CliftonLarsonAllen

How to Prepare Now for a Successful Business Sale Later

May 16, 2017

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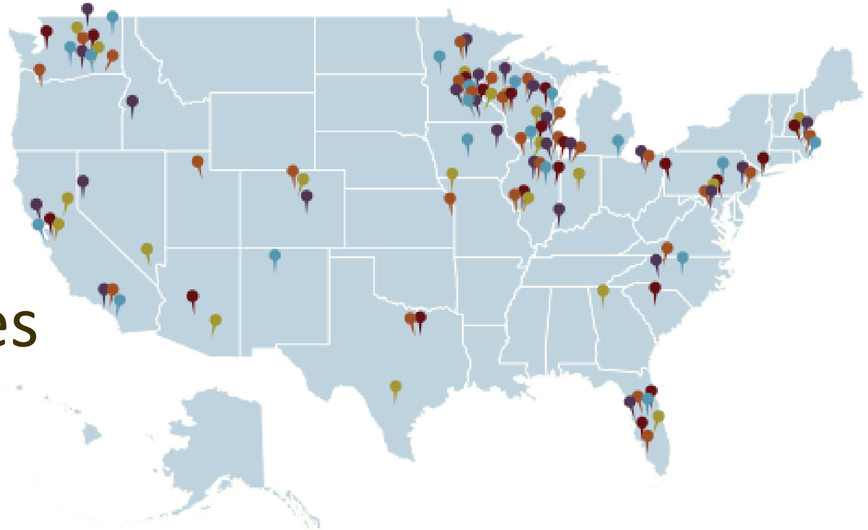
About CliftonLarsonAllen

- A professional services firm with three distinct business lines
  - Wealth Advisory
  - Outsourcing
  - Audit, Tax, and Consulting
- More than 5,000 employees
- Offices coast to coast



Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC.

About CliftonLarsonAllen

- Transaction support team helps negotiate better terms and improve value
- M&A advisory professionals design and manage a customized process, creating competitive tension to optimize valuations and non-economic terms
- Capabilities are complemented by our strong collective knowledge of your industry

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC. Merger and acquisition, wealth management, and investment planning services are offered through CliftonLarsonAllen Wealth Advisors, LLC, member FINRA and SIPC.

Speaker Introductions

- **Craig Arends**
  Managing Principal, Private Equity Practice
  Craig has more than 20 years of experience in public accounting serving public companies, private equity groups, and companies raising debt and equity
- **Ben Axelrod**
  Head of Investment Banking Advisory
  Ben has more than 15 years of transaction experience focused on providing strategic advice to middle market entrepreneurs and corporate clients.
- **Samantha Metcalf**
  Managing Principal, Manufacturing and Distribution
  Sam has more than 15 years of experience providing assurance, tax, and consulting services to closely-held companies including retail, emerging growth, printing, and manufacturing entities.

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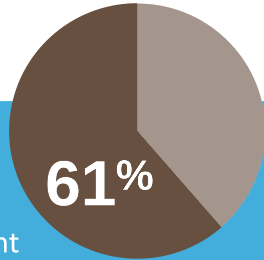
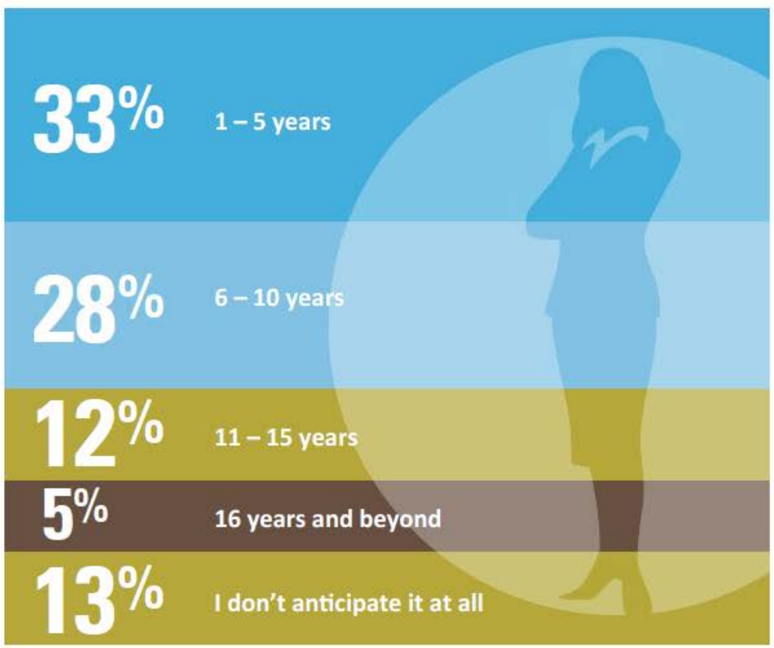
Ownership Transition Facts



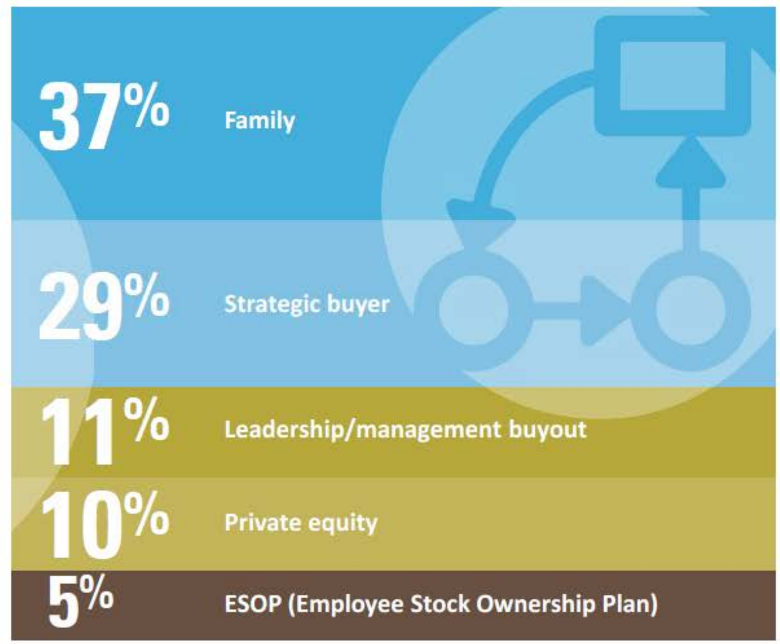
Survey participants that will have a transition event (ownership, leadership, or both) within the next 10 years,

Level of Preparedness for Transition

Length of Time Anticipated for Succession



Likely Strategic Plan for Succession



Only showing those at 5 percent or more of mentions.

Agenda and Discussion Topics

- Business planning
- Financial preparation
- What to expect in the sales process
- Tips to improve positioning

Business Planning

Operate as if your business is always for sale!

Business Planning

- A Healthy Sustainable Business Creates Options
- Understand Your Strengths and Value Drivers
- Know Your Blind Spots and Areas for Improvement

Business and Personal Planning

- Have the Right Team
- Understand Owner's Reliance on Company For Financial Goals
- Understand All Options

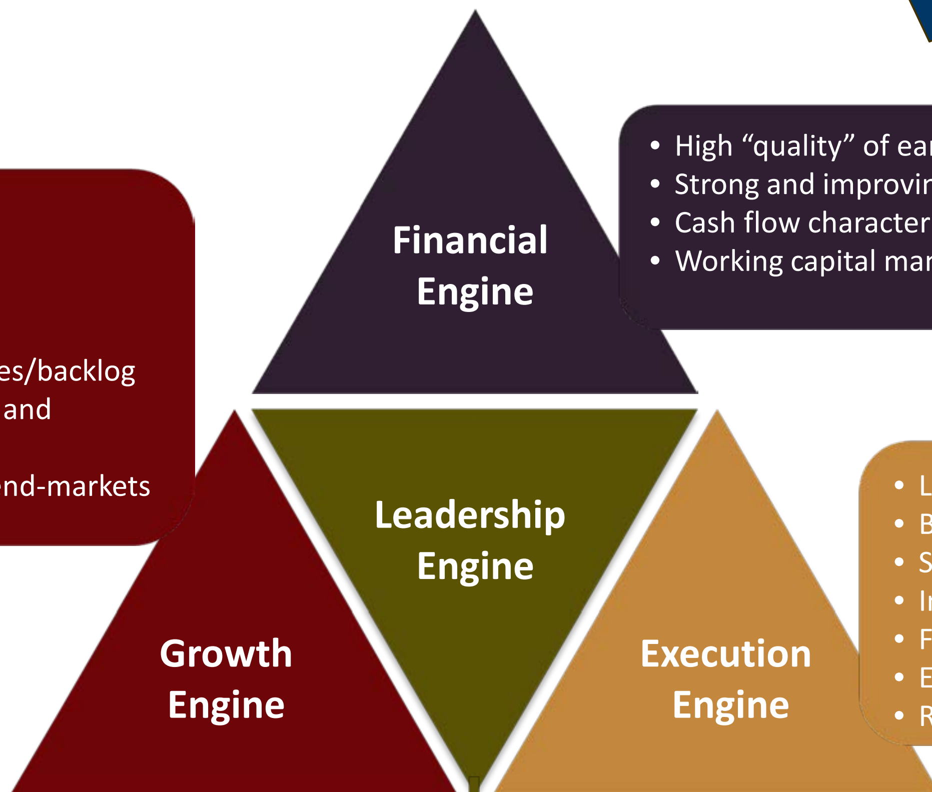
Personal Planning

- Lay Out Your Dream
- Communicate Your Dream To Those That Need To Know
- Create a Financial Plan
- Create Options Through Wealth Diversification

It is About More Than Just Numbers…

Build a Healthy, Sustainable Business

How Will Buyers Perceive Your Business?



Financial Engine

- High "quality" of earnings
- Strong and improving margins
- Cash flow characteristics
- Working capital management

Growth Engine

- Value proposition
- Scalability
- Customer and market concentration
- Actionable opportunities/backlog
- Track record of organic and inorganic growth
- Growing industry and end-markets

Execution Engine

- Leading market position
- Barriers to entry
- Strong R&D/engineering
- Industry-leading KPIs
- Flexibility
- Employee base
- Resilience through downturns

Leadership Engine

- Integration of the other three engines
- Empowered and experienced team
- Clear succession plans and prepared for unexpected

Have the Right Team

Who

- Legal
- Accounting and tax
- Investment banking
- Lender
- Professional management team
- Board of advisors

Characteristics

- Ability to provide honest feedback and criticism
- Appropriate technical skillset
- Experienced in their field
- Aligned with culture, supports goals and dreams

Financial Preparation

Valuation Methodology

Enterprise Value

Enterprise Value less debt = Equity Value

Cash Free/Debt Free

Normalized or Targeted Net Working Capital

Stock vs. Asset Deal

Rise of Sell-Side Quality of Earnings

- Competitive and efficient market process
- Increasing valuation multiples
- More intense buy side process
- Over 40% of investment banker deals failed
- Long established European practice

Objective of Sell-Side Quality of Earnings

- Preserve value through the process
- Increase certainty of close
- Decrease time to close
- Reduce the number of "surprises" in the process
- Prepare the business owner and company for the buy-side process

What Is Sell-Side Quality of Earnings?

- An independent analysis of the seller's financial information
- Components of a typical Q of E engagement
  - Analysis of EBITDA
    - ◊ Assessment of the defensibility of the adjustments to EBITDA
    - ◊ Independent identification of EBITDA adjustments
  - Analysis of management's numbers including historical working capital and working capital pegs
  - Tax Matters
- Assist in the preparation of a financial information package
- What is the difference between an audit with a Q of E?
- Who typically provides the Q of E?

What Determines Scope?

- General quality of the existing financial information
- Are the financial statements, compiled, reviewed or audited?
- Are there specific issues with the company revenue generation (e.g. percentage of completion) or sales that would benefit from additional analysis
- Large changes in working capital or other balance sheet accounts
- Seasonality and cyclicality and the potential affects on the working capital
- Rapid growth or dramatic swings in the profitability of a business
- Changes in the Company’s cost structures were a pro-forma analysis would be beneficial
- Tax complexity

Understanding Adjustments to EBITDA

- Owner Compensation and Perks
- Non-Arms-Length Revenue or Expenses
- Revenue or Expenses Generated by Redundant Assets
- Rent of Facilities at Prices Above or Below Fair Market Value
- Recapitalizing vs. Expensing Items
- Non-Recurring Expenses
- Lawsuits, Arbitrations, Insurance Claim Recoveries and One-Time Disputes

Understanding Adjustments to EBITDA (continued)

- Professional Fees
- Recruiting Expenses
- Severance Expenses
- Inventory Write-downs
- Restructuring Charges
- Non-cash Stock Compensation Expense

Normal Level of Working Capital

Buyer wants to have a target as **high as possible** (more positive, less negative)

Seller wants to have a target as **low** as possible

- Pay for change, not absolute amounts
- Seasonality
- Growth
- “Wide” versus “narrow” definition

Additional Thoughts

- Federal Taxes
  - Personal Expenses
  - Accounting Positions
- State Taxes
  - Income Taxes
  - Sales Taxes
  - Other Taxes (Realty Transfer, Franchise)
- Unrecorded Liabilities
- Capex
  - Requirements
  - Liens

SIMPLIFYING THE COMPLEX:

What to Expect In a Sale Process

Understand All Transition Options

- Private Equity
- Strategic Buyer
- ESOP
- Management Buyout
- Family Transition
- Other

It is important
UNDERSTAND OPTIONS
for a business transition,
but the exact outcome
does not need to be known.

Four Phases of a Sale Process

Plan

Prepare

Market

Complete transaction

Not Every Sale Happens via an "Auction"

- Sale to family
- Sale to business partner(s)
- Sale to management
- Sale to employees (ESOP)
- Introduction/referral by 3rd party
- Takeovers
- Unsolicited approach

OWNER BEWARE

- Can be and oftentimes are bottom-feeders
- You are likely not the only one approached
- Buyers are typically sophisticated and experienced
- Tires will be kicked, re-kicked and kicked again…
- Odds of deal closing are slim

Why a "Process?"

- Competitive tension
- Value maximization
- Certainty of close
- Speed
- Comparability of options
- Both buyer and seller know the other is serious
- Seller has greater control
- Better representations and warranties package

What to Expect: Process Milestones

Stage 1
- Initial Due Diligence
- Offering Materials / Buyer Identification
- Buyer Outreach
- Indications of Interest

Stage 2
- Narrow Field Through Negotiation
- Management Meetings / Operations Tours
- Deep Due Diligence / Review of Purchase Agreement
- Letters of Intent

Stage 3
- Negotiate Key Terms and Price
- Grant Exclusivity (Potentially)
- Confirmatory Diligence / Agreement Drafting
- Execute Definitive Agreement / Regulatory Filings/ Approvals
- Closing

Common Reasons Transactions Do Not Close

Buyer

Re-trading of price or terms

Excessive due diligence

No buy-in from ultimate decision maker

Lack of internal ownership

Another transaction/event

Change in strategy

Earnout terms

No trust

Deal fatigue

Personalities

Allocation of risk

Working capital

Regulatory changes

Seller

Emotion / “cold feet”

Key departures

Due diligence issues

Competitive landscape

Lack of conviction in future

Major downturn in performance

Tips to Improve Positioning

Create an Exit Strategy

- Whether approached by a buyer or going to market after years of preparation, the process steps must be deliberate
- Most of the work for attracting buyers should be done before company goes to market
- Work with advisor team to develop an exit strategy early
- Allows for long-term planning
- Ideally, begin several years before a potential transaction

Prepare Financial Information

- If financial statements are not audited, consider an audit
- Ideally, at least two years of audited financial statements prepared by a reputable national firm
- Helps identify any key accounting issues before company goes to market
- Complete a quality of earnings study

Assess and Bolster the Management Team

- Management strength is a key factor in almost all M&A
- Identify any existing gaps and fill them
- If can’t fill gaps well in advance of a process, have plan in place
- Consider ways of incentivizing management team
  - Equity/phantom stock plan
  - Stay bonuses
  - Transaction bonuses

Evaluate Your Customer/Client Base

- Heavy customer concentration can be problematic
- Any one customer representing more than 20% of total revenue will likely be seen as a significant risk
- When possible, enter into written contracts with key customers and suppliers (but preserve flexibility)
- Review existing contracts with counsel for consents, transferability, change of control provisions, etc.
- Amend non-transferable contracts if possible

Business Housekeeping

- Evaluate shedding non-core assets or closing unprofitable operations/segments
- Consider cost-savings measures such as consolidating facilities, re-allocating resources, etc.
- Analyze working capital needs, take steps to optimize
- Look for opportunities to increase efficiencies

Corporate Housekeeping

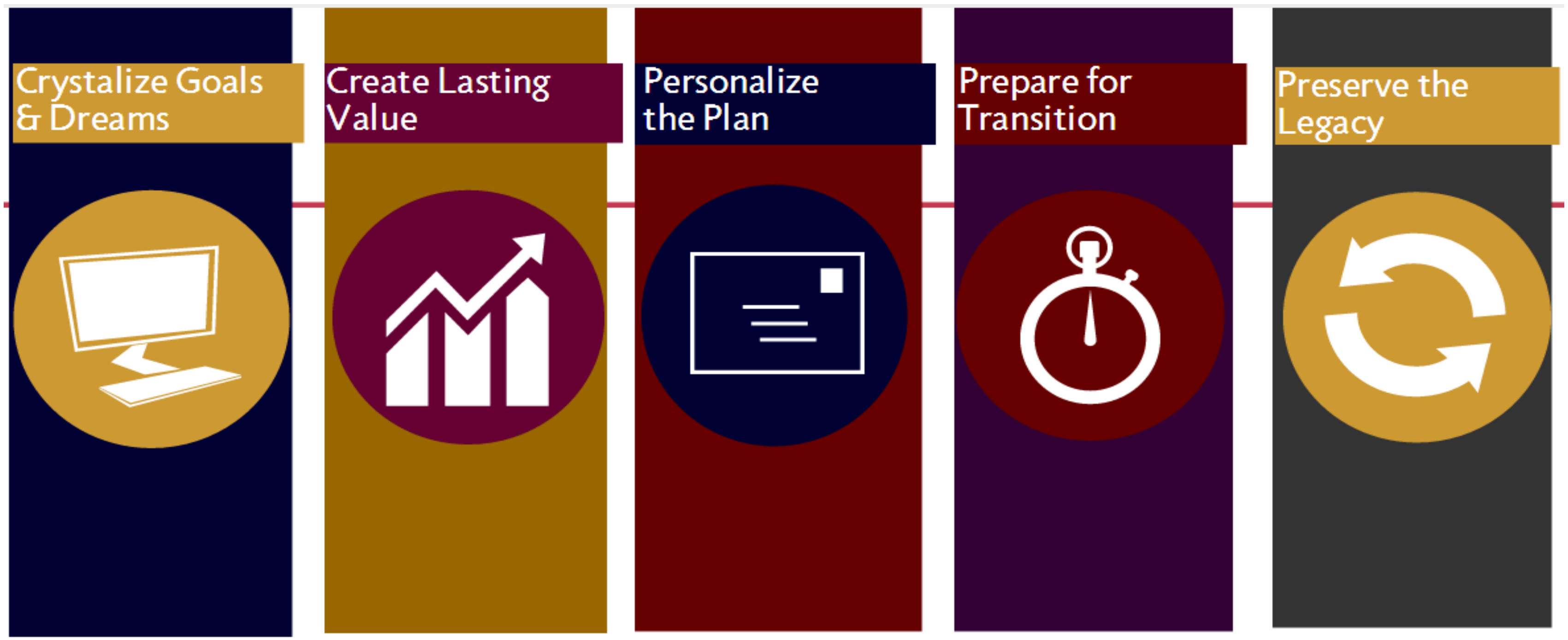
- Thoroughly review corporate structure, stock register, minute book, records, policies, contracts, insurance, liabilities, employee issues, etc.
- Address any material issues as soon as possible – this is time and money well-spent
- Organization of corporate records will be required as part of any due diligence
- Consider conducting an "intellectual property audit" to fill in any gaps in protection

Get Started Today

Making it Actionable – Getting Tactical

- Prepare and understand owner's personal financial plan
- Evaluate your company using the "value-triangle"
- Understand options for exit strategy
- Prepare audited financial
- Bolster the management team
- Evaluate your outside service team
- Business and corporate housekeeping

Making it Actionable – Start Now



THE BEST PLANS ARE DEVELOPED 5-7 YEARS IN ADVANCE OF A TRANSITION

Q&A

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