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Table of Experts

MERGERS & ACQUISITIONS

Experts discuss what business owners should consider if they're thinking of selling.

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Robust merger & acquisition activity means opportunities exist for many business owners considering their next steps

RAY SCHEY: Describe the impact of the Covid-19 pandemic and the various relief efforts on the M&A market.

ANDREW WESTERN: The impact of Covid-19 and the relief efforts has obviously changed over time. When it first hit, there was a very large amount of uncertainty. I was working on a few transactions at that time. On one, we pressed pause for a couple of weeks to see how things shook out but then proceeded and closed in early April 2020. A number of other transactions, pressed pause for 60 to 90 days. I think once the initial relief efforts passed, particularly the Paycheck Protection Program, and as we started to get into early summer, activity started to pick up again, which was great to see.

It was surprising, thinking back to how things looked in March 2020 or early April 2020, but since early summer 2020, activity in the M&A world has been extremely robust. Lots of transactions, multiples are very high for sellers. I think there's a lot of liquidity in the market. The PPP was extremely helpful for business owners to help keep their companies on the right track. So, we've seen that high-level of activity continue through today.

RAY SCHEY: The M&A activity, how much of that might be attributed to the fact that business owners are moving on in age and the market is right for moving on? Is the age of some of the business owners creating this opportunity?

ANDREW WESTERN: That has been going on for a few years now. We refer to it colloquially as the "baby boomer transition." I think a lot of the business owners, if they're at that age where they're looking to transition or exit, are seeing very high valuation multiples right now and are taking a "strike while the iron's hot" approach. This generational transition was definitely driving activity pre-Covid-19. It's continuing to drive activity today, and I suspect that for the next number of years, that this transition is going to continue to be a driver in the M&A world.

RAY SCHEY: How should the owners of businesses be thinking about the M&A market as we do start to come out of this Covid situation?

DAVID SHAPIRO: I think the fundamentals are still very strong for M&A activity especially for private business owners. You have private equity groups that have raised an abundance of capital, so there's a lot of PE money that needs to be put to work relatively quickly since PE funds have a limited period of time to make new investments. And then you have public companies whose stock prices are very high providing a strong currency to do deals.

Of course, for business owners considering a sale in the near term the immediate Covid impact and how their industry might change going forward are serious considerations. There are certainly some industries that were hit very hard by Covid given the shutdowns, but there are many industries — maybe most — that are doing fine or close to normal, and some have even benefited from all this. Resiliency is the key question. Owners of companies that can demonstrate that resiliency through Covid are in a strong position should they decide to sell.

BILL CALLAHAN: The primary thing we are seeing is the amount of diligence being done by all the parties in an M&A transaction. There may be enhanced seller-side diligence being performed by a CPA firm to take a deep-dive in the numbers to make sure they can accurately present a financial picture that is attractive to an interested group of buyers and that can be verified. On the buyer-side, we are of course seeing comments from buyers' quality of earnings partners as to how Covid has impacted the business and if there are any long-term effects in the business because of it.

RAY SCHEY: Bill, when someone wants to buy a business what options are available for financing the acquisition?

BILL CALLAHAN: Much will depend on the complexity of the transaction. Typically, there will be a capital stack of contributed and borrowed capital. This will include senior bank debt financing or perhaps SBA-backed financing and some other combination of seller-financing where the seller will receive some of the sales price upfront and the rest over time, maturing at the same time of the senior debt piece. It may also include subordinated debt lenders such as mezzanine debt an SBIC (Small Business Investment Company). There may also be private equity, new owner equity, friends and family, etc.

RAY SCHEY: Are banks actively lending for acquisitions?

BILL CALLAHAN: Yes, the appetite is still there but the diligence efforts have changed significantly. This is because balance sheets may have some noise in them post-Covid. With the increase in liquidity across

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Bill Callahan currently serves as President & CEO of Arizona Bank & Trust, an affiliate of Heartland Financial, USA, which has nine banking centers in Phoenix, Scottsdale, Mesa, Chandler, Tempe and Gilbert and combined assets over $1.5 billion. He also oversees all operational activities of the Bank, including commercial, retail, private client services, private banking and residential mortgage lending. In addition, he is responsible for the strategic vision and direction of the bank as well as Board of Director activities.

Bill has an MBA from the University of Iowa and an undergraduate degree in Business Administration/Finance from Loras College. He has 33 years of banking experience in the Dubuque, IA and Phoenix, AZ markets.

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many asset classes, it is important for financial institutions to move those assets into high-quality loans.

RAY SCHEY: How have banks' lending appetites changed over the past year through the Covid crisis?

BILL CALLAHAN: Diligence efforts are now geared toward digging deeper into the financial statements that are being presented to see what may be going on. More importantly, the ability to see into the future for a consistent earnings stream that can support a level of debt that a new or expanded company will take on. PPP and the second round of PPP have made a big difference in financial statement presentation. Digging deeper will help determine if the opportunity is sustainable or if the effects of Covid

may impact the business for the long haul. Call it the new normal.

RAY SCHEY: What buyer attributes are banks looking for when supporting an acquisition?

BILL CALLAHAN: Knowledge and experience of the buyer in the targeted business. Is there a strong management team that will remain in place, or does the buyer have the right people to put in place to run the company going forward? You also want to know that you have some depth in that management team as well. Most of us will be looking for industries that have a consistent revenue stream. Today it is more difficult to lend to those industries that have a history of cyclicality. We target those opportunities in companies with strong, diversified customer bases and not those that rely on just a few large clients.

RAY SCHEY: Andrew, what is your role in the M&A transaction as legal counsel for both the buyer as well as the seller?

ANDREW WESTERN: Let's take the seller-side first. Typically, if I were to pick an ideal situation, I'd get involved very early, probably as the seller is starting to think about selling their business. There's not that much work for me to do, but I think it's very helpful for a seller to talk through the process and to plan the process. One of the first steps a seller really needs to do is get organized. That's something as simple as making sure you have electronic copies of all your governing documents and contracts and having them all in a Dropbox or folder system that's easily accessible. My experience is that if a business owner involves their M&A counsel early on, then they are much better prepared for the transaction and the investment in fees is minimal.

It's not work I have to do, it's work that the seller and folks at their company need to do, but it's helpful to have those initial conversations. The work really starts for me, as an M&A counsel, when a business owner is starting to have discussions with potential buyers and considering what are the deal points that are going to be important to the business owner. Part of my role is to make sure those deal points are reflected in a letter of intent or a term sheet and then assisting the business owner through the due diligence process.

Once the due diligence process has commenced, then an M&A counsel tends to spend most of their time negotiating the deal documents and making sure they accurately reflect the business owner's intentions, making sure the business owner understands what those documents and terms mean and their potential impact (including post-closing impact). Even after a deal closes, I am often needed to help answer some post-closing questions.

The buyer-side of a transaction is fairly similar. My early involvement largely depends on how much experience the buyer has in doing acquisitions. The more experience they have, there's probably less need for an M&A counsel earlier on, but the process is really the same. It's assisting the buyer with the letter of intent and due diligence. It's helping to negotiate the documents and making sure the documents reflect the parties' intent. The goal I always have as an M&A lawyer is facilitating the transaction,

making sure everybody's on the same page, so that we can get to a successful closing.

RAY SCHEY: I know that every deal is different, but what's the range of the time from start to finish that you see for M&A transactions?

ANDREW WESTERN: There's quite a range. On the fast side for a successful closing, I've had deals that only take three or four weeks. That's very rare. Those are deals where the buyers and sellers typically have a pre-existing relationship, there is a lot of transparency and openness, and the deal structure and terms are pretty simple and straightforward. On the other end of the spectrum, I've had transactions where it might take close to a year from when we first start negotiating an LOI, and it goes through various iterations, then there is due diligence and negotiating and finalizing the transaction documents. If you think even more broadly about a deal process from when a seller is perhaps first introduced to the buyer they ultimately choose, that could be a multiyear process.

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RAY SCHEY: Would this be a good time for businesses to look for opportunities to grow their business through acquisition?

DAVID SHAPIRO: I think there will be real opportunities to grow through acquisitions particularly with baby boomer business owners. Let's say you're a 60-year-old owner and you started a business 30 years ago. You've lived through a domestic terrorist attack that led to two wars, a financial crisis and now a pandemic, all of which caused serious economic disruptions. An event like what we're seeing with Covid will trigger in the mind of some owners that it's time to sell because they feel, "OK, I dodged this bullet, or I survived that crisis. I don't want to have to go through another one.

These are the types of owners who are approachable for a potential add-on acquisition to your business. If you're approaching one of these types of owners in your industry, you have an advantage over private equity generally, or a large strategic because these owners will view you as a more credible buyer with a real understanding of the industry. It is definitely worth probing with these types of owners to look for these opportunities..

BILL CALLAHAN: Yes, despite the shutdowns of the last year, the trends do continue. As baby boomers make their way toward retirement, there is no shortage of opportunities to add through acquisition. Finding complementary or compatible acquisition targets is the biggest driver of new M&A prospects.

RAY SCHEY: Andrew, what are the key action items for a business owner in preparing to sell his or her business?

ANDREW WESTERN: There are a few things, and they are fairly

high level. The first thing is understanding what you as a seller want out of a sale transaction. What price are you looking for? And thinking a bit more deeply about, what does that price mean? What is it you're trying to achieve?

For example, if you're a baby boomer who's looking to retire, how long do you need the sale proceeds to last? Where do you want to live? What do you want to do? Is the after-tax liquidity you're going to receive in a transaction able to provide for all those factors?

Second, it's preparing your business for a sale transaction. Making sure you're organized for a due diligence process where a buyer is going to want to review your financials and legal documentation in great detail. Also making sure you address any lingering operational issues (for example, employment or benefit plan issues) and try to get those resolved before you get into an M&A process. My experience has been that it's much more cost efficient to analyze and resolve these operational items on your own before you get into an M&A process. Once you are in the M&A process, things move quickly and there are more parties involved in these issues, the potential buyer and their advisers, so it can make finding a solution more difficult and expensive.

RAY SCHEY: How should business owners view the private equity investors as potential buyers of their companies compared to strategic buyers?

DAVID SHAPIRO: While in the long-term history of M&A we've seen strategic buyers paying a higher price than private equity, because of all the capital that's been raised, private equity is now willing to compete with strategics on price as they have a lot of capital to invest. What private equity can also offer is the ability for an owner to remain involved in the business post-closing, so very often an owner may retain 10-25% ownership in the business on a post-close basis, and then may continue to run the company. This may be more desirable for an owner who is not ready to fully retire and would like to participate in the upside of the growth with continued ownership.

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BILL CALLAHAN: The most significant difference is that private equity buyers tend to be finance people who may or may not have operating capabilities. Thus, the seller may be asked to remain for some period of time within the business. Private equity buyers also have a

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shorter time frame in which they plan to own the business fitting to when they want to return capital to their investors. On the other hand, a strategic buyer is probably looking to own your business for life and may not need you to stay on into the future. They view a purchase like this as an add-on to what they have today.

RAY SCHEY: What percentage of the M&A deals now are via private equity?

DAVID SHAPIRO: I don't know the number. I'm cautious to throw out a number because I don't know it off the top of my head. Private equity is a significant percentage. If I had to guess, it'd be more than half.

ANDREW WESTERN: That's exactly what I was just going to say. I would say in the last two to three years, a majority of the sell-side deals we have done, the buyers have been private equity.

DAVID SHAPIRO: If we keep in mind for a moment that the vast majority of companies in the United States are less than $10 million and even less than $5 million of revenue, that's just the reality. When you get to that small of a business, private equity is unlikely to be the buyer. Even what we think about as strategic buyers are unlikely to be the buyer. Very often, it's a local group of high-net worth individuals, or it's the executive who left a corporate job and has some money and wants to take a run at starting or buying a small business. That really is where the majority of the volume is. It often doesn't get captured in reporting because those deals don't land anywhere with investment banks or publicly announced deals or anything in those databases. That is really where most of the transactions happen from a volume standpoint in number of transactions, not dollars, but number of transactions.

RAY SCHEY: Describe the importance of having an experienced team of advisers for the buyer or the seller, such as legal, financial, etc., in the M&A process.

ANDREW WESTERN: I think it's really key. Often when you're on the sell-side, this is the only M&A transaction that the business owner has ever done in their entire career; they've been running a business for however long it's been. It could be 30, 40 years, they've never done this before. Therefore, it's really important to have an experienced team of advisers so that the business owner understands what is going on. M&A counsel is one of those advisers, someone who understands the terms of an M&A deal, what the process is, and the issues you need to think about. Having an experienced banker, whether that's a commercial banker or more of an investment banker, that's also key to help understand the financial terms of the deal. Also, having a tax adviser is important so that everyone can understand the potential tax impact.

It's really important to get your ducks in a row as you get ready to enter into the process of a transaction. But what happens too often is there are some meaningful business issues that have not been addressed, and if you're looking to sell in 12 months or less, you haven't given yourself enough time to fix.

DAVID SHAPIRO
CLA (CliftonLarsonAllen LLP)

That's often a forgotten issue in M&A transactions; the structure can really change the tax impact for a seller, and significantly alter the after-tax proceeds available for the seller. Depending on your industry, there might be more focused advisers on certain regulatory issues or other types of business issues that you'd want to have involved to help you understand the impact of certain specific deal terms. It all really comes together because the business owner understands their business, and the experienced advisers understand the M&A process, so the team can work together to help make the right decisions.

Whenever I've been part of a successful M&A transaction, there always is a team of advisers that are helping to get that transaction closed.

BILL CALLAHAN: Having a good team in place is important for several reasons. This will most likely be the only time you will sell a business. With a quality team, you can mitigate the huge learning curve as that team will be able to navigate all the nuances of a sale for you. It also allows you, the seller, to continue to run the business as the transaction is making its way toward the finish line. Quite often we see sellers taking their eye off the ball, causing a reduction in price prior to close or more disturbingly, having the sale fall through.

RAY SCHEY: What are some of the things that business owners should be thinking about? Who might see a sale of their business on the horizon?

DAVID SHAPIRO: It's really important to get your ducks in a row as you get ready to enter into the process of a transaction. But what happens too often is there are some meaningful business issues that have not been addressed, and if you're looking to sell in 12 months or less, you haven't given yourself enough time to fix. The group that I work in at CliftonLarsonAllen helps owners plan for their exit from the business, whether it's a sale to an insider, like family or management or a sale to a third party like PE or a strategic.

We like to start three to five years in advance and think about three broad categories: one is the attractiveness and readiness of the business to be sold. It's critically important to think about how a buyer or the next owner will view your business and what impact that will have on price and structure of a deal. The second piece is your personal finances. Do you have an understanding of what your personal assets will be after the sale of your business and what kind of a

lifestyle you will be able to support? The third piece — because these business owners have put their blood, sweat and tears into these businesses — is what do you want life to look like after the sale of the company? What do you want to do when you get up in the morning? These are different for every owner and it's really a best practice for them to consider all of these things well in advance so when they come to the point when they're ready to

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DAVID SHAPIRO

Director Owner Transition Services

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David works in the Ownership Transition Advisery Group and has over 25 years of finance experience with a primary focus on Mergers & Acquisitions. As a certified exit planning adviser (CEPA), David uses a holistic approach to advising business owners who are planning for a transition in ownership of their business. David also works with businesses on strategy, value creation, raising capital and general business consulting.

Previously, David worked for a national commercial banking organization and two private investment groups, all with a focus on investing in buy outs of middle market companies. He has worked with numerous shareholders, board members and C – Level executives on solving business challenges and maximizing shareholder value.

talk to someone like Andrew and say, "OK, I'm ready to sell" they can move forward with confidence.

You want to have all these things thought through years in advance in order to maximize your opportunity to achieve your objectives years in advance as opposed to trying to do it while you're in the process. Exit planning is good business strategy in general, and it should be part of your general business strategic planning.

BILL CALLAHAN: Dressing-up the financial results that show the potential buyer that you have something to actually sell. If they have run the business as an extension of themselves personally and that cannot be readily identified or broken out, it may not allow for a future purchase price that you feel is fair for your business. Are there members of your team that are impactful for the future success of the acquired business? What will happen with them once it is sold?

RAY SCHEY: What impact are you seeing from SPACs (special purpose acquisition companies) in the acquisition world?

ANDREW WESTERN: At one level it's contributing to the overall activity level in the M&A market. It's another source of capital, of liquidity, that is now looking at potential acquisitions. It's getting these companies access to the public capital markets. It's really another way of becoming a public company. Obviously, it's grown tremendously, particularly over the last 12 to 15 months.

These types of transactions seem to be more focused on more mature startup and growth companies that may have been gearing up towards a potential IPO. Historically, that would have been their path. They do multiple rounds of financing, and then they IPO. We'll see how this evolves over time, if there's a particular size of company that really tends to be more of the focus of a SPAC transaction, or if it starts to move down market a little bit.

DAVID SHAPIRO: It does seem to be sector specific. I don't know if I've seen too many SPACs that are targeting, let's just say, lower middle-market companies, businesses with less than a $100 million of revenue that are creditworthy, old economy type companies, manufacturing business services and distribution. But it's interesting, it's a variation almost of a private equity model. We'll see if it has legs and if it has staying power.

> *There are a lot of business owners that have been thinking more about an exit. They've been thinking more about what an exit or transition would mean for them. They've been talking to their advisers about preparing themselves, strategically and tactically, for an M&A transaction. I think business owners are thinking about this more than they were 18 or 24 months ago.*
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RAY SCHEY: What's the future of M&A activity over the next several months?

ANDREW WESTERN: It's very healthy right now and I think it will continue. There are a lot of business owners that have been thinking more about an exit. They've been thinking more about what an exit or transition would mean for them. They've been talking to their advisers about preparing themselves, strategically and tactically, for an M&A transaction. I think business owners are thinking about this more than they were 18 or 24 months ago.

There's still a lot of liquidity in the market. There's still a lot of potential acquirers out there. I'm very hopeful that activity is going to continue. Eventually, there will be a slowdown, but even as that overall slowdown starts to happen, there are still transactions that are going to happen. There's still the right fit between buyer and seller that will happen. I don't know that this level of activity will continue for years to come, but we're really optimistic about the market today.

DAVID SHAPIRO: I think it still remains strong. The fundamentals are there. I can remember dealing with business owners from older generations who had the mentality that they were just never going to sell. We used to joke, when they died, they were going to be chairman of the board. But with all the private equity capital that's been raised, it's very tempting for owners — and the valuations are so high — it's just so tempting for owners. What's very typical is if you look at an owner's personal balance sheet, their personal net worth is heavily concentrated in the ownership of their business. That weighs on them as they get older particularly after dealing with the pandemic. Their perspective on risk changes and many will be motivated to sell.