysis:

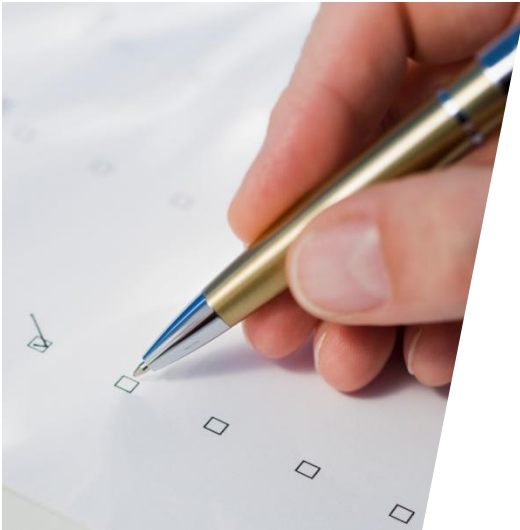
- ▶ **Carve-out issues** are to be considered: the production of dining room tables currently takes place in a separate plant in Switzerland; warehousing and logistics are also independently managed. However, the accounting system, HR and procurement services of the modern and classic segment are centralized and would have to be separated in a potential transaction.
- ▶ **Identify potential cost savings** prior to the transaction: reduction in production costs of dining room tables are to be assumed in the future as management recently ordered and installed new manufacturing machines (potential to realize better margins due to lower labor costs and comparable quality standards). Pro-forma earnings should, hence, be taken into consideration.
- ▶ **Opportunities:** market research revealed that Premium Furniture Holding AG shows high growth potential in the dining room table market in the USA and Asia.
- ▶ **Strengths:** Competitive advantages of Premium Furniture Holding AG's dining room table segment include high quality products, proprietary and unique production processes (difficult to replicate), strong market reputation and premium pricing.

### Conclusion

- ▶ By conducting an attractiveness analysis in the pre-sale planning phase, value erosion in the formal M&A process is likely to be minimized.

# Common pitfalls

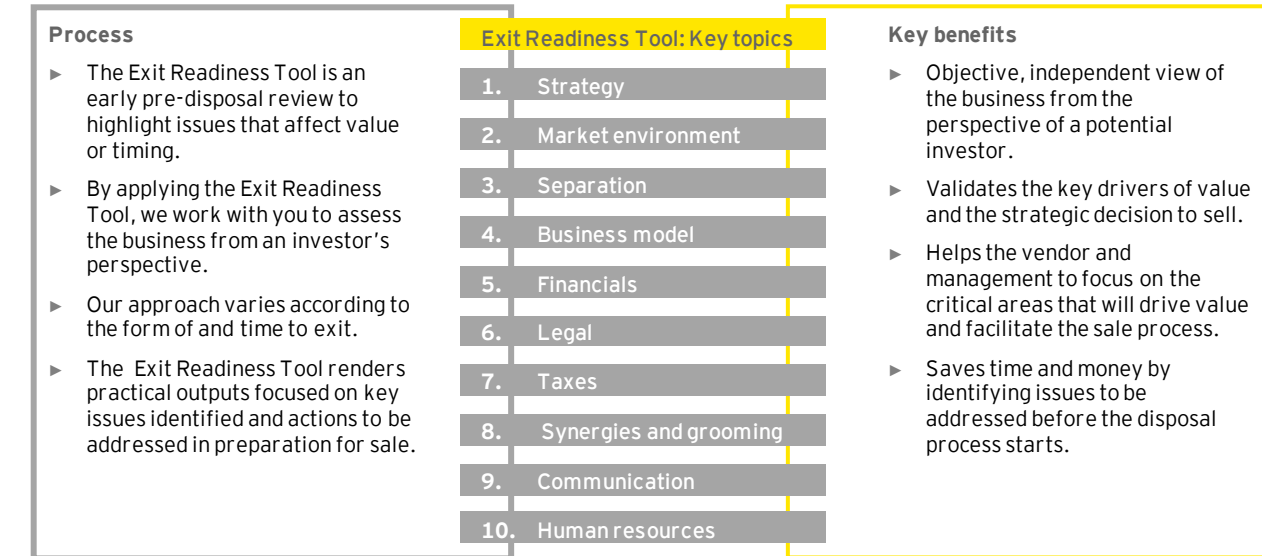
Pre-sale planning is important to prevent from the following pitfalls.\*



1. Prolonged M&A processes tentatively conclude in a reduced purchase price.
2. Portfolio evaluation not done or done but against insufficiently detailed criteria.
3. Preparation fails to meet the requirements or resources of a structured M&A process.
4. Vendors do not pursue multiple divestment options.
5. Vendors fail to customize the business case or tailor communication for each potential buyer.
6. Vendors fail to make the link between historical results and forecasts with sufficiently granular analysis.
7. Vendor's lack a plan for operational handover resulting in unrealistic timing to complete the transaction.
8. Vendor is not sufficiently aware of own issues and risks and not prepared for a due diligence.
9. Confidentiality is not maintained and a communication concept not properly established.
10. Vendors lack to portray a good first impression in the formal sales process.

\* Results are based on research by EY and the Economist Intelligence Unit. Details are available on request.

EY's "Exit Readiness Tool" helps to avoid pitfalls and focuses on critical issues that drive value and facilitate the sale process.



An excerpt of our Exit Readiness Tool is shown on the following pages.

# Checklist: Timing and pre-sale planning



The following checklist outlines key topics in preparation for sale.

## 1. Strategy

Have you evaluated other possible alternatives to a sale?	Y   N   NA
Are you aware of all strengths and weaknesses of your business?	Y   N   NA
Is your strategy reasonable to achieve your desired market position in the future based on your current business situation?	Y   N   NA

## 2. Market environment

Are current market conditions in your sector favorable for an exit?	Y   N   NA
Did you analyze your competitors' market position also regarding clients and suppliers?	Y   N   NA
Is your company well positioned to deal with any imminent threats and opportunities within the industry?	Y   N   NA

## 3. Separation

Did you analyze any potential carve-out issues to be taken into consideration (centrally managed functions, shared services / assets and inter-company transaction)?	Y   N   NA
--	------------

Y = Yes; N = No; NA = not applicable

## 4. Business model

Is your business plan updated and your business model transparent? Do you have enough market data to support your business plan?	Y   N   NA
Can you describe your company's specific life cycle, infrastructure, talent, board, partners and customer considerations?	Y   N   NA
Does your organizational chart support your business model and strategy?	Y   N   NA
Have you assessed the quality and concentration of as well as the reliability of contracts with your customers and suppliers?	Y   N   NA
Did you consider further investments required to support productivity plans and targets?	Y   N   NA

## 5. Financials

Have you prepared and reviewed financial projections and quality of earnings?	Y   N   NA
Is the performance of the last year above average performance?	Y   N   NA
Does your track record show consistency or even an upward trend?	Y   N   NA
Have you considered normalizing / adjusting earnings or net working capital?	Y   N   NA
Have accounting policies been consistently applied?	Y   N   NA

## 6. Legal

Did you consider alternative deal structures (share deal or asset deal)?	Y   N   NA
Is your company free of any litigation or pending lawsuits / contingent liabilities?	Y   N   NA
Are all corporate legal documents available and consistent?	Y   N   NA
Did you analyze any contractual break-costs, share transfer restrictions and change of control clauses?	Y   N   NA

## 7. Taxes

Have you considered the corporate structure to minimize your company's effective tax rate?	Y   N   NA
Is your company compliant with tax regulations?	Y   N   NA
Did you consider how a potential gain / loss resulting from the sale is treated from a tax perspective?	Y   N   NA
Did you analyze potential tax burdens at the source on repatriation of sales proceeds to the parent?	Y   N   NA

## 8. Synergies and grooming

Did you consider any synergies (cost reduction, revenue enhancement, asset reduction, tax reduction, financial synergies) in connection with a potential sale?	Y   N   NA
Did you analyze any possibilities to groom, i.e. streamline or restructure your business?	Y   N   NA
Can you dispose of redundant assets before the sale of the business?	Y   N   NA

## 9. Communication

Do you know how to convey your value proposition to the appropriate investing audiences and gauge market perception?	Y   N   NA
Have you considered how to communicate the sale internally?	Y   N   NA
Have you communicated realistic timeline expectations to key stakeholders?	Y   N   NA

## 10. Human resources

Does your company have enough time and resources to support a transaction?	Y   N   NA
Do I have a professional team to handle the transaction (internal / external)?	Y   N   NA
Is the management appropriately incentivized?	Y   N   NA

Please note: You might want to consider a longer pre-sale planning period if your answers to most questions are skewed towards "no". By answering most questions with "yes", your pre-sale planning period might be shortened.

# Get in contact with Ernst & Young!



If you have any questions related to Mergers and Acquisitions, please do not hesitate to contact us:



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## M&A Meeting request

If you would like to arrange for a meeting, please contact Jürg Stucker, Marc Reinhardt (see previous page) or Corinne Güntert directly.

- Yes, I would like to arrange for a conversation / meeting with Ernst & Young.

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# Glossary

Asset deal	Acquisition of a company's assets; in general, no liabilities are assumed
Carve-out	A parent company sells a minority stake in a subsidiary in an IPO
Core competency / competitive advantage	A narrowly defined field or task at which a company excels and outperforms its competitors
DD	Due diligence; an investigation, review, or analysis of a potential investment. Due diligence serves to confirm all material facts in regards to a sale
Grooming	Optimizing your business prior to a potential sale including business operations, legal and tax issues, shareholder structure, etc.
HR	Human resources; responsible for finding, screening, recruiting and training job applicants, as well as administering employee-related issues
IM	Information memorandum; sales document for potential buyers
IPO	Initial public offering; the first sale of stock by a private company to the public. IPOs are often issued by smaller, younger companies seeking capital to expand. IPOs are also sought after by large privately-owned companies to raise additional capital or to allow for a full or partial exit of existing shareholders
Joint venture	Cooperation of two or more businesses in which each party agrees to share profits, losses and control in a pre-defined enterprise
LBO	Leveraged buy-out; an investor acquires a controlling interest in a company's equity; a significant percentage of the purchase price is financed through debt (financial leverage)
M&A	Mergers & acquisitions

Market consolidation	Structural changes in the industrial landscape, often resulting in M&A transactions e.g. merging of separate companies or business activities into one
MBI	Management buy-in; an external management team purchases a controlling interest in the target
MBO	Management buy-out; current management and / or executives of a company purchase a controlling interest in the subject entity from existing shareholders
Merger	The combining of two or more companies, generally by offering the stockholders of one company securities in the acquiring company in exchange for the surrender of their stock
Mgmt	Management
SPA	Share purchase agreement; legal contract outlining the terms and conditions regarding the sale of the target's equity / shares
Spin-off	A type of corporate reorganization, whereby a subsidiary is separated from its parent company to form an independent entity through the sale or distribution of shares (usually in form of a share dividend) in the independent company to new and existing investors
Split-off	A type of corporate reorganization, whereby a subsidiary is separated from its parent company by exchanging shares in the parent company for shares in the new, independent company
SWOT	Strengths, weaknesses, opportunities and threats
Trade sale	Sale of the company's shares or assets to a strategic or financial buyer