

# Intele-CardNews

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As the current telecommunications resale industry matures, it is the goal of many telecommunications and technology companies to grow through acquisition or realize the entrepreneurs' financial goals through the sale of the enterprise. However, for every truly successful merger and acquisition, the landscape is littered with unrealized potential and economic loss. So, how does a business travel the choppy and dangerous M&A waters successfully? In short, prepare, prepare, prepare.

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## Preliminary considerations

Before embarking on the road to a merger or an acquisition, it is critical to consider and understand whether such a course is really in your business interest. Some of the most common and valid reasons why companies consider a merger or acquisition transaction include:

- the ability to gain competitive advantage through size
- a broadening of the company's product line and/or distribution territory
- relieving pressure at executive and/or administrative level
- geographic diversification
- achieving economies of scale cashing out

The fast pace of the telecommunications industry often turns these valid reasons into economic necessities virtually overnight. For example, your prime competitor offers a new product at a price that you cannot match at your current traffic volume or distribution territory. In these circumstances, merger or acquisition may be required just to survive.



In contrast, the need to merge or to acquire may be a byproduct of the growth and success of your business. Running your business on a day-to-day basis may no longer be an effective use of your time. In many circumstances, the skill sets necessary to form and grow a small business are no longer adequate for the needs of operating a large company. Or, your business plan requires enhancements in plant and facilities that are beyond the company's current economic ability. Again, a merger or acquisition may be the most direct way to obtain necessary resources.

Once the decision has been made to consider a merger or acquisition, the real work begins. The threshold question is whether your economic and personal goals are best achieved by building your company through a strategic merger or an acquisition or by finding a buyer and cashing out your business. In analyzing the strategic merger or acquisition option, a number of factors should be considered, including:

- What are the component parts of my current business?
- What are my current strengths and weaknesses?
- What are my objectives?
- What new or expanded elements does a better business model contain?
- What are the build-out costs and personnel requirements to fulfill the new business model?
- What is the time frame to build out the new business model?
- What other impediments exist in contemplating a build-out?
- What price am I willing to pay to acquire these new elements?
- Which existing companies contain the required elements?
- Which of these identified candidates could be interested in being acquired?
- Conversely, if you are considering being acquired, you should consider the following issues:
  - What is the value of my business to a strategic acquirer?
  - Which companies would benefit from my current business structure and elements?
  - Which companies contain complementary elements or would benefit through economy of scale?
  - Which of these identified companies would be capable of making a strategic acquisition?

Careful consideration of these issues with your financial advisors and legal counsel should help you decide on the optimum path to take your business.

## **Starting the process**

### ***The business plan***

Whether you have decided to merge, acquire or be acquired, you will need a written business plan. The purpose of a business plan is to create a comprehensive statement about your business, the market in which it operates, its assets and financial status, its strategic risks and goals, and its market value.

The process of drafting your business plan should include input from key managers from all aspects of your business operations, as well as competent financial advisors and legal counsel. We strongly recommend that you start by drafting a solid two- to-five page Executive Summary of your business plan.

The executive summary, as well as the full business plan, should contain discrete sections addressing the following subjects:

- the business concept
- products/services your company will sell and to whom it will sell them
- current status of the company
- benefits that the company's products will provide for its customers
- critical factors for success
- three-to five-year financial objectives
- the company's current financial situation
- the offering (capital needed, equity offered)
- use of funds invested (in general terms)
- summary revenue and net income projections
- anticipated exit options

Except where you are specifically requested to provide a complete Business Plan, we strongly recommend that you provide targets with the executive summary. Only qualified prospects should be given the full business plan.

### **Valuing the business**

The process of valuing your business is not only difficult as an arithmetic exercise but in many cases, it is also difficult emotionally, particularly for early-stage entrepreneurs. Indeed, entrepreneurs often come to view their business as if it were a member of the family and value it in that manner. This, of course, can lead to unreasonable expectations and even irrational responses to legitimate offers and business proposals. This concern is one reason why we encourage our clients – and particularly our entrepreneurial clients – to obtain independent advice on all financial issues, including the value of their business.

Recognizing these concerns, it is also true that valuing a business, particularly a growing business in the telecommunications industry, is often as much art as science. Nonetheless, we do recommend that you start by valuing those assets that can be reasonably valued.

Assets generally include:

- real property
- equipment
- intellectual property (trademarks, patents, copyrights, inventions, etc.)
- term contracts and other tangible relationships.

A number of methodologies can be applied to value these assets, including:

- multiples of monthly or annual cash flow, profit, sales, revenues and/or earnings
- discounted cash flow analyses
- analyses of the values applied to comparable companies. In difficult or unusual circumstances "including circumstances where there are substantial contingent liabilities and/or pending litigation " you may want to formalize the valuation process by obtaining a fair value opinion from a recognized firm. Where these issues exist, you should be careful to have this issue reviewed by your attorney before proceeding.

## **Finding appropriate candidates**

With your business plan and company valuation in hand, you are prepared to begin locating and contacting potential merger or acquisition targets. Approaches can be made directly or through third- party agents or brokers.

If you use a third party, be certain that you select the third party carefully and that you have a clear written agreement as to the terms and conditions under which that third party may approach target companies and the financial reward to the third party for closing a deal.

Your agreement with a third party should address the following key issues:

- Does the third party have exclusive rights to promote the company? This issue needs to be carefully considered
- Can the third party contact any target, or must the third party identify the target to you first?
- How and when is the third party to be compensated? Is it only upon successful closing or upon producing a qualified target? Who pays the third party's expenses? Is there a monthly retainer?
- How much is the third party paid? Is payment all in cash or is some to be paid out in stock or other things of value? Each of these key points should be addressed in a written agreement, particularly if you have a relationship with the third party before prospecting begins.

## **Negotiating the deal**

With a prospect in hand, the time has come to negotiate the deal. The first critical step in this process is to assemble the negotiating team. We would recommend that it consist of one or more senior staff/business owners, the company's accountant, financial advisor and attorney.

Typically, it is best if the actual process of negotiating the deal is left to the company's financial advisor and/or attorney and that the decision-makers stay behind the scenes. If you have hired the right people, this procedure will take the emotion out of the process and bring it to a more expeditious and advantageous conclusion.

The negotiation process generally leads first to a letter of intent.

A letter of intent should be a short document that sets forth the key terms of the parties' agreement. It should not, as a general matter, attempt to address every issue that will be the subject of the final agreement.

Acquired companies should be careful not to allow themselves to be hamstrung by a letter of intent that imposes exclusivity restrictions or other onerous limitations on their business. We also strongly urge companies providing financial and other confidential information in the negotiating process to sign comprehensive non-disclosure agreements before releasing such materials or otherwise disclosing such information.

## **The due diligence process**

Comprehensive due diligence is critical to a successful transaction. We have found that most companies really do not know the company that they are considering for a merger or acquisition until they have completed the due diligence process. Inevitably, the due diligence process uncovers facts and issues that need to be considered.

Companies considering a merger or an acquisition should perform internal due diligence before they are subject to the due diligence process by the other side. This internal due diligence can uncover critical shortcomings in the business that can be remedied before they become known by the other side. For example, internal due diligence can uncover shortcomings in a company's contracts or mistakes in bookkeeping that can, at a minimum, be an source of embarrassment (giving the other side negotiating leverage) and can significantly affect valuation. The internal due diligence process should, at a minimum, include a review of the following matters:

- financial records including A/R and A/P, P/L statements and audits
- supplier and customer records
- legal records including ownership, corporate formation and status, minutes of board meetings, internal agreements affecting or limiting the right to sell the company (e.g., right of refusal, buyout agreements), employment agreements, external agreements with customers and suppliers (including agreements that cannot be assigned) and litigation records
- intellectual property assets (e.g., copyrights, trademarks, patents, etc.) and regulatory review (Federal Communications Commission, state Public Utility Commissions Securities and Exchange Commission, Federal Trade Commission (Antitrust, as necessary) and Department of Justice (Antitrust, as necessary))

Careful attention to these issues will not only make the due diligence process run more smoothly, but it will inevitably add value to your company, both in terms of its perceived value as a well run organization, and in real terms as issues are identified and resolved before they are uncovered by the other party.

Of course, you will also want to perform comprehensive due diligence of the other party on these and other issues. Again, we encourage you to leave this task to a financial advisor and attorney that is familiar with this process.

## **The structure of the deal**

Merger and acquisition transactions can take many structures too numerous to discuss properly in this article. These structures include:

- cash
- debt
- equity
- mixed cash, debt and equity
- merger
- acquisition
- reverse merger
- asset purchase.

Each alternative deal structure has its benefits and costs, which can vary depending on a wide range of factors, including:

- the financial and corporate structures of the parties
- the nature of the businesses
- tax issues
- outstanding liabilities and debts
- the financial needs and goals of the parties.

Each of these issues needs to be considered carefully in structuring a deal that maximizes the benefit to each party.

Discussions regarding the structure of the deal should also address whether current management will be employed by the new entity and the terms and conditions of such employment. Key terms to consider include not only the standard issues of salary and benefits, but also issues including the circumstances under which employees can be dismissed and non-compete issues. These last two issues can be a critical element of a transaction and should be considered carefully.

### **Additional considerations**

In a merger, as in a marriage, there are substantial adjustments to be made by both parties. Making the parts mesh is an art, as well as a science. Substantial consideration must be given to the melding process in order to yield a successful result. Key employees are critical to the pre-merger and post merger process. Administrative personal need to be reassured that they will retain their jobs or that they will receive acceptable severance packages in order to retain their enthusiasm through the merger and acquisition process.

Moreover, entrepreneurs by their very nature have strong egos. The struggle for dominance between executives of the new organization often creates risk and uncertainty for the newly formed entity. Setting up the new organizational chart pre-merger, and establishing systems for the post-merger environment, including such issues as which culture will dominate, which methods will survive, who will lead, and who will follow, will facilitate the process.

### **Conclusion**

Successful mergers or acquisitions are the result of careful and exhaustive preplanning. Failures are often the result of impulsive action or incomplete research, thought or investigation. The same elements that led to the initial success of the enterprise " hard work, careful planning and a little luck " need to be employed in this next logical business step. Careful consideration of all aspects of the transaction, both economic and personal, will greatly increase the chances of the success of the transaction and the realization of the entrepreneurs' dream.

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