

## **Bidding Strategies in M&A Auctions: Planning and Executing Winning Bids, Minimizing Costs of Losing Bids**

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# **Bidding Strategies in M&A Auctions:** Planning and Executing Winning Bids, Minimizing Costs of Losing Bids

*Presented by:*

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# A Seller's Perspective

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# Pros and Cons of Auction from Seller's Perspective

## ▶ Key Advantages

- ▶ Reach more potential buyers
- ▶ Competitive process should maximize price and result in more favorable deal terms
- ▶ More control over process, timing, and transaction documents
- ▶ Market check for directors

# Pros and Cons of Auction from Seller's Perspective

## ▶ Key Disadvantages

- ▶ Higher cost
- ▶ Multiple bidder auction generally more disruptive to business operations than single buyer negotiated transaction
- ▶ More difficult to maintain confidentiality of process (employees, customers, suppliers, etc.)
- ▶ Competitive risk from bidders who are not serious
- ▶ Adverse “market” perceptions if process is unsuccessful
- ▶ Public company may not want to put itself “in play”



# M&A Auction Process -- Seller's Perspective

- ▶ Hire an investment banker
- ▶ Seller and banker prepare Confidential Information Memorandum
  - ▶ For a public company target, public filings will be reviewed in lieu of CIM
- ▶ Perform internal due diligence and create virtual data room
- ▶ Banker contacts potential bidders
- ▶ Confidentiality agreements with potential bidders and deliver CIM
  - ▶ Key approach issues
- ▶ Banker can request initial indications of interest to narrow field of bidders
  - ▶ Approach to narrowing field will be informed by competitiveness of the auction
- ▶ Management presentations for qualified bidders

# M&A Auction Process -- Seller's Perspective (cont.)

- ▶ Seller distributes bid package – form purchase agreement and bid instructions
- ▶ Buyers submit bids
- ▶ Seller analyzes bids and ranks them
- ▶ Seller commences negotiations (or second round of auction) with short-listed bidders
- ▶ Short-term exclusivity agreement with winning bidder (sometimes)
- ▶ Enter into definitive agreement with single bidder

# Typical Bid Instructions

- ▶ Submit your offer
  - ▶ Price and form of consideration (consider requiring value for tax benefits)
  - ▶ Structure
  - ▶ Required rollover/reinvestment
  - ▶ “Binding” offers vs. preliminary indications
- ▶ Mark up purchase agreement (not just an issues list)
  - ▶ Significant changes are unwelcome
- ▶ Explain financing
  - ▶ Commitment letters included if a key component of financing
- ▶ List required approvals and closing conditions
- ▶ List all material assumptions in arriving at offer (especially price)
- ▶ List remaining due diligence
- ▶ Timing to sign/close
- ▶ Plans for management team (including any conditions)
- ▶ List outside advisors
- ▶ Explain internal level of review/approval
- ▶ Reply by a set date and time

# Seller's Goals in Auction

- ▶ Create real or apparent competitive market for unique/ scarce asset
  - ▶ Strategic v. Private Equity bidders
- ▶ Obtain highest purchase price and best form of consideration (presumably all cash)
- ▶ Speed of Execution
- ▶ Secure favorable deal terms
  - ▶ For private M&A, limited post-closing indemnity or other post-closing obligations (e.g., transition services)
  - ▶ For public M&A, maximize Board's fiduciary flexibility before stockholder vote
- ▶ Achieve certainty of closing
  - ▶ Limited conditionality
  - ▶ Robust covenants to get the deal done (e.g., antitrust)
  - ▶ No financing out
  - ▶ Specific performance
- ▶ Employee Protection

# Seller Ranks Bids

- ▶ Price
  - ▶ Amount
  - ▶ Form of consideration
  - ▶ Structure (including tax impact)
- ▶ Certainty to closing
  - ▶ Regulatory approvals and closing conditions
  - ▶ Financing contingency?
  - ▶ Remaining due diligence (e.g., Quality of Earnings)
- ▶ Timing
- ▶ Indemnity terms (private M&A)
- ▶ Other key factors
- ▶ Reputation/integrity of bidder

# Seller Maximizing Deal Leverage During Various Stages of the Process

## ▶ Initial Stages

- ▶ Provide as much information as possible (subject to confidentiality/competition concerns)
- ▶ Highlight the good stuff
- ▶ Don't hide the bad stuff

## ▶ Final Bid/Exclusivity/LOI Stage

- ▶ Negotiate key terms with multiple bidders if price is close
- ▶ Attach Exhibit to LOI nailing down key terms from agreement markup
- ▶ Keep exclusivity short
- ▶ Provide timelines/benchmarks for exclusivity to continue

## ▶ Negotiation of Definitive Agreement Stage

- ▶ Move quickly and confirm you have a deal before extending exclusivity

# Confidentiality Agreements & Exclusivity Agreements

## ▶ Confidentiality Agreements

- ▶ Unilateral v. mutual
- ▶ Standstill (overt / back-door)
- ▶ Employee non-hire/non-solicit
- ▶ No teaming provisions

## ▶ Exclusivity Agreements

- ▶ Bidder obligation to reaffirm valuation/key terms upon seller request
- ▶ Good faith commitment/Automatic extension if working in good faith
- ▶ Expense reimbursement
- ▶ Exclusivity fee/Refundable deposit
- ▶ Termination triggers (e.g., bidder seeks to reduce price/alter key terms)

# A Bidder's Perspective



# Bidder's Objectives

- ▶ Confirm pricing/valuation
- ▶ Build credibility with seller and its advisors
- ▶ Identify synergies and dis-synergies
- ▶ Identify risks and obstacles
- ▶ Ultimately, win the bid and get exclusivity
  - ▶ Key considerations as to timing, terms, and other considerations when requesting (bidder) and granting (seller) exclusivity
- ▶ Minimize the cost of bidding (particularly if losing) – financial and management time and attention

# Overcoming Seller's Leverage

- ▶ Only commit on key issues if needed
- ▶ When possible, leave issues open subject to due diligence
- ▶ Be aware of clues in the process that may indicate that competition isn't as robust as it is held out to be
- ▶ Figure out what's most important to seller  
For example:
  - ▶ Timing of cash v. amount of cash in escrow
  - ▶ Closing certainty v. key indemnity terms
  - ▶ Deal protections v. regulatory cooperation

# Successful Bidder Strategies

- ▶ Play by the rules (or do even better than the rules)
- ▶ Due diligence
- ▶ Focus on real issues (tailoring the bid)
- ▶ Be a serious bidder (avoid low-ball offers)
- ▶ Exercise restraint in early rounds
- ▶ Money talks
- ▶ Bid in the alternative
- ▶ Provide certainty to close
- ▶ Identify and act on shifting deal leverage
- ▶ Jumping the auction

# Play by the Rules

- ▶ Conform bid to bid instructions to the greatest extent possible
- ▶ Mark up the purchase agreement, but don't overdo it – “market terms for market price”
  - ▶ Use footnotes to signal open issues (shows fewer markings when seller is reviewing)
  - ▶ In rep and warranty insurance deals (in most private M&A auctions these days), seller should expect robust reps and warranties

# Due Diligence

- ▶ Undertake a serious due diligence effort
  - ▶ Review SEC filings if the auction is for a public company
- ▶ Devote sufficient resources to review the documents posted in the virtual data room to:
  - ▶ identify genuine business issues
  - ▶ validate your valuation
  - ▶ understand working capital requirements
  - ▶ identify synergies and dis-synergies
  - ▶ demonstrate seriousness of bidder
- ▶ Potential competitors need to be mindful of competitively sensitive information issues

# Focus on Real Issues

- ▶ Address real (rather than theoretical) issues in mark-up of purchase agreement
  - ▶ Focus more on real money issues
- ▶ In private M&A, use rep and warranty insurance to your advantage
- ▶ Mechanical changes, if necessary, shouldn't concern seller
  - ▶ For example, if you see a real risk that the working capital true-up mechanics just don't work, then fix them
- ▶ Consider speaking to seller counsel if a significant issue in draft is unclear

# Be a Serious Bidder

- ▶ Don't bid if you aren't serious – a low-ball bid rarely succeeds in winning the bid for a valuable asset
- ▶ Demonstrate your interest by your actions – assemble deal team, attend management presentation and make site visits, spend time in the virtual data room, engage with the bankers, provide a thoughtful mark-up of the purchase agreement, and meet or exceed deadlines
- ▶ Know your reputation as a buyer: Do you get deals done? Do you “re-trade” deals? Are you litigious?
- ▶ Be careful of unreasonable asks (e.g., extensive transition services)

# Exercise restraint in early rounds

- ▶ Understand the process: bidders will be asked to bid more until they say “no”
- ▶ Consider bidding in a range to get to the next round but save some powder for the last push by the seller
- ▶ Know when to say no and lose the bid
- ▶ Think hard about asks for special indemnities or unusual closing conditions



# Money Talks

- ▶ The highest bid almost always wins
- ▶ Cash is king
- ▶ Timing of when cash is received is critical
  - ▶ For example, a short escrow period
- ▶ Serious bidders will have credible, executable financing strategies
  - ▶ Debt financing
    - ▶ Existing credit facilities/cash on hand
    - ▶ Debt commitment
    - ▶ “Highly confident” letter
  - ▶ Equity financing
    - ▶ Equity commitment/equity partner(s)
    - ▶ Equity offering

# Bid in the Alternative

- ▶ If you don't like the seller's proposed sale terms, give the seller an alternative
- ▶ For example, in a private M&A auction, if the seller insists on a 12-month rep and warranty survival period, then formulate your bid based on that survival but also bid on the basis of an extended survival period

# Provide Certainty to Close

## ▶ Sellers will expect closing certainty

- ▶ Self-assess and address regulatory overlap
- ▶ Provide a financing package that doesn't have gaps with the main transaction terms (e.g., matching MAE definitions in debt commitment letter and purchase agreement)
- ▶ Avoid third-party consent closing condition for non-essential contracts
- ▶ Carefully weigh bidder-friendly conditionality requests
  - ▶ MAE v. materiality bring-down
  - ▶ No appraisal exercise
  - ▶ New employment arrangements

# Assess and Use Shifting Deal Leverage

- ▶ As bidders drop out of later rounds, the leverage of the remaining bidders begins to increase and the continued bidding confers a benefit on the seller
- ▶ Sellers and their bankers will work hard to maintain the dynamics of a competitive market
- ▶ If appropriate, a bidder that perceives it is in “second” place may seek an expense reimbursement from the seller for staying in the auction

# Jumping the Auction

- ▶ If extremely serious about transaction, consider trying to pre-empt the process (or even operate outside of it if the auction is for a public company)
- ▶ Need to be very prepared and ready to fire on all cylinders
- ▶ Expect a very short exclusivity period (or none at all)
- ▶ Expect little diligence
- ▶ Expect little latitude to deviate from seller's auction draft of purchase agreement

# Bidding Strategies in M&A Auctions:

Planning and Executing Winning Bids, Minimizing Costs of Losing Bids

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