NOTEBOOK OF IDEAS FOR

DIVESTITURES
OF SECURITY GUARD COMPANIES

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THE INTERMEDIARY - *They're necessary for a successful transaction, but choose them carefully*

(Written by Robert H. Perry)

In 1989, the directors of Standard Brands, a NYSE giant, were contemplating the sale of Pinkerton, its $400 million subsidiary. Their decision would affect the financial interests of thousands of shareholders, which meant there could be no mistakes. So they sought the help of an investment banking firm, who were outside professionals experienced in the sale process.

Although finding a buyer is one of the important reasons for seeking the help of outside advisors, that may not have been important to Standard Brands. It had the resources of its own to come up with the hundreds of prospects that would be contacted.

What Standard Brands needed from these advisors was their experience in managing sale transactions. But before it started the process, it needed the investment bankers to analyze what the sale would mean for the shareholders. If it decided to go forward with the sale, the investment bankers would advise on the many offers it would receive and guide it through the negotiations. The investment bankers would be resourceful and make a deal happen, a deal that would satisfy the shareholders.

The investment bank Standard Brands chose was well-known on Wall Street and familiar to its thousands of shareholders. This was very important for Standard Brand's managers. They had the fiduciary responsibility of looking after its shareholders' interests, and the shareholders needed to know a competent firm would manage the sale process.

This would be by far one of the largest transactions for the security guard industry. The buyer prospects had to have access to a lot of money, which eliminated all but a few buyers financially capable of handling a deal of this magnitude. Most were public companies who would hire their own "buy side" investment bankers. In fact, one large NYSE buyer prospect retained our firm to be an advisor.

The directors took the investment bank's advice to sell, then gave it the task of managing the process. After contacting hundreds of buyer prospects, it narrowed the buyers down to a few. Through a series of negotiating meetings, it received a price of over 50 times earnings from

CPP, a well-known, privately held national security guard provider. This was a very attractive windfall for Standard Brand's shareholders and undisputed proof that their investment bankers had represented them well.

CPP consolidated the two operations and took on the Pinkerton name. And the investment bankers would once again be a meaningful force in Pinkerton's future. Through their continued guidance, Pinkerton went public and today is a global company and a member of the New York Stock Exchange, with sales exceeding $1 billion.

Now think about another situation. The company was smaller . . . much smaller, but the need for professional help was just as great. It was a $12 million privately held security guard company and the most logical buyer was probably a competitor. The company represented almost all of the two owners' net worth and they wanted to retire.

The owners especially needed someone to manage the deal and, unlike Standard Brands, they also needed someone to find the most compatible buyer. But the company was too small for the large investment banking firms. In fact, they didn't need most of the other services the investment bankers provided. They needed a firm that specialized in mid-market sized companies.

. . . regardless of the company's size, when the time comes to sell, having a competent advisor is essential for a successful transaction. But because there are so many advisor types - variously called "INTERMEDIARIES" - finding the right one may be difficult.

Enter our firm. Like the investment bankers for Standard Brands, we advised our client on the proper time to sell; then we prepared the detailed offering package that emphasized all the attractive aspects of the company. But unlike Standard Brand's investment bankers, we did not contact hundreds of prospects . . . we didn't have to. We had been through the sale process many times for security guard companies. We knew who the serious buyers were, the ones with the experience and funds to get the deal consummated.

We contacted only these few, five to be exact; which, with our experience in managing the process, was enough for a competitive bidding - a very important aspect to getting our client an attractive price.

One can conclude from the above examples that regardless of a company's size, when the time comes to sell, having a competent advisor is essential for a successful transaction. But because there are so many advisor types - variously called "INTERMEDIARIES" - finding the right one may be difficult.

The type needed depends on whether the entity selecting the intermediary is a buyer or seller, and a public or privately held company. It also depends on the size of the company, since there are very few intermediaries that are qualified to manage the larger transactions. And one of the most important factors is whether an industry specialist exists.

A starting point for selecting the firm that's best for the task is to examine the several categories of professionals (a term used loosely in some selections) who offer intermediation as at least one of their many services.

Each has a different expertise. Each adds a different amount of value to a transaction. The only common denominator between some members of the group is that at various times each is referred to as an intermediary.

FINDERS - The finder usually requires the least expertise of all the intermediary groups since their only function is to introduce the parties. They are not involved in the on-going negotiations, hence they do not perform much upfront work, such as preparing the offering package. They most often work for and are paid by the buyer in a transaction. They seldom charge upfront fees. They receive most (if not all) of their fee at the completion of a transaction, usually a negotiated percentage of the purchase price.

When a finder brings the buyer or seller into a transaction, the buyer or seller usually seeks the help of an intermediary who gets more involved in the process to advise during the negotiations and otherwise manage the transaction.

BUSINESS BROKERS - Unlike finders, business brokers have involvement, although limited, in the sale process. However, their largest contribution to the sale is finding a buyer, a process often handled indiscriminately. They usually represent sellers, but in some instances may be working for the buyer. They handle small transactions - sales of less than $5 million, with an average of around $500,000. They are the intermediary of choice for selling "Mom & Pop" type businesses. Most of their buyer prospects are individuals, rather than investment groups or corporations, who are only interested in the larger companies. They rely heavily on advertising in the classified section of local newspapers as a source for buyer prospects.

INVESTMENT BANKERS - As previously mentioned, their clients are usually publicly held companies or very large private companies with many shareholders. They can be a well-known Wall Street firm that operates nationally and internationally, or a smaller firm operating regionally. They are usually not interested in representing the smaller (but by no means small) private companies.

Most investment bankers are licensed security dealers, therefore are regulated by the complicated public securities laws. They are the only intermediary type licensed to deal in public stocks and raise money through public debt offerings. They provide a full range of services to their large clients - starting from the initial public offering, then continued advice on improving shareholder value through mergers, acquisitions and divestitures.

MERGERS & ACQUISITIONS ADVISORY BOUTIQUES - These boutiques are also known as private investment bankers and often just called - "intermediaries." *THEY ARE THE INVESTMENT BANKERS FOR THE SMALLER COMPANIES.* They sell all types of manufacturing, service, retail and distribution companies. Their typical client has sales between $5 million and $100 million, however the client could be much smaller for the boutique firm that specializes in certain industries, as explained below. They may or may not be licensed stockbrokers since their dealings are with privately held clients.

Usually the principals of boutiques have a financial or legal background. Some boutiques offer many of the services of investment banks for their mid-sized clients, with the exception of the public stock and debt offerings.

The boutique, like investment banks, spends a lot of time getting to know their client and the business *before* they start the sale process. Like investment bankers, they advise on the timing of and preparation for the sale. They then manage the process on behalf of their client . . . all the way through the closing.

The problem comes in finding an M&A boutique firm. Most directories do not have classifications for this type of firm. They may be listed under Investment Bankers or Business Brokers, or they may choose not to be listed at all.

SPECIALIZED MERGER & ACQUISITION BOUTIQUE FIRMS - These are the M&A advisory boutique firms that specialize in certain industries. Some serve only one industry, while others may serve two or three.

These firms, if they have managed a sufficient number of transactions for a *single* industry, are very efficient in the sale process for sellers within their area of expertise. Thus, they can afford to handle smaller transactions. Their deal size is $500,000 to $100 million.

Industries that are consolidating attract these intermediaries who specialize. The alarm industry has drawn a number of specialized intermediaries over the years, as well as janitorial firms, media properties, medical groups, various manufacturing products and temporary help services, to name a few.

Our firm has represented over 100 security guard company sellers. We have earned the "bragging rights" to call ourselves a specialized mergers and acquisition boutique firm for the security guard industry.

What all the specialized boutique firms have in common is their unique expertise enabling them to add more value to their transactions than that added by the intermediaries who do not specialize.

Good ones not only add enough value to cover their fees; the value they add covers their fees several times over.

They do this through managing the transaction for their client. This involves handling many different tasks, but focused on one goal – a *successful* consummated transaction.

Unlike the accountant and attorney, the client's other *important* advisors, the intermediary does not get paid (at least most of their fees) until this goal is accomplished. This makes them motivated to work smart, stay focused and be resourceful.

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Here are some of the value-added services the specialized mergers and acquisition boutique firm brings to manage the process for their clients:

- ***They Advise On Timing For The Sale***

In our very first issue of *Divestitures* we described how important timing is for a successful transaction. The market for selling any company, especially security guard companies, is driven by the existence or absence of aggressive buyers.

And who should know the market better than the intermediary who only sells security guard companies? We've been representing sellers of security guard companies for almost 20 years. During this time, we've seen the market go from good to bad and back to good again several times, often for unexplainable reasons.

We've seen premiums paid for companies in certain areas of the county (or world), while at the same time companies in other areas could not be sold. Not only have we seen the price change according to where the guard company is located, we've seen general economic conditions affect the pricing.

The buyer population is constantly changing. Some of the aggressive buyers today were not even in the security guard business three years ago. When they decided to get into the business, we were one of the first advisors they contacted. They knew the deal flow we could bring them was important to their growth plans.

Our firm's existence depends on our staying current with the selling conditions. This market intelligence enables us to advise our clients on the price they can expect and who will be the three or four most likely buyers. Then the client decides whether to go forward with the sale.

- ***They Prepare The Offering Package***

The properly prepared offering package tells the buyer the important information they need to know in order to establish their level of interest in the seller.

It tells the good and the bad. It gives enough information to enable the buyer in deciding whether to move forward in negotiations. At the same time the package will not disclose confidential information that may be used against the seller should it inadvertently fall into the hands of an unscrupulous competitor. And the line between disclosing enough but not too much is one that can only be drawn by an intermediary experienced in the industry.

Through the package, the intermediary is able to disseminate the information to the several buyer prospects simultaneously. This ensures fairness among the prospects and, again, if properly prepared, enables the intermediary to dictate a timetable for responses.

- ***They Work In Tandem With The Accountants And Attorneys***

Astute intermediaries know their area of responsibility in a transaction. They recognize the importance of having competent attorneys and accountants representing their client and know how to work with them in their client's best interest. They make sure the client brings these professionals into the process in the early stages of the transaction.

We're able to assist these professionals at various stages of the negotiations. We have managed over 100 transactions, and have the benefit of solutions to the many issues that threatened the success of all these deals. The solutions were orchestrated by the advisor team and we bring this knowledge to every closing.

One deal we managed was being structured in such a way that there was a potential tax problem for our clients. The problem dealt with our clients being taxed immediately on funds they would receive in several quarterly installments.

They were also represented by a large law firm that had a well-qualified tax department, as well as a Big Six accounting firm. Both firms had spent a considerable amount of time researching the issue. We decided to help by doing research of our own behind the scenes.

We turned to our library of articles from various accounting and tax journals dealing with the tax ramifications of buying and selling businesses. We have accumulated these articles for over 20 years, and the range of subjects is quite extensive.

I spent an entire weekend examining the many hundreds of subjects until I found an article that dealt with our clients' problem and gave a favorable opinion on our clients' intended position. It cited the Internal Revenue Ruling, which had allowed the position in a previous tax case, and gave the authority the tax advisors were looking for in structuring the transaction.

First thing Monday morning, I was on the phone with our clients' senior tax attorney to give him the information I found. He concluded that the Revenue Ruling gave our client the comfort level they needed to proceed with the transaction, which was a very attractive deal for them. They did not want to lose this deal, but would have turned it down if the tax bill was going to be as large as originally thought.

Would the tax advisors have eventually come up with the solution we found? Probably. However, our involvement certainly expedited the process and saved our clients money that was going to be spent on further research.

- ***They Add Credibility To The Transaction***

It's also through adding credibility to the transaction that the intermediary gets the seller the best price. And even though they represent the seller, they can benefit the buyer through saving them a lot of time and money.

The intermediary tests the seller's sincerity level *before* they agree to start the sale. And before the buyer is contacted, the intermediary has already spent a considerable amount of time with the seller - finding out the reason for selling, gathering the necessary information, and getting the process organized.

Getting the best price for the seller is not only accomplished through properly organizing the information, but often it's simply a result of the intermediary being "involved" in the transaction.

We were recently retained by a very large privately held company to advise in the sale of their $60 million security guard company subsidiary. Since it had their own in-house financial talent, it did not need us to prepare the package or get involved in the due diligence process. What it needed was the credibility our firm brought just by being associated with the sale. I would sit in on the meetings as a reminder to the buyer prospects of our ability to assemble the most aggressive buyers in the marketplace. This was a not so subtle way of keeping the buyers alerted to the fact that they were competing with others in the process; which ultimately meant a better price to our client/seller.

And the intermediary adds credibility to the deal by keeping the process moving. This deal momentum is very important to the success of the transaction.

The astute intermediary is constantly in touch with the buyer and seller and their accountants and attorneys. The intermediary sets deadlines to have certain steps accomplished and maintains the all-important sense of urgency to the tasks.

Neither the buyer nor the seller can push the deal without seeming overly anxious - to do so would cause them to lose their negotiating leverage. For the same reason, the accountants or attorneys, who are only extensions of their respective clients, cannot force this process.

However the intermediary can do the prodding necessary to keep the parties moving. And they can do it without sacrificing the negotiating leverage of their client. Everyone in the deal knows the intermediary's reason for drawing the negotiations to a prompt and satisfactory close is for the purpose of getting paid.

The astute intermediary is constantly in touch with the buyer and seller and their accountants and attorneys. The intermediary sets deadlines to have certain steps accomplished and maintains the all-important sense of urgency to the tasks.

The problem is finding the specialized M&A firm that has the experience and resources to get the job done. Many claim to have a unique knowledge of the security guard industry – but do they?

There are some ways a seller prospect can determine whether the firm is qualified.

- *LOOK AT THE INTERMEDIARY'S TRACK RECORD*

As a starting point to determine how well the intermediary has performed one should look at the total number of deals the intermediary has completed for their area of specialization, in the case of this article – security guard companies.

One should also look at the geographic locations of the prior sellers as a way of determining whether the intermediary is willing or can effectively handle the sale of a company located hundreds or thousands of miles from the intermediary's office.

The most important consideration in evaluating the track record is the number of consummated transactions compared to the number of sellers represented. This gives the seller some idea of their chances for a successful transaction with the intermediary under examination.

A good intermediary, and one with which a seller prospect should have the best chance of success, reaches a successful consummated transaction for at least 80% of the clients they represent.

- *EVALUATE THE INTERMEDIARY'S COMMITMENT TO THE DEAL*

Most intermediaries charge an up front fee. The amount is usually nominal and does not come close to covering the intermediary's expenses in getting the sale started. But it's a way of proving whether the seller is sincere in going forward with the deal. This is a very important consideration for the intermediary who's about to invest $10,000 - $30,000 for office personnel just to get the offering package prepared, as well as the travel expenses to the several meetings the intermediary will have with the buyer and seller.

The intermediaries who are confident in their ability to get the deal done will make this financial investment. The ones who are not will ask the client to pay for all the upfront costs or simply refuse to attend the meetings. This of course is counter to what the intermediary needs to do in managing the deal for the client.

Not only is it important that the intermediary make the financial commitment, but they should make a social commitment as well. This means the intermediary should spend time with the prospective client to develop a comfortable relationship, before getting started with the sale, even if it means several "getting to know each other" trips paid for by the intermediary.

After all, the largest asset the seller has is usually the business that's being sold. Their quality of life during retirement may depend on the success of the sale, so there can be no mistakes. The prudent intermediary should be aware of the emotional battles the seller will be going through in making this once-in-a-lifetime decision and be willing to meet (as often as necessary) to answer all of the seller's questions about the process or otherwise give them emotional support.

- *OBTAIN REFERENCES*

Talking with someone who has been represented by the intermediary is a good way to find out how well the intermediary performs. This should certainly be done as one of the first steps in this selection process.

The seller prospect should be wary of the intermediary who will not provide a list of previous clients to contact. Contacting these references however should not be the sole source of evaluation.

For obvious reasons the intermediary will not include a dissatisfied client on the reference list; which means the seller prospect should also make inquiries through third parties.

- *INQUIRE THROUGH THIRD PARTIES*

Going outside the intermediary's realm of influence - third party verification - is a way to obtain an unbiased opinion about the intermediary's dealings.

To do this, the seller prospect could research trade journals for articles written by the intermediary. This would give the seller some sense of the intermediary's abilities and knowledge of the industry. The seller could also talk to associates. If the intermediary is really active, as they should be, many industry associates will know, or know someone who knows, the intermediary. These people are usually willing to furnish information about the intermediary's character and competence.

Although this third party verification can be very helpful, any intelligence obtained this way should be scrutinized closely. Sometimes the intermediary in representing a client may have confrontations with members of the negotiating party, which results in less than friendly relationships. The confrontation may be an isolated event and strictly out of character for the intermediary and even though the intermediary may be competent in getting the job done, any inquiry made to the party to whom the confrontation is directed may be biased against the intermediary.

- *LISTEN TO THE INTERMEDIARY . . . ARE THEIR PROMISES CREDIBLE?*

The seasoned intermediary knows the worth of a company, how long it should take to consummate the deal and the terms the seller should expect. These things should be discussed before reaching a representation agreement.

The problem is, *many intermediaries get carried away with their promises*. They say what they think the seller wants to hear, or offer unrealistic expectations that encourage the seller to select them as the intermediary of choice.

They get the seller committed to an exclusive representation agreement, then expect the seller to accept a more reasonable price (often much lower than the intermediary quoted in the interview) in order to get the deal closed. . .and the intermediary to get paid.

If during the interview, the intermediary describes a deal that seems too good to be true, then the seller should keep looking for a deal manager.

There have been and always will be sellers who go through the process without an intermediary to manage the transaction. We believe this is because they do not fully understand the intermediary's role and value they (well, at least some of them) add to the transaction. It could also be that the seller just does not know where to find the intermediary who has the experience to handle a transaction in the seller's industry.

Such was the subject of a recent *Wall Street Journal* article. The text dealt with the changes the Internet has made to the process of buying and selling businesses. There are several web sites where a seller, for a nominal fee, can list the business for sale and be contacted directly by a buyer prospect - in effect cutting out the "expensive" middleman called the intermediary.

The real meaning of the article came at the end with the mention that Internet selling had *serious* shortcomings. Sellers who dealt with buyers directly had less than successful results because they did not have the benefit of the valuable advice given by the intermediary. Sellers were spending a lot of time dealing with unqualified buyer prospects and most importantly were losing control of the confidential handling.

This article is not about using an intermediary to "speak" for the seller or otherwise make the seller's decisions. In fact, the intermediary should use every opportunity to get the seller and buyer to communicate directly with each other. After all, they need to establish a rapport that will enhance their working relationship after the deal closes.

This article *is* about how the intermediary who, when working in tandem with the accountants and attorneys, can make the difference between a poor deal and one in which all parties win. They make this difference by managing the negotiations.

When selling a business, sellers don't necessarily get what they deserve. They get the results of their intermediary's efforts in negotiating . . . and that's why the seller should choose the intermediary *very* carefully.

This periodic informational letter is published by:

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Established in 1977, we are the recognized specialists in the sale and valuation methods for 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 South America.

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