# Is it time for Strategic Deals for Brazil's engineering & consulting industry?

By Jim Chamness | February 2013

Brazil continues to be a preferred destination for investment as firms and governments struggle with economic problems in Europe, Japan and the United States (Grant Thorton, *Global Economy in 2013*. http://www.internationalbusinessreport.com). Despite Brazil's disappointing economic growth in the past 12 to 18 months, economists and business leaders continue to project average annual growth rates (real GDP) of 3.3% to 3.5% for 2013 and beyond (Business Monitor International - Jan 7, 2013). With massive government and private sector investments in energy and infrastructure, growth for business in these sectors is certain to outpace GDP growth significantly. Under the second phase of the Accelerated Growth Program (PAC-2), the government of Brazil will spend R$ 955 Billion in development of the country's energy generation and distribution system, roads, railroads, ports, airports, and stadiums, as it prepares for the World Cup in 2014 and the Olympic Games in 2016. Development of sub-salt oil reserves and global demand for commodities will also continue to stimulate near-term growth. Combined, these factors make Brazil a compelling market for global engineering and consulting firms seeking sustainable growth.

These factors present a unique opportunity for Brazilian business owners prepared to negotiate with "strategic buyers". Understanding the interests and priorities of strategic buyers while focusing your company on value creation can greatly enhance your ability to maximize the value of your business.

## Strategic versus Financial Buyers

Potential buyers can be grouped into two general categories, "Strategic Buyers" and "Financial Buyers". The fundamental differences between these categories are reviewed below.

**Strategic Buyers** are looking for synergies. They want to understand how your business will complement their existing business to increase long-term shareholder value. They may be willing to take on more risk because they are already engaged in "your business" and typically understand the risks and opportunities. Their investment horizon may be longer term, as they seek opportunities for long-term growth.

Because strategic buyers tend to get more value out of an acquisition than the near term financial value of the company being acquired, ***strategic buyers will often be willing to pay a premium price in order to close a deal***.

A strategic buyer is often a company in the same industry that wants to move into a new region or a company in an unrelated business seeking to diversify their product or service offerings. They seek strengths that could help their existing business, or new business lines to sell to existing customers.

**Financial Buyers** are primarily interested in maximizing the return on their investment (ROI) within a defined timeframe, often on the order of 3 to 5 years. To select acquisition targets likely to achieve ROI criteria, financial buyers scrutinize a company's assets, financial statements, and profitability, as they search for attractive near term growth opportunities.

Financial buyers typically evaluate a potential acquisition as a stand-alone investment, since they generally don't plan on integrating the business with a larger company.

Both types of buyers evaluate acquisition opportunities carefully and comprehensively, reviewing financial performance, operations management, sales, and corporate compliance. Proven profitability and future earnings potential are critical considerations for all transactions.

## Positioning your business to maximize value

Understanding off balance sheet considerations that drive value provides perspective that can be used to strengthen your business and position your firm, increasing the selling price substantially. Some key considerations you can act on to enhance your company's strategic value are discussed below.

> *It is noteworthy that if you can increase the EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) multiplier from 5x to 6x you are increasing the value of your business by 20%!*

**1. Identify competitive advantages**

It is important to understand your firm's strengths, weaknesses and competitive position in the marketplace. This will enable you to identify and leverage competitive advantages when identifying targets and presenting your firm to potential acquirers. Future prospects of the markets you serve may themselves drive business value.

Begin with business plan development. A written Strategic Plan that includes market analysis and identifies growth plans can go a long way to demonstrate your understanding of your business and its future earnings potential. Coupled with effective business processes for tracking backlog, prospects, and forecasting future sales, these tools focus your business on quantifiable goals that enable you to make better business decisions and enhance your credibility with potential buyers.

Reach out to your most valued customers and ask them what they value most about your service, and where you need to improve. Don't assume you know.

**2. Differentiation**
Ask yourself: What differentiates your company from your competitors? Offering unique technology, services or products, which competitors can't easily replicate, or superior service or quality, creates competitive advantage. This can make your company much more attractive to strategic buyers.

**3. Establish your firm, and your team, as industry experts**
Leverage media and industry associations to establish your firm, and key members of your team, as industry experts. This can be accomplished by publishing press releases and contributing articles to professional and industry journals, and through active participation in industry conferences, blogs, and group discussions in social media. Build relationships with reporters to use you as source for relevant articles. Establishing your firm as an industry leader, sought after for its expertise, will increase the visibility and credibility of your business, making you a prized target for strategic buyers.

**4. Build your long-term backlog**
Revenue from long-term contracts and master service agreements (MSAs) tends to reduce the risk that key customers may leave following an acquisition, or the owner's departure from the business. As such, backlog associated with long-term or recurring contracts, such as environmental monitoring, operations & maintenance, licensing, and compliance services may increase your firm's strategic value.

**5. Customer Diversity**
Businesses that derive most of their revenue from one or few clients run the risk of a severe downturn if their client's business does not perform well, if priorities change, or simply as a result of changes in a client's management or procurement practices. If key clients leave following a transaction, chances are the purchaser will have overpaid for your business.

It is good practice to build a diverse customer base. Although there are no "magic numbers", keeping the proportion of sales derived from any single client to less than 10 or even 5 percent of the total, may be considered a good rule of thumb.

**6. Diversify your Product or Service Offerings**
Serving a well-defined "niche" may itself create strategic value, depending on the current market. Providing a diversity of services to your clients will generally attract more potential buyers, however, and increase the intrinsic value of your business. If you cannot currently emphasize all of the services you offer to maximize their market potential, offering a variety of products and services can still add value with strategic buyers, particularly to those that have the capital to invest and take advantage of the inherent growth potential.

**7. Management Team / Transition Planning**
If you haven't already, you should begin involving key employees, or hiring experienced professionals, to strengthen your management team. The owners of

many small businesses tend to make the mistake of running their business on their own, with only one or few people empowered or capable of making critical decisions. This can jeopardize the company's future when the owner(s) depart. Talent development and succession planning are critical factors for business sustainability and long-term success. Buyers will be willing to pay more if you can demonstrate that you have a strong management team in place, who are prepared and enthusiastic with the prospect of taking on company leadership. Bonuses and equity participation may be necessary to build the desired level of commitment and keep key players around after you leave. This is a small investment to help maximize the value and ensure the future viability of your business.

It is important for owners to recognize that staying on in some capacity for a few years will not only boost your firm's sale price, but may be imperative to close a deal.

**8. Barriers to Entry**
Strategic buyers are often interested in entering a market to take advantage of time sensitive opportunities, such as those resulting from Brazil's current emphasis on infrastructure improvement and development of offshore oil & gas resources. Requirements for pre-qualification and local content, the need for professional licenses recognized by local authorities, and permits required by regulatory agencies can constitute expensive and time-consuming market entry barriers, even for well-qualified global firms new to the local market. Positioning your firm with this in mind will increase your competitive advantage and the value of your firm.

**9. Operations Management**
The easier it is for a prospective buyer to understand your business, and hence to envision running your business profitably, the more likely it is that your business will sell at a premium. This requires well-defined and documented systems for financial management and reporting, marketing and sales, project management and control, and policies for employee development and management.

Management systems should be documented and auditable.

**10. Cash Flow and Valuation**
Although buyers (and sellers) use a variety of approaches for business valuation, experience shows that nearly all buyers will compare purchase price to a multiple of the business's earning potential, such as Earnings Before Interest Taxes, Depreciation and Amortization (EBITDA). This enables potential buyers to evaluate ROI and provides a tangible basis for comparing acquisition alternatives. Identifying ways to improve EBITDA on a sustainable basis will always enhance value.

**11. Accounting**
A common area of weakness with small- and medium-sized businesses is financial documentation. Many businesses treat accounting as an exercise required only for tax compliance. While this is important, the value of audited financial statements that

conform to international accounting standards cannot be overstated. This initial investment will facilitate due diligence and negotiation, will reduce the time required to close a deal, and may result in a higher premium when the business is sold.

**12. Website**

A well developed company website can be a value-added asset, if it demonstrates your ability to effectively present yourself to the market. A website provides an opportunity to convey the factors that make your business unique, and can itself be leveraged as a tool to provide value for your customers and your team.

It is prudent to take a look at your website, and that of your competitors, to ensure that your website is an asset and not a liability when you present your firm to potential buyers.

**13. Assemble a Team of experienced professional advisors**

Identify an experienced CPA, transaction attorney, and business advisor before you present your firm to potential buyers. This will enable you to assess your company's vulnerabilities before a potential acquirer does, avoiding potentially embarrassing and costly surprises. This should include an M&A Advisory firm with relevant industry experience. The process of selling a firm is complex and often emotional. Owners can easily be overwhelmed by the added workload as they struggle to manage transaction-related responsibilities in addition to normal day-to-day operations. An M&A advisor can coordinate the entire transaction process so that owners can continue to focus on business performance. An experienced M&A advisor brings an unbiased perspective to help business owners evaluate alternatives and to serve as an advocate and intermediary during negotiations.

With the assistance of qualified advisors you should be well prepared to identify qualified strategic buyers and to position yourself to negotiate the best value for your business.

**14. Think Globally**

When hiring an M&A advisor, ensure that they can provide global exposure for your firm. Strategic buyers are often international firms seeking to expand their business geographically. Your advisor should understand your business, and have the connections and resources to present your firm to well-qualified potential buyers domestically and globally. International exposure will ensure that your company is in front of the best pool of potential buyers. This often translates into a stronger price.

For more information about 1stWEST Mergers & Acquisitions LLC, please visit our website at www.1stwestma.com.

To contact Jim Chamness, please call: USA +1 (303) 470-1832;

Brazil +55 (21) 8226-9358 or email Jim at j.chamness@1stwest.com.br