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Table of Experts Panel (L-R): Mick McCormick, Christine Nowaczyk, Andrew Kelly, Ben L. Darwin

Ben L. Darwin: Mick, I think it would be good to start by learning how your company helps businesses get ready to go to market.

Mick McCormick: Part of it starts pre-integration. How do we make sure or help so the transaction gets completed. We can help the target company through making sure their processes are ready when they get there, their team is ready, they have solid plans. Once that's done and the transaction's complete, then we can help them with the integration and post-integration.

That first 180 days is critical on HR and finance, and you have different processes generally speaking because that company was not set up to be run by somebody else. Different sets of expectations, and you have a team in that company that's fully utilized already running the business, and so they need a little extra help in identifying how to integrate systems, people and processes, and once they're set, that's a great foundation after the first 180 days. If they don't do that, it can take years if ever to integrate into an acquire.

Ben L. Darwin: Do sellers anticipate this is

what they're going to be doing when they begin the process of deciding to pursue a transaction?

Mick McCormick: Usually, the owners we're working with are private equity or large family offices, so they're not strategic purchasers. Those private equity firms or family offices, they don't want to run the office. They want to be governing partners, and the challenge for them is how do they make sure that they're good governors and let the operating team run. They both need to agree on what the goals are, what those measurements for success look like, and getting the two organizations there in process and people is the key.

Ben L. Darwin: Christine, from the bank's point of view, often times you get engaged into these transactions because you have a relationship with the seller. What's your view on what you just heard from Mick?

Christine Nowaczyk: I agree with Mick that in-depth advance preparation for the sale helps support a successful integration. For example, it is not uncommon for often over-burdened management teams to struggle with the increased financial reporting and

heightened transparency that results after a sale. It's a different ballgame and therefore important to ensure that expectations are aligned with roles and responsibilities being identified before consummating the transaction. Management teams that are used to running the day-to-day operations of a business may not be experienced in reporting to new investors, lenders or owners. In many instances, they have not been accountable to an outside board of directors, managed the risk of carrying increased debt levels, or had to provide higher quality financial statements. There always seems to be some level of

surprise and an underestimate of what it takes to successfully prepare for and integrate a transaction.

Ben L. Darwin: So how do people bridge the gap?

Christine Nowaczyk: Using skilled advisers is always a good idea. This includes resources to evaluate your company's internal team, external partnerships, capital structure and marketing strategy going forward. Finding an experienced investment banker, commercial banker, talent firm and PR partner can help you to identify what to expect on the other side of the transaction and to plan accordingly for resources. Knowing who will fill leadership roles, manage the heightened reporting, oversee due diligence, merge systems and all of the other responsibilities that result from a transaction should be determined ahead of time. In many instances, it comes from support outside of the people running the business.

Ben L. Darwin: Why should it be somebody other than the people already in the business?

Christine Nowaczyk: With all of the moving parts in a transaction, it's not uncommon for sellers to take their eye off the ball due to increased demands on their time and attention. They are often faced with important life-long strategic and financial decisions that require thoughtful reflection. With all of this, operations and the overall business can struggle, particularly since in the early stages of most transactions, the opportunity is held close to the vest. Experienced advisers can add value by offering solutions to help them continue to execute well, identify succession gaps and to meet shareholder expectations. As a capital provider,

we want to see the company be successful going forward, and this includes exceeding projections that are verified by quality financial reporting and independent



BEN L. DARWIN, CPA
Principal
CliftonLarsonAllen LLP
MODERATOR

Ben is the principal-in-charge of tax services for the Phoenix Arizona office. He has more than 27 years experience as a business adviser and tax consultant to entrepreneurs. As a principal with CLA, Ben's vision and insight

has helped clients build and retain capital by leveraging tax saving strategies. His commitment to private clients and their unique needs has also contributed to the successful transition of family businesses to new generations. Ben focuses on clients in the real estate industry, working with emerging fund managers and sponsors, private family offices, private groups and

business owners in the Southwest who acquire real estate including developers, investors and operators. He is highly knowledgeable in specialized technical areas such as mergers and acquisitions, business succession planning, pass-through taxation, accounting method planning, and estate and gift planning.

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due diligence.

Ben L. Darwin: So it is a resource and a time issue?

Christine Nowaczyk: Yes, it's a resource and in many instances, a talent issue. Sellers that are experts at running their businesses are not necessarily experienced in the nuances of M&A or in leading more complex organizations. They may lack the leadership and technical talent required to meet the demands of the new business, the new owners and likely an ever-changing industry. It's not uncommon to bring in additional financial, legal, technical and compliance resources to support a transaction.

Ben L. Darwin: From the post-closing lender's point of view there is an expectation around financial reporting. What does that look like?

Christine Nowaczyk: For the core middle market, it generally includes upgrading financial statements to an audited quality, providing detailed projections, verifying the quality of earnings and testing the company's books and records to ensure everything is in order. It is not uncommon to verify that taxes have been paid, litigation has been mitigated, contracts have been validated and that assets have been properly valued.

Ben L. Darwin: Andrew, lets shift to the legal side. A seller gets ready, goes to market, identifies potential suitors or equity investors, closes and then steps into the post-closing phase. What are your thoughts about the steps involved?

Andrew Kelly: I think the preparation and getting the company ready for a transaction or a sale is important, but I would echo this idea that the management team shouldn't take its eye off running the business because a lot of times these things don't close for whatever reason. So, bringing in outside people to help with this process, educating the founders in particular, is important. This is often a one-time event for them. Explaining the entire process to them is one thing that we try to do at the outset.

Ben L. Darwin: Sellers are often surprised or blindsided by if you will during this process. What are some of the examples of blind-spots that you see come up?

Andrew Kelly: Sometimes just the depth

of due diligence the buyers want to perform, particularly if they're a private equity firm. They have whole teams of people and even outsource some of the work. They will come in and do such a deep dive that a founder just doesn't understand, and sometimes they haven't organized the business in a way that makes the due diligence process easy. Owners know what's important to their successful operation of the business, but an outsider who's coming in is going to want to see everything. If it's not well-organized, then the due diligence process can turn into a bit of a

black hole.

Ben L. Darwin: How do you help them see the movie or read the script before it happens?

Christine Nowaczyk: Setting appropriate expectations from that start and bringing in outside resources can alleviate much of the stress and help to improve chances to close a deal. Much of the required due diligence and transparency in M&A can be new to the seller who is used to running their business and not being beholden to others. An advisor like Mick can come in and help the company to improve its data, review financial statements, identify talent gaps and assess the company's overall marketability. Advisers have industry knowledge and tools to help bolster valuations. Sellers need to know from the start that we're going to peel back all aspects of the onion to help them achieve the best possible market value.

Mick McCormick: We do this all the time where communicating to the seller that by having your books and your processes in order builds confidence, and the clients we work with, substantially mostly the acquirers, will pay another at probably one more times multiple for a company that is well organized and ready for that process, and the reason why is they have confidence in that company..

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ANDREW P. KELLY
Attorney
Osborn Maledon

Andrew Kelly is a partner at the Phoenix law firm Osborn Maledon whose practice focuses on commercial transactions, including mergers and acquisitions, software licensing, entity formation, employment matters, securities and general counsel services.

Kelly has been recognized by Southwest Super Lawyers (Business/Corporate, 2017-2018); by Chambers USA, America's Leading Lawyers for Business (Corporate/M&A, 2006-2018); by The Best Lawyers in America®, Gaming Law (Corporate Law, 2009-2018); and by Arizona's Finest Lawyers.

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I think the preparation and getting the company ready for a transaction or a sale is important, but I would echo this idea that the management team shouldn't take its eye off running the business because a lot of times these things don't close for whatever reason.

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MICK MCCORMICK
Partner/Co-Founder
GO Intellectual Capital

Mick brings a proven general management track record, 30 years of developing teams that executed superior financial returns in sporting goods business. As executive vice president of Global Sales at Columbia Sportswear, he led the repositioning of four brands - Columbia, Mountain Hardwear, Sorel, & Montrail. Launched a comprehensive Retail Organization - Global Branded Stores, E-Comm and Outlet, profitably improving the consumer's experience. CMO of Golf Galaxy - the fastest growing golf retailer in the US. It's successful growth led to an IPO in 2005. Got his Go-to-Market chops with 10 years at Nike, leading a variety of teams in sporting goods, team, running specialty, and department stores.

That first 180 days is critical on HR and finance, and you have different processes generally speaking because that company was not set up to be run by somebody else.

contracts. That's worth an incremental \$5 million dollars to that seller.

Andrew Kelly: And you're going to progress more quickly. The longer the transaction process goes on, the more complications can occur; so having things ready to go can let the transaction happen much more quickly.

Christine Nowaczyk: The last thing you want as a seller is any surprises, so don't take offense to the rigorous due diligence. In the long-run, it will help you earn more money and improve your ability to close the deal.

Ben L. Darwin: So, how far in advance should an owner start planning for a transaction?

Andrew Kelly: It depends on what their plans are. If it's a founder who's looking to retire or exit, then they may have a date in mind. But some of these things are sort of best practices that the business might want to be doing, and would benefit from, anyway. A year would be a reasonable time to start the process in earnest.

Christine Nowaczyk: I would say a year to two years to get your affairs in order. This includes your financials, contracts and systems. It allows time to fix any shortcomings.

Mick McCormick: I agree with a year or two. The other part, which I think is important, is privately held companies, generally speaking, don't know what the value of their company is. So, if you were to ask an entrepreneurial owner, "What's the value of the company?"

Well, this competitor sold for X. That's not the value of your company. What we recommend is these companies go through evaluation, not a certified one, just a high-level evaluation. So, my company is worth \$25 million dollars today, and here's the reasons why in the market it's worth that.



What's so important about that is that's now our scorecard to start with. What are those levers to pull to make my company worth \$50 million dollars four years from now, and would you like to do that? There are those key levers in there so that they can drive that value in the process. Every publicly traded company knows exactly the value of its business every second of every day.

Ben L. Darwin: In your experience, what are

the gaps between what the owner sees as the drivers of value versus what the acquirer sees?

Andrew Kelly: I think the acquirer, depending on if it is a financial buyer or a strategic buyer, might have different points of view. For a financial buyer, the cash flow is going to be critically important to them; whereas a seller, who may have been running the business without this transaction in mind, at least in the near term, might have different goals and might be less focused on those metrics.

Christine Nowaczyk: Cash flow is always a leading driver of value that seems to be consistent across the board. Disconnects exist when it comes to how we evaluate the cash flow, but at the end of the day, it is king. It is important to be able to identify those uses of cash that are not integral to the ongoing success of the business and that when added back, could potentially increase the value of a transaction. This practice is not uncommon in many closely-held businesses. Some gaps exist when it comes to valuing strategic assets. Ensuring that assets are titled and owned correctly is important. Ensuring that intellectual property and technologies are protected also adds value to the business and supports expectations.

Mick McCormick: We're obsessed with the balance sheet because evaluation is going to be driven off of discounted cash flows, and so when we go in, there's a couple areas we focus in on that a lot of entrepreneurs don't think about. They think about, "I've got cash coming in; I'm okay." It's not what I'm investing to drive my initiatives, so one area is going to be they usually have too much tied up in inventory. Usually the receivables are too long on day sales outstanding. Managing those better can improve their multiple significantly.

The third one is understanding what return on invested capital means. Instead of some fancy equation in an accounting class, basically saying in your strategic plan, you're going to invest X amount. This initiative's going to get you a two-year payback, this one's going to get you a seven-year payback. They're both going to cost you the same amount. Which one should you do? That concept helps these entrepreneurs tremendously because then you say, "Go after the two-year payback."













Ben L. Darwin: What are the two or three risk areas that come up in due diligence that you would advise owners to be thinking about?

Christine Nowaczyk: Technology is top of the list in today's environment followed closely by talent assessment.

Ben L. Darwin: Why technology?

Christine Nowaczyk: Protecting data, systems and confidential client information is a business risk that impacts all of us. It is important for buyers to know what they are getting into and what amount of investment will be required going forward. No one wants a technology breach or failure that impacts the value and reputation of a business. The second point for me is on the people side of the business. Evaluating the talent that exists within the company today and how they will contribute to its success going forward. Understanding the level of employee engagement and commitment to the culture is key. It is not uncommon in M&A today to rely on advisers that focus on people, their aptitude

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and their character.

Andrew Kelly: I would echo Christine's comment about technology, in particular privacy and cybersecurity exposures. There are lots of examples of big companies, Equifax or somebody like that, having massive problems in these areas. But even for privately held businesses, a breach like that can generate tremendous potential liability. Making sure your company has done what it can to protect against these kinds of things is something a sophisticated buyer is going to carefully analyze these days.

Assuring security of data would be one thing that you could focus on as you're trying to get the company ready. It's something you should be doing anyway.

Ben Darwin: How do buyers deal with the technology risk in a transaction?

Andrew Kelly: They would see what the seller has in place. If they identify weaknesses, they know it. And it's something that you can try to address in the contracts, because if an event happened before closing, they're going to want to make sure the seller remains responsible for it. But it's also something they want to assure that if they close, can they adequately address it? What will be the expense associated with it? So, they can bake that into their overall analysis of whether they want to do a transaction.

Mick McCormick: The other one I would add is, that team is going to have to grow that business after it closes. How do you identify the value of that company, number one? And the ability of the team to execute?

The value of the company can be done by consumer or business-to-business research. More than 90 percent of our business-to-business clients don't ever reach out to their customers to ask how they're doing, what they can do better and what products are in the future. They do it informally, but they don't do it on an annual basis.

The other one is, there's going to be a plan in place. There's always a plan the operating team puts in place. How do you pressure test that? They're going to have to execute it. You need the ability, as the choir, to come in and say, ok, we see this, let's pressure test it.

Ben Darwin: Another area I think sellers are interested in learning from this group about is how a company can create the handcuffs that will reward and insure that key players stick around post closing.

Christine Nowaczyk: There are many ways to structure the retention of talent including contractual arrangements, employment agreements, cash and stock bonuses, transition services and post-transaction performance compensation. Hiring an experienced attorney to help you document these situations is a necessity. As a business leader, it's important to honestly evaluate the skill set of the team that is being acquired and to quickly determine where you have gaps. The length of retention-based

punishment handcuffs. So, we want them to achieve their goals with some nice little carrots out there. Sometimes it's not enough to make that much difference. And you see that in the operating tapes.

Christine Nowaczyk: And, you need clearly defined expectations and calculations as it pertains to seller earn-outs. The more you leave for interpretation down the road, the more problems arise.

Andrew Kelly: Typically in a deal, certain



agreements is integral and depends on your assessment of the business needs, which can often morph post-transaction. There are often difficult decisions when it comes to evaluating talent, particularly where employees have been with the business and its seller for a long time, but may not have the opportunity for the same role in a more complex business environment. You need to ensure everyone is in the right seat, and then provide incentives that are aligned with the current objectives and culture.

Mick McCormick: The evaluation of the team is critical to know where those gaps are. You need to know as much. We like seeing transactions where the team has quite a bit of skin in the game for the upside.

If that's there, those handcuffs become golden handcuffs instead of ones that are really

key individuals will get employment agreements with the company or the acquirer going forward. These individuals can be incentivized through equity grants or phantom stock grants or other benefits like that. That's the golden handcuff, which is coupled with non-competition agreements with these same individuals, to give the buyer some degree of confidence that these key people aren't going to go out and start competing with their former employer.

At the highest level, founders who the buyer wants to stay on and keep running the business are frequently rolling over a portion of their deal proceeds into the acquiring company and owning it directly. That self-interest is well-embedded in the structure of company going forward.

Ben Darwin: Those handcuffs and incentives come in the form of contracts that have tax implications to the employee and the employer. And recently with the Jobs and Tax Cuts Act passed in December the landscape has changed. How has this impacted how the Acquirer/Suitor approached a transaction and how is this effecting sellers?

From the reader's point of view, understanding how acquirers are going to be looking at this landscape, both in terms of the opportunities they see in the marketplace, in terms of what tax reform has meant to just heating up the economy, to how they approach a transaction.

What are you seeing that mean to the M&A industry as a whole? And what are the implications to sellers today?

Andrew Kelly: The new tax act was the biggest change in the tax code in the last 30 years or so. In the M&A world, I think the reduction in the corporate income tax should mean corporations will have more capital available to engage in mergers and acquisitions. That's a good thing. There should be more activity due to that.

Another change in the tax code I think is advantageous for the buyers is the change in the expensing rules: Under the new law there is an allowance for the immediate (100%) expensing of certain types of tangible assets, including used assets. I think you'll see a lot of deals being structured to let buyers take advantage of that new treatment immediately. Buyers will be pushing to have as much of the purchase price as they can allocated to a class of assets that they can expense 100 percent in year one. Buyers may not want to do that. So, there'll be a negotiation over that.

Those are two high-level changes I think will start showing up quickly. The new tax law has only been in effect for six months. Things are really just starting to show up in practice.

Ben Darwin: A hot tax topic is whether the target or the acquirer should operate as a pass-through entity, a partnership or S corporation, or a C corporation. How is this being addressed in deals today?

Andrew Kelly: It's a tough call. We work with lots of accounting firms on these structuring issues, and there is no single right answer. The decision to convert is a pretty

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**CHRISTINE NOWACZYK**

SVP & Corporate Banking Executive
Bank of Arizona

Christine serves on the Bank of Arizona executive team and leads the corporate banking line of business which provides solutions to the middle market, corporate and Native American segments. She joined \$34 billion BOK Financial in 2006, after nearly two decades with JPMorgan Chase, to help build its Bank of Arizona subsidiary. Christine is a leader within the Association for Corporate Growth, a global community for middle-market M&A deal-makers and business leaders. She was appointed to the ACG Global Board of Directors, responsible for shaping the organization's 59 worldwide chapters that serve more than 90,000 investors, executives, lenders and advisers to growing companies. Christine is President Emeritus of ACG Arizona and a member of Arizona Business Leadership. Her philanthropic roles focus on improving the lives of Arizona's most vulnerable children. Christine is Board Chairman of Educare Arizona, a nationally-acclaimed early learning program and a Past-President of Children's Action Alliance.

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significant one. It just needs to be well-analyzed. I hate to say it, but these tax laws can also be reversed. You're going to risk making a significant change without a lot of certainty that some of these things might not change, depending on the elections.

Ben Darwin: It does seem that acquirers are still looking for post-closing deductions. Thus it would seem that asset acquisition transactions continue to be popular because they generate deductions. Do you see that approach continuing?

Andrew Kelly: I definitely do. And even on a stock deal, you'll see people trying to structure them with a Section 338(h)(10) election so they can still get the stepped-up basis in the assets.

Ben Darwin: Shifting gears to Mick, when you think about tax reform, what are owner's perspectives about the impact of tax law changes on their business? On a potential transaction?

Mick McCormick: I would agree with both of you. It's kind of a flip of a coin right now. I think there's a lot of wait and see what happens. Tax laws could change. We see a lot of people just staying where they're at right now to see where it stands.

But we also see something bigger on the global side. Don't know where it's going to wash out. Transactions were down in Q1, in the U.S., and a large part of that was the uncertainty about where the tax laws were going to wash out.

I was fortunate enough to go to the ACG Capital Growth event in Chicago a week and a half ago. I sat in the Global M&A discussion. On that were, three global law firms, and two global accounting firms. And they all represented Japan, China, Canada, and Europe, the UK and then mainland Europe.

What was interesting in that discussion was there has been a huge shift from those companies investing into other countries around the world to refocusing their purchases on middle-market America. Every single geography. Japan was investing in South East Asia and the rest of Asia, and it has now shifted



already most 100 percent in those firms to the U.S. I couldn't believe it with Canada, the same way.

There's a bigger opportunity here for the United States and our middle-market clients because there's \$1 trillion of private equity sitting there. Now you have this global market coming because of the tax. That was interesting to see how their clients were shifting investments to the United States.

Ben Darwin: So, that implies that there's going to be more capital seeking opportunities in the U.S.

Christine Nowaczyk: Yes, there is global economic uncertainty and we're in a rising interest rate environment, which is another consideration that you have to factor in addition to the impact of tax reform.

To Mick's point, we're seeing the resurgence of Main Street and made in America investments. More small businesses are being formed than failing, and funding is coming from U.S.-based investors, whether it be private equity, family office or individuals seeking yield.

To Mick's point, we're seeing the resurgence of main street, as I like to call it. And that is the investment in the United States. U.S.-based investors, whether it be private equity, family office, high-net-worth individuals, they're looking to stay here with their investments.



We're seeing less and less activity going abroad. **Ben Darwin:** One of the things that came out of tax reform was a potential limitation on the deduction of interest. I'm curious whether there's a sense that this will change how deals are structured financially?

Christine Nowaczyk: Deductibility of interest is certainly an influencing factor and will have a meaningful impact on highly leveraged businesses. However, capital structures have been driven by the abundance of resources and how aggressively investors are working to put their money to use. High valuations, flexibility and competition have played a significant role.

Mick McCormick: It's also up to the individual seller, and what they're trying to do or acquire, what they're trying to accomplish with the capital structure. That still drives more of the decision-making process than the tax.

Ben Darwin: I'd like to wrap up by having each of you share a little bit about what you see as the current trends in the M&A space.

Christine Nowaczyk: The past two years have been robust for middle market M&A and we don't see that slowing down soon. The need for advancing technology is driving growth as is companies working to improve their digital strategy. M&A as a way to acquire talent is trending too. Given a relatively low interest rate environment, ample capital seeking investment, regulatory reform, strong earnings and plenty of liquidity, M&A should be solid for the upcoming year.

Mick McCormick: We see with the high multiples, depending on the marketplace from, say, seven to 12 on multiples. Acquirers are looking for a way to get into the five- to six-time multiple. The way they are doing that is, they're identifying a target, say an acquirer wants to acquire \$10 million of Evado, they're going to acquire it but not at a 10 to 12 multiple at \$100 million to a \$120 million value.

What they're going to do is buy one company at a five to six multiple at \$3 million of Evado, and then add on another two, three or four companies to that at five to six multiple. Now they have four or five companies they've rolled into that at five to six. So, good strategy if you can get it to grow.

The challenge is now you've increase your risk for to five-fold on execution. You bought Evado now at \$55 million or \$60 million, and you're going to experience that upside, you just have to make sure all those companies have the ability to execute that process. We see that as a major trend right now.

Christine Nowaczyk: There's more of a convergence across industries than what we've seen in the past, combining sectors such as technology and media or health care and pharmaceuticals. We're expecting to see combinations of businesses in ways that we never have in the past.

Mick McCormick: There's more opportunity now than I've ever seen in my lifetime.

Andrew Kelly: I would echo Christine's comments that we see it as very robust. You see the national and international statistics are ramping up nicely. I think it's a little tougher to get great data on Arizona specifically, but anecdotally, the work that we're doing, we're very busy. Talk to other professionals in the area, and the Arizona M&A scene seems to be also very robust.