

CONFIDENTIALITY

In the Mergers and Acquisition Process

SECOND QUARTER 2010

A confidentiality agreement is typically the first agreement entered into by the parties considering a potential merger or acquisition. While seemingly straightforward, the issue of confidentiality is often critical to the success or failure of the transaction. Both buyers and sellers have several key reasons to be concerned about confidentiality, including client/customer and employee reactions, market intelligence, and competitors.

2010 continues to show signs that merger and acquisition activity will increase, such as increased confidence in private and public sectors, companies with plenty with cash on hand, and improving economic indicators. As such, sellers in 2010 and 2011 can reasonably expect that they will encounter an M&A market with multiple targets looking to be acquired and an increased number of buyers looking to pay better multiples.

Key Confidentiality Concerns

Sellers

- *Protect identity of company during vetting process*
- *Avoid premature disclosures*
- *Limit exposure in the market*
- *Manage risk during the transaction*
- *Prevent leak of sensitive information*

Buyers

- *Ensure potential targets are attractive*
- *Avoid shakeups at company to be acquired, resulting in operational or staff disruptions*
- *Protect company's competitive advantage*

Wyatt Matas & Associates expects strategic buyers (competitors or those in similar businesses as the seller) to be the most active buyers and be willing to pay better valuations. Financial buyers are still reliant debt markets to finance much of the transactions, which have yet to work themselves out. To this end, managing the vetting of the buyer, due diligence, and transaction process while maintaining confidentiality will be very difficult and more important.

Given the challenges in protecting confidentiality, companies should consider the following to help mitigate risk, manage confidentiality, and ensure a smooth transaction process.

While a confidentiality agreement is typically the first agreement to be entered into during a M&A transaction, the importance of confidentiality starts when the seller decides to pursue a sale.

The following are key points for confidentiality in the beginning of the M&A process:

Limiting exposure early on is key. Those sellers that plan on using an M&A advisor should be careful to pick an advisor that can access key decision makers directly. Do not sign with a broker that "lists" businesses for sale on websites, blast faxes or emails. These approaches are typical for business brokers. The vast majority of responses to business-for-sale advertisements are not serious or qualified. Businesses need to protect exposure to only serious buyers during this process. A broker will place a blind ad to attract interest and

prematurely divulge information before appropriate buyer due diligence has been performed. Typically, an investment banker will vet a potential buyer before contacting them and have the credibility to access C-level executives directly, assuming the strategic route is the preferred strategy. This allows for a frank conversation about the real interest of the potential buyer and how confidentiality will be handled within the buying company.

Identify potential warning signs early in the process. While time consuming, the potential buyer vetting process is critical to protect confidentiality. If asked in a blind call without the appropriate due diligence, most potential strategic and financial buyers will initially express interest in reviewing the seller's "selling documents," if only to gain insight into a competitor or industry. While these selling documents are a necessary part of the acquisition process, only those qualified

buyers should receive such documents. The vetting process should serve to identify potential buyers' business plans, legal structures, competition approvals, and other strategic considerations that could potentially enhance or derail the deal later.

Avoid premature disclosure. As mentioned above, it is necessary to disclose certain information about the seller's business in order to have productive conversations with potential buyers. However, sellers have significant motivation to avoid the premature disclosure of certain information that might do irreputable harm to the business if the transaction does not close or if they do not decide to sell. Failing to manage the release of information or preparing for the inevitable rumors surrounding a deal can result in several unfavorable consequences:

- If employees learn their company is looking to sell, they may quit out of fear of the unknown. Disruptions in staff or operations can serve as a deterrent to potential buyers to continue the deal.
- Competitors may use the information to undermine your company's standing with clients/customers and other business partners by painting an air of weakness or uncertainty.
- If there are negative issues within the selling company that will eventually need to be disclosed to a potential buyer, managing the release and positioning of that information is essential to preventing the derailment of the transaction.

Maintain confidentiality throughout the transaction. Confidentiality does not stop with the introduction of the selling company to one or multiple buyers at the start of the acquisition process. Protection of confidentiality continues through the transaction process all the way through the closing of the potential deal. This requires some give and take from both the buyer and seller. The seller wants to be assured that the transaction will close on the terms agreed to in the letter of intent, and the buyer wants to be assured that they are buying what they were presented during the pre-LOI stages. Protecting confidentiality during this stage of the transaction requires a firm hand on the seller's part where appropriate, but a willingness to compromise once milestones are hit by the potential buyer.

If a transaction is being managed properly, weekly calls

between the buyer and seller will take place to update each side on the progress of the transaction. Part of the weekly agenda should be a discussion of confidentiality issues that might develop in the coming week. This reminds the buyer that confidentiality is important to seller and addresses how to proactively handle specific areas of concerns before they occur.

Ensuring confidentiality in the M&A process is key for a successful deal. While deals typically do not suffer from too much discretion, a failure to limit exposure, manage information, and protect information can derail a transaction and have negative consequences for a company. Enlisting the services of a real advisor helps to ensure appropriate confidentiality throughout the transaction.

To speak to directly one of Wyatt Matas & Associates' merger and acquisition advisors, feel free to contact Chip Measells, Managing Partner, at 202-661-4691 or by email at chipm@wyattmatas.com.

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