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Table of Experts

Mergers & Acquisitions

What sellers, buyers should look for as M&A market hits its peak

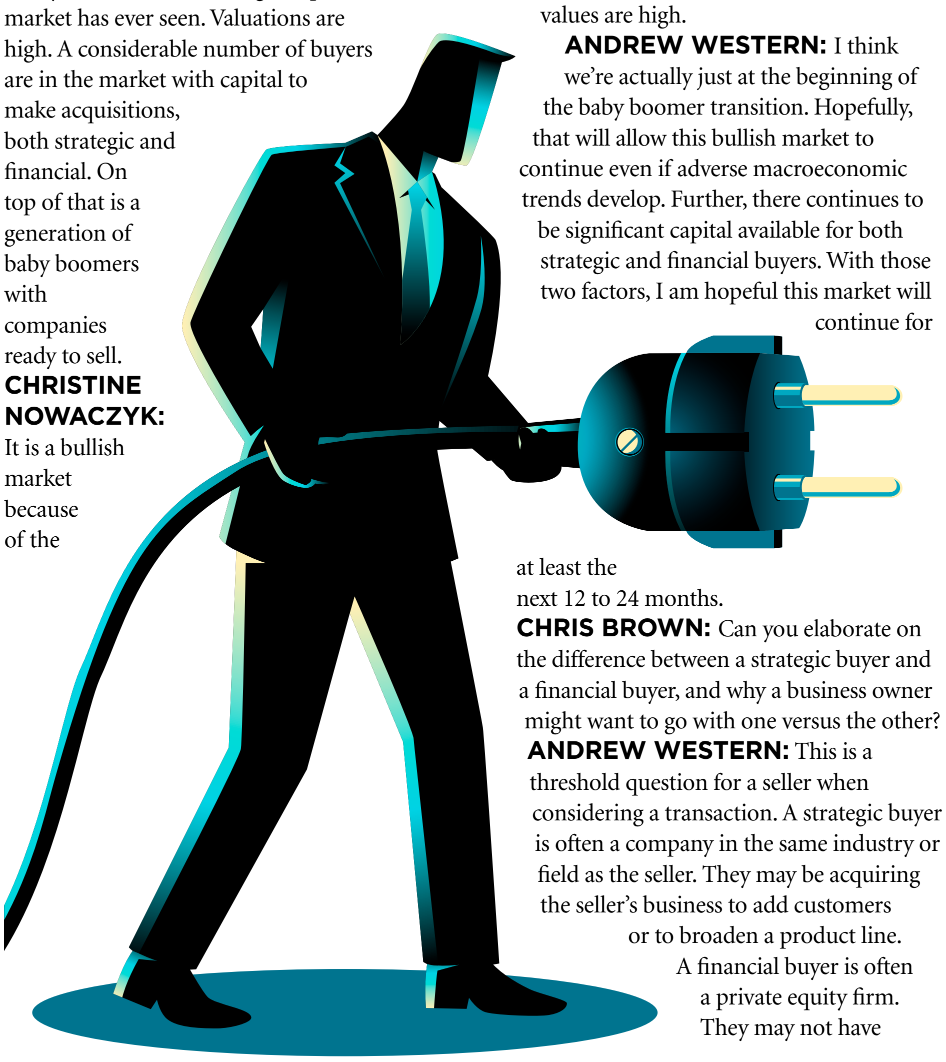
Table of Experts Panel (L-R): *Mark Young, Andrew Western, Christine Nowaczyk, Chris Brown*

CHRIS BROWN: Let's start out with telling us what the current state of the mergers and acquisition market is.

MARK YOUNG: What we're seeing is a continuation of a really strong market that has been ongoing now for the past three or four years. 2018 was the highest point the market has ever seen. Valuations are high. A considerable number of buyers are in the market with capital to make acquisitions, both strategic and financial. On top of that is a generation of baby boomers with companies ready to sell.

CHRISTINE NOWACZYK: It is a bullish market because of the ample capital that is available, combined with a good economy and a low interest rate environment. There is a strong sense of urgency to get deals done now while the market remains so positive. I'm glad Mark mentioned baby boomers in his remarks. For those owners, it's a great time to get top dollar for your asset while values are high.

ANDREW WESTERN: I think we're actually just at the beginning of the baby boomer transition. Hopefully, that will allow this bullish market to continue even if adverse macroeconomic trends develop. Further, there continues to be significant capital available for both strategic and financial buyers. With those two factors, I am hopeful this market will continue for at least the next 12 to 24 months.



CHRIS BROWN: Can you elaborate on the difference between a strategic buyer and a financial buyer, and why a business owner might want to go with one versus the other?

ANDREW WESTERN: This is a threshold question for a seller when considering a transaction. A strategic buyer is often a company in the same industry or field as the seller. They may be acquiring the seller's business to add customers or to broaden a product line. A financial buyer is often a private equity firm. They may not have any specific industry experience, but they are likely acquiring the seller's business due to its operational and financial strength. A financial buyer is often injecting growth capital in order to rapidly expand and grow the seller's business.

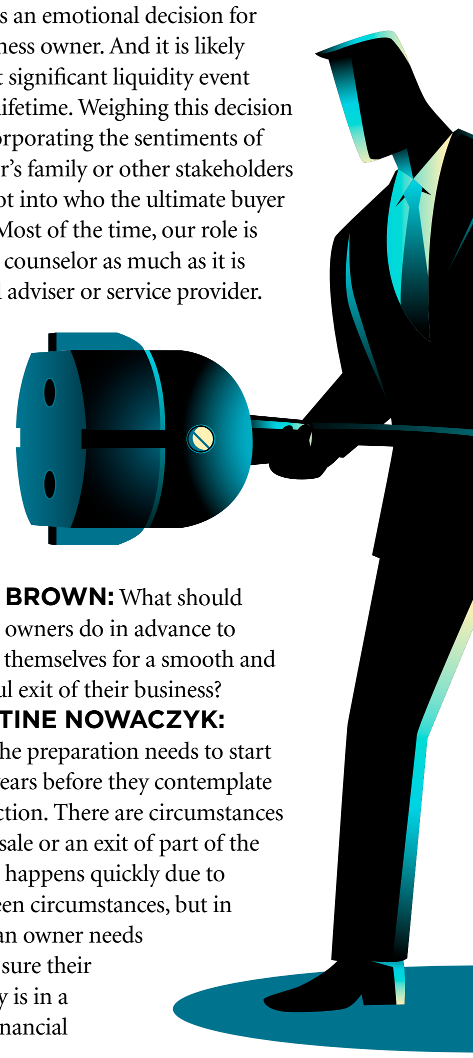
When a seller is thinking about those two types of buyers, he or she wants to think about what is their goal. Do you want to exit completely from operations and get your one-time liquidity event? Or do you want some liquidity now but still run and grow your business for the next five to seven years? That's the real difference. A strategic buyer often only has a limited post-closing role for the seller (if any). With a financial buyer, a seller will likely retain a significant portion of their enterprise value. Anywhere from 10% to 50%. A financial buyer is going to expect the seller to continue to run the company for the next 3 to 7 years until there is a secondary exit.

CHRIS BROWN: When you're running a deal process and you're helping a seller sell their company, how might you help them evaluate those buyers and those potential people to exit to?

MARK YOUNG: Just like a buyer does due diligence on our client's company, we do due diligence on those buyers. We look at what the reputation history has been. Do they just do a lot of looking or do they actually close deals? How have they treated other sellers in the past? One criteria that we use is, are they a funded buyer versus unfunded. So, do they have their own capital or if they look at a deal, do they have to go find capital to do a deal? And that's a big decision point with our clients because if the buyer does not have their own capital that means the deal has to be sold twice, once to the buyer and once then to their financing sources.

We really dig in and also look at what type of culture mash is going to be and if they're going to ask our sellers to stay on what's their role going to be. We have a matrix of about 10 or 15 criteria that we use to look at the different buyers and try to help our clients decide which one they'd like to go down the path with.

CHRISTINE NOWACZYK: Advisers need to understand that positioning a company for sale is an emotional decision for the business owner. And it is likely the most significant liquidity event of their lifetime. Weighing this decision and incorporating the sentiments of an owner's family or other stakeholders plays a lot into who the ultimate buyer will be. Most of the time, our role is that of a counselor as much as it is financial adviser or service provider.



CHRIS BROWN: What should business owners do in advance to position themselves for a smooth and successful exit of their business?

CHRISTINE NOWACZYK: Ideally, the preparation needs to start several years before they contemplate a transaction. There are circumstances where a sale or an exit of part of the business happens quickly due to unforeseen circumstances, but in general an owner needs to make sure their company is in a strong financial

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position well in advance of the exit. This ensures that valuation expectations are met and it improves certainty to close. An owner should spend time mitigating business risks that can be addressed such as reviewing the documentation on key contracts, protecting proprietary assets, upgrading financial reporting and testing IT systems. They should look for ways to eliminate unnecessary costs and increase cash flow to maximize value from the perspective of a buyer.

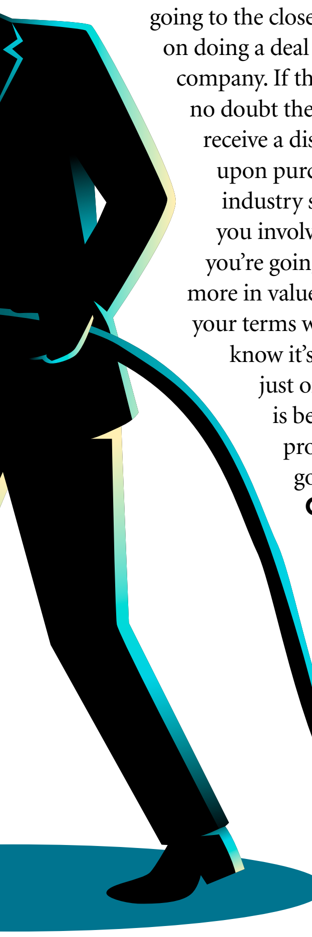
CHRIS BROWN: On the flip side, for business owners thinking of acquiring another business or adding on a smaller group as a bolt-on, what might they be doing to prepare for an acquisition over the next 12, 24, 36 months?

ANDREW WESTERN: As a buyer, you want to first develop an acquisition strategy based on the metrics and values that are important to you and that are going to add value to your existing business or your existing platform. Second, you want to make sure you have the right advisers: legal counsel, financial adviser, an accountant, and others as appropriate. You're going to need that team in-place in order to analyze the potential target companies you're looking at and help you conduct your due diligence. Having the right team in place, and having a solid relationship with them, is key to having a successful acquisition.

CHRIS BROWN: What are some of those roles that those advisers might take, and what's a risk a business owner might take if they try to go it alone and don't get those right folks involved?

MARK YOUNG: We always have the conversation with a business owner . . . Why would they want to take on a transaction that's very complex, and when they're going to be paired up against, most likely, a very experienced buyer when they've never done a deal like this before? We see it time and again that business owners decide to go it alone. Some of our best clients are ones that had failed sales and then come to us to help.

It's a grueling process to get to a close. The last thing a business owner should want to see happen is their business tail off as they're going to the close because they focused on doing a deal and not running the company. If that does happen, there's no doubt the buyers will want to receive a discount on the agreed upon purchase price. There are industry statistics that show if you involve the right professionals you're going to receive 20% to 25% more in value, and not only value, but your terms will be better and you'll know it's a market deal. If there's just one buyer for whatever is being sold, the buyer is probably going to get a good deal.



CHRISTINE NOWACZYK: Many owners are the key players leading their company's operations, and when they get side tracked pursuing a deal, often times the business is

negatively impacted, which can lower the value. It is not uncommon for the sale of a company to be confidential, during which time the owner can't confide in their colleagues. An outside adviser serves as a sounding board in addition to delivering higher valuations through their industry experience and dedicated focus to the transaction.

ANDREW WESTERN: Understandably, a seller typically doesn't realize how much work goes into a transaction because they've never done a transaction like this before. As a trusted adviser, one of my first goals is to help a seller understand that in addition to his or her full-time job of running their company, we're going to add a second full-time job, and that's getting this transaction closed.

CHRIS BROWN: Keeping along those lines, can each of you tell me a little bit about what your specific role is in an M&A transaction and where you are helping bring value to your client?

MARK YOUNG: We play the quarterback for the transaction, and we get involved early. We go through the company's financials and operations, and try to understand the business, try to understand where there are weaknesses. We try to mitigate as many of those risks as possible before we go to market. We prepare the marketing material and then we go to a select group of buyers, investors, that have expressed an interest in that type and/or size of company. Then we hold what we call a controlled auction process. We share some information, we try to develop interest. Elicit their initial offers, and then weed those down to best offers and bring them in for the management meetings, so our clients can meet those buyers, get to know them, see where the best fit might be and then take the best offer forward to consummate a deal.

CHRISTINE NOWACZYK: The role of a commercial bank has evolved as it pertains to M&A transactions. Due to high levels of liquidity in the market, our leverage limitations imposed by regulators, and the availability of more flexible capital sources, we may or may not be involved in financing the deal. However, we play an important role in supporting the operations of the company through working capital and capital expenditure financing. We are always involved in the day-to-day cash management for companies, which includes transactions for collecting and disbursing funds. We manage short- and long-term

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CHRIS BROWN
VP of Business Development
Montage Partners

Chris sources and screens new investments, builds and maintains intermediary relationships, and connects with owners and management of lower middle-market companies.

Chris was previously a manager in the assurance practice at PricewaterhouseCoopers, and holds a bachelor's degree in accounting, cum laude, from Azusa Pacific University.

"You talked about that right now we're in a seller's market, and so it's a good time for sellers to get both strong valuations and great terms."

CHRISTINE NOWACZYK | SVP & Corporate Banking Executive | **BOK Financial**

Christine serves on the BOK Financial executive team in Arizona where she leads the corporate banking line of business and has also been appointed to the company's Tulsa-based Executive Diversity and Inclusion Council. She joined BOK Financial in 2006, after nearly two decades with JPMorgan Chase, to help build its Arizona subsidiary.

Christine is a leader within the Association for Corporate Growth. She serves on its Chicago-based ACG Global Board of Directors, responsible for shaping the organization's 59 chapters supporting more than 100,000 investors, executives, and advisers to growing companies.

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liquidity. Banks can play an active role in corporate trust solutions for M&A, which includes escrow agent and bond services. We're also a resource for individual wealth advice for the seller around tax, investment and risk mitigation strategies.

ANDREW WESTERN: A big misconception about an M&A attorney is that you don't need us until you're actually negotiating a purchase agreement. A significant portion of the value we add to a transaction occurs long before a purchase agreement is drafted. In my experience, the transactions where clients have the most success, are the ones where I have been involved for several months (or perhaps even years) prior to a closing.

A good M&A attorney can add a lot of value in helping a seller get organized and prepared for due diligence from a potential buyer. Further, once a seller starts reviewing or negotiating letters of intent with potential buyers, there is a lot of value that can be missed if a seller is not trying to negotiate terms upfront. My experience is that a seller has the most leverage when he or she is negotiating that letter of intent. So, why not try to get some big-ticket items hammered out early?

After the letter of intent is finalized, we start moving into negotiating the definitive documents, making sure terms that were agreed upon in the letter of intent are there, and getting the transaction closed successfully. Finally, hopefully, post-closing there's very little or no need for us. But to the extent post-closing issues arise, we advise our clients through that process and help them resolve issues then.

CHRIS BROWN: Every deal is obviously different, but what might a normal or traditional timeline look like from the time they sit down in your chair to when the wires go out and ownership of the company is transferred?

MARK YOUNG: We tell our clients upfront it will typically be an eight- to 12-month process. Some of them are dictated by when financial statements are ready. Everyone wants to do it quicker if we can, but that timeframe is pretty typical.

CHRIS BROWN: What if we see an economic slowdown in the next 24 months, how might you expect that to impact deal valuations and deal terms?

ANDREW WESTERN: Right now we're seeing seller-friendly deal terms. I think you likely will see those shift to be more buyer-friendly if there is a slowdown. However, for the reasons we've already discussed, I think there will still be a lot of M&A activity. Keep in mind that if a slowdown adversely affects returns in traditional investments, like the stock market, folks are going to look to other places to find returns. Private equity (financial buyers) has been a place where those returns can be delivered.

CHRISTINE NOWACZYK: I would add that uncertainty around current issues, such as trade tariffs, policy changes and supply chain challenges, will continue to weigh on individual deal situations. However, we still have a lot of business owners who don't want to miss the opportunity to exit now, as they did before the last downturn. There is pent-up anxiety about making sure they get a deal done, even if the value comes down in the next 24 months. If it's a gradual economic slowdown, multiples are not going to drop significantly enough to prevent a transaction from occurring.

CHRIS BROWN: When we think about the services that you provide as a corporate banker, how would a downturn affect how you look at providing those types of things to a company, maybe the terms they could get or what they're able to access?

CHRISTINE NOWACZYK: We always look to partner with strong teams and identify whether or not they have been through a downturn before and how they fared. We evaluate the strength of the balance sheet and its ability to support the business on a prolonged basis should operations be depressed for a while in a downturn. Lenders are likely to require more equity during these times as we are typically not paid to take on additional risk, so the capital structure may shift. Other key factors include requirements around hedging interest rates, commodities or currency risk for greater certainty in planning. We'll suggest that operators identify options to protect the business during the cycle, so that what we lend into today will continue to be viable down the road.

CHRIS BROWN: You talked about that right now we're in a seller's market, and so it's a good time for sellers to get both strong valuations and great terms. I think a lot of us are familiar with valuation, but what are some of those terms that people might not think about that might be different in a buyer's market versus a seller's market?

ANDREW WESTERN: Other than valuation, the focus tends to be related to what we call indemnification. This is the seller's liability, post-closing, to the buyer for problems with the seller's company. These terms are reps and warranties from the seller about their business, escrows or holdbacks, thresholds for making claims, and survival periods within which claims have to be made. One of the developments we have seen in the market, really during the past 36 months, is what we call rep and warranty insurance. I think it is a great thing for both buyers and sellers because it has streamlined the negotiation process around purchase agreements, and indemnification in particular.

We used to spend a ton of time negotiating reps and warranties in a transaction. With rep

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and warranty insurance, buyers and sellers are aligned to have robust reps and warranties in the purchase agreement and accurately disclose any exceptions. So there is a lot less negotiation. The reason for this alignment of interests is that post-closing, the buyer largely makes indemnity claims against this insurance policy, not the seller.

This gives greater certainty to a buyer because it doesn't have to chase-down a seller. It also gives a lot more certainty to a seller because the insurance carrier has taken on much of the risk for indemnity claims.

Due to this greater certainty, we see buyers agreeing to escrows of 1% of the transaction value (as opposed to 10% to 15% in a transaction without rep and warranty insurance). So in addition to a more certain risk profile, a seller is also getting more liquidity.

CHRIS BROWN: Mark, turning to you, we're in a bit of a high-valuation environment right now and for most owners their business is their baby, they built it, they've put time into it, they love it, and they want to get top dollar for it. How do you help manage some of those valuation expectations that an owner might have, and keep those kind of in line so they're not surprised by the bids that come in?

MARK YOUNG: That's a big challenge that we face. Often times our clients come to us with a preconceived notion of what they think the value of their business is, and that notion can be based on facts, the market, or it can be based on what their buddy told them they sold their business for. We need to do our job and focus them on what we think the value's going to be. We present industry statistics. We tell them that if we go to a wide enough swathe of the market, focused on the buyers that want to buy their type of company, we'll get market offers. And those market offers, hopefully, are at or above what they thought their company is worth.

Sometimes it's less, but that's what the market's willing to pay for their company at that point in time. We kind of have to convince them of that's what it's worth. Whether or not they want to go forward, it's their decision.

CHRIS BROWN: If one of you wouldn't mind sharing a story of a successful transaction or a unique situation where your expertise was able to help guide them through a particular tough point in the process.

ANDREW WESTERN: One that comes to my mind is a recent transaction. A very mature business, one owner, with very clear idea of valuation.

The seller put together a great team of advisers, and we were able to find a buyer who agreed with our valuation. Should be pretty simple, right? However, like any business that's been around for 30 or 40 years, there were a lot of diligence issues. Many of them things that happened 20 years ago. So there were a lot of diligence items we just had to clarify and get resolved. We did. And then, pretty far into the transaction, we realized there was an obscure state regulatory issue, and we had to completely restructure the transaction in order to get to a closing. We did.

The moral of that deal was, this was a transaction we all thought was going to be easy. At multiple points in time there was a new issue that no one expected or could have predicted, but because that seller had the right team of advisers in place, we were able to get to a successful closing with the valuation the seller needed.

CHRISTINE NOWACZYK: All the more reason to get your partners involved early and to set expectations such that there will be bumps in the road. I think what surprises most business owners, and Mark you probably experience this a lot, is the level of scrutiny that they're going to go through with these transactions. To me, it is one of the hardest obstacles we as advisers have to overcome and have to be able to explain in order to best prepare our clients.

MARK YOUNG: You have to have thick skin to get through it. We had one client about six months ago, that we had suggested they do upfront due diligence and they said their information was good. Post close, they told us, we wished we'd done due diligence before, it would have been a lot simpler on us to get through the process.

CHRISTINE NOWACZYK: What has also changed over time is the amount of data that is readily available in the market and what is evaluated as part of transaction due diligence. It's much different than it was a decade ago. Sellers can expect scrutiny at the individual level including detailed background checks of key leaders and intense scouring of data, all

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MARK YOUNG

Managing Partner
CKS Advisors

Mark brings more than 35 years of combined experience in investment banking (M&A), corporate finance, and leadership roles to his clients.

Prior to joining CKS Advisors, Mark held executive positions with money center financial institutions including Merrill Lynch and US Bank, as well as several regional financial institutions. During his career, he has successfully structured, negotiated and closed a wide range of transactions amounting to more than $2 billion in transaction value.

Mark is a member of The Alliance of M&A Advisors and The M&A Source, both respected industry associations.

Education: Received his MBA from Portland State University and is also a graduate of Lewis and Clark College.

"We have a strong economy, much stronger than many other parts of the country, which bodes well for our businesses."

ANDREW WESTERN

Partner

Osborn Maledon

Andrew Western is a partner at Osborn Maledon. He is an experienced deal lawyer with extensive M&A experience on both the buy-side and sell-side. In addition to M&A practice, Andy regularly represents growth-oriented and entrepreneurial clients in connection with financing transactions and serving as their outside general counsel. Prior to joining Osborn Maledon, he practiced at Latham & Watkins LLP in Southern California where he advised publicly traded companies and private equity firms in connection with complex M&A and capital markets transactions.

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information that a buyer will use to negotiate a deal. Sellers need to be well-prepared to address information that surfaces.

ANDREW WESTERN: I think part of the problem here is that some of these issues are ones that weren't problematic 5 or 10 years ago, but today are very problematic given changes in the regulatory environment or society in general. Often a seller, particularly when he or she has been with their business for long time, will say: "Yeah, something happened, but it wasn't a big deal." And as an adviser you have to educate them, "Well, it's a big deal now."

CHRIS BROWN: One of the things I keep hearing is get your advisers involved. Who are the other people that a business owner should get involved, and when should they start talking to those experts?

MARK YOUNG: The other advisers would be, depending on the type of business that you have, if you've got technology involved, you want to make sure you've got your IP attorneys and/or your patent attorneys up to speed with what's going on. If your business involves a lot of insurance related things, you want to make sure you've got your insurance broker up to speed. It really depends on the type of company you have. We always, if it's possible, involve your key people ahead of time, so they're aware of it, so they can add value. The buyers are going to want to know there's going to be a management team in place in most cases.

CHRISTINE NOWACZYK: It's interesting because now you can hire a consultant, to help you hire more consultants, to get through a transaction. It can be overwhelming for a seller. I echo Mark's comments and add that human capital is top of mind today. People drive business. The due diligence involving individuals and around employment practices are key areas of focus. There are resources available in the market to evaluate these aspects of the business. On the technology front, data privacy and secure environments for customer information should also be top of mind.

ANDREW WESTERN: A key adviser is the accountant. It is critical, early on, to analyze what tax structures are going to be

most beneficial to the seller in a transaction. Typically, you can't really avoid taxes, but you can defer them. This analysis is particularly important when you're looking at a financial buyer, and the seller will be rolling equity. It's never a good situation to have a tax surprise post-closing, so you want to understand the structure and the impact early on.

CHRIS BROWN: Mark, you brought up a patent attorney, and we have an M&A attorney sitting here at the end of the table. Andy, could you elaborate a little bit on why it's important to get an M&A-specific attorney involved?

ANDREW WESTERN: A lot of it has to with understanding the market, understanding deal terms, and understanding the deal process. It is very difficult for an adviser to deliver value to a client when he or she doesn't have experience in M&A transactions. As an M&A attorney, I have a lot of experience on both sides of the table, and I understand market terms in a given situation. I also have enough experience to know when I need to consult with another expert. I think one sign of a trusted adviser is someone who will tell you, "We need to talk to somebody else to help advise us on this particular issue."

CHRISTINE NOWACZYK: And it is even more important when you are in a specialty industry with nuances that can impact a transaction.

MARK YOUNG: One of the first things we do is determine what experience the clients

attorney has with M&A, because the buyers are going to have a very experienced legal team, and the last thing you want to do is pair an inexperienced attorney up against a very experienced buyer group because it's not going to go well. It could sour the deal, because if they're not familiar with the way the process is run, the terms, and the many nuances of a deal, it just doesn't go well.

CHRIS BROWN: What do you see in Arizona today from the business community and the M&A perspective? What do you like about the market here, and where do you see it going over the next 12 to 24 months?

MARK YOUNG: If we go through our last five deals that we've closed, we've had the same buyer from Michigan buy two companies, a buyer from Ohio, a buyer from Texas, and a buyer from Minnesota. What that tells us is Phoenix is an attractive market for investors seeking to buy companies. We have a strong economy, much stronger than many other parts of the country, which bodes well for our businesses. And, it shows that companies want to come here and do business . . . they see the growth opportunities.

CHRISTINE NOWACZYK: I would agree that the Arizona market is very strong. In addition to being a great place to live, we have smart entrepreneurs who have grown very successful businesses in areas of technology, wellness, and business services. There is ample capital from a variety of sources including banks, private investors, private equity and family offices. It's a collaborative environment too with experienced service providers available to help advise on transactions, so we are very optimistic about the direction of Arizona.

ANDREW WESTERN: Yes, and I think we have a very diverse economy. We have a lot more traditional small to-midsize businesses with baby boomer owners who are very established, and we have a lot of younger, growth-oriented companies, a lot of entrepreneurial spirit, not just in the Valley, but in Arizona in general. That attracts a lot of people to this market. In a lot of our transactions, buyers are not Arizona-based.

CHRIS BROWN: Thinking about both the broader economy and the Phoenix-specific economy, I guess we'll just ask. Recession next 24 months, yes or no?

MARK YOUNG: My comment would be, is just don't talk ourselves into wanting it, and I don't think we'll have one.

CHRISTINE NOWACZYK: I think we're all keeping our eye on industry bellwethers that point to it coming down the road, probably not until the end of 2020. But it's going to be a gradual decline as we are still in such a strong economic environment. Interest rates remain low and there is liquidity available to sustain companies for an extended period of time.

ANDREW WESTERN: I would not be surprised to see a gradual slowdown during that time period, but I would be surprised to see a rapid or drastic slowdown.

MARK YOUNG: Hey, I think I can add to that. Do we think it's going to slow a bit? Sure,