Q2 2012

Outsourced Business Services Sector Review

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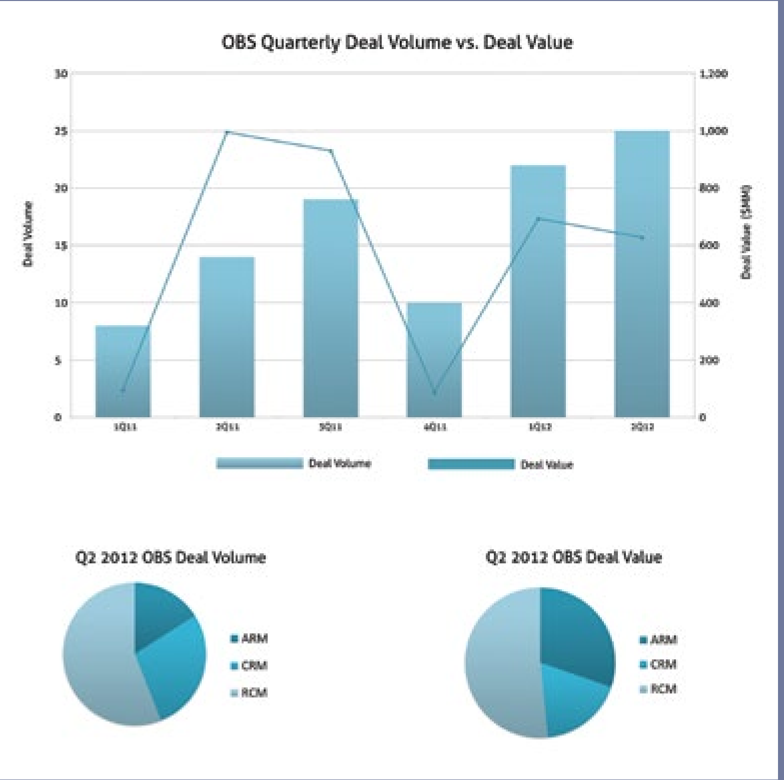
Outsourced Business Services Sector Review

Q2 2012

By Mark Russell, Director of Kaulkin Ginsberg

The M&A marketplace continued its roller coaster ride in Q2 as buyers and sellers attempted to negotiate deals while taking into account declining global economic conditions and market uncertainty as a result of anemic organic growth trends in most industries. These deal issues caused disparities between buyer and seller value expectations, which negatively impacted global M&A market volumes in Q2 compared to last year (down 22% from Q2 2011 according to Ernst & Young's Global M&A Quarterly Tracker). Surprisingly, these issues had little to no impact on deal activity within the outsourced business services (OBS) sector, particularly in the U.S. healthcare revenue cycle management industry.



In fact, the second quarter continued the trend of increased deal activity experienced in Q1 within the OBS sector. In Q2, 25 deals were completed representing over $628 million in deal value. For the first half of 2012, 47 transactions were completed generating north of $1.3 billion in total deal value. This compares to 22 completed transactions during the first half of 2011 representing less than $1.1 billion in deal value.

So why is the OBS sector not experiencing the same declining M&A trend as the rest of the global market? It's because the U.S. healthcare RCM industry is growing strong and will continue to experience growth despite the economic and market trends unfolding in the U.S. and abroad, and this is driving interest from strategic and financial buyers. According to the U.S. Center for Medicine and Medicaid Services, spending on healthcare in the U.S. will rise to $3.9 trillion by 2015 from $2.1 trillion in 2011, a roughly 85% increase in four years. And, with the U.S. Supreme Court voting 5-4 that the Obama Care program was constitutional, this plan will move forward and ultimately require a portion of the uninsured U.S. population to either get insurance or pay a penalty for not having insurance. While the upcoming Presidential election will have a significant impact on how much of the Obama Care plan is eventually implemented, regardless of the outcome the healthcare RCM industry will continue to grow and attract buyer interest for the foreseeable future

Here is an updated summary chart on how OBS companies are being valued in today's market:

Size of Acquired Company ($ Revenues)				
H1 2012 Multiples/Structure	Small* (<$2M)	Mid-Sized* ($2-10M)	Large** ($10-20M)	Platform** ($20M+)
Multiples	2-4X SDE	3-6X Adj. EBITDA	5-7X Adj. EBITDA	6-9X Adj. EBITDA
Structure	25%-100% cash	50%-100% cash	60%-100% cash	60%-100% cash

* SDE = Seller's Discretionary Earnings (Seller compensation + expenses combined with EBITDA)
** Adj. EBITDA = Adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation + Amortization adjusted for non-recurring expenses that would not exist post-transaction)

With most industries experiencing minimal organic growth, strategic and financial buyers are aggressively pursuing M&A opportunities to achieve their growth objectives. This is leading to an increase in direct solicitations to companies that the buyers feel best fit their business needs. While this type of attention may be flattering to some business owners, there are risks that business owners should assess when responding to these inquiries. Mike Ginsberg has written an article about these risks and what owners can do to avoid them.

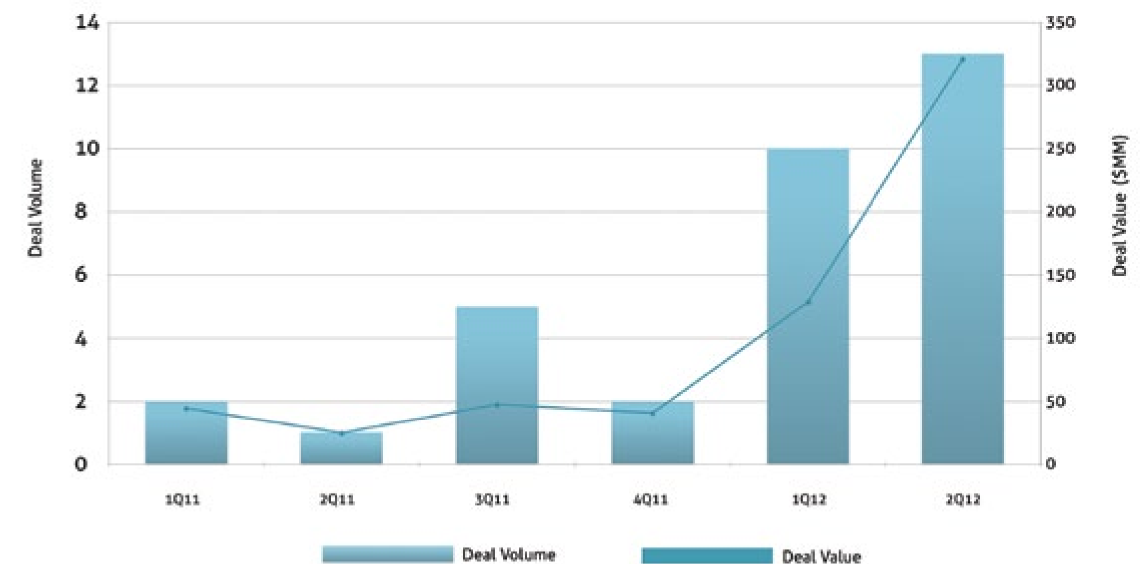
However, buyers are keeping a watchful eye on the moves of the Consumer Financial Protection Bureau (CFPB). Expert, Rozanne Andersen has provided a Q2 legislative and regulatory update for the ARM industry.

Overall, we expect the merger and acquisition (M&A) market to remain active in the OBS sector for the rest of 2012, driven by the following trends:

- The U.S. healthcare RCM industry is growing and will continue to attract interest from strategic and financial buyers
- Strategic and financial buyers are continuing to pursue acquisition opportunities in order to support their own growth objectives
- Owners remain motivated to complete their transactions this year as the capital gains tax rate is expected to increase in 2013

RCM Industry: Q2 2012 Overview

The healthcare Revenue Cycle Management (RCM) services industry has been a driver of M&A activity in 2012 due to its attractive growth trend and constituents' ability to generate good profit margins. There were 13 total transactions in Q2, representing $321 million in deal value. For the first half of 2012 there were 23 transactions that generated more than $450 million in deal value. This level of activity exceeds all of 2011, which produced 10 transactions totaling $159 million in deal value.



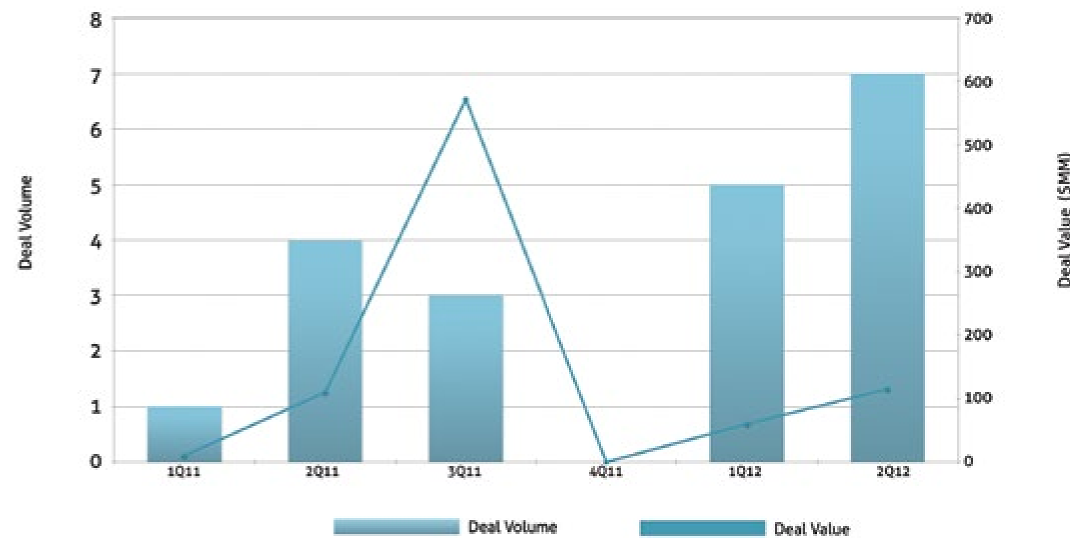
While the issue of how the Supreme Court would vote on the constitutionality of Obama Care was a hot topic at the HFMA ANI conference last month, the outcome has had no impact on the level of M&A activity or buyer/seller interest in pursuing deals.

In addition to the organic growth opportunities, the healthcare RCM industry is also undergoing some current trends that may spark an even higher level of M&A activity in the near-term:

- Healthcare providers are consolidating and/or joining larger networks, resulting in fewer future client prospects – this may lead to a consolidation phase among RCM vendors
- The transition to ICD-10 coding is motivating some RCM vendors to acquire this capability, and others to be acquired so they can leverage the capabilities of a larger, more established company – MTBC has acquired three RCM companies this year due to this trend
- Some RCM vendors have had success cross-selling and up-selling new services to their healthcare provider clients, motivating them to pursue acquisitions of companies that offer new services and clients and enable them to vertically integrate these capabilities into their existing client base

CRM Industry: Q2 2012 Overview

The CRM industry continues to grow at a slow rate (2-3% per year), but opportunities are sprouting up both within and outside of the U.S., and acquisition activity is increasing internationally. In fact, five of the seven transactions completed in the second quarter involved companies that were located outside of the U.S. The issue is that most of the M&A activity involves a mid-sized company acquiring a small company.



The challenge for the CRM industry is that most of the publicly traded companies are not experiencing strong growth rates nor are they trading at attractive multiples.

Still, CRM companies with niche service offerings are garnering interest, as well as those that target markets with significant growth potential, including:

- Remote agent market, otherwise known as Work-At-Home-Agents (WAHA)
- Hispanic market
- Remote help desk technology support
- Brazil, India, China and other emerging international markets
- eSolutions – use of social media outlets to generate business opportunities for clients

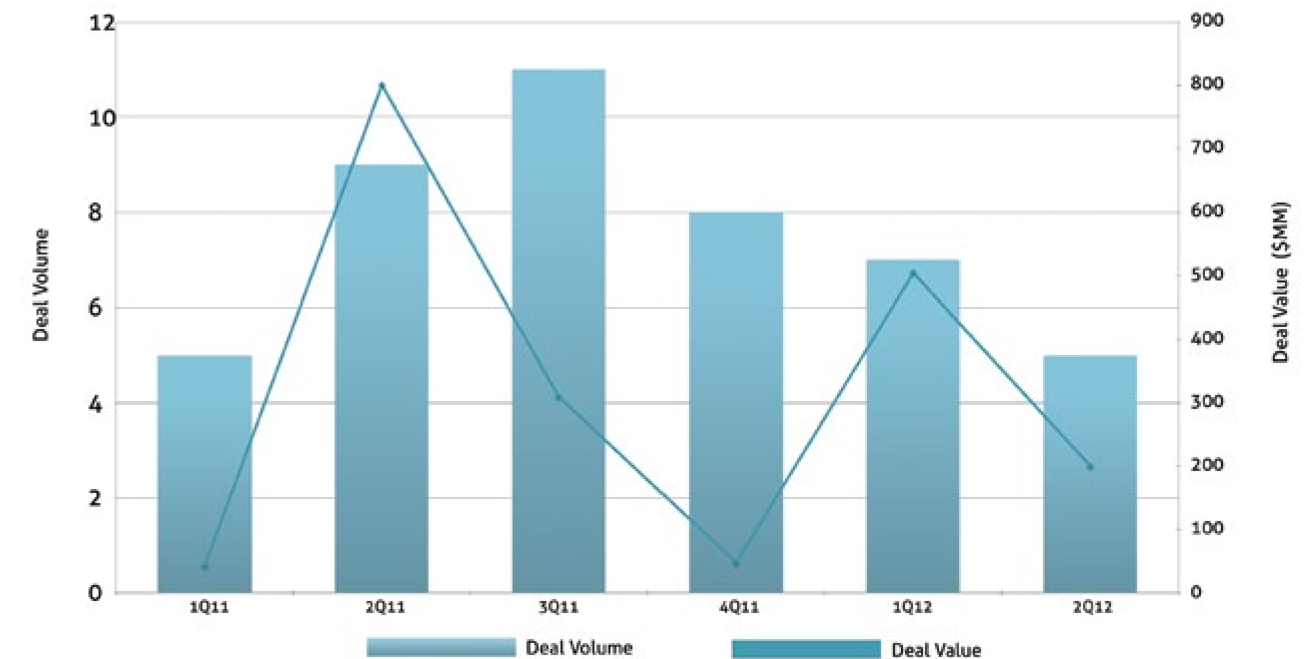
We expect the CRM market to remain relatively quiet in 2012 within the U.S., but continue to generate M&A activity internationally particularly in the emerging markets noted above.

Kaulkin Ginsberg tracks the market trends and deal activity within the Outsourced Business Services (OBS) sector, which includes the Accounts Receivable Management (ARM), Customer Relationship Management (CRM), and Revenue Cycle Management (RCM) industries.

ARM Industry: Q2 2012 Overview

Q2 was a quiet M&A period for the ARM industry, generating only five deals and roughly $200 million in deal value. The most notable deal was Encore Capital's acquisition of Propel Financial Services, an acquirer and servicer of tax liens for $186M. While buyers remain interested in the ARM industry, there are strong caution flags in certain market segments due to the regulatory changes and uncertainty around performance in specific markets. The primary areas attracting buyer interest include:

- Healthcare (Hospitals, physician groups, pharmaceutical companies)
- Government (Federal, state and local government entities)
- Student Loans (Dept of ED, private loan issuers, guarantors)



The following trends may spark an increase in M&A activity in the coming quarters:

- More local and state governments are seeking to outsource collection needs in order to generate future revenues
- The Department of Education held their meeting on July 10th, and is still targeting the selection of vendors for their next contract in February of 2013
- Healthcare RCM companies are interested in expanding their services to include collections
- Financial services clients are continuing to consolidate their vendor networks, producing opportunities for consolidation among the vendors

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ARM Legislative and Regulatory Briefing: Q2 2012

By Rozanne M. Andersen, Esq., Vice President, Chief Compliance and Marketing Officer of Ontario Systems LLC

The good news for the ARM industry is legislative and regulatory activity was relatively quiet during the second quarter of 2012 (April – June). This fact alone may be of some comfort to ARM industry decision makers and compliance officers who must constantly monitor and react to changes in legislative and regulatory requirements.

- The Consumer Financial Protection Bureau (CFPB) hummed along with little pushback coming from 44 Senate republicans who in May 2011 had resolved to challenge the appointment of Richard Cordray as Director;
- The Federal Trade Commission (FTC) focused its efforts on credit repair organizations and shutting down debt collection scams ;
- No federal laws of any noteworthy significance were passed or defeated but Al Franken is at it again with his End Debt Collector Abuse Act and Barney Frank reintroduced his Foti "fix;"
- State legislative activity paled in comparison to the previous three years; and
- State regulatory authorities maintained "business as usual."

Unfortunately, ARM industry members cannot assume this dearth of activity means they can become complacent. During this same quarter, negative press exploded at the local, state and federal level, most notably with regard to medical collection activity by Accretive Health. Over the past 16 years, negative press has served as the leading indicator that increased activity by lawmakers and regulatory bodies will follow. The first sign of this coming true is Senator Franken's plan to breathe new life into his 2010 End Debt Collector Abuse Act in response to the Accretive Health debacle.

Two Sheriffs in Town

Confusion in the market place remains over the role and function of the FTC and the role and function of the CFPB. To clarify, both agencies will exist in tandem. The Dodd- Frank Act expressly granted the CFPB the power and authority to oversee and regulate the collection and asset purchasing industry as a nonbank financial market and to promulgate regulations under the FDCPA and the Fair Credit Reporting Act. In contrast, the FTC never has had the authority to promulgate regulations under the FDCPA. In limited instances, Congress has granted the FTC the authority to promulgate regulations under the Fair Credit Reporting Act (FCRA). In light of Congress' decision to grant the CFPB such broad rule making authority over the industry it is unlikely Congress will ever grant the FTC such authority in the future.

Both the FTC and the CFPB will continue to have enforcement authority. With regard to our industry, the FTC's enforcement authority is limited to bringing legal actions for alleged violations of the FDCPA, FCRA and the FTC Act. However it has broad powers to pursue such actions against any organization or individual who is legally required to comply with these laws regardless of the organization's size.

In contrast, the CFPB's enforcement authority is not limited to these two federal laws. Nor is it limited to only bringing legal actions (administrative or judicial proceedings) against industry members subject to its jurisdiction. The CFPB may enforce a variety of federal laws when exercising its supervisory authority and may do so in a variety of ways (e.g. written reprimand, informal warning, administrative action, litigation, etc.). It can also refer matters to states. However, its supervisory power to initiate such enforcement actions is limited to only those collection agencies, asset buyers, credit reporting agencies and service providers to such organizations that satisfy the definition of larger participant. Under the Dodd Frank Act, the CFPB must release its definition of larger participant for the collection industry and the credit reporting industry by July 21,

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2012. Although the CFPB's regulatory authority extends to all participants in the collection and asset purchasing market, its supervisory authority is limited to only those collection agencies, asset buyers, credit report agencies and service providers to such organizations that satisfy the definition of larger participant.

Federal Trade Commission Action

With respect to the ARM industry, there were no administrative or judicial actions reported by the FTC filed against collection agencies or asset purchasers during the second quarter of 2012. But several of the FTC's enforcement actions this quarter did touch our industry – albeit indirectly.

- The FTC temporarily shut down a Florida based operation that allegedly continued to pitch bogus credit-repair services nationwide, despite a 2010 court order requiring it to stop. The new court order, which will remain in place while the FTC seeks a contempt ruling against the defendants for violating the original order, bars the scam operators from all activities involving credit repair, and from offering credit-related products, programs, or services.
- In response to charges from the Federal Trade Commission, a U.S. district court halted an operation the FTC alleged collected phantom payday loan debts that consumers either did not owe to the defendants or did not owe at all. According to FTC documents filed with the court, the defendants' scheme allegedly involved more than 2.7 million calls to at least 600,000 different phone numbers nationwide whereby they fraudulently collected more than $5.2 million from consumers, many of whom were strapped for cash and thought the money they were paying would be applied to loans they owed.
- As part of its continuing crackdown on scams that target consumers in financial distress, the FTC charged Tracy, California-based Kirit Patel and two companies he controls with violating the FTC Act and the FDCPA. Often pretending to be American law enforcement agents such as "Officer Mike Johnson" or representatives of fake government agencies like the "Federal Crime Unit of the Department of Justice," callers from India who were working with the defendants would harass consumers with back-to-back calls, according to the FTC. The FTC filed the complaint and requested a temporary restraining order in the U.S. District Court for the Eastern District of California on April 3, 2012. On April 5, 2012, the court granted the FTC's request.
- The Federal Trade Commission also put a stop to the allegedly deceptive practices of a debt settlement operation that lured consumers with exaggerated claims about how it could help reduce their debts. The defendants behind the operation have agreed to a settlement order that imposes a judgment of $3.3 million that prohibits them from making any further misleading claims.
- The FTC case against FDN Solutions, LLC and Timothy Daniels is part of the agency's continuing crackdown on scams that target consumers in financial distress. The defendants claimed they could reduce consumers' debts, typically by 40-60 percent, according to the FTC complaint. However, the FTC charged these savings claims were misleading because they did not take into account the consumers who dropped out of the program, or the fact that the fees each client paid totaled 30 percent of the savings achieved.

Congressional Action

Fair Debt Collection Practices Clarification Act of 2012: On May 17, Rep. Barney Frank (D-Mass.) introduced a revised version of H.R. 4101, the Fair Debt Collection Practices Clarification Act of 2012, in the U.S. House of Representatives. The bill was reintroduced as H.R. 5794 with the same title.

The stated purpose for the reintroduction was to further clarify the limitation on liability when leaving voice mail messages, which staff indicated was Rep. Frank's intent all along. The change is to make it clear that for the limited liability

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section to apply, a debt collector can only rely on a CFPB-issued rule, regulation, interpretation, advisory opinion, etc., as opposed to an interpretation or advisory opinion by an outside or third party. There were no other changes in the reintroduced bill. The new language provides, "Nothing in the previous sentence shall be construed as providing an exemption from liability based on any rule, regulation, interpretation, advisory opinion, or approval made by any entity other than the Bureau or an official or employee of the Bureau.''

Although stranger things have happened, particularly in such a heated election year, there is little indication this bill will pass during the remaining months of this Congress. But the fact the bill was introduced during this Congress will help it gain momentum if it is reintroduced in the next Congress by a new author [Frank is retiring]. Reform legislation as proposed in this bill usually needs to be vetted for a year or two before passage is likely.

End Debt Collector Abuse Act: In May, Senator Al Franken (D-MN U.S.) announced his intent to reintroduce his End Debt Collector Abuse Act. The revisions to the 2010 version of this bill will likely include tough new rules for medical debt collection agencies and healthcare providers. According to Franken, the bill will address abusive debt collection practices detailed extensively in reports by the Federal Trade Commission, GAO, Minnesota Attorney General and recent news articles and amend the FDCPA to:

• Recognize the special nature of medical debt. Franken asserts because FDCPA protections in most cases do not apply to creditors collecting on their own debt and apply only to debts in default, his bill would address any gap in the law by making clear that FDCPA protections against abusive, deceptive, and unfair practices apply to anyone collecting a medical debt, regardless of the age of the debt. In effect, this amendment would make health care providers subject to the FDCPA when collecting medical debt and eliminate the exemption which currently extends to third party debt collectors collecting debt [medical] that is not in default.

• Protect patients during treatment. The bill would protect patients by prohibiting collectors from contacting consumers in hospital emergency rooms, labor and delivery departments, and intensive care units. The bill would also prohibit collectors from withholding, delaying, or implying that emergency medical services will be withheld until a debt is paid. Finally, the bill would expressly prohibit collectors from using protected health information (as defined by HIPAA) to collect a debt, except as is absolutely necessary to provide adequate information to consumers.

• Help patients access financial assistance. The bill would help patients access financial assistance programs such as hospital charity care programs or Medicaid by requiring those collecting on a medical debt to inform consumers about any financial assistance programs that may help pay their medical bills.

• Prohibit debt collectors from seeking arrest warrants to collect on debts. The bill would prohibit collectors from seeking arrest warrants to collect debts, but it would not prohibit courts from issuing warrants if a judge decides it's merited by the case.

• Expand the requirements of the validation notice. In addition to existing requirements under the FDCPA, the bill would require debt collectors to include in the validation notice the name and address of the original creditor; an itemization of the principal, interest, and fees that make up the debt; how to file a complaint with the collector and would require debt collectors to conduct thorough investigations when consumers dispute a debt and produce verification specific to the disputed issue. Just so you know, this language is almost exactly what the National Consumer Law Center requested as amendments to the FDCPA as far back as 2007.

• Hold bad actors accountable. The statutory damage limits have not been raised since the bill's passage in 1977, gradually limiting the effectiveness of the law to deter bad actors. Due to inflation, debt collectors who break the law today are effectively getting a 74% discount. For that reason, the bill would raise statutory damage limits to reflect inflation since 1977 and index them to inflation going forward. The bill would also confirm that judges can provide injunctive relief to consumers when debt collectors continue to violate their rights under the FDCPA. Once again, this language was strongly supported by the National Consumer Law Center in 2007.

I find it interesting that Senator Franken has already received endorsements for his legislation from numerous Minnesota organizations as well as national organizations. These organizations are well organized, connected and carry tremendous political weight. Industry associations should be mindful of these groups and work hard to open lines of communication with each one of them if they have any expectation of defeating or modifying this proposed legislation. The following organizations have endorsed Franken's soon to be introduced legislation.

SEIU Minnesota, Take Action Minnesota; Housing Preservation Project; Latino Economic Development Center; Minnesota Community Action Partnership; Metropolitan Consortium of Community Developers; Legal Services Advocacy Project (Minnesota); Lutheran Social Service of MN; Minnesota Jewish Community Relations Council; Catholic Charities of St. Paul and Minneapolis; Minnesota Nurses Association; Affirmative Options Coalition; Minnesota Disability Law Center; Mid-Minnesota Legal Aide

National Consumer Law Center (on behalf of its low-income clients); Consumers Union; National Consumers League; National Health Law Program; Families USA; National Association of Consumer Advocates; Consumer Action; Consumer Federation of America; National Immigration Law Center; Community Catalyst; NAACP; The Leadership Conference on Civil and Human Rights.

State Legislative and Regulatory Action

As predicted in previous ARM Legislative and Regulatory Briefings, proposed state legislation primarily staged to further curb debt buying activity and eliminate or restrict the ability to collect out of statute debt gained legs in the second quarter. Fortunately, through the efforts of ACA International, DBA International, industry coalitions and the efforts of industry members such as Encore Capital Group and Cavalry, the bills were either tabled, sent back to committee or died.

• **California Senate Bill 890** also known as The Fair Debt Buyers Practices Act, authored by Sen. Mark Leno (D-San Francisco) and originally introduced in February 2011 was passed by the Assembly Judiciary Committee. The legislation now goes to another Assembly committee, the Banking Committee, for consideration. This bill will prohibit debt buyers from obtaining a judgment in a debt collection lawsuit unless the debt buyer can document their ownership of the debt, the balance of the debt, the date of the default or last payment, the identity of prior owners of the debt and the name and address of the debtor in the original creditor's records.

• **Oklahoma Senate Bill 1430** aimed to advance licensing for debt buying and collection activity, eliminating the ability to collection out of statute debt and requiring unreasonable documentation standards was tabled.

• **Georgia Senate Bill 448** seeking to limit the amount one can recover from a guarantor of a purchased debt to the lesser of the actual amount paid for the debt plus the rate stated on the face of the obligation or the maximum amount permitted to be collected under the guaranty failed to move to the House floor for a vote before the Assembly adjourned.

• **Rhode Island House Bill 7528** would have limited recovery on defaulted debt to no more than three times the purchase price when the original creditor sells the debt and was sent to committee for further study.

• **Louisiana House Bill 782** which passed the House and failed in the Senate would make clear the practice of negotiating and settling debts is the practice of law and must therefore only be conducted by an attorney licensed to practice law in the state of Louisiana. Fortunately an amendment was added clarifying debt collection activity conducted pursuant to the FDCPA will

not be affected by this law. The bill is basically aimed at debt settlement companies rather than the collection industry.

• **Minnesota House Bill 2335** was introduced by the Minnesota Association of Collectors to require collection agencies to use a member of the National Association of Professional Background Screeners when conducting background checks as required by the state of Minnesota to obtain a license to be an individual collector. The bill also introduces much needed clarification to the scope and timing of the required background checks.

• **Missouri Senate Bill 484** adds automated phone calls to the types of calls prohibited to individuals who sign up on the do not call list and exempts certain automated calls. It provides that entities that make automated calls shall not block their number from appearing on any caller identification service and automatic dialing announcing devices are prohibited from being used to call Missourians' personal phones unless the device will disconnect within 10 seconds of the receiver hanging up. The bill has been referred to Committee.

• **South Carolina Senate Bill 1004** would amend section 16-17-445 of the 1976 code, relating to the regulation of unsolicited consumer telephone calls, to provide that telephone solicitors must include accurate identifying information on caller identification displays. It would prohibit "spoofing" and gives the Department of Consumer Affairs the authority to monitor compliance. In committee, the bill was amended to apply to all users of a telephone and not just limited to solicitations. The bill has been referred to committee.

State legislation that either passed or is likely to pass imminently includes:

• **Arizona House Bill 2664** was signed by the governor on May 9, 2012. This bill clarifies a cardholder assumes liability for charges and interest on and account and indicates acceptance of the terms by the cardholder's written or electronic signature or by any other electronic record acceptance. California Senate Bill 890 would place more restrictions on debt buyers operating in the state. The primary impact of the bill would be to require more documentation from buyers during the debt collection process.

• **Illinois House Bill 4695** largely spurred by the efforts of Illinois Attorney General, Linda Madigan, would amend the state's Collection Agency Act. This bill provides that each collection agency shall develop and maintain a written internal policy regarding the prevention of debtor incarceration and would take effect January 1, 2013.

• **Massachusetts – H.B. 4073** will prohibit all robocalls [defined as an automated phone call that uses both a computerized auto-dialer and a computer-delivered pre-recorded message] in the commonwealth to any hands-free mobile telephones, mobile electronic devices and mobile telephones. This legislation does not apply to messages from school districts to students, parents or employees; messages advising employees of work schedules; messages on behalf of correctional facilities advising victims; or messages on behalf of municipalities and government.

• **Ohio – S.B. 224** signed by Governor John Kasich on June 26, 2012 shortens the statute of limitations on an agreement, contract or promise in writing from 15 years to 8 years after the cause of action accrued.

I am confident the 3d quarter of 2012 will be interesting to say the least. The CFPB must release its definition of larger participant on or before July 21, 2012. With the release of this definition, so too will come the first wave of change stemming from the CFPB for the debt collection and asset purchasing industry. Until such time, we all wait with anticipation. For additional information about the CFPB proposed examination process please contact Rozanne.Andersen@Ontario Systems.com.

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Top Pitfalls to Avoid When Responding to an Unsolicited Offer to Buy Business

By Mike Ginsberg, President and CEO of Kaulkin Ginsberg

Last month, I received a call from an owner of a family business. I am going to name him Matthew and change his company's specifics to protect confidentiality, but the story is eerily similar each time I field a call from a frustrated business owner who decided to walk down the road toward selling his business with a buyer that approached him directly only to have the transaction fall apart before closing.

I knew this particular owner for years so he trusted me and thought I would understand his frustration. Matthew and his business partner Max own a $30 million profitable healthcare services business with two operating centers based in the Midwest and Southeast that they started 20 years ago. The business had 2 sizeable anchor clients, multiple revenue cycle service offerings and was well positioned among competing service providers. It wasn't unusual for buyers and brokers to solicit them directly about selling their business.

Usually they don't respond but this time around they chose to respond positively. The buyer was a private equity firm that already owns a larger RCM company than theirs. Matthew had discussed with his financial advisor the topic of selling the business before the potential capital gains tax rate increase at the end of the year. He and his partner had been in business for a long time and thought the timing was right in their personal lives to sell. They thought they had little to lose and a lot to gain by responding positively to the inquiry. They scheduled an initial call, which went well so they decided to meet the buyer face-to-face. Before too long, they executed a confidentiality agreement, shared financial and operational information, and brought the buyer in to meet their staff.

A few weeks passed and the partners signed a non-binding letter-of-intent granting the buyer 90 days exclusivity to perform due diligence and work with lenders to secure debt financing for the purchase. The price and terms were set and the sellers were confident their company would hold up to legal, financial and operational reviews. They were sure the deal would close.

The deal hit some turbulence in the first 30 days when the buyer expressed disagreement with specific add-backs that the partners included when calculating their company's adjusted EBITDA, lowering the EBITDA by over $1 million annually. They also did not foresee negotiations around setting working capital amounts and escrow holdbacks, in essence further reducing the cash amount that was expected to be paid at closing. The buyer explained that making adjustments during due diligence was not atypical and they had to lower the price and change the terms significantly in order to secure financing. The deal quickly unraveled right before their eyes and the partners were left explaining to their management why the sale did not go through. To make matters worse, word got out to competitors that the company was for sale and they had to explain to key clients what happened. The worst case scenario became their reality.

Matthew and Sam made some serious, and avoidable, mistakes when they decided to sell their business to the unsolicited buyer that approached them directly. Here are the top pitfalls they could have avoided:

The owners moved too quickly. The selling company is more than 20 years old and performing well. What was the big rush for the seller when it came time to sign a letter of intent? For the buyer, the timeframe is different. Most buyers want to execute a letter of intent as soon as possible and effectively remove the seller's negotiating power by giving them sole right to pick over the seller's business without competition applying pressure to the price or process. In this case the partners had built a successful business over 2 decades but hastily jumped at signing the LOI before making sure important matters like adjustments to EBITDA were negotiated and firmly set.

The owners involved clients too early in the diligence process. In this case, the buyer convinced the partners to allow them to meet with major clients early in the diligence process to discuss the sale and ensure continuity

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of business. This should never have occurred until terms of the definitive agreement were firmly set and financing was secured.

They did not set controls for diligence process. The buyer dictated when they would be at the company conducting their due diligence, who they wanted to meet with and what information they were to receive. The sellers should have set firm visitation hours, disclosed their vacation schedules so as to preserve peace on the home front, and conducted information reviews either in an on-line data room or at counsel's office to avoid unnecessary disruption.

They never did reverse due diligence on the buyer. The seller assumed that since they were approached by a private equity firm, and since the firm owned a large RCM company, the buyer was reputable and financially strong. Remember what happens when you assume? They should have done homework on the buyer, including past sellers they either completed or did not complete transactions with, before signing the LOI.

They signed the Letter of Intent before finalizing major financial negotiations. Adjusted EBITDA should have been completely investigated until both parties, in writing, completely agreed to its components. The sellers probably did not realize they needed to address working capital provisions or escrow amounts. The first time they even heard of these provisions was after they executed the LOI.

The owners prematurely told their entire staff about the sale. This is a big no-no. Would you tell your kids that you're going to a ballgame before checking the price of the tickets or if they are sold out? I wouldn't. Why would you concern your staff prematurely about a potential sale, especially in today's troubled economy, before making sure a transaction is eminent? It's perfectly reasonable to allow the would-be buyer access to senior executives but not to the rank-and-file personnel.

They should have only entrusted key executives into the process before signing the LOI. For a sale of a service business to occur in a way that enables the owners to leave the business entirely, certain key executives with proven ability to operate the business must be firmly in place. Prudent sellers will work financial incentives for key exec into their transaction to ensure a smooth transition to new ownership. An experienced buyer would require these executives to be locked down with non-compete/non-solicitation provisions in their employment contracts.

It's captivating to get an unsolicited offer from someone who wants to buy your business. By avoiding key mistakes, owners will maintain leverage throughout the negotiating process.