



# **Defining Your Growth Agenda**

*How to Position for a Value-Maximizing Exit*

June 21, 2017

# Outline

- **Business Owner Considerations**
- Evolving Value Drivers and “Strategic Assets”
- Positioning to Maximize Corporate Value
- M&A Sales Process Overview
  - Legal Considerations
- Success Factors and Summary

# When is the Right Time to Sell?

- **Valuation Influencers**
  - Business performance and trajectory
  - Market trends and market value drivers
  - Financial markets
- **Products and Infrastructure**
  - Product and/or service relevance
  - Physical asset condition
  - Operations and processes
  - Sales and marketing
  - Governance and legal issues
- **Ownership and Management Considerations**



**The process takes time, allowing operations to be fine-tuned**

# U.S. M&A Activity

## Public and Private – May 2017

	Strategic	Financial	Total/Avg.
Volume	\$47B	\$55B	\$102B
Number of Deals	656	160	816
Average Value	\$194M	\$1.28B	\$357M
Average Multiple	10.9x	14.5x	12.7x

Source: Paul / Weiss

# Who Needs to Know?

- **Confidentiality is key!**
  - Competitors will spin impact of the transaction
  - “Difficult” customers could use as excuse to switch
  - Partners could get nervous, may strain relationship
  - Suppliers could change terms
- **Internal**
  - Senior financial resource
  - Other?
- **External**
  - Lawyer
  - Investment Banker
  - Personal Financial Advisor
  - Accountant / Auditor
  - Other?



# Outline

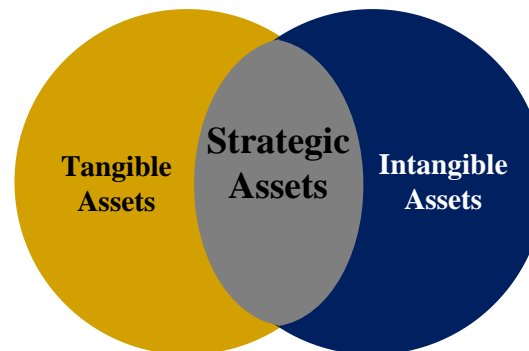
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# Strategic Assets

- Accounting of high profile transactions point to increasing purchase price allocated to goodwill due to **strong strategic asset value**

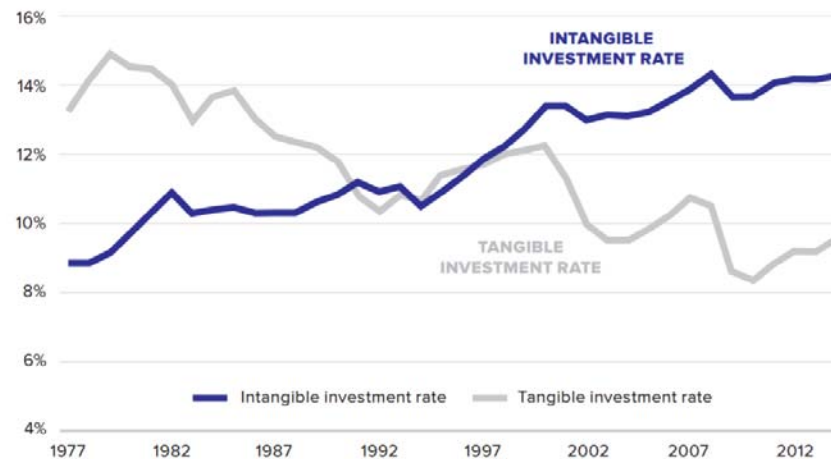


- Strategic assets ...
  - Create recurring benefits
  - Are unique to a company
  - And difficult to imitate



# Evolving Value Drivers

- Corporations have steadily increased intangible asset investment, while decreasing investment in tangible assets
- The investment cross-over occurred in the mid-1990s



From: Lev and Gu, "The End of Accounting and the Path Forward for Investors and Managers," 2016.

- Investments in strategic assets can provide a better ROI than efforts focused solely on earnings growth!

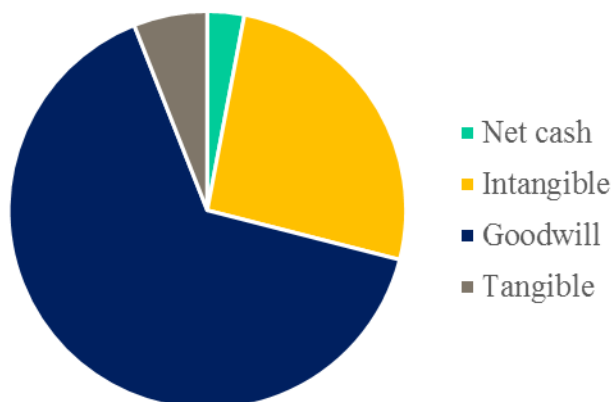


# Tech Segment Example

Over 500 M&A deals between 2010 and 2016 in “Tech” were analyzed to uncover strategic asset value and goodwill drivers



Purchase Price = Cash + Intangible Assets + Goodwill + Tangible Assets - Liabilities



- Sector analysis helps determine drivers that influence “above-market” value
- For Tech sector, such drivers included strengths in **social media, web advertising, and data analytics**
- Additionally, an active user/subscriber base was a driver in over 60% of acquisitions

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# Understanding 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:

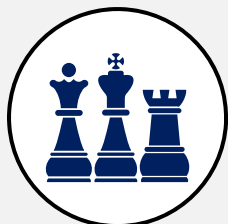
- Fill product/service gaps, achieve vertical integration, diversify
- Consolidation or buildup
- Pricing: “accretive” and provide additional value through synergy
- Concerns: integration, strategic fit, and culture – but may not want you!



## Sellers:

- Achieve liquidity
- Access additional growth resources
- Sell into consolidation
- Concerns: pricing, liquidity, and lifestyle

# Strategic Asset Concepts



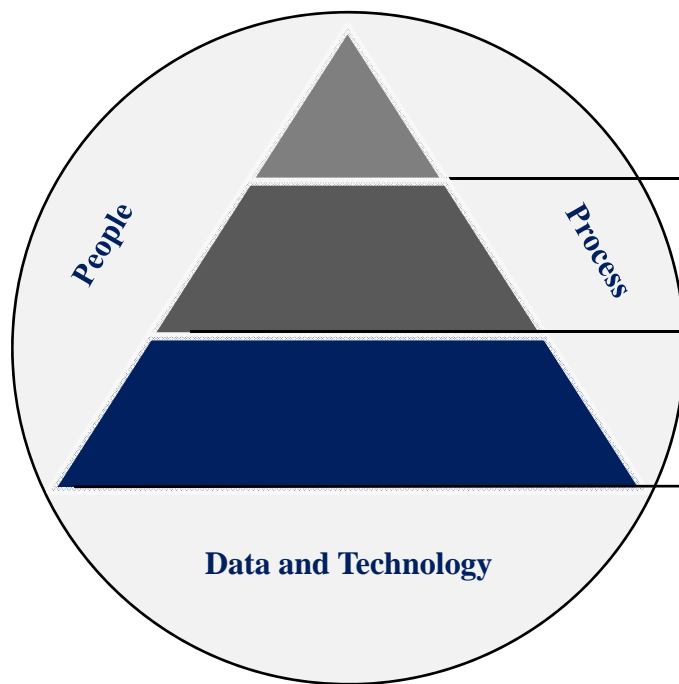
Address challenging strategic issues from innovation approaches to product designs, from technology assessments to portfolio management.

## Strategic Asset Development



Align the strategy and the most qualified leaders, project managers, and analysts to implement plans by turning vision into execution.

## Monetization and Valuation



### Phase 3: Strategic asset monetization

- Financial analysis and valuation – recasting historic results and developing *pro forma*
- Preparing and implementing a business sale in direction most desired by potential buyers

### Phase 2: Predictable and transparent processes

- Process maps, process improvement initiatives, and metrics
- Implementation of intellectual property initiatives and proprietary process refinement

### Phase 1: Planning and strategic asset development

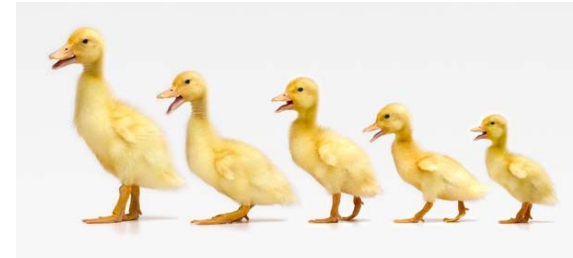
- Goal setting, corporate and market assessment, competitive analysis, gap analysis, etc.
- Strategic Plan – prioritized objectives to support growth and strategic asset enrichment
- Tactical Plan –roadmap of activities, resources, and timing leading up to a sale process

# Financials and Recasting

- Privately held companies' financials are recast to accurately represent cash generation
- 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 issues
- Clean "cap table"

# Operations and Governance

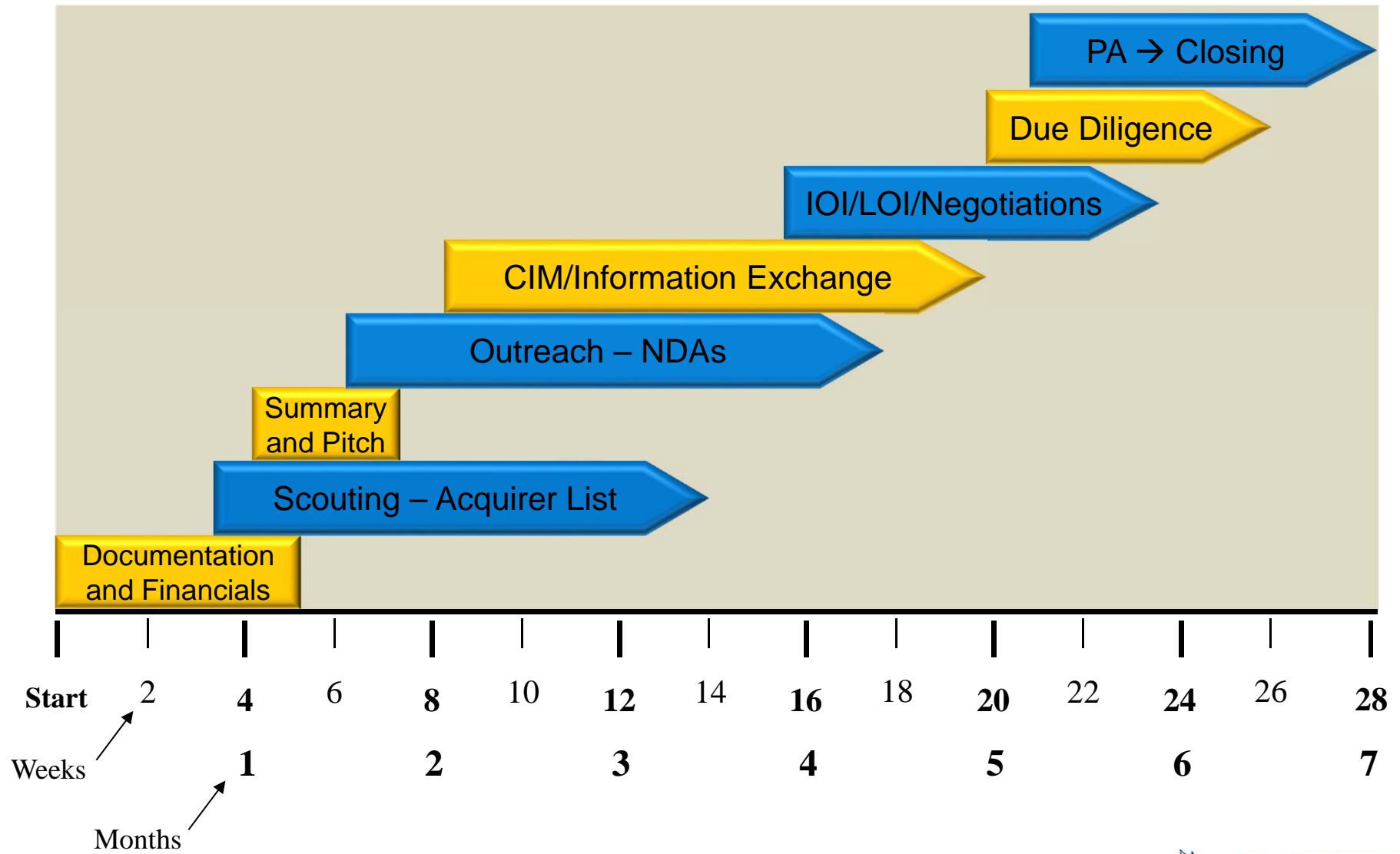
- Supplier and customer agreements
- Rental/lease agreements
- IP ownership
- Process mapping and optimization
- Contract terms and assignment clauses
- Employment agreements and compensations plans
- Creditor terms and covenants
- Shareholder consents and approval requirements
- Board meetings, committees,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



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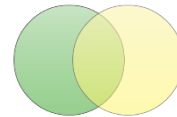
# Sales Process Example





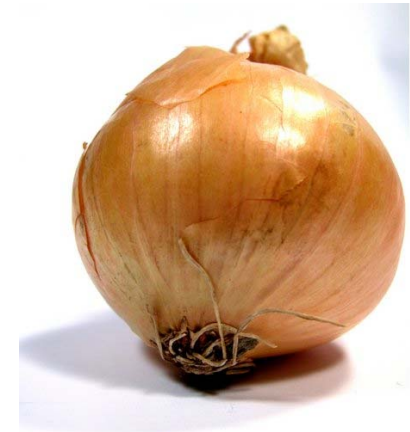
# Scouting

- 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



# Outbound Phase

- Blueprint target buyers
- Anonymous contacting
- Peeling of the onion:
  - Phone pitch
  - Anonymous executive summary
  - NDA → Information memorandum
  - Meeting/conversations with management
  - Due diligence for IOI and/or LOI
  - Signed LOI triggers **detailed** due diligence
- “No Shop” periods
- Preemptive offer concept



# Letter of Intent

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



# 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



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# Transaction Success Factors

- Understand valuation approaches and set reasonable expectations
- Understand buyers' desires and motives
- Utilize performance metrics wherever possible
- Sales management and opportunity tracking
- Prepared for due diligence phase and responsive to requests
- Continue planning and implementing growth initiatives
- Detailed letter of intent reduces legal wrangling
- Fact: valuation and deal structure are equally important!
- Clear ownership of Intellectual Property
- Consider *Reviewed* or *Audited* financials



# Summary

- Be prepared!
- Key your eye on the ball
- Monitor market dynamics and trajectory
- Work proactively on expanding the corporation's set of strategic assets
- Lock down on processes, IP, and governance
- Build quality support team early
- Be prepared!





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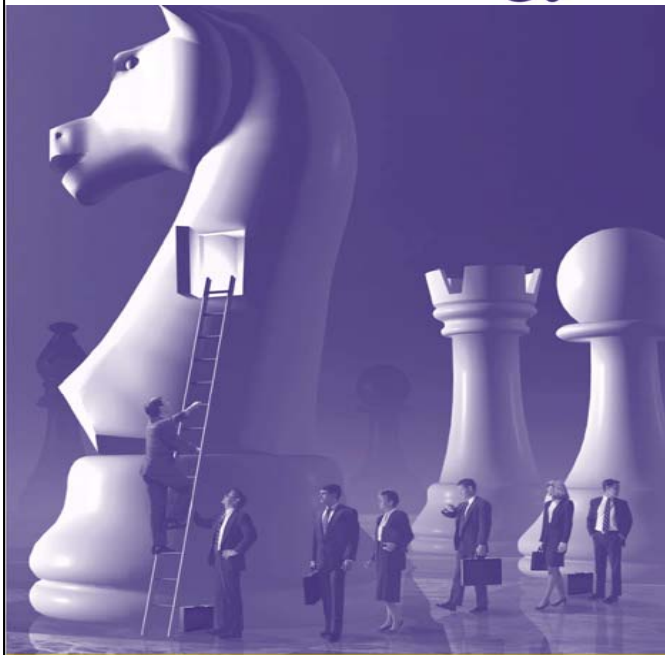
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What's Your  
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Joe Burke, Partner  
June 21, 2017





# DUE DILIGENCE

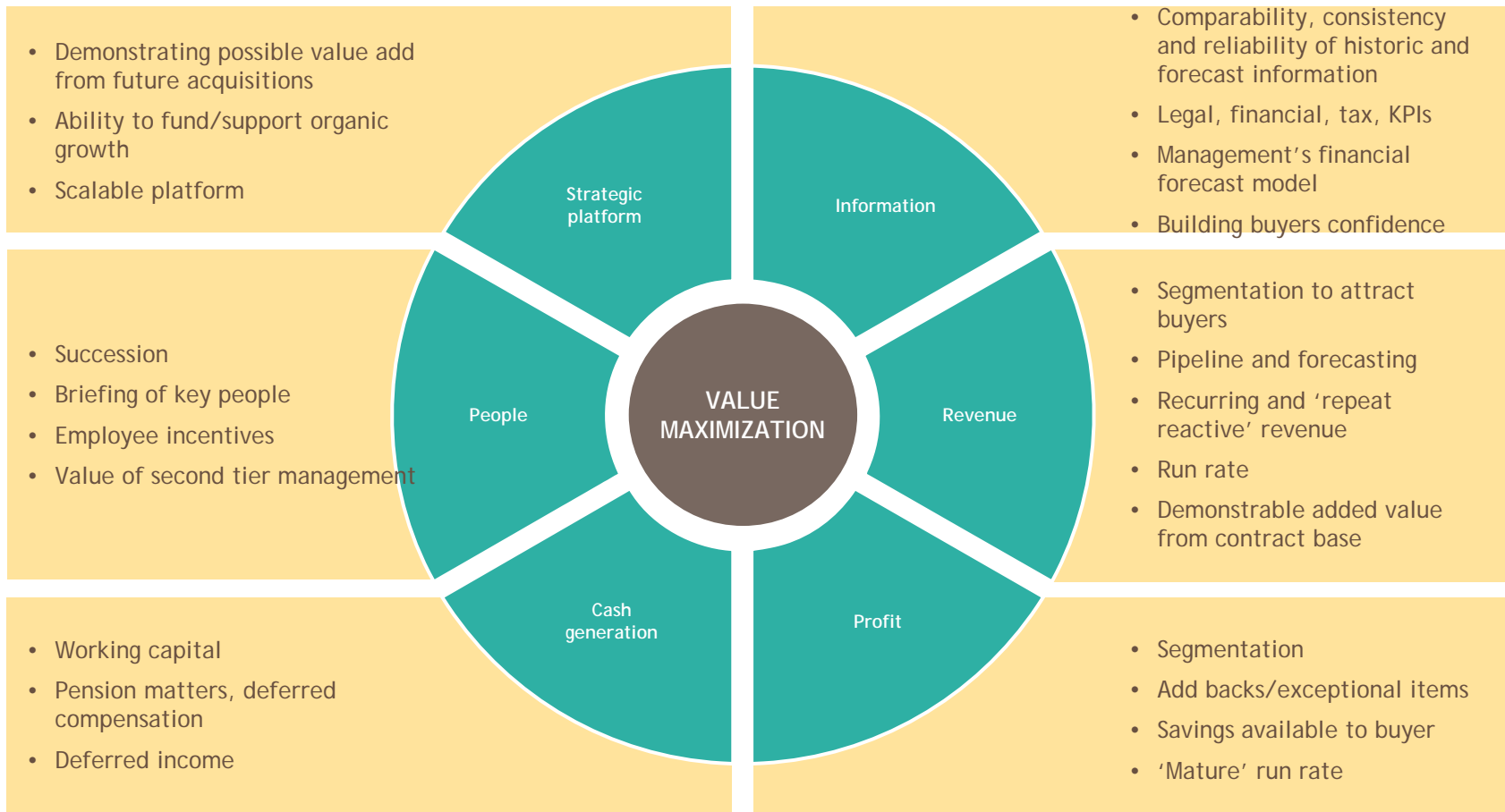
- Sell-Side Readiness
- Anticipating Potential Buyer Needs
- Due Diligence Topics
- Difference Between an Audit and Diligence
- Financial Controls: Systems, People, Processes
- What Sellers Do Wrong
- Summary



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# SELL-SIDE READINESS VALUE MAXIMIZATION





# SELL-SIDE READINESS DUE DILIGENCE

- The Role and Purpose of Due Diligence:
  - Confirm the investment hypothesis
  - Identify risks and opportunities
  - Integration planning



# SELL-SIDE READINESS SPEED IS A COMPETITIVE ADVANTAGE

- Not haste - race ready
- Preparation and the ability to quickly deploy resources with real depth
  - Internal M&A SWAT team
  - Integrated external support
  - Following a pre-defined M&A process
- Exclusive arrangements and auction environments
- Shorter transaction timelines = Lower transaction costs



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# ANTICIPATING POTENTIAL BUYER NEEDS

## Strategic Buyers

- ✓ Access to customer/geography
- ✓ Products and capabilities
- ✓ Performance Qualifications to improve win rate on key proposals
- ✓ Reduce overhead for more competitive pricing
- ✓ Access to talent, technology

## Financial Buyers

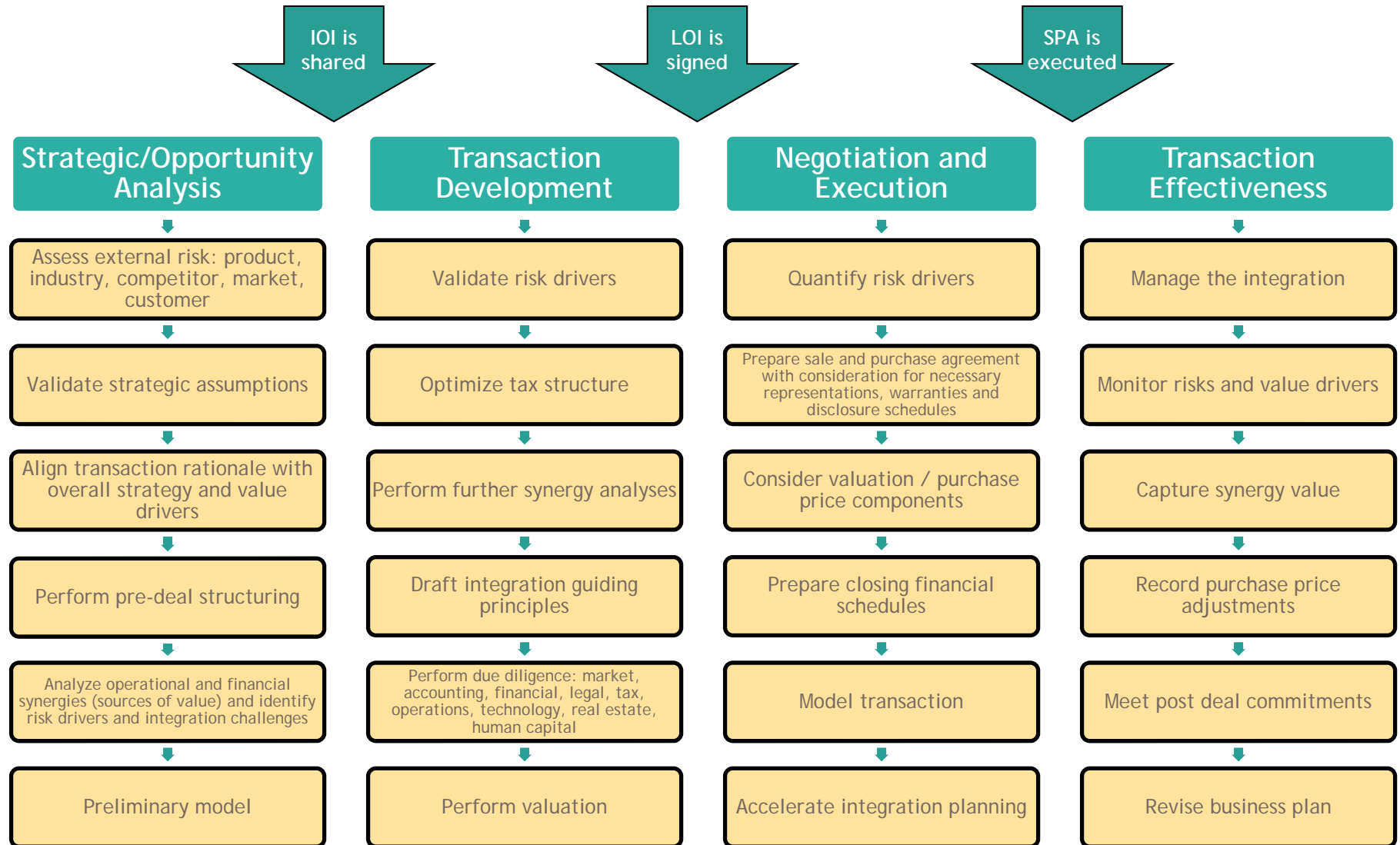
- ✓ Predictable cash flows
- ✓ Low credit risk
- ✓ Ability to roll up and scale
- ✓ Availability of talent!!



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- Preparing the Dataroom
- Tax Impact
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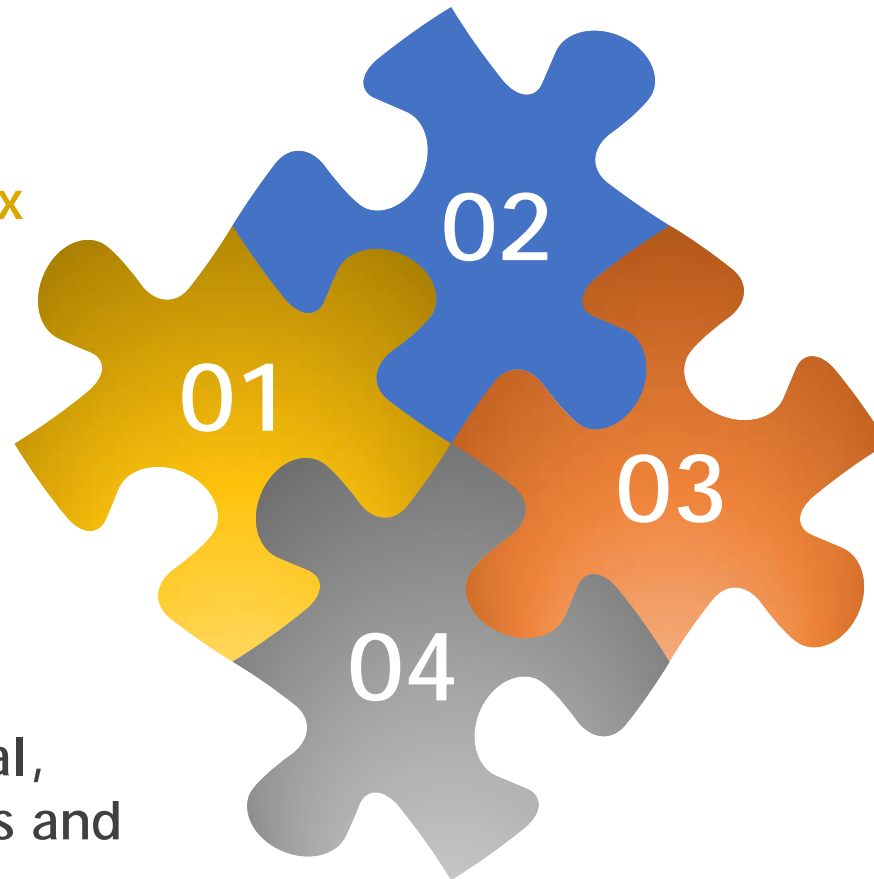
# TRANSACTION LIFECYCLE



# DUE DILIGENCE TOPICS

01 - Tax due diligence and tax structuring

02 - Information technology due diligence



04 - Legal, environmental, human resources and insurance

03 - Operational due diligence and synergy identification



# FINANCIAL DUE DILIGENCE

## Key Areas

### Quality of Earnings

- ✓ Attempt to get to a normalized or run-rate EBITDA or earnings stream
- ✓ Generally four categories
  - Corrections of errors and timing issues
  - Noncash transactions
  - Nonrecurring transactions
  - Pro forma adjustments for historical or expected future transactions

### Debt, debt-like, commitments and contingencies

- ✓ Identify liabilities that should be considered as debt, as these should be a reduction in purchase price if assumed by the Buyer.
- ✓ Contingent liabilities/off-balance sheet financing and commitments

### Quality of Net Assets & Working Capital

- ✓ Measure true value of assets being acquired/implications on purchase price adjustment, typically:
  - Accounts receivable and inventories
  - Reserves
  - Deferred costs
  - Industry-specific accounting issues

**Learnings from financial due diligence incorporated in (i) transaction model, (ii) purchase agreement, and (iii) integration plan**

# SELL SIDE DUE DILIGENCE

## THE ANALYSIS OF A BUSINESS COMMISSIONED BY THE SELLER

- ▶ Pre sale due diligence is objective and balanced
- ▶ The work is commissioned by the seller as part of the divestiture process
- ▶ Covering critical business aspects
- ▶ The work is designed to satisfy purchasers' need for information and objective assessment (due diligence), and is carried out from a purchasers' perspective
- ▶ The report is cleared with management for factual accuracy
- ▶ The seller is advised of findings and issues before inviting offers
- ▶ Prospective purchasers are issued with identical information
- ▶ Enables purchasers to make informed bids and to create a level playing field for multiple bidders.



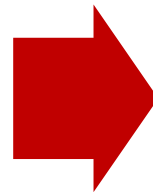
## SELLER RETAINS CONTROL OF THE DIVESTITURE PROCESS

Seller has oversight of the due diligence process and access to all outputs



## REDUCES DISRUPTION

The divestiture process is simplified and accelerated



## REDUCES RISK OF VALUE EROSION

Early identification and mitigation of issues will instill Buyer confidence



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# DIFFERENCES BETWEEN AN AUDIT AND DUE DILIGENCE

## Audit

- ✓ Performed in accordance with the numerous standards (e.g., Generally Accepted Auditing Standards, PCAOB, COSO, GAAP, etc.)
- ✓ Give an opinion on the financial statements
- ✓ Includes testing of underlying transactions (invoices, bank reconciliations, contracts)
- ✓ Includes use of model audit programs and checklists
- ✓ Financial statements must be presented within strict guidelines
- ✓ Primarily balance sheet focus
- ✓ Primarily historical focus

## Due Diligence

- ✓ Performed under the AICPA Consulting standards, act in an advisory capacity providing issues-based findings, observations, and recommendations
- ✓ Do not provide assurance or opinion
- ✓ Limited testing: mostly rely on management assertions
- ✓ No templates, programs, or checklists used
- ✓ Deliverables are tailored to the needs of the particular transaction
- ✓ No materiality threshold
- ✓ P&L focused
- ✓ Historical focus always with the thinking of how it will affect the future





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# FINANCIAL CONTROLS SYSTEMS, PEOPLE, PROCESSES

- ✓ Reconcile, Reconcile, Reconcile
  
- ✓ Accounting environment
  - ✓ Systems
  - ✓ People
  - ✓ Processes/Controls
  - ✓ Audited?
  
- ✓ Subledger detail
  
- ✓ Non-financial metrics
  
- ✓ Audit type procedures
  - ✓ Cash Proof
  - ✓ Payroll Reconciliation
  - ✓ Vouching



# FINANCIAL CONTROLS SYSTEMS, PEOPLE, PROCESSES

- Upgrade your financial reporting-compilation, review, audit
- Eliminate 'non business' expenses, i.e., personal expenses, boat, plane, trips etc.
- Accurately report inventory in advance of a transition
- Develop internal management reporting systems like performance score cards
- Respond to data requests in a timely fashion
- Be sure your CPA understands business transitions & transition tax issues.
- Does your CPA have credibility with financial institutions?



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# WHAT SELLERS DO WRONG

- Changes to financial results previously reported in a teaser or Offer Memorandum
- Customer/LOB profitability analysis
- Bridge historical performance to forecast
- Prepare stub period financials
- Demonstrate ability to prepare financial reporting required for an SEC filer
- Clear accounting policies and practices that can be compared to potential buyer's
- Identification and quantification of EBITDA adjustments
- Ability to quickly update financial data for later periods as diligence progresses
- Considerations for working capital peg
- Considerations for integration
- Lock up key people



## WHY TRANSACTIONS DO NOT CLOSE

- Top Pitfalls
  - Missing Forecast
  - Lost Customers/Contracts
- Seller Remorse
  - Mismatch with Buyer
  - Not prepared
- Fatigue
  - Time Kills Deals



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# THANK YOU

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