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Lessons Learned On the Lines

Paul Sperry shares nine lessons for deal pros to live by

Paul Sperry

Somehow, in the blink of an eye, I have morphed from a young, energetic banker pushing deals at maximum speed into a much slower, wizened old guy.

Yet, as years in the M&A business gradually fade into decades, and as I now forget more of my past deals than I remember, I have come to realize that what I presently lack in stamina is more than compensated by experience. I may not pile on the West Coast red-eye flights like I used to, but I am certainly a far wiser, far better banker than when I started out in this business three decades ago.

By way of background, in the early 1980's, I was a graduate student pursuing a Ph.D. in history at Columbia University. After a few years of academia, I got restless and landed a job with Victor Niederhoffer, a world-champion squash player who also happened to run an investment bank. At the time, Niederhoffer liked to hire "mongrels," those whose pedigrees were off-kilter, but who seemed to have skills and talents not readily apparent on CVs. I clearly fit the mold. He threw all new recruits to the lions; those with the instincts to survive ended up prospering.

After a few wild years and a few completed deals, I decided to set sail on my own. Fortunately, I had the good sense to convince Beatrice Mitchell, a co-worker, to join me. Thus, in 1986, we set up our own M&A advisory shop, Sperry, Mitchell & Co. Our focus then, as it remains today, was advising private middle market companies in sale or merger transactions.

In those days, the terms "financial sponsors" and "private equity" had not yet entered the



lexicon. If we couldn't get corporate buyers to take the bait, we were left to sell our clients to a bedraggled array of "boot-strappers" and "LBO artists."

Back then, few sponsors had committed capital. Most tended to "pass the hat" with each deal. On top of that, few banks understood or participated in leveraged lending, leaving the field to a small handful of mostly non-bank lenders, many of whom had origins as factors to the garment trade (like Heller and Congress Financial).

From those modest beginnings, Beatrice and I have grown a nice business. As tribute to my firm's 25th Anniversary, Mergers & Acquisitions Journal has asked me to share some of my col-

lected wisdom, gleaned over three decades and hundreds of deals. I'll admit that my 'List of Lessons' is somewhat ad hoc. Still, I think that there is a kernel of universal truth in each one:

Lesson 1: Choose your partners carefully

Good partners not only do their job very well, they push you to do your job even better. Good partners expand your horizons, introduce fresh ideas, and open up a whole new source of connections.

Whether you are picking a lawyer to represent you, a co-investor in a deal, or an individual with whom you want to start a business, always choose someone who is smarter, more connected, and more driven than you. No matter how highly we all think of ourselves (and we do!), the world is full of people who are more competent and more clever than we are. Find these people and persuade them to partner with you.

In my case, I was fortunate enough to find Beatrice Mitchell. She is intelligent, witty and charming; people just instinctively want to do business with her. She's also a real dynamo and a natural-born banker.

Good partnerships make all the difference between success and failure.

Lesson 2: No profitable deal is ever a bad deal

For most owners of private companies, the bulk of their net worth is tied up in their businesses. Therefore, I would argue that it is prudent for them, perhaps even incumbent on them, to periodically review the market and consider monetizing all or a portion of their holdings.

Unfortunately, too many company owners expect the party to last forever. It never does. Owners want to perfectly time their sale, to squeeze every last drop of juice from the lemon, before bailing. Sadly, this strategy generally ends in tears. I cannot begin to count the number of company owners who waited too long, only to lose way more value on the downside than they ever could have captured on the upside. The best time to sell is when the markets are receptive, when there are clear skies ahead, and when the runway for buyers is open.

No profitable trade is ever a bad trade. Sure, a new owner can continue to grow your business, and reap many times your returns in a future sale. However, success is not a zero-sum game; your success does not hinge on the next guy's failure. Revel in your success, and accept his too. Indeed, you should be proud that you created such a wonderful platform that next owner couldn't screw it up.

Lesson 3: Seller financing is evil

Years ago, buyers relied on private company sellers to finance a part of their deals, because that portion of the capital structure was just not available elsewhere. Thankfully, those days are over. Today, there are billions of mezzanine dollars waiting to be deployed in middle market deals. If a financial sponsor cannot find institutional buyers for all the paper in a proposed deal, I can assure you that our client wants no part of that paper either. There is such a large and active mezzanine market today that there is simply no reason for private company sellers to finance deals through seller paper.

Lesson 4: Earn-outs are not evil

While seller financing is an unnecessary evil, earn-outs are not. Indeed, I pursue earn-outs for my clients every chance I get.

Sadly, earn-outs have gotten a bad rap. Everyone has heard the litany of reasons to treat earn-outs like leprosy: they are difficult to negotiate, difficult to properly draft into legal documents, and difficult to administer post-closing. It is generally accepted that earn-outs are just "an agreement to disagree," and always result in bickering between parties. Conventional wisdom is to avoid earn-outs at all costs.

In fact, conventional wisdom is wrong. Of course, there are minefields to be avoided in properly structuring and implementing earn-outs. And of course, earn-outs should be viewed

by sellers as supplemental to their deal, not a key ingredient of their deal. Still, earn-outs are a fabulous way for sellers to: 1.) demonstrate their faith in the continued growth and performance of their businesses (whether they really believe it or not), and 2.) share in some incremental upside should the businesses really perform. I much prefer earn-outs over options, warrants or even retained or rolled equity. The parameters and duration of earn-outs are generally well-defined, tightly-drawn and more in my clients' control.

Like most things in life, earn-outs are only as complex and difficult as we choose to make them. In our experience, earn-outs do not lead to any more disagreements or "tricky behavior" than most other aspects of M&A deals. Indeed, over the past decade, we have had many, many more disagreements with buyers over post-closing true-ups of working capital than we've ever had over earn-out payments. Most buyers are thrilled to pay out further dollars if certain pre-determined thresholds are truly met.

Lesson 5: We're all salesmen

To be successful in any career, we need to sell ourselves. My sister the research scientist needs to sell her projects to get funding. My sister-in-law the public defender needs to sell her clients' innocence to judges and juries. My brother-in-law the PE deal-meister is forever selling himself to investors, sellers, and potential management teams. In the end, we are all peddlers. Even though we in the deal business wear custom suits, summer in the Hamptons, and are very impressed with ourselves, we have way more in common with the guy selling ladies shoes at the mall than any of us wants to acknowledge. Embrace your inner salesman.

Lesson 6: Relationships are important

Never underestimate the value of relationships. Long-term success in the deal business is fundamentally based on developing great communication skills and maintaining a wide array of relationships with people.

Analytical skills are fungible and way overrated. They can easily be bought in the market. Ultimately, deals are made between people. The best dealmakers are those who understand that truth and focus on developing personal relationships.

Lesson 7:And so is integrity

Anyone who works in the deal business long enough eventually faces the dilemma of expediency versus doing the right thing. In such instances, take the long view and do the right thing. There is always another deal. There is always another client. Never trade your good name just to get a deal done. Your reputation is the pillar on which your career and long-term success is based. Never compromise that. Besides, no deal, no fee, is worth more than your self-respect.

Lesson 8: It's all about results

Marx's Labor Theory of Value was discredited almost the day he first espoused it, yet some in the finance field still seem to adhere to its precepts. Success is not about how hard one works, or how much time and effort one throws at a project. Rather, it's all about results. We have toiled for years on projects, only to have clients walk away from deals of a lifetime at the last minute, often for petty reasons. These broken deals are frustrating, demoralizing and, ultimately, unprofitable. Conversely, there have been instances in which we have made a few calls to facilitate introductions, and have been rewarded handsomely for doing so. My socialist friends at Columbia are horrified to think that one could be paid so well for so little effort. They just don't understand that time and effort have nothing to do with it. Results are all that matters.

Lesson 9: Have fun and enjoy business

This Lesson is somewhat obvious, but we still need to be reminded of it from time to time. We're all in business to make money, but money without fun becomes boring rather quickly. There is no better business than the deal business. It is populated with interesting, motivated, and engaged people. Our client entrepreneurs are the salt of the Earth and the reason our economy is still the envy of the World. While the M&A business can be demanding and intense, it behooves us to keep matters in perspective and focus on having fun doing what we all love doing: making deals.

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