



# **Trends and Transitions**

*Strategic Planning for You and Your Company*

March 5, 2013

# Outline

- **M&A Market Dynamics**
- Selling Considerations
- Preparing to Sell
- The Sales Process
- Legal Considerations
- Final Thoughts and Summary

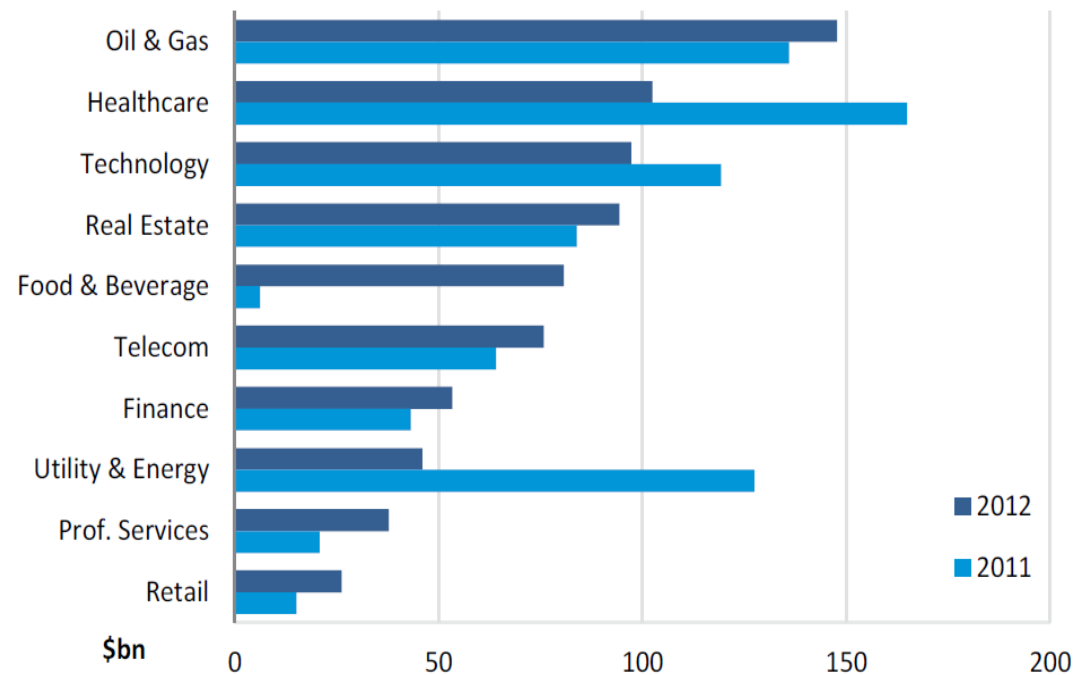
# Global M&A Sector Trends

Global Target Sector Ranking - 2012				
Rank	Target Sector	Volume \$bn	Deals	% Change 2012 vs 2011
1	Oil & Gas	366.9	1,762	34%
2	Real Estate	243.2	3,092	-13%
3	Finance	218.4	2,727	-15%
4	Technology	202.3	5,985	-11%
5	Food & Beverage	192.1	1,503	114%
6	Telecom	173.4	1,050	-6%
7	Healthcare	163.4	2,537	-29%
8	Utility & Energy	155.7	1,290	-38%
9	Mining	140.8	2,086	-5%
10	Professional Services	85.4	4,504	44%

Source: Dealogic

# Global M&A Sector Trends

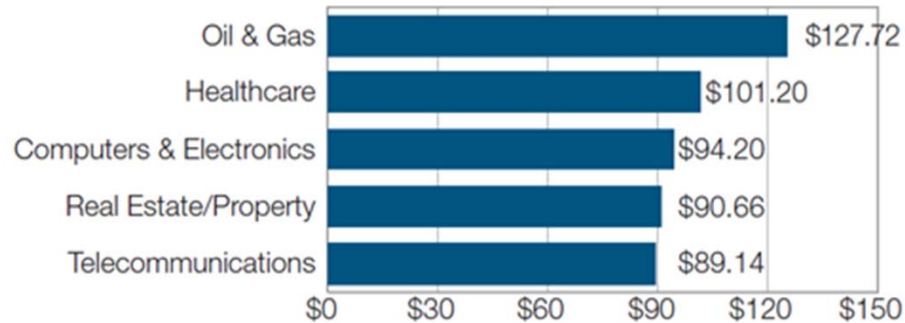
Top 10 US Target Sectors 2011 - 2012



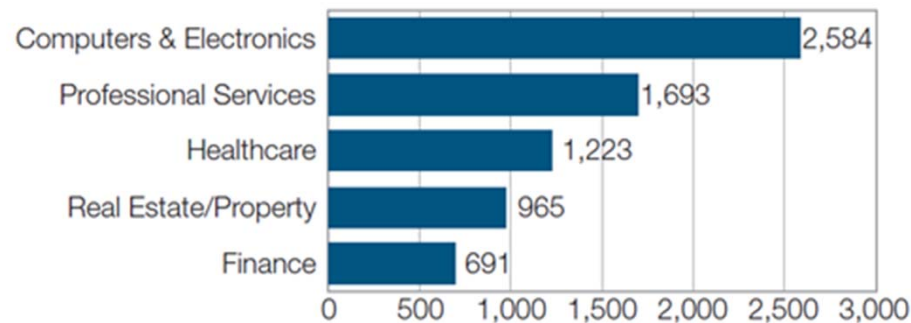
Source: Dealogic

# U.S. M&A Activity (last 12 months)

## By Volume (US \$B)



## By Number of Deals



Source: Dealogic

# U.S. M&A Activity (Feb. 2013)

	<b>Strategic</b>	<b>Financial</b>	<b>Total/Avg</b>
Volume	\$52B	\$11B	\$63B
Number of Deals	1,039	223	1,262
Average Value	\$174M	\$247M	\$184M
Average Multiple	11.4x	16.0x	12.4x

Source: Dealogic

# Outline

- M&A Market Dynamics
- **Selling Considerations**
- Preparing to Sell
- Sales Process
- Legal Considerations
- Final Thoughts and Summary

# When is the Right Time to Sell?

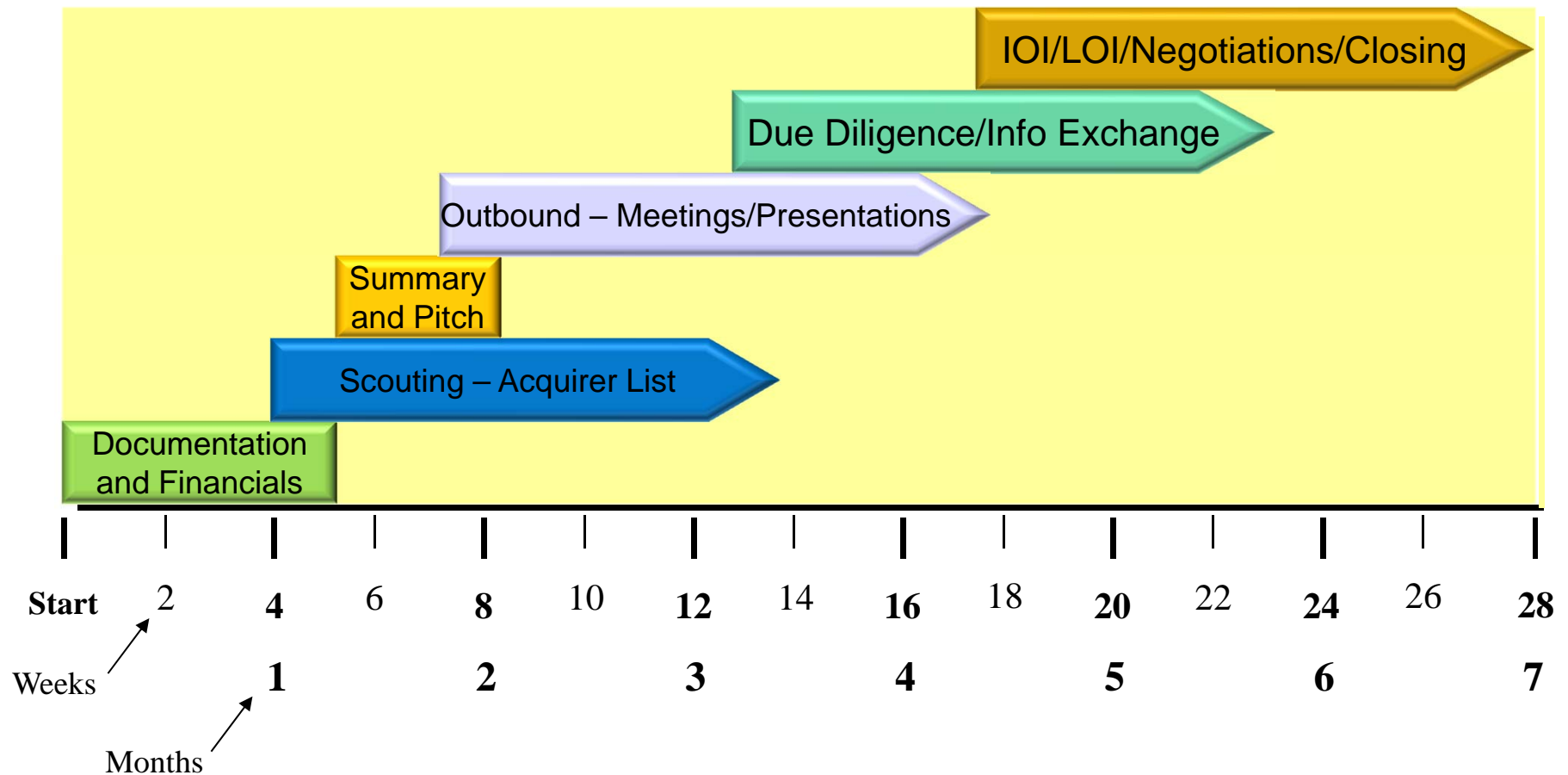
- **Valuation**
  - Business performance and trajectory
  - Market trends and market value drivers
  - Financial markets
- **Infrastructure**
  - Physical assets
  - Operations
  - Sales and marketing
  - Legal issues
- **Management and Ownership**
- **Process takes time**
  - Build business for the sale
  - Understand key requirements





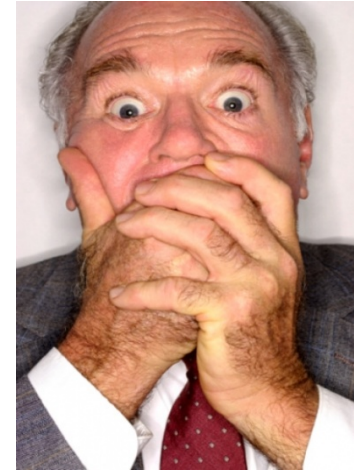
# Sales Process Overview

## Gates and Company Transaction Process Timeline



# Who Needs to Know?

- **Confidentiality is key!**
  - Competitors will spin impact of the transaction
  - “Fringe” customers could use as excuse to switch
  - Partners could get nervous – loss of relationship or key contact(s)
  - Suppliers could change terms
- **Internal**
  - Senior financial resource
  - Other?
- **External**
  - Lawyer
  - Investment Banker
  - Personal Financial Advisor
  - Accountant
  - Other?



# Outline

- M&A Market Dynamics
- Selling Considerations
- **Preparing to Sell**
- Sales Process
- Legal Considerations
- Final Thoughts and Summary

# Documentation Overview

- Offering memorandum
- Financial compilation
- Target acquirers list
- Anonymous executive summary
- The “pitch”
- Non-disclosure agreement
- Form of Indication of Interest
- Form of Letter of Intent
- Due diligence binder (secure data site)



# Financials and Recasting

- Privately held companies' financials are recast to reflect how they would look as a public entity
- Typical add-backs include:
  - Owners' salary in excess of market
  - Management perks in excess of market
  - One-time extraordinary expenses
  - Operational/accounting policies for foreign subsidiaries
  - Other
- Balance sheet
- Anonymous executive summaries show basic P&L

# Outline

- M&A Market Dynamics
- Selling Considerations
- Preparing to Sell
- **The Sales Process**
- Legal Considerations
- Final Thoughts and Summary

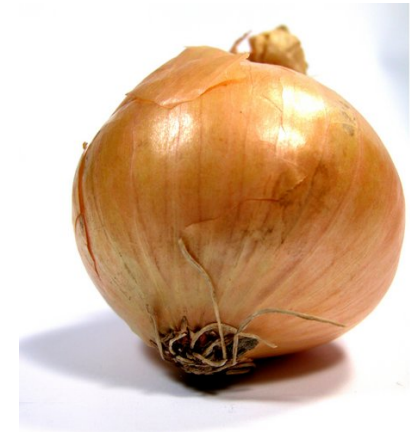
# Scouting

- Various sales methodologies
- Criteria development
  - Strategic and/or Financial
  - Size (revenue, number of employees, etc.)
  - Target market sectors
  - Geographic considerations
  - Product/service offering
  - Seek *fits* and/or *gaps*
- Methods for identification and tracking
  - Proprietary database
  - Internal professionals and contact network
  - Venture capital and private equity firms
  - Trade associations
  - Market research
  - Contact management system for tracking



# Outbound Phase

- Blueprint target
- Anonymous contacting
- Peeling of the onion:
  - Phone pitch
  - Anonymous executive summary
  - Full offering memorandum
  - Meeting/conversations with management
  - Due diligence for IOI and/or LOI
  - Signed LOI triggers detailed due diligence
- “No Shop” periods
- Preemptive offers





# John Doe's Deal Structure

- The business is asset light, steady growth
- Recast EBITDA ~\$18.9 million
- Weighted average valuation largely based on Market Approach (using ~6.6 multiple)
- Resulting valuation of \$125 million
- John's 80% = \$100 million
- Strategic buyer's LOI has:
  - \$75 million cash to John (\$25 million to partners) at Closing
  - \$25 million in Seller Note (to include indemnity holdback)
  - A portion in Equity of Buyer could also be a component of consideration
  - 90 day "No Shop" exclusivity
  - Might cover other components (e.g., management employment, indemnification, non-compete agreements, etc.)



# Due Diligence Checklist

## 1. Business

- a. Business history – brief.
- b. Current business plan and budget.
- c. Copies of any documents (i.e., published studies, articles, etc.) supporting the marketing data and other statements in the business plan.
- d. Copy of any due diligence work done on/by the Company within the past 24 months.

## 2. Market Dynamics, Clients, and Competition

- a. Describe markets served
- b. Clients
  - i. Client reference list – representative list and contact information (names, telephone, and e-mail).
  - ii. List current clients, ranking by last fiscal year's revenue (including a list of top ten customers for each of the last three years by revenue available, indicate expected revenue for suppliers list. volume). Indicate buying units for those companies with multiple buying locations. Also, where current fiscal year for clients; as well as those for which you are on the preferred suppliers list.
  - iii. Describe representative client engagement/contract.
  - iv. Representative set of client contracts.
  - v. Samples of any client satisfaction surveys or reference letters.
  - vi. Describe client situations that are in trouble, if any.
- c. Competition
  - i. Provide list of key competitors and estimated market share.
  - ii. Describe how Company attempts to differentiate itself versus competition.

## 3. Products and Services

- a. Describe current offerings – include complete set of marketing and promotional materials and company newsletters.
- b. Price list with discounts.
- c. Describe price trends – by offering, historical, expected.
- d. Contract with rebates.

## 4. Sales and Marketing

- a. Describe how products and services are marketed and sold.
- b. Provide detail on current sales pipeline.
- c. Describe any formal business alliances (e.g., alliance partner, nature of relationship, purpose, results to date, etc.)
- d. Describe how contracts are bid and managed for each product/service offering.

# Due Diligence Checklist

- a. Sales management:
  - i. Sales organization
  - ii. Territory description
  - iii. Compensation plans
  - iv. Sales cycle
  - v. Pricing policies
  - vi. Forecasting process
  - vii. Method of measuring and tracking key elements of the sales process
  - viii. Sales performance reports for the last 12 months
- b. Describe sales process to 1) gain new clients and 2) build existing relationships; list client assignments by salesperson.
- c. Provide samples of marketing literature.

## 5. People and Organization

- a. Organization structure.
- b. Profiles of key people and their specific duties.
- c. Compensation plan of key employees.
- d. Employee headcount over last three years and general comments about titles, salaries, and service date.
- e. Policies and benefits
- f. For 1099 independent contractors, copy of their contract and corporate ID number.
- g. Describe recruiting and retention system. Describe any unique methods, systems, incentives, etc. to recruit and retain staff and key personnel.
- h. Indicate relevant data for new hires, turnover, etc., for the past two years.

## 6. Financial Information

### Historical

- a. Annual financial data since 1999 (audits, review, or detailed internal statements).
- b. Current year-to-date results (and comparable prior year results).
- c. Monthly and/or quarterly financial statements for past two years and year-to-date (for total Company, each line of products/service, and each location).
- d. Adjustments – identify any expenses that were unusual “one-time” charges in each year and/or would not be incurred following a transaction.

### Projected

- e. Current version of the 2002 financial plan by month or quarter (as detailed as possible) and the 2003 plan (total year) with projected cash flow and balance sheet statements.
- f. Any longer term financial and/or business plan if available.

### General Information

- g. Auditors – name, contact, phone number, and e-mail.
- h. Current management key element reports.
- i. Description of accounting policies in use (revenue recognition, etc.)
- j. Management letters from auditors and replies thereto.

# Due Diligence Checklist

- k. Capital expenditures for the past two years and for current year broken down according to:
  - i. Amount spent on new versus replacement equipment.
  - ii. Amount of capital expenditures by significant item and as a percentage of total expenditures.
  - iii. Depreciation expense.
- l. Charges to operations over the past two years.
- m. Credit terms with suppliers/vendors
- n. Schedule of lease rental expense and estimated increase on any lease renewal.
- o. Description of banking relationships, including name, address, and phone number of major lending institutions, contact at each institution, length of relationship, size of current credit limits, and outstanding balances.
- p. Closing binders from each round of debt/equity financing, including terms and conditions.
- q. List of current shareholders and their ownership and capital structure.
- r. Description of any major liabilities or contingent liabilities that are outstanding.
- s. All documents and agreements evidencing borrowings, whether secured or unsecured, by the Company or its subsidiaries, including loan and credit agreements, promissory notes, and other evidence of indebtedness and all guarantees.

## 7. General Company Information

- a. Articles of Incorporation, by-laws and minutes of all shareholders, board, and board committee meetings.
- b. Shareholder Agreement and all amendments.
- c. Legal structure (C-corp, S-corp, LLC, etc.)
- d. Organizational chart by legal entity, division, and department.
- e. List of all cities and states where Company has offices.
- f. Copies of all existing or contemplated benefit plans, including any retirement and profit sharing plans and/or incentive stock option plans.
- g. Representative samples of all material employment agreements, non-compete contracts, and consulting agreements that are in effect or contemplated.
- h. All joint venture, research and development, marketing and distribution agreements to which the Company is a party.
- i. Description of all litigation in which the Company is involved.
- j. Types and amounts of all insurance policies.
- k. Identify legal advisors.

## 8. Government Regulation

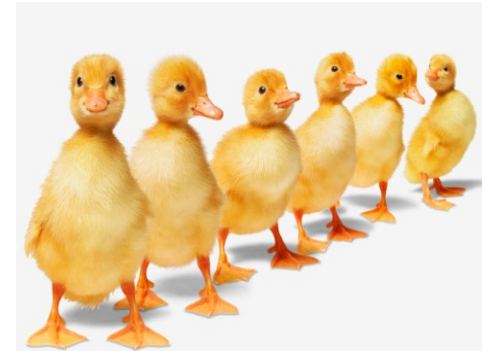
- a. List of all regulatory agencies and major legislation affecting the Company and its business (e.g., Federal, state, and local regulation). Copies of correspondence with these regulatory agencies.
- b. List of any trade or professional associations of which Company is a member.

# Outline

- M&A Market Dynamics
- Selling Considerations
- Preparing to Sell
- The Sales Process
- **Legal Considerations**
- Final Thoughts and Summary

# Operations and Governance

- Employment agreements and compensations plans
- Supplier and customer agreements
- Rental/lease agreements
- IP ownership
- Contract terms and assignment clauses
- Creditor terms and covenants
- Shareholder consents and approval requirements
- Board meetings, committees, and meeting minutes



# Letter of Intent

- Starts with “Non-Binding”
- Form of transaction
- Purchase price
- Definitive agreement
- Access to company
- Representations and warranties
- Exclusivity (a.k.a. “No-Shop”)
- Conditions to closing
- Confidentiality
- Disclosure



# Deal Structures

- Asset sale
  - Buyer preference: limits liability, favorable asset treatment
  - Seller will pay more in taxes and retains contingent liabilities
- Stock sale
  - Seller preference: transfers liability, capital gains
  - Buyer takes assets and liability, no favorable asset treatment
- Merger
  - Board approval, buyer takes liabilities, can involve stock swap
- Other
  - *“People can be creative!”*



# Definitive Purchase Agreement

- Purchase and sale of ...
- Purchase price
  - Cash
  - Note
  - Stock
  - Earn-out
- Representations and Warranties
- Covenants (negative and affirmative)
- Conditions to Closing
- Indemnification
- General Provisions



# Indemnification

- Settling post-closing issues and breaches
- Responsible party/parties
- Escrow and Holdbacks
  - May be tied to seller note
- Limitations (the “cap”)
- Claims (basket or deductible)
- Survival period



# Outline

- M&A Market Dynamics
- Selling Considerations
- Preparing to Sell
- The Sales Process
- Legal Considerations
- **Final Thoughts and Summary**

# M&A Drivers

- Financial buyers:
  - Buy, build or bolt, and flip
  - Pricing: ROI and EBITDA
  - Concerns: financial return and deal structure
  - Provide vehicle for secondary transaction
- Strategic buyers:
  - Fill product/service gaps, achieve vertical integration, diversify
  - Consolidation or buildup
  - Pricing: “accretive” and provide additional value through synergy
  - Concerns: integration, strategic fit, and culture – but may not want you!
- Sellers:
  - Achieve liquidity
  - Access additional growth resources
  - Sell into consolidation
  - Concerns: pricing, liquidity, and lifestyle

# Transaction Success Factors

- Understand valuation approach and set reasonable expectations
- Multi-year history with minimal fluctuations
- Utilize performance metrics as appropriate
- Sales management and opportunity tracking
- Sellers' market or at least neutral
- Business performance tracking to projections during process
- At least two interested buyers
- Prepared for due diligence phase and responsive to information requests (especially financial)
- Expedient/successful execution
  - Negotiation, due diligence, and closing



# Final Considerations

- Don't stop strategic growth planning
- Financial remuneration for key employees?
- Use pipeline approach – evergreen list of potential acquirers
- Work each opportunity like it is the only one
- Understand buyers' motives
- Don't snub a low offer – it can help the process
- Stock *versus* Asset sale considerations – ask accountant!
- Detailed letter of intent reduces legal wrangling
- Develop negotiating strategy early in process
- Clear ownership of Intellectual Property
- Clean capitalization table
- Consider *Reviewed* or *Audited* financials

# Summary

- Be prepared!
- Key your eye on the ball
  - Continue strategic planning and implementing growth initiatives
  - Utilize business performance metrics and manage financial performance closely
- Monitor market and transaction activity
- Be reasonable about valuation expectation
- Make it easy to thoroughly document your business
- Build support team early
- Be prepared!



# Contacts

## **Jason Adams**

Associate, *Investment Banking*

(302) 428-1338 x10

JAdams@GatesAndCompany.com

## **David Gates**

Managing Director

(302) 428-1338 x16

DGates@ GatesAndCompany.com

## **Kelly Gates**

Principal

(302) 428-1338 x15

KGates@ GatesAndCompany.com

## **Debbie Hobbs**

Associate, *Consulting Services*

(302) 428-1338 x10

DHobbs@ GatesAndCompany.com

The advertisement features a large white chess knight on the left, with a ladder leaning against it. Several business professionals in suits are standing around the base of the knight and other chess pieces, including a king and a pawn. The background is a dark purple gradient. The text 'What's Your Attack Strategy?' is written in a serif font at the top. At the bottom, the Gates and Company logo is displayed on a yellow background, consisting of a white chess knight head and the text 'GATES AND COMPANY'.

[www.gatesandcompany.com](http://www.gatesandcompany.com)

Management Consulting and Investment Banking ~ Helping Companies Grow

