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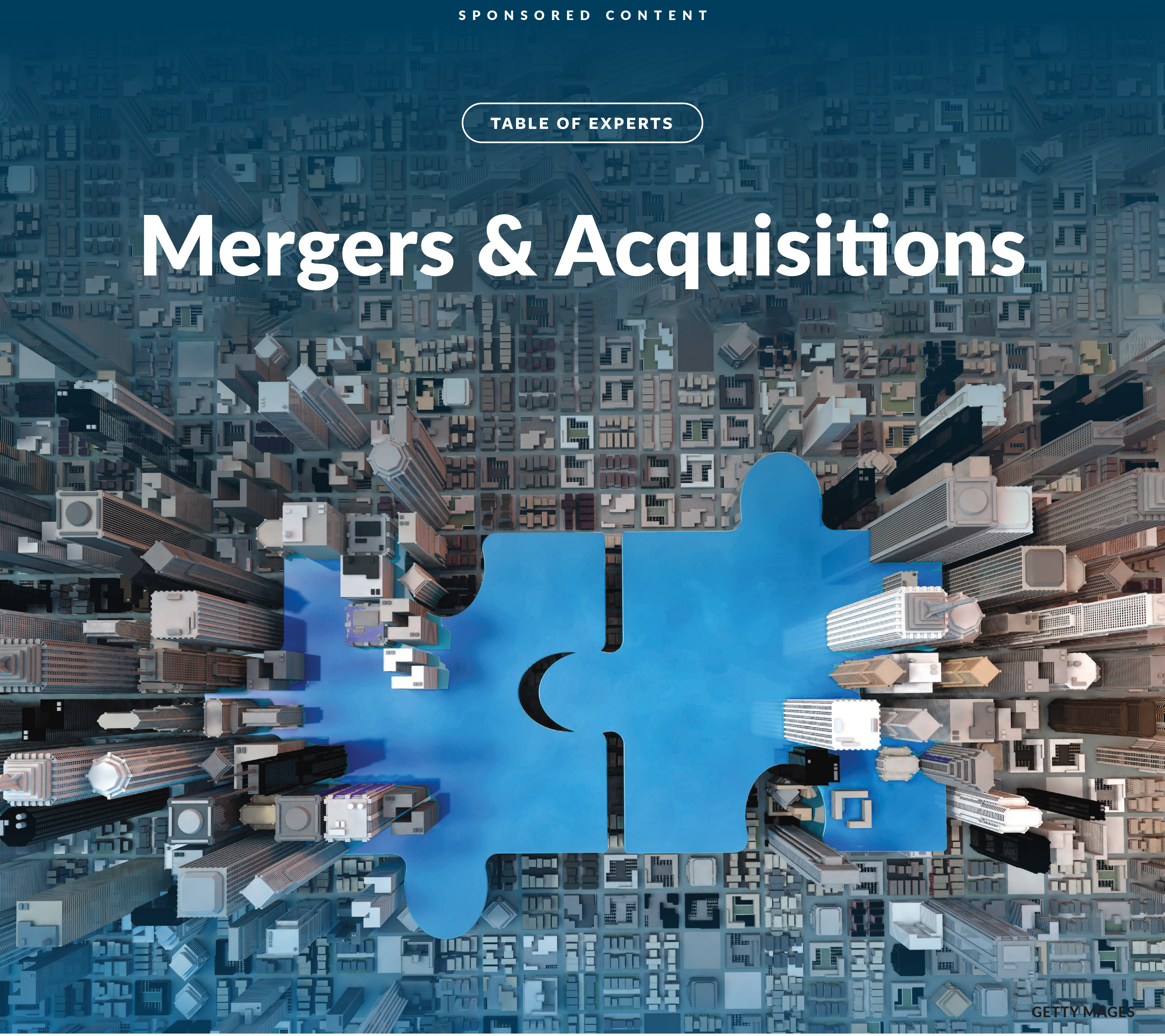
Mergers & Acquisitions



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ATTORNEYS AT LAW

THE EXPERTS:

ANDY WESTERN
Partner, Corporate Transactions Group
Osborn Maledon

Andy Western is a partner in the corporate group at Osborn Maledon, P.A. where his practice focuses on sophisticated business transactions as well as serving as outside general counsel to private businesses. On a daily basis Andy is working alongside Boards of Directors, CEOs, and CFOs on day-to-day strategizing and problem-solving. Prior to joining Osborn Maledon, Andy worked at Latham & Watkins LLP in Southern California representing clients in multibillion-dollar transactions.
Andy graduated from the UCLA School of Law and received a Bachelor of Science in Political Science and a Bachelor of Commerce in Economics from Santa Clara University. Andy is recognized by Best Lawyers® for Corporate Law; from 2017 to 2019, he was named a Rising Star in Securities and Corporate Finance by Southwest Super Lawyers.

GREG OGARD
Vice President
Montage Partners

Greg Ogard is a Vice President with Montage Partners. He is responsible for sourcing, evaluating, executing, and monitoring investments in the firm's professional and technology services and healthcare sectors.

Prior to joining Montage Partners, Greg was an Associate at Platte River Equity, a middle market private equity firm where he was responsible deal execution and portfolio company oversight. Previously, Greg was an Analyst with Citigroup where he focused on mergers and acquisitions, strategic advisory, and capital market transactions.

MATTHEW BARTHOLOMEW
Principal, Deal Services Group
CliftonLarsonAllen

Matt is a Principal in the CliftonLarsonAllen LLP Deal Services Group, providing financial diligence services to private equity, privately held clients primarily in the construction, energy, manufacturing & distribution, business services and consumer products/ecommerce industries, including pre-LOI and post-transaction assistance with companies ranging from pre-revenue to $1b+.

BRENDAN J SULLIVAN
Principal-, Transaction Tax Services
CliftonLarsonAllen

Brendan has more than 20 years in public accounting experience, including significant experience serving multinational corporations, private equity firms, and closely held businesses with transaction tax planning, domestic and cross-border transaction structuring and planning, compliance, and consulting.

MODERATOR: RAY SCHEY, President and Publisher, Phoenix Business Journal

Recently, the Phoenix Business Journal hosted an insightful panel discussion on Mergers & Acquisitions. The panel featured industry experts including Andy Western, Partner in the Corporate Transactions Group at Osborn Maledon; Matt Bartholomew, Principal in the Deal Services Group at CliftonLarsonAllen; Greg Ogard, Vice President at Montage Partners; and Brendan J. Sullivan, Principal in Transaction Tax Services at CliftonLarsonAllen. The discussion was moderated by Ray Schey, President and Publisher of the Phoenix Business Journal.

Ray Schey: Greg, give us a quick overview of the current state of the mergers and acquisition market.

Greg Ogard: We're starting to see a bit of recovery. Q1 was slow, but the spring and summer started to bounce back. We're cautiously optimistic about the back half of the year, which is a welcome relief after a quiet 2023.

We're excited to see pipelines filling up and more opportunities come to market. Credit markets have loosened up as well, which certainly helps us boost activity.

There's also fatigue from sellers. A lot of folks were waiting for conditions to improve, hoping that they could wait it out. As the lull in activity has stretched, fatigue is wearing on owners. Whether it be financial sponsors or founders, owners are ready to think about next steps sooner rather than later after the last 12 to 24 months of "wait and see".

Ray: Yeah, a pent-up demand as a result of the interest rates and so on over the past 12 months. A lot of those people have been sitting on the sidelines waiting for opportunities to come along, then. Andy, is that right?

Andy: I think so. I think a lot of potential sellers decided to put their head down and focus on just operating their business after they saw valuations decline or potential buyer interest dry up after the peak in 2021. Running a small business is not an easy thing; it's a 24/7 job for most people. When you've been doing that for 20-40 years, it's understandable if, mentally and emotionally, you are ready to exit. After the last 12-24 months, I think a lot of potential sellers are ready to exit and think the M&A environment has improved enough for them.

Ray: Understood, thanks. So, for Matt and Brendan. Certainly, the hurdles encountered from financial and tax perspective in deals, we've seen some things there, too. What can each of you share about some of what you've seen from your perspective with taxes?

Brendan Sullivan: On our side, the biggest hurdles have always been and continue to be sales tax issues. Anytime sellers come to the market, everyone believes that they're bringing the best of the best and everything's perfect. It just tends not to be that way.

Ray: Right, you think you're at the finish line, and then you're not. Matt, anything to add on top of that?

Matthew Bartholomew: From a financial records perspective, the financials aren't necessarily telling you the story of the business in the same way as what we saw before; Sellers should prepare more than what we see now in terms of being able to tell their business story through the financials. I always encourage owner/founder operators to try to ensure that the accounting and reporting structure are telling story of the business.

Ray: Sure. So, Greg, turning back to you. What should a business owner expect from an M&A transaction with a private equity buyer?

Greg: One of the biggest shocks typically is the level of scrutiny and diligence that private equity firms really get into. That can be surprising for owners that have spent years building the business and know how the sausage is made.

But for investors coming in new to the business, we've got a lot of questions, and we typically have a lot of advisors, like Brendan, Matt, and Andy, we work with. That can be overwhelming, particularly with the volume and the pace at which we dig in.

Ray: Okay. A question for Andy: when should a business owner start thinking about the process of selling their business?

Andy: As soon as possible. Most business owners will go through this sale process once in their life, and it's unlike anything else they've done. It can be really frustrating for an unprepared seller when they know everything about their business, but they know nothing about the process of selling their business.

For this reason, it is important to engage with experienced advisors early in a business's lifecycle. These advisors can help a business owner build a solid foundation for a successful M&A transaction that may be many years down the road.

Ray: Got it, thank you. So, I'm going to turn back to Matt and Brendan and ask the same question I asked Greg earlier: what do you expect from an M&A transaction with a private equity buyer you usually see?

Matthew: In working with private equity buyers, they bring to bear a lot of scrutiny on a Seller, and rightfully so in paying what they perceive to be top-dollar for the subject business. There's a certain familiarity that builds up as a private equity gets to know the business, the management team and the products and services. Once there is a Letter of Intent in place, the level of detailed scrutiny is as high as ever as other stakeholders are brought into the process as well – lender, insurance provider, co-investors, etc. Sellers should prepare to share everything; ideally in an organized fashion to save time and cost.

Ray: Brendan, anything to add to that?

Brendan: I feel like it's more of a misconception around the idea that private equity is somehow different than any other buyer. I think the PE firms in general, with the proliferation of them over time, have become people first. Their goal is to integrate companies, build a larger company, and create synergies. Providing the management insight that was lacking in the lower-middle market, and the middle-market companies they brought to market.

Andy: Just to add to that, one thing that's unique about the private equity model is the "rollover" concept. For example, the seller owns 100% of the business today, and they sell 80% of their ownership to a private equity firm and keep 20% going forward (or "rolls over" 20%). Therefore, the seller gets to participate

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>
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> Osborn Maledon

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in the appreciation in value that the private equity firm builds. Private equity firms like this because it keeps the seller engaged and committed to the success of the business.

Ray: Interesting. Who would be the key advisors that a business owner should engage with when they're thinking about selling their business? And then, does the business buyer utilize the same type of advisors too, in the transaction?

Andy: The key advisors are legal, financial/accounting, and tax. This is the same for both buyers and sellers. I think the key characteristics you want in these advisors are trustworthiness and applicable experience. You want a lawyer who specializes in corporate and M&A transactions. You want an accountant that understands GAAP principles and accounting issues that may be unique to your business. And you want a tax advisor who understands corporate and partnership tax structures.

Matthew: If I may offer up two additional ones to add on to what Andy shared. First, from a private wealth perspective, so many owner/founder/operators are about to transact, receive a great deal of proceeds and quickly put a plan where those proceeds go.

Secondly, I'd encourage owner/founder/operators to talk to a variety of investment bankers or brokers in your local market, or operating in your industry or space, to help understand possible business value. There's still a bit of value gap from 2021 – early 2023 that some owner/founders have relative to where the market is now.

Ray: I was going to ask about an estate attorney too. I assume that's somebody that should be part of that process too, in those conversations. Let's throw it back to Greg. How should a business owner prepare for the business sale, ahead of the sale? What should they do to prepare?

Greg: The best first step is getting your ducks in a row, if you will. Talking with folks like Brendan to ensure your tax filings and payments are up to date. Talking with folks like Matt to make sure your numbers are accurate. Those are two of the biggest areas of derailment.

Then beyond taxes and financials, preparing anything on the operations and strategy of the business can help investors better understand the business quickly. That helps speed up the learning process, minimizes the time taken away from running your business, and allows for a smoother transaction.

Ray: Anything else you would add to that, Brendan, based on taxes and so on from CLA's perspective and yours?

Brendan: It goes back to the "preparation is king". Realistically, if you want to take your company to market, four to five years before you want to do it is probably when you should start making sure everything looks good.

Two, the best tax planning is planning. It's not reactionary, you do it in advance. I think where a lot of people suffer is the idea that good advice isn't cheap or free. Expecting that, if you want to have a Ferrari, you can't buy it on a Chevy Chevette budget. You have to actually pay for it, you have to maintain it, and then it will work and will drive like the sports car it is.

Ray: Andy, which advisors lead this M&A process for a seller?

Andy: My experience is that the M&A lawyer is often the "quarterback" in an M&A transaction. Obviously, the lawyer's expertise is in drafting and negotiating the letter of intent and the transaction documents, but we often need to coordinate closely with the accounting and tax advisors (especially on tax structuring). A key part of the counseling role of an M&A lawyer is making sure that your client understands the terms of the transaction, and understands what is customary or "market" in an M&A transaction.

However, the process among the advisors should be very collaborative. There is a lot of interplay among these areas of expertise and coordination is key.

Ray: Another question to Greg. How do you evaluate the buyers from both a strategic and financial perspective, but especially financial too? What goes into that process?

Greg: Price is obviously the most visible for

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CliftonLarsonAllen

sellers. Within price, though, are points like structure and terms. It's important to have a good team around you to help understand and evaluate, for example, what an earn out is and what that means for you and your proceeds as a seller; or what rolled equity is, what that opportunity looks like to receive partial liquidity today while remaining invested in the business.

Another important area are the qualitative factors at stake. Are you aligned with the buyer's values and their plans for business? Financial and strategic buyers may have very different plans for how the business will be run after a transaction. Strategic buyers may not have space for your team in their broader organization. Financial buyers may have different goals. For us, we prefer to back our teams and build around them.

The last piece is evaluating buyers. Sellers should evaluate buyers, just as buyers are evaluating sellers. Do the buyers have a strong, established track record? Do they have relevant experience in your industry? What's the certainty and timeline of closing?

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GREG OGARD
Montage Partners

Ray: Back to you, Andy. What are the key differences for the seller to consider between a financial or private equity buyer and a strategic buyer?

Andy: I think a big difference can be the potential "rollover" opportunity we discussed earlier with private equity buyers. That can be a big economic opportunity for a seller. But that may not be the right fit for some sellers. This is why it is really important for good advisors to understand the goals of a seller. While a "rollover" opportunity with a financial buyer may be a big economic opportunity, a seller may not have any interest in that go-forward structure and it may not be valuable to them, so pursuing that type of buyer would be a waste of time.

Ray: Final question. In addition to principal, who else within the company that's looking for M&A activity should be involved. At what point should they be part of that?

Andy: I'll go first. I think it depends on each business. I would not advise anybody to try and do this alone, without involving at least some of their management team. It is very helpful to get this small team involved early, particularly in the earlier diligence phase. What you're trying to manage as a business owner is wanting to keep confidentiality around the process, but also moving the M&A transaction forward smoothly.

Brendan: Given that the average legal tax and financial IRLS is somewhere between 200 and 300 items,. It's anyone that's relevant to the process. If there's going to be questions about that department, you're going to need someone who can knowledgeably speak about it. Otherwise, you're creating roadblocks for your own successful deal.

Matthew: This speaks to the need for professionalization or having a culture of professionalization. Even if you are a smaller business - sub-$10 million in revenue – you never know when the "right party" may reach out to you because they like your business. Be prepared.

Ray: Great. I'm glad I asked the question. It's definitely relevant. I think throughout this conversation too, people reading this, that would be some of the questions they would have too. Well, thank you everyone. I think it was a great conversation.