



Private Equity Sales

What you need to know to prepare for the sale of your company.

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The mergers and acquisition (M&A) market has seen a significant boost in 2021 and into 2022, primarily due to favorable capital market trends, driven by the increased desire to invest that has been fueled by the low cost of capital. This significant population of owners in the

engineering and construction (E&C) sector who either are aging and close to retirement without a succession plan or have suffered significantly during the pandemic has created a significant pipeline of E&C companies wanting to sell. The increased supply of sellers and growing demand from investors

has resulted in M&A volume exceeding pre-pandemic levels by 20% across all E&C segments. The recently passed infrastructure bill is expected to generate additional increased interest in E&C companies, as federal dollars create new projects, thereby increasing contractor backlog.

There are unique differences within the pattern of investors driving this M&A boom:

- The size of individual deals is down significantly, with more smaller deals than mega deals being recorded.
- Private equity interest in E&C companies has increased significantly in an effort to diversify investment portfolios. The E&C industry presents large opportunities for investors, as private owners are more open to nontraditional exits than they have been previously, and this is a market largely untapped by private equity. The lower cost of capital and increased desire to invest in the E&C industry has generated higher-valuation multiples, making it very attractive for owners to sell.

How to Prepare for a Sale

There is a lot to consider when preparing for the potential sale of a company, including how to smooth the process and key areas of focus for a successful transaction.

1. **Set expectations:** In the early stages of deciding to sell a company, business owners should set realistic expectations.
- **Marketability**—Obtain an understanding of what the business could be worth, which is commonly referred to as an indication of value. This exercise entails historical information on a high level, normalizing earnings before interest, taxes, depreciation and amortization (EBITDA) and developing an acceptable multiple. This can be industry- or market-research-based on comparable deals, or

determined simply by what the owner is willing to accept in order to walk away from the deal.

Identify key performance indicators (KPIs) for your business, which should be industry-specific, representative of your operations and actively used to manage the business. These indicators will be used to highlight trends and provide analysis of operations over historical periods. The right KPIs can make a difference between looking average and looking like the top performer in your market. One important aspect of this process is determining the after-tax proceeds and backing into the gross purchase price.

- **Realistic deadlines and timetables**—In general, deals can take anywhere from 60 days to more than 120 days. Setting a realistic timeframe for the deal to close is important for all parties involved and will dictate a lot of the flow of information.
- **Team**—Assemble a team of professionals who will assist you throughout the process, including an attorney, an investment banker or broker and an accountant. This team of professionals will utilize the goals of the business owner to develop the timeframe, deadlines, roles and responsibilities for the transaction.
- 2. **Gather financial information:** One area that is commonly overlooked is the quality of a company's financial information.
- **Basis of accounting**—In general, buyers request the financial accounting records of the selling

company to be in accordance with generally accepted accounting principles in the United States (GAAP). In many smaller deals, companies do not have the infrastructure to provide consistent financial reporting in accordance with GAAP, and in many cases the owners of the company manage their business on a cash or other basis of accounting. Any deviation from GAAP usually requires additional time and resources by the buyer and their team to build in any necessary adjustments for GAAP presentation, causing delays in ultimately getting a deal done.

- **Timeliness of financial information**—Companies that have strong internal controls have specific financial-statement closing and account-reconciliation procedures, usually closing out 30 to 45 days following month-end or year-end. Prepare and maintain balance-sheet and income-statement account reconciliations. Financial statements that are reconciled more than three months after a period end are considered "stale," or not accurately reflecting the current financial condition of a company. Monthly or quarterly financial-statement closing and account-reconciliation procedures are important when evaluating a business, including looking at seasonality and volume trends. Account reconciliations are always requested during the buyer's due-diligence process to validate balances, especially for unaudited periods.
- **Quality of financial information**—In addition to the timeliness of

financial information, the quality of information available to a prospective buyer prior to the performance of due diligence is imperative. A company that doesn't have proper account reconciliation and cut-off procedures creates doubt and impairs a buyer's ability to rely on the financial information provided, usually resulting in additional due diligence by the buyer to gain comfort. A buyer must be able to rely on the EBITDA and financial information in order to accurately propose a purchase price.

Other Considerations

Focus on EBITDA: One way to set the expectation for a purchase price based on a multiple of EBITDA is to identify upfront potential normalization adjustments. Normalization, or pro forma, adjustments to EBITDA represent one-time items that are non-recurring to a company's business operations. Normalization adjustments to EBITDA remove the inconsistencies from period to period, with the goal of establishing normal business operations on a historical basis, which then can be used in pro forma presentations and models. Oftentimes this involves a sell-side quality of earnings analysis, which provides a clear accounting picture of the company with the identified normalization adjustment.

What qualifies as a normalization adjustment?

- Excess owner compensation and benefits

- Legal, advisory or professional fees dealing with legal claims or settlements
- Charitable donations (discretionary in nature)
- Executive recruiting fees
- Board of director fees
- Relocation expenses
- Business and headcount restructuring expenses
- Business impacts from one-time external factors (e.g., natural disasters, pandemics)

Focus on net working capital:

Another key metric that is measured during the evaluation of a business by a buyer is net working capital (NWC), which is current assets less current liabilities. The focus is the quality of the assets and liabilities of the target. During the due-diligence process, the calculation of NWC is clearly defined as part of the letter of intent (LOI), usually adjusted for non-business-related current assets or liabilities. Prior to the deal closing, the NWC amount is usually set as a "peg" based on an estimate of trailing months' NWC results and measured both as of the close and in some cases post-closing considerations and NWC requirements.

Common adjustments to NWC include:


- Related party assets/liabilities
- Prepaid expenses and deposits
- Income-tax-related assets
- Debt-like items (including deferred revenue and customer deposits)
- Discretionary payroll accruals

Focus on the fine print: The LOI is executed early in a transaction, during the "dating" phase between a buyer and seller. The LOI sets

expectations and definitions, and it's important that the proper due diligence is performed on both sides (seller and buyer) to make sure that these expectations are clearly defined in accordance with each party's goals and objectives.

Once diligence is completed by both parties and the deal is in the closing stages, the purchase-and-sale agreement is drafted using the terms of the LOI, adjusted for any items and areas identified during diligence. These areas include basis of accounting (exceptions to GAAP), NWC and EBITDA closing and post-closing requirements, as well as other closing and post-closing items. It's important that both sides have an adequate review of this process to properly identify any areas of risk and exposure. The closing process of a transaction usually entails a tug of war between parties in agreeing on adjustments, to both EBITDA and NWC.

The More You Know

There are many factors impacting a transaction involving the sale of a company. With the increased boom in M&A transactions, the important thing to remember is the importance of understanding the nature and extent of the proposed transaction (e.g., stock versus asset deal), properly planning for the deal and making the necessary investment of time and resources to develop your team of professionals. 

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