

DIVESTITURES OF SECURITY GUARD COMPANIES

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THE SELLER'S DUE DILIGENCE . . . ON THE BUYER

A review of the most successful sale transactions in the past few years will reveal that each success was primarily due to the seller performing a thorough due diligence on the buyer prospect.

The due diligence supports the seller's likelihood of receiving an adequate price and collecting all the monies due. The diligence is a process that examines the buyer's financial ability to secure the deal, the conditions, the track record and compatibility of the two companies.

The due diligence is done in stages. The financial verification is usually first. Most of the due diligence is handled by the seller's negotiating team – attorneys, accountants and deal manager (intermediary) - since they offer the best experience in such matters.

The questions they ask the buyer are sometimes probing, sensitive and often embarrassing, thus causing awkward or tense moments. Using the advisors to handle these matters allow the principals to maintain their much needed friendly relations.

And it's important to note that the timing of the due diligence is very crucial. For obvious reasons, it is done before the seller signs a "standstill" agreement with the buyer that prohibits the seller from negotiating with other prospects that may be just as viable. It is done before the seller

spends a lot of time in negotiations and money for advisory fees. It is also done before bringing the key employees into the negotiations, and before contacting customers – if this is a requirement to closing the transaction.

In fact, if the seller has retained a deal manager who has experience in managing security guard company sales, the buyer has more than likely been qualified before the sale process starts. Experienced deal managers have probably completed one or several transactions with the buyer prospects. They have firsthand knowledge of the buyer's financial ability and conditions to the deal. They know which conditions are negotiable and which are not. Further, since their fee is mostly contingent on a successful transaction, they will not waste time on buyers who are not qualified. They will not initiate negotiations with buyer prospects who may not be compatible with the seller.

CHECK THE BUYER'S FINANCIAL ABILITY TO DO THE DEAL

When Securitas made a cash tender offer for Burns, and Falck merged with Group 4 Securitas, checking the buyers' financial affairs was not a difficult task. Securitas and Falck are both public companies, and their financial affairs are a matter of public record.

However, when the buyer prospect is a privately-held company, checking the financial ability may take some work. The seller is not only concerned about the buyer's ability to come up with the cash needed to close the transaction, but is also concerned about the buyer's ability to make any deferred payments that may be contingent on a guarantee of the accounts after closing.

Here are some of the things the seller's team needs to know about the buyer's financial ability:

- Does the balance sheet indicate an adequate net hard asset value?
- Is the buyer borrowing the purchase price from the bank? If so, is the seller's deferred payment subordinated to any senior bank borrowings? What is the bank's role in approving the acquisition?
- Will the buyer agree to hold the deferred payment in an escrow account controlled by an independent escrow agent? If not, will the buyer agree to guarantee the deferred payment with a bank letter of credit?
- Are there any pending lawsuits that, if settled against the buyer, may impair the buyer's ability to make the seller's installment payments?
- Is the buyer making the purchase through a "thinly capitalized" corporation and not guaranteeing its debts?

CHECK THE BUYER'S TRACK RECORD

A good indicator of how well a buyer keeps its promises and performs during the negotiations and after closing is the comments from sellers who have had dealings with the buyer.

The seller's team should ask the buyer for references, and make inquiries to the buyer about prior acquisitions. Again, it's in this area that the experienced deal manager can provide a good source of information on how well the buyer performs.

Here are some of the questions to ask in checking the buyer's track record:

- How many deals has the buyer consummated?
- Were the sellers satisfied with the buyer's performance?
- Did the sellers receive all of the deferred purchase price? If not, why?
- How long did it take the buyer to consummate the transaction?
- Is the deal structured as a stock or asset transaction? (The answer to this question may have a dramatic tax consequence to the seller.)
- What is the approval process?
- Does the buyer require a guarantee of the accounts? If so . . .
 - o What's the duration of the guarantee?
 - o Will the buyer allow the seller to replace lost accounts with new accounts?
 - o Will the buyer allow the new accounts to increase the purchase price?
 - o Is the seller protected in the event an account leaves because the buyer did not properly service the account?
 - o How is the company run during the guarantee period?
 - o Which of the seller's personnel will be retained?
 - o Will the operating name be changed?
 - o What is the seller's involvement during the transition?

CHECK THE CONDITIONS THE BUYER HAS PLACED ON THE DEAL

Although the price and terms are very important aspects of every deal, the conditions which must be met in order to receive the monies are equally important. Many of the conditions are found in the purchase agreement; however, some may be oral and relate to how the company is run during any period for which the seller may be guaranteeing the continuation of the accounts.

Most buyers do not prepare the purchase agreement until they finish the due diligence on the seller. Since the seller needs to know the conditions that will be in the contract before the buyer starts its due diligence, the seller should ask for a sample agreement (if the buyer has one available), or at a minimum should find out the conditions the buyer will require.

A word of caution about the sample purchase contract: in reviewing the sample contract, the seller's advisors should make sure that the sample contract is compatible with the seller's type of transaction. If it isn't, some of the provisions will not apply or will be different. Also, there may be conditions to the seller's deal that may not be set forth in the sample contract.

Here are some of the important things to know about the conditions to the deal:

- What is the expiration period of the representations and warranties in the purchase contract?
- Is the deal signed and closed simultaneously? If not, what's the seller's liability in the period between signing and closing?
- When and how is the sale announced to the employees and general public?
- Will a portion of the selling price be allocated to a covenant not to compete? If so, how much? (The answer to this question could have a significant tax impact on the seller. The amount of the impact, positive or negative, depends on whether the seller is organized as an S or C corporation.)

CHECK THE COMPATIBILITY FACTOR

In order for the deal to be successful the buyer and seller must be compatible. They must share common philosophies on providing service to the customers, career paths , and benefits for the employees.

Much of the compatibility checking can be done through negotiating meetings with all the seller's and buyer's team members present. However, the seller spending one on one time with the buyer principal in a non-business setting affords the opportunity to find out things that would not ordinarily be learned from the structured meetings.

A good setting for this "get together" is a quiet restaurant or a golf game. The parties can be more relaxed and will often use this as a catalyst to resolve difficult issues that may have surfaced in the formal meetings. It's also a good setting for discussing the buyer's conditions that may not be appropriate to handle in the formal purchase agreement.

A Word of Caution :

The preceding is not intended as an all-inclusive list of due diligence items. It's merely a presentation of some of the seller's concerns in checking out the buyer prospect. Each deal is different and the degree to which a buyer should be examined varies. RHPA

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ROBERT H. PERRY & ASSOCIATES, INCORPORATED

Established in 1977, we are the recognized specialists in managing the sale of security guard companies. We have successfully represented over 100 sellers of security guard companies located in the United States, Canada, Western Europe, the Caribbean and SouthAmerica.

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