Both the national and local business economies are in the middle of a mergers and acquisitions boom. Although many of the deals involve big players—Sprint, for instance, agreed to buy Nextel Communications in December—local experts say that many deals involve smaller companies. Now is a great time for business owners to sell, they say, particularly if owners know the best ways to market their companies and create advantageous deals.

A Short M&A History
The current activity in mergers and acquisitions began late in 2003, and followed three years of relatively few deals. That quiet time contrasted with the booming economy of the late 1990s, which saw a flurry of mergers and acquisitions when companies had extra cash. The stock market was riding high and companies that didn’t use cash could use high stock valuations to fund acquisitions. Plus, banks offered liberal financing.

Some companies bought competitors to improve their market share. Others bought because another company had assets that were easier to acquire than to build. Leveraged buyout firms purchased companies, improved them, and sold them. Many companies were happy to be bought. At the time, prices were strong, as much as nine times earnings before interest, taxes, depreciation, and amortization—an adjusted bottom line known as EBITDA—for well-run, profitable firms, says Frank Bennett, a partner and co-chair of the mergers and acquisitions subgroup at the Minneapolis-based law firm of Lindquist & Vennum.

The mergers and acquisitions market slumped in 2000. A slowing economy made potential buyers more risk averse and potential sellers less appealing as all businesses saw profits drop. Equity prices fell as well, making stock less appealing. Banks were increasingly conservative in their underwriting standards, having made too many bad loans.

Prices dropped for the deals being made, dipping lower than four times EBITDA, Bennett says. Sellers decided to wait for better days. While they waited, all companies survived by trimming unnecessary expenses and strengthening core businesses.

The M&A Market is Back
This may be the right time for private companies to sell.

By Ingrid Case

The M&A Market Revives
In late 2003, the mergers and acquisitions business started to regain vigor. The economy and stock market improved, as did company profits and stock valuations. Firms that survived the economic downturn are stronger, and many have capital to invest. They’ve had a chance to think carefully about which acquisitions would help their core businesses.

Banks’ debt portfolios improved after writing off nonperforming loans. They allowed a higher ratio of total debt to EBITDA in acquisition deals, and in general were more willing to help fund mergers and acquisitions deals. Though the number of banks has not significantly increased, a number of non-bank financiers have recently entered the business loan market. Antares Capital Corporation based in Chicago, Merrill Lynch Capital based in New York City, Capital Source in Chevy Chase, Maryland, Dymas Capital Management in Chicago, and Madison Capital Funding in New York City, have helped expand the pool of capital available to businesses. The high-yield debt market, which experts say is white hot, is another improved source of money.

Private equity firms became another major source of funding. These firms have pent-up capital from the quiet years of 2000 to 2003, and many are now aggressively looking for places to invest it. Private equity firms became another major source of funding. These firms have pent-up capital from the quiet years of 2000 to 2003, and many are aggressively looking for places to invest it. Jack Helms, managing partner at the Minneapolis-based investment banking firm Goldsmith Agio Helms, estimates that private equity firms have approximately $125 billion, which with normal leverage, presents more than $300 billion with which to buy businesses.

“The money is there because the investor perception is that there will be a better return than in the public equity market,” he says.
Cargill and IMC Global Join Forces

The Mosaic Company is born

In a deal between Minnetonka-based Cargill and Illinois-based IMC Global, two companies joined forces, spinning off the fertilizer businesses of the two parents to create The Mosaic Company in Minnetonka.

Cargill, which is the largest privately held company in the world, includes fertilizer among its agricultural products. That end of the business, which includes phosphate mining and distribution around the world, is capital intensive to run, with funds needed for everything from mining equipment to tanker shipment. Cargill was looking for a partner to help shoulder the load.

In 1999, Cargill retained Minneapolis-based law firm Dorsey and Whitney to act as lead outside corporate counsel for a possible acquisition or merger. Cargill's executives knew which companies they saw as possible business partners, and in 2003, negotiations with IMC Global began to look promising.

IMC was also in the fertilizer business, with good basic mining facilities and potash, another standard crop fertilizer. The company was in financial difficulty, with debts from previous acquisitions and an inability to raise prices because of market glut, among other reasons. It needed a partner that was in better financial shape.

IMC's product and production capacity interested Cargill's managers. Complicated financial and legal maneuvering ensued. Cargill restructured its business to separate out business units in various countries, a move that allowed its fertilizer business to be transferred to a different company. The deal was structured in a way that avoided as many taxes as possible, with stock exchanges instead of cash transactions, says Robert Rosenbaum, a partner at Dorsey & Whitney and lead attorney for the deal.

The companies created a new holding company that would become The Mosaic Company. IMC Global became the wholly owned subsidiary of The Mosaic Company, and changed its name to Mosaic Global. "When the smoke had cleared," Rosenbaum says, "the Mosaic Company was a new, publicly traded company that owned the old Cargill and IMC fertilizer businesses."

The Mosaic Company has annual revenues exceeding $4.5 billion and market capitalization for fiscal 2004 of $5.6 billion. Cargill owns approximately 66 percent of the firm, with IMC stockholders holding the remaining 34 percent.

IMC stockholders voted "overwhelmingly" for the deal, Rosenbaum says. The stock did well on its first day of trading. The novel deal made The Mosaic Company the 12th largest publicly traded company in Minnesota. It's also the first time the privately held Cargill has taken a controlling position in a U.S. public company.

—T.C.

These factors helped kick-start the mergers and acquisitions market. December 2004 was the busiest in history, according to Thomson Financial, a New York City–based firm that tracks mergers and acquisition data. The month's total of $301.6 billion in global mergers and acquisitions made it even busier (in dollar value of deals announced) than December 1998, which was the apex of the most recent merger mania. For 2004, deals were up nearly 50 percent over 2003.

A good proportion of these numbers were generated by deals between big companies. Twin Cities–area mergers and acquisitions professionals, however, say that they are seeing numerous larger public companies buying smaller private companies. The market has "a large number of pent-up sellers" that were ready to sell but were waiting for a more favorable business climate to do so. Helms says, "That window opened in late 2003, and I think the rapid activity will continue in 2005."

People usually sell businesses when three factors converge: personal timing, estate planning, and financial planning.

Market the Firm, Negotiate a Deal

While private companies in general may be attractive acquisition targets, Twin Cities experts emphasize that companies with desirable assets and good future prospects are most likely to attract suitors. The ideal acquisition, says Angela Busch, managing director for mergers and acquisitions at the Minneapolis office of investment banking firm RBC Capital Markets, owned by Royal Bank of Canada, has developed "a solution that nobody else has that is to die for." Buyers want a piece of technology, or intellectual property "that will move things forward for their companies," she says.

If you have those kinds of assets, make sure the whole world knows it, even if you don't plan to sell the company anytime soon. "You should be networking and letting people know what you're doing, so they're aware and interested. One day, they might come to you," Busch says.

Networking should extend beyond firms you think are logical buyers. "Entrepreneurs think they know who the buyers are, and 80 percent of the time they're wrong," Helms says. That's particularly true of logical buyers in the same field. A competitor may prefer continued competition to paying top dollar for your business, he says. Someone who isn't yet in your market may put a higher value on your assets because of the market platform you've created. "Ideally, you should look for a buyer in an adjacent market," he says.

Talk to an investment banker or lawyer who specializes in mergers and acquisitions early in the process, bringing the benefit of your team's advice to every stage of the sale. That's particularly true if you're unfamiliar with selling a business, says Philip E. Bauer, a partner in the Minneapolis-based law firm of Dorsey & Whitney. "The sale of the company might be the first time you do a M&A transaction, and you're completely overwhelmed," he says. "This may be your big chance to cash in, and you may only get one chance."
**Time the Sale**

With a marketing and a negotiating team in place, you’ll need to think about when to sell. Helms says that people usually sell private businesses when three factors converge: personal timing, estate planning, and financial planning.

Personal timing has become more important. Whereas earlier generations generally sold companies when faced with retirement—and if their children didn’t want to inherit the business—today’s entrepreneurs often step down when they decide to do something else. “Their whole identity isn’t tied up with the business,” Helms says. Your identity might suggest starting another business or heading into retirement. It’s time to sell a firm when other projects look irresistible.

Estate planning is another reason to sell a company. Business owners faced with advancing age need to form business succession plans. Sometimes children or other key stockholders will take over the firm. In other situations, family members or current stockholders may not want or are not qualified to manage it. In that case, selling the firm may be the smart path.

Regardless of your reasons for selling, don’t wait until you’re desperate. Many acquiring companies may want the original owner to stay on for one to two years to ensure a smooth transition.

Planning a sale for the right time in the business cycle is the third piece of timing your sale. Many privately held businesses start small and grow. The point when they reach medium size is often a good time to sell them. “In today’s competitive environment, where large companies are aggregating huge economies of scale, when your business grows into a middle market, you should either grow aggressively or sell. You cannot tread water,” Helms says. You’ll also need to plan your sale for the right time in the larger business cycle. No matter how strong your company, it may be difficult to sell if the overall mergers and acquisitions market, stock market, and debt markets are not in your favor. “You don’t want to sell in a trough,” Helms says.

Finally, don’t wait too long. You may think that you want to stay as long as the company’s prospects are good, but good prospects are exactly what attract a buyer. “You should always sell at a point when your prospects are bright,” Helms says. “You have to give the buyer something to be excited about in terms of growth prospects to get full value.”

**Run a Tight Ship**

Selling your business can be a major distraction. Don’t ease off on day-to-day business management. You need to present buyers with a company that’s working at full tilt, which means continuing to aggressively manage the business.

What goes for profits also applies to capital expenditures. “There can be a tendency to stop making capital expendi-

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**Let’s Make a Deal**

A ripe environment for mergers and acquisitions

Three in 10 business leaders expect their companies to change owners within the next 10 years, according to a survey of 300 business leaders conducted by Chicago-based Grant Thornton. Survey respondents (44 percent) expected to change ownership within three to five years. “It’s a healthy environment for mergers and acquisitions,” says Jon Freeland, partner with Minneapolis-based The M&A Group, Sorenson Freeland Partners. “The strategic buyers are starting to wake up again, thinking it may be time to take a chance—but cautiously.” According to Freeland, who specializes in buying and selling small-cap deals, the current convergence of factors—banks loosening their purse strings, equity firms looking for ROI, and baby-boomers nearing retirement—make this economic environment particularly likely to spur mergers and acquisitions.

Recent mergers in the medical device industry include Johnson & Johnson’s mid-December acquisition of Guidant Corporation, Minnesota’s fourth largest medical device manufacturer; and fifth largest medical device manufacturer St. Jude’s February 2005 acquisition of Maple Grove-based med-tech start-up Velocimed.

In 2004, other notable deals involving a Minnesota company, either as acquirer or target included:

- St. Paul Company acquires Travelers Property Casualty Corporation—$16.1 billion.
- UnitedHealth Group acquires Oxford Health Plans Inc.—$5 billion.
- May Department Stores acquires the Marshall Fields division of Target Corporation—$3.2 billion. (Federated Department stores announced its acquisition of May Department Stores in February.)
- Cargill acquires IMC Global, Inc.—$1.7 billion.

—P. D.
If that’s the case, a financial tool called an earnout may be

You and the buyer may not agree on your company’s worth. Beware the Earnout

prospective buyers tell you what the company is worth. Let

“Put out too high a number and you’ll scare off buyers; too

low and you leave money on the table,” he says. Let

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he suggests, give competitors a shorter period of “thinking

time” to do something, they don’t have to do it,” Bauer says.

Make sure your presentation is complete and consistent. Focus on earnings quality and opportunities for growth, says Helms, and make sure your message is consistent. Give

every potential buyer the same information at the same time.

The exception to this rule, Helms says, is when you entertain competitors’ offers for your business, and you feel uncomfortable giving them too much information. In that case, he suggests, give competitors a shorter period of “thinking time” by giving them your presentation after you give it to

other potential buyers. Dole out information bit by bit to de-

termine true interest in a purchase rather than revealing how

you do business.

In either case, Helms says, never state an asking price. “Put out too high a number and you’ll scare off buyers; too low and you leave money on the table,” he says. Let

prospective buyers tell you what the company is worth.

Beware the Earnout

You and the buyer may not agree on your company’s worth. If that’s the case, a financial tool called an earnout may be

what gets the deal done. An earnout is a bridge between a

buyer’s and seller’s estimate of a firm’s value. In an earnout, a buyer pays a seller a certain amount at closing, plus more money based on how the company performs. An earnout might be based on a product clearing FDA approval, for instance, or on the sales or profits from a particular product or

directly to any buyer’s performance. An earnout based on revenue or profitability may be more

suitable to your business. An earnout based on the profits, because the buyer largely controls

charges against those profits. An earnout based on a one-
time occurrence, such as FDA approval, can also be relative-

ly simple.

If you do consider an earnout, keep it simple. An earnout

based on revenue or the number of units sold, for instance, is

less prone to arguments of interpretation than an earnout

based on the profits, because the buyer largely controls

charges against those profits. An earnout based on a one-
time occurrence, such as FDA approval, can also be relative-

ly simple.

If you continue working for the company after the sale, you may have more control over how your assets are treated, and that can make an earnout more attractive. “I think

there’s the one they focus on to the same degree” that you did, he

notes. In the final analysis, however, even a seller who stays

on cannot force the buyer to rearrange its priorities. “Unless

you specifically write it into the contract that the buyer has
to do something, they don’t have to do it,” Bauer says.

Keep earnouts to a small percentage of the purchase price. “If a seller is placing a third or more of the value in an earnout, they’re likely to be disappointed,” Bauer says, not-
ing that such situations often end in litigation, in part be-
cause expectations were probably higher than they should have been. An earnout or other purchase price adjustment should occur over a relatively short period of time—months, perhaps, but not years, because so many factors can change with the passage of time. As an earnout alternative, Bauer suggests an equally short-term solution: a price adjustment at closing, or perhaps 60 or 90 days after the closing, with the possibility of either party giving money to the other based on the sold company’s performance.

If it sounds complicated, that’s because it is. Handle the sale of your company carefully, though, and this could be the moment to profit from the last venture and move on to

the next.

Ingrid Case of Minneapolis is a freelance writer.