BITING THE (AGENCY) BULLET

THE INSIDER'S GUIDE TO BUYING, SELLING OR MERGING WITH ANOTHER AD AGENCY

AGENCY212

A company of The Tucker Partnership, Inc.

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1.

INTRODUCTION

There are three solid approaches to growing an Ad Agency:

• New business development

• Organic Growth from your current client base

• Acquisition of revenue

Numbers one and two are self-explanatory. And the fact is, any good agency head will always be working on all three—it's an integral part of the job description.

In the same vein, there are three solid approaches for an Agency in (financial) trouble:

• New business development (with a focus on revenue-generating projects)

• Organic growth (not passive) from current clients

• Pro-active search for a merger partner

Again numbers one and two are self-explanatory. The focus of this paper is on the third option on both lists.

2.

OH CRAP! ARE WE RUNNING OUT OF POSITIVE CASH FLOW?

It's one of the things agency principals should address on a regular basis. It's easy to remain calm and collected when you have a few million dollars in the corporate account, right? Well think about this: How much of that actually belongs to the agency? For example, when we are paid for media placement the most we can carve out of the total sum paid to us by our trusting clients is generally 15%. That means the other 85% is only passing through our account. One way to keep track of what is actually yours is to maintain a separate media bank account. You deposit funds into it and then transfer commissions only to your operating account. Because once you cross the line and start using client funds to pay your operating expenses things can get out of hand fast. In fact, I have been approached by a number of agencies that let this kind of accounting go too far before taking action. What happens when you go too far? Your company and the equity you have built go south.

There are several other reasons to look for a merger partner (e.g. weakness in a particular skill set at your agency) but this paper is focused on mergers that are motivated and driven by financials.

Cut to the Chase
(and Cut out the Bull)

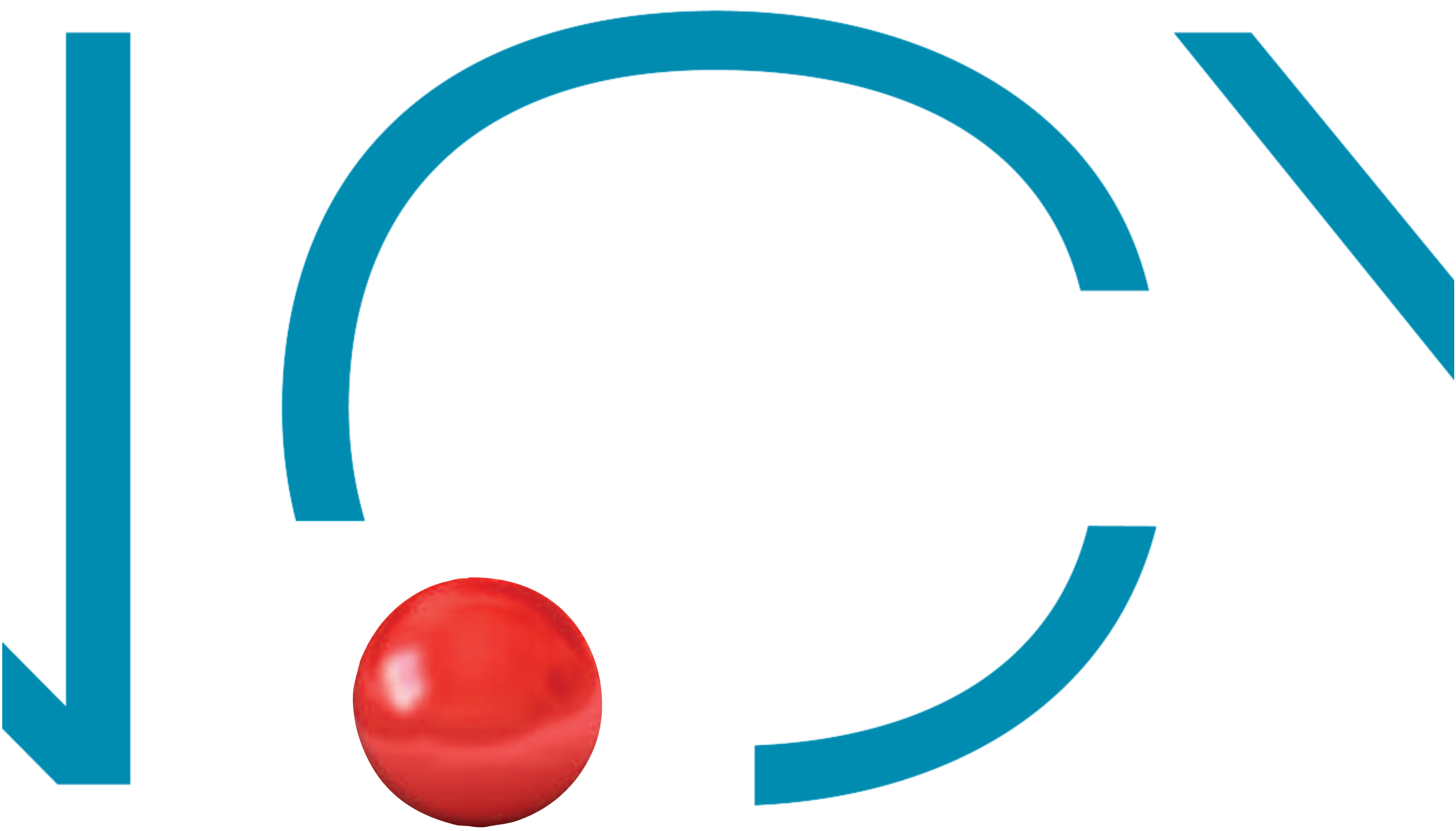
3.

MERGE?
WHAT DOES THAT *REALLY* MEAN?

It's pretty simple. If the new shareholders agreement allows you to keep some share in the company indefinitely, then by definition it is a merger. If it is an acquisition, however, there is most likely a buyout timeframe. Much of your decision-making—including the choice between merger and acquisition—will be driven by your present situation.

Are you looking for an exit strategy? A safe haven? Or more critical mass?

So who exactly do you call when you're thinking about, or in fact are ready, to deal? Let me remind you: when it comes to financial deals, we are not in the most sophisticated of industries. A fundamental rule of thumb is if you have a minimum of $10 million in Gross Revenue (not billings!) you can pick up the phone and call the Holding Companies or one or two of the other M&A specialists out there. Under $10 million and you'll be flying without a net. But read on, you are not without options.



4.

ARE WE MARKETABLE? HOW DO I CONDUCT A VALUATION OF THE AGENCY?

Generally, your agency will be judged by two somewhat different measuring sticks:

1. **Gross Revenue** (Gross Income). The amount you have after you pay all out-of-pocket expenses—such as media, production, printing, etc. In other words, the funds that actually belong to you. Below the Gross revenue line are payroll and all your operating expenses.

2. **EBIT** (Earnings Before Interest and Taxes). (And yes, there could be a problem if you're showing no profit. More on that shortly.) The reason EBIT is important is that the valuation process will zero-in on this number (averaging it out over a three year period) and use a multiple of it to come up with what is known as Fair Market Value (FMV). And how is that multiple arrived at? By going through a checklist that includes an assortment of risk factors. Make certain you understand all the criteria before you set out on any M&A trail. Keep reading....

5.

WHAT ARE THE RISK FACTORS THAT WILL BE USED IN YOUR VALUATION?

Before I go any further, let me drop a few caveats/disclaimers on this page. I am specifically addressing, in this particular space, the more traditional ad agency. As such, multipliers in the 2.0 range will, as a rule, reflect high-risk considerations. If you are in average territory you are looking at a multiplier between 2.1 and 3.5. Higher multiples usually constitute an above average rating (check points coming). Multipliers above 5 usually mean: "New media" (where they "print money" for now) or one of the holding companies (we will trade our worthless stock for your business).

So here are the Risk Factors that will be considered:

- **Stability of earnings (The key is the existence of agency/client contracts)**
- **Stability of client base (Many buyers will want to meet your clients)**
- **Financial reporting quality (With the need to conduct due diligence that has a high comfort level)**
- **Overall marketability of the agency (Read: new business prowess)**
- **Stability of the industries in which clients conduct their business (Figure cigarettes to be a problem)**
- **Employee dependency (Is there room for "synergies?" Are relationship managers "silos?")**
- **Employee stability (What is the average number of years at the firm?)**
- **Competition (Be honest, you know who they are!)**
- **Depth of Management (If the school bus transports most of your staff to and from work you have a problem)**
- **Importance of agency Principals (Double-edged sword, since your new partners will want you to sign a non-compete. Suffice to say it is better that all upper management client relationships go through you rather than through underlings)**

So, for example, if your multiple comes out to 3.95 and your 3-year average EBIT is $800,000, your overall payout could be $3,160,000. (Don't fret. Everyone thinks they are worth more! Get over it!)

6.

OKAY, I WANT TO DO THIS (SELL). WHAT DOES A PAYOUT LOOK LIKE?

This is tricky. The standard procedure is to pay 50% at signing (this is also where you are asked to put your signature on non-compete documents, in effect signing away your right to work in this business as an independent for many years). Then the other 50% will in all likelihood be split over the next two years (payments are based on fiscal performance). Here's a dirty little secret: look at the down payment of 50% as possibly the only real money you will ever see for the sale of your company. If you make friends with this notion during negotiations it may stop you from slitting your wrists later on.

7.

WHAT IF WE ARE NOT PROFITABLE?

Clearly this is a problem. The FMV calculation based on the multiple of earnings goes away. There is, of course, Gross Revenue. And there is a very big possibility that if you could lower your payroll and operating expenses after a sale or merger you could become wildly profitable. For example, if you can get out of your lease and move in with the buyer or merger partner you would realize instant savings. You could then look at all back office and administrative personnel and find "synergies" (read: layoffs). At this point

You might be well on the way to a sizeable profit.

The truth is, most smaller independent agencies would be interested in executing a deal like this. Especially if the agency is clean, without any outstanding debt (more on that next).

You can always work out a payment plan, as well. For example, base the down payment on a percentage of Gross Revenue and then come to an agreement on profitability goals for the new company. You then take a percentage of that profit over the next three years based on a multiple you think is fair.

8.

WHAT IF I HAVE NEARLY RUN THIS AGENCY INTO THE TOILET WITH DEBT?

As I mentioned at the top of this paper, **debt can add up quickly**—especially when you use money that's in your bank accounts that doesn't belong to you. It becomes something very much like a Ponzi scheme. The client pays you for the media; you string the media out for, first 60 days, then 90, and then, oh shit! You can still sell, but your options are limited. Here are a few:

- You find an agency to buy your company, and the purchasing agency then negotiates to pay off your debt. You "participate" in any future profits that come from the revenue you brought in.
- You downsize, set up a payment plan to pay down the debt and get your company back into a cash-positive position, then look for a partner.
- Walk away.

Want a Healthy Agency? Take Your Medicine.

9.

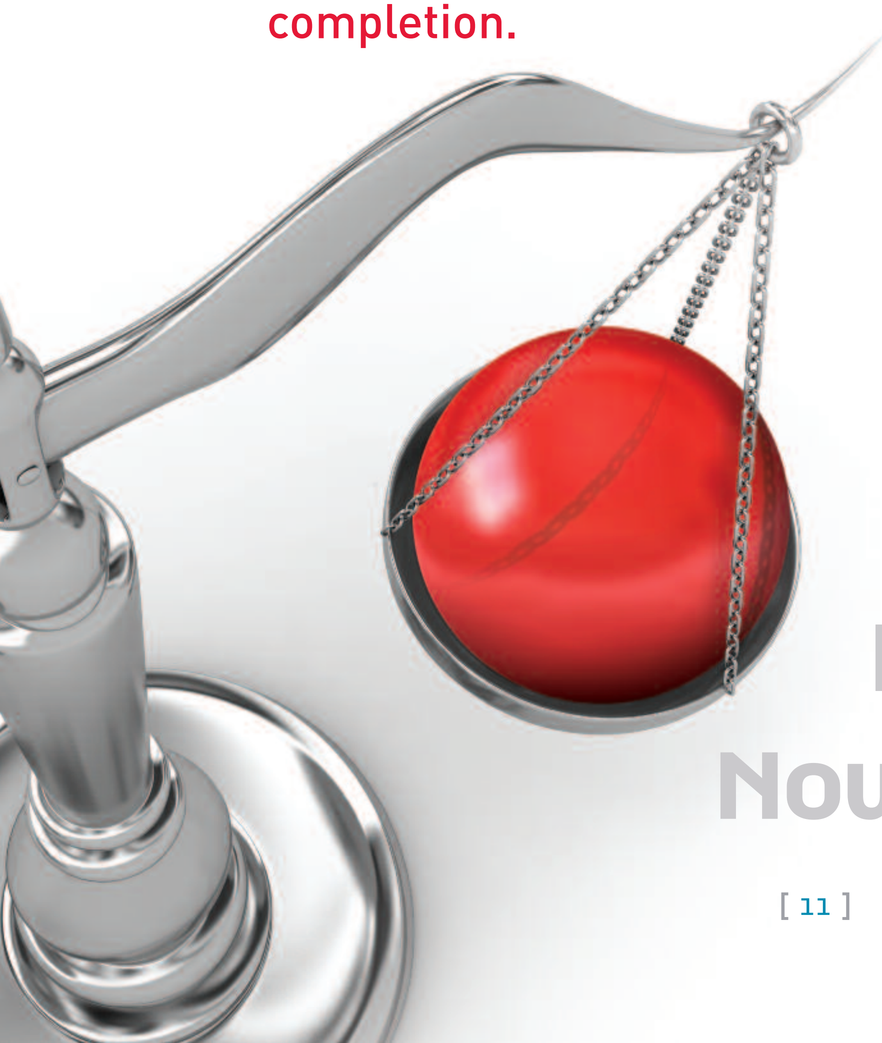
DO WE NEED A LAWYER?

Sadly, yes. The only question is when? My suggestion is to wait until the "deal memo" is written. This is the unofficial document that outlines all the specifics of the deal.

10.

HOW LONG DOES THE WHOLE PROCESS TAKE?

Longer than you intend it to take, for sure. Figure no less than three months and more likely six. Buying, selling, merging, deal-making—it's all a very emotional business. **Expect plenty of stops and starts along the road to completion.**



**It's a Big Deal.
Now Deal with It.**

11.

WHAT DO I TELL MY CLIENTS?

As I mentioned, many agencies (buyers) will want you to accompany them when they first meet and visit with your clients. But one way or the other, when you inform your clients about the upcoming merger or sale, you will clearly need the "elevator speech." Some of the elements that you and your new and improved agency will offer them are obvious:

- **Bigger and better**
- **More depth of services to help us crack your next challenge (examples are good)**
- **Will put us in a stronger position to compete in the industry (all clients like their agencies to win)**
- **Our resources will expand (example: we never really had a Brand Strategy dept., now we do)**
- **Not to worry I am still here (for now!)**

Note: Not discussed here is what happens to the agency name. This is not only an ego issue (Bullshit, we all have one!) but could also pose a problem for your clients. You could use the "slash" (e.g., Cooper and Benson/Agency212) or drop the name completely; you just have to be sure your clients are not left wondering if they have been pawned off on someone they didn't hire. In some cases you can "vertically integrate" an agency into a new organization, insert the slash into the name, and you've got a win/win.

For more information, or if you simply want to have a friendly chat about your options (yes, I will send you a signed NDA first) shoot me off an email. It will not cost you anything but your time. And I won't try to sell you anything.

Afterwards, if you think you'd like to pursue this further, we actually have a process I created after completing a number of deals over the years. More than I can say for any of the other so-called experts out there (Read: never met one who actually built their own agency. They also have no understanding of how desperately, at times, Agency Principals need someone of their own kind to talk to) And, we won't charge you the astronomical fees I have foolishly paid in the past.

You can reach me at btucker@agency212.com.

ABOUT BILL TUCKER

Bill is the CEO of Agency212, a New York City-based (Chelsea) Advertising firm. He spent his formative years growing up at Scali McCabe Sloves, perhaps the premiere Creative Shop of the 70's and 80's. He left when he was EVP, Account Management, to start his first venture; Lowe Tucker Metcalf. That evolved into The Tucker Partnership. His agency found great financial and creative success with major clients (read: money makers!) such as Quaker State Motor Oil and GE Corporate. Bill's company has made numerous acquisitions over the years to build critical mass and expand the different disciplines of the agency. About six or seven years ago Bill had an "Epiphany" that the one thing in common about making an acquisition was that the Principals almost always lost their entrepreneurial spirit and passion. So Bill decided that he would only take a minority interest in most acquisitions and simply help the firm to grow with the help of his Agency. At that point he changed the name of the Agency to Agency212 and The Tucker Partnership became a "boutique holding company" with vertically integrated firms like iFuel Interactive/ Agency212, Hofstetter & Partners/Agency212 and The Fresh Produce Group/Agency212. Bill's agency today has an array of national accounts, including Warnaco, Loews Hotels and Resorts, DK Publishing, Borghese, Cavit Wines, G.P. Putnam, Random House and many more. For more information please go to www.agency212.com.

AGENCY212

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