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# Class 3: Deal Execution and Book Building

# Lesson 2: Closing Deals and Managing Relationships

***Class Script***

**Course 3, Lesson 2: Closing Deals and Managing Relationships**

1. *Introduction*
   * **Lesson Overview**
     1. During this lesson, The Warren Fox Group will cover topics that deal with:
        1. Banker Responsibilities during Closing
        2. Building and Maintaining Relationships
   * **Abbreviated Sectional Review**
     1. Discuss and describe banker responsibilities up-to and during closing:
        1. As a deal arrives at its final stages, there are processes and procedures that need to be closely monitored by the deal team.
           1. Junior practitioners will heavily focus on confirmatory due diligence and deal administration to ensure timely facilitation of information and communications between all parties involved in the closing procedures of the deal.
           2. Senior practitioners will heavily focus on deal negotiations and managing client expectations to ensure that the deal comes to a fair and successful conclusion.
     2. Discuss and describe ways to build and maintain industry relationships:
        1. In the banking industry, there is a saying that goes like this: “The best way to build a relationship, is to do a deal with someone.”
           1. The lesson concludes with best practices as it pertains to business development and relationship-maintenance, harping on the industry’s core values: networking, communication, and trustworthiness.
2. *Banker Responsibilities during Closing*
   * **Background**
     1. Successfully closing a capital markets deal is a long, arduous process that takes months to complete from start to finish.
     2. As the deal nears completion, practitioners are put under increasing amounts of pressure to successfully close the deal.
        1. **Deal Announcement**
           1. The time frame lasting from deal-announcement to deal-close is a high-pressured window that needs to be managed efficiently and effectively by sell-side investment bankers.
           2. Typically, the deal is announced following the execution of a letter of intent or LOI.
           3. The LOI usually outlines specific actions and associated timelines that need to be completed for the deal to successfully close.

These actions primarily relate to due diligence requirements.

* + - 1. **Responsibilities**
         1. At this point in the deal, the deal team members are “all-hands-on-deck” with respect to execution.

Meaning that practitioners will prioritize the closing responsibilities for this particular deal over all other deals and all other work-related responsibilities.

* + - * 1. The practitioners have a very specific set of objectives that they need to complete and attend-to for the deal to close.

The Warren Fox Group attempts to breakdown these responsibilities in the remainder of this section.

* + **Junior Banker Responsibilities**
    1. Responsibilities Prior to Deal Announcement:
       1. As the bid deadline looms, the junior bankers are tasked with facilitating Management Presentations, scheduling Product Demos, and answering a wide-variety of diligence requests from potential buyers and their advisors.
       2. In addition to doing all the above, the junior bankers will begin shelling out a Round 2 Virtual Data Room.
          1. **Background**

The Round 2 VDR is a more in-depth data room for only those buyers whom the client would like to continue the process with, following an attractive bid submission.

At or around the bid deadline, potential buyers will submit an indication of interest to the bankers and then the bankers will collect those submissions and discuss the bids with the seller.

In some cases, there are multiple potential buyers and in other cases there is only one potential buyer, and in some unfortunate situations, there will be no bids.

In the case when the seller receives no bid submissions, the bid deadline will likely have to be extended or the deal might not continue due to lack of interest.

* + - * 1. **Procedures around Round 2 VDR creation**

Round 2 VDRs are meant for additional diligence and sharing of more sensitive information with legitimate buyers.

When a potential buyer puts forth an attractive bid, although it is not legally binding, it provides the seller with an additional layer of comfort that the buyer is serious with their intentions and not simply conducting a reconnaissance mission.

Creating a Round 2 VDR involves a lot of input from the client and meticulous attention to detail, ensuring that the right amount redaction is utilized and VDR permissions are set accordingly, depending on the buyer.

Clients might prefer to share certain information with one buyer but not with another in the Round 2 VDR.

For example, information shared with a competitor might differ than information shared with a private equity firm.

Although this is an acceptable practice at this point in the deal, the banker and the client need to ensure that a fair auction process ensues and all necessary information is made available at the right times in the deal.

* + - * 1. **Components of a Round 2 VDR could include:**

Employee Contracts and in-depth employee organizational charts

Customer Contracts

Supplier Contracts

More in-depth disclosures around Product and Technology

Vesting schedules necessary to pay out current owners and employees during a change of control scenario

More in-depth Case Studies and Customer References

Credit agreements with current lenders

More in-depth financial schedules that highlight revenue build, customer concentration, customer LTV, and customer acquisition costs

* + 1. Responsibilities Following the Deal Announcement:
       1. Deal announcement usually occurs in parallel with the execution of the LOI, in which both parties agree to move forward with the deal at an agreed upon price range and timetable for closing.
          1. **Due Diligence Responsibilities**

During this time the most important part of the deal is ensuring that the buyer has the ability to successfully complete their confirmatory due diligence process.

The deal is typically dependent on the buyer’s ability to complete its diligence process in full.

If confirmatory due diligence is not completed, the deal could falter and the buyer could ask for an extension.

The buyer is going to need to complete a sweeping review of the company which include legal, tax, financial, industry and regulatory diligence.

This review requires long, in-depth meetings between multiple parties:

The buyer’s management team

The seller’s management team

The buyer’s legal, tax, and business advisors

The seller’s legal and banking advisors

Junior practitioner will attend due diligence meetings to facilitate requests, take notes, and to handle any other administrational items.

* + - * 1. **Financial Analysis Responsibilities**

The Letter of Intent does not always offer an exact purchase price. More often than not, the LOI has a valuation range and not an exact purchase price.

Therefore, between executing an LOI and executing a purchase agreement, the junior bankers are hard at work creating valuation guidance.

Updating the financial model.

The junior bankers need to ensure that the financial model present in the Round 2 VDR is updated with the most current information.

Updating market-based valuation analyses.

Given that M&A deals could last for months, there is a possibility that market multiples may have changed.

Therefore, it is important that junior banker refresh relative valuation analyses that could change the pricing multiple.

For example, updating valuation information for guideline public companies and adding any new precedent transactions.

Creating analysis around purchase price schedules.

Total considerations, or total purchase price, could vary depending on deal structure.

For example, the deal could include roll-over equity, earn-outs, and other items that could impact the amount the total considerations received at and after closing.

One of the most important items that has a direct effect on total considerations delivered at closing is the working capital peg.

Junior Bankers are expected to provide financial analysis to substantiate a normalized working capital assumption.

The working capital peg is a calculation that shows the working capital levels necessary to maintain normal business operations.

The peg is important because the purchase price is adjusted relative to the final working capital amount on closing day.

For example, if the client presents a final working capital figure that is above the working capital peg, then the purchase price is increased by the difference, and vice versa if the final working capital figures are below the peg.

* + **Senior Banker Responsibilities**
    1. Responsibilities Prior to Deal Announcement:
       1. Senior bankers will work on negotiating terms with potential buyers as bids begin to arrive.
          1. Senior bankers will collect bids and deliver bids to the client.
          2. The client and the senior bankers will evaluate each component of the bid and determine which buyer or buyers should be allowed to continue the process.
          3. After selecting the most attractive bid or bids, the bankers will enter into negotiations with the buyers to move closer to a bid selection.
       2. During this time period, of receiving initial bids, the senior bankers are also tasked with managing the client.
          1. When bids first arrive, it will result in a wide array of emotions, questions, and reactions from the seller.
       3. The main goal of the investment banker is to close any gaps between the bid-ask spread to arrive at an acceptable offer that satisfies the seller (or the client).
    2. Managing client emotions during the negotiation process:
       1. It is not uncommon for a bid to deviate way below the seller’s expectations which could cause the seller to take offense.
       2. It is the senior banker’s job to be emotionally-neutral and level-set the client.
          1. It is ill-advised to have a clouded-mind when negotiating with a sophisticated buyer, therefore the senior bankers will present the client with all the appropriate options for rebuttal and the best way to move forward.
    3. Answering client questions during the closing process:
       1. When bids and offers come in, they will likely have a very detailed list of conditions and contingencies that must be addressed.
       2. The senior banker’s role is not to provide legal advice, but rather to offer financial and business opinions on deal terms, such as:
          1. Exclusivity
          2. Deal Strcuture
          3. Diligence Timing
          4. Board Representation
          5. Employee Retention
          6. Non-Compete Agreements
          7. Roll-over Equity and Earnout Structures
       3. The senior banker’s ultimate job, at this point in the deal, is to understand the client’s desires and to ensure that the offer is agreeable with client expectations.
          1. For example, if the client acts as the CEO and wants to exit the business directly following the transaction, but the buyer wants to retain the management team, then the senior bankers will need to re-align the buyer’s expectations or negotiate a very friendly earnout agreement to entice the CEO to stay around.
       4. The client will also be curious as to whether senior bankers believe that a buyer’s terms are typical or atypical, relative to similar deals the bankers have done in the past.
          1. For example, if the senior bankers have sold a similar company to Buyer X before, then the client will want to know how Buyer X’s behavior towards the them relates to similar deals Buyer X has done in the past, with respect to deal terms, diligence processes, and overall valuation:

In some verticals, there are very active buyers and a main selling point of the bank is to have relationships with these buyers and to have done deals with these buyers in the past.

Having bankers that have done deals with a buyer in the past, allows the banker to provide the client with a benchmark relative to past deals, which ultimately helps the seller with negotiations.

* + 1. Present financial analysis to guide negotiations:
       1. As soon as the offer comes in, the bankers are going to be doing as much analysis as possible to negotiate the best deal for the client.
       2. The junior bankers will conduct most of the analysis, but the senior bankers will be presenting the analysis to both the seller and the buyer.
       3. The senior banker’s value is being able to utilize financial analysis and other tools to best serve the client during the negotiation process:
          1. The valuation of the company is what a willing and able buyer pays for the target, meaning that the price paid could deviate far from fair market value as determined by the analysis.

For example, the value proposition of a target to Buyer X could greatly deviate from the value position to Buyer Y. This could be due to a number of scenarios, better synergies, less competition, compatible cultures, etc. It is the senior banker’s responsibility to pitch the client’s value proposition to the buyer to ensure that the client’s goals are met.

* + - * 1. Therefore, the senior banker’s responsibility is to position the client’s current value proposition directly with the buyer’s wants and needs, to derive the best possible scenario for the client:

The ability to present a client’s value proposition to a buyer could involve the following:

Business model

Distribution model

Product differentiation

Customer base

Potential revenue or cost synergies

Current market environment

Current status of the auction process

* + 1. Closing the deal
       1. Once the client accepts an offer, the goal will be to arrive at an agreeable set of circumstances while conducting confirmatory due diligence so that the buyer can present a definitive agreement to the seller.
       2. The senior bankers must ensure that the client is meeting all of their diligence obligations.
          1. For example:

Submitting additional financial documents and schedules

Opening access to product testing

Legal and tax reviews

Conducting personnel interviews of key members of the seller’s management team

Ensuring regulatory checks

* + - 1. The senior banker must ensure the buyer is completing all of its obligations, especially if the deal is utilizing leverage.
         1. For example:

It is not uncommon for a deal to die because financing can’t be sourced properly.

Therefore, if a private equity firm is acting as the buyer, the seller might negotiate certain timelines for the buyer to produce an official equity commitment letter and debt commitment letter.

* + 1. Final thoughts on client management
       1. It is very important that the senior bankers remind the client of their operational responsibilities throughout the entire closing process.
          1. Some deals take months to close, while other deals never close at all.
          2. Therefore, the client cannot relieve any of its operational responsibilities during the closing period.
       2. Above all, the buyer will expect the client to maintain the normal course of operations up until closing.
          1. There should be no unusual or unexpected outflows of cash or working capital, as this could result in penalty or a reduced purchase price.

1. *Building and Maintaining Relationships*
   * **Banker Responsibilities Post-Closing**
     1. Once the deal officially closes and the funds have been wired, it is not customary in a typical sell-side investment banking mandate for the banker to have any material obligations following the deal.
        1. For an administrational standpoint, the bankers will create a tombstone to highlight the transaction and they will update the bank’s official transaction count and transaction volume statistics to reflect in the marketing materials.
     2. Sell-side investment banking is mostly transactional in nature.
        1. Some clients could be engaged on a monthly retainer fee but, ultimately, investment banking is not a recurring revenue business, especially for M&A practitioners.
        2. Therefore, it is very important for the bank to maintain a deep network and pipeline of potential new clients to ensure continuous deal flow.
   * **Building and Maintaining Relationships**
     1. Client relationships management:
        1. Bankers engage in a range of activities to drive organic deal flow, such as:
           1. Attending conferences
           2. Holding events or dinners
           3. Publishing industry-based content
           4. Managing inbound referrals
           5. Leading outreach efforts to potential clients
     2. Investor relationship management:
        1. Bankers engage in a range of activities to expand their investor networks, such as:
           1. Holding sponsor calls to update investors on market developments and specific targets
           2. Sending cold email and facilitating introductory calls with potential investor partners
           3. Attending conferences
           4. Publishing industry-based content
           5. Being a fair dealer and closing transactions with investors

Ultimately, the last example is the best way to build and maintain relationships with an investor network, as a sell-side investment banker.

The industry is built on **trust** and bankers build trust with investors by showing them fair deals that are properly priced.

* + Final thoughts on relationship management:
    1. The goal of each sell-side investment banker is to be a fair dealer, which includes:
       1. Appropriately underwriting the client.
       2. Accurately presenting the client to the market.
          1. It is the buyer’s responsibility to conduct significant levels of due diligence, but it is the banker’s responsibility to honestly disclose the entire risk profile of its client to the buyer.
    2. The financial community is incestual, the investors talk to one another, and they even sometimes come-in together on the same deals.
       1. If an investment bank behaves poorly and is an unfair dealer, its reputation will be damaged.
       2. Banks with poor reputations do not last long in the industry, because a poor reputation renders an investment banker completely useless, because an untrustworthy banker will never find a counterparty willing to invest in one of their deals.
          1. Therefore, in conclusion, the most important skill in investment banking, regardless of seniority, desk, or position, is the ability build and maintain investor relationships in the marketplace.

1. *Summary*
   * Throughout the second lesson of Deal Execution and Book Building, The Warren Fox Group has covered a multitude of topics:
     1. Banker Responsibilities during closing
     2. Building and Maintaining Relationships
   * After the second lesson, viewers have a clear grasp on closing procedures and deal team responsibilities during a close, the due diligence required to close a deal, the importance of value proposition and negotiations, and the importance of trust in the marketplace.
     1. The important take-aways of Lesson 2 include:
        1. The difference between junior and senior banker responsibilities during a close.
        2. The difference between deal announcement and deal close, and the processes required for a successful close.
        3. Investment banking is not a recurring revenue business model, therefore being a fair dealer is a great way to build a good reputation and a solid network base.
     2. The goal of Lesson 2 is:
        1. Identify the key items and actions necessary to close.
        2. Identify roles and responsibilities for practitioners during closing procedures.
        3. Reiterate the importance of networking and relationship management in the investment banking industry.
        4. Highlight the importance of fair dealing.
        5. Highlight the importance of always acting in a trustworthy and accountable fashion.

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