

THE ANATOMY OF AN OFFERING MEMORANDUM

When you are trying to sell your entire business or even a large portfolio of merchants, one of the most important ways to maximize the potential sales price is by preparing a well written, informative and compelling offering memorandum. Below, I will describe what an offering memorandum is, the importance of the document and the various components of that document.

What is an Offering Memorandum?

An offering memorandum (“OM”) is a booklet, usually neatly bound, that is prepared in order to try to sell a valuable asset, usually an entire company or in the case of the bankcard industry large portfolios of merchants. The OM is the document that is sent to potential purchasers when they express interest in purchasing the company or merchant portfolio. As the first glimpse the buyer has of the company, the OM has to be compelling or the purchaser will never make an offer for the company. For that reason, great care must be taken to ensure the OM grabs the reader’s interest and presents a well thought out case as to why the buyer should purchase the company.

In larger transactions, the OM is usually prepared by the company selling the asset in collaboration with their investment bankers. The investment bankers are retained by the company to sell the company and the investment bankers get a share of the sales price in the event of a sale, similar to a real estate agent in a real estate transaction. The investment bankers will work with the company’s executives to learn as much about the business as possible, including its finances and the reasons why the company is a valuable asset. The investment bankers and the company will continue to work on the OM and refine it until the OM is ready for distribution to potential purchasers.

Once the OM is completed, it is time to try to sell the asset. The investment bankers will solicit interest for the company from potential buyers that they know and also companies that logically may be interested in the purchase. If a potential buyer shows any interest in purchasing, once the buyer signs a confidentiality agreement, the OM is sent to that buyer. Below, I will discuss the main components of the OM and the importance of each part.

The Executive Summary

The executive summary is arguably the most important part of the OM. That is because it is the first thing most buyers will read about the company. Unless the executive summary grabs the reader’s attention, it is unlikely the potential buyer will bother to read any more of the document.

As the name implies, the executive summary is a summary of the important parts of the OM and highlights various value propositions of the company. The executive summary is short, sometimes just one page but generally less than 5, and contains brief facts about the company to show why the company is valuable, how it is different from its competitors and why the company is poised to grow and prosper. Another important part of most executive summaries is a condensed version of the company's income statement. The executive summary provides historical income and profit information about the company, as well as pro forma estimates on how the company will perform and hopefully become more profitable in the future.

Industry Overview

The next section of the OM typically provides an overview of the seller's industry and information about competitors. The importance of this section is to give the reader information about the potential size of the market that can be captured in the industry. Buyers like to invest in industries with a lot of potential for growth. For instance, an industry with a potential market of \$1 billion in sales is better, for the most part, than a market where the whole industry is only expected to sell \$100 million. The bigger the industry, the more potential the seller has to make more money and the easier it is, all things being equal, for the buyer to get a better return on its investment. Another portion of this section is usually reserved to profile the main companies in the industry, that is the seller's competitors.

Company Profile

This section of the OM gives the seller an opportunity to describe why it is a great company, why its people are a notch above the rest and why the company will be able to beat out its competitors. As to the company, one of the main questions most buyer have is why will it win over its competitors? This usually has to do with superior or unique marketing efforts. Buyers want to know how the company is currently obtaining business. In addition, they want to know what innovative ways the company has planned to increase its market share. Of course, there must be an explanation of how these marketing efforts are better than its competitors and that they are not easily duplicated.

Information about the operations of the business is also a key part of this section. The actual process flow, such as how new merchant applications are processed, can be explained in this section. To the extent that the process is automated (saving time and money), such facts can be highlighted and explained. Also, there is usually a place reserved to present short biographies of the key executives of the company, with a particular emphasis on their experience in the industry.

Financials

Arguably the most important part of the OM is the company's financials. A buyer wants to see that the company is doing well and making money as reflected by the historical income statement and balance sheet. But the main way the financial statements can increase the value of the company is by showing how well the company can perform in the future.

The OM financials will include a "pro forma" analysis of the income statement for the company. This is an estimate about how the company can perform from a financial perspective in the future. These pro forma financials are based upon a set of assumptions about things like the costs of acquiring new customers, operating costs related to producing the company's products or services and the potential for the company to expand its market share in the industry.

It is critical that the financial assumptions for the pro forma financials are well thought out and can be defended by the seller. Invariably, buyers will want to obtain an understanding of the financial assumptions underlying the pro forma income statement and will ask many questions about why the assumptions are correct, given the circumstances. Unless the seller can defend against these attacks on the foundation of the financial assumptions, the purchaser will discount the pro forma financial statement's accuracy and reduce its offered purchase price accordingly.

A well written OM is the keystone of a successful sale of a business or large merchant portfolio. It takes a lot of time to get the OM right, but it is time well spent given the tremendous return on investment.

* Paul A. Rianda, Esq. is an attorney who has specialized in providing legal advice to the bankcard industry for over 10 years. For more information about this article or any other matters, please contact Mr. Rianda at www.riandalaw.com, (949) 261-7700 or via email at paul@riandalaw.com

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