WHAT NOT TO OVERLOOK: THE MIDDLELAYER

One thing that will ensure Houston's midmarket companies miss out on optimal valuations is overlooking the significance of middle management, said Andy Ray, principal at Houston-based accounting and consulting firm PKF Texas, an independently owned affiliate of London-based PKF International.

"The No. 1 performance driver, the great untapped performance driver, in a business is the capability and commitment level of the middle-management team," said Ray.

And according to Ray, middle management is wuffly unattended in Houston.

"From a support standpoint, what you see is nobody has any kind of formal development program. It's all on-the-job training. (Companies) don't invest in the development of their folks," said Ray. "Then they lose engagement and get beat up by the job."

And it can be a costly mistake for companies that are trying to develop an exit strategy. When a company is acquired, the C-suite becomes less important to the value of a company because the buyer has its own C-suite. Plus, it wants to be assured that what it's buying can run well even without the CEO, said Ray.

One of the biggest and quickest ways a company can boost its value in an acquisition is to establish a second-in-command role. This manager should be positioned to run the company if the CEO were to depart and would stick with the company after a sale. This one simple structural change can add anywhere between 5 and 10 percent to a company's valuation when it goes to market, said Ray.

"Unfortunately, very few have that kind of foresight," said Ray.

There are three ways companies that have neglected mid-level managers can make up for lost time and still drive up sales premiums if they want to transact this year.

1. Establish that second-in-command role.
2. Get two or three profit-enhancement projects in the pipeline. CEOs should make the biggest project by letting their middle managers come up with an extremely large volume of ideas, narrow it down to two or three, then let the managers run with them. CEOs should serve more as a mentor and project manager rather than someone with their hands in every step of the execution.
3. Make opportunistic hires where you can. If you can swap out a C-team manager for an A-team manager who's newly available thanks to energy job cuts, do it. That will boost the management team and later get baked into a stronger valuation.

"You need to look at your management team as an investment for the long run," said Ray. "I'm always gauging their commitment level and their capability, and that's not necessarily the ability to get through the day-to-day but rather their ability to affect change."

"The No. 1 performance driver, the great untapped performance driver, in a business is the capability and commitment level of the middle-management team."

ANDY RAY, principal at PKF Texas

"Just because the industry is down doesn't mean there's not money," said Brinegar. "There are a lot of people that are high-risk, high-reward type (of) people."

TODD BRINEGAR, managing partner at Fisker.us

THE DEAL YOU NEVER WANTED TO MAKE

Let's face it: You role high when oil was $100 a barrel and weren't prepared when prices dropped to $50. You're over-leveraged and struggling to maintain a positive cash flow. You don't want to file for Chapter 11 and are looking for a deal to leave you with your dignity and a decent amount of dough.

If you find yourself in the position of needing a deal because cash flow has gone wayward and you're swimming in debt to the point that your lenders can't renegotiate terms anymore, you're in need of a strategic alternative.

To the extent you're able to, you may be able to dispense with parts of your business in miniature transactions with cut selling the whole, said Todd Brinegar, managing partner at Fisker.us.

"That is very easy to do and very fast to do," he said. "It's a life line, and depending on how much control and ownership you want to give up, it's a great way to get operational cash flow. You can structure a deal in six weeks."

Whether selling parts or the whole company, if you're vulnerable, then discretion becomes more important, said Brinegar.

"Discretion in going to market is good, but complete transparency is important once you sit down with a potential buyer because deals are ultimately based on trust and credibility built up over many discussions, said Cliff Ather-
The dealmaker’s guide to selling strategically

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WE KNEW THIS TIME WAS COMING: Houston dealmakers reached a consensus in January that mergers and acquisitions were going to heat up in the second half of the year as the drop in oil prices has hung some energy companies out to dry, and left others ready to buy.

Smaller (exploration and production) companies — maybe they have more debt — they have less of an ability to weather a downturn, so they’re the ones that are more likely to become targets of acquisitions,” said Nick Lele, partner in the mergers and acquisitions firm Voisin Walker. & S & K.

Perhaps you need a fresh infusion of capital, or you’ve made plenty of money and the time is ripe to retire. Or perhaps you suffer the ill fate of being forced to sell because you were over-leveraged. Whatever the case, focus on your exit strategy.

THE EXPERTS: These Houston experts have counselled on how you can navigate the best deal.

CLIFF ATHERTON
Managing director
at GulfSider Group

TODD BRINEGAR
Managing partner
at fiskau.us

ANDY RAY
Managing partner
at PKF Texas

STEP 1

DECIDE ON YOUR ULTIMATE GOAL

If your company is struggling beyond rescue, but you don’t want to sell for tax reasons, see “The Do’s and Don’ts of Selling in Taxes” on page 20A. Only proceed if you’re confident a sale is the right move. Otherwise, choose your course.

STEP 2

STRATEGIC BUYER OR PRIVATE EQUITY FIRM

Whether you’re looking to retire or grow your business, buyers generally fall under two broad categories: strategic, meaning other companies, and private equity firms. To decide which is best for you, consider the following.

STEP 3

THE STRATEGY

How to market your company once you’ve decided on a route.

KEEP AND EXPAND + STRATEGIC BUYER

One tactic that can be most useful if you’re likely to preserve your business’s legacy (by selling to a strategic buyer to preserve the transaction with the applied name retention — a strategic partnership.

When you look at a strategic alliance, it’s usually a 12-month process leading up to a merger. There’s a huge risk in that, because your competitor will gain all the inside knowledge and strong muscle will walk away,” said Brinegar. “When you start on that strategic alliance, it’s a bit like the camel’s neck being pulled out of the tent. You know there’s a lot of saliva behind that last bit.”

If you don’t want your business bought and then immediately sold, a strategic partnership is your route. If you have time to examine the buyer and get the best sense of what would happen to your company post-deal, this method also allows you to go to market in a very gradual and controlled way. Sure, some investors might see through the partnership and call it a deal in training, but this route will render the possibility of a rush of mixed-bag buyers less likely.

KEEP AND EXPAND + PRIVATE EQUITY FIRM

This is where things get really interesting. If deployed correctly, this process can help you not only survive the oil slump, but come out better, faster, stronger and with more capital than when you were at your peak.

“Actually we feel like your odds are much better of preserving your culture if you go with a private equity firm,” said Atherton.

However, if you don’t do your due diligence, you might wind up with a situation in which your company’s culture is lost or disintegrated. If you know who your potential new parent company is, do some homework and then take a hard look at the option. You can interview, tour the site, and let your employees in on the potential new owners. It will also give you a better idea of what they’re all about.

Private equity firms frequently offer up business owners that they’ve worked with for years, and we strongly suggest that our clients should call the references that are offered, look at the firm’s portfolio and the exits they’ve had,” said Atherton. “It’s an opportunity for the seller to be proactive.

Houston dealmakers are seeing plenty of buyers with many different variables, so the opportunities in the current market are plentiful.

SELL AND RETIRE + STRATEGIC BUYER

There are plenty of sellers that market themselves on their own simply by approaching their potential buyers directly, or by dropping hints in the right circles and then waiting to see what comes of it. “You knock across the net, talk to your suppliers, ask them, ‘Is there anyone in the market that you could see me combining with?’” said Atherton.

While it does happen, it’s important to know the drawbacks of the do-it-yourself approach. The most obvious, of course, is that it’s difficult to vet your buyers in that situation, and you may get declarations of interest from buyers who either aren’t serious or will run your legacy into the ground. “If you put these broader strategies, the broad market confusion, and you also get a lot of people who are not qualified,” said Atherton.

So if you’ve had a few going on already, try and be discreet. Discretion will have a better shot if you have a single targeted buyer that you approach directly.

You can also go through a business broker, a matchmaker for sorts of buyers and sellers. The advantage of a business broker is that they tend to base their fees on the transaction values, so they’ll do no double the buyer for a higher purchase price. The drawback is that brokers may push for higher purchase values at inappropriate times and possibly negotiations. And then you may find yourself paying a broker a percentage of the sales price, so make sure you’re ready to hands off your broker if that’s the method of preference.

SELL AND RETIRE + PRIVATE EQUITY FIRM

While big and large business owners turn to private equity buyers when they want to stay on with the business and oversee its growth and help preserve it, there’s a possible无缝 collaboration involved here. You have to make sure that your middle managers are wisely able to exist out of this, which you and if you really want to drive valuation, all of a sudden you’re not going to have to do anything.”

It’s going to be very important to the PE firm that the management team is onboard in mind. Make sure your leadership team is in a position to survive, if not thrive, without you will have a significant positive impact on the buyer’s overall valuation of the business’s purchase price. See “What not to overlook: The middle layer” on page 20A.