

# DIVESTITURES OF SECURITY GUARD COMPANIES

1996

Volume 2, No. 2

A periodic informational letter published by Robert H. Perry & Associates - Dedicated to Buyers and Sellers of Security Guard Companies

## Choosing the Proper Method to Sell a Company.

(Written by Robert H. Perry)

### CONTENTS

#### Cover

*There are three methods to use when selling a company.*

*1. The Auction Method*

*2. The "My Company's Not For Sale, But Make Me An Offer" Method*

*3. The "My Company's For Sale, And Here's My Price" Method*

#### PAGE 5

*The Life of a Deal*

The decision to sell a company or division is usually arrived at through a long drawn-out process and can involve many decision makers.

Often, the decision to sell for the closely-held company is based on a different set of circumstances than that of the public company or a privately-held company with many shareholders.

For the owner of a closely-held company, the decision process can be a very emotional one and is usually brought about by age, health, marital problems, or financial difficulties. The decision not only can take a long time, but is also very difficult if not agonizing.

The process is more objective in the case of large companies selling off a division or companies with multiple owners. It usually boils down to a decision based strictly on financial motives. The business may not fit the plans they have for their other unrelated divisions.

Although these two seller groups have different reasons for wanting or needing to sell, there is one thing they

have in common – once they decide to sell, they each want top price and they want the deal consummated quickly.

But their success in achieving either depends on two factors. They must be selling at a time when there are sufficient aggressive buyers in the market place – remember our article on "Timing is Everything"? – and they must let the market place know that the company's available for purchase.

Every sale has its unique characteristics, but basically there are three methods to market a company. The one to be used is determined by the seller's concern about confidentiality and how quickly the sale needs to be consummated. Then, these factors are weighed against the need for maximum value, since the aspects of the timetable and confidentiality concerns could be counter to maximizing the selling price.

Unfortunately, all three methods do not always accomplish the most desired results, as can be concluded

from the following explanations:

## The Auction Method

When CPP bought Pinkerton from American Brands in 1988, the sale was conducted by using the auction method. The same was true for the sale of Globe Security and Security Bureau when they were purchased by Borg-Warner.

We mention the name of these three companies because they were publicly owned and the details are public information. However, the auction method can be and frequently is used to sell privately held companies as well.

The auction method is based on the notion that a spirit of competition among a large group of buyers will result in a higher price to the sellers.

It also is a way for the seller to have more control over the day the company will eventually be sold, thereby eliminating the problems resulting from delays in a sale. The process is usually orchestrated by an investment banking firm (in the case of public companies), specialized intermediary, business broker, lawyer or accountant.

There are numerous variations in the method which is dictated by the procedures of the individual intermediary firm, but in general, the steps are as follows:

1. Many buyer prospects are contacted through an introductory letter sent out by the intermediary and a one page profile, that does not disclose the identity of the company being sold. The buyer candidate is instructed to contact the intermediary if there is interest in the seller prospect.

2. Those buyer prospects who respond with interest are required to execute a Confidentiality Agreement. Usually, the Agreement identifies the seller, but often the seller is only

described as a number or through some code that identifies the seller through the intermediary's files. (As a side note – we always identify the seller in the Confidentiality Agreement; if a code is used, how can the buyer be bound to the terms of the agreement?)

3. A detailed descriptive package is sent to the buyer prospects who executed the Confidentiality Agreement. The package tells the history of the company, and gives financial information and other data that helps the prospect establish an initial interest. Also, along with a package, the intermediary sends the details of the auction process. This usually dictates that:

- ◆ By a certain date, the intermediary needs to receive from the prospect a written expression of interest; which sets forth the price or a price range, a method of payment and any special guarantee provision.
- ◆ The buyer prospects furnish information in support of the prospect's financial ability to conclude the transaction.

4. On the date specified as the deadline for receipt of all offers, the intermediary and the seller will review the written expressions of interest and develop their "short list" of buyer prospects. The prospects who make the "short list" are the ones with the most acceptable offers.

5. The prospects on the "short list" are allowed to visit the due diligence room (not in the presence of the other buyer prospects, of course), where various information is assembled which supports the information presented in the initial offering package – as well as presenting other sensitive data.

6. The buyer prospects are then

allowed to change their offer based on the information examined in the due diligence room.

7. The buyer prospect list is now narrowed down to the one best final offer submitted during this round of negotiations.

8. The successful buyer prospect submits a buy/sell contract that sets forth the terms of the agreement. (Note – sometimes each prospect is required to submit a first draft agreement after they make the "short list" identified in step number four above.) The parties involved negotiate the details of the contract until terms are reached that are acceptable to both buyer and seller.

The auction process is usually the preferred method when a public company, or a division of a public company is being sold. The commonly used intermediary is a high profile investment banking firm with a track record of successful auction sales. The selling company is large enough to attract many qualified prospects who are usually willing to give priority to the deadlines imposed by the intermediary.

The auction method does not usually work as well for the small and medium sized company. These companies require a higher degree of confidentiality. Although the prospects are bound by written Confidentiality Agreements, the successful buyer is concerned about the many companies that have seen the account information. The process allows many buyer prospects access to sensitive information about the seller.

In addition to the confidentiality concern in using the auction method, there are a couple of other negatives:

◆ Using this method eliminates some of the aggressive buyers. These buyers just will not be involved in a company being sold through the

auction process – whether it is large or small. They are turned off by the seller who is only interested in getting the highest price in a short time period – thereby eliminating the more personal contact needed for long-term relationships.

The auction process also usually does not give these buyers enough time to interpret the results of their due diligence.

◆ Since the auction method allows for setting an absolute deadline for the bidding to end, it lets the successful buyer know when the other buyer prospects will be eliminated. There are always last minute issues that come up in every deal which require some give and take on the part of the buyer and seller. Once the buyer competition has been eliminated, the seller loses much of his leverage in getting favorable resolutions on these issues.

### **The "My Company's Not For Sale, But Make Me An Offer" Method**

All "so-called" sellers like the sound of this method because it appears to give them a way of putting their company on the market while at the same time allows them to deny their company is for sale, should the word leak out to the employees or customers. Also, the owner of the company that is "not for sale" usually has more leverage in the negotiations.

We put the "so-called" label on these sellers because we're always suspicious that the owner who chooses this method is doing so because they're usually not as motivated to sell as the owner who chooses a more pro-active method.

In this method, unlike the auction method there are no mass mailings to buyer prospects, no comprehensive packages prepared, no deadlines for receiving offers, no due diligence

room – how can there be if the owner is creating an illusion that the company's not for sale?

There are some very good reasons for choosing this method, but unfortunately it is often chosen for less valid reasons by owners who are misinformed about the selling process. Below are a couple of the wrong reasons:

1. *(The Perception)* Many owners feel that by putting their company on

proportion to the number of buyer prospects who know about this information. However, it is also true that the experienced intermediary will screen the buyer prospects as to their financial ability to get the deal completed and orchestrate the negotiations in such a way that the chances of the word leaking out are kept to a minimum.

In fact, it is more likely that the word will leak out when an owner is trying to handle the negotiations on

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*There is one overwhelming reason why this method should not be used, but if used, should be done so by a specialized intermediary with special skills in the art of negotiating. The biggest drawback to this method is that it does not allow for a pro-active process of letting aggressive buyers know the company is available - which is very important if the seller expects to receive maximum price for the company.*

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the market, they are sending a message to the business community that they are in financial trouble. They feel the community will equate selling as an admission of failure.

*(The Reality)* The prudent entrepreneur looks on the sale of a company as just another economic event and so does most of the business community.

2. *(The Perception)* Putting the company on the market often involves the introduction of an intermediary. The owner is concerned about who the intermediary is talking to and what information is being distributed about the owner's company.

*(The Reality)* It is true that the chances of the word leaking out that the company's for sale is in direct

his own than when an experienced intermediary is involved.

There is one overwhelming reason why this method should not be used, but if used, should be done so by a specialized intermediary with special skills in the art of negotiating. The biggest drawback to this method is that it does not allow for a pro-active process of letting aggressive buyers know the company is available – which is very important if the seller expects to receive maximum price for the company.

Without the benefit of being pro-active, the seller who chooses this method has to depend on lady luck to send the right buyer to their door just at the time they're ready to sell...or they have to be creative in getting a

buyer interested in the company without appearing interested in selling.

A specialized intermediary can create the illusion that the company's not for sale, and still be somewhat pro-active in the process. But this is very difficult to do, even for the specialized intermediary and usually is not as successful as some other method.

We have agreed, in the past, to represent sellers who required this method and we were somewhat successful in using it.

We initiated such negotiations by suggesting that a buyer consider a particular company. With the thought in mind that because of our relationship with the prospective seller, we could get the owner to consider an offer. Of course, in reality, we already knew the owner would sell, because he had retained us to sell the company.

In fact, we still have a few owners who call us on a regular basis to talk about their acquisition plans and before we hang up, they mention that they would sell if the price was right.

We encourage these sellers to go ahead and put the company on the market, so we can use the more desirable "My Company's For Sale" method as explained later in this article.

There is a final reason for not using this method....it does not allow the owner to price the company – which is another important aspect of seller-favored negotiations – a subject we plan to discuss in a future issue of *Divestitures*. If the owner is appearing as though the company is not for sale, then logically, the owner does not have a price in mind.

### **The "My Company's For Sale, And Here's My Price" Method**

Under this method, the seller's

telling a buyer prospect that he's motivated to sell and he has a price in mind for his company.

When a buyer prospect submits a written proposal that gives the seller his asking price on acceptable terms, the company is taken off the market and the seller and buyer finish negotiating the final points of the buy/sell contract.

In the real world of selling companies, the process seldom works this smoothly. But when this method is used correctly, it is the most effective of all the methods.

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*But when this method is used correctly, it is the most effective of all the methods....Talking about the effectiveness of this method is one thing, but implementing it in such a way that it renders the seller the desired results is another; and the tricky part lies in establishing a price.*

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On the Positive Side, this method:

- ◆ Allows the seller to go first on establishing the price – which is an important factor for the seller.
- ◆ Allows the buyer and seller to spend ample time together in order to establish the all important relationships needed for post closing assistance.
- ◆ Attracts more qualified and aggressive buyers. As mentioned previously, some buyers are turned off by the auction method and most buyers are reluctant to negotiate with an owner who's not pro-active in the sale process.

Talking about the effectiveness of this method is one thing, but implementing it in such a way that it renders the seller the desired results

is another; and the tricky part lies in establishing a price.

If the company is under-priced, the seller leaves money at the closing table. On the other hand, if the company is over-priced, it will not be sold and if it's grossly over priced, it may be impossible to get any buyers to even start negotiations.

A way to overcome this pricing dilemma is to hire an experienced intermediary who's familiar with the pricing techniques for the security guard industry. Most accountants, bankers and general appraisers cannot

do an adequate job, unless they have worked extensively with security guard companies.

Take this seller we once represented as an example of what could happen if the wrong professional values the company:

Before we got involved in representing him in the sale, he hired a well-known national business brokerage firm to perform a valuation of his guard accounts. They arrived at \$2,000,000 as the value for the accounts and their fee was \$35,000 to put together the valuation material.

The owner didn't like the value. He contacted us and we were awarded the sale assignment. We valued the accounts at \$4,500,000; which we got for our seller/client by contacting only four buyer prospects.

As mentioned, there are many variations to the above methods and

sometimes the characteristic of one becomes a characteristic of the other. For instance, the seller using the "My Company's For Sale" method, which by definition has an asking price, may decide somewhere during the process to solicit offers – which is also an important characteristic of the auction method.

### **How is the Buyer Affected by the Method?**

Up to this point in this presentation, our focus has been on the seller's point of view for the three methods. But, the buyer is also impacted by the method chosen.

Since the three methods do not always come clearly labeled, the seller or seller's representatives need to send clear messages to the buyer prospect regarding the procedure for the negotiations.

If the seller does not explain the ground rules, or if they are confusing

or unclear, the buyer prospect can have many "false starts," or find that he's still working hard on the figures, only to learn that the company has been taken off the market or has already been sold.

It is best if the seller, or seller's representatives, clearly state the procedures for the negotiations at the time the buyer is first contacted – even if there is only one buyer prospect involved. The buyer will then know how to frame the needed responses and plan the timetable for submitting an offer.

However, if this does not happen, the buyer should inquire about the negotiation procedures and ground rules.

Some of the important questions the buyer needs to ask are:

- ◆ Are there any other buyer prospects involved in the process?

- ◆ What information is being presented to the other prospects?
- ◆ When did the other prospects receive their information?
- ◆ Is there an asking price?...if so, does the price assume a stock or asset transaction?
- ◆ What is the time frame for submitting a written offer?
- ◆ Is the seller willing to take the company off the market if the written offer is accepted?

There's a final comment to make about the methods to put a company on the market...although the method in marketing the company is very important, just as important is choosing the proper time to sell, having competent advisors and having the proper mind set.

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## **The Life of a Deal**

*(Written by Robert H. Perry)*

Unless a seller chooses the auction method to sell the company, there's very little control over how long it will take to get the deal consummated. And we've already talked about how undesirable the auction method is.

We've represented nearly eighty security guard sellers over the past fifteen years – located in the U.S.A., Canada, Western Europe, the Caribbean and South America.

The shortest time it took to consummate a deal from start to finish was three days. We closed one last week that had gross sales of only \$1.2 million annually and it took two years to locate the right buyer and get the deal closed.

A \$75 million company was recently sold and from start to finish, the process took a little less than seventy-five days.

The amount of time it takes to conclude a transaction can seldom be determined with any degree of accuracy. And as illustrated above, the size of the company being sold is not a determining factor.

But it usually takes longer than anticipated. Delays can be caused by regulatory approvals, vacation schedules for the buyer, seller or advisors; holidays, board approvals, etc.

The one thing I do know is that there's a lot of work in getting a deal to closing. The process is very detail

oriented and time consuming. Much of this needs to be done by the seller's competent advisors – accountants, lawyers and intermediaries. This way, the seller can spend more time on the day to day activities of running the company; a very important consideration in keeping the business healthy during the sale process.

The average time it takes us to sell a company is around seventy-five days. But it can take much longer.

Consider a security guard company we recently sold. The company had annual sales of \$7 million and we worked with nine buyer prospects. Page six contains a summary of our efforts in getting the deal consummated:

**Life of a Deal - (Continued from page 5)**

	<u>Meetings</u>	<u>Long Dist. Calls</u>	<u>Overnight Mailings</u>	<u>Faxes</u>
1st Month	1	32	14	10
2nd Month	3	49	6	2
3rd Month	1	45	6	21
4th Month	1	43	3	5
5th Month	1	32	2	0
6th Month	6	45	2	5
7th Month	<u>2</u>	<u>15</u>	<u>0</u>	<u>0</u>
	<u>15</u>	<u>261</u>	<u>33</u>	<u>43</u>

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This periodic informational letter is published by:

**ROBERT H. PERRY & ASSOCIATES, INC.**

Established in 1977, we are the recognized specialists in the sales and valuation techniques for security guard companies. We have successfully represented nearly 80 sellers of security guard companies located in the U.S.A, Canada, Western Europe, The Caribbean and South America.

POST OFFICE BOX 67 - ZIP 27402  
400 WEST MARKET STREET, SUITE 301  
GREENSBORO, NC (U.S.A.) 27401

(910) 272-2266

FAX (910) 272-1142