ROUNDTABLE DISCUSSION

THE MARKET FOR BUYERS AND SELLERS

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Putting together the pieces for a successful deal outcome

The new federal tax law, tariffs, wage inflation and rising interest rates are just some of the economic nuances keeping dealmakers on their toes. Savvy buyers and sellers, however, know that developing a smart, proactive and nimble business acquisition or sale strategy is key to achieving their desired results at the finish line. Private equity firms and banks are at the ready, with financing and uninvested capital available to deploy and lend. While M&A markets are dynamic and evolving, the current economic environment foretells of continued robust dealmaking activity in 2019, according to the roundtable panelists featured in this *Crain Content Studio —Cleveland* discussion on buying and selling strategies. The panelists, whose experience spans private equity, corporate, M&A and business law, share their thoughts on M&A market expectations in 2019 and ways to optimize established, emerging and planned deals.

THE PANEL

STEVE DYKE
Managing Partner
Align Capital Partners

A co-founder of the firm, Steve Dyke is responsible for all aspects of Align Capital Partner's activity along with his partners, Rob Langley and Chris Jones. He also serves on Align Capital Partner's investment committee. Prior to founding Align, Steve was a partner at The Riverside Co. Prior to Riverside, he was a banker at a Denver-based sell-side investment banking boutique firm. Dyke's interest and expertise in small business was developed over years in commercial lending, owning a computer peripheral manufacturer, and serving as CEO of a medical device manufacturer. Dyke has a bachelor's degree in accounting from Colorado State University and an MBA from Vanderbilt University's Owen Graduate School of Management.

AMY C. HELD
Senior Vice President, Corporate Strategy, M&A and International
The J.M. Smucker Co.

As a member of Smucker's executive leadership team, Amy manages The J.M. Smucker Co.'s operations outside of the U.S., as well as facilitating the development of Smucker's corporate strategy. Amy also manages the company's acquisition and divestiture processes. She previously was the managing principal of the Cincinnati office of Willis Towers Watson (formerly Towers Watson). Prior to that role, Amy was a certified public accountant with Coopers & Lybrand (now PwC) and Grant Thornton. Amy has a bachelor's degree in business administration from the University of Notre Dame and an MBA from the University of Chicago Booth School of Business.

MIKE MCMAHON
Group Head and Managing Director
KeyBanc Capital Markets

Mike McMahon is the group head and managing director in the Mergers & Acquisitions Group at KeyBanc Capital Markets. McMahon has 20 years of financial advisory experience, primarily focused on advising clients on mergers and acquisitions. He has extensive experience working with industrial and energy businesses. Prior to joining KeyBanc Capital Markets, McMahon was a senior associate at Harris Williams & Co., a mergers and acquisitions advisory firm, and a corporate finance analyst at Duff & Phelps LLC, where he advised clients in sell-side transactions, ESOP fairness opinions and corporate valuations. McMahon has a bachelor's degree of business administration in accountancy from the University of Notre Dame and an MBA from the Kellogg School of Management at Northwestern University. He is a certified public accountant and a member of the American Institute of Certified Public Accountants. He was the board chair and continues to serve on the board of directors for United Cerebral Palsy of Greater Cleveland.

MEGAN L. MEHALKO
Co-Chair, Corporate & Securities Practice Group
Benesch

Megan L. Mehalko is co-chair of Benesch's Corporate & Securities Practice Group and a member of the firm's executive committee, professional development committee and finance committee. She advises companies and private equity funds on corporate governance, securities law issues and strategic transactions. She has extensive experience with mergers, acquisitions, divestitures, domestic and cross-border strategic alliances and joint ventures, as well as general business counseling and distressed/insolvent company acquisitions and restructurings. Mehalko has represented companies in the manufacturing, plastics, rubber, metal forging, chemicals, health care devices and consumer products industries. She also is actively involved with the firm's public company practice, private equity group and polymer industry team. Mehalko received a bachelor's degree in economics and political science from Bucknell University and a J.D. from Case Western Reserve University. Mehalko serves on the boards of Laurel School, College Now and Business Volunteers Unlimited.

Q&A

How does a seller best position itself for a successful sale today? How does a buyer best position itself for a successful acquisition today?

AMY HELD: The definition of success is likely different depending on your side of the table, or on the underlying rationale of each transaction. Regardless, buyers and sellers each will be more successful if they begin the process with a crystallized articulation of what a successful deal is and is not for them. Is it just about getting the highest or lowest price? Or finding a partner with similar values who will represent the right "home" for the business?

Know what matters most to you and why.

Another key step for either side is crafting the "story" — this is not necessarily a 100-page deck of facts and figures — but a true narrative reflecting the heart and soul of why you are the right choice to buy (or be bought). Knowing, and when appropriate, sharing your "why" behind the transaction will increase the chance of a successful deal.

MIKE MCMAHON: Experienced sellers analyze, critique and refine management's strategic plan. They understand the correlation between effectively supporting and articulating the growth strategy with garnering premium valuations.

Before going to market, the best sellers invest significant time and effort in preparing the company for a sale process. Momentum and responsiveness during a process are critical and are impossible to achieve without adequate preparation upfront.

Buyers that stick close to their acquisition strategies are more likely to invest time on the right targets that will be accretive to their companies. They know what they want and have the ability to move quickly and often can justify more attractive valuations.

MEGAN MEHALKO: We are seeing buyers being very aggressive on timelines to distinguish their bids. While sellers are being aggressive on deal terms and indemnity exposure, buyers are willing to move fast, identifying areas of risk and focusing on those areas in due diligence.

Representation and Warranty Insurance is increasingly being used as a tool to allow sellers to walk away from a transaction with very limited post-closing exposure. Buyers are getting more and more comfortable with RWI. In addition, technology and Artificial Intelligence are being used to streamline the due diligence process. AI for document review, particularly on larger transactions with lots of documents, will be more common as this resource becomes more available and understood.

> *"We believe winning bidders act with unquestionable integrity at every step, convey a genuine passion for the target business and can articulate a compelling vision for the future grounded in meaningful market insights."*
>
> **— AMY C. HELD,** *Senior Vice President, Corporate Strategy, M&A and International,* The J.M. Smucker Co.

STEVE DYKE: It's always helpful to have a well-organized seller who has thought through their business in advance of an exit and made the investments necessary for a solid foundation. Buyers discount businesses that need significant infrastructure investments. Incomplete management teams, inadequate IT systems or production processes running at maximum capacity all factor into valuation or in some cases can cause buyers to pass on the opportunity altogether.

In addition, having a thorough and well-organized data room compiled before launching a process helps speed things along and can greatly reduce stress on a management team. Sellers can get diligence request lists from their legal counsel and/or intermediaries to help their business and management teams be well-prepared for a sale process.

Buyers improve their chances for success by understanding a seller's objectives for the transaction and then creating a deal structure to meet those needs. Many sellers and their management teams also place great value in their legacy and their employees' future. A buyer who has relevant industry experience can lessen that concern, along with access to a network of technical resources. Finding tangible ways to be a value-added partner post-closing is often worth more than the last dollar of the purchase price.

How do you see the current administration's policies and rising interest rates impacting the deal markets?

STEVE DYKE: We're already seeing margin pressure due to tariffs creeping into processes. At a minimum, it's something that we're asking about on every deal we look at these days. Sellers should get ahead of the situation and analyze the potential impact from tariffs and evaluate alternative suppliers and/or materials that could mitigate or eliminate the issue. We're starting to see wage inflation for the first time in years, and sellers should be prepared to address the impact this will have on their business.

Interest rates are on the rise at the same time that the new tax plan is limiting the deductibility of interest expense. These factors will increase borrowing costs and potentially reduce debt levels used by private equity, which in turn could impact purchase price multiples paid for companies.

However, private equity still has a lot of dry powder. Public equities remain richly valued, and lenders are still motivated to lend, so there's plenty of "currency" still available to do deals. As a result, we don't see M&A activity slowing down in any meaningful or prolonged way.

MEGAN MEHALKO: Uncertainty about trade wars and imposition of tariffs are causing some buyers to be particularly cautious. For companies that are impacted, due diligence is focused on determining the impact on costs and profitability going forward. The uncertainty is negatively impacting value to the sellers in these cases.

With respect to rising interest rates, we haven't seen a discernable impact yet. However, we do see buyers, who are still flush with cash, putting more equity into deals. There seems to be more restraint on over-leveraging balance sheets.

MIKE MCMAHON: Though rising interest rates increase the cost of capital, we are still enjoying below-average interest rate levels and will continue to do so for some time. More importantly, the availability of debt financing and equity dry powder continues to drive valuations.

Depending on whether a company is on the selling or purchasing end of tariff-impacted materials, management teams are flexing daily operating decisions, and earnings are being impacted in the near-term.

Has the competitive environment changed your approach to M&A, and if so, how?

MEGAN MEHALKO: As lawyers, we are responding to our clients' needs as we approach M&A transactions. Increasingly, we are turning review of purchase agreements in limited time and performing due diligence on an expedited basis to allow our clients to react with the speed required to be a successful bidder in a competitive environment.

STEVE DYKE: We're very disciplined about only participating in processes where we have a high degree of conviction about the opportunity due to prior industry experience, unique outside resources or another distinctive angle. Without these things, it's difficult to distinguish yourself to a seller outside of just paying the highest price, which can cause significant headwinds for the investment down the road.

AMY HELD: Large-scale acquisitions — like the acquisition of Folgers or our entry into the pet food category — have played a transformative role in Smucker's growth. What is different for us today is that growth in our industry is predominantly coming from small, emerging food and beverage startups. Since making smart choices about "where to play" is a central tenet of our portfolio management strategy, the new competitive environment required us to refine and refocus our M&A playbook, particularly in early deal phases like target identification. Specifically, we needed to cultivate stronger relationships with the startup and venture capital communities, broadening the M&A ecosystem in which we traditionally operated. We're excited to launch a new partnership model reflecting this vision in the first half of 2019.

How much and what type of preparation should go into developing a sellers' growth plan and projections?

MIKE MCMAHON: The seller's growth plan is the most critical value driver for a business. Achieving a growth multiple is predicated on a business' growth trajectory and the ability to underpin its financial projections.

Typically, the seller will work closely with its M&A advisor to pressure test the forecast to ensure it incorporates management's growth strategies and any capital investment required to execute its plan. The projections in the model must be achievable and credible. Missing forecast during the process almost always results in value degradation.

STEVE DYKE: Sellers should prepare projections well in advance of selling their business. A high-quality strategic growth plan should be credible and defensible. Buyers will spend a lot time dissecting it to pressure test the various assumptions that went into building the projections. It's important that the growth plan is management's own forecast, and not the intermediary's.

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Nothing is worse than being told, "Those aren't our numbers. Our bankers put those projections together." However, a good intermediary can help create the plan and present it in a standardized format that is easily understood by buyers.

What debt multiples are you seeing? Do you think this will continue?

MIKE MCMAHON: The debt financing markets continue to be robust and very competitive in terms of leverage multiples, pricing and terms. Given the availability of capital, we have been in a period of rising debt multiples for some time, which continue to remain significantly higher than historical averages.

In addition, given the level of competition, pricing and terms are very favorable to companies and equity investors. As we look to 2019, the economy continues to keep pace, and the availability of capital will likely offset any movements by the Fed, which should keep debt multiples at strong levels in the near-term.

Beyond just price, what are the top three ways private equity firms can differentiate themselves in a process?

STEVE DYKE: First and foremost, buyers need to take the time to understand ownership's and management's objectives for selling the business and then develop a deal structure and growth plan for achieving those goals. Examples may include tailoring equity incentive plans to drive outsized growth; expanding the shareholder base to create wealth generation opportunities for key employees who otherwise wouldn't have the opportunity; or helping plan and execute a buy-and-build strategy. It's difficult to prevail in a process if you're only bringing money to the table, as valuation is rarely a sellers only consideration. Sometimes, it's not even the top priority.

Another differentiator is providing access to a toolkit of operating resources that can help management teams achieve their growth plans by accelerating investments in sales, marketing, operations or technology. Also, firms that can provide incremental capital and expertise to identify and close add-on acquisitions can help teams dramatically scale their businesses.

In the case of Align, our goal is to double or triple the size of our companies, while being a value-added partner. Therefore, we make sure our management teams have the resources they need to accomplish that level of growth.

MIKE MCMAHON: In addition to valuation, certainty of close is a top priority for any seller. Processes are disruptive to any organization. The risk of conducting a process and going down the path with a single buyer and then ultimately not closing is unacceptable. To increase certainty of close, private equity buyers can front-run more diligence earlier in the process, proceed without a financing contingency and minimize time to close.

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> **— STEVE DYKE,** *Managing Partner,* Align Capital Partners

Who should be brought into the seller's inner circle, and what is the appropriate timing of disclosure?

MIKE MCMAHON: Irrespective of ownership structure, private or public, a seller is always challenged with determining the size of the inner circle within the organization and the timing of bringing individuals into the transaction process. Minimizing confidentiality leaks and disruption within the organization is a high priority. The seller also must balance these concerns by having a team in place that can gather the pertinent information required for marketing materials and buyer diligence, while building and articulating a compelling investment thesis for buyers to evaluate.

Sellers typically work closely with their M&A advisor to determine the scope of the group, including the rationale for inclusion, as well as the staging of bringing individuals into the inner circle. At a minimum, the CEO/president and CFO-types are involved at the outset to kick off the preparation and data compilation phase of the process.

However, in many cases, sales and operations leaders are brought in to offer more substance and details pertaining to the growth strategy and the key success factors that differentiate a business amongst its peers. As the process unfolds and qualified buyers enter into more substantive diligence, the CEO, CFO, vice president of marketing and vice president of operations represent the senior leadership that will execute on the strategic plan going forward.

STEVE DYKE: This is a very seller-specific issue and depends on the culture of the business. Some sellers are very proactive and talk to employees in advance of launching a sale process. As a buyer, we like that as it demonstrates an open, collaborative culture.

Others prefer to keep things close to the vest and only tell a couple of people in the organization. While sometimes this can make sense, employees, customers and suppliers often find out anyway, so it's typically better to control the message by informing interested parties up front. If you don't, the team will likely find out anyway. They often fear the worst-case scenario, which typically creates more angst than if the seller were upfront about the expected sale process from the beginning.

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Many companies now have a venture or incubator team to partner and nurture startup businesses in lieu of acquiring. Are you participating in this way and if so, what benefits have you seen or observed?

MEGAN MEHALKO: We have clients that have benefited from this approach. In one case, our client was raising capital to finalize development of its product and obtain FDA clearance. We identified a strategic partner and approached its development company. The development company made a minority investment. The product was finished, received FDA approval, and because the initial investment by the development company gave the strategic partner more knowledge and comfort with the technology, product and team, that buyer was the successful acquirer in the end. This approach can create a partnership that benefits both parties.

What are the pros and cons of conducting a broad auction process versus a targeted process?

STEVE DYKE: A broad auction exposes the company to significantly more buyers, which might end up identifying a less obvious buyer. However, broad auctions can be more burdensome for management teams, as there are more buyers to meet, questions to answer and information requests to fulfill. A broad process also places sensitive information in the hands of many more potential buyers, which may increase the chances of news about the contemplated sale reaching the marketplace sooner than the owners prefer.

MEGAN MEHALKO: A broad auction process can be very taxing on management, who are still trying to run a company during a sale process. If a broad auction is being run, it is important that advisors, management and stakeholders agree to very clear process parameters and responsibilities up front.

The burden should be on advisors to run interference, vet proposals and bidders, and distill the results of the process so that stakeholders can determine the best alternatives. A broad auction process can bring value in the nature of bidders that were not identified at the outset. Additional competition can also drive up values in an auction process.

MIKE MCMAHON: When contemplating a sale process, sellers must weigh the pros and cons of going out to a broad group of parties relative to conducting a more targeted approach.

Targeted processes are typically considered if there are identified parties with certain strategic angles that are motivated to aggressively pursue the business. Relative to a broad process, approaching a targeted group will reduce confidentiality leaks, minimize inefficiencies around educating non-strategic parties that are getting up the curve and can potentially streamline the timing to completing a transaction. Lastly, in a frothy M&A market, certain strategic buyers that have the ability to pay synergistic valuations are more likely to engage in a targeted process versus a broad, prescribed auction process.

Though broad processes increase sensitivity concerns and could take longer to reach a conclusion, the seller gains additional comfort that the process did not overlook any buyers and, in the end, maximized alternatives and ultimately valuation. Selling shareholders, such as private equity groups, with external fiduciary obligations to investors often gravitate toward a controlled, broad auction process to ensure every stone was turned over to maximize the outcome.

What is the most critical piece of advice you share with management teams in advance of buyer visits?

MIKE MCMAHON: Though management teams are experts in their fields and have a deep understanding of their respective businesses, making a formal presentation to an interested party is often unnatural for them. Often, their humility can prevent them from showcasing what they have done as a team to take the franchise from good to great.

Advisors spend significant time with teams in management presentation dress rehearsals to ensure the team's passion and conviction in their business models and that strategic growth plans are conveyed to visiting buyers. It is perfectly appropriate to be proud of what you have accomplished and even more so to demonstrate enthusiasm about what lies ahead.

Management team commitment and conviction is a top selling point in any process. No matter how attractive a strategic plan looks on paper, the team has to demonstrate a commitment and ability to execute it.

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How does a buyer best position itself with the target's key stakeholders?

AMY HELD: It is important to focus on the larger, strategic picture and not just getting the right price. We believe winning bidders act with unquestionable integrity at every step, convey a genuine passion for the target business and can articulate a compelling vision for the future grounded in meaningful market insights. It's not always just about who can wire the most proceeds. For many sellers, it matters just as much — and sometimes more — to find the right home for their business, brands/products and employees.

MIKE MCMAHON: Every seller appreciates a buyer that is fully engaged during the process. From the first call from the investment banker describing the opportunity to later stage diligence, the level of engagement must continue to rise. The best buyers typically demonstrate engagement through hours of substantive independent preparation to understand the target's business. Sellers are always evaluating a particular buyer's line of questioning, whether they understand what drives the business and lastly, but most importantly, the interest level of the decision-maker on the buyer's team.

If a decision-maker is absent or disengaged in a process, sellers can feel slighted and lose confidence in the buyer's ability to consummate a transaction. Moreover, it sends a signal as to their business' importance to a financial portfolio or broader organization going forward. By demonstrating a commitment to working diligently and thoughtfully through their evaluation process, effective buyers not only can differentiate themselves in the short term, but they are more likely to establish a longstanding bond with the management team.

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MEGAN MEHALKO: The nature of the stakeholders heavily influences how a buyer should position itself. A family owned business, interested in protecting its legacy and its employees, will have very different priorities from a seller interested in maximizing value and walking away. A buyer must understand the drivers of the seller's decision and adjust its approach accordingly.

Sometimes, it requires months, even years, to build a relationship and trust with the stakeholders to position yourself as the right buyer for the company. In others, where the seller has decided to sell in a competitive auction process, it means the buyer needs to show up with the best bid, differentiated based on the priorities articulated by the seller, whether that bid reflects value, elimination of post-closing exposure or continued involvement of current management.

How do you expect deal flow to change over the next year? What are you doing to address any anticipated changes?

STEVE DYKE: We don't expect deal flow to change materially in 2019. It's still a really good time to sell a business due to the strong economy, lending environment and amount of capital needing to be deployed by private equity firms. Align will continue to focus on buying family-owned specialty manufacturing, distribution and business services companies and bringing a high degree of conviction and certainty of close to the processes where we have an angle and actively engage. If we do our job right, we expect to deploy as much capital in 2019 as we have in previous years.

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