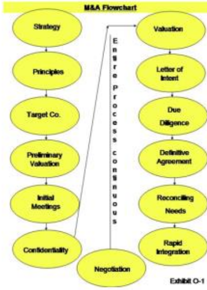
Mergers & Acquisitions Tips, Traps and Terrors

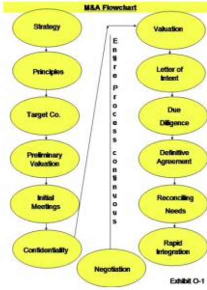
NCACPA – September 2022

by Jim Lindell, CPA, CSP, CGMA



OBJECTIVES

- Recognize M&A start to finish
- Identify reasons to pursue M&A
- Identify M&A Candidates
- Contrast Company Valuation
- Identify Due Diligence requirements
- Recognize the Human Impact of M&A
- Determine Steps for a Company for Sale



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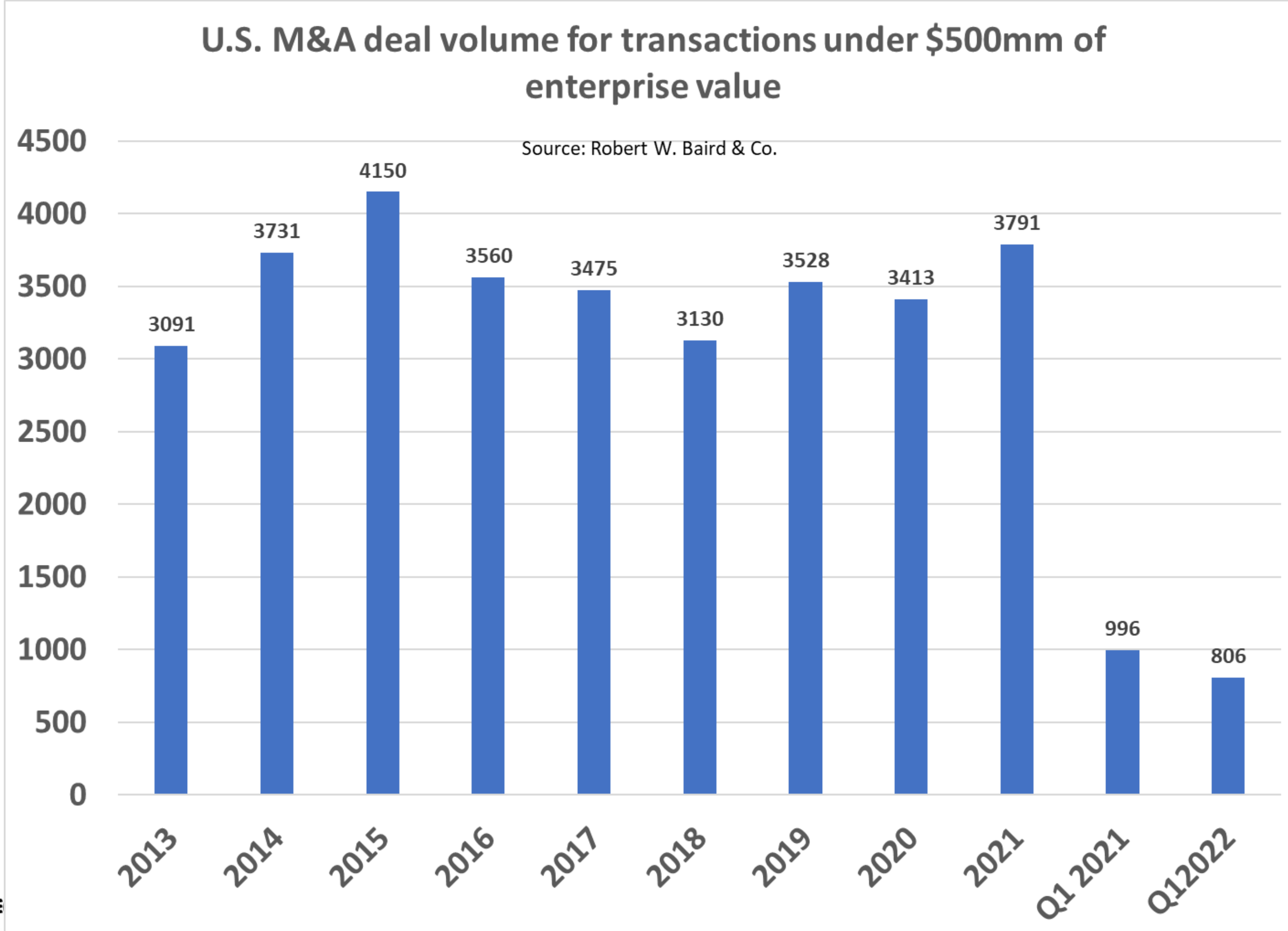
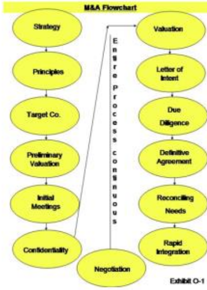
What are the current trends effecting the M&A marketplace?





Cleary Gull Market Monitor
2nd Q 2022

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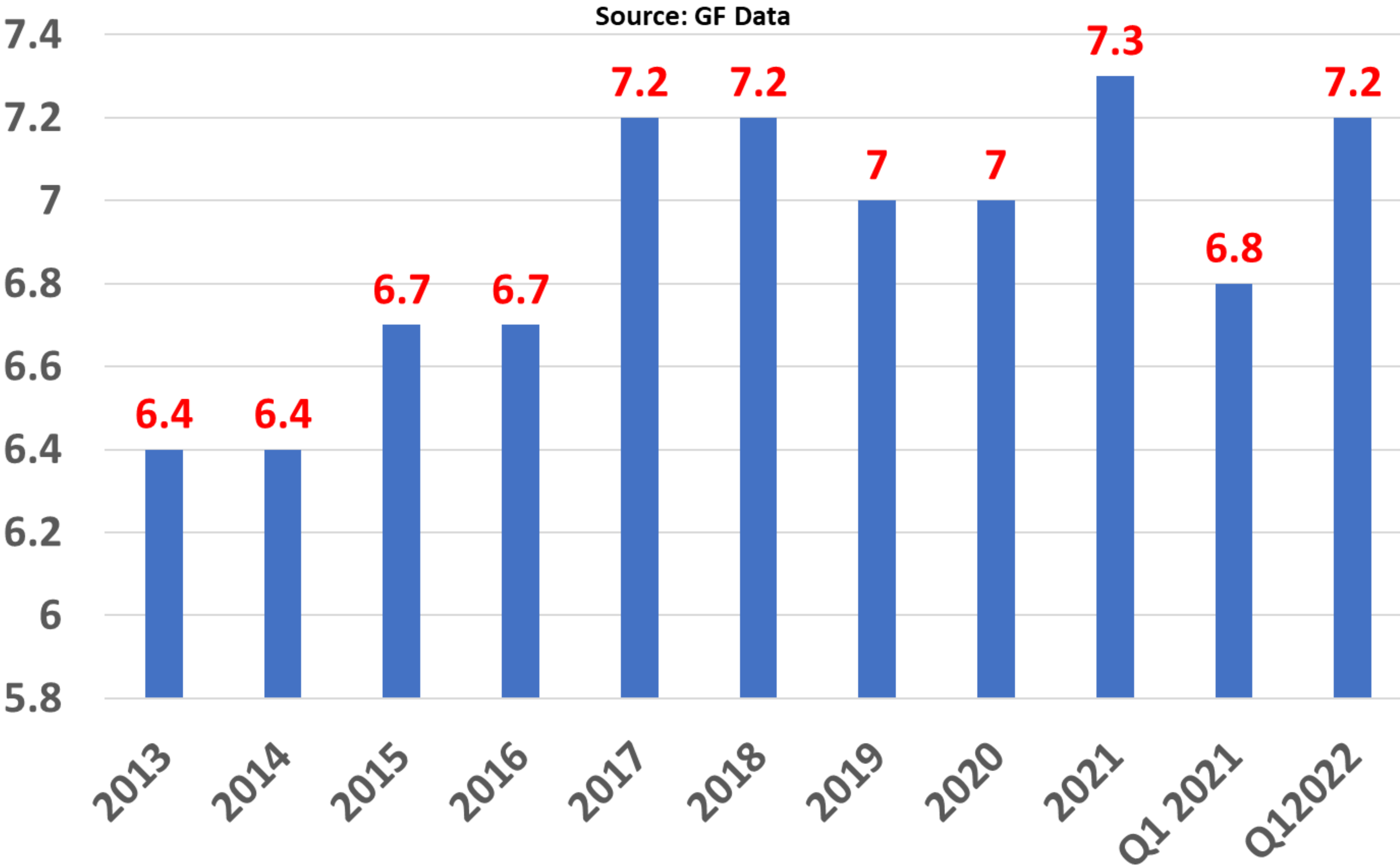
Average EBITDA multiples for $10mm - $250mm of enterprise value PE-backed LBOs



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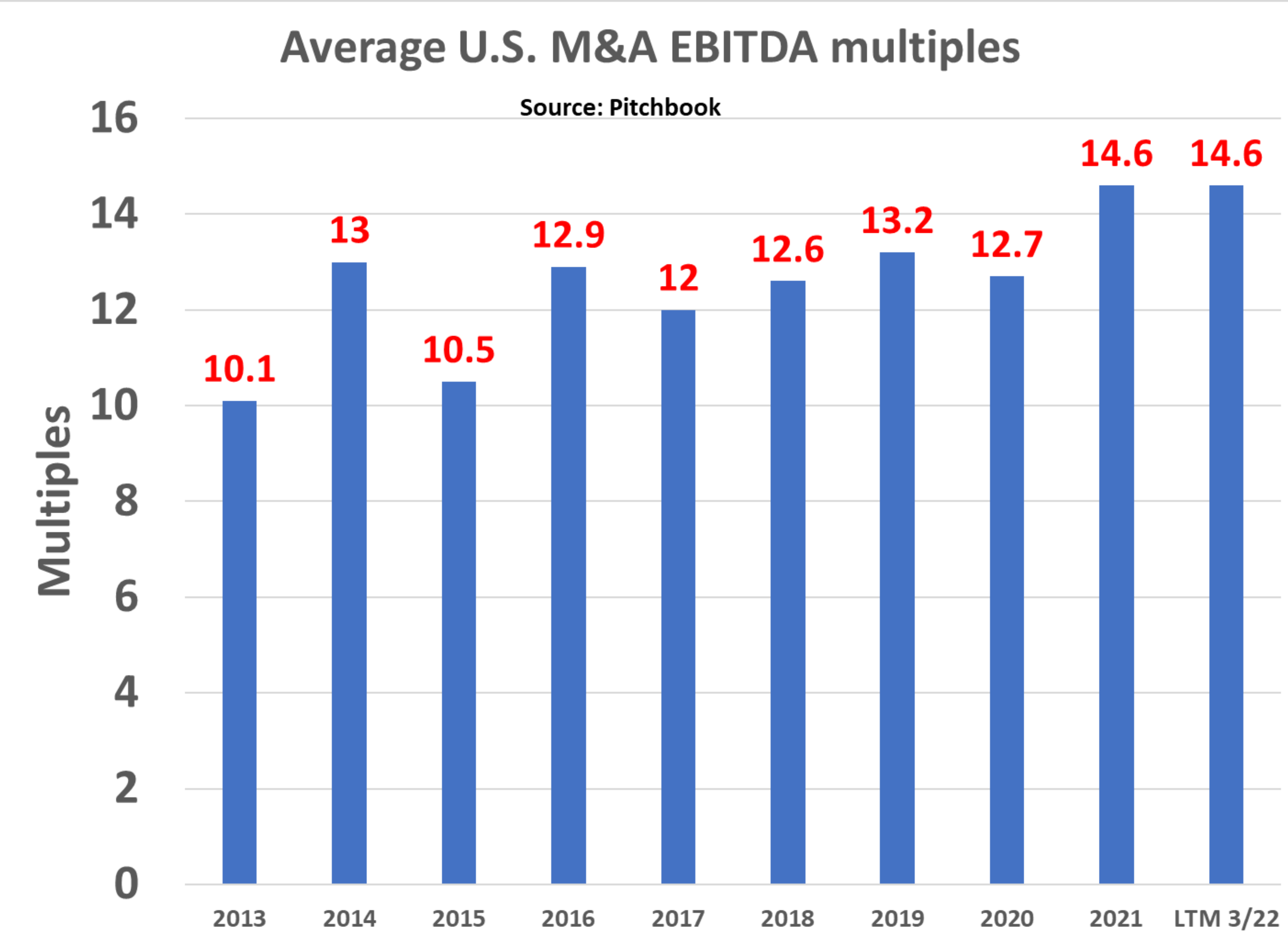

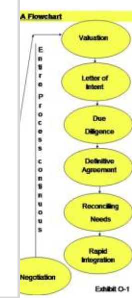

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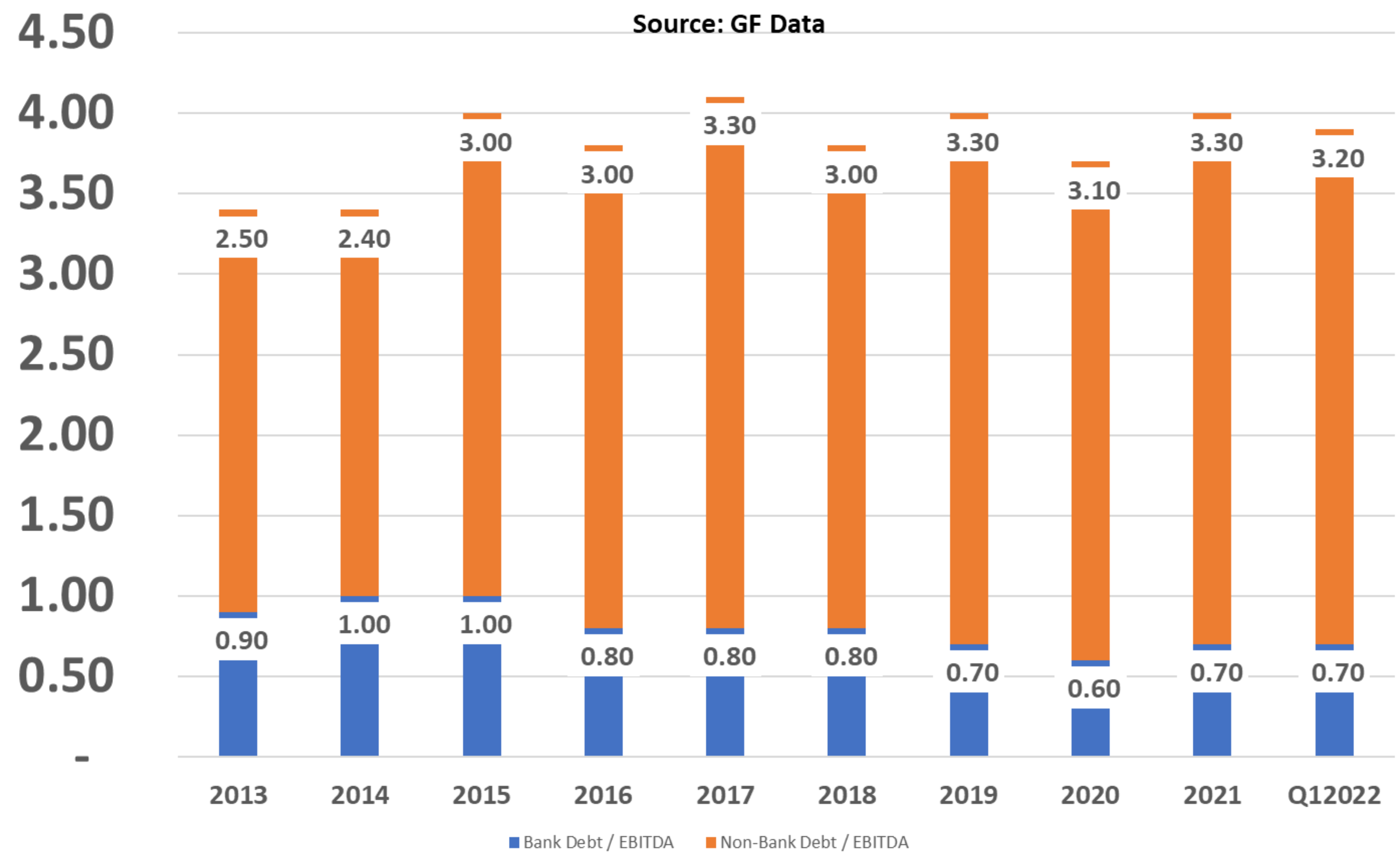
Average LBO debt multiples for deals with $10mm – $250mm of enterprise value



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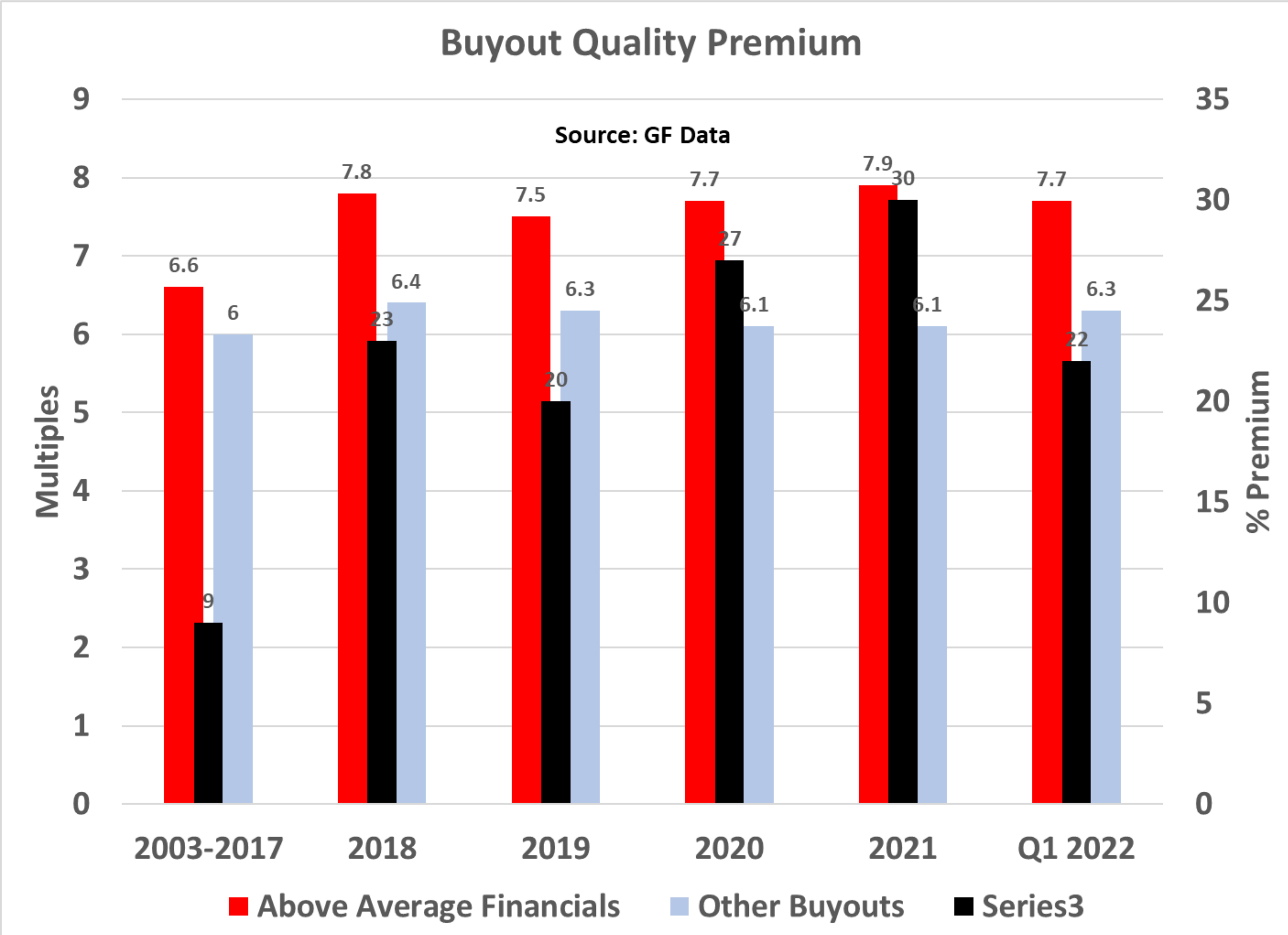

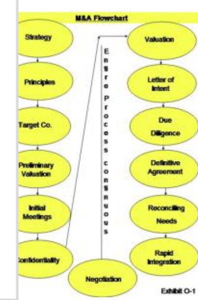

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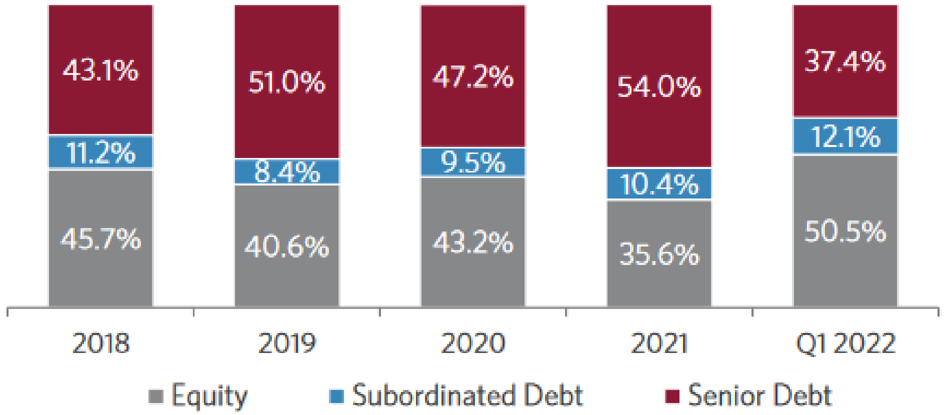
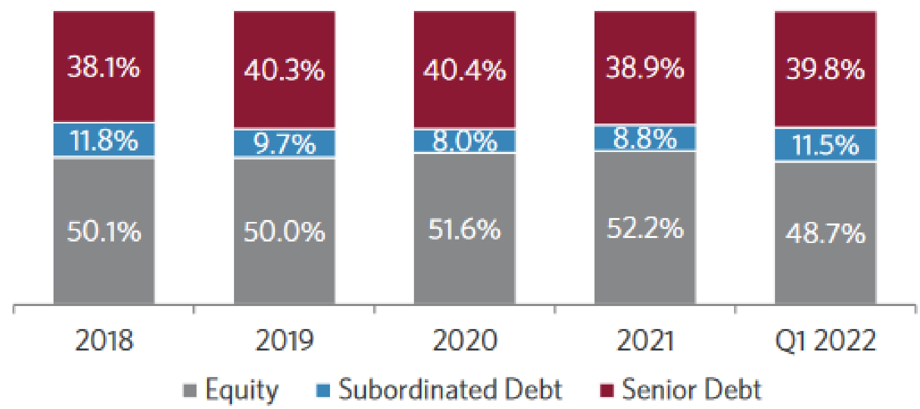
Equity and debt structure for deals with $10 to $25mm of enterprise value



Source: GF Data®

Equity and debt structure for deals with $25 to $250mm of enterprise value



Source: GF Data®

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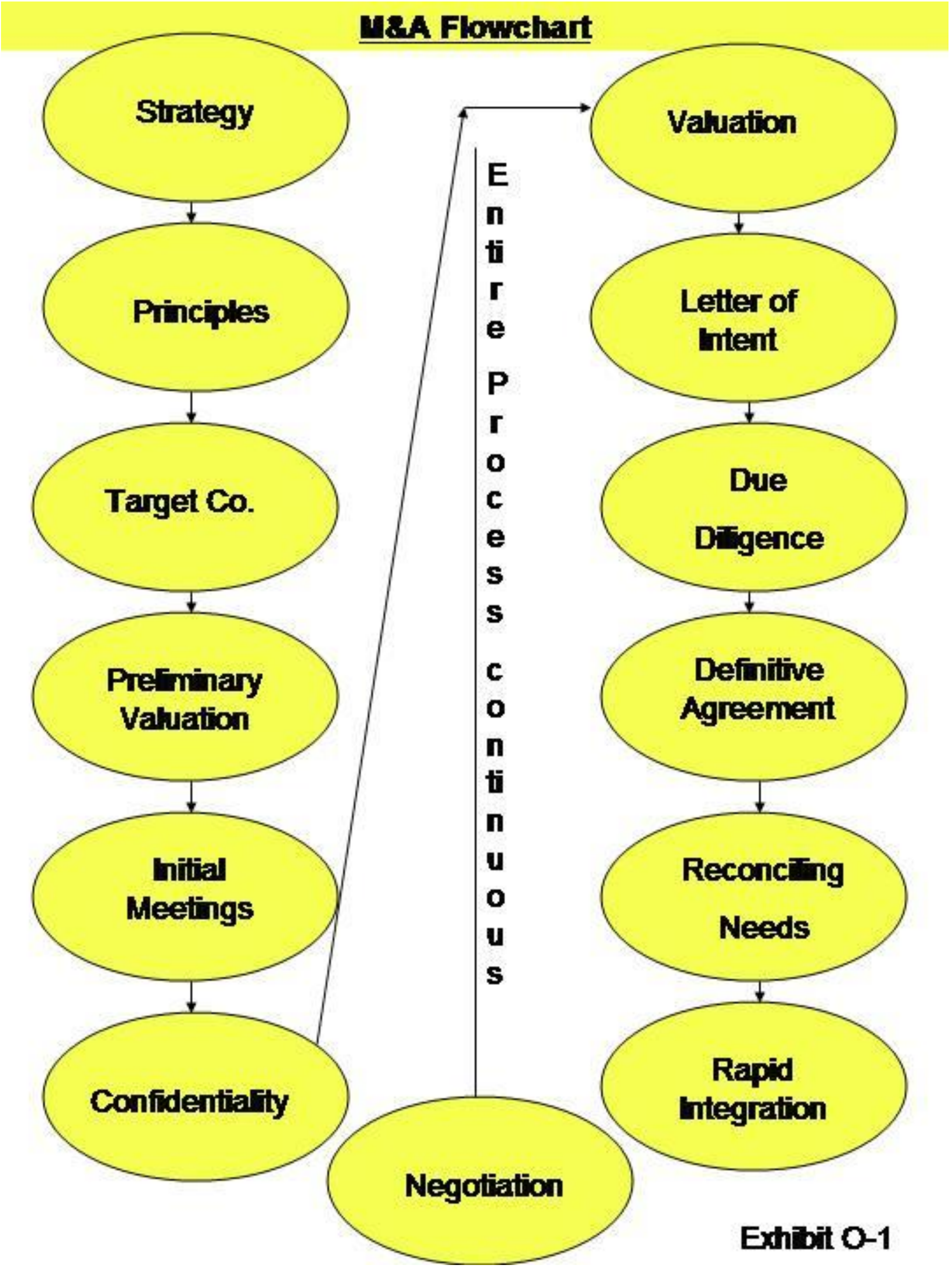

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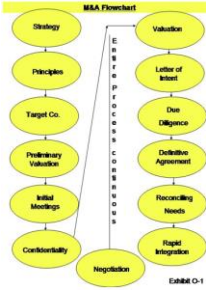
Concepts apply to all

- Buying
- Selling
- Merging



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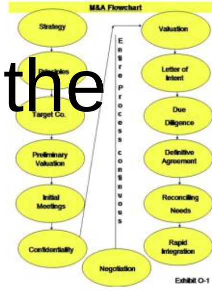
Why Acquire at all?

- Are there Alternatives?
  - Additional capacity
  - New customer acquisition
  - New market or channel
- However, would it not be possible to:
  - Lease additional capacity in a different part of the country?
  - Gain a new customer by different marketing efforts or new product development?
  - Subcontract to another company that has the channel that currently desire?
  - Organic growth



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Alternatives to Acquisition

- Create a joint venture
- Create a subcontract agreement
- Sublease additional manufacturing capacity.

Establish Principles

- The company must be profitable (or not)
- The company must have revenues in excess of $_______ (fill in the blank)
- The company must have or must not have a union plant
- Senior management must be willing to stay around for 18 months
- The company must not have incurred any operating losses within the last three years
- Any individual customer may not make up more than 20 percent of the target's business

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Principles (cont.)

- All information systems will be migrated to the acquiring company's platform within nine months
- The company will only acquire a company on an asset basis (or on a stock basis)
- The target company must have a distribution channel in the Far East
- The target company must not have any material outstanding legal issues
- The acquiring company will not pay more than five times EBITDA

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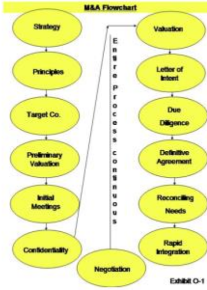
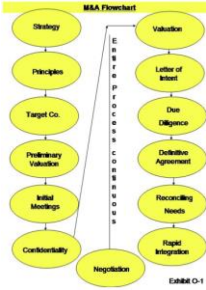
M&A Team

- CEO
- CFO
- Attorney
- Operations
- Human Resources
- Information Technology
- CPA / Valuation Expert
- Insurance Consultant



Human Side

- Have you ever been sold?
- How did it make you feel?
- What is our obligation to employees in the M&A process?



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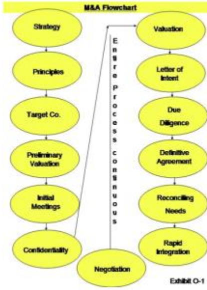
Possible Criteria

- Your essential company information,
- Your company philosophy,
- The size of your company,
- Geographic coverage of your company,
- Industry that you are involved,
- Size of company that you're looking to acquire,
- Industry that the target is involved with,
- Historical profitability of the target,



Possible Criteria

- Possible deal structure (i.e. cash, stock, combination),
- Who you are, what you do and where you do it
- Your company's core competencies
- How you are financed
- Whether you want to buy all or part of the business
- Whether you want people, places or things, or stand-alone business units
- The contact person at your company
- Your guiding principles - key disclosure may deter wasted resources.

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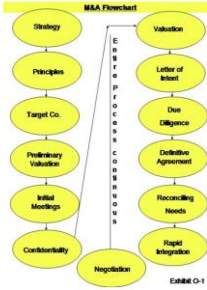
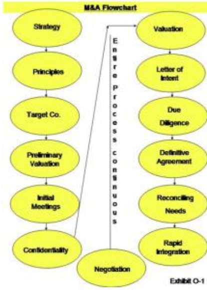
Where to find companies on-line

- bizbuysell.com
- businessesforsale.com
- bizquest.com
- hoovers.com
- Bizsale.com
- dealstream.com



Confidentiality Letter

- Agree not to reveal that they are in discussions about a potential transaction
- Simple or detailed
- Prohibits one company from raiding “or stealing” the employees of another company
- May request the return of information
- Establish the time frame on how long the confidentiality will remain in effect.

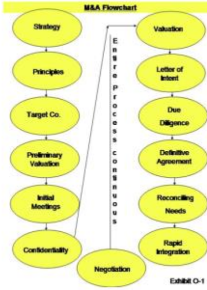


Valuation

Art

-Or-

Science?



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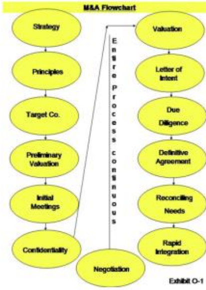
VALUATION



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Items that affect valuation

- Ego of the CEO
- Purchase prices of similar companies over recent months (can even be years)
- Synergies that will add value to combined companies
- New efficiencies that result from the combined companies
- Continued participation or influence of the former owner
- Elimination of a competitor

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Modifications to Valuation

- Premiums
  - Gaining control of a market
  - Eliminating a competitor
  - Gaining access to highly unique product, brand, management team, etc.
- Discounts
  - Major customer
  - Keyman in the business
  - Threatened litigation
  - Environmental problems

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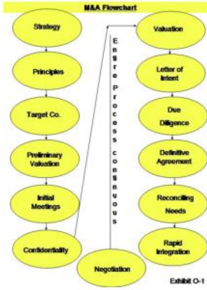
Negotiation - Trick

<u>*“Whoever speaks first in the negotiation loses!”*</u>



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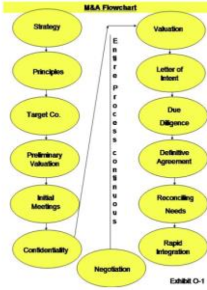
Tricks in Negotiation

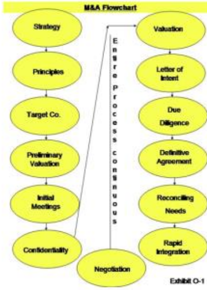
Each side should:

- Seek to understand the other sides position
- Seek for mutual gain
- Understand that the issue does not have to be a fixed “pie”
- Refuse to allow anger and emotional outbursts into the discussions
- Practice win-win techniques



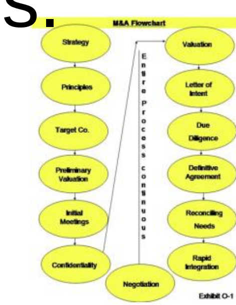
Purposes of Due Diligence

- Discover hidden liabilities
- Discover hidden assets
- Confirm information already provided
- Discover opportunity X previously unknown
- Identify threats previously unknown



Quality of Earnings Report

A detailed analysis of all the components of a company's revenue and expenses. The reports are often requested by a board of directors of a strategic buyer or an investment committees of a private equity buyer. The primary objective of a quality of earnings report is to assess the sustainability and accuracy of historical earnings as well as the achievability of future projections.



Source: https://www.divestopedia.com/definition/1000/quality-of-earnings-report

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Quality of earnings analysis

- Breakdown of revenue by appropriate components, such as customers and product/service lines
- Analysis of historic revenue trends
- Determination of one-time expenses vs. recurring expenses
- Determination of fixed vs. variable costs
- Analysis of impact on both revenue and expenses due to management changes
- Analysis of assumptions used in cash flow projections and scenario analysis

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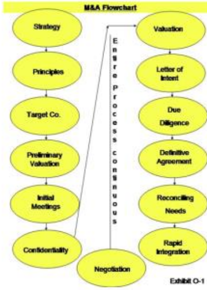
Source: https://www.divestopedia.com/definition/1000/quality-of-earnings-report

Reconciling Buyer and Seller

- There are many opportunities for the deal to fall apart. How can both parties be brought together?
  - Changing the total amount of consideration
  - Changing the timeframe or the installments of the consideration
  - Allowing the target company to retain some assets
  - Granting the owner certain perks (health-insurance, automobile expenses, country club dues, expense accounts, etc.)
  - Arranging creative consulting agreements
  - Allowing family members to maintain offices or to remain involved in the company



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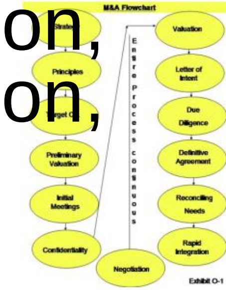
Rapid Integration

- Communication, communication,



Pitfalls in the sale process

- **Not being prepared.**
- **Breaches of confidentiality.** If word gets out that you have put your company on the market, the following can happen:
  - Employees may discuss the pending sale with people they shouldn't.
  - Morale can suffer. Employees may begin to look for new jobs.
  - Customer relationships can suffer from inconsistent service.
  - Competitors may tell customers that the business is being sold in the hopes of taking business away from you.
- **Failure to check out the buyer.**
- **Talking to only one buyer.**

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Pitfalls in the sale process

- **Talking with competitors.**
- **Underestimating the value of the business.**
- **Premature disclosure.**
  - Specific customer or supplier information
  - Specific product margins
  - Trade secrets
  - Information about unprotected technologies
  - Corporate or marketing strategies
  - A detailed balance sheet
- **Failure to use competent professionals.**
- **Failure to understand buyer synergies or plans.**

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Questions, Comments & Follow-up

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