

NOTEBOOK OF IDEAS FOR
DIVESTITURES
OF PRIVATE SECURITY COMPANIES

Vol. 17 No. 2

THE IMPORTANCE OF THE SELLER'S DUE DILIGENCE ON THE BUYER

We initiate and manage transactions for sellers of private security companies.

Click [here](#) to visit our website. View our recently updated - [Publications](#) section, and read about industry acquisitions in our [News and Press](#) section.

Contact Information

Physical Address
301 N. Elm St. Suite 710
Greensboro, NC (USA) 27401

Mailing Address
PO Box 67
Greensboro, NC (USA) 27402

Telephone
(336) 272-2266

Facsimile
(336) 272-1142

Email

Owners of private security companies are frequently being contacted today by potential buyers asking if they want to sell their company. This flurry of activity is a result of several things happening in our economy:

1. Private equity groups are sitting on a stockpile of cash that needs to be put to work, 2. Some "brokers" are hungry for listings and are calling owners pretending to have a buyer interested in "their" company, 3. Large security companies are looking to replace shrinking margins through acquiring their smaller, but in most instances, more profitable, competitors.

Many of the buyer prospects are "bottom fishers", or are just looking for bargains, regardless of the industry and the owner is just one on a list of several hundred calls the buyer will be making. But there are some very credible buyers in the market place today. Some are spreading the word that they are pro-active in acquisitions and are talking with many seller prospects, while others are targeting only a few specific companies they want to buy and are quietly entering into serious negotiations.

Unfortunately, the prospects do not come clearly labeled, which leaves the owners with the daunting task of finding out just how serious the buyer is in buying the company and whether the prospect has the financial resources to get through the transaction. Therefore, it behooves the owner (or the owner's advisor, as explained later) to ask the probing questions before the parties get much further in their discussions.

Here is what the owner needs to find out about the prospect on the initial contact:

- ***Is the person making the contact the principal or a representative of the principal (a broker)?***
- ***Has the buyer done its homework in the industry? Does the buyer know the challenges of owning a security company that brings with it liability and employment issues; as well as margins under competitive pressures?***
- ***Has the buyer made any acquisitions in the private security industry and what has been the track record of the acquisitions?***

Once the owner has these questions satisfactorily out of the way, the owner can feel comfortable in spending more time learning about what the buyer has in mind. However, as the discussions continue, and at certain stages, the owner needs to find out even more about the buyer.

This due diligence on the buyer is usually handled in stages, as set forth below, and sometimes handled by the seller's internal personnel or outside negotiating team - attorneys, accountants and deal manager (intermediary) - depending on what's being examined during the due diligence.

Some of the questions needed to be asked of the buyer may be probing, sensitive or embarrassing, thus causing awkward or tense moments. Using the advisors to handle these matters allow the principals to maintain their much-needed friendly relations.

And it's important to note that the timing of the due diligence is very crucial. For obvious reasons, most of it is done before the seller signs a "standstill" agreement with the buyer that prohibits the seller from negotiating with other prospects that may be just as viable. It is done before the seller spends even more time in negotiations and money for advisory fees. It is also done before bringing the key employees into the negotiations, and before contacting customers - if this is a requirement to closing the transaction.

In fact, if the seller has retained a deal manager who has experience in managing the sale of private security companies, the buyer has more than likely been qualified before the sale process starts. The deal manager would have probably completed one or several transactions with the buyer prospects. They have firsthand knowledge of the buyer's financial ability and conditions to the deal. They know which conditions are negotiable and which are not. Further, since their fee is mostly contingent on a successful transaction, they will not waste time on buyers who are not qualified.

Where is the buyer getting its money?

When Securitas made a cash tender offer for Burns, and Falck merged with Group 4, checking the buyers' financial affairs was not a difficult task. Securitas and Falck were public companies, and their financial affairs were a matter of public record.

However, when the buyer prospect is a privately-held company, checking the financial ability may take some work. The seller is not only concerned about the buyer's ability to come up with the cash needed to close the transaction, but is also concerned about the buyer's ability to make any deferred payments that may be contingent on a guarantee of the accounts after closing.

Here are some of the things the seller's team needs to know about the buyer's financial ability:

- Is the buyer borrowing the purchase price from the bank? If so, is the seller's deferred payment subordinated to any senior bank borrowings? What is the bank's role in approving the acquisition?
- What is the collateral for the deferred payment?
- Are there any pending lawsuits that, if settled against the buyer, may impair the buyer's ability to make the seller's installment payments?
- Is the buyer making the purchase through a "thinly capitalized" corporation and not guaranteeing its debts?

What's the buyer's track record on previous purchases?

A good indicator of how well a buyer keeps its promises and performs during the negotiations and after closing is the comments from sellers who sold their company to the buyer.

The seller's team should ask the buyer for references, and make inquiries to the buyer about prior acquisitions. Again, it's in this area that the experienced deal manager can provide a good source of information on how well the buyer performs.

Here are some of the questions to ask in checking the buyer's track record:

- How many deals has the buyer consummated?
- Were the sellers satisfied with the buyer's performance?
- Did the sellers receive all of the deferred purchase price? If not, why?
- How long did it take the buyer to consummate the transaction?

What conditions is the buyer placing on the deal?

Although the price and terms are very important aspects of every deal, the conditions which must be met in order to receive the monies are equally important. Many of the conditions are found in the purchase agreement; however, some may be oral and relate to how the company is run during any period for which the seller may be guaranteeing the continuation of the accounts.

Most buyers do not prepare the purchase agreement until they finish the due diligence on the seller. Since the seller needs to know the conditions that will be in the contract before the buyer starts its due diligence, the seller should ask for a sample agreement (if the buyer has one available), or at a minimum should find out the conditions the buyer will require.

A word of caution about the sample purchase contract: in reviewing the sample contract, the seller's advisors should make sure that the sample contract is compatible with the seller's type of transaction. If it isn't, some of the provisions will not apply or will be different. Also, there may be conditions to the seller's deal that may not be set forth in the sample contract.

Here are some of the important things to know about the conditions to the deal:

- Is the deal structured as a stock or asset transaction? (The answer to this question may have a dramatic tax consequence to the seller.)
- What is the approval process?
- Does the buyer require a guarantee of the accounts? If so . . .
 - What's the duration of the guarantee?
 - Will the buyer allow the seller to replace lost accounts with new accounts?
 - Will the buyer allow the new accounts to increase the purchase price?
 - Is the seller protected in the event an account leaves because the buyer did not properly service the account?
 - How is the company run during the guarantee period?
 - Which of the seller's personnel will be retained?
 - Will the operating name be changed?
 - What is the seller's involvement during the transition?
- What is the expiration period of the representations and warranties in the purchase contract?
- Is the deal signed and closed simultaneously? If not, what's the seller's liability in the period between signing and closing?
- When and how is the sale announced to the employees and general public?
- Will a portion of the selling price be allocated to a covenant not to compete? If so, how much? (The answer to this question could have a significant tax impact on the seller. The amount of the impact, positive or negative, depends on whether the seller is organized as an S or C corporation.)

Are the buyer's operating philosophies compatible with those of the seller?

This is very important if there is an account retention condition to the seller getting all its money after closing. The customers need to stay happy after the sale, or they may leave. Therefore in order for the deal to be successful and the accounts be happy after closing, the buyer and seller must be compatible. They must share common philosophies on providing service to the customers, career paths, and benefits for the employees.

Much of the compatibility checking can be done through negotiating meetings with all the seller's and buyer's team members present. However, the seller spending one on one time with the buyer principal in a non-business setting affords the opportunity to find out things that would not ordinarily be learned from the structured meetings.

A good setting for this "get together" is a quiet restaurant or a golf game. The parties can be more relaxed and will often use this as a catalyst to resolve difficult issues that may have surfaced in the formal meetings. It's also a good setting for discussing the buyer's conditions that may not be appropriate to handle in the formal purchase agreement.

A Word of Caution:

The preceding is not intended as an all-inclusive list of due diligence items. It's merely a presentation of some of the seller's concerns in checking out the buyer prospect. Each deal is different and the degree to which a buyer should be examined varies.

Written by: Robert Perry

ROBERT H. PERRY
Associates, Incorporated

P.O. Box 67 (zip 27402)
301 N. Elm Street, Suite 710
Greensboro, NC 27401 (U.S.A.)
Tel: 336.272.2266 Fax: 336.272.1142
E-mail: rhp@roberthperry.com
www.roberthperry.com

whatsoever in connection with the use of the information contained herein. If legal, accounting, or tax advice is required, the services of a competent professional should be obtained. © All rights reserved. May not be reproduced without permission.

[Forward email](#)



Try it FREE today.

This email was sent to rhp@roberthperry.com by rhp@roberthperry.com | [Update Profile/Email Address](#) | Instant removal with [SafeUnsubscribe™](#) | [Privacy Policy](#).

Robert H. Perry & Associates, Inc. | 301 N. Elm Street, Suite 710 | Greensboro | NC | 27401