Growing by Acquisition
Overview of the Acquisition Process

Richard Snyder
Director
Audit & Accounting

Jennifer Kreischer
M&A Advisory Specialist

www.kmco.com

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller

PEOPLE | IDEAS | SOLUTIONS

Agenda

1. Clear strategic objectives
2. Assessing opportunity and risk
3. Successful integration
4. Examples
5. Current trends

Clear Strategic Objectives

1. Why do they matter?
2. What do they impact?

Why Do Clear Objectives Matter?

- You'll never be able to declare success unless you define it. Growth through acquisition can be risky.
- Objectives of the transaction should align with your company-wide goals
- Even before you have a target in mind, you should know your growth objectives
  - Opportunistic transactions may become available
  - If you are clear about what you need, opportunities may come to you based on how you talk about your business
  - When in-person negotiation shut down due to the pandemic, the transactions that happened were those with prior relationships

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

What Do Objectives Impact?

- They allow quick screen out of unsuitable opportunities
- Allow a tailored search for opportunities
- Affect how much value you will see from an acquisition
  - There is a difference between the value you will obtain from an acquisition and what you should expect to pay.
  - If you see the real value coming from actions you will take in the future, you should not have to pay the seller for that portion (synergy).
- Drive your integration plan

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

POLLING QUESTION

Assessing Opportunity & Risk

1. Overview of steps in the process
2. Your deal team
3. Elements of due diligence

Overview of Steps in the Process

After preliminary screening/identification based on strategic objectives:

- Assemble your deal team (more on a separate slide)
- Assess value and terms based on preliminary information
  - Letter of Intent (LOI) outlines terms, timing of exclusivity & access for due diligence
  - Value indicated in LOI assumes the numbers they described are accurate
- Due diligence (more on a separate slide)
- Final structure and negotiation
- Closing
- Post-closing purchase price adjustment(s)
- Integration

Your Deal Team

- Your team is critical to your success. While your internal team may have many of the skills needed, you will likely need outside help to fill out the skills or time commitment needed.
- Point person for negotiations with seller – usually the CEO/President
- Investment banker/outside adviser
  - Full service investment advisory firm can help you find target companies
  - Other advisers can help negotiate the process and provide support
  - May not be needed if you are experienced in M&A
  - Outside accountants and attorney may be enough
- Attorney experienced with legal due diligence, purchase and sale agreements (PSA), intellectual property

Your Deal Team, cont'd

- Keeper of the financial model
  - Most transactions are valued using either a multiple of EBITDA or a discounted cash flow
  - The model starts with what the seller gives you and is adjusted based on:
    - Due diligence findings
    - Your future plans for the business
    - Costs of integration
- Accounting/financial due diligence support
- Other due diligence expertise, which can include:
  - Environmental
  - Technology
  - Human resources/benefits
  - International

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Due Diligence – Objectives

- Do the risks associated with the transaction outweigh potential benefits?
- Do you have enough information to assess the company?
- What issues need to be addressed in the definitive purchase and sale agreement?
- How sustainable are the cash flows and will they support the valuation?

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Due Diligence – Range of Outcomes

- Continuum from “Don’t touch it for ANY price”
- To “Break out the checkbook and buy NOW”
- In between – mismatch between the risks taken and the price. Levers to adjust include:
  - Price
  - Structure
  - Representations and warranties
  - Insurance
  - Changing plans for integration

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Due Diligence – How to Keep Score

- Quality of earnings
  - Historical results of operations
  - Bridge into forecast
  - Findings impact price at the multiple
- Quality of assets
  - Evaluation of the net assets to be purchased
  - Findings have one for one impact on purchase price
  - Assessment of assets can lead to Q of E findings
- Debt & debt-like items – commitments of cash

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

POLLING QUESTION

Due Diligence – Quality of Earnings

- Reconcile earnings (EBITDA, net income) to financial statements
- Understand and corroborate (or not) management adjustments
- Analyze components of P/L and trends to identify:
  - Non-recurring transactions
  - Changes in the business
  - How the business makes money (which products, customers, etc.)
  - What drives the costs of the business
  - Correction of errors (either recorded or needed)
  - Non-cash transactions
  - Pro forma adjustments

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Due Diligence – Q of E Adjustments

Examples of Q of E adjustments include:

- One-time/non-recurring
  - Litigation settlement expenses/income
  - Management fees
  - Private company expenses
  - Unusual bad debts or inventory write-offs
  - Transaction expenses
  - Severance or other restructuring expenses
  - Unusual incentive compensation
- Impact of presenting target's results in accordance with generally accepted accounting principles and/or buyer's GAAP

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Due Diligence – Other Insights

Q of E adjustments can provide insight beyond the impact on the numbers:

- Channel stuffing (pushing sales into earlier period to make the results look good) – will sales be minimal just after close?
- Reversing reserves built up in prior periods – is it done to “dress up” the target company?
- Lower plant operating costs – has deferred maintenance harmed the assets?
- What can you learn about Target management or records?
  - Conservative or aggressive?
  - Impacted by incentive compensation
  - Unable to answer questions about the business

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

POLLING QUESTION

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Successful Integration

1. Culture
2. People
3. Prioritization

Culture

- From the development of the strategy through integrating acquired companies, your company culture should be central
- If significant changes are necessary to the way people work, give care in communications and timing
- Pay attention to how customers will sense the culture of the combined company

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

People

Culture is about the people, but there are some more tactical steps required to keep people happy after the transaction is closed.

- Distribute paychecks on time
- Understand and communicate clearly any changes in benefits, including paid time off
- Make sure employees understand how they fit into the buyer's organization

Prioritization

- Integration plans can include a long list of items to tackle
- If valuation depends primarily on one project, be sure to tackle it early in the process
- Think about costs and benefits of changes and understand that 80% of the value is derived from 20% of the line items in the plan. Focus on the 20%.
- Don’t forget to communicate with the customers and vendors
- Understand barriers to progress, which can include:
  - Culture & people
  - Systems

POLLING QUESTION

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Examples

Example 1 – Fill Out a Product Offering

Value	Due Diligence	Integration
Future earnings of the acquired business + Earnings from selling their products to your existing customers + Earnings from selling your products to their customers - Costs of integration	Full understanding of their existing business + Understand their relationships with customers – can you see broader product line? + Will your customers buy their product?	Cultural fit + How will you cross sell products? + Make sure earn-outs don't incentivize the opposite behavior

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Example 2 – Fill Out Geography

Value	Due Diligence	Integration
Future earnings of the acquired business + Possible future earnings from products/services offered by one party & not the other - Costs of integration	Full understanding of their existing business + Understand opportunities to expand sales at either customer base + Is competition different in the new geography	Cultural fit + How will you cross sell products? + Make sure earn-outs don't incentivize the opposite behavior

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Example 3 – Skilled Workforce, Plan to Use Differently

Value	Due Diligence	Integration
Future earnings of the acquired business - Earnings from low-value work you won't have them do + Earnings from higher value work you will purse post-acquisition - Costs of integration	Full understanding of their existing business + Capabilities of team – can they do the new work you envision? + Are there any dependencies between work you plan to end & rest of business?	Cultural fit + Strong leadership of new opportunities + How will you cross sell products? + Make sure earn-outs & compensation structures don't incentivize the opposite behavior

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

POLLING QUESTION

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Current Trends

1. Valuation
2. Structure
3. Processes

Valuation

- Early in 2020, valuations dropped due to the unknowns from COVID (if deals even got done)
- Valuations have been coming back up again in late 2020, early 2021
- Buyers:
  - Private equity has lots of “dry powder”/funds available to invest
  - Strategic buyers have been very active in the market – drives quicker flips by PE and they then recycle the funds with more acquisitions
- Sellers are motivated:
  - Expecting increases in capital gains taxes
  - Many buyers are ready to retire after a number of business cycles and the pandemic

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Structure

- Banks pulled back financing in early 2020, requiring more seller notes to close transactions
  - Banks are financing again, but being much tougher on add-backs in Q of E and other terms
- More uncertainty than typical with projections
- Earn-outs
  - Allow more time for seller to prove out their value proposition
  - If value is not delivered, seller does not have to pay
  - Key is to understand how the earn-out will be measured and what motivation it gives sellers, especially if they are employed after the transaction

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Processes

- Transactions did close, even while only interaction was remote
  - Most of these were either in process in early 2020 or between parties that knew each other well before the shutdown
- Success of virtual due diligence means:
  - Investment bankers are reaching out to broader groups of potential buyers as they can participate without traveling
- Some hybrid model is expected going forward
  - Fewer members of the buyer’s team will be on-site
  - Other team members will be linked in virtually
  - May make it possible for buyers to involve more of their team

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

POLLING QUESTION

Thank You!

Contact the Presenter

Richard Snyder
Director, Audit & Accounting
rsnyder@kmco.com

Rich has a wide range of experience providing business advisory services, audit, accounting, and tax services to a variety of businesses, including family-owned and privately-held companies. He also has assisted clients with various business advisory services including quality of earnings and acquisition due diligence, post transaction assistance with purchase accounting, operational audits and reviews, and bank refinancing. Rich also serves as audit director in several other industries, including manufacturing and distribution, media companies, professional service companies, and others.

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

Contact the Presenter

Jennifer Kreischer
M&A Advisory Specialist
jlkreischer@kmco.com

Jennifer has over 25 years of experience providing services including financial due diligence for buyers and sellers, transaction structuring, purchase price adjustment advice, purchase agreement review, and related advisory services. She has advised on a variety of complex transactions, including cross border, carve-outs, recapitalizations, initial public offerings, and rollups.

Jennifer has significant experience performing quality of earnings analysis and operational due diligence. She has led projects to assess M&A process, purchase accounting, and implementation of IFRS for companies in a variety of industries.

Jennifer has a broad range of industry experience, including power and utilities, industrial products, healthcare, service businesses, and industry consolidations.

She is a frequent speaker at M&A conferences and has facilitated a number of client roundtable sessions in the U.S., Canada, and Europe to explore the implications of new accounting standards.

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS

About Kreischer Miller

Kreischer Miller is an accounting, tax, and business advisory firm that has been serving clients in the Greater Philadelphia region since 1975. We've built our firm to respond to the unique needs of growth-oriented private companies, helping you smoothly transition through growth phases, business cycles, and ownership changes. The companies we work with need to be able to quickly adapt and respond to changing market opportunities and challenges. That's why our focus is on being responsive, decisive, and forward-thinking. We're up to the challenge—always looking at the road ahead, not in the rear-view mirror. **Learn more at www.kmco.com.**

Center for Private Company Excellence®
A Kreischer Miller Knowledge Venture

Kreischer Miller
PEOPLE | IDEAS | SOLUTIONS