

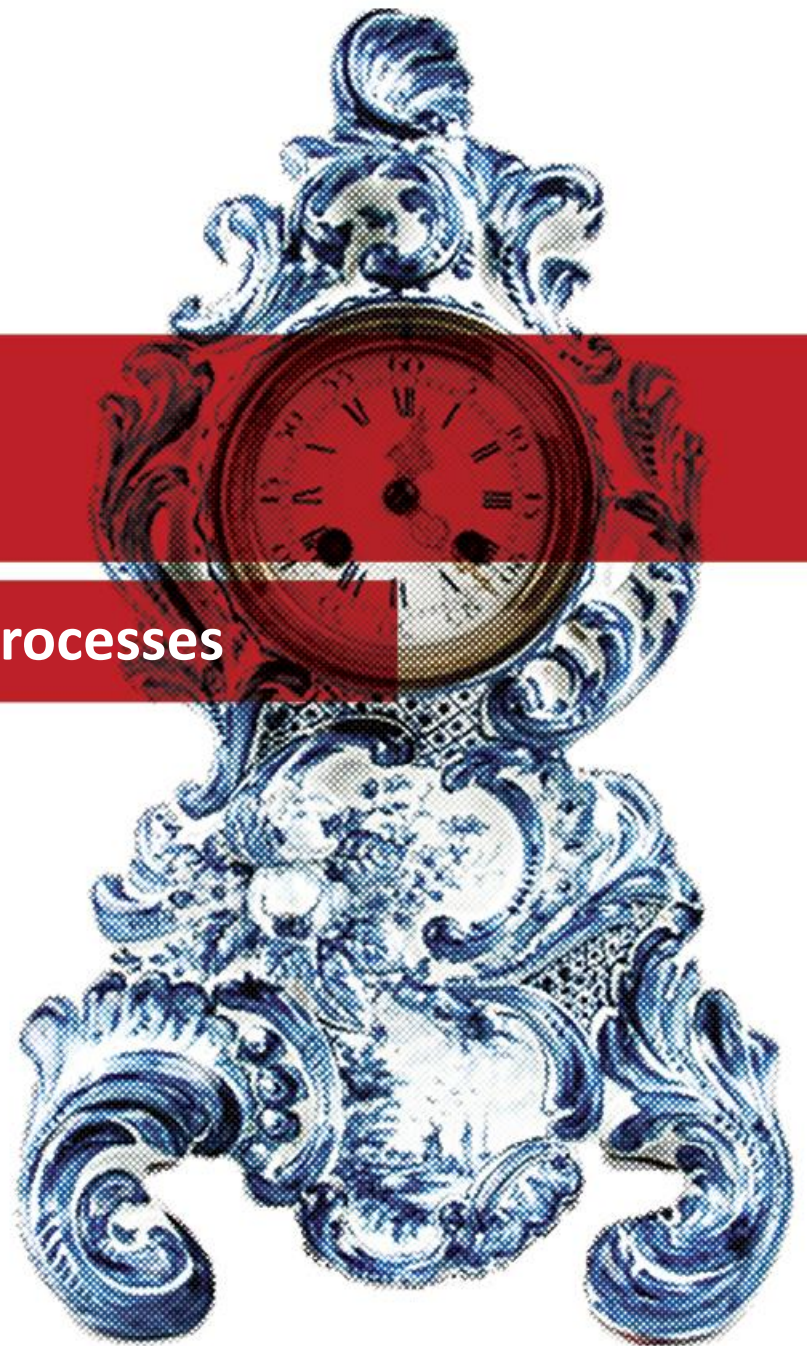
Master in Finance

Negotiation techniques in M&A processes

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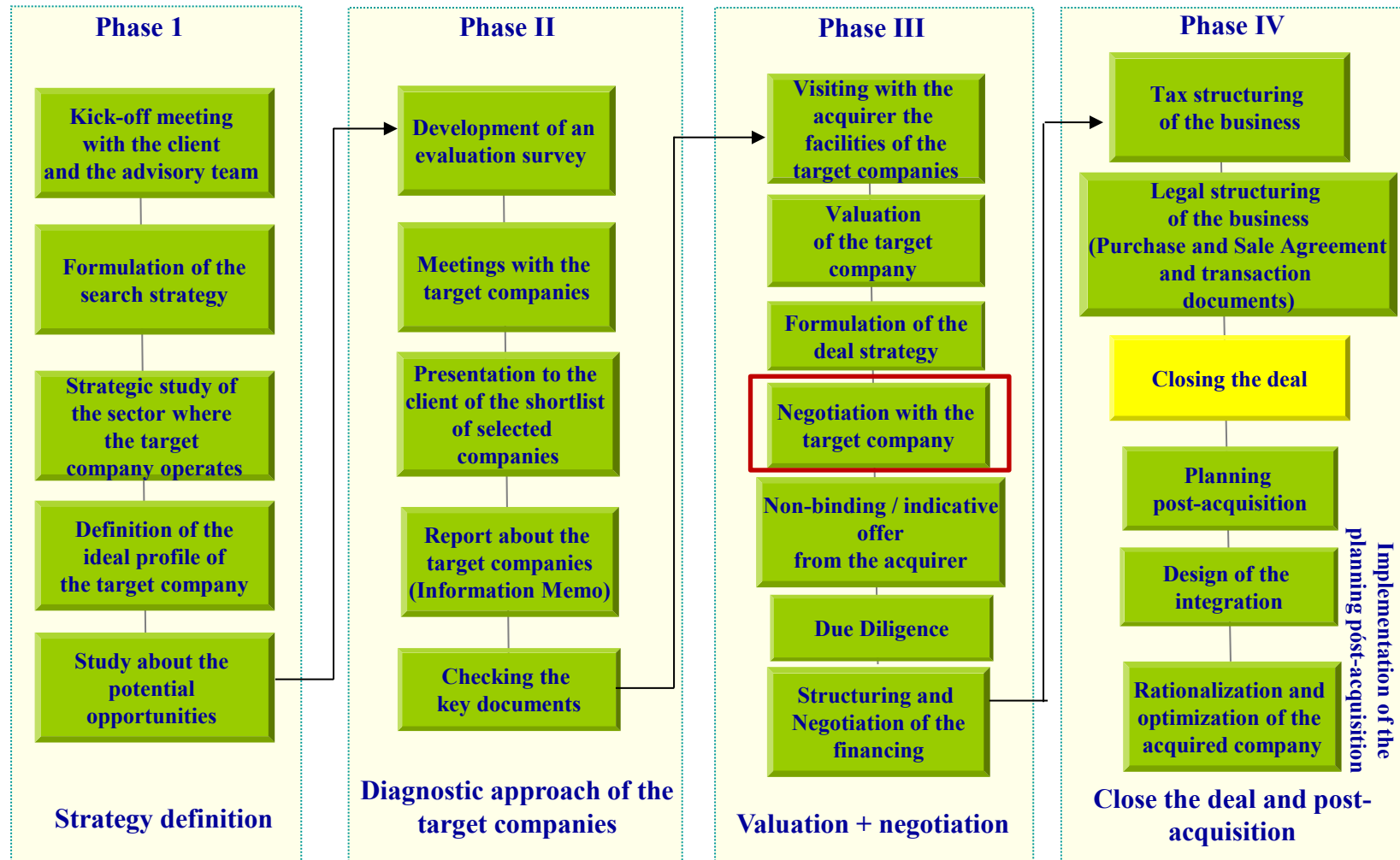
Transaction process

Before entering on the negotiation aspects let's see first where we are in the transaction process:

- Stages of an acquisition process
- Stages of a sale process

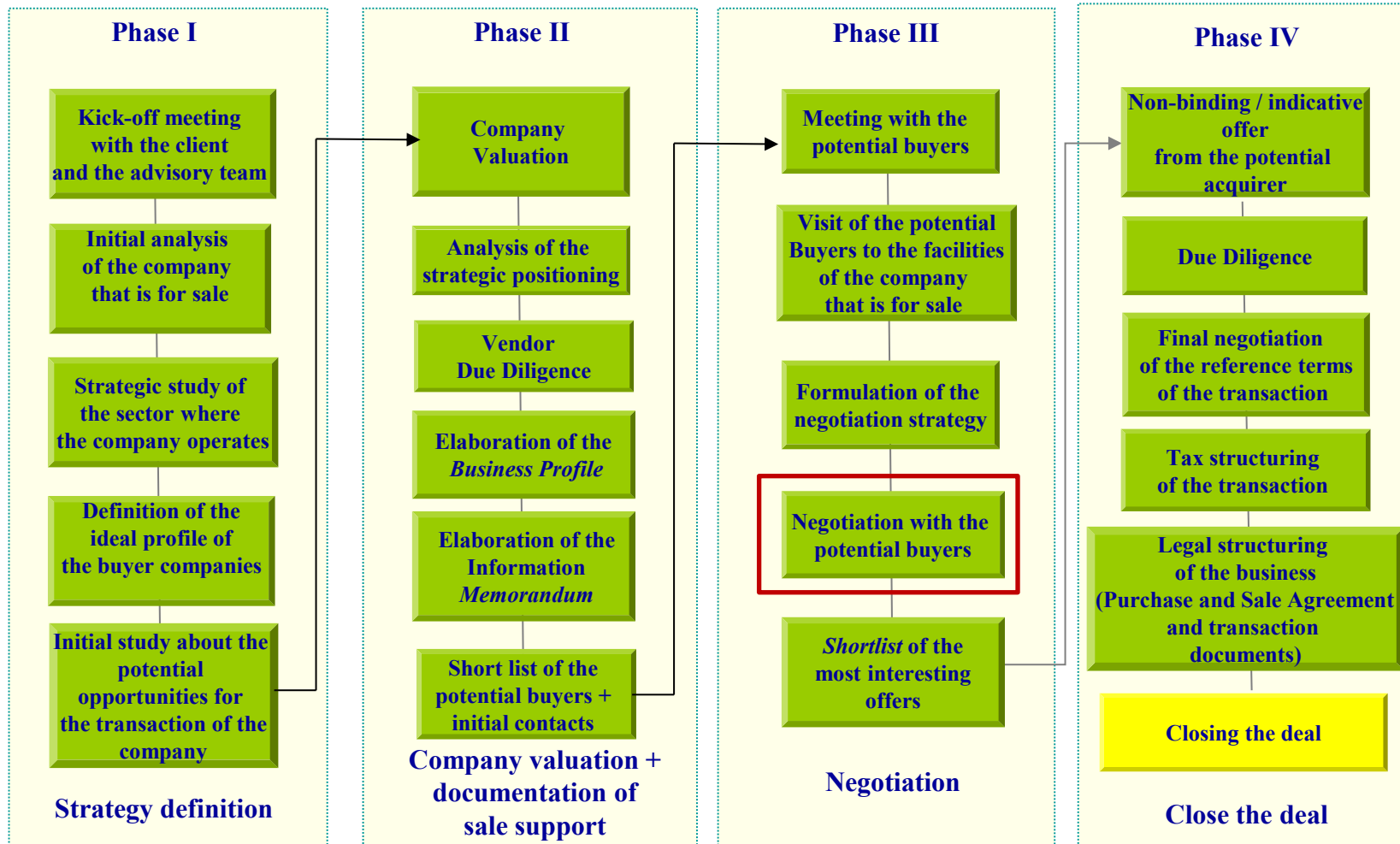
The M&A process – a global vision

Stages of an acquisition process



The M&A process – a global vision

Stages of a sale process



What is to negotiate?

It is the understanding and the convergence between parts in order to establish an agreement that create counterparts for the involved players.

How is the way to negotiate?

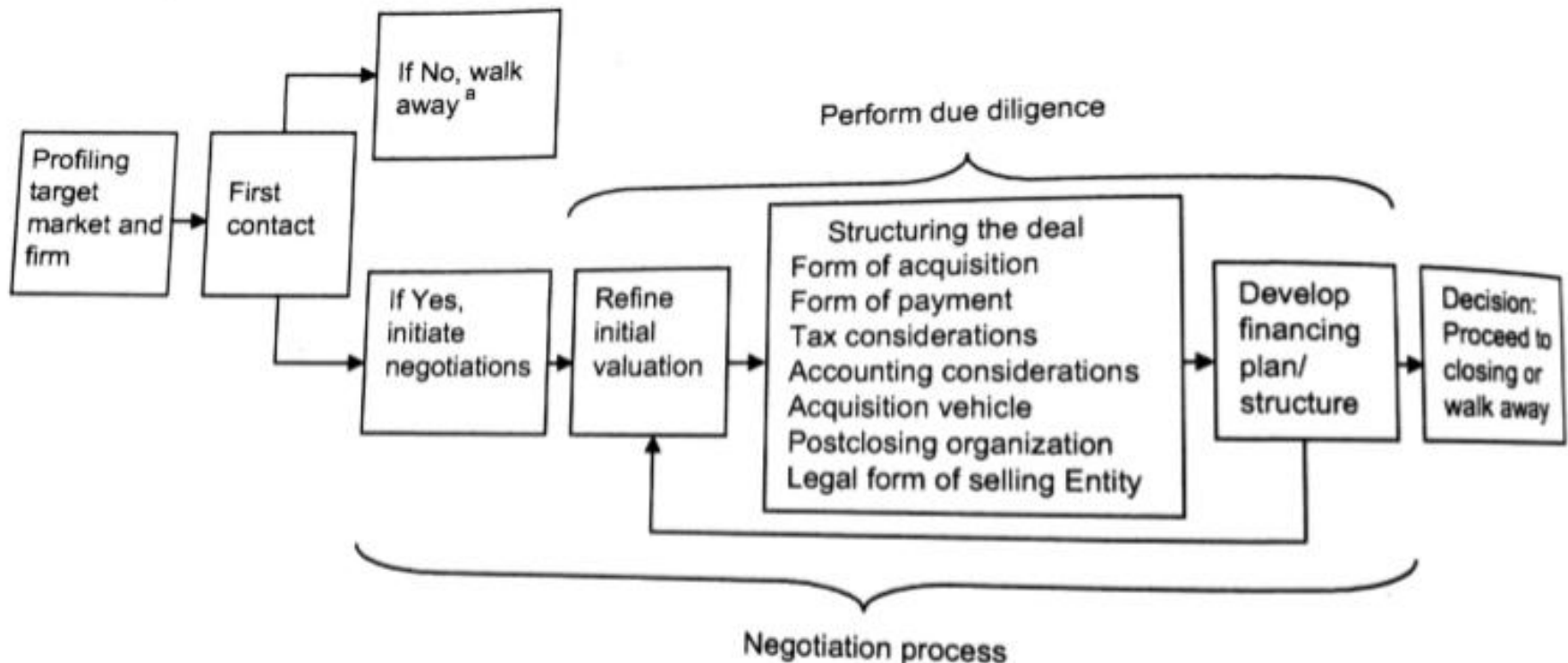
- Unlike an exact science that finds an exact solution in response to a problem formulation, the **negotiation is a not an exact process** and the final result can not be predicted with absolute certainty at the beginning.
- The uncertainty can not be a dominant characteristic of a decision process. Therefore, the **setting of a number of preparation and development steps is essential** to ensure the success of the negotiation.

The steps of the negotiation process



The Steps of the Negotiation Process

The Steps of the Negotiation Process:



Source: M. DePamphilis, Donald (2018)
*Mergers, Acquisitions and Other
Restructuring Activities*

The Steps of the Negotiation Process



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The Steps of the Negotiation Process:

1. Preparation
2. Presentation
3. Consideration of mutual interest
4. Preliminar investigation / Due Diligence
5. Negotiation
6. Conclusion

1. Preparation

The preparation for the business:

- This step is included in the period of pre-release of the **acquisition** offer, when the acquiring company makes a SWOT analysis:
 - It is analyzed the strong and weak points of the target company, having into account the opportunities and threats of the environment.
- The **selection** process is, with no doubt, the most important one.
 - First of all, it is essential **to know what are the motivations for the acquisition** which will help to set the first contact with the target company.

1. Preparation

What is going to help us to decide ? Some questions:

- The target company is essential for the production chain of the acquiring company?
- The target company is essential for the commercial structure of the acquiring company?
- What are the expected earnings after acquiring the target company, and why is better to acquire than subcontract or expand ?
- The customer portfolio of the target company allows to reach objectives of market share that the acquiring company intends to achieve?
- The target company has the pretended products for the diversification strategy of the acquiring company?

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1. Preparation

What is going to help us to decide ? Some questions:

- The target company is well managed, it is getting the market, but its dimension does not allow it to grow more without being integrated in a larger organization?
- The target company is cheap?
- The acquisition of the target company will allow to achieve considerable economies of scale and will increase the competitiveness of the acquiring company?
- Any other relevant motivation?

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1. Preparation

What are the criteria for the selection?

- Dimension
- Results
- Legal Structure
- Products portfolio diversification
- Research & Development
- Certificates of quality (or other certificates)
- Distribution Channels
- Customer Portfolio
- Image
- Equipments
- Facilities
- Location
- Other

1. Preparation

What is the strategic planning for the driving up of the business?

- Who are the possible candidates?
- Who should be the candidates?
- What are the roles of each candidate?
- What is the profile of each candidate?
- What is the expected vision of each one?
- **Who are the advisors?** Were they expected?
- Who is the decision maker?
- Who influence positively on the decision maker?
- Who influence negatively on the decision maker?

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1. Preparation

Briefly, enunciate the next points:

- The motivations
- The variables of critical analysis
- The possible players and their roles

2. Presentation

The Acquiring Company Identifies

- Its intention of purchase
- Its motivations
- Why, from its perspective, it is a positive operation
- Its career
- Its business portfolio
- Its sphere of action
- Its references (clients, suppliers, banks, ...)
- Etc.

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3. Consideration of mutual interest

Consideration of mutual interest:

- This is the phase where both parts involved in the process confirm between them if there are motivations part to part and if there are some expectations (mainly of the acquiring company) if keeps intact and/or if are increasing.

3. Consideration of mutual interest

Criteria of interest confirmation by the acquiring company:

- Extent of a range of products
- The complementarity of the economical activity, being **vertical or horizontal**
- The confirmation of expectations concerning the market share
- The dimension
- The required profitability of the investment
- The continuity or not of the **management team**
- Other...

3. Consideration of mutual interest

At the same line, the target company should consider:

- The financial health of the acquiring company
- The way of financial implementation
- Cultural proximity
- Possibility of the use of services with higher performance level
- The effective analysis regarding the sale of the shareholders' participation

The Steps of the Negotiation Process

3. Consideration of mutual interest

With the confirmation of the **Mutual Interest**, it is common that both parts grant **Intention Letters (Memorandum of Understanding – MOU)**.



Objectives:

- Setting a moral obligation, although without legal force between the parts;
- Setting the main points of the agreement, which will avoid conflicts in the next phases.



3. Consideration of mutual interest

Intention Letters

It is recommended because:

- It is required that the parts spend time thinking about the base principles of the agreement
- Separate “decision” of “small interest”
- Its execution come to be very difficult to change the terms of the letter without offering a better alternative
- Define initial positions, that is, in which step we are

The Steps of the Negotiation Process



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3. Consideration of mutual interest

Intention Letters

From the buyer perspective:

- Definition of interest (total/partial acquisition...)
- Price and conditions of payment
- Requests access to a due diligence

4. Preliminary Investigation/Due Diligence

Preliminary Investigation

- According to the mentioned before, the content of the intention letter usually includes the due diligence, that is, the collection of the necessary information in order to make the valuation of the company and this way, to define:
 - **First:** The price and the respective acceptable business range for the acquiring company;
 - **After that:** Legal, Financial and Taxes positions.

5. The Negotiation

“Good Gentlemen always flavor the finest tea around a business table”

That means:

- Learn to be elegant
- Know the process and want to conciliate
- Value added for all parts



5. The Negotiation

Meeting Preparations

Assuming that the previous steps had the detail and the necessary planning, managers should know:

- What is the essential information for the meeting
- Who are the intermediaries and its motivations
- What is the base price
- What is the limit price

5. The Negotiation

Location to carry out the negotiation

In your own field:

- ✓ It is easy to plan strategic interruptions.
- ✓ It is easy to request the specific collaboration of the company staff to provide inputs.
- ✗ It is difficult to avoid interruptions not planned.

In the other field:

- ✓ The decisions can be postponed with the point that it has to be asked someone of the company.
- ✓ It does not feel as you are in your environment.
- ✗ There is no control on the logistic.

5. The Negotiation

Location to carry out the negotiation

Neutral field:

- ✓ As a whole, none of the parties feel restricted or with more power on the situation.
- ✗ However, it is always difficult for both parties to go sufficiently prepared with all the information.

- ➔ The most important is never to be prisoner nor with pre-designed ideas.
- ➔ Being in a business is also learning to be and to learn to be versatile or, at least, versatile enough to reach the goal.

5. The Negotiation

Fundamental Aspects

1. To consider the personality of the other part, particularly:

- Is the **seller risk adverse**, or prefer to maximize the profitability?
- Verify if there are convergent interests or disagreement in the other part;
- Verify the “Degree of confidence/mistrust” of the other part;
- Verify the quality and readiness of the answers in the meeting concerning our requirements;
- In what concerns the requirement of the detailed and confidential information;
- Equally, to be well prepared and to provide information with quality, in a complete, paused and objective way.

5. The Negotiation

Fundamental Aspects

2. For the success, the company must:

- Start and keep a soft, diplomatic and **gentle position avoiding arrogance or demonstrations of prepotency.**
- The acquiring company must not attribute too much importance to the price.
- Develop a **post-acquisition planning**, with special emphasis in the business integration planning, but also considering all the functional areas of the company, its human resources and its organization.

5. The Negotiation

Fundamental Aspects

3. Equally the target company must be proactive:

- It should not create pre-conceived judgments and not assume that the acquiring company has the only objective of minimization of the acquisition price.
- Make a due-diligence to the acquiring company in case of a M&A exchanging for shares.
- Ask to management, legal, taxes and accounting audit in order to avoid possible contingencies (Ex. **Vendor Due Diligence**).
- Not use the price as an excuse, if you are not interested in the sale.
- Cooperate with the acquiring company focusing in solving questions related to human resources, capital structure and the integration with organizational character (for products or services).

5. The Negotiation

Fundamental Aspects

4. Principles of Agreement:

- Define the headlines to the progress.
- It just makes sense if the basic structure of the business was defined including price and payment terms.

5. The Negotiation

Fundamental Aspects

5. Contracts with Managers:

- It is easy to realize that the managers and seniors of the target company want to know the conditions and offers of the acquiring company.
- In bad-leading or bad-defined situations, the managers will feel uncomfortable because their future is in the air, so they may try to block the agreement.

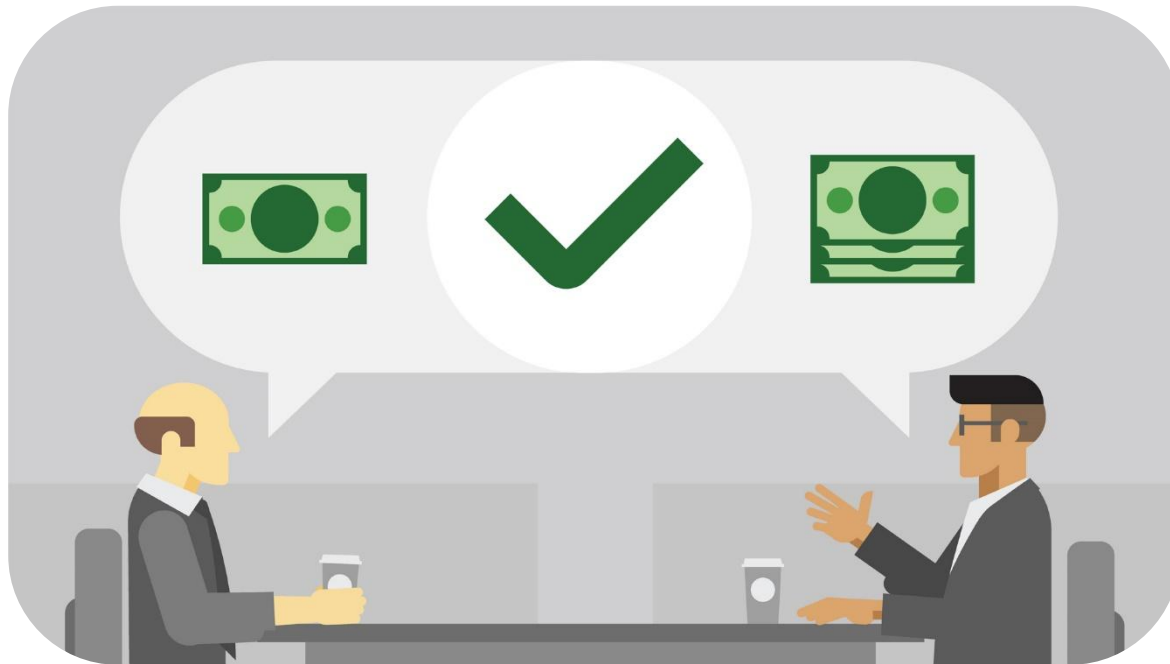
6. Conclusion

Conclusion and Contract

Some inherent aspects to the conclusion:

1. Restriction to how will run the future
2. Agreements of training and familiarization
3. Working contracts/consulting
4. Earn-out clauses
5. Making control decisions beforehand
6. Period of operational transition and acquisition management

Negotiation Strategies



Negotiation Strategies

In **business** the strategy will be always formed around: I want to buy cheap – I want to sell expensive. And this way, designs itself the **two ways** of getting this objective:

- **The first**, keep the statement the same: “What I earn, you lose, and we do final accounts now”.
- **The second** modify softly: “I give, and you give and despite giving both less, we will pick what we want tomorrow”.

These are the **two key strategies** in the M&A negotiating process.

1. WIN-LOSE MODEL:

Characteristics:

- Each part involved tries to maximize its results;
- The result is null: the earnings of one part are the same amount that the loose of the other part.

Negotiations adopting the Win-Lose Model:

- Each part involved tries to maximize in detriment of the other part.
- Consider that the interests are opposites.
- Vision from the opposite part and not from the partner part.



2. WIN-WIN MODEL:



Reciprocity Negotiation:

- Demands and concessions made in a rational and equitable way;
- There is a positive convergence of both sides for the agreement.
- "Demand" done based on reciprocity.
- The problem is when some of the parties do not move with the win-win assumption.

Soft Negotiation:

- Gentleness and sympathy;
- Creating positive attitudes and responses both sides.

2. WIN-WIN MODEL:

Characteristics :

- Search for points of common interest
- Seeking synergies
- Looking for partnerships, alliances and increase in value
- Form a positive sum game

“Jiu Jitsu” attitude or flexibility attitude:

- The negotiator seeks to know the power of the other party, controlling the pace and maintaining a respectful relationship.
- Establish or raise key issues and find solutions by mutual agreement rather than rigid solutions.
- It establishes a broad view of all key points, and not only on price, to identify common views and enhance value creation.
- All elements have an interest in the generation of negotiated solutions.

3. Negotiation with Arbitration - Advisor

Characteristics

- Mediator in the search for consensus, establishing points of convergence between the parties;
- Useful when both parties need support towards factors that do not dominate;
- Solve any problem that can be an obstacle for closing the deal;
- Negotiations conducted with the most professional way;
- Increase the possibility of success of the negotiation related with the higher distance and independence of the advisor in relation to the operation.

In preparing the rounds of negotiation, the buyer and seller should reflect on:

- What the common agreement points are
- What the differences of interest are
- What the points of separation or degree are
- How to re-define the negotiation and keep the cooperative attitude

That is:

ACT IN ACCORDANCE WITH THE PRINCIPLES OF AN INTEGRATIVE MODEL

To get that, it is essential to:

- Define a cooperative strategy;
- Define objectives that satisfy both parties;
- Create solutions for problems and divergences;
- Focus the negotiation on the interests of each one and **not take a rigid position**;
- Separate problems from the business;
- Be able to separate personal interests of negotiable interests;
- Be able to hear;
- Be able to question.

Danger Signals

The breaking of the business can happen at any moment. The reason can be anything. Anyway, the causes are usually the next ones:

- The credibility
- The confidence
- The timing

Danger Signals - Warnings

- In key areas specialized personal is not used;
- The information requested, being simple or complex, is always delayed;
- The answer to the information requested concerns other different things, or still going around without satisfying us;
- There is missed information;
- There is no cooperation coming from the other part;
- There are meetings delayed without an acceptable reason.

Danger Signals – Warnings (cont)

- New actors appear in the meetings;
- The seller establishes limitations of access to people, documents, places or assets;
- The attitude of the counter-part denotes “something hidden” or, from the other hand, pushes the business “ahead at any price”;
- Any other that do not leave us well impressed/confidant.

Situations of Impasse

- The impasses happen when there is lack of agreement in one or several points considered essential for the actors in the negotiation process.
- The price will always be the most relevant point.

Conditions of payment

- Value of the tranches;
- Temporal distance between payments
- Acquisition value subject to future restrictions

Possibilities of payments

- Part in material form
- Transference of assets

Situations of Impasse (cont)

Incorporation/transference of staff

- Not desired people;
- Desired people;
- Distribution of places (mainly relevant in case of mergers/incorporations of SME involving, for instance, family members);
- Exclusion of the seller from the economic activity.

Situations of Impasse (cont)

Analyzing the most common situation: Price

- It appears in the difference of the **asset transference** from the acquiring company to the acquired company's owners.
- It appears in the difference of not transferring all the assets of the acquired company to the acquiring company
- Etc. - always **open the imagination** and **find creative solutions**

Situations of Impasse (cont)

Analyzing the conditions of payment:

- In order to solve, it must be considered all the hypotheses referred and remember the elementary rules that all businessperson knows:
 - If it is **paid more** at head ... **later** will be paid the rest
 - If it is **paid less** at head ... **sooner** will be paid the rest
- Another hypothesis when it is pretended to **pay low tranches**, it is proposed the payment kind of “leasing”. A potentially interesting solution in SME for the acquired company, but with the risk involved of failure.
 -  It can be overcome if the seller requests, and the buyer accepts, a **bank guarantee – first demand bank guarantee**.

Situations of Impasse (cont)

Earn-Out: Way to solve impasses

- The Earn-Out is a method of compensation for the seller.
- The Earn-Out can be used when both parties do not get to find a price of common agreement. If between both parties there is a climate of mutual confidence then, part of the price could be established of a contingent way or postponed subject to results.
- This way, keeps determined in a contract that part of the price of the sale will be done with a contingent way, to be **paid wholly or partly** depending on the **level of performance** of the acquired company.

Ex. Situations where exist a low confidence level in the accounts of the target company.

Earn-Out

For the earn-out payment it is necessary to:

- Exist a transparent relation and confidence
 - The negotiation have advanced in an integrative way (Win-Win Model)
 - Define the way of the contingent price: monetary, shares, etc...
 - The criteria of the performance measurement
-  This is the most sensitive because it expresses the conditions of analysis results that will form part of the price paid as contingent. **It can be based in:**
- Estimation by the **operational result**;
 - Estimation by the **net result**;
 - Estimation by the **operational cash-flow**;

Whatever the method is, it should be set out the formula for calculation of the price contingent;
It also should be written the period of analysis that will be defined as one in which the assessment results will form the price contingent.

Some formal aspects underlying the negotiation process

Preliminary Legal Transaction Documents

Typically, seller and buyer in an M&A transaction negotiate the following documents:

- Term sheet
- Letter of Intent (LOI) / Memorandum of Understanding (MoU)
- Confidentiality agreement (also called nondisclosure agreement)

Note – LOI vs MOU: Both types of agreements describe the intention of taking a specific action and are not legally binding documents even though they may include legally binding clauses. The difference between LOI and MOU mainly depends on the discretion of the parties involved and the nature of the project in concern; **LOI** is more suitable to use as a **primary agreement** in major alliances such as **mergers and acquisitions** where a steady platform for negotiation is necessary whereas **MOU** may be more suitable to use as an alternative to a contract.

Source: Cueto, Santiago A. “Memorandum of Understanding and Letter of Intent: What’s the Difference?”
International Business Law Advisor. N.p., 21 Apr. 2010.

Some formal aspects underlying the negotiation process

Preliminary Legal Transaction Documents

Term Sheet

A term sheet **outlines the primary areas of agreement** and is often used as the basis for a more detailed LOI.

It has 2 to 4 pages and stipulates:

- The total consideration or purchase price (often as a range)
- What is being acquired (assets or stock)
- Limitations on the use of proprietary data
- **No-shop provision preventing the seller from sharing the terms of the buyer's bid with other potential buyers**
- Transaction data

Many transactions **skip the term sheet** and go directly to negotiating an LOI.

Some formal aspects underlying the negotiation process

Preliminary Legal Transaction Documents

Letter of intent (LOI) – MOU (Memorandum of Understanding)

- Description of the **transaction way**: Merger, acquisition of shares, assignment of shares, etc.
- Important details for the purchase: For instance, the **valuation method**.
- Protection clauses – for instance in the case of companies in difficult situation.
- Special agreements: Such as **labor contracts**.
- “**No shop**” clauses: Making difficult for the seller to find other buyers in a specific period (ex. 2 or 3 months)
- **Commission for compensation (*bust-up*)**: Being payed to the buyer in case the seller desires to sell the acquiring company to third parties.

Some formal aspects underlying the negotiation process

Preliminary Legal Transaction Documents

Confidentiality agreement

- After or at the same time that the signature of the Letter of Intent (LOI) is elaborated the **confidentiality agreement** in which the parties agree that the released information during the process will serve only for the original purpose – to proceed to the acquisition, and that the information will be kept as confidential.
- Usually, it is also defined a limit term for the agreement.

Some formal aspects underlying the negotiation process

Some Formal Aspects

Buy – sell Agreement

Definition:

A **buy-sell agreement** (also known as a **buyout agreement**) is a **contract between shareholders or partners** that sets the **rules and mechanisms** for buying or selling ownership interests **in future situations**, such as death, retirement, incapacity, or withdrawal of a shareholder.

Purpose:

Serves as a **shareholder protection and continuity mechanism**.

Establishes **who can buy, under what conditions, and at what valuation** when certain events occur.

Some formal aspects underlying the negotiation process

Some Formal Aspects

Buy – sell Agreement

Typical contents:

- Triggering events (death, incapacity, conflict, exit, etc.)
- Valuation methods
- Terms and conditions for exercising purchase rights
- Restrictions on share transfers

Usage:

👉 It is a **preventive governance document, not linked to a specific M&A transaction**, but designed to **maintain ownership stability** within a company.

Some formal aspects underlying the negotiation process

Some Formal Aspects

Sale and Purchase Agreement (SPA)

Definition:

A **Sale and Purchase Agreement (SPA)** is the **main transaction document** in a merger or acquisition (M&A), governing the **definitive sale and transfer** of a company (share deal) or its assets (asset deal).

Purpose:

Formalizes the **definitive sale** between the buyer and the seller.
Sets out the **commercial and legal terms** of the transaction.

Some formal aspects underlying the negotiation process

Some Formal Aspects

Sale and Purchase Agreement (SPA)

Typical contents

- Identification of the parties (buyer and seller)
- Purchase price and adjustment mechanisms (price adjustment, earn-out, etc.)
- Representations and warranties
- Indemnities
- Conditions precedent
- Closing provisions and timing

Usage:

👉 It is a **transactional and event-specific** document, used in a **concrete M&A deal**.

Some formal aspects underlying the negotiation process

“Buy-sell Agreement” VS “Sale and Purchase Agreement (SPA)”

Although “Buy-sell Agreement” and “Sale and Purchase Agreement (SPA)” may seem similar, they are not exactly the same thing and are not used in the same contexts.

The **SPA** is the **operative contract** that executes a specific M&A transaction.

The **buy-sell agreement** is a **preemptive shareholder arrangement** that regulates how such transactions may occur **internally among owners** in the future.

Some formal aspects underlying the negotiation process

“Buy-sell Agreement” VS “Sale and Purchase Agreement (SPA)”

Aspect	SPA – Sale and Purchase Agreement	Buy-sell Agreement
Purpose	To formalize the actual purchase and sale of a company or assets	To define future rules for share transfers among existing shareholders
Timing	Used during a specific M&A transaction	Signed in advance as part of corporate governance
Parties	Buyer and seller (can include external parties)	Existing shareholders or partners
Nature	Transactional contract	Preventive / governance agreement
Triggering event	Actual sale or acquisition	Future event (death, withdrawal, dispute, etc.)
Focus	Commercial terms, price, warranties	Valuation method and internal transfer mechanism

Some formal aspects underlying the negotiation process

SPA – Sale and Purchase agreement - EXERCISE

Search in internet for examples of **Sale and Purchase agreement** in M&A context.

Negotiation Exercise



Exercise 1

The Pink Cadillac case



Exercise 1

The Pink Cadillac case

Transaction subject: 1968 Pink Cadillac convertible

Contest Money Prize: \$ 50,000

Group 1 – Buyers

Minimize acquisition price

Buyers are “car collectors”

Group 2 – Sellers

Maximize selling price

Reserved info

The car has a paint problem. There is a fungus in the paint that can grow and damage in a relevant way the paint of the car
The car has no mechanical problem.

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