

Roy Y Salisbury
Marking the Path Forward

M&A Playbook for Business Owners

Strategic Growth Through Acquisitions



Professional. Experienced. Knowledgeable.

By,

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Roy Salisbury is an accomplished professional with extensive experience in business development spanning over 44 years. Currently serving as the Managing Member of C2C Private Investment Company, he holds prominent roles as the CEO of Small Business Development Group, Inc. (SBDG) and Head of Business Development for Stony Hill Advisors, Inc.

Throughout his career, Roy has gained invaluable insights from various perspectives in transactions, having been involved as an entrepreneur, buyer, seller, broker, advisor, and consultant. His expertise encompasses a wide range of deal-making activities, including public offerings, private placements, and mergers and acquisitions (M&A) transactions. He has also demonstrated proficiency in navigating challenging situations such as turnarounds, restructuring, and bankruptcy while engaging with financial institutions, investors, stock exchanges, and regulatory bodies like the Securities and Exchange Commission (SEC).

Roy's extensive background covers diverse industries, including manufacturing, oil and gas, construction, recycling and renewable energy, logistics and distribution, e-commerce, food and hospitality, investment banking, management consulting, technology and telecommunications, timber, and travel. As an investor and principal, he has actively participated in numerous transactions within these sectors.

His business journey began in 1979 after receiving an Honorable Discharge from the United States Marine Corps. Roy established Salisbury Logging & Trucking, an independent timber company that expanded upon the family business. In 1982, he transitioned to Travel Agency Commission Services, Inc., a troubled company, leading it through Chapter 11 bankruptcy and subsequently acquiring its assets as part of Audit Systems, Inc. During the period from 1983 to 1989, Roy engaged in several start-ups and small businesses, including Recycle Unlimited, which collected and recycled aluminum cans, supplying them to Container Recovery Corporation, a subsidiary of Anheuser-Busch.

In 1989, Roy seized the opportunity to assume control of Kaypro Computer Corporation, a distressed computer company and a major manufacturer of personal computers in California. Unfortunately, Kaypro underwent liquidation in 1990. From 1991 to 2003, he actively participated in various



bankruptcy transactions, including the recapitalization of the NJ Bell Building. Additionally, he bought and sold multiple restaurants and pubs.

In the year 2000, Roy partnered with a UK counterpart to establish Transatlantic Surety & Bond Ltd, accompanied by its U.S. subsidiary, Transatlantic Financial Services, Inc. In 2001, the company transformed into TS&B Holdings, Inc., operating as a business development company under the 1940 Act.

Between 2004 and 2023, Roy operated under RYS&Co, a general partnership functioning as a Private Investment Company. Later on, RYS&Co evolved into C2C Private Investment Company, LLC. In 2013, C2C Business Strategies, LLC (formerly RYS&Co Management, LLC) was established. Throughout this period, Roy actively engaged in merger and acquisition activities, turnarounds, and capital formation. Notably, he participated in the acquisition of American Card Services, Inc. in 2006.

Presently, Roy continues to provide M&A consulting services for private and public companies in the U.S., leveraging his extensive expertise and industry knowledge.

- Discharged from USMC 1978
- Lifetime member of the American Legion
- Supporter of Wounded Warriors
- Board of Directors Progress Works a 501 (c) 3 non-profit
- Childhood Cancer
- Make A Wish
- Zoomies Funny Farm
- Tunnels 2 Towers

From the perspective of a contrarian entrepreneur, business owner, investor, consultant, coach, and author:

Breaking the Mold

As a contrarian entrepreneur, I live to challenge the accepted way of doing things. While others follow the herd, I purposely take the road less traveled. Questioning norms and defying conventions is in my DNA.

Finding Diamonds in the Rough

The mainstream ideas that get all the hype and attention? Those aren't for me. I seek out the unglamorous, overlooked opportunities that everyone else stupidly dismisses as boring or unviable. That's where I find my diamonds in the rough.



Trusting My Instincts

I think for myself, from the ground up. Popular opinion means nothing to me. When my instincts and analysis tell me there's an unconventional path worth pursuing, I trust them over the naysayers and doubters every single time. Conformity is a prison for the mind.

Unstoppable Determination

Sure, the start is always an uphill battle when you're a contrarian. The skeptics will mock, investors will scoff, and failures will mount. But I'm stubbornly determined to the point of obsession. I will grind through the setbacks and keep pushing until I prove my crazy idea is brilliant.

Eternal Optimism

At my core, I'm a rational optimist. Despite all the negativity and opposition, I face for my contrarian ways, I'm eternally confident that bucking the trends and defying conventions is the path to creating something remarkable and valuable. The doubters only motivate me more.

That's the contrarian mindset that drives me as an entrepreneur. I see the world through a different lens, and I wouldn't have it any other way.

As a contrarian entrepreneur focused on "unsexy" businesses, here are some examples I would highlight of unglamorous but successful ventures:

Waste Management

The garbage and waste disposal industry is about as unsexy as it gets. But companies like Waste Management have built multi-billion-dollar empires by providing an essential service that everyone needs. Dealing with society's literal trash is far from glamorous, but it's a massively profitable and recession-proof business when executed well.

Plumbing Services

There's nothing sexy about unclogging drains or fixing leaky pipes. Yet plumbing is a \$110 billion industry in the U.S. alone. Smart contrarian entrepreneurs have built very lucrative plumbing businesses by innovating in areas like customer service, scheduling software, and pricing models for this decidedly unglamorous trade.

Industrial Parts Manufacturing

Making specialized electronic controls or components for niche industrial applications is the definition of an "unsexy" business. However, by finding an underserved market need and becoming the go-to supplier, I could build a highly profitable manufacturing company without any flashy branding or mass appeal.



Funeral Services

Death care is about as somber and unglamorous an industry as exists. But funeral homes are also an indispensable service that every community requires. By running an efficient, well-respected funeral business, I could build a lucrative company providing this necessary but emotionally difficult offering.

Landscaping

Mowing lawns and maintaining yards and gardens is dirty, physical work - the opposite of a glamorous business. Yet by delivering consistent quality and innovating with employee compensation models, I could build a remarkably successful landscaping operation capitalizing on this very unglamorous but universal need.

The common thread across these examples is finding an unglamorous but essential service that people need and executing it exceptionally well through smart operations and customer-centric innovations. That's the contrarian path to success in "unsexy" industries.

Here are some innovative strategies that successful "unsexy" businesses have used:

Leveraging Technology and Software

Many unsexy businesses have disrupted their industries by applying technology and developing custom software solutions to solve common customer pain points.

- Netflix used technology to eliminate the need for physical video rental stores, disrupting the movie rental industry.
- One company spent two years developing software to improve service scheduling and meet customer needs in their unsexy business.
- Advocacy System, an unsexy legal services business, grew 400% by developing internal software and processes to streamline operations across clients instead of reinventing for each one.

Focusing on Customer Experience

Unsexy businesses have innovated by enhancing the customer experience in unique ways that differentiate them from competitors.

- One cleaning business allowed customers to rate satisfaction and directly tied employee compensation to those ratings, leading to exponential growth.
- Copywriters and marketers can leverage their "unique DNA" of experiences to craft compelling marketing for unsexy businesses that resonate with customers.



Solving Mundane Problems Creatively

Even small creative changes to solve mundane problems in an industry can be innovative and drive success for an unsexy business.

- Pepsodent reinvented toothpaste in the 1900s by adding citric acid and mint oil to create a tingling sensation that made teeth feel cleaner, capitalizing on consumer perception.

Operational Efficiency and Consistency

Developing standardized efficient operations and processes across locations or clients is an innovative strategy for scaling unsexy businesses consistently.

- The Advocacy System grew rapidly by creating internal processes that could be replicated across all clients instead of reinventing for each one.

The key innovative strategies seem to revolve around applying technology creatively, enhancing the customer experience in unique ways, solving mundane industry problems differently, and developing operationally efficient standardized processes to scale. By thinking innovatively, even the most unsexy businesses can disrupt their industries.



TABLE OF CONTENTS

1. INTRODUCTION	8
2. PREFACE	12
3. THE NOTION OF EXPANSION VIA ACQUISITION	17
4. CONSIDERING ACQUISITION.....	24
5. TARGETING AN ACQUISITION.....	40
6. KEY STEPS IN BUYING A BUSINESS.....	47
7. BUSINESS INTEGRATION	55
8. DUE DILIGENCE	62
9. VALUATION	72
10. A POWERFUL TOOL	77
11. THE BENEFITS OF ACQUISITION	80
12. WHY ACQUISITION.....	87
13. KNOWING THE TYPES OF ACQUIRERS	90
14. CAPITAL FORMATION PROCESSES	93
15. PATH TO YOUR EXIT	104
16. CASE STUDIES	109



INTRODUCTION

The purpose of this book is to give the reader a practical view of the process of being a buyer, whether an existing company looking for growth or an entrepreneur seeking a business.

The Focus is on How and Why to Grow Through Acquisition

Any planned acquisition should be accretive to the acquirer (Accretive Acquisition), this type of acquisition will increase the acquiring company's earnings per share (EPS). It tends to be favorable for the company's market price because the price paid by the acquiring firm is lower than the boost that the new acquisition is expected to provide to the acquiring company's EPS. This type of acquisition is said to occur when the price-earnings (P/E) ratio of the acquiring firm is greater than that of the target firm.



Additional types of Accretive benefits relating to a post-acquisition transaction are as follows:

Accretive Income

Accretive Income refers to the gradual or incremental growth in value for a company, typically resulting from a business deal or financial transaction. In the context of mergers and acquisitions, a deal is considered accretive if it increases the acquiring firm's earnings per share (EPS) after the transaction. This can occur when the newly acquired assets or businesses add more value to the company than the costs associated with the acquisition. Accretion can also refer to the increase in the value of a bond or security over time, such as through interest accrual. Accretive income signifies a positive impact on a company's financial performance or asset value.

Difference between Accretive and Passive Income

Accretive income and passive income are different concepts. Accretive income refers to the gradual growth in value for a company, often resulting from a business deal or financial transaction that increases the company's earnings per share. On the other hand, passive income is earned with minimal effort, such as from rental income, dividends, or interest from investments. The key difference is that accretive income is a measure of value growth for a company, while passive income is a stream of income that does not require active involvement.

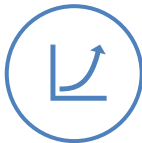


Accretive Capital

Accretive Capital is important to a business owner because it refers to investments made in assets that increase the value of a company over time. In the context of mergers and acquisitions, a deal is considered accretive if it leads to an increase in the company's earnings per share (EPS). Accretive capital expenditures are vital for a company's long-term growth and success, as they involve investments that add more value to the company than the costs associated with the acquisition. This can occur when acquired assets are purchased at a discount to their perceived current market value or when they are expected to grow because of the transaction. Therefore, accretive capital can contribute to the overall financial health and performance of a business.

The Trade-Off Between Internal Growth and Growth Via Acquisition

Internal growth involves making investments in assets such as land, buildings, and machinery, as well as in human capital and customer relationships. This approach requires a substantial financial commitment and time for an investment to generate cash flow. On the other hand, growth via acquisition (External) allows a firm to quickly access new markets and assets by purchasing an established business or a division of a firm. This can provide instant access to cash flows, albeit with integration costs.

	Pros	Cons
 Mergers & Acquisitions	▪ Growth is faster ▪ You gain knowledge & experience ▪ You move up in the competition	▪ Strategic growth is expensive ▪ Culture and operation changes can be difficult ▪ You may lose control
 Organic / Internal Growth	▪ Organic growth happens internally ▪ You maintain control ▪ It is less expensive	▪ Growth is much slower ▪ There are limits ▪ May reduce your competitive edge



The decision between internal growth and growth via acquisition (External) is influenced by the relationship between the two. Before acquiring, a firm can always choose to pursue internal growth, making it a fallback strategy. The acquisition will allow for a faster growth curve and done right enhance the value of the acquirer and the acquiree based on simple arbitrage.

“Arbitrage is a useful tool for bridging the differences between the buyer and the seller over enterprise value. It provides a mechanism to support a higher selling price than the buyer might otherwise be willing to justify. The Arbitrage Value Proposition is a simple concept that involves increasing the value of a company between buying it and selling it before improvements. The core requirement for arbitrage is the capability of realizing a profit from a valuation differential.”

In summary, the decision between internal growth and growth via acquisition involves complex trade-offs and strategic considerations, and the timing and approach to an acquisition can have significant implications for the firm's value proposition.

The Common Goals of Acquisition

Acquisitions can indeed be a viable growth strategy for companies of all sizes. While they are often associated with larger corporations, smaller companies can also benefit significantly from strategic acquisitions. Here are some key points to consider:

Strategic Expansion: For smaller companies, acquisitions can serve as a strategic tool to rapidly expand their market presence, gain access to new technologies, or enter new geographic areas. By acquiring another business, a smaller company can quickly achieve a level of scale and market reach that would have taken much longer to attain through organic growth.

Competitive Advantage: Acquisitions can provide smaller companies with a competitive advantage by allowing them to consolidate their position in the market, gain access to new customer segments, and enhance their product or service offerings. This can help level the playing field with larger competitors and strengthen the company's overall market position.

Operational Efficiencies: Through acquisitions, smaller companies can realize operational efficiencies and cost savings by integrating the acquired business into their existing operations. This can lead to economies of scale, improved resource utilization, and streamlined processes, driving profitability and growth.

Talent and Expertise: Acquiring another company can also bring in new talent, expertise, and intellectual property that may not be readily available through organic means. This can be particularly valuable for smaller companies looking to enhance their capabilities and innovate in their respective industries.



Access to Capital and Resources: Acquisitions can provide smaller companies with access to additional capital, resources, and market knowledge that can fuel further growth and expansion. This can be especially beneficial for companies looking to accelerate their development and compete more effectively in their target markets.

By carefully evaluating potential targets and executing acquisitions with a clear strategic vision, smaller companies can leverage this growth strategy to achieve their business objectives and create long-term value.





PREFACE

Introduction

A buyer's market can be advantageous for a private business owner who plans to exit their business within the next two to three years or longer. In general, an owner can increase the value of their business through strategic acquisitions or mergers before exit. However, the size of the business matters when it comes to attracting potential buyers, particularly in the case of strategic corporate buyers or private equity groups.

Collaboration between similar businesses can increase the respective values of individual companies in an exit scenario. For example, if two business owners plan to exit in two years and are individually valued at three times the current market multiple, they may be too small to attract potential buyers. However, if the two companies combine, they could potentially be valued at four times the multiple before any operational improvements.

How to Improve the Valuation of Combined Businesses?

With proper pre-planning, due diligence preparation, business valuation, target acquisition, deal structure options for acquisition / merger, integration support, operational enhancement strategies, and a go-to-market strategy post-transaction, the combined valuation of the two businesses can be improved to attract potential strategic corporate or private equity group buyers for an enhanced multiple. It is important to note that this approach may not be suitable for everyone, and it requires patience, planning, and a willingness to make compromises among the participants.

Lower Middle Market: An Opportunity

The lower and middle market companies play a significant role in the economy, contributing to about one-third of the U.S. economy and employing approximately 48 million people. Lower middle market companies, typically defined by annual revenues ranging from \$5 million to \$50 million, face various challenges, including limited access to capital, competition from strategic buyers, valuation and pricing pressures, talent retention and transition, regulatory complexities, and broader macroeconomic forces such as inflation, talent shortages, and recession. These challenges can impact the growth, stability, and overall performance of lower middle market companies.

Baby Boomers: Custodians of the Nation's Wealth

In addition, the term "baby boomers" refers to the demographic cohort born between 1946 and 1964, known for their significant impact on the economy and politics. As baby boomers are now reaching retirement age, with the oldest nearing 80 and the youngest turning 60, they hold a substantial portion of the nation's wealth. An intergenerational transfer of wealth is expected as they pass on their assets to their heirs. It is estimated that 70% of the 12 million baby boomer-owned businesses will be changing



hands over the next couple of decades, representing a substantial portion of the wealth controlled by baby boomers in the form of private business ownership.

Impact of Baby Boomer Business Transfers on the Lower Middle Market

These dynamics have significant implications for the lower middle market, as the transfer of ownership and management of baby boomer-owned businesses can impact M&A activities, talent retention, and overall market dynamics. Understanding and addressing these interrelated factors is crucial for stakeholders in the lower middle market to navigate the evolving landscape and capitalize on the opportunities presented by the transfer of wealth and ownership.

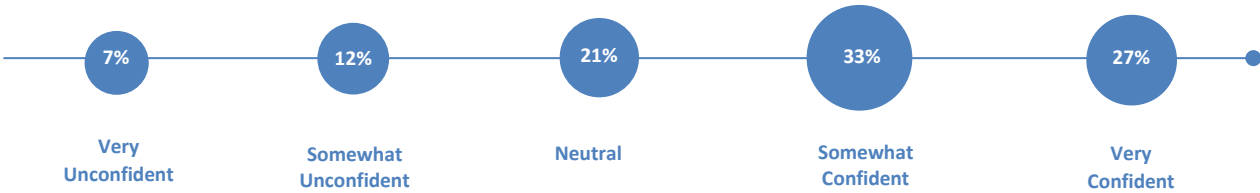
Baby Boomer Business Transfers Is a Significant Opportunity to Buy

The transfer of businesses from baby boomers presents a significant opportunity for acquisition. Retiring baby boomer business owners are expected to sell or bequeath \$10 trillion worth of assets over the next two decades, with around 10 million baby boomer-owned businesses set to change hands between 2019 and 2029. This transition is driven by factors such as the desire for control of their destinies, the perception of small business ownership as safer, and the need to influence spending patterns and investment decisions in retirement. The "great wealth transfer" from baby boomers is estimated to be \$72 trillion, which could have a substantial impact on the economy and market dynamics. As a result, this presents a significant opportunity for individuals or entities looking to acquire businesses from retiring baby boomers.

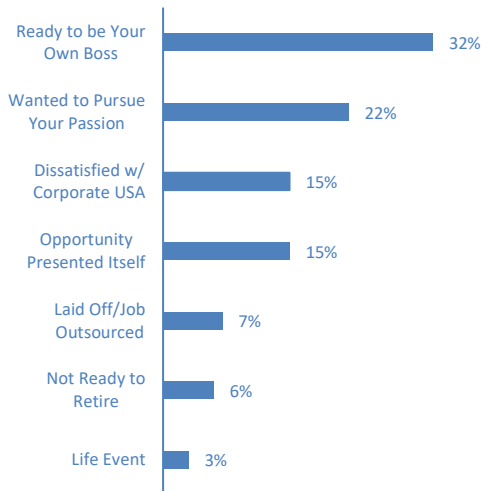




Confidence in Political Climate



Motivation for Opening Business



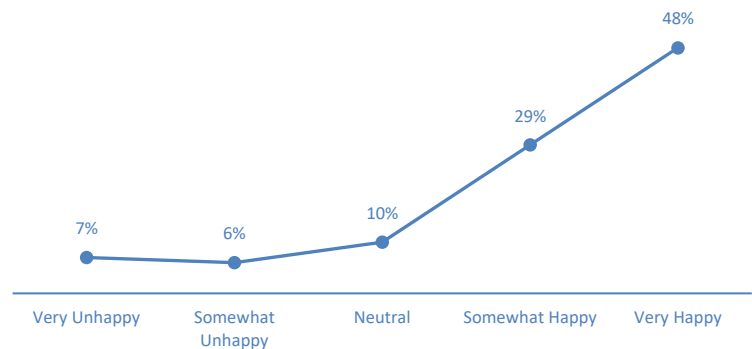
Top 3 Challenges for Small Business Owners



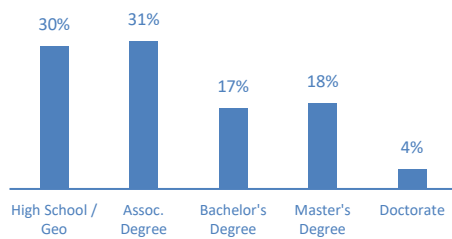
Gender Distribution



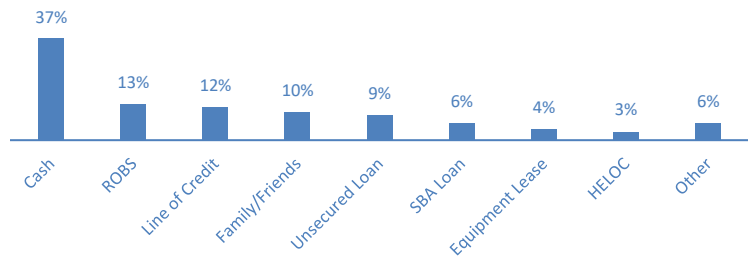
Happiness Level



Education



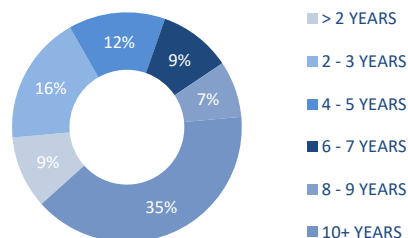
Most Popular Financing Methods



Source: "Boomers in Business – 2020 Trends" – Guidant Financial, 2020



Years in Business



Top Five Small Business Industries



78%

Of All
Respondents
Said their
Business was
Currently
Profitable



Source: "Boomers in Business – 2020 Trends" – Guidant Financial, 2020

Why Buy a Lower Middle Market Company Now

Potential buyers are attracted to lower middle market companies for several reasons. These companies typically have lower valuation multiples, making them an attractive investment opportunity. Skilled business buyers / owners can also more easily obtain operational improvements for businesses in the lower middle market. Additionally, lower middle market companies are less developed, more niche, and often family-owned, which can present unique opportunities for buyers / owners to add value and grow the businesses. The lower middle market also allows buyers / owners to purchase assets with low debt compared to larger companies, reducing risk. Furthermore, the right lower middle-market firms operate in highly fragmented and very profitable industries, making them prime targets for acquisition and consolidation.

Market Segments – Upper, Middle, and Lower



Upper Middle Market

Companies with annual revenue range between \$500 million - \$1 billion



Middle Market

Companies with annual revenue range between \$50 million - \$1 billion



Lower Middle Market

Companies with annual revenue range between \$5 million - \$50 million

The lower middle market is gaining popularity among private equity firms and strategically due to the increased number of opportunities provided by this market segment, better valuations, and the potential for creating returns. The competition for acquisition targets in the upper middle market is driving up valuations, making the hurdle rate for a return on those investments much higher and harder



to obtain. By targeting the lower middle market instead, investors can acquire businesses at better valuations and grow those businesses to achieve higher returns. As a buyer / owner, you can compete with private equity and strategic buyers.

The lower middle market presents several compelling reasons to consider buying companies within this segment. Some of the key benefits include:

Lower Debt and Risk: Lower middle market companies typically have low levels of debt compared to larger companies, which can reduce the overall risk for investors.

Better Valuations: Buyers / Owners can acquire businesses at more favorable valuations in the lower middle market, as opposed to the upper middle market where increasing competition can drive up valuations, making it more challenging to achieve attractive returns.

Operational Improvements: Skilled business buyers / owners could implement operational improvements more readily in lower-middle market businesses, potentially leading to enhanced performance and profitability.

Diverse Selection and Niche Opportunities: The lower middle market encompasses a wide range of companies, from small "Mom & Pop" service shops to highly innovative technology firms, offering unique niche opportunities for investors to add value and foster growth.

Potential for Higher Returns: The lower middle market is increasingly attractive to investors due to the potential for generating higher returns through acquisition and consolidation, as well as the greater number of opportunities available within this market segment.

Less Competition: While there is growing competition in the lower middle market, it is less intense than in the upper middle market, making it an appealing space for proactive buyers and sellers.

In summary, the lower middle market offers buyers / investors the potential for more favorable valuations, reduced risk, and distinctive opportunities for growth and value creation compared to larger companies. These factors make it an attractive option for investors seeking to capitalize on the unique advantages of this market segment.





THE NOTION OF EXPANSION VIA ACQUISITION

Overview

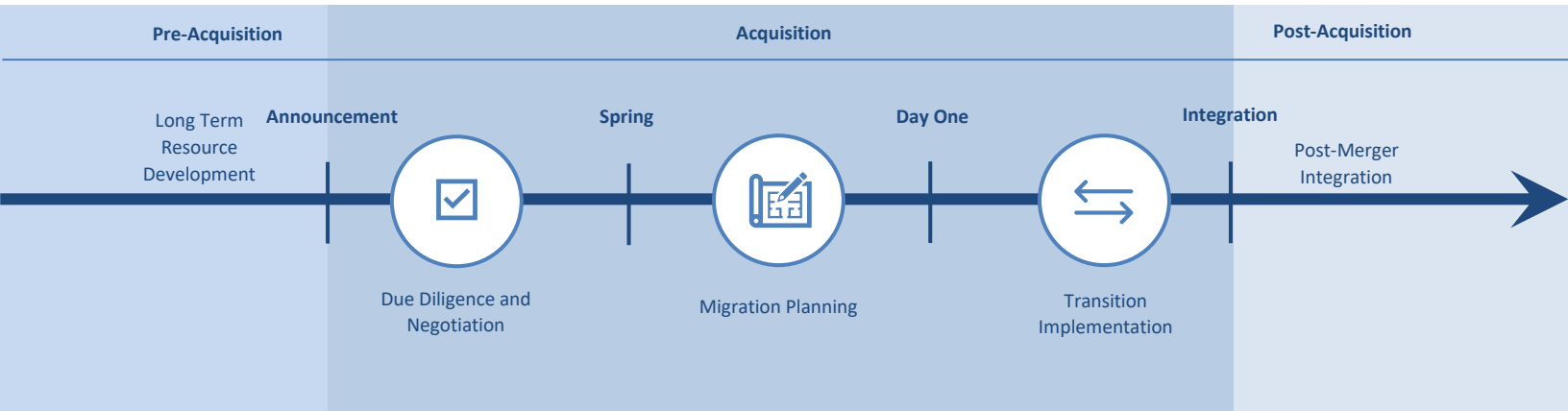
Indeed, most businesses can leverage an acquisition model, which entails purchasing other businesses, to facilitate growth. This approach is frequently employed by companies aiming to penetrate new markets, secure a competitive advantage, address a gap in their portfolio, or enhance their long-term competitive position. Acquisitions can offer immediate access to new customers, operational infrastructure, and market presence. They can also aid in diversifying a company's product or service portfolio, thereby reducing risk and enhancing resilience in the face of economic instability.

Benefits of Expanding via Acquisition

Expansion via acquisition is a prevalent strategy employed by companies to attain various goals such as diversification, increased market share, and workforce expansion. Studies have shown that companies can adopt a non-synergistic strategy and achieve substantial growth and sustained returns through acquisitions. Acquisitions have proven to be effective as a growth strategy in scenarios such as addressing critical service offering gaps, rapidly entering new markets, and finding solutions to business challenges.

Private Equity: Business Model

The private equity sector has been utilizing and refining the process for decades, using acquisition to grow their platform companies after the initial acquisition. (Buy-Build-EXIT)



The business model of private equity groups involves raising capital from external sources, investing in a series of private equity deals, selling, or exiting those investments, and returning the proceeds to the external capital partners while retaining a portion of the profits for the partners of the private equity firm.



Private equity firms are typically adept at assembling strong, highly motivated executive teams and may provide operational support to help build and grow a better company. The returns of private equity are typically realized after a few years, making it a long-term investment. Private equity firms invest in growth-stage and more mature companies in exchange for a majority stake in the business.

Private equity firms may also acquire private companies or public ones in their entirety or invest in buyouts as part of a consortium. The private equity business model is characterized by the acquisition of companies, operational support, and the eventual sale of investments to generate returns for the firm and its investors.

Buy and Build Strategy

The buy and build model, also known as a buy-and-build strategy, is commonly used by private equity firms to expand operations, generate value, and increase returns. It involves acquiring a platform company with established internal capabilities and then adding smaller businesses to create more value. This strategy aims to improve or restructure existing businesses, often through acquisitions, to create a larger and more valuable enterprise. The buy and build strategy can result in significant value creation, but its success depends on proper execution and the expertise of the acquiring firm. The primary difference in this context is that the Buyer/Owner is the platform company.

Takeaways

- Buyers / Owners seeking strategic acquisitions in many respects become a microcosm in Private Equity
- As buyer / owner, you are employing the same PE model without employing a middleman approach
- The same goal of private equity applies to a private company employing a growth strategy through

Business Owners Need to Think Like Investors

In today's economic environment, it is indeed crucial for business owners to think like investors. This shift in mindset is necessary because it allows business owners to focus on maximizing the value of their business, rather than just running it day-to-day. Investors are primarily concerned with the return on their investment. They buy assets when they are undervalued ("buy low") and sell them when they are overvalued ("sell high"). This principle applies to businesses as well. If a business owner can increase the value of their business, they can sell it for a higher price, thereby maximizing their return.

Bridging the Gap

To bridge the gap between the "buy low, sell high" mentality of investors and the operational focus of business owners, a strategic exit plan is needed, and most do not have one! This fact increases the opportunity value for the buyer / owner when making targeted acquisitions. If a business is sold when



the economy is strong and buyers have easy access to capital, it can command a higher price. Conversely, if a business is sold during a downturn or when capital is tight, it may fetch a lower price.

For example, Buyers / Owners with \$1 million in adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization) can indeed strengthen their value proposition by double digits before the first acquisition. This is achieved by implementing strategies that increase the profitability and efficiency of the business, thereby increasing its EBITDA and overall value. The same process will be used in the acquired acquisition.

Be Sure to Practice What You Preach

By reducing costs, a business can increase its profitability and value. This can be achieved through efficiency improvements, renegotiating contracts, and reducing waste. By growing revenue, a business can increase its profitability and value. This can be achieved through marketing and sales efforts, expanding into new markets, or launching new products or services. By acquiring other businesses, a business owner can increase the size and profitability of their business, thereby increasing its value. This strategy requires careful planning and execution to ensure the acquired business is integrated successfully and delivers the expected benefits.

Maximizing Value Through Robust Financial Reporting and Transparency

Many sellers are genuinely concerned about the legacy of their company post-acquisition. By showcasing strong financial reporting and transparency, the buyer can alleviate these concerns and convey a sense of responsibility and trustworthiness, which are crucial for the seller when considering the long-term impact of the acquisition on their legacy. In summary, improving financial reporting and transparency not only enhances the buyer's perceived value but also addresses the seller's concerns about legacy, fostering a more positive and fruitful acquisition process. By implementing these strategies, business owners can increase the value of their business, thereby positioning themselves to "sell high" when the time is right. This is indeed a strategy used by savvy institutional buyers, and it can also be used by business owners to maximize the value of their business.

"I am a better investor because I am a businessman and a better businessman because I am an investor"
- Warren Buffett

Have You Considered Your Exit Strategy?

It is advisable to start developing an exit plan as early as possible, ideally during the startup or early growth stages of the business. Proper exit planning can help maximize the business's value, minimize potential risks, and ensure a smooth transition for all stakeholders involved.



When is the Right Time for Business Owners to Consider an Exit Strategy?

Business owners should start planning their exit strategy 2 to 5 years in advance to maximize the value of their business and ensure a smooth transition for all stakeholders. Delaying planning until the last minute can limit the available options and make it challenging to maximize the value of the business. The exit planning process may seem overwhelming, yet the initial work can be accomplished in about three months of part-time participation without disrupting the business. Once you decide to sell your company, you need to understand the process for executing that decision.

Are You Serious About the Strategy?

For buyers / owners serious about growth, mergers and acquisitions can be a central part of their strategy, enabling them to overtake competitors and quickly enter new markets. This process can also be well suited for a company's owner when planning for an exit down the road to create a significant increase in value. It is important for companies considering this strategy to carefully assess the potential cultural differences and develop integration plans to mitigate any negative impact on the organizations involved. Additionally, thorough due diligence is essential to ensure that the acquisition will truly support the company's long-term growth objectives.

Authors Note # 1

I joined the United States Marine Corps in May of 1975, and I can honestly say it was one of the best decisions I've ever made. Initially, I had no intention of becoming a Marine. I tried to enlist in the Air Force, Navy, and Army, but I was turned away because I didn't have a high school diploma. Frustrated and feeling a bit lost, I walked into the Marine Recruiting Office and declared my desire to join the Marine Corps.

What I learned during my time in the Marines is that there is nothing I can't achieve if I set my mind and sights on a target. I also discovered that leadership and respect are a two-way street; you should never ask someone to do something you wouldn't be willing to do yourself.

When I arrived at Parris Island, South Carolina, I immediately thought I had made the biggest mistake of my life. A drill instructor, wearing a Smokey Bear hat, boarded the bus and shouted, "You have 10 seconds to get off my bus, and 8 are already gone!"

It was day one, and I had no sleep (I arrived the night before). I found myself in line for a physical and a weigh-in, only to discover I was 8 pounds over the maximum weight. The doctor said, "We have to throw this one back," and I felt a wave of relief wash over me. But it didn't last long. Senior Drill Instructor Staff Sergeant Hudson told the doctor, "I'll bring him back in the morning." I thought to myself, "Why would you do that? I can't lose 8 pounds in 24 hours!"



Incredibly and completely dehydrated, I lost weight and weighed in at a quarter pounds under the maximum weight the next day. I attributed the feat by doing more mountain climbing, jumping jacks, and plain old hyper activities. Staff Sergeant Hudson introduced me to under great duress. "A U.S. gallon of water weighs about 8.34 pounds"

Ten weeks later, I faced knee and back problems and was sent to the hospital. The doctor informed my Senior Drill Instructor that I could be medically discharged. Without thinking, I blurted out, "No way!" I was determined to push through, and I did. I graduated with my platoon and was ready for the Fleet Marine Force.

My experience taught me that you can accomplish anything you set your mind to.





Common Myths of One Business Buying Another



Affordability

Many people believe they can never afford to buy a business. However, there are various financing options available, such as SBA loans, seller financing, and private equity. With the right strategy and financial planning, buying a business can be more attainable than commonly thought.



Risk

While buying a business does involve risk, it is not necessarily "too much" risk. Conducting thorough due diligence, seeking professional advice, and having a clear business plan can help mitigate risks. Many successful entrepreneurs have built their wealth through acquiring existing businesses.



Deal Structure

There is no one-size-fits-all approach to structuring a deal when buying a business. Buyers can negotiate various terms, such as the purchase price, payment structure, and post-acquisition involvement. Flexibility in deal structuring allows for creative solutions that can benefit both the buyer and the seller.



Asset Sale vs Stock Sale

In an asset acquisition, the buyer only acquires the assets and liabilities it identifies and agrees to acquire and assume from the seller. This allows the buyer to specify the liabilities it is willing to assume, leaving other liabilities behind and limiting exposure to undisclosed or unknown liabilities.

On the other hand, in a stock purchase, the buyer acquires all the target company's assets, rights, and liabilities, including undisclosed or unknown liabilities, as a matter of law. Therefore, in a stock purchase, the buyer may assume unknown or uncertain liabilities, while in an asset acquisition, the buyer has more control over the liabilities it assumes, reducing the risk of undisclosed or unknown liabilities.



Asset Purchase Agreement

Preferred by the buyer

Allows buyer a step-up basis in assets, enabling additional post-acquisition depreciation or amortization deductions from corporate tax

Proceeds are taxed at the corporate level and again on distribution to the shareholders

Buyer does not assume liabilities or history of Seller company

Allows acquisition of select assets, excluding high-risk or non-desirably assets

Does Not Allow QSBS exclusion at the corporate tax level, shareholders may still qualify if proceeds are received in a liquidating distribution

May require a significant number of consents for transfer of assets

Typically, but not always, results in more ordinary income being reported by the Seller, particularly companies with high amounts of cash, accounts receivables, and inventory

Stock / Equity Purchase Agreement

Preferred by the seller

No step-up basis in assets, rather the Buyer's basis is in corporate stock and doesn't generally provide a current tax benefit

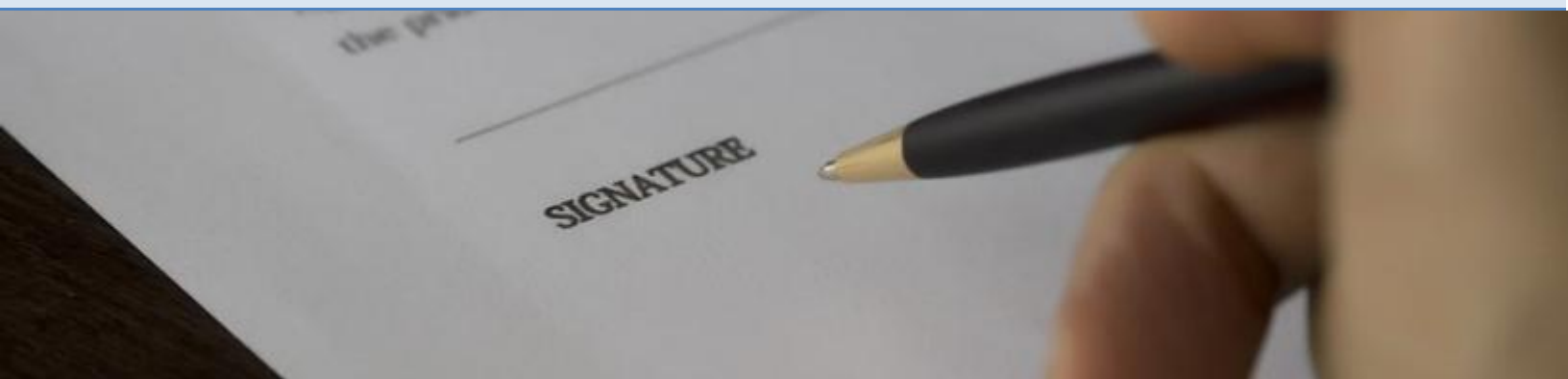
Avoids subjecting proceeds to corporate tax and allows selling shareholders to receive capital gains treatment on the sale of stock

Requires fewer consents for contract assignments or assignments of other assets

Application of Qualified Small Business Stock exclusion at shareholder level may eliminate all or a significant portion of taxable gain

Buyer may be stuck with the existing structure of the Seller Company unless rolled up into another parent entity

Buyer assumes history and any liabilities not paid off prior to closing



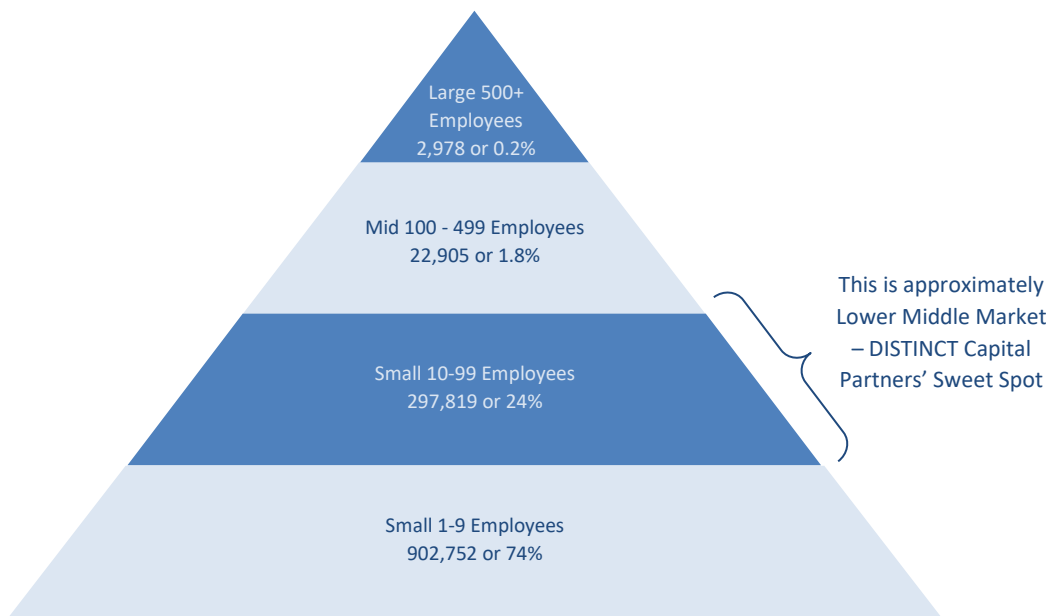


CONSIDERING ACQUISITION

The Lower Middle Market (LMM)

The lower middle market (LMM) and middle market segments of M&A (Mergers and Acquisitions) often operate under the radar, primarily due to the lack of public data compared to larger, multinational investment banks. However, these segments have shown remarkable resilience in the face of various challenges, including interest rate increases, supply chain disruptions, geopolitical unrest, and the lingering effects of COVID-era dealmaking.

The LMM typically includes companies with revenues between \$5 million and \$50 million, while the middle market encompasses companies with revenues between \$50 million and \$1 billion. These segments are often more agile and adaptable than their larger counterparts, allowing them to weather economic storms more effectively.



Despite the reported slowdown in M&A activity, it is important to note that this primarily reflects a decrease in larger deals in the bulge bracket. The bulge bracket refers to the world's largest and most profitable multinational investment banks. These banks are often involved in the biggest, most complex, and most valuable transactions. The data from these deals is more readily available and therefore often shapes the overall narrative around M&A activity.

However, this doesn't necessarily reflect what's happening in the LMM and middle market segments. These segments have shown incredible resilience and are primed for a robust 2024. This resilience is



due to a combination of factors, including the ability to adapt quickly to changing market conditions, a focus on local or regional markets which may be less affected by global disruptions, and the ability to leverage relationships and networks to secure deals.

To get a more accurate picture of what's happening in the LMM and middle market segments, it would be beneficial to look at a range of metrics. These could include the number of deals being made, the total value of these deals, and the sectors in which these deals are occurring. Additionally, it would be useful to consider the impact of various external factors, such as changes in interest rates, supply chain disruptions, and geopolitical unrest.

In conclusion, while there may be a slowdown in M&A activity in the bulge bracket, this does not necessarily reflect the state of the LMM and middle market segments. These segments have shown remarkable resilience and are well-positioned for future growth. Therefore, it is crucial to consider a range of metrics and factors when assessing the health and prospects of these segments.

Growth Potential

Lower middle-market (LMM) and middle-market companies often present significant growth potential for several reasons:



Growth Opportunities in Lower and Middle-Market



Niche Market Expertise



Operational Improvements



Scalable Business



Small Companies



Dynamic



Easy Financing

Niche Market Expertise: These companies often operate in niche markets where they have developed specific expertise and competitive advantages. This can lead to high growth rates if the niche market expands or if the company can successfully enter new markets.

Operational Improvements: Smaller companies often have opportunities for operational improvements. These can include implementing more efficient processes, adopting new technologies, or improving supply chain management. Such improvements can lead to significant increases in profitability and growth.

Scalable Business: Many LMM and middle-market companies have scalable business models. This means that they can increase their sales and profits at a faster rate than their costs, leading to high growth rates.



Small Companies: Smaller companies are often attractive targets for mergers and acquisitions. This can provide a significant boost to growth, either through the acquisition of new capabilities or through the consolidation of market share.

Dynamic: Smaller companies are often more innovative and adaptable than larger ones. This can allow them to respond more quickly to changes in the market, seize new opportunities, and achieve high growth rates.

Easy Financing: Lenders are eager to offer financing to LMM and middle-market companies. This access to capital can fuel growth by enabling these companies to invest in new projects, acquisitions, or operational improvements.

However, it is important to note that while these factors can lead to high growth potential, they also come with risks. Smaller companies often face greater competition, have less bargaining power with suppliers and customers, and are more vulnerable to economic downturns. Therefore, investors need to carefully evaluate the growth potential of these companies and balance it against these risks:

Obstacles to Capital Access: Lower-middle market companies often face challenges in accessing capital for mergers and acquisitions (M&A) due to a variety of reasons. These companies typically have revenues between \$5 million and \$50 million, and they often fall into a gap between small businesses, which can access Small Business Administration (SBA) loans and other small business financing, and larger companies, which have access to a wider range of financing options.

Lack of Profitability and Transparency: Traditional lenders and financial institutions may perceive these companies as higher risk due to their size, lack of collateral, or the volatility of their cash flows. These lenders often require a track record of profitability and a strong balance sheet, which many lower-middle-market companies may not have.

Limited Availability of Resources: Additionally, lower-middle market companies may not have the resources to meet the stringent reporting requirements of traditional lenders.

However, this situation presents an opportunity for larger companies. They can leverage their access to capital to acquire smaller, well-run companies that are struggling to access financing. This can be a strategic move to expand their market share, diversify their product offerings, or acquire new technologies or capabilities.

Considering Acquisition

The first step in considering an acquisition is to assess whether you and your firm are ready for the process. This involves evaluating your own operational and financial readiness before delving into the acquisition process. When considering an acquisition, it is essential to assess the seller's level of



organization across operations, financial controls, and reporting. This ensures that you are not asking for something that you do not yet have and helps in determining the compatibility and potential synergies between the two entities.

When acquiring a business, the acquirer needs to implement various financial controls to ensure a smooth transition and effective management. Some of the key financial controls needed by an acquirer of a business include:

Standardized Financial Reporting and System Integration: Establishing standardized financial reporting processes and integrating the financial systems of the acquired business with those of the acquirer.

Robust Internal Controls: Implementing robust internal controls to ensure compliance with financial regulations and prevent fraud.

Regulation & Management of the Cash Flows: Monitoring and managing the cash flow of the acquired business to ensure its liquidity and financial stability.

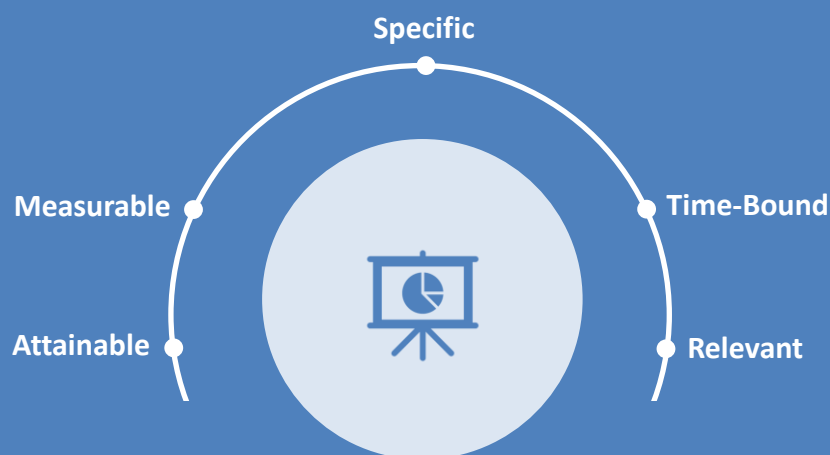
Identification & Mitigation of Risks: Identifying and mitigating financial risks associated with the acquisition, such as market risks, operational risks, and regulatory risks.

Efficient Tax Structures and Strategies: Developing tax-efficient structures and strategies to optimize the tax implications of the acquisition.

Predefined Key Performance Indicators: Establish key performance indicators (KPIs) to measure the financial performance and success of the acquisition.

These controls are crucial for the acquirer to effectively manage the financial aspects of the acquired business and ensure successful integration.

Key Performance Indicators





It is important to recognize that the acquisition process is time-consuming and entails direct costs. Therefore, thorough preparation and due diligence are crucial to ensure a smooth and successful acquisition. By being well-prepared and understanding the potential challenges and costs involved, you can approach the acquisition process with a clear and informed perspective, increasing the likelihood of a favorable outcome.

The process of acquisition in the context of business is indeed a multifaceted endeavor that requires careful consideration and strategic planning. The need for a detailed plan with all the goals and objectives set out in a clear and concise plan is a must.

The concept of "hope for the best, plan for the worst" is widely recognized and applied in different areas, emphasizing the importance of proactive risk management and preparedness. While it may not be possible to anticipate every potential challenge, the mindset of being ready for adverse scenarios can contribute to more effective decision-making and goal achievement. This approach involves identifying and addressing potential risks, conducting thorough planning, and maintaining a resilient and adaptable mindset to navigate uncertainties and setbacks.

When a company is contemplating an acquisition, several crucial steps and considerations come into play to ensure the success of the endeavor. Firstly, it is vital to align the acquisition with the overall goals and strategic direction of the acquiring company. This involves assessing how the acquisition fits into the company's long-term vision and growth strategy. Thoroughly evaluating the potential benefits and values of the acquisition is essential as well. This includes identifying synergies, market opportunities, and potential risks associated with the target company.

The priorities and guidelines outlined for businesses seeking to grow through acquisitions are crucial for ensuring a favorable outcome. Let's break down each priority and its significance:

Create a "Deal Team"

A dedicated team supports the executive officers in planning and executing the acquisition, addressing potential problems, and preventing negative impacts on daily operations. Specialists such as attorneys, accountants, investment bankers, and consultants bring expertise to the process.

Ensure a Thorough Due Diligence Process

Due diligence involves investigating and analyzing the target business to uncover any potential issues or undisclosed obligations. It helps the acquirer make an informed decision and mitigates the risk of unexpected problems post-acquisition.



Identify the Right Acquisition Target Candidates

Creating a pipeline of potential target companies aligns the strategic vision of the acquirer with its business objectives. Factors for target consideration include market share, profitability, management team, innovation, and legal / regulatory issues.

Target Valuation

A sound valuation process involves analyzing historical financial performance, forecasting future performance, and applying various valuation methods to estimate the target's value. Detailed financial modeling and careful consideration of debt are essential.

Identify The Synergies to Be Realized

Pursuing an acquisition strategy offers the opportunity to realize synergies such as greater efficiency and economies of scale between the acquirer and the target.

Importance of Post-Acquisition Integration

Planning for post-acquisition integration is critical for capturing anticipated synergies and ensuring the success of the acquisition. Realistic planning and swift action during the first 100 days post-deal are essential. By addressing these priorities early in the deal process and throughout the integration, companies can increase their chances of success in growth-oriented acquisitions. A disciplined approach and understanding of the required initiatives and actions are key to capturing the expected value of growth opportunities.

Differences in Types of Acquisitions

There are several types of acquisitions, each based on the relationship between the acquiring and acquired companies. The main types of acquisitions include:

Vertical Acquisition

In this type, the parent company acquires a company along its supply chain, either upstream (e.g., a vendor / supplier) or downstream (e.g., a processor or retailer). A vertical acquisition, also known as a vertical merger, occurs when a company acquires another company in the same industry but at a different stage of the production process or supply chain. This type of acquisition is aimed at increasing control over the supply chain, reducing costs, and increasing efficiency. It can also help secure the supply of essential goods, avoid disruption in supply, and restrict supply to competitors. For example, if a clothing company acquires a textile factory, it would be considered a vertical acquisition.

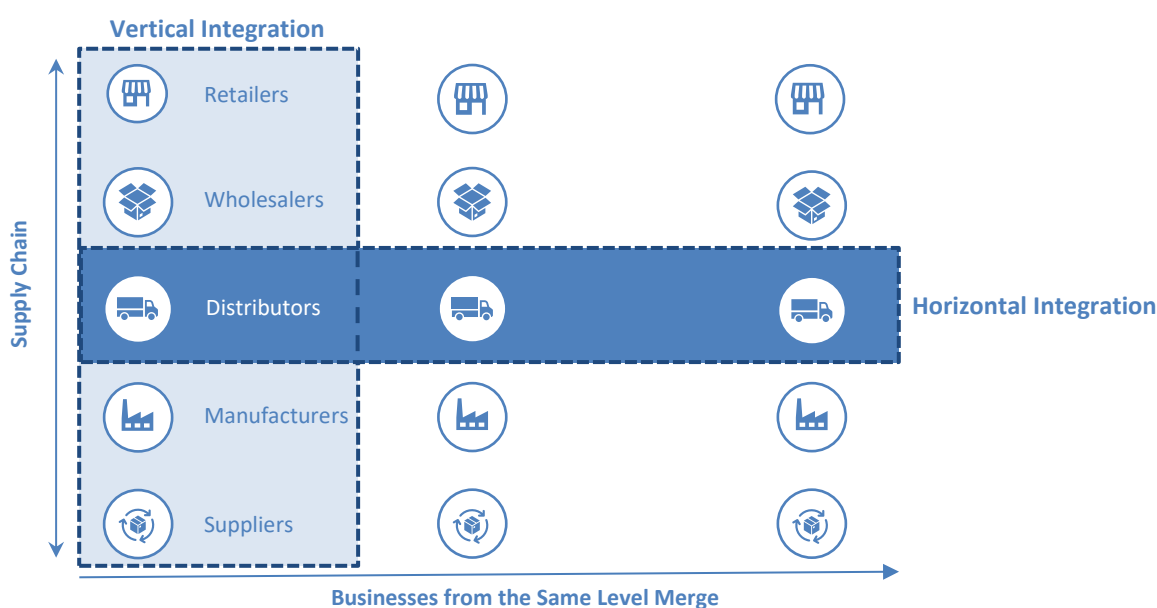
Horizontal Acquisition

In this case, the parent company buys a competitor or another firm in the same industry and at the same point in the supply chain. A horizontal acquisition, also known as a horizontal merger or horizontal



integration is a strategy in which one company acquires another company in the same industry and at the same production stage. This type of acquisition allows the acquiring company to increase its market share, reduce competition, diversify its product offerings, and tap into new markets within the same industry. It does not involve a pivot in the basic business operations of the acquiring company but rather expands its production capacity and control over the production process. Horizontal acquisitions are often pursued to eliminate competition and quickly increase market share.

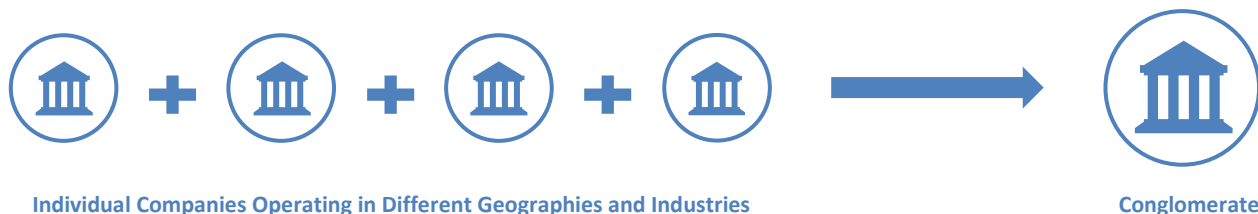
Vertical Integration and Horizontal Integration



Conglomerate Acquisition

This occurs when the acquiring company purchases a company that is unrelated to its own business, often in a different industry. A conglomerate acquisition, also known as a conglomerate merger, is a merger of firms that are involved in economically unrelated business activities. It typically occurs between firms in different industries or geographic areas. There are two types of conglomerate mergers: pure and mixed. Pure conglomerate mergers involve firms with nothing in common, while mixed conglomerate mergers involve firms that are looking for product extensions or market expansions. These mergers can serve various purposes, including expanding into new markets, reducing unsystematic risks, eliminating redundant activities, and attaining cross-selling and diversification leading to reduced risk exposure. While conglomerate mergers can result in strategic benefits and synergies, they can also lead to potential drawbacks such as loss of efficiency, clashing of cultures, and a shift away from the core businesses.

Conglomerate Acquisition

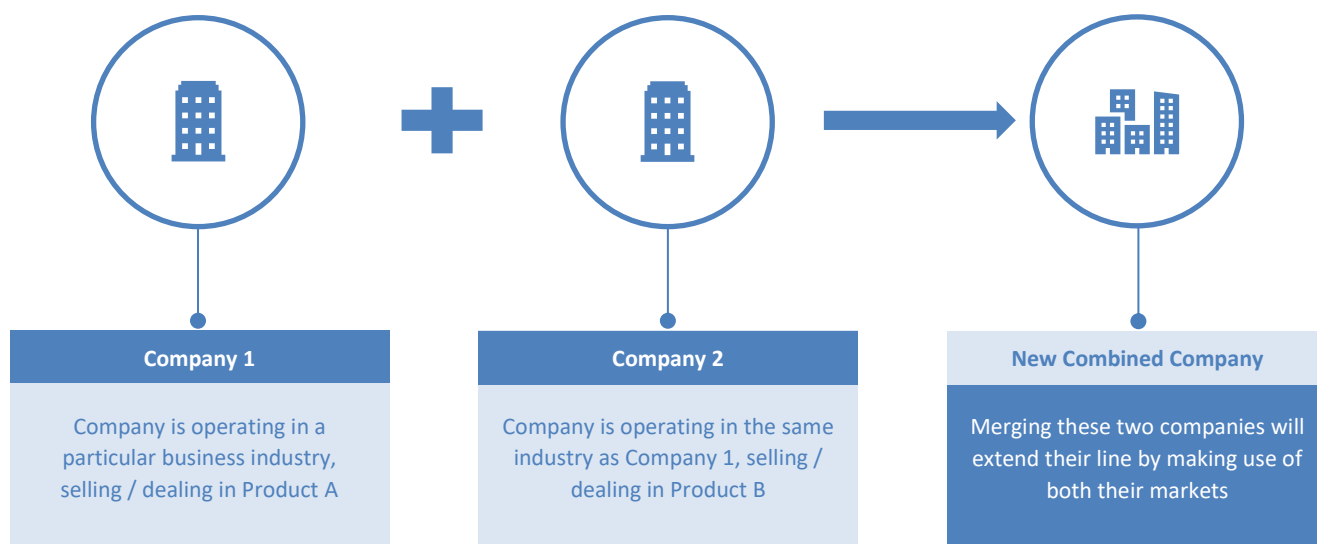


Congeneric Acquisition

A congeneric acquisition, also known as a concentric acquisition, occurs when one company buys another company that offers different products or services but caters to the same customer base. The two companies involved in the deal have different product lines and services, even if they broadly serve the same market. This type of acquisition can help the acquiring company to quickly increase its market share or expand its product line. It is a twist on horizontal acquisition, where the companies involved have different product lines and services but serve the same market.

Each type of acquisition serves different strategic purposes and can create value for the acquiring company in various ways.

Congeneric Merger

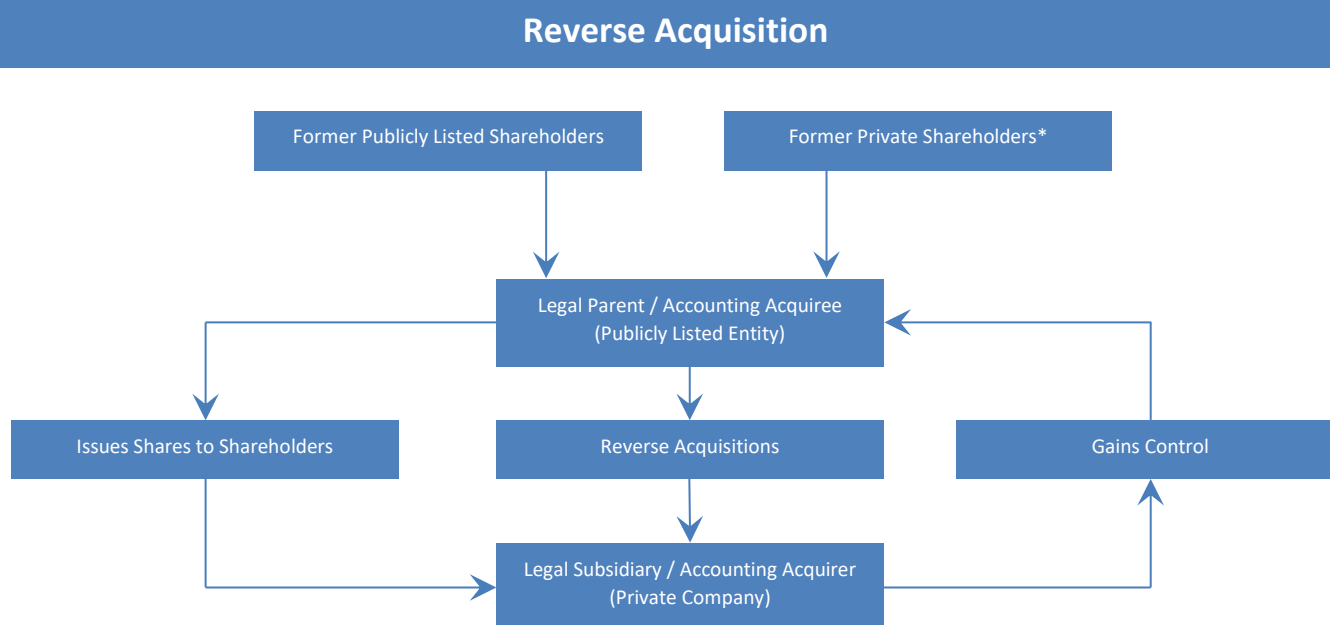




Reverse Acquisition

A reverse acquisition, also known as a reverse takeover (RTO), is a process where a private company acquires a public company. This allows the private company to become publicly traded without going through an initial public offering (IPO). This process provides the private company with access to the public market and can be a quicker and cheaper method of going public compared to an IPO. The Securities and Exchange Commission (SEC) highlights that many private companies, including those based in foreign countries, seek to access the U.S. capital markets through reverse mergers. From an accounting perspective, a reverse acquisition occurs when the entity that issues securities is identified as the acquiree for accounting purposes.

This is explained in the following diagram:



* The Former Private Shareholders, as a group, will own the majority of the voting rights of the combined entity.

The Risks Associated with Acquisitions

The risks associated with acquiring a company can indeed be significant, but they can be mitigated through careful and thorough processes. Overvaluing the target company can lead to overpayment and financial losses. To mitigate this risk, it is important to conduct a comprehensive valuation that takes into account all relevant factors, such as the company's financial stability and liabilities.



M&A Risks

Mitigation Strategies



Inadequate due diligence procedures can also lead to unexpected challenges and losses. To address this risk, thorough due diligence should be conducted to uncover important facts about the target company, including its financial stability and potential liabilities.

Furthermore, underestimating integration challenges can lead to inefficiencies, conflicts, and employee turnover. To mitigate this risk, effective integration planning and execution are essential. This includes addressing corporate cultures, management styles, and operational processes to ensure a smooth transition and minimize disruptions. Security concerns of acquiring a company, such as unknown liabilities, can be mitigated through thorough due diligence and careful assessment of potential risks. Additionally, neglecting cultural considerations and change management can hinder the success of the acquisition. To address this, it is important to proactively manage cultural differences and effectively plan for change management to ensure successful integration.

In summary, the risks associated with acquiring a company can be mitigated through thorough due diligence, careful valuation, and effective integration planning and execution. By addressing these areas diligently, organizations can minimize the potential challenges and maximize the success of the acquisition.

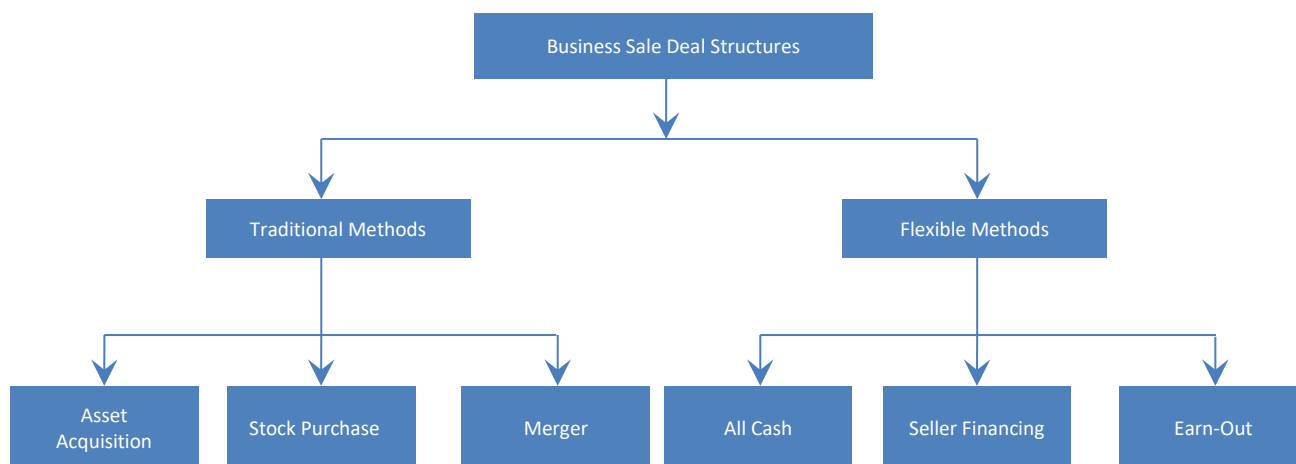
Deal Structure

The deal structure for a business acquisition can take various forms, each with its own merits and potential drawbacks. The three traditional methods of structuring an acquisition deal are asset acquisition, stock purchase, and merger, and they can also be combined to achieve a more flexible deal structure. In addition to these traditional methods, there are other creative and flexible deal structuring



methods, such as all-cash up front, down payment with financing, and earnout. The choice of structure is critical to the success of the deal for both parties, and it involves a balancing of competing legal, tax, and business issues to craft a mutually beneficial transaction structure. Each structure has its advantages and implications for both the buyer and the seller, and the selection of the most suitable structure depends on the specific circumstances of the acquisition.

Methods of Deal Structuring



The advantages of an asset acquisition include the ability for the buyer to choose which assets to purchase and avoid assuming certain assets and liabilities, receiving a step-up in the basis of the assets purchased for tax purposes, and the potential to avoid transfer taxes. Additionally, the exposure to unknown liabilities is limited, leading to less time, money, and resources spent on due diligence. However, the main disadvantage is that the acquirer does not receive the "step-up" tax benefit or the advantage of handpicking assets and liabilities, and all assets and liabilities transfer at carrying value, which can limit the tax benefits.

On the other hand, in a stock purchase, the buyer acquires the target company's outstanding stock and, as a matter of law, acquires all the company's assets, rights, and liabilities, including undisclosed or unknown liabilities. This simplifies the transaction and allows the buyer to obtain no assignable contracts, permits, and licenses without the consent of the other party. However, the buyer takes the target company as it finds it, regarding both assets and liabilities, which may include unknown or uncertain liabilities.



Leveraged Buy Out (LBO)

A financial transaction where one company acquires another using a significant amount of borrowed money, or leverage, to meet the cost of acquisition. The assets of the company being acquired are often used as collateral for the loans, along with the assets of the acquiring company.

In an LBO, there is usually a high debt-to-equity ratio, often around 90% debt to 10% equity. The use of debt, which typically has a lower cost of capital than equity, serves to reduce the overall cost of financing the acquisition. This is because interest payments often reduce corporate income tax liability, whereas dividend payments normally do not.

LBOs are often carried out to take a company private or to spin off part of an existing business. They can take many forms, such as a Management Buyout (MBO), where a company's senior management team purchases all or part of the business.

Potential LBO benefits provide the opportunity to sell a business that might not be at its peak performance but still has cash flow and the potential for growth. The objective of an LBO is to pay down the debt through cash flow from operations and asset disposals, potentially followed by a resale of the company later.

Authors Note # 2

I received an honorable discharge in August 1978, holding the rank of Corporal (E-4) after training as a Combat Engineer and Bulk Fuel Specialist.

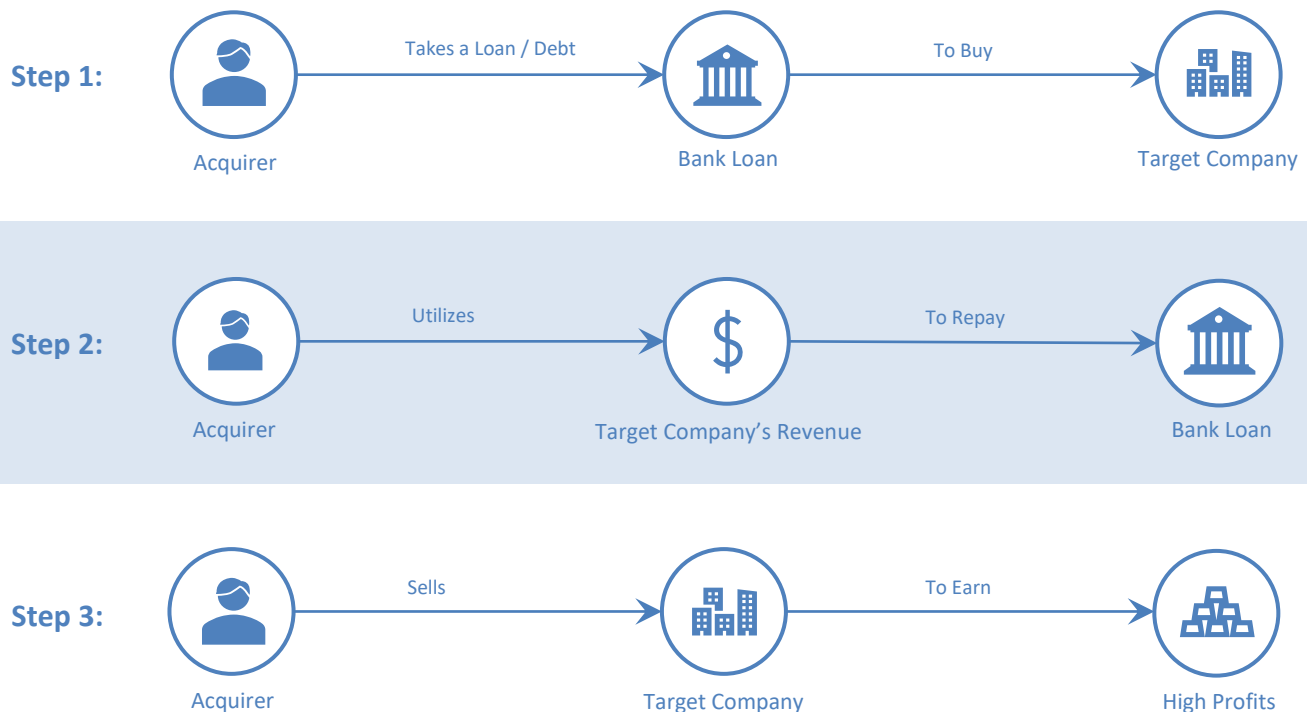
Upon my discharge from the Marine Corps, I had a straightforward plan: to find a partner to share my life with. I married Ellen M. Higley on September 8, 1979, and we have now been happily married for 46 years.

I aspired to start my own business, following in the footsteps of my family, who were involved in the timber and sawmill industry. This led me to establish Salisbury Logging.

Both my wife and I desired children, and while I envisioned having one boy and one girl, life took a different turn, resulting in four boys and one miscarriage of a girl.

Initially, my business thrived; however, as the timber markets and the economy entered a recession, I was advised by a lawyer to file for Chapter 7 bankruptcy. At that time, I was unaware of alternatives like Chapter 11 reorganization bankruptcy, which might have salvaged my business. This experience eventually guided me toward becoming a turnaround advisor.

Leverage Buy Out (LBO) Steps



Why The Need for Alternatives to LBOs In the Current Economy

According to the Federal Reserve's quarterly survey of senior lending officers, banks are tightening credit standards for business loans. This tightening of lending standards is also being observed in the private credit industry, with private credit firms seeing opportunities as banks tighten lending. Private credit funds are filling in gaps in the flow of credit and providing liquidity to lenders who need it. The tightening of lending standards by U.S. domestic banks is expected to slow the flow of credit to small businesses and households. Small businesses are already experiencing this credit tightening, with the National Federation of Independent Business reporting that turbulence in the U.S. banking system may trigger a credit tightening equivalent to an increase in the federal funds rate.

Soft LBO: A Collaborative Model

Between the economy and new regulations under consideration, there is a need to help business brokers and intermediaries think outside of the box to get their transactions done. The two glaring issues facing brokers and sellers today are unrealistic valuations and buyer financing.



Realistic valuations need to be targeted to the financial market's expectations. Business valuation is a mathematical process - not an emotional one or one based on perceived value. It doesn't matter what a buyer is willing to pay as a premium-to-market if they don't have enough cash and or can't access enough cash.

Buyer financing is not as simple as it once might have been. To be successful it needs to be tied to the buyer and the seller's objectives with flexibility. If the buyer has enough cash and the seller will hold paper, the transaction has less to do with valuation. However, once a third player is brought in the form of other people's money to fund the transaction, the transaction becomes very complex. For many reasons, the chances of completion become questionable, at best, without proper valuation.

To demonstrate this premise, let us assume there are three key players within a given transaction: a seller; a buyer; and a funding source.

First and foremost, a transaction cannot be completed without satisfying the funding source. Logically, the larger the transaction, the more difficult satisfying the funding source becomes.

A Soft Leveraged Buyout (S-LBO) can be a viable method that works for qualified transactions that have both a qualified buyer and a motivated seller.

A buyer and seller will enter into a purchase and sales agreement subject to a subsequent financing transaction that will be based on an exempt security offering filed with the SEC, and applicable state securities offices.

Why Companies Do Not Sell

By knowing the reason why some companies fail to sell a buyer can access transactions with a full understanding of the market landscape. The reasons for not selling can vary, but they often include the following factors:

Unrealistic Expectations

Some business owners may have unrealistic expectations for the price and terms of the sale, such as insisting on all cash at closing or being inflexible in negotiating other terms.

Poor or No Exit Strategy

Failing to have a solid exit strategy in place can be a common mistake. This may occur when the owner wasn't planning on selling the business until they were forced to due to unforeseen events or circumstances.



Unstable Outlook for the Company

If a business has too many problems at the present time or on the horizon, it may not be an attractive investment for potential buyers.

Outside Factors

Factors such as the business being in a rural area, being in a niche field with a limited buyer pool, or not being pre-approved for bank financing can also contribute to a business not selling.

Too Specialized or Non-Competitive

Companies that are overly specialized or lack competitiveness might find it difficult to attract buyers.

Only 30% to 40% of businesses listed for sale ever sell. The median close rate was 6.46% for businesses listed on the largest business-for-sale marketplace between 2018 and 2022. For businesses with a listing price of under \$1,000,000, only 20% of them ever sell.

Authors Note # 3

I coined the term "Soft Leverage Buy Out" (Soft LBO) nearly 20 years ago, and since then, I have utilized this innovative process in various forms to successfully acquire both private and public companies. Throughout my career, I have applied the Soft LBO strategy to gain control of numerous public companies across diverse industries, including:

Public Companies:

- Pet products manufacturing
- Financial services (debit card)
- Product tracking and logistics
- Mineral mining
- Holding companies

I have also acquired several private companies in sectors such as:

Private Companies:

- Travel agency auditing
- Computer peripherals
- International holding
- Commercial mortgages
- Hard drive repair and remanufacturing
- Food service and hospitality



- Business services

The Soft LBO is particularly advantageous when a seller is looking for growth before a final exit. This approach effectively gives the seller a "second bite of the apple," allowing them to benefit from future success after the initial sale. Together with my team, I use the Soft LBO model not only to grow our own business through acquisitions but also to support our clients in achieving their growth objectives. This versatile strategy has proven to be an effective tool in navigating the complexities of mergers and acquisitions while fostering mutual benefit for all parties involved.

The Soft Leverage Buy Out (Soft LBO) model offers unique advantages to both buyers and sellers, creating a mutually beneficial transaction structure. Here's how it benefits each party:

- The Soft LBO allows buyers to acquire companies with less initial capital outlay compared to traditional acquisitions. This enables buyers to pursue larger deals or multiple acquisitions that might otherwise be out of reach.
- By using leverage, buyers can potentially achieve higher returns on their equity investment. The debt component amplifies gains if the acquired company's value appreciates.
- Buyers can gain control of the company over time, allowing for a smoother transition and integration process.
- The Soft LBO is particularly advantageous for sellers seeking growth before a final exit. It allows them to retain a stake in the company and benefit from future success.
- Sellers have the opportunity to profit twice - once during the initial sale and again when the company achieves further growth under new ownership.
- Often, the existing management team is retained, ensuring operational continuity and leveraging their expertise.
- The injection of capital and strategic guidance from the buyer can help improve the company's market position and growth potential.
- Both parties are incentivized to work towards the company's success, as they share in the potential upside.
- The Soft LBO model can be tailored to suit the specific needs and goals of both the buyer and seller, making it adaptable to various scenarios.
- By maintaining seller involvement, the buyer benefits from their industry knowledge and experience, potentially reducing operational risks.

The Soft LBO model effectively bridges the gap between traditional acquisitions and partnerships, offering a more collaborative approach to mergers and acquisitions. It allows for a gradual transition of ownership while providing both parties with opportunities for financial gain and strategic growth.



TARGETING AN ACQUISITION

The Overall Market

The lower and middle private companies in the lower middle market, with annual revenues typically ranging from \$5 million to \$100 million, are often family-owned and may not be immediately ready to sell. These companies are attractive to buyers due to their diverse nature and potential for value creation. Private equity firms specializing in the lower middle market typically invest in companies valued between \$10 million and \$250 million, providing capital and resources for growth. However, the decision to sell or seek outside investment depends on various factors such as the company's growth potential, the need for capital, and the willingness to give up some control in exchange for resources.

How to Find the Right Acquisition Targets?



Analyze Players

Look at the potential players who you might consider acquiring



Dig into the Data

Do your research on company performance and the pros and cons of investing



Connect

Focus your efforts on long-term relationship-building

Why are Buyers Drawn to Companies in The Lower Middle Market Segment?

The attractiveness of a lower middle-market company to buyers is indeed due to their diverse nature, potential for value creation, and the opportunity for investors to purchase assets with low debt compared to much larger companies. These factors present a unique opportunity for buyers to exploit potential weaknesses as part of any negotiation to purchase. As a buyer, having a clear vision of your goals and desires when completing a transaction is crucial for making informed and strategic decisions.

Key Considerations for Acquiring Lower Middle-Market Companies

When considering the acquisition of a lower middle-market company, it is important for buyers to conduct thorough due diligence to understand the company's financial health, market position, growth prospects, and potential risks. Additionally, having a well-defined acquisition strategy, a strong understanding of the industry, and a clear plan for value creation post-acquisition are essential for a successful transaction.



Buyers should also consider the cultural fit between their own organization and the target company, as well as the potential impact on existing management and employees. By carefully evaluating these factors and maintaining a clear vision of their goals, buyers can position themselves to make informed and strategic decisions when pursuing opportunities in the lower middle market.

Maintaining Focus Throughout the Acquisition Process

Positioning your Company as a buyer will require a clear vision of several teams pre and post-transaction to maintain focus and stay on task. Losing focus during the acquisition process can have detrimental effects on the outcome of the deal. It can risk losing valuable momentum, lead to challenges and difficulties, and negatively affect employee morale. Additionally, a lack of focus on the primary goal of operating the business effectively can occur during post-merger integration, impacting the ultimate success of the deal. Therefore, maintaining focus throughout the acquisition process is crucial for its success and the effective operation of the business.

What Drives Companies to Sell

The most common reasons why businesses are sold include retirement, which is the most common reason for profitable companies to be sold. The heavy burden of business ownership can lead to burnout, prompting owners to sell. Other factors such as declining revenues, negative industry changes, or the need to raise capital for a new venture also prompt owners to sell.

These are just a few of the many factors that can influence a business owner's decision to sell their company.

The Acquisition Team

As a buyer, you will need to have an acquisition team. When buying a business, it is essential to assemble an acquisition team to navigate the complex process. The team typically includes professionals such as attorneys, accountants, and brokers. A team plays an active role in negotiations, drafting proposals, conducting reviews, and closing deals. A professional accountant helps manage and understand the financial aspects of the business being acquired. A broker acts as a liaison between the buyer and the seller, facilitating the deal. These experts support the buyer in every phase of the acquisition, ensuring a successful and well-informed purchase. Additionally, wealth advisors and investors may also be involved in the negotiation process. Assembling a knowledgeable and experienced acquisition team is crucial for a successful business purchase.

Assembling an acquisition team can be challenging due to the involvement of specialists and analysts with independent goals, which can lead to fragmented views of the agreement. Common challenges in assembling an acquisition team include:



Multiple / Fragmented Views

The involvement of specialists and analysts with independent goals can result in multiple, fragmented views of the agreement.

Integration Problems

During the integration phase, challenges such as culture and change management can create an inefficient or toxic work environment.

Information Management

Challenges related to information management, including insufficient resources, integrating new files / systems, and maintaining privacy and confidentiality, can also arise during mergers and acquisitions.

Negotiation and Deal Stage Challenges

Challenges during the negotiation stage, including tight timelines and uncertain timing, can make the process complex.

Overcoming Challenges

To overcome the challenges mentioned, organizations can benefit from the following strategies:

Comprehensive Assessment of Talent and Capabilities: Conducting comprehensive assessments of the existing talent pool and organizational capabilities can help identify strengths, weaknesses, and areas for improvement. This can inform targeted development initiatives and resource allocation to address specific needs.

Early Involvement of the Information Management Team: Engaging the information management team from the outset of a project or initiative can ensure that data-related challenges are proactively addressed. This early involvement allows for the establishment of robust data management processes and the integration of data-driven insights into decision-making.

Proactive Planning and Mitigation of Potential Roadblocks: By engaging in proactive planning, organizations can identify potential challenges and develop contingency plans to mitigate their impact. This may involve scenario planning, risk assessments, and the establishment of clear protocols for addressing unforeseen obstacles.

By implementing these strategies, organizations can enhance their ability to navigate complex challenges, leverage their talent and resources effectively, and foster a culture of proactive problem-solving and resilience.



Identify Your Goals for Acquisition

The goals for acquisition can vary depending on the context, such as customer acquisition, mergers and acquisitions, or seller acquisition goals. In the context of customer acquisition, the goals may include increasing the number of leads, revenue from new customers, and marketing's contribution to revenue. For mergers and acquisitions, the objectives can be to mitigate weaknesses, bolster combined strengths, remove a competitor, or undergo exponential growth. In the case of seller acquisition goals, it is important to know the type of buyer one wants to attract, such as strategic, financial, internal, or solo entrepreneurs, and to identify specific motivations for the sale. In general, setting clear and specific goals is essential for successful acquisition strategies, and these goals should be measurable, achievable, relevant, and time-bound.

Operations

Some of the operational reasons for buying a company include:

Lower Operational Costs: Buying an existing business can lead to lower operating costs, as many initial activities and costs have already been completed, and the business may have an established customer base and cash flow.

Pre-Existing Revenue Streams: Existing businesses already generate a revenue stream, making it easier to obtain financing compared to starting a business from scratch.

Time-Efficient: An existing business is already operational, with established policies, procedures, and a customer base, providing a quicker path to becoming operational compared to starting a new business.

Target Company's Superior Expertise: The acquiring company may have superior management or expertise that can be used to unlock value in the target business.

Talent Acquisition

The benefits of acquihiring include the rapid injection of skilled and experienced talent into the acquiring company, saving time and money in acquiring new talent, and providing an effective shortcut to quickly hire the best talent in large numbers. Acquihiring is also a smart recruitment strategy, especially in industries with a small pool of qualified workers, as it allows companies to bring in employees without negotiating salary the same way as a traditional hiring process. Additionally, acquihiring can provide a favorable exit strategy for employees, with the prestige of being bought by a larger company, and it may also have tax benefits and keep venture capitalists happy. However, it is important to note that there can be drawbacks to acquihires, such as potential misalignment between the acquired company and the acquiring company, cultural challenges, and retention issues.



Financial Strategies

The financial reasons for acquiring include the following:

Possible Synergies: Acquisitions can be pursued to increase the wealth of shareholders by creating synergies that increase the value of the newly created entity.

Achieving Economies of Scale: Acquiring another company can lead to cost savings and efficiency improvements through economies of scale.

Diversification of Operations: M&A can be motivated by a desire to diversify business operations, enter new markets, or diversify risks relating to products or markets.

Gaining Access to Unique Assets: Companies may pursue acquisitions to gain access to unique assets, such as new technologies, that cannot be obtained through other means.

Overcoming Financial Limitations: Acquisitions can help a company overcome its financial limitations by merging with another company.

Achieving Growth: Acquiring another business can help in gaining greater market share and boosting revenue and growth.

Improved Financial Stability: Acquisition can contribute to improving the financial stability of the acquiring company.

In summary, the financial reasons for acquiring include creating value, achieving economies of scale, diversifying operations, gaining access to unique assets, overcoming financial limitations, and achieving growth and improved financial stability.





Revenue Synergies	Cost Synergies
Greater market share % and brand recognition	Eliminate overlapping workforce functions and reduce headcount
Cross-Selling / Upselling / Product bundling opportunities	Cost-saving from reduced professional services fees (e.g. Marketing)
Geographic expansion and new distribution channels	Closure or consolidation of redundant facilities
Pricing Power from reduced competition	Negotiating leverage over suppliers (i.e. Extend payables)
Access to new end markets and customer types	Streamlined internal processes and integration of operational “Best practices”

How To Find Acquisitions

To find qualified acquisitions, you can consider the following approaches.

Identifying Acquisition Opportunities Through Key Industry Contacts: Start by getting the word out to people who might know which businesses are for sale and have access to unknown opportunities, like lawyers, accountants, business brokers, M&A Advisors, and relationships within your target industry to help uncover leads.

In-Depth Screening Process: Involve a detailed qualification process to ensure the company you are targeting meets your criteria, including industry, product portfolio, turnover, location, and the motives for selling. This may also involve analyzing the management team, financial strength, and reputation of the company.

Outsourcing Acquisition Process: Consider outsourcing the acquisition process to a business search specialist who can help with detailed background research and finding the right company that meets your criteria.

Use of AI Platforms: Consider using AI-powered deal-sourcing platforms that allow you to input your specific acquisition criteria and then source, sort, and conduct due diligence on potential deals. These platforms can help source deals faster, uncover hidden opportunities, and provide deeper insights for decision-making.

Online Marketplaces: Explore online marketplaces such as Acquire.com, which connects buyers and sellers, allowing you to browse vetted listings and connect with qualified buyers.



By leveraging these approaches, you can increase the likelihood of finding and acquiring qualified companies that align with your strategic objectives.

Most businesses that are for sale often prepare a Confidential Information Memorandum (CIM) to provide detailed information to potential buyers. The CIM is a comprehensive document that outlines the key aspects of the business, including its history, operations, financial performance, market position, and growth potential. It is designed to help prospective buyers evaluate the opportunity and make informed decisions about whether to pursue the acquisition. The CIM is typically shared with serious and qualified buyers after they have signed a non-disclosure agreement to protect the sensitive information it contains.

A CIM is not Due Diligence and is select information giving you an insight into the target.

A Confidential Information Memorandum (CIM) is a document used in M&A to convey important information in a sale process. It provides potential buyers with detailed information about the business being sold, including financial statements, management team, market overview, and industry summary. The CIM is not a legally binding contract, nor does it include a company's valuation. It is a marketing document intended to make a company look as attractive as possible, but buyers will always conduct their due diligence to confirm the information presented in the CIM. The CIM is the first step in the due diligence process for M&A deals, and it is crucial in providing potential buyers with comprehensive information about the business, allowing them to make informed decisions about whether to pursue the purchase.





KEY STEPS IN BUYING A BUSINESS

The steps in buying a business are simple to bullet out but will require a great deal of attention in proceeding with the process. To quote “The Devil is in the Details”.

To buy an existing business, you can follow a step-by-step guide that typically includes the following key steps:

Find a Business to Purchase i.e. search for a business that fits your interests and talents.

To identify your skill and knowledge base for a business, you can follow these steps:

- Clearly define the objectives of your business to understand the skills and knowledge needed to achieve them.
- Evaluate the present skills and knowledge of your workforce to identify any gaps. This can be done by analyzing employee performance and turnover data.
- Understand the qualifications required for each role in your business, considering future, strategies, and technologies.
- Create a table for each job role listing the required knowledge and skills, and classify each as high, medium, or low priority. This will help in prioritizing the areas that need development.
- Continuously develop your knowledge and skills through professional development courses, online resources, and attending relevant events.
- Acquire essential business skills such as financial management, communication, leadership, marketing, and sales, as these are vital for business success.

By following these steps, you can effectively identify your skill and knowledge base for a business and take the necessary actions to bridge any gaps and ensure success.

Value the Business

Business valuation is the process of determining the economic value of a business, which is essential for various purposes such as sale value, taxation, and financial reporting. There are several methods to value a business, including:

Book Value: This method involves calculating the business's value by subtracting its liabilities from its assets. However, it is considered unreliable due to its simplicity.

Market Capitalization: This is a simple method that involves multiplying the company's share price by its total number of shares.



Discounted Cash Flow Analysis: This method uses a complex formula to analyze the business's annual cash flow and determine its value using a "Net Present Value" calculation.

Revenue-based Valuation: This approach involves calculating the business's value based on its annual sales, typically using a multiple of the sales figure.

Earnings Multipliers: This method involves using a price / earnings (P/E) ratio to determine the business's value based on its projected earnings.

It is important to consider a combination of these methods to obtain a comprehensive understanding of a business's value. Conducting a business valuation is crucial for making informed decisions related to investment, sale, or strategic planning.

Negotiate a Purchase Price

Engage in negotiations with the seller to agree on a price that reflects the value of the business. To negotiate a purchase price for a business, it is important to approach the process with preparation, empathy, and a focus on mutual benefit. Some of the key steps and considerations are as follows:

- As a buyer, determine the maximum amount you are willing to pay and the price you cannot exceed. This will provide a clear framework for the negotiation process.
- Recognize the emotional investment of the seller in the business. Being empathetic and understanding can help build a positive negotiation environment.
- Consider engaging a business broker, lawyer, or mediator to facilitate the negotiation process and ensure a fair purchase price for both parties.
- During negotiations, seek to understand the seller's needs and focus on finding a mutually beneficial deal. Identifying common interests can lead to a more successful negotiation.
- In addition to the purchase price, consider negotiating financing terms, contingencies, time frames, and other relevant aspects of the deal. A balanced approach to all deal points is essential.
- Conducting a business valuation as part of the due diligence process is crucial to understanding the worth of the business and informing the negotiation.
- By following these steps and considerations, buyers can engage in effective negotiations with the seller to agree on a purchase price that reflects the true value of the business.

Submit a Letter of Intent (LOI)

Prepare a non-binding agreement that outlines the negotiated terms and expresses your intent to buy the business.



- A Letter of Intent (LOI) is a document that declares the preliminary commitment of one party to engage in a deal or project with another party. It outlines the chief terms of a prospective deal and is commonly used in major business transactions.
- The purpose of an LOI is to clarify which key points of a deal must be negotiated, protect all parties involved, and announce the nature of the deal, such as a joint venture or a merger.
- LOIs are typically used to signal that two parties are negotiating a deal, and they are usually drafted and signed while negotiations between parties are ongoing.
- The LOI must be concise, engaging, and should avoid jargon, adjectives, and subjective statements that are not supported by facts.
- In specific contexts, such as applying for grants or submitting business proposals, an LOI may need to include additional details such as project title, topic number, subtopic letter, and principal investigator's name and contact information.
- When submitting an LOI, it is important to follow the specific guidelines and requirements of the organization or institution to which it is being submitted.

Complete Due Diligence

Thoroughly examine the business's financial, legal, and operational aspects to ensure there are no hidden problems.

- Due diligence is the process of thoroughly evaluating a company or a situation before deciding or entering into a financial transaction. It involves collecting and analyzing information to ensure that the decision-making party is not held legally liable for any loss or damage. This process is essential in various scenarios, particularly in business transactions, mergers, and acquisitions.
- There are several types of due diligence, each focusing on various aspects of the target company. These can include financial due diligence, legal due diligence, operational due diligence, human resources due diligence, and environmental due diligence.
- The due diligence process typically involves a comprehensive review or audit of the target company to gain a deep understanding of its operations, people, and potential risks. It helps the acquiring firm assess the target company's business, assets, capabilities, and financial performance.
- By conducting due diligence, the buyer can confirm the accuracy of the information presented, find, and mitigate any risks, ensure legal and regulatory compliance, and make informed decisions based on facts.

In summary, due diligence is a critical step in any business or financial transaction, as it provides the necessary information to make well-informed decisions and mitigate potential risks.



Obtain Financing

Obtaining financing for a business can be crucial for its growth and success.

Financing refers to the process of providing funds for business activities, making purchases, or investing. There are distinct options for obtaining financing, including debt financing, equity financing, and mezzanine capital.

Debt financing involves borrowing money that needs to be repaid with interest, while equity financing involves selling a stake in the business in exchange for funds.

Additionally, the U.S. government offers programs to help businesses obtain bank loans for development, working capital, and project financing needs. When seeking financing, it is important to assess the funding options available and consider the specific needs and circumstances of the business.

Close the Transaction

Finalize the purchase by signing the sales agreement and completing the transfer of ownership. Drafting a purchase and sale agreement for a business involves creating a legal document that sets forth the terms and conditions of the transfer. This agreement, also known as a Business Purchase Agreement, is used to buy or sell diverse types of businesses, including sole proprietorships, partnerships, corporations, and limited liability companies (LLCs).

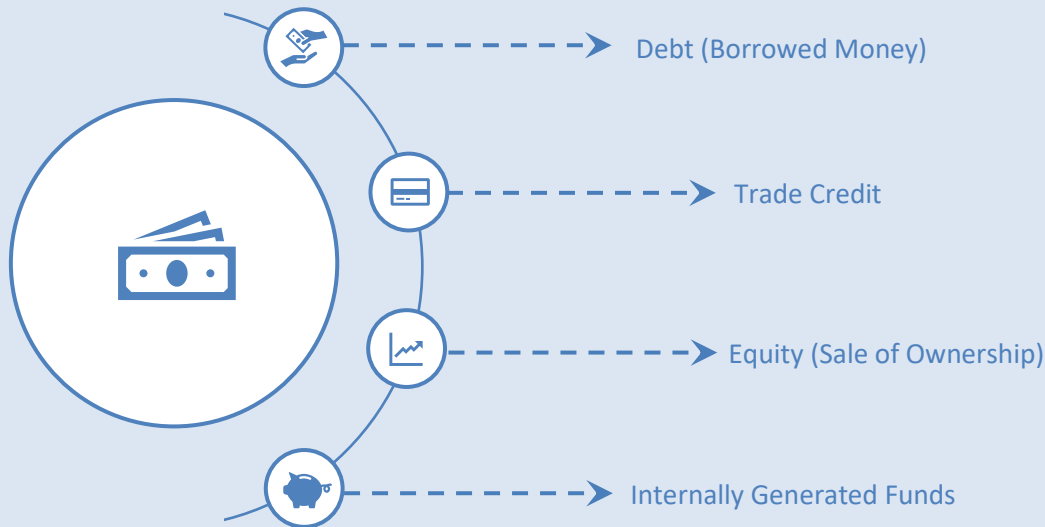
The agreement typically includes details such as the purchase price, closing arrangements, representations and warranties, confidentiality, non-compete clauses, and the allocation of the total price among distinct categories, such as inventory, equipment, and goodwill. The agreement is drafted by the parties and their advisors after a letter of intent has been signed, and its provisions are negotiated until both parties reach a mutually acceptable arrangement.

A well-drafted business purchase agreement is essential for protecting the interests of both the buyer and the seller and ensuring a smooth transfer of the business.

Capital Sources When Buying a Business

The major sources of capital for buying a business include equity common and preferred capital, debt capital, and free cashflow.

Sources of Capital



Common Stock (Equity)

Common stock is a type of stock that represents ownership in a corporation. Shareholders of common stock have the following rights:

- Common stock shareholders have the right to vote to elect the members of the board of directors. Typically, shareholders may cast one vote per share. Shareholders will have a residual claim on the corporation's assets and income in the form of dividends.
- They are entitled to collect dividends when the corporation's board of directors declares its payment. In the event of liquidation, common stockholders may have rights to the corporation's remaining assets after the creditors and owners of preferred stock are repaid.
- Common stock represents a residual ownership stake in a company, providing the right to claim any other corporate assets after all other financial obligations have been met.
- Common stock comes with the possibility of receiving dividends and capital appreciation. If a company does well, the value of its common stock can increase, allowing investors to share in the company's success over time.

In summary, common stock provides shareholders with ownership rights, voting rights, and the potential for returns through dividends and capital appreciation. However, in the event of liquidation, common stockholders are paid only after bondholders, preferred shareholders, and other creditors have been satisfied.



Preferred Stock (Equity)

Preferred stock, also known as preference shares, is a type of stock that may have a combination of features not possessed by common stock. It is considered a hybrid instrument, combining properties of both an equity and a debt instrument. Preferred stockholders have a higher claim on assets and earnings than common stockholders, and they often have a priority claim whenever a company pays dividends or distributes assets to shareholders. Preferred stock is less risky than common stock and can be seen as a hybrid security that integrates features of both common stocks and bonds. It shares characteristics of both stocks and bonds, offering higher yields than corporate bonds and favorable tax treatment.

Secured Debt

- Secured debt is a type of debt that is backed by collateral, such as a car or a house. If the borrower defaults on the loan or debt repayment, the creditor can take possession of the collateral. This provides the lender with added security, which often results in lower interest rates compared to unsecured debt.
- Common examples of secured debt for consumers include mortgages and auto loans. Secured debt is considered less risky for the lender, but it carries the risk that the borrower may forfeit the collateral if they cannot repay. In contrast, unsecured debt does not require collateral and is based solely on the borrower's creditworthiness.
- Secured debt is often associated with borrowers who have poor creditworthiness, as securing the loan with collateral significantly reduces the risk for the lender. Examples of secured debt include mortgages, equity lines of credit, and vehicle and equipment loans. On the other hand, unsecured debt, such as credit card debt, does not require collateral and is considered riskier for the lender, resulting in higher interest rates.

Unsecured Debt

- Unsecured debt refers to loans that are not backed by collateral. This means that if the borrower defaults on the loan, the lender may not be able to recover their investment because the borrower is not required to pledge any specific assets as security for the loan.
- Examples of unsecured debt include credit cards, medical bills, and utility bills. Unsecured debts are considered riskier for the lender and carry higher interest rates than collateralized loans. If a borrower defaults on unsecured debt, the lender can take actions such as reporting the default to credit rating agencies, hiring a credit collection agency, or seeking legal recourse.



Royalty Financing

- Royalty financing is a type of investment in which a business receives funding based on its future revenue, like an advance on a paycheck. This form of financing is often used in industries such as life sciences, technology, and mining. Unlike traditional loans, royalty financing involves variable payments that fluctuate with the borrower's revenue performance, and the term of the financing is also variable.
- It is a means of raising capital with significant differences from regular debt financing and equity financing. Royalty financing can be an attractive option for businesses seeking flexible and less risky funding, as it does not involve minimum payments, personal guarantees, fixed loan terms, lump sum payments, or restrictive conditions.
- This form of financing is particularly prevalent in the life sciences industry, where it can be used to fund critical needs such as product launches, acquisitions, and further research and development. Royalty financing allows innovators to access capital markets without the risks and distractions of traditional equity financing, while also enabling them to retain control of their operations and processes.

Seller Financing

- Seller financing, also known as owner financing, is a loan provided by the seller of a property or business to the purchaser. It allows the buyer to make installment payments to the seller, usually monthly, over a specified time, at an agreed-upon interest rate, until the loan is fully repaid.
- This arrangement is beneficial for buyers who may not be able to obtain a loan from a bank and for sellers looking to attract a wider pool of potential buyers. The loan is typically secured by the property being sold, and in the event of default, the property is repossessed or foreclosed on, like a bank loan. To protect both parties' interests, a legally binding purchase agreement should be drawn up with the assistance of an attorney.
- Seller financing can be used in business transactions, and it is an alternative form of credit that can be useful in situations where traditional financing is unavailable. The terms of seller financing, including the loan amount, interest rate, and repayment schedule, are outlined in a promissory note signed by the buyer and seller. This arrangement eliminates the need for a traditional lender and can simplify the process of buying and selling a property or business.
- An earnout is a pricing structure in mergers and acquisitions where the sellers must "earn" part of the purchase price based on the performance of the business following the acquisition. It is a contractual provision stating that the seller of a business is to obtain future compensation if the business achieves certain financial goals. Earnouts are often employed when the buyer and seller disagree about the expected growth and performance of the business.



- This structure allows the seller to benefit from additional compensation if the business performs while providing the buyer with protection against underperformance. Earnouts are popular among private equity investors as a way of keeping the previous owners involved following the acquisition. The terms and conditions of an earnout are dependent on which party will manage the business after the acquisition. An earnout might also help to align the buyer and seller with the expected post-deal performance of the business. However, it can also lead to disputes over the earnout calculations and encourage short-term behaviors that are sub-optimal for the business's longer-term success.

Authors Note # 4

In my career, I have raised capital using various forms of private placement exemptions to State and Federal securities laws “the corny term other people’s money OPM” the very same strategy that Private Equity Groups, Hedge Funds, and Venture Capitalists use to build multibillion-dollar enterprise.

My Team and I have participated in transactions from \$500K to \$65 million.

President Obama signed into law the Jumpstart Our Business Startups (JOBS) Act on April 5, 2012, which was designed to open up capital markets for small businesses.

For those who have the fortitude to venture forth the tools available and the internet opens up options to make acquisitions and fund them without Wall Street or bank debt.





BUSINESS INTEGRATION

Integration can be the hardest part of a transaction. Business integration can indeed be a challenging process, especially when integrating one or more businesses. Some of the key challenges associated with business integration include:

Cultural Differences: Bringing together employees from different organizational cultures can lead to conflicts and resistance, requiring careful management and communication to ensure a smooth transition.

Cumbersome and Time-Consuming: Aligning business processes, systems, and technologies across integrated entities can be complex and time-consuming, often requiring significant resources and expertise.

Priority Discrepancies: Harmonizing the strategic direction, goals, and objectives of the merged entities is crucial for long-term success but can be challenging due to differing priorities and market dynamics.

Regulatory Hurdles: Navigating the complex landscape of regulatory requirements and legal considerations in different jurisdictions can pose significant hurdles during the integration process.

Talent Retention: Retaining key talent, managing redundancies, and ensuring a cohesive organizational structure are critical aspects of business integration that demand careful planning and execution.

Addressing these challenges effectively requires a comprehensive understanding of the integration process, strategic planning, and the ability to navigate complexities with a clear vision for the integrated entity's future. While challenging, successful business integration can lead to enhanced competitiveness, synergies, and long-term value creation.

Some Of the Common Integration Issues are:

Disparate Data Formats and Sources: Integrating data from various sources with different formats can be a significant challenge, requiring efforts to create a unified data repository.

Integration Costs: The costs associated with integrating different business processes, systems, and resources can be substantial, involving investments in time, effort, and potentially sophisticated programming.

Operational and Strategic Integration: Harmonizing business processes, functions, resources, and leadership teams from merged entities can pose significant challenges and risks, such as loss of efficiency, disruption of service, and misalignment of interests and incentives.

Communication and Collaboration: Better communication, enhanced data accessibility, and collaborative culture are essential for successful business integration.



B2B Integration Challenges: Connecting with partners and customers, data exchange between different systems, and dealing with diverse technological environments are common challenges in B2B integration.

Addressing these challenges requires a clear vision, collaborative leadership, and a comprehensive digital strategy to enable automation, integration, and optimization of vital business processes.

You will need an Integration Team Post-Acquisition

The post-acquisition integration process typically requires the formation of an integration team to manage the transition effectively. The integration team usually consists of the following key components:

Steering Committee: This committee sets the direction of the deal, manages final approvals, and creates a high-level integration strategy.

Integration Management Office (IMO): The IMO is a specialized team responsible for converting the steering committee's strategy into detailed roadmaps and ensuring that the action plans are followed. They also stand as the final authority on all decisions and coordinate cross-functional integration activities.

Operational Team: Composed of operational leaders from both companies, this team coordinates all cross-functional integration activities, manages the moving parts, and drives the synergy capture process.

External Advisors: Experienced external advisors can provide trusted guidance and help in keeping employees focused on running the current business. Third-party legal teams are also important in the transaction.

Integration Leader: The leader of the integration team must possess adequate skillset, resources, and ownership to drive the integration forward. They should have designated time to be fully focused on the integration.

The integration team plays a crucial role in ensuring a smooth and successful post-acquisition integration by overseeing various aspects of the process, including strategy development, detailed planning, and coordination of cross-functional activities.

Authors Note # 5

In the mid-1980s, I and my team bought a company out of Chapter 11 bankruptcy in the financial services space, specializing in travel agency auditing. The company had five offices across the United States, and what should have been a straightforward integration became anything but.



Some managers remained loyal to the previous regime and resisted adapting to the new business model. They refused to take directions from corporate, believing we couldn't operate without them. Our Managing Director in Ohio was particularly problematic, refusing to take calls and frequently playing golf at a country club where the company paid the dues. He instructed his office manager to have me schedule appointments if I wanted to speak with him.

As a Marine, I found this approach unacceptable. I immediately booked a flight to Ohio. Upon arriving at the office, I was informed that both the Director and office manager were out. The receptionist, unaware of who I was, attempted to schedule an appointment for me to return later.

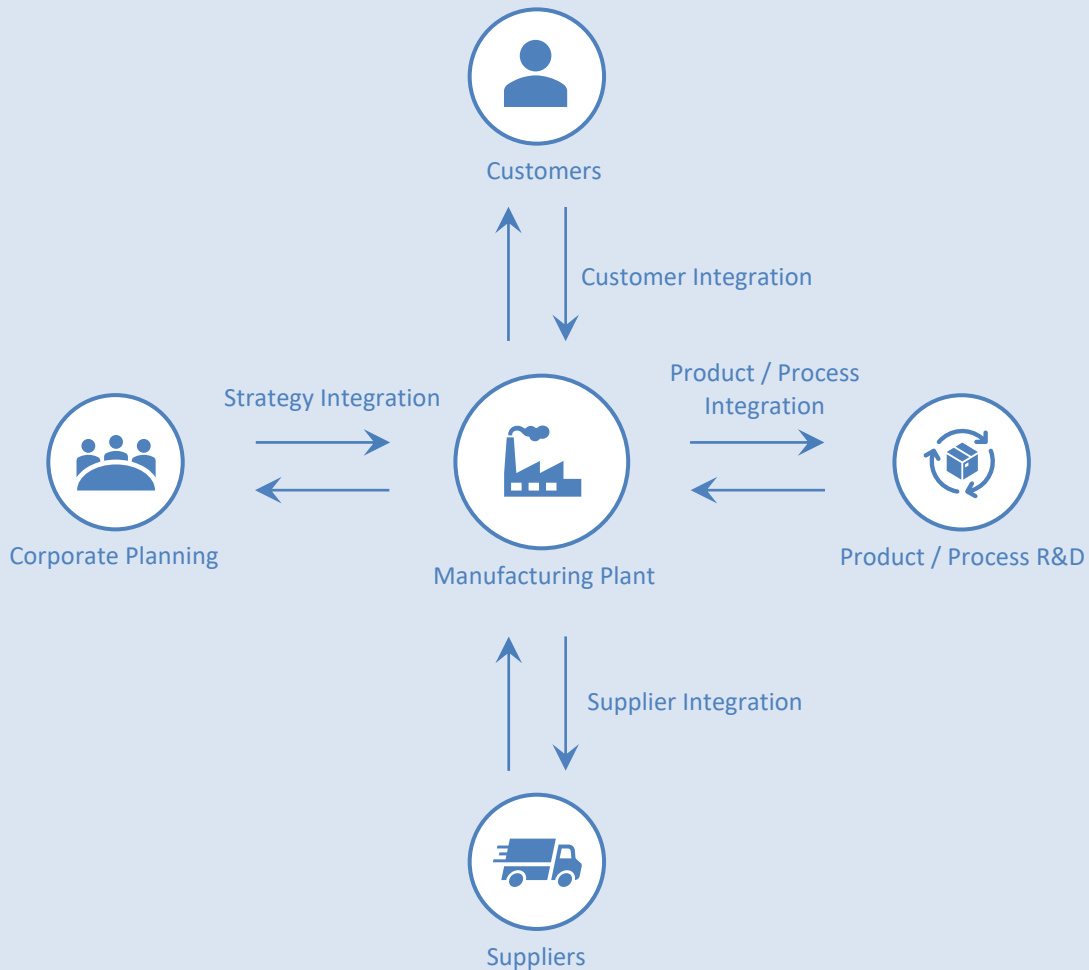
I politely asked which office belonged to the Director and started towards it. The receptionist protested, claiming the door was locked and I couldn't enter. After explaining my identity and position, I requested she contact the Director. When informed there was no key available, I opened the door "the Marine Corps way."

To his credit, the Director arrived within 30 minutes. I fired him on the spot and had two local police officers escort him from the premises. When the office manager arrived, we had a discussion in the Director's office. I promoted her to Managing Director and had her gather the 20-plus employees to apologize for the disturbance and introduce their new boss.

While this situation was extreme, it highlights why integration planning is crucial for success when acquiring companies, especially those emerging from bankruptcy. Proper planning can help identify and address potential issues with personnel, company culture, and operational changes before they escalate to such drastic measures.



Business Integrations



To ensure effective communication within a post-merger integration team, the following key steps and best practices can be implemented:

- Assemble a Cross-Functional Team to ensure that communication is part of a dedicated team that includes legal, senior management, and IT. This team will be critical in crafting and executing the acquisition communications plan.
- Identifying key audiences and customized communication approaches for all employees. This can include conducting town hall meetings, webinars, written communications, and feedback mechanisms to encourage two-way dialogue. Create channels for two-way dialogue, gather



feedback from employees, and monitor the effectiveness of communication efforts. Be prepared to adjust the approach if certain messages are not resonating or if issues persist.

- Regular, transparent communication with all stakeholders, including employees, customers, suppliers, executives, and investors, is crucial. The communication strategy should adapt to reflect changes and provide up-to-date information. Develop a clear plan and schedule of communications aligned with integration milestones, especially for Day 1, should be developed. Executive members or sponsors should be involved in delivering key messages.

By following these steps and best practices, organizations can foster effective communication within the post-merger integration team, leading to better understanding, alignment, and commitment, and a successful merger.

The Cultural Risks of Mergers and Acquisitions Include:

Cultural incompatibility can leave employees feeling isolated, unsupported, and unsure about the future, which can undercut the upsides of the deal and even derail it. The cultural clash of two companies' philosophies, styles, values, and habits can hinder the integration process, and it can be the primary reason why many deals fail to achieve their objectives.

To address these risks, companies should prioritize cultural integration, link the cultural program to tangible outcomes, and implement an integration plan and process as early as possible.

Some Common Cultural Differences that can Arise During a Merger or Acquisition Include:

Decision-Making Styles: Differences in decision-making styles, such as the speed of decision-making, the level of consultation, and the leadership style, can lead to conflicts and slow down the integration process.

Work Environment and Responsibility: Variances in the work environment, level of responsibility given to employees, and management structure can cause confusion and reduced operating results, leading to increased employee turnover.

Communication: Varied communication styles, including the clarity and consistency of the communication process, can result in misunderstandings, friction, and tension, making it difficult for teams to work together effectively.

National and Corporate Cultures: Differences in national and corporate cultures, including awareness of the partner's corporate and national culture, can impact the success or failure of the merger or acquisition.



Leadership Style: Variances in leadership style, such as dictatorial or consultative, and the shift in leadership style, can lead to turnover among employees who object to the change.

By being aware of these potential cultural differences, companies can proactively address and manage them to facilitate a smoother integration process during a merger or acquisition.

To Ensure a Smooth Integration of Cultures After a Merger or Acquisition, the Following Steps can be Taken:

Define the Cultural Objective: Clearly define the desired culture that should emerge from the combination of the two organizations. This is typically a task for the chief executive, and it involves making hard choices about the culture the company wants to see.

Diagnose Differences: Conduct a thorough diagnosis of the cultural differences that matter. This involves identifying the specific behaviors and cultural aspects that are essential for the success of the merged entity.

Leadership and Communication: Leadership style plays a crucial role in bringing together the best elements of both cultures. Employees look for signals from the top of the organization, so leadership's commitment to cultural integration is vital. Effective communication about the cultural integration process is also essential.

Redefine Core Values: Redefine the core values of the merged company, taking the best from both organizations and creating a new set of core values that reflect the combined entity.

Training and Development: Engage in team-building activities and provide ongoing training for all levels of the organization to ensure that team members are aligned in their roles and responsibilities.

By following these steps, companies can work to integrate the cultures of the merging entities, creating a new, cohesive culture that supports the success of the combined organization.

Cultural Integration

The impact of cultural differences on acquisition outcomes cannot be overstated, and the emphasis on cultural awareness, communication, leadership, and trust aligns with best practices in this area. The impact of cultural differences on acquisition outcomes is significant, with culture being the cause of 30 percent of failed integrations. While case studies can offer detailed examples, the guidance you've found provides a solid foundation for understanding and managing culture during acquisition. It is important to leverage these insights and strategies to navigate the complexities of cultural integration in the context of mergers and acquisitions.

Cultural differences can lead to adverse outcomes such as mistrust, resentment, and decreased employee morale, which can impede financial performance during the post-acquisition period. It is



important to emphasize cultural awareness, communication, leadership, and trust to manage culture during acquisition, as these factors are critical to integrating acquired firms and ensuring the long-term success of the merged entity. *“The Daimler-Benz merger with Chrysler in 1998 is a famous example of how cultural differences contributed to the failure of an international merger. Therefore, understanding and managing cultural integration is essential for the success of mergers and acquisitions, and it is advised to address critical cultural issues that are directly linked to business outcomes.*





DUE DILIGENCE

In business, due diligence is essential for acquisitions to provide the buyer with an assurance of all relevant facts and financial information before the deal closes. It helps in making informed decisions, enhancing the quality of information, and reducing the risk for the purchaser.

Due diligence is crucial when acquiring a private company for several reasons. It involves a comprehensive investigation to identify any risks or issues that may affect the acquisition. This includes assessing the target company's overall business operations, reviewing its strategic plans, operational processes, customer base, and competitive landscape. Additionally, legal due diligence is performed to identify any legal risks, review contracts, licenses, permits, and ensure compliance with laws and regulations.

When acquiring a private company, accurate financial records, market analysis, and technology assessment are also essential components of due diligence. Due diligence is particularly challenging for private companies due to the possible lack of listed documentation, which may require more face-to-face interviews and on-site assessments. In summary, due diligence is important in acquiring a private company to uncover potential risks, ensure the deal is sound, and certify the company's compliance with laws and regulations.

Negligent Due Diligence

Inadequate research and analysis of the target company can lead to unforeseen issues; therefore, it is important to follow the following steps:

Conduct Comprehensive Due Diligence: Thoroughly assess the target company's financial, operational, legal, and strategic aspects to reduce the risk of poor due diligence.

Use Different Valuation Methods: Employ various valuation methods such as discounted cash flow, comparable company analysis, and precedent transaction analysis to ensure a thorough and objective evaluation of the target company.

Seek External Financial Advisors: Obtain an unbiased perspective by engaging external financial advisors to reduce the risk of overpaying.

Negotiate Wisely and Effectively: Focus not only on the price but also on the terms and conditions of the deal, such as warranties, indemnities, closing mechanisms, and post-deal integration. Employing a contingent bid and flexible bid can also help avoid overpaying for the target company.

Be Ready to Walk Away: If the deal isn't increasing, be prepared to pursue other opportunities. There are always other target companies in the market and overpaying for one can harm financial performance and reputation.



Overpaying for the Target Company

This can negatively impact the financial health of the acquiring company. To mitigate the risk of overpaying for a target company, several strategies can be employed:

Conduct Comprehensive Due Diligence: Conduct a comprehensive evaluation of the target company's financial, operational, legal, and strategic dimensions to minimize the risk associated with inadequate due diligence.

Use Different Valuation Methods: Utilize different valuation techniques, including discounted cash flow, comparable company analysis, and precedent transaction analysis, to achieve a comprehensive and unbiased assessment of the target company.

Seek External Financial Advisors: Seek an impartial viewpoint by consulting external financial advisors to mitigate the risk of overpayment.

Negotiate Wisely and Effectively: Concentrate on both the price and the terms and conditions of the agreement, including warranties, indemnities, closing mechanisms, and post-deal integration. Using a contingent bid and a flexible bid approach can also help prevent overpaying for the target company.

Be Ready to Walk Away: If the deal isn't progressing, be ready to explore alternative opportunities. There are always other potential target companies available and paying too much for one can negatively impact both financial performance and reputation.

Overestimating Possible Synergies: Unrealistic expectations regarding cost savings and revenue enhancements.

Integration Challenges: Difficulties in merging corporate cultures, management styles, and operational processes can lead to inefficiencies and conflicts.

Unexpected Costs: The buyer may miss its growth and cost targets as the two business units struggle with the integration process.

Keep Emotion Out of The Deal Process

The role of emotions in the deal process is a topic of debate. While some sources suggest using emotions to your advantage in sales negotiations, others emphasize the importance of managing and controlling emotions during the negotiation process. It is advised to maintain emotional intelligence, understand the impact of emotions on decision-making, and react with emotional maturity. However, the consensus is to keep emotions in check and not let them escalate tensions or reduce trust during negotiations. It is important to be aware of your feelings, stay in the present, and move forward without baggage, which is a key aspect of managing emotions during a negotiation. The goal is to guide and manage emotions for both the buyer and the seller to achieve the best possible outcome.



Due Diligence Checklist

Corporate Documents

Copies of Certificate, or Articles of Incorporation / Organization and all amendments, and copies of filed annual reports (including all subsidiaries).

Copies of Bylaws / Operating Agreement and all amendments.

Copies of all corporate / organization minutes, including unanimous consents, of all meetings of the stockholders / Members and the Board of Directors / Management Committee.

Copies of material information or documents furnished to stockholders / Members and to directors during the last two (2) years. Formats for such information may include email communication and facsimile transmission.

Copies of stock / unit transfer ledgers including the number of shareholders, the number of shares held, dates of issuance, restrictive legends, consideration paid, and any missing certificates with explanation.

Provide all details on restrictions on transfers of shares / units indicated in the Articles of Incorporation / Organization, Bylaws, Operating Agreements, or buy-sell agreements.

List states and countries in which the company is qualified to do business, file tax returns, and or maintain an office (including all subsidiaries).

Copy of the most recently obtained good standing certificates for all states and jurisdictions where the company and its subsidiaries are qualified to do business.

List names under which the company has operated in the past three (3) years.

Copies of any powers of attorney on any matter.

Previous Issuance of Securities

Sample copies of stock certificates (substitute equivalents for limited liability companies), warrants and options, and unit certificates (e.g. LLC, LP).

Does the Company currently have any outstanding convertible securities? If yes, describe.

Copies of reports and documents filed with and correspondence from and to the Securities and Exchange Commission.

Business Description

Copy of the Company's most recent business plan, investor presentation, and revenue model, with assumptions, marketing plans, and product development materials.



Detailed analysis of the Company's competitive environment. What gives the Company an edge over its competition? What milestones does the Company need to fulfill over the next two (2) years to succeed in its competitive landscape?

Copies of all marketing and other descriptive brochures / materials prepared within the last year.

Copies of all testimonials, press releases and press clippings about the Company and its respective industry are maintained in its files.

Financial Matters

Copies of financial statements for five (5) years.

Copies of interim financial statements prepared since the date of the most recent year-end statement.

List any material contingent liabilities (e.g. guarantees) and provide details and the amount of the contingent liability.

List the Company's current accounts payable and accounts receivable schedules and provide the current schedules.

List the Company's bank(s) and or other lender(s) with whom the Company does business or with whom the Company has accounts.

Describe any Small Business Administration (SBA) relationships, past or present.

List mortgages, liens, pledges, security interests, charges, or other encumbrances to which the stock of the Company or any of its property (real or personal) is subject and, if readily available, the location of offices where such documents or financing statements are filed.

Are the Company's liabilities or obligations partially or fully guaranteed by another entity?

Copies of documentation showing liabilities or obligations partially or fully guaranteed by another entity.

List outstanding commitments for any capital expenditures.

Copies of accountants' or attorneys' audit letter responses.

Tax Matters

Copies of federal, state, local, and foreign income and franchise tax returns for each of the last five (5) years.

Copies of correspondence with the Internal Revenue Service or other taxing authorities.



Copies of agreements, consents, elections, and waivers filed or made with the Internal Revenue Service or other taxing authorities.

List any pending tax disputes or matters, including audits.

Litigation or Administrative Proceedings

Detail all outstanding legal proceedings against the Company, its Founder(s), Officers, and Directors / Members, both pending, or prior, and provide copies of any pleadings or correspondence related thereto.

Identify whether the Company has been notified that it may be the subject of an upcoming claim, lawsuit arbitration, or investigation. Provide copies of material pleadings related thereto.

Identify whether the Company is planning or has notified any party that the Company may institute legal proceedings. If the answer to any of the foregoing is in the affirmative, provide a detailed account and copies of correspondence related thereto.

List and detail any judgments, orders, or decrees to which the Company is subject, and include the venue (e.g. county, state, federal).

Copies of any settlement documentation.

Copies of correspondence with auditors or accountants regarding threatened or pending litigation, assessment or claims.

Copies of correspondence, reports, filings, or other material information from or to any regulatory body.

Summarize the disputes with suppliers, competitors, or customers.

Officers & Directors, Employees, Benefit Plans and Labor Disputes

Management organization chart.

Biographical information for each director, senior executive officer, and key personnel.

Have any members of management, including all officers, directors, and senior management been convicted of a felony? If so, explain.

Have any members of management, including all officers, directors, and senior management been convicted of a securities infraction(s)? If so, explain.

Have any members of management, including all officers, directors, and senior management been disbarred? If so, explain.



Have any members of management, including all officers, directors, and senior management had their professional license not renewed for cause or stripped? If so, explain.

Have any members of management, including all officers, directors, and senior management filed for bankruptcy protection (all Chapters) within the most recent five (5) years? If so, explain.

List the compensation paid to officers, directors, key employees, and related parties for the most recent fiscal year.

List separately salary, bonuses, and non-cash compensation (i.e. use of cars, property, etc.).

Copies of all employment and consulting agreements, loan agreements, and documents relating to other transactions with officers, directors, key employees, and related parties.

Copies of confidentiality, non-disclosure, non-competition, or similar agreements executed with officers, directors, and key employees.

Copies of all director and officer liability policies, and key man insurance policies.

Copies of labor union contracts and collective bargaining arrangements, the number of employees covered by each such agreement, and the anticipated expiration dates thereof.

Describe any employment agreements, performance or other material bonus plans, employee retirement payments, profit-sharing plans, pension plans, or other fringe benefits, such as group life insurance, major medical plans, medical reimbursement plans, supplemental unemployment benefit plans, or welfare plans, salary continuation plans, and union contracts.

List, with a brief summary, any deferred compensation programs.

Copies of any documents related to workers' compensation or disability policies.

List and provide copies of all workers' compensation or disability claims.

Copy of the current employee handbook or any similar document describing policies (policies may include work hours, vacations, holidays, sick leave, tuition reimbursement, and other similar benefits).

Material Contracts and Agreements

Copies of all executed non-disclosure, non-compete, non-circumvent agreements with consultants, contractors, or other third parties.

Copies of all executed fee agreements with consultants, contractors, or other third parties that are currently in effect.

Copies of any executed joint venture, partnership, or strategic alliance agreements.



Copies of standard forms of agreement (e.g. sales contracts or other basic customer agreements, purchase orders, etc.) used in the normal course of business.

Copies of warranty or guarantee agreements or arrangements.

Copies of any executed sales agency, distribution, or dealer agreements.

Copies of any executed supplier / vendor agreements.

Copies and summarize contracts restricting the ability to compete in any line of business with any person or entity or committing to continue in any line of business (e.g. non-competition agreements, nondisclosure agreements, confidentiality agreements, etc.).

Copies of any research and development agreements.

Copies of any executed union contracts, government contracts, contracts with customers and suppliers, and consulting contracts. Summarize contract assignability, possible antitrust violations, enforceability, and breaches or defaults.

Describe any existing or pending oral contracts or commitments.

Acquisition Documents and Sales of Securities

Copies of agreements (including term sheets, agreements in principle, memoranda of understanding, etc.) related to the purchase or sale of securities or material assets, or the issuance or repurchase of the Company's securities.

Properties, Leases, and Insurance

List real estate owned / leased / rented / used by the Company, stating whether owned or leased, whether lessee or lessor, and including locations, brief descriptions, lease / rent per month, net lease or not, guaranties, defaults or breaches, and assignability.

If revenue-generating property / properties, provide rent rolls, occupancy rates, and statistics.

List of all personal property / fixed assets owned by the Company including machinery and equipment, and miscellaneous equipment such as airplanes, trucks, and cars.

Copies of mortgages, deeds, surveys, maps, rights of way, easements, leases, and other material contracts related to such real estate.

Copies of title insurance policies or lawyers' abstract reports.

Copies of zoning variances and local permits, both pending and issued.

Copies of purchase contracts, leases, or other arrangements concerning material items of equipment.



Copies of material leases, security agreements, and other material agreements related to the Company's personal property and fixtures.

Copies of all insurance policies or a summary thereof specifying policy limits and carrier(s).

List of any material insurance claims currently pending.

Intellectual Property (Patents, Trademarks, Copyrights, Trade Secrets)

List patent registrations and applications identifying each patent by title, registration / application number and date and country where filed.

List the trademark(s), service mark(s), and trade name(s) registrations and applications identifying each name or mark, registration / application number and date, status (e.g. registered, renewed, abandoned, submitted), and country or state where registered.

List copyright registrations and applications identifying each copyright by title, registration number, and date.

Describe all franchise and distributorship agreements, license agreements, merchandising agreements, or assignments relating to any patent, technology service mark, trade dress or copyright, and any related documents thereto.

List all agreements pursuant to which any patent, technology, trade secret, trademark, trade name, service mark, trade dress, or copyright has been sold or transferred.

List of other intangible property, including domain names, websites, and any related agreements, and provide details of ownership / control (i.e. whether owned by the Company, controlled through contracted services, owned by officers, directors, or key personnel).

Customers and Suppliers

List major customers, including information about the type and number of products and services they purchase, and their locations.

List major suppliers, including information about the type and number of materials they supply.

Licenses, Permits, Etc.

List all material federal, state, local, and foreign government permits, licenses, and approvals (excluding those listed elsewhere herein) either held or required to be held by the Company for the conduct of its business (e.g. vendor license, proof of equipment calibration).

Copies of material correspondence, reports, and notices relating to laws and regulations administered by any federal, state, local, or foreign governmental agency.



Environmental and Related Matters

Provide details and information concerning any regulated inspection of the Company and any of its subsidiaries by any federal, state, or local regulatory body (e.g. EPA, FDA, etc.).

Copies of reports, whether prepared internally or by third parties, concerning environmental matters relating to current or former properties.

Copies of applications, statements, or reports filed with or given to the Federal Environmental Protection Agency, any state department of environment regulations, or any similar state or local regulatory body, authority, or agency.

Copies of all notices, complaints, suits, or similar documents sent to, received by, or served upon the Company by the Federal Environmental Protection Agency, any state department of environmental regulation, or any similar state or local regulatory body, authority, or agency.

Copies of reports, whether prepared internally or by third parties, concerning compliance with waste disposal regulations (hazardous or otherwise).

Copies of permits or other hazardous waste disposal agreements.

Miscellaneous

List the names of the Company's attorneys, accountants, financial public relations firm, and other professional service providers? Provide all relevant contact information.

Provide us with any copies of other documents or information that you feel will be useful to use in our due diligence efforts.

The Consequences of Not Conducting Due Diligence can be Significant and Far-Reaching

Impact on Reputation: Insufficient due diligence can lead to reputational damage, affecting the brand, careers, and stock prices.

Financial Impact: It can cause financial losses and affect the bottom line of a business to the point of failure.

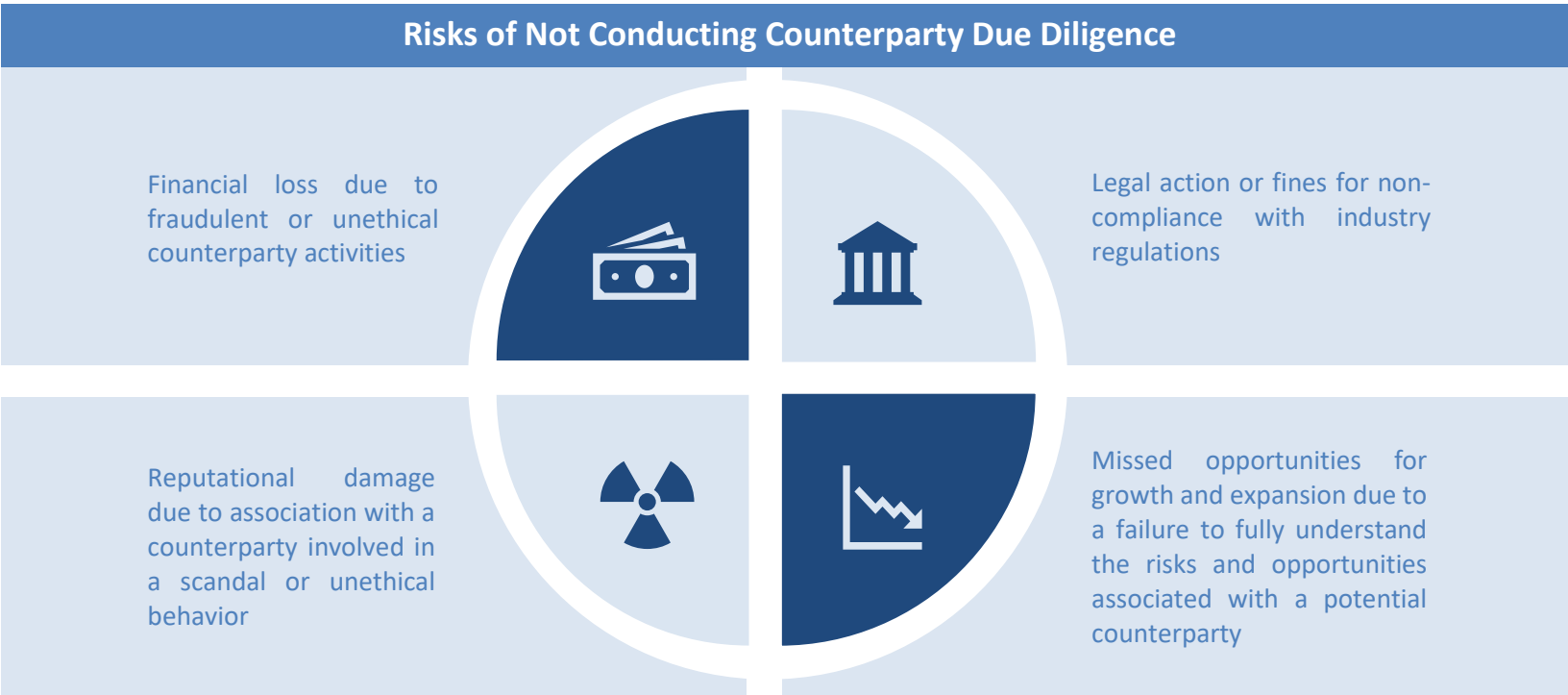
Legal and Regulatory Risks: Inadequate due diligence may lead to criminal convictions, incarceration of executives, and stiff regulatory fines and penalties.

Ethical Risks: It can elevate the risk of unethical business practices, bribery, and other forms of corruption.

Risk of Unforeseen Issues: Without due diligence, unexpected surprises may arise, and informed decision-making may be compromised.



In summary, the consequences of not conducting due diligence can range from financial and legal ramifications to damage to the reputation and integrity of individuals and organizations. It underscores the importance of thorough due diligence in various fields to mitigate risks and ensure informed decision-making.





VALUATION

Valuating a business acquisition is crucial for several reasons. The acquisition price is based on the value of the company, and an accurate valuation is essential to ensure a fair deal or transaction. It helps in determining the economic worth of a company and can uncover weaknesses in the finances of the acquisition target. Valuation is also important for understanding how much the target company is worth, how much to pay for it, and how much value can be created by combining it with the acquiring company.

Various methods are used to determine the value of a company, such as market capitalization, earnings-based methods, and discounted cash flow. Hiring a professional business valuator is often recommended to ensure an objective and thorough valuation.

In summary, taking care in evaluating a business acquisition is essential to ensure a fair deal, understand the economic worth of the company, and make informed decisions about the acquisition.

The common methods used to value a smaller company for acquisition include:

Earnings-Based Methods

Earnings-based methods are a type of business valuation approach that focuses on the company's ability to generate income. These methods include the discounted cash flow (DCF) analysis, capitalization of earnings, and price-to-earnings (P/E) ratio analysis. The DCF method is based on projections of future cash flows, adjusted to get the current market value of the company. Capitalization of earnings involves calculating the net present value of expected future earnings, while the P/E ratio analysis assesses the company's current stock price relative to its per-share earnings. These methods provide an objective and quantitative framework for assessing a company's value, making them a popular choice among financial professionals.

Earnings-based methods are forward-looking, as they rely on projections of future cash flows or earnings, enabling investors and business owners to account for potential growth and risks. However, they can also involve subjective decisions about discount rates and other variables and may be less suitable for businesses with uncertain or volatile earnings.

Asset-Based Methods

An asset-based approach is a type of business valuation that focuses on a company's net asset value, which is identified by subtracting total liabilities from total assets. This approach is used to value the overall business and is usually performed during the purchase or sale of the business, or a merger or acquisition. It involves using the assets and liabilities values on the balance sheet and can be used for companies that own both tangible and intangible assets. There are several methods available for calculating the value of a company, and the asset-based approach is the easiest to apply relative to the



traditional income-based and market approaches. The asset-based method is sound because there's plenty of flexibility regarding the valuation, but it can be quite complex, especially for those with little experience. Valuing a company using this method requires profound knowledge, experience, accuracy, and attention to detail.

Discounted Cash Flow (DCF)

This method involves forecasting the future cash flows of the target company and discounting them to their present value.

Discounted Cash Flow (DCF) is a valuation method used to estimate the value of an investment based on its expected future cash flow. The DCF formula is the sum of the cash flow in each period divided by one plus the discount rate raised to the power of the period number. The present value of expected future cash flows is arrived at by using a projected discount rate. If the DCF is higher than the current cost of the investment, the opportunity could result in positive returns and may be worthwhile. The DCF analysis is widely used in investment finance, real estate development, corporate financial management, and patent valuation.

Enterprise value (EV)

Enterprise Value is a measure of a company's total value, often used as a more comprehensive alternative to equity market capitalization. It includes the market capitalization of a company, short-term and long-term debt, and any minority interest. To build enterprise value, business owners can focus on areas such as working capital management, business processes, supply chain management, customer retention, and risk management.

This can help in reducing organizational risk through capital management and increasing profitable growth. By improving financial and operational aspects, private business owners can prepare their company for an exit strategy or increase its value, a concept known as Building Enterprise Value. A high-level Enterprise Value calculation for a privately held company might look something like Enterprise Value (EV) = (Owner's Equity + Total Debt) – Cash on hand, and equivalents.

To increase enterprise value, business owners can consider the following strategies:

- This involves questioning the value of every aspect of the business and focusing on value creation rather than cost reduction.
- This step involves fine-tuning operations, thinking strategically about processes and systems, and scoring the business on operational metrics such as vision, leadership, and procedures.
- In the social media age, improving the company's online presence can add value and contribute to enterprise value growth.



These strategies focus on areas such as working capital management, business processes, supply chain management, customer retention, and risk management, all of which can contribute to increasing enterprise value.

The Market Value of Invested Capital (MVIC)

The market value of invested capital is a business valuation metric that represents the total capital invested in a company, including tangible assets and goodwill. It is widely used to measure the value of small businesses and is calculated as the market value of owners' equity plus long-term interest-bearing debt. MVIC is an important tool for evaluating a company's worth and formulating investment strategies. It is often used in small business sales, where the buyer pays MVIC for the business, as most small business sales are structured as asset transactions. MVIC typically excludes the value of business-owned property, consulting agreement values, and a contingent portion of the purchase price but may include the value of non-compete agreements. The equation for MVIC is Market Value of Invested Capital (MVIC) = Market Value of Equity + Market Value of Debt.

Adjusted Book Value Method:

Advantages:

Reflects Fair Market Value: The adjusted book value method accounts for unrecorded liabilities and intangible assets, providing a more accurate reflection of the company's fair market value.

Useful for Distressed Businesses: It is often used to assign value to distressed businesses, as it can capture potential equity available in a firm.

Clear Understanding of Asset Values: The individual asset valuations provide a clear understanding of where the business generates value, which can be useful in the negotiating process and when a company is restructuring its debt.

Disadvantages:

High Cost and Time-Consuming: The major disadvantages are the high cost associated with implementing the calculation and the time-consuming nature of the process, as it may require hiring specialized appraisers and adjusting asset values.

Not Suitable for Profitable Companies: It may not provide an accurate picture of a profitable company's operating value and is not often accepted as such.

In summary, while the adjusted book value method provides a more accurate reflection of a company's fair market value and is useful for distressed businesses, it can be costly and time-consuming, and may not be suitable for profitable companies.



Acquisition Cost Estimation

Business acquisition cost, also known as customer acquisition cost (CAC), is the total expense incurred by a business to acquire a new customer. It is an important metric for businesses to understand the efficiency of their sales and marketing efforts. The CAC can be calculated using the formula:

The cost of acquisition includes all upfront costs incurred when purchasing a business asset, such as the purchase price of the item, costs to ship it to its point of use, costs to install the item, and costs to get it up and running. It also includes adjustments like incentives, discounts, and closing costs.

To calculate the customer acquisition cost, one needs to add together the total marketing and sales expenses and divide that total by the number of new customers acquired within a specific period. This metric is essential for businesses to assess the efficiency of their sales and marketing strategies and to make informed decisions about resource allocation and business growth.

Customer acquisition cost is a key metric that helps businesses understand the efficiency of their sales and marketing efforts. By calculating and analyzing CAC, companies can make informed decisions about their business strategies and resource allocation.

From these simplified definitions, it can readily be seen that each will, as previously stated, result in different valuation figures. Add to that the propensity of sellers to have deeply held emotional attachments to businesses that they built during long years of hard work and risk-taking, it is not difficult to understand why many transactions fail due to the inability of both sides to reach an agreement over valuation.





Authors Note # 6

I have found that there is no substitute to thorough Due Diligence in assessing the value of a business today as well as the future potential. I consider myself a Big Picture Guy, so I always assemble a solid team to conduct due diligence.

In one case, we were in the process of finalizing a transaction and doing a spot check on inventory, which was largely made up of Seagate 40 meg hard drives for personal computers, all palletized and orderly stacked on racks in the warehouse. One of my team members, a CPA from Tennessee, was leading the spot check, and the warehouse manager was directing him to what to look at. After opening a number of boxes, my guy says to the manager, "I want to see a pallet from the top rack." The manager looked like a deer in headlights, and for good reason. When the forklift lowered the pallet that should have contained 500 drives, it was empty. All in all, the inventory was short 1,000 drives at a value of \$500 each.

While all this was going on, I, the Big Picture Guy, was bonding with the seller.

The irony of the story gets better: the owner who we were to buy the company from was unaware of the missing hard drives. You might guess who did know.





A POWERFUL TOOL

Growth through acquisitions can be a powerful strategy for companies looking to expand. Market downturns and inflationary environments can truly be a good time to consider an acquisition as an operating company. Companies make acquisitions for various reasons, including stimulating growth, gaining competitive advantages, increasing market share, and influencing supply chains. Acquiring new technology or expertise, scaling in the new economy, and achieving cost efficiencies are also common motives for acquisitions.

Additionally, acquisitions can be a way to transform a company and improve its performance, as well as to access new markets, products, and management talent. While there are potential risks and challenges involved in acquisitions, successful deals can lead to higher value and growth for the acquiring company and its shareholders.

Lower-Middle Market Companies

The lower to middle market companies in the U.S. typically refer to firms with annual revenues ranging from \$5 million to \$50 million, although some sources mention a valuation between \$10 million and \$100 million. These companies are family-owned, with the senior management ranks often occupied by family members. They are less developed in terms of management depth, software and systems, and robust planning and control processes.

Lower middle market companies are usually more niche, which can offer advantages to private equity (PE) firms, such as higher ROI and less competition for investment. Capital sources for these companies include government / public-sponsored entities, bank debt, asset-based lending, and mezzanine debt. The lower middle market has witnessed a notable surge in family offices in recent years, and some financial investors see an opportunity to get ahead of the demand for manufactured goods, particularly those made in America and within the USMCA supply chain.

The middle market is the segment of American businesses with annual revenues in the range of \$10 million to \$1 billion, depending on the industry they operate in. There are about 200,000 middle-market firms in the U.S., most of them privately owned or closely held, and their annual revenues combined total more than \$10 trillion. Middle-market companies account for about one-third of the U.S. economy and are responsible for about 48 million jobs. When publicly traded, middle markets tend to trade as small-cap or micro-cap stocks.

Growth Opportunities

The growth opportunities for lower middle market companies in the U.S. are significant. These companies, with annual revenues typically ranging from \$5 million to \$50 million, have unique characteristics and are past the startup stage, scaling, and growing. They often offer innovative products or services, which creates opportunities for them in areas such as healthcare, technology, and



other specialized industries. Private equity firms remain active in the lower middle market, seeking to invest in companies with solid growth potential and attractive valuations. Additionally, as the global economy becomes increasingly interconnected, cross-border M&A activity is expected to increase, providing opportunities for lower middle market companies to expand their operations. These companies can access capital from various sources, including government / public sponsored entities, bank debt, asset-based lending, and mezzanine debt, to support their growth initiatives.

Building the Company

Lower middle market companies can build scale and gain market share through various strategies and opportunities. These companies have the potential to grow and become part of the higher market segment. Some strategies and opportunities for growth and market share expansion include:

Innovative Products and Services: Lower middle market companies often offer innovative products or services, which can be a key driver for gaining market share, especially in specialized industries such as healthcare, technology, and clean energy.

Private Equity Investment: Private equity firms remain active in the lower middle market, seeking to invest in companies with solid growth potential and attractive valuations. This investment can provide the capital needed for expansion and market share growth.

Cross-Border Activity: As the global economy becomes increasingly interconnected, cross-border M&A activity is expected to increase, creating opportunities for lower middle market companies to expand their operations and gain market share.

Local and Regional Ecosystems: Lower-middle market companies often benefit from local or regional support networks, such as industry associations and chambers of commerce. Building and leveraging these networks can help in gaining market share and scaling the business.

Acquisitions and Consolidation: Lower middle market companies can consider acquiring other companies to expand their market share and consolidate their position in the industry.

Digital Transformation: Embracing digital transformation and leveraging technology can be a significant driver for scaling the business and gaining market share, especially in today's increasingly digital business environment.

By employing these strategies and capitalizing on the opportunities available, lower middle market companies can effectively build scale and gain market share in the U.S.



Authors Note # 7

In the 1980s, I found myself partnering with an entrepreneur and at the helm of a small technology company specializing in computer software and hardware. The market was fiercely competitive, and it quickly became apparent that growth was essential for our survival.

To achieve this growth, we implemented a strategic acquisition plan targeting complementary businesses:

- Our first acquisition was a value-added reseller of Digital Equipment Corporation (DEC) products. This move expanded our product offerings and client base, allowing us to tap into the growing market for DEC's popular VAX systems and PDP-11 computers.
- The second acquisition brought in a value-added reseller of Seagate Technologies Holdings PLC hard drives as well as a Value-Added Reseller of IBM. This strengthened our position in the storage solutions market and allowed us to offer a wider range of products, including IBM's successful PC line.
- Our third acquisition was an independent hard drive repair facility, which added valuable technical expertise and service capabilities to our portfolio. This move was particularly strategic given the increasing importance of data storage in the rapidly evolving computer industry.

Through these carefully chosen acquisitions, we successfully built a vertically integrated firm. This growth-through-acquisition strategy allowed us to expand into new markets and significantly increase our market share. By diversifying our services and product lines, we were able to offer more comprehensive solutions to our clients and solidify our position in the rapidly evolving computer industry.

The vertical integration resulting from these acquisitions proved to be a key factor in our company's ability to adapt and thrive in the dynamic tech landscape of the late 1980s and early 1990s. It is positioned for us to better meet the diverse needs of our customers and compete more effectively in an increasingly crowded marketplace.

Our strategy was particularly effective given the rapid changes in the computer industry during this period. The 1980s saw the rise of personal computers, with companies like IBM, Apple, and Commodore competing for market share. Additionally, the development of new technologies such as graphical user interfaces, CD-ROMs, and improved storage solutions created new opportunities for businesses in the tech sector.

By positioning ourselves as a comprehensive solution provider with expertise in hardware, software, and services from multiple major manufacturers, we were able to capitalize on the growing demand for integrated computer systems and support. This approach allowed us to navigate the competitive landscape and establish a strong foundation for future growth in the ever-changing world of technology.



THE BENEFITS OF ACQUISITION

Merger versus Acquisition

A merger is a type of business combination that involves two separate entities combining forces to create a new, joint organization. On the other hand, an acquisition refers to the takeover of one entity by another. In a merger, two companies join to form a new entity, while in an acquisition, one company takes over another and establishes itself as the new owner. Therefore, a merger is not a type of sale or acquisition, but rather a distinct form of business combination.

Small Businesses: The Backbone of an Economy

Small businesses are widely regarded as the backbone of the economy due to their significant contributions to job creation, economic growth, and innovation. According to the U.S. Small Business Administration, small businesses generate 44% of U.S. economic activity and create two-thirds of net new jobs. Additionally, they are responsible for over 64% of new jobs in the last 15 years and have been recognized as the driving force behind economic development in the United States. Small businesses also play a vital role in supporting local communities by putting money back into the economy through paychecks and taxes, which can further contribute to the creation of new small businesses and the improvement of local public services. Therefore, the evidence from various sources supports the assertion that small businesses are indeed the backbone of the economy.

Definition of a Small Business

The definition of a small business can vary, but the United States Small Business Administration (SBA) provides a comprehensive definition. According to the SBA, a small business is a concern that is organized for profit, has a place of business in the U.S., operates primarily within the U.S. or makes a significant contribution to the U.S. economy, is independently owned and operated, and is not dominant in its field on a national basis. The business may be a sole proprietorship, partnership, corporation, or any other legal form. The SBA defines a small business based on industry-specific standards, such as the average number of employees or average annual receipts. These standards are outlined in Title 13 of the Code of Federal Regulations, part 121 (13 CFR §121).

Small Business Versus Large Corporations

The difference between a small business and a large corporation lies in various factors, including size, organizational structure, and financial resources. According to the U.S. Small Business Administration (SBA), a company with fewer than 500 employees is considered a small business, while anything above that is categorized as a large business.

Additionally, small businesses are typically privately owned and have fewer employees and less annual revenue than large corporations. They often rely on personal savings or bank loans for funding, while larger companies may have access to additional financing options such as investors or public offerings.



Before any purchase and sale transaction can move forward to completion, an agreed valuation must be derived; this only makes sense, since both buyer and seller must come to a common understanding of the factors that determine the value and then reach an agreement on the sale price, payment method and time period, as well as on other related matters. It soon becomes apparent to both sides that there are several valid ways to determine the valuation, that each of these methods will establish a different valuation, and that all parties will not necessarily agree with the valuations determined.

Arbitrage

The understanding of arbitrage and how it may apply to a specific transaction is often a way to bridge these differences between buyer and seller over enterprise value, in that arbitrage provides a tool to support a higher selling price than a buyer might otherwise be willing and able to justify.

According to Investopedia¹,

“Arbitrage is the simultaneous purchase and sale of an asset to profit from an imbalance in the price. It is a trade that profits by exploiting the price differences of identical or similar financial instruments on different markets or in different forms. Arbitrage exists because of market inefficiencies and would therefore not exist if all markets were perfectly efficient.”

“Arbitrage occurs when a security is purchased in one market and simultaneously sold in another market at a higher price, thus considered to be risk-free profit for the trader. Arbitrage provides a mechanism to ensure prices do not deviate from fair value for long periods of time. With advancements in technology, it has become extremely difficult to profit from pricing errors in the market. Many traders have computerized trading systems set to monitor fluctuations in similar financial instruments. Any inefficient pricing setups are usually acted upon quickly, and the opportunity is often eliminated in a matter of seconds. Arbitrage is a necessary force in the financial marketplace.”

Arbitrage Definition and Value Proposition: The Arbitrage Value Proposition is a simple concept that increases the value of a company between buying it and selling it prior to improvements. The textbook definition of arbitrage is buying a commodity on one exchange and selling it on another simultaneously and at a higher price, pocketing the spread called arbitrage.

This assumes that the market for the commodity is less than perfect, with buyers and sellers of different capabilities and knowledge accounting for the price disparity. Such information leads to inefficient markets in which the most astute participants stand to pull greater profits than in more efficient markets. While there is no such thing as a truly perfect market, that is, one in which all participants have equal capabilities and information, some are more imperfect than others.

Source: “Arbitrage: How Arbitraging Works in Investing, With Examples” – Investopedia



A seller may take umbrage at his or her business being considered a commodity, but the selling and buying of private businesses is an imperfect market as are many commodity markets, thus meeting the core requirement for arbitrage, which is the capability of realizing a profit from a valuation differential.

Value Arbitrage

Private markets, absent of exchanges, are particularly imperfect and thus ripe for arbitrage opportunities, although less straightforward and concrete than the commodity example. Value Arbitrage is a tool private equity firms and strategic buyers use to generate automatic positive returns before even realizing a single benefit. Knowledge of the method can help both buy-side and sell-side advisors win fair prices for their clients.

Value Arbitrage for business hinges on the fact that the business will be sold at some point in the future, as opposed to its being held and made more operationally profitable to increase ROI, although the latter is also an aim. It is primarily a tool of private equity but is also used by strategic buyers.

Below are three instances of a Value Arbitrage strategy:

Acquisition to Grow: Size and scope matter. The larger of two otherwise identical companies will usually sell at a higher multiple for no other reason than the fact that *it is larger*. If companies with \$5 million in EBITDA sell at 5x earnings, and companies with greater than \$20 million EBITDA sell at 7x earnings, it follows that a company with \$20 million in EBITDA can hypothetically acquire a \$5 million EBITDA company for \$25 million and automatically be able to sell that company, as part of its whole, for \$35 million. This is multiple-of-EBITDA arbitrage. Some strategic buyers and private equity portfolio companies build strategies around rolling up industries solely for the purpose of increasing aggregate EBITDA and are then able to sell the whole company for a greater value than the sum of its parts.

Repositioning the Target in a More Buoyant Industry: Assumed profitability growth is another driver of company and industry valuation multiples. If a consensus of buyers thinks the smartphone market will grow faster than the windowpane market because of bullish views on the middle class and bearish views on construction, then they pay more per share of a smartphone manufacturer's earnings than those of a window manufacturer, say 7x and 4x, respectively. A manufacturer of windows may also have the capability to turn glass into something useful for smartphones, say their screens. Thus, a financial buyer could purchase the window manufacturer at 4x EBITDA, tweak the strategy and business plan, and flip it back into the market as a smartphone play at 7x EBITDA. Likewise, a smartphone company could buy the window company at 4x, fit it into the business model, and capture the spread when it sells itself at 7x.

Rolling a Private Company into a Public Company: If a public company trading at 20x earnings buys a small private company for 10x earnings, the earnings of the latter automatically trade at 20x as part of the whole entity, given that the transaction is small enough not to be scrutinized. When the public



company reports earnings for the first time after making the acquisition, the tranche of its earnings from the acquisition naturally trades at the same multiple as the whole entity, 20x instead of 10x, completing the arbitrage.

Value arbitrage is a concept that can benefit both buyers and sellers in a deal. It involves identifying and capitalizing on discrepancies in the valuation of assets or securities. For a buyer, being aware of potential value arbitrage opportunities can lead to the identification of assets that are undervalued, providing the potential for significant gains. This can also justify a higher buying price, as long as the risk-reward profile remains favorable.

On the sell side, understanding value arbitrage can be advantageous for advisers running a sale. It allows them to recognize and communicate the true value of the assets being sold, potentially leading to a more favorable deal for their clients. Additionally, being knowledgeable about value arbitrage can enhance the overall advisory capacity, making the adviser a more informed and valuable resource for their clients.

In essence, regardless of whether you are a buyer or a seller, having a deep understanding of value arbitrage and its implications can significantly enhance your ability to identify and capitalize on lucrative opportunities, ultimately leading to more informed and successful deal-making. An alternative structure is a qualified transaction that allows the seller to sell his or her company at a much better value. We call the structure 'Partnering & Recapitalization', and it allows the seller to structure a favorable value proposition greater than conventional options.

The following is an example of the transaction structure, along with an example of the sale of a fictitious company worth \$40 million:

- 1) A Seller sells less than 100% of the stock in his or her company, but more than 50%.
- 2) The Sellers receive MORE than the pro-rata value of stock sold in cash, or an equivalent value.
 - a) Cash amount is based on a conventional multiple valuation.
 - b) Equity is retained in the acquired company; and,
 - c) The Seller realizes a premium enhancement in convertible Preferred shares.
- 3) The Seller partners with the Buyer, (forming a Holding Company) and they continue to operate and grow the Seller's company according to its new combined business model and strategic plan. The capital used for growth comes from the Buyer and recapitalization of the Seller's company. The Seller's initial proceeds have been taken off the table (the Seller has effectively taken chips off the table and has protected that value). Typically, over time, the Seller takes on a different, higher-level role, since one of the Seller's goals was also to exit from the daily grind of management. The Seller may choose to move into a role of strategic planning and growth or may wish to focus on identifying possible additional acquisitions. He or she will be appropriately compensated for that work. The role the Seller will play will be determined by his or her strengths and preferences, and upon the depth of the Buyer and that of the company's management team.



- 4) Since the transaction strategy is to grow the selling company aggressively, internally and through acquisition, after a period (typically between 3 and 7 years), the company should be materially larger than it was when originally sold. Consequently, when the Seller finally sells all or a portion of the stock he or she retained from the original sale, the Seller realizes sale proceeds that are typically *greater* than those anticipated at the initial closing, depending, of course, on the success of the intervening growth strategy.
- 5) As you can see, this Partnership strategy works for the following reasons:
 - a) The Buyer and Seller work together as partners to grow the company, thereby expanding its value proposition throughout the process until completion of the transaction.
 - b) The Seller's interests are protected by staying involved as senior management, receiving compensation for his work, and acting as the senior bank until fully paid.
 - c) The Buyer's interests are protected because he assumes a primary management role as he earns his position in the transaction as his cash and working capital are deployed.
 - d) The Buyer owns a larger, stronger, growing company with greater value than when originally purchased; and,
 - e) The Seller receives a greater return on the sale than the original valuation could have supported, plus the Seller has benefitted from a planned exit strategy.

Example of a Typical Transaction (for Illustrative Purposes ONLY):

The Seller and Buyer form a new holding company to place the Seller's company into as a portfolio company. A special purpose vehicle (SPV) is a legal entity created for a specific, often temporary, business purpose. SPVs are commonly used for isolating financial risk, facilitating investment, or managing assets. They are typically used in complex financial transactions such as securitization, project finance, and structured finance. SPVs are designed to be bankruptcy-remote, meaning that the financial problems of the entity that creates the SPV should not affect the SPV. This can provide investors with a greater sense of security when participating in certain types of transactions.

- We will assume that initially, the company has a \$40 million value proposition. The Seller in this example sells 60% of the company to the New Holding Company in the form of cash and debt. The Seller receives \$24 million for that 60%, retaining 40% value in the portfolio company, and receives an \$8 million premium in the form of Preferred Stock in the holding company, thereby increasing the valuation to the seller.
- The Buyer, who has partnered with the Seller to grow the company, benefits from the value growth as well. The Holding Company does not have to get involved in the daily activity of the business. The Holding Company will be able to contribute the additional capital necessary to grow the portfolio company (Sellers Company) and provide a platform to make strategic acquisitions.
- The Holding Company is an investment-backed acquisition company (The Seller, Buyer, and new money) with the goal of achieving a listing on NASDAQ or NYSE.



- Any company that becomes a subsidiary of the Holding Company through acquisition will benefit from the valuation arbitrage resulting from the public process, enhancing the value of the Preferred stock shares in the Holding Company held by the Seller. (\$8 million could become \$16 million during the 3 to 7 years proposed operating window)
- The goal of this strategy is to increase the Seller's company size over a period of up to seven (7) years as new locations are opened, and additional bolt-on acquisitions are made using capital deployed by the Holding Company and investors. During this transaction period, the Company's growth increases its value proposition to \$60 million. The Seller receives 40% of this value, or \$24 million in this example.
- Upon exit and sale of stock in the example above, the Seller has walked away with \$64 million from the sale of a company that was originally worth \$40 million. In addition, the Seller holds \$8 million in preferred shares, thereby realizing a \$72 million return in value received, which is 97% greater than the initial valuation.

It is important to note that the above example has been presented for illustrative purposes only. All transactions are different, and each will be driven by its own set of valuations, analyses, market conditions, management skill sets, and other relevant circumstances.

This type of deal structure is becoming a much more common practice for transactions that can be structured on a staged exit for the Seller. It is very good for Sellers that don't want to retire completely from their business, or for Sellers that have children who can carry the torch after the initial sale. From a wealth planning perspective, it is a preferred structure because it allows a Seller to take chips off the table immediately while continuing to grow with the stock that remains in the company. This is very important for many business owners where the majority of their net worth is tied up in the value of their business.

From an operating standpoint, buyers and sellers really like this type of structure because it minimizes the risk related to an owner and his experiential expertise leaving the business entirely and maintains operational continuity for successful growth. In the case of the example above, we have assumed that the owner, or his or her children, will remain in the business and will maintain management team continuity through the transaction.

In many cases, Buyers are even willing to pay more for companies when this type of structure is in place, specifically because management team risk is effectively eliminated.

When is it Most Appropriate to Pursue Type of Deal Structure?

- When the Seller is not ready to walk away completely from the business and is willing to partner with the Buyer to grow the business.



- When a Seller has children, who can remain with the business post-transaction and work with AEH as a partner to grow the business. The children can cash in on the value of the stock they retain, based on the future growth they facilitate. The original entrepreneurs (father or mother in this case) take most, if not all, of the cash from the original sale.
- When an owner or management team is young and simply wants to take chips off the table via the transaction; or,
- When an owner or management team needs help or an injection of capital from a new partner to finance the continued growth or expansion of the company.

There is very little downside to this type of structure with a defined execution strategy. From a wealth management standpoint, the Seller is taking chips off the table. If the future unfolds the way the Seller and Buyer plan, then there is a double-digit enhancement.





WHY ACQUISITION

Determining the goals of an acquisition and the ultimate goals of a sale or transition is crucial for a well-designed plan. For a buyer / owner, this involves carefully considering the purpose of the acquisition, whether it is to expand market share, acquire new technology, or enter new markets. Understanding the long-term objectives of the acquisition will help in identifying the right opportunities and structuring the deal effectively.

Similarly, when planning for a sale or transition, it is important to have a clear vision of the ultimate goals. This could involve transitioning the business to family members, selling to a strategic buyer, or implementing growth strategies to increase the company's value before a sale. By defining these goals, the owner can develop a comprehensive plan that addresses all aspects of the process, including financial, legal, and operational considerations.

A well-designed plan considers the specific objectives of the acquisition or sale and aligns them with the overall strategic direction of the business. This approach provides clarity and direction and helps ensure that the necessary steps are taken to achieve the desired outcomes.

History of Acquisitions in the 21st Century

The 21st century has seen a significant number of acquisitions, with companies using this strategy to redirect and reshape their corporate strategies, gain access to new markets, products, technology, resources, or management talent, and achieve various other objectives. Some of the biggest acquisitions in global corporate history have been valued at well over \$100 billion, such as the acquisition of Mannesmann AG by Vodafone in 1999. Acquisitions have been a common occurrence in the corporate world, often executed as part of a company's growth strategy for reasons such as diversification, increased market share, geographical outreach, and technological advancements. While there are potential risks and challenges involved, successful acquisitions can lead to higher value and growth for the acquiring company and its shareholders.

When Small Companies Acquire Other Businesses, They May Face Several Challenges, Including:

Resource Constraints: Small deals at small companies often face resource constraints in terms of time, personnel, and financial investments. Additionally, smaller companies may not have the same level of sophistication in terms of financial reporting, governance, or compliance as larger organizations, making thorough due diligence crucial to identify any risks, potential liabilities, or undisclosed issues that could impact the deal's value or integration process.

Financial Management: Small businesses may face challenges in terms of managing the financial aspects of an acquisition, including securing funding, assessing the financial health of the target company, and integrating its financial systems with its own.



Integration and Cultural Alignment: Integrating the acquired business into the existing company can be challenging, particularly in terms of aligning cultures, processes, and systems. This is especially true for small companies with limited experience in managing acquisitions.

Talent Management: Acquiring companies may struggle with retaining key talent from the acquired business, as well as integrating the skills and expertise of the new employees into their existing teams.

Market Access and Customer Base: Small companies may find it challenging to effectively access new markets and customer bases after an acquisition, particularly if they lack the resources and brand recognition of larger firms.

By addressing these challenges effectively, small companies can unlock significant benefits from acquisitions, such as access to innovation, technology, markets, and talent.

Acquisitions Aren't Just for Big Companies

Acquisitions are not exclusive to larger companies. In fact, smaller, more innovative companies are often the targets of acquisitions by larger firms. This is because smaller companies are frequently the source of significant innovation, as they are more agile and willing to take greater risks. Larger companies may acquire smaller ones to gain access to new technology, markets, customers, or talent. Additionally, acquisitions can provide an opportunity for the acquiring company to grow market share without significant organic growth. Therefore, companies of all sizes engage in acquisitions to achieve various strategic objectives, such as gaining a competitive edge, accessing new markets, and driving innovation.

Reasons Why Small Companies Might Acquire Other Businesses Include:

Access to Innovation and Talent: Small companies often possess innovative technologies, intellectual property, or specialized knowledge that can complement a larger company's existing offerings. Acquiring smaller firms allows the larger company to gain access to new ideas, talent, and expertise, fostering innovation and driving growth.

Market Expansion: Acquiring smaller companies enables small businesses to quickly penetrate new markets or niche segments. Instead of starting from scratch, they can leverage the existing customer base and distribution channels of the acquired company.

Access to Technology: Acquiring a business can provide access to new technology, which can be crucial for staying competitive and meeting customer demands.

Access to Markets and Customers: Acquiring a business can provide a fast entryway into different market segments and access to a larger customer base, enabling the acquirer to increase its market share and sales.



Spurring Innovation: Small businesses are more innovative than big businesses, and acquiring smaller companies can help larger companies spur innovation and stay ahead in the market.

Growth and Competitive Advantage: Acquiring smaller competitors can help small companies consolidate their market share and increase their competitive advantage.

By acquiring other businesses, small companies can achieve various strategic advantages, including accessing new markets, spurring innovation, and gaining a competitive edge.

[Here's an Outline for a Growth Strategy Through Acquisition](#)

Strategic Fit: Ensure the acquired company aligns with the long-term strategic goals of the acquiring company.

Due Diligence: Conduct a thorough due diligence process to assess the financial, operational, and cultural compatibility of the two companies.

Cultural Integration: Pay attention to the cultural and people issues, as the merging of two corporate cultures can be a significant challenge.

Financial Viability: Evaluate the target company's potential for success, necessary changes, and integration with the acquiring company.

Post-Merger Integration (PMI): Plan for the integration process to realize the full potential of the merged entity.

Growth Potential: Assess the target company's potential to generate sufficient earnings and provide a suitable return on investment.





KNOWING THE TYPES OF ACQUIRERS

The Types of Acquirers of Businesses Can be Broadly Categorized into Several Groups as Follows:

Strategic Buyers: These are companies that are looking to expand their operations or gain a competitive advantage by acquiring another business in the same or a related industry.

Financial Buyers: This category includes private equity firms, hedge funds, family offices, and high-net-worth individuals (HNWIs). Financial buyers often use a significant amount of leverage in their acquisitions and view business acquisitions as capital growth tools.

Corporate Acquirers: These are companies that purchase other companies with the belief that they will gain a benefit from the acquisition, which could be achieved through a cash purchase, share purchase, or exchange of shares.

Merchant Acquirers: These are merchant banks utilized by merchants to process electronic payments for customers. They facilitate electronic payments through their merchant network and manage the settlements.

Individual Buyers: These are people who want to acquire businesses as a way of life and typically look at smaller owner-operated companies. They are looking to replace the owner and manage the business themselves.

These categories encompass a wide range of acquirers, each with different motivations and strategies for acquiring businesses.

Some of the Benefits of Acquisition Growth

Acquisitions can lead to an expanded presence in multiple markets, a larger customer base, and a bigger portfolio of products and services, contributing to operational complexity and overall growth.

Both the acquirer and the target company can experience growth through the acquisition process, making it a mutually beneficial strategy.

Risks and Mitigation

M&A deals can pose risks, including cultural integration challenges and overpaying for the target company. Mitigation steps should be outlined to address these risks.

Obtaining Quality Staff and Skills: M&A can provide access to talented personnel and additional skills, enhancing the capabilities of the acquiring company.

Economies of Scale and Scope: M&A can lead to greater financial strength, increased access to capital, better bargaining power, and lower production costs, resulting in economic gains and efficiencies.



Synergies: M&A can create synergies, where the combined entity is more valuable than the sum of its parts, leading to improved performance and competitive advantages.

Market Access and Expansion: M&A can help in accessing a wider customer base, increasing market share, and exploring new markets, contributing to business expansion.

Cost Reduction and Increased Profit: M&A can lead to reduced costs, shared marketing budgets, and increased purchasing power, ultimately contributing to higher profitability.

Diversification and Innovation: M&A can facilitate diversification, innovation, and the acquisition of new products, services, or intellectual property, enabling companies to stay competitive and enter new business areas.

Key Factors in Evaluating Acquisition Potential:

Financial Health: Analyze the target company's financial statements, debt load, and litigation to ensure it is priced right, has manageable debt, and clean financial records.

Strategic Fit: Conduct careful market research, explore company culture and values, and identify what you hope to achieve from the deal to assess the strategic alignment and potential synergies.

Valuation Methods: Utilize various valuation methods, such as asset-based, income-based, or market-based approaches, to estimate the target company's worth and the value it can bring to the acquiring company.

Cultural Integration: Consider the cultural fit and potential challenges of integrating the two companies, as overlooking cultural integration can lead to value loss and employee attrition.

Economic Gains and Synergies: Evaluate the potential for economic gains, economies of scale, scope, and other synergies that can be realized through a merger or acquisition.

By carefully assessing these factors, companies can make informed decisions about the potential of a merger or acquisition and maximize the chances of successful integration and growth.

How to Gauge Cultural Compatibility Before a Merger:

Gauging Alignment: Evaluate whether the cultures of the two organizations will be compatible in a merged situation. This assessment should occur during the identification of risks posed by the merger, during the integration plan development, at the close of the deal, and post-close when unanticipated challenges may arise.

Employee Surveys: Use assessment tools like employee and manager surveys to determine in advance whether a merger is viable. Surveys can examine corporate cultural characteristics, such as teamwork, diversity, focus on financial performance, trust in management, and decision-making processes.



Diagnose How Work Gets Done: Understand and manage culture during a merger by diagnosing how work gets done, setting priorities, and hard-wiring and supporting change. This process should start early, well before the closing of the deal if possible.

Assess Decision-Making Processes: Evaluate decision-making processes, including who makes final decisions, at what level decisions are made, when decisions are made, and the clarity and consistency around the decision-making process.

By following these steps, companies can gain insight into the cultural compatibility of the two organizations, identify potential areas of misalignment, and take proactive measures to address cultural challenges before they impact the success of the merger or acquisition.





CAPITAL FORMATION PROCESSES

There are multiple challenges that lower and middle-market companies face when trying to raise capital. These companies often encounter a unique set of obstacles.

Firstly, the cost of raising capital can be significant. This includes not only the direct costs, such as fees paid to investment banks, lawyers, and accountants but also indirect costs, such as the time and effort required to prepare for a capital raise.

Secondly, finding qualified support can be difficult. While many firms cater to large corporations, fewer specialize in serving lower middle-market companies. These companies often require a different set of services and expertise, given their smaller size and unique challenges.

Thirdly, even if a company can find a firm that is willing to help it raise capital, there is no guarantee that the firm will be able to provide the access to capital that the company needs. This is particularly true in the lower middle market, where companies are often seen as riskier investments.

Strategies for Lower Middle Market Companies to Overcome these Challenges

Build Strong Relationships: Cultivate relationships with potential investors and financial institutions well before you need to raise capital. This can help you gain access to capital when you need it.

Leverage Local Networks: Local banks, credit unions, and economic development organizations often have programs designed to support small and medium-sized businesses.

Consider Alternative Funding Sources: Crowdfunding, peer-to-peer lending, and venture capital are all potential sources of capital for lower-middle market companies.

Hire a Specialized Advisor: Consider hiring an advisor who specializes in the lower middle market. They can help you navigate the capital raising process and connect you with potential investors.

Prepare Thoroughly: Make sure your financials are in order and prepare a compelling business plan and pitch. This can increase your chances of successfully raising capital.

Remember, every company's situation is unique, so it is important to carefully consider your options and seek advice from qualified professionals. When raising capital for an acquisition, several key factors should be considered:

When considering acquiring a company to add to your current operations, it is crucial to evaluate the impact on your capital levels and management structure. Potential acquirers should carefully assess their own capital position to ensure they have the financial capacity to conduct the transaction without jeopardizing their stability or growth prospects.



Plan for Integration: Additionally, it is important to recognize that the integration of the acquired company may lead to added levels of management, which can impact the acquirer's organizational structure and operational efficiency. Acquirers should plan for potential changes in management and ensure that the integration process is well-managed to minimize disruptions.

Realistic Cost Savings Post-Acquisition: Furthermore, it is common for acquirers to anticipate quick cost savings through the elimination of redundant functions as part of the consolidation process. However, realizing these savings often takes time, and in some cases, there may be no significant cost reductions. Acquirers need to have a realistic understanding of the timeline and potential outcomes of cost-saving initiatives following an acquisition.

Investor Effects on Ownership Dynamics: Lenders such as banks, asset-based lenders (ABL), and private debt lenders are not owners of the company. However, they may impose loan covenants, which are conditions that the borrower must adhere to. These covenants are designed to protect the lender's interests and may restrict the company's activities. It is essential for buyers to carefully weigh the pros and cons of investor participation and lending. Investors can bring valuable expertise and resources to the table, but their ownership stake means sharing control and potential profits. Lenders provide capital without diluting ownership, but their loan covenants can limit the company's flexibility.

The decision should align with the company's long-term goals and the buyer's vision for the business. Seeking professional advice from financial and legal experts can help in navigating these considerations and making informed choices.

Present Economic Landscape: The current economic conditions and inflationary trends can indeed have an adverse effect if too much leverage is used. In times of inflation, the cost of borrowing typically increases, which can put pressure on businesses and individuals with high levels of debt. Additionally, inflation erodes the purchasing power of money, making it more challenging to service debt. This can lead to financial strain, defaults, and a broader economic impact. It is important for individuals and businesses to carefully manage their leverage and consider the potential risks associated with high levels of debt, especially during periods of economic uncertainty and inflation. Diversifying investments, maintaining a healthy cash position, and prudent risk management are crucial in such environments.

Financing the Acquisition: Acquisition financing is a complex process that often involves a combination of debt and equity. The various financing options include bank debt, mezzanine funding, private equity, internal cash accruals, and raising capital through an initial public offering (IPO). Private equity can be structured in different forms, such as through private equity groups (PEG) or through direct-to-market options that bypass intermediaries. Each financing option has its own advantages and considerations, and the optimal structure depends on the specific circumstances of the acquisition and the preferences of the parties involved. It is important to carefully evaluate and compare the various financing options to determine the most suitable approach for a particular acquisition.



In this section, we will explore various strategies that can be utilized to fulfill the objectives of the proposed transaction. While some of these strategies might be familiar to you, others might be new and unfamiliar.

Types of Bank Financing Available for Acquiring a Business

When acquiring a small to medium-sized business, there are several types of bank financing options available. These include:

Conventional Loans: These are traditional loans offered by banks. They typically require a good credit score and substantial assets.

Business Line of Credit: This is a revolving credit that allows businesses to borrow money as needed, up to a certain limit. It is flexible and can be used for various purposes, including business acquisition.

Revenue-based Loans: These loans are based on the revenue of the business. They are typically used by businesses with high revenue but low-profit margins.

SBA Loans: The Small Business Administration (SBA) offers several loan programs, including the popular 7(a) loan, which can be used for business acquisition. These loans are often more accessible and have more favorable terms than conventional loans.

Equipment Financing: If the business acquisition includes equipment, an equipment loan could be used to finance part of the purchase.

When considering financing options for a business acquisition, it is important to weigh the benefits and drawbacks of each option. Factors such as the size and type of the business, the buyer's creditworthiness, and the loan terms will influence the best choice. It is common for lenders to require additional collateral and restrictive personal guarantees from the acquirer's owners to mitigate their risk. Understanding these factors and their implications is crucial in making an informed decision.

Asset Based Lenders

Asset-based lenders, also known as hard money lenders or private money lenders, focus on the value of the underlying asset, such as real estate, when deciding to provide a loan to a borrower. They do not emphasize the borrower's credit score and history as much as traditional lenders do. Asset-based loans are often considered riskier for the lender, resulting in higher interest rates. These lenders can be a suitable option for individuals or businesses that may not qualify for traditional bank loans due to credit history or other reasons. Some well-known asset-based lenders include New Silver, Griffin Funding, and CoreVest Finance.

Asset-based lending, or ABL, is an alternative for businesses with substantial assets to access significant financing based on the assets they own, such as accounts receivable, real estate, and equipment. ABL can provide access to significant financing with a covenant-light structure and flexibility in making future



decisions. The financing can be structured as an asset-backed line of credit or an asset-based term loan, with rates typically ranging from 9% to 25%.

In summary, asset-based lenders serve as an alternative source of financing, particularly for real estate investors and businesses with valuable assets, offering loans based on the value of the underlying assets rather than the borrower's creditworthiness.

Private Equity Group

Private equity firms work by investing money collected from investors to acquire controlling stakes in companies. They then collaborate with company executives to enhance the value of the businesses, known as portfolio companies, intending to sell them later at a profit. Private equity owners make money by buying companies they believe have value and can be improved, and they may provide operational support to help build and grow a better company. These firms are skilled at selling businesses by finding buyers willing to pay a good price, and their success is attributed to the strategy of buying to sell.

Private equity investors raise pools of capital from limited partners to form a fund, and once they've hit their investment target, they begin acquiring companies. Selling to a private equity group has both pros and cons. Some of the pros include access to capital, expertise, and a wider network, as well as the potential to release capital and reduce risk. On the other hand, some of the cons involve the loss of control, differing incentives and goals, and potential short-term focus on profitability at the expense of long-term strategic goals. It is important to carefully consider these factors and weigh the advantages and disadvantages before making a decision.

Venture Capital

Venture capital is a form of private equity financing provided by venture capital firms or funds to startups, early-stage, and emerging companies with high growth potential. It is invested in exchange for an equity stake in the business, and the return is earned when the venture capitalist "exits" by selling its shareholdings. Venture capitalists are expected to bring managerial and technical expertise, as well as capital, to their investments.

Venture capital funds are structured as limited partnerships, with general partners managing the fund and serving as advisors. The process of venture capital begins with a startup pitching to a VC firm, which then evaluates the opportunity and, after providing funding, may take an active role in the company by offering guidance and resources.

Venture capital (VC) can be a valuable source of funding for startups, providing access to significant capital, expertise, networks, and support. However, it also comes with certain disadvantages, such as the loss of control and dilution of ownership. Here are the key pros and cons of using venture capital:



The Pros of Venture Capital

Access to Significant Capital: Venture capital typically invests large amounts of capital in startups, providing the necessary funds for growth and expansion.

Expertise and Guidance: VC firms provide expertise, guidance, and networking opportunities, which can be valuable for the growth and success of the startup.

Separation of Personal Assets: When a business secures funding from a venture capitalist, the owner's personal assets remain separate from those of the business.

The Cons of Venture Capital

Loss of Control: Raising funding from venture capital means giving up some level of control over the business.

Dilution of Ownership: Founders may experience a reduction in their ownership stake due to the issuance of new shares to investors.

High Standards and Due Diligence: Venture capitalists have high standards, and startups need to pass due diligence processes to secure funding.

Startups considering venture capital should carefully evaluate these pros and cons, ask critical questions, and ensure alignment with the investor's expectations. Additionally, they should also consider alternative financing options to make an informed decision.

Exempt Offering for Self-Issue

A private placement is a sale of stock shares or bonds to pre-selected investors and institutions, offering a private alternative to issuing publicly offered securities. It is regulated by the U.S. Securities and Exchange Commission under Regulation D, which provides exemptions from registration. In a private placement, the offering and sale of securities are made between a business and a select number of investors, typically accredited investors, and are exempt from registering with the SEC.

This allows the issuer to avoid certain costs associated with a public offering and maintain confidentiality. Private placements can be in the form of long-term, fixed-rate senior debt or other structuring alternatives, and they typically have a three-to-five-year holding period before investors can cash out. Investors are encouraged to conduct due diligence and consult with a financial professional before investing in a private placement.

The Self-Issuance of a Private Placement Offers Several Benefits and Risks



Benefits

Fewer Regulatory Requirements: Private placements are unregulated compared to public offerings, allowing the issuer to avoid certain costs and ongoing regulatory obligations.

Confidentiality and Control: Issuers can maintain confidentiality and have greater control over the selection of investors and the terms of the offering.

Cost and Time Savings: Private placements can save on underwriter fees and expedite the process compared to public offerings.

Risks

Limited Access to Capital: Private placements may limit a company's access to capital compared to a public offering.

Higher Costs and Complexity: Issuers may have to pay higher interest rates to investors due to the added risk, and the process of finding and attracting investors can be more challenging.

Loss of Control and Dilution: There is a risk of loss of control if private placements result in increased ownership from investors, and existing shareholders may sustain at least a short-term loss from the resulting dilution.

While private placements offer advantages such as flexibility, confidentiality, and cost savings, they also come with the potential drawbacks of limited access to capital, higher costs, and loss of control. Companies considering self-issuance of a private placement should carefully evaluate these factors.

The self-issuance of a private placement has several legal implications. Private placements are subject to the antifraud provisions of the federal securities laws, meaning that any information provided must be true and may not omit any material facts necessary to prevent fraud. While private placements are exempt from certain regulatory requirements that apply to public offerings, they may still have to comply with state securities laws, including state registration requirements or a state exemption from registration.

Risks of Private Placement Offerings

The private placement offering risks frequently include the lack of regulatory review, as private placements are exempt from registration at the federal and state level, and the potential for high returns compared to other available investment options, which can be misleading. Investors in private placements are encouraged to conduct their own due diligence on the offering, potentially consulting with their own legal counsel.

The legal implications of self-issuance of a private placement involve adherence to antifraud provisions, potential state law requirements, and the need for investors to conduct thorough due diligence to



protect themselves. The consequences of violating securities laws in a private placement can be severe. The U.S. Securities and Exchange Commission (SEC) actively enforces these provisions and can take legal action against companies found to be in violation.

Penalties for securities fraud can lead to substantial fines, securities issuance prohibitions, and, in severe cases, criminal charges. Violating federal anti-fraud provisions, such as misrepresenting or omitting material facts in connection with the sale of securities, can result in civil liability and criminal penalties. Additionally, private placements are exempt from registration at the federal and state levels, and engaging in fraudulent practices can lead to regulatory and legal repercussions.

In summary, the consequences of violating securities laws in a private placement include substantial fines, securities issuance prohibitions, civil liability, and in severe cases, criminal charges. It is essential for companies engaging in private placements to adhere to securities laws and regulations to avoid these serious consequences.

Reg D 504

Rule 504 of Regulation D is a Securities and Exchange Commission (SEC) regulation that provides an exemption from the registration requirements of the federal securities laws for some companies when they offer and sell securities. It allows the offer and sale of up to \$10 million of securities in a 12-month period. Companies using this exemption must file a notice with the Commission on Form D within 15 days after the first sale of securities in the offering. Additionally, a company must comply with state securities laws and regulations in the states in which securities are offered. However, companies using this exemption must still provide sufficient information to investors to avoid violating securities laws. Certain companies are not eligible to use Rule 504, such as Exchange Act reporting companies, investment companies, and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company. Furthermore, companies that are disqualified under Rule 504's "bad actor" disqualification provisions are also not eligible to use this rule. The "bad actor" disqualification provisions disqualify offerings from relying on Rule 504 if the company or other relevant parties have been convicted of, or sanctioned for, securities fraud or other violations of specified laws.

Pros and Cons of Regulation D Rule 504

The Pros

Quicker and Lower-Cost Access to Funding: Rule 504 provides quicker and lower-cost access to investor funding, making it ideal for smaller companies and entrepreneurs.

Increased Limit: The SEC amended Rule 504 to increase the maximum number of securities that may be sold from \$1 million to \$5 million, and up to \$10 million in a 12-month period.



The Cons

Restrictions on Securities: Securities sold under Rule 504 typically carry restrictions that limit the options available to investors if they want to sell their securities.

Disclosure Requirements: Some states require a comprehensive level of document disclosure, making Rule 504 less desirable for some companies.

Limited to Private Companies: Rule 504 is not available to public companies subject to SEC reporting requirements.

In summary, while Rule 504 offers advantages such as quick access to funding and increased limits, companies must also consider compliance with state laws, restrictions on securities, and disclosure requirements as potential drawbacks.

Reg D 506 (b)

Rule 506(b) of Regulation D, which is part of the Securities Act of 1933, allows companies to sell securities to an unlimited number of accredited investors and up to 35 non-accredited investors without registration. The key features of Rule 506(b) include the ability to raise an unlimited amount of money if there is no public solicitation for those funds. Non-accredited investors must be sophisticated, and they must be provided with additional disclosure documents.

The offering is subject to "bad actor" disqualification provisions, and the company is required to file a notice with the SEC on Form D. Unlike Rule 506(c), Rule 506(b) prohibits the use of general solicitation or advertising to market the securities, and the investors in the offering must all be accredited investors. Overall, Rule 506(b) provides a "safe harbor" for companies to raise capital without the need for public solicitation.

For more information, you can refer to the Securities and Exchange Commission's official website, which provides detailed resources and compliance guides on Rule 506(b) and other exempt offerings under Regulation D.

Reg D 506 (c)

Rule 506(c) is a regulation under the Securities Act that allows companies to broadly solicit and advertise their securities offering to the public. To comply with Rule 506(c), the following conditions must be met: all purchasers in the offering must be accredited investors, the issuer must take reasonable steps to verify the purchaser's accredited investor status, and certain other conditions in Regulation D must be satisfied. This regulation was created as part of the JOBS Act to help the U.S. economy recover from the Great Recession by allowing issuers to raise capital from a larger pool of investors. Unlike Rule 506(b), which does not allow general solicitation or advertising, Rule 506(c)



permits the issuer to solicit or advertise for potential investors, but only accredited investors are allowed to purchase in such offerings.

Crowd Funding

Regulation Crowdfunding (Reg CF) is a method for eligible companies to raise capital by offering and selling securities to the public through online crowdfunding platforms. This regulatory framework, introduced with the JOBS Act in 2016, aims to democratize the investment industry by allowing unaccredited investors to participate in early-stage investing. Some key points about Regulation of Crowdfunding include:

It enables eligible companies to offer and sell securities through crowdfunding, with a maximum aggregate amount of \$5 million that can be raised through crowdfunding offerings.

All transactions must be conducted online through an SEC-registered intermediary, either a broker-dealer or a funding portal.

There are limits on the amount individual non-accredited investors can invest across all offerings in a 12-month period.

Investors should be aware of the risks involved in these investments, as they often involve younger and less established companies.

Investors interested in Regulation Crowdfunding should carefully consider the risks involved and conduct thorough research before making any investments.

For more detailed information, you can refer to the official SEC website and the specific regulations outlined in 17 CFR Part 227.

The Pros and Cons of Crowdfunding:

Pros of Crowdfunding

Credit Score Not Required: Unlike traditional loans, crowdfunding does not require a credit score, making it accessible to a wider range of individuals and startups.

Proof of Concept: It serves to validate the market demand for a product or service before full-scale production or launch.

Organic Customer Base: Crowdfunding can help create an organic customer base and engage early adopters who may also provide valuable feedback.

Free Marketing: The process of crowdfunding can act as a form of free marketing, as it requires active promotion and sharing of the campaign.



Multiple Sources of Funding: Funds are raised from a large number of contributors, which can diversify the risk of non-payment.

Avoids Loan Interest: Crowdfunding avoids the interest costs associated with business loans, which can be beneficial for cash flow.

Fast Capital Raising: It can be a quick way to raise funds, often faster than traditional methods such as bank loans.

Cons of Crowdfunding

No Guarantee of Success: There is no certainty that a crowdfunding campaign will reach its funding goal, which can be a significant risk.

All-or-Nothing Approach: Many platforms operate on an all-or-nothing model, where funds are only received if the target amount is reached.

Time and Effort: Successful campaigns require careful planning, a solid marketing strategy, and a lot of effort to promote.

Potential for Idea Theft: Publicly sharing your idea can expose it to the risk of being copied by others.

Pressure to Deliver: Once funded, there is pressure to deliver on the promises made during the campaign, which can be challenging.

Fees: Crowdfunding platforms may charge fees that can eat into the amount raised.

Equity Loss: In equity-based crowdfunding, you may have to give up a portion of your company's equity in exchange for funding.

Crowdfunding offers a range of benefits, particularly for those who may not have access to traditional funding sources or who wish to validate their business concept with an engaged audience. However, it also comes with challenges, such as the risk of not meeting funding goals and the potential loss of control over certain aspects of the business. It is important for entrepreneurs to weigh these pros and cons carefully before deciding to pursue crowdfunding as a financing option.

Registration S-1

Form S-1 is the initial registration form for new securities required by the U.S. Securities and Exchange Commission (SEC) for public companies that are based in the U.S. It is filed in connection with an initial public offering (IPO) and follow-on offerings of new securities. The form contains two parts: Part I, which is the prospectus, and Part II, which contains supplemental information that the SEC does not require the issuer to provide. The form must contain all material information about the company;



otherwise, the issuer may be liable for securities fraud. It is also known as the registration statement under the Securities Act of 1933.

The S-1 form requires companies to provide detailed information about their business and the securities they are offering. This includes information about the company's management, financial statements, risk factors, and other essential details. The form is an important document for investors to consider the merits of an offering and make educated investment decisions.





PATH TO YOUR EXIT

This section assumes the reader already knows the need for planning the exit even before the first acquisition. “Know your exit before you invest.”

An exit strategy is a critical component of investment and business planning, serving as a comprehensive plan that outlines how a business owner or investor intends to exit their investment or business venture. The importance of having an exit strategy lies in its ability to maximize the value of the investment, mitigate risks, provide financial security, ensure a smooth transition, attract investors, assist in estate planning, and ensure legal and regulatory compliance.

Exit Strategies

There are various types of exit strategies, including mergers and acquisitions (M&A), selling stakes to partners or investors, family succession, management and employee buyouts (MBO), initial public offerings (IPO), liquidation, and bankruptcy. The choice of an exit strategy depends on the individual's financial, personal, and business goals.

Not having a sound exit strategy can lead to significant risks such as undervaluing the business, missing life goals, personal burnout, and not being prepared for unexpected events. It is essential for business owners to work with an exit planning advisor well in advance of their desired selling point to improve the likelihood of a successful outcome.

An exit strategy also helps define a business's objectives and is a key factor that investors consider when deciding whether to commit funds. It is a sign of a well-thought-out business plan and demonstrates that the entrepreneur is prepared for all eventualities.

For investors, particularly in stocks, an exit strategy is a plan to leave an investment, ideally by selling it for more than the purchase price. It helps investors realize profits or mitigate potential losses and provides a clear set of conditions under which they will exit their investment.

In summary, an exit strategy is an essential aspect of investment and business planning that should not be overlooked. It provides a structured path for exiting an investment or business, maximizes value, reduces risks, and aligns with personal and financial goals.

An Exit Strategy Can Help Maximize Investment Returns in Several Ways:

Accretive Exit Strategies: These involve actively improving the value of an investment before selling it, thereby maximizing returns on investments.

Identifying the Most Opportune Time to Exit: By having a clear plan in place, investors can identify the most opportune time to exit an investment, such as when the investment reaches a certain valuation or achieves a specific target price.



Locking in Profits and Diversifying Portfolios: An exit plan allows investors to lock in their profits when an investment reaches its target price, and it also enables them to free up capital that can be reinvested in different ventures or asset classes, thus contributing to maximizing returns and diversifying portfolios.

Return Maximization and Risk Mitigation: An exit strategy helps investors seize the right moment to cash in on their investment when it is at its peak value, thereby maximizing returns. It also minimizes potential losses by providing a clear path to exit, thus contributing to risk mitigation.

Preventing Emotional Decision-Making and Providing Clarity: An exit strategy can prevent emotional decision-making and provide clarity about when to sell, thereby helping investors stay focused on their end goals and avoid staying invested too long in an investment that's doing well.

In summary, an exit strategy plays a crucial role in maximizing investment returns by enabling investors to identify the right time to exit, lock in profits, diversify portfolios, and mitigate risks. It also provides a clear plan to prevent emotional decision-making and stay focused on investment objectives.

Accretive exit strategies involve actively improving the value of an investment before selling it, with the aim of achieving a higher price than the initial investment. Some examples of accretive exit strategies include:

Selling Stake to Another Investor: One common option is to sell the stake in the company to another investor.

Initial Public Offering (IPO): Taking the company public through an IPO is an accretive exit strategy.

Merger or Acquisition: Investors can consider a merger or acquisition to exit their investment.

Accretive exit strategies require significant planning and execution, such as improving operational efficiency, expanding product or service offerings, or implementing cost-cutting measures to increase the value of the investment before exiting.

These strategies are particularly attractive to investors looking to maximize their returns, and with careful planning and execution, investors can significantly increase the value of their investments and achieve a higher rate of return.

Types of Investors

Angel Investors: Angel investors are individuals who provide capital to startup businesses in exchange for ownership equity or convertible debt. They often get involved at the early stages of a company and may offer not only funding but also feedback, advice, and contacts. Angel investors typically invest their own funds and may seek to support startups with intriguing ideas. The amount of investment from angel investors is modest, averaging about \$50,000, and most angels keep their involvement in startups



to no more than 10% of their portfolios. Angel investors can be individuals with high incomes or net worths, successful small business owners, or investors who make financing small businesses a professional pastime.

Venture Capitalists: Venture capitalists are investors who form limited partnerships to pool investment funds, which they use to fund startup companies in return for equity stakes in those companies. They typically invest in startups and early-stage companies with high growth potential but little operating history. Venture capitalists are usually very selective in their investments, looking for companies with an excellent management team, a large potential market, and high growth potential. They also provide technical support and managerial expertise to the companies they invest in. Venture capital investing has traditionally been limited to accredited investors and institutional investors, and it demands a substantial financial commitment and the ability to conduct in-depth due diligence.

Venture capitalists aim to grow their portfolio companies to the point where they become profitable and then sell off their stakes at a profit, distributing the returns to their investors. They are typically involved in guiding the new companies and assisting at four stages in the company's development: idea generation, start-up, ramp-up, and exit. While they are often associated with guiding the companies they invest in good industries and structure their deals to minimize risk and maximize returns.

Peer-to-Peer Lenders: Peer-to-peer (P2P) lending is a form of financial technology that allows individuals to obtain loans directly from other individuals, cutting out the traditional financial institution as the middleman. P2P lending websites connect borrowers directly to investors, who fund the loans. Some well-known P2P lending platforms include LendingClub, Prosper, Upstart, and Funding Circle. P2P loans can be more accessible to borrowers, offering lower interest rates compared to credit cards. However, it is important to note that the default rates for P2P loans are generally higher than those in traditional finance.

P2P lending can be advantageous for both borrowers and investors. Borrowers may find it easier to access funds, especially those with low credit scores, while investors can potentially earn a better return on their cash savings than traditional savings accounts or other low-risk investments.

The process of obtaining a P2P loan involves applying for funds through a P2P lending platform, which then facilitates the funding from individual investors. The loan terms and interest rates are set by the platform, and once the loan is funded, the borrower makes monthly payments directly to the investors who funded the loan.

High-Net-Worth Individuals: High-Net-Worth Individuals (HNWIs) are people who have amassed investable (or liquid) assets of \$1 million or more. These assets can include cash, stocks, bonds, and some real estate investments. The term "high net worth individual" is used in the world of private wealth management and represents the management of assets of private entities, including HNWIs or



accredited investors. The classification of HNWI can be further broken down into three categories based on the value of their liquid assets: HNWI with assets between \$1 million and \$5 million, very-high-net-worth individuals (VHNWIs) with assets between \$5 million and \$30 million, and ultra-high-net-worth individuals (UHNWIs) with assets of more than \$30 million.

Banks: Banks are financial institutions that provide funding to businesses. They offer a wide variety of deposit, lending, and investment products to individuals and businesses. In the context of small business funding, banks, including large national banks and community development financial institutions (CDFIs), play a crucial role in providing capital, mentoring, training, and technical assistance to small and minority-owned businesses in underserved communities. Additionally, the Small Business Lending Fund (SBLF) is a dedicated fund designed to provide capital to qualified community banks and small businesses, encouraging them to work together, create jobs, and promote economic growth in communities across the nation. When seeking business loans, it is important for businesses to consider the various types of loans available and the specific offerings of different banks, including national banks, local institutions, and credit unions.

Corporate Investors: Corporate investors, such as established companies, play a significant role in the success of startups. Research has shown that having a corporate investor decreases the chance of a startup going bankrupt and increases its valuation relative to EBITDA if there is an exit. This trend has emerged due to the rise of corporate venture capital (CVC), which has created a mutually beneficial ecosystem where startups gain access to financial resources, industry expertise, and validation, while corporations benefit from innovation, external growth opportunities, and access to top talent. The strategic acquisition of startups by corporates enables them to access innovative technologies, fast-track their entry into new markets, and stay ahead of emerging trends and disruptions. Startups can undergo three main types of acquisitions: purchase, merger, and investment, with each type offering different benefits to the acquiring company. Overall, startups with corporate investors are more successful than those without, and having a CVC investor at various stages of the startup journey offers unique advantages, including access to resources, expertise, and potential exit opportunities.

Each type of investor has its own characteristics and level of involvement in the businesses they invest in there is also overlap of investor types.

Types of Buyers

Wealthy Individuals buyers: Wealthy individuals can be potential buyers for businesses. They are often willing to pay a premium for high-quality products and services that hold their value over time. Wealthy buyers are usually older, well-educated, and have a high disposable income. They expect exceptional service and are an important target market for many businesses. When it comes to acquiring businesses, wealthy individuals can fall into the category of individual buyers, who are looking to acquire businesses as a way of life and typically focus on smaller owner-operated companies. These



individual buyers can be high-net-worth individuals (HNWI) with assets greater than \$1 million. Additionally, wealthy individuals can also be classified as financial or "professional" buyers, encompassing high net worth individuals, family offices, and institutional investors, driven by strong financial returns.

Strategic buyers: A strategic buyer is a company or investor that seeks to acquire companies or assets, whose acquisition will add synergistic value to their existing portfolio. Strategic buyers are often in the same industry as the target companies, but not always. They prioritize the fit between the target company and their strategic goals, seeking to create long-term value by expanding market presence, enhancing product portfolios, accessing new technologies, realizing synergies, consolidating markets, and mitigating risks. Strategic buyers usually enter negotiations with a unique value proposition in mind, which rationalizes the acquisition. The investment horizon for a strategic buyer tends to be longer, and they often merge the acquired companies entirely post-deal and never intend to sell them resulting in a divestiture in such a case.

Financial Buyer: A financial buyer, also known as a private equity firm, is a type of buyer in an acquisition primarily interested in the return that can be achieved from the investment. They focus on the cash flow the investment will generate and potential exit strategies, such as an initial public offering (IPO) or selling the company outright to a strategic buyer. Financial buyers may seek to improve cash flows by growing revenues, cutting costs, or merging with similar companies to create economies of scale. They are typically long-term investors looking for a solid, well-managed company and often represent an alternative to company owners who want to sell their businesses.

Institutional Buyers: Institutional investors are entities that pool money to purchase securities, real property, and other investment assets or originate loans. They include commercial banks, central banks, credit unions, government-linked companies, insurers, pension funds, sovereign wealth funds, charities, hedge funds, REITs, investment advisors, endowments, and mutual funds. They are considered sophisticated investors who are knowledgeable and subject to fewer protective regulations compared to retail investors. Institutional investors play a significant role in financial markets by influencing corporate behavior, exercising voting rights, and providing capital for entrepreneurs. Examples of institutional investors include mutual funds, pensions, hedge funds, and insurance companies.

Industry Buyers: Industry buyers are a type of business buyer who is well-versed in a specific industry and tend to merge with or acquire direct competitors. They are known for focusing on building value that is difficult to replicate and are not willing to pay for goodwill. Industry buyers are often seen as the buyers of last resort because they usually pay the lowest price. They may be the only suitable option for businesses that are asset-intensive with less-than-favorable margins or are so specialized that only a competitor may purchase them.



CASE STUDIES

Star Equity Holdings Acquired Timber Tech For \$23.0 Million

Overview

Star Equity Holdings, Inc. announced the acquisition of Timber Technologies, LLC (Timber Tech) on May 20, 2024, for a purchase price of \$23.0 million (cash-free & debt-free).

The purchase price of \$23.0 million will be majorly paid in cash alongside some preferred stock of Star Equity Holdings, Inc. Out of the purchase price, \$16.0 million will be paid as upfront cash, \$4.0 million in deferred cash, and the remaining \$3.0 million earn-out to be paid in 2 years with 50.0% payable in cash & 50.0% in preferred stock of Star Equity Holdings, Inc. The earn-out adjusted EBITDA targets are \$5.4 million for year 1 and \$6.0 million for year 2. Star Equity Holdings closed a \$7.0 million term loan with Bridgewater Bank to partially finance this acquisition.

Post the acquisition, Timber Technologies will operate as a part of the Star Equity Holdings' Building Solutions division. Additionally, the co-owners of Timber Technologies, Tom Niska and Dale Schiferl, will retain their existing positions and remain with the company.

Target Company

Founded in 2003, Timber Technologies is a Wisconsin-based manufacturer of glue-laminated timber products ("glulam") intended for various end markets and applications, including agriculture, industrial, infrastructure, and building construction. It manufactures engineered wood products including glulam beams, columns, and posts for pole barn and post frame. Its glulam products are more durable, environmentally sustainable, and possess superior strength in comparison to solid timber and other building materials.

Acquiring Company

Star Equity Holdings, Inc. is a diversified holding company. Star Equity Holdings was founded in 1985 and is listed on the NASDAQ with the ticker symbol: STRR. The company has two divisions: Building Solutions and Investments. The Building Solutions division designs and manufactures modular units, structural wall panels, and glulam columns, beams, & trusses, for the New England and Midwest markets. The Investment division oversees and finances the company's real estate assets, along with its investments in both private and public companies.



Objective

The acquisition of Timber Technologies represents a major milestone in Star Equity Holdings' growth strategy. The acquisition will enable Star Equity Holdings' Building Solutions division to expand into markets beyond multi-family and residential construction. With its strategic location, Timber Technologies will also facilitate collaboration with Star's existing Minneapolis-area businesses, EdgeBuilder and Glenbrook. The acquisition is expected to add to the profitability of Star Equity Holdings as Timber Technologies has a 20-year history of consistent profitability and cash generation. In 2023, Timber Technologies reported a revenue of \$18.8 million and adjusted EBITDA of \$5.5 million. The high demand for its products in niche markets, combined with its presence in the Midwest and Northwest is expected to make Timber Technologies a valuable addition to Star's Building Solutions division.

The acquisition will support Timber Technologies' next phase of growth. The expertise and oversight provided by the Star Equity Holdings team in the construction sector make this partnership an ideal match for Timber Technologies.

Source: "Star Equity Holdings acquires Timber Technologies" – Investing.com

Ultralife Corp Acquired Electrochem Solutions For \$50.0 million

Overview

Ultralife Corporation announced that it has completed the acquisition of Electrochem Solutions, Inc. for \$50.0 Million from Integer Holdings Corporation on October 31, 2024.

The purchase consideration was made by Ultralife Corp through a new credit and security agreement with KeyBank, N.A. serving as the administrative agent, and M&T Bank and Community Bank acting as the lenders. Electrochem Solutions reported a revenue of \$34.0 million for the trailing twelve-month period ended September 30, 2024.

Target Company

Founded in 1979, Electrochem Solutions, based in Raynham, Massachusetts, designs and manufactures batteries, and provides customized power solutions for critical market applications. It produces primary lithium metal and ultracapacitor cells, as well as battery packs for energy, military, and various environmental, industrial, and utility sectors. The company's products include non-rechargeable and rechargeable power solutions, chargers and docking stations, battery packs, power supplies, and Ironworks phosphate batteries.



Electrochem Solutions' former parent company, Integer Holdings Corporation, is a medical device contract development and manufacturing organization (CDMO), serving cardiac rhythm management, neuromodulation, and cardio and vascular markets. Its brands include Greatbatch Medical and Lake Region Medical. It is listed on the NYSE with the ticker symbol: ITGR.

Acquiring Company

Ultralife Corporation designs, manufactures, installs, and maintains power and communications systems including rechargeable and non-rechargeable batteries, chargers, communications and electronics systems and accessories, and custom-engineered systems. It caters to customers across the globe in the government & defense, medical, safety & security, energy, industrial, and robotics sectors. It is listed on the NASDAQ with the ticker symbol: ULBI.

Objective

The acquisition of Electrochem Solutions is expected to strengthen Ultralife Corporation's product portfolio and facilitate entry into new markets. The acquisition's objective is to bolster Ultralife's competitive position by creating new cross-selling opportunities and enabling the company to tap into adjacent markets that require reliable and safe power solutions.

The divestiture of Electrochem Solutions by Integer Holdings is expected to enable it to focus exclusively on the medical device market. Integer Holdings' management plans to use the proceeds from the transaction to reduce its debt and support its inorganic growth strategy.

Source: "Ultralife Corporation Completes Acquisition of Electrochem Solutions, Inc." – Globe Newswire

CSW Industrials Acquired Dust Free For \$27.4 Million

Overview

CSW Industrials, Inc., announced the strategic acquisition of Dust Free, LP for a purchase consideration of \$27.4 Million on February 6, 2024.

The purchase consideration was made using CSW Industrials' available cash on hand and borrowings under its existing \$500.0 Million revolving credit facility. The deal valued Dust Free, LP at 7.5x of its trailing twelve months EBITDA, excluding future earn-outs.

Target Company

Founded in 1982 with headquarters in Royse City, Texas, Dust Free, LP is a manufacturer of air filtration equipment designed to benefit allergy patients with a clean indoor environment. It offers a comprehensive line of patented IAQ products for residential and commercial HVAC applications. Its



patented product range is designed to improve indoor air quality through three key processes: Filtration, Purification, and UV Inactivation.

Acquiring Company

Headquartered in Dallas, Texas, CSW Industrials, Inc. is an industrial company with domain expertise across three segments: Contractor Solutions, Engineered Building Solutions, and Specialized Reliability Solutions. It serves HVAC/R, plumbing, general industrial, architecturally specified building products, energy, mining, and rail transportation markets. It is listed on the Nasdaq with a ticker symbol: CSWI.

Objective

The acquisition of Dust Free, LP supports CSW Industrials, Inc.'s commitment to expanding its product offerings for residential and commercial customers. This acquisition is expected to enhance CSW Industrials' product portfolio in the HVAC/R and plumbing sectors, driving significant growth. CSW Industrials has been a master distributor of Dust Free's products since 2021, thus allowing CSW Industrials to integrate backward with this acquisition. The integration of Dust Free is expected to enable CSW Industrials to provide cutting-edge technology to improve indoor air quality.

This acquisition is expected to enable Dust Free to leverage CSW Industrials' established distribution network and expertise in supplying products to the HVAC/R market, while also allowing the development of innovative IAQ products.

Source: "CSW Industrials acquires Dust Free for \$27.4 million" – Investing.com

Integer Holdings acquired Pulse Technologies for \$140.0 Million

Overview

Integer Holdings Corporation announced the acquisition of Pulse Technologies for a purchase consideration of approximately \$140.0 Million on January 5, 2024.

The purchase consideration was subject to customary adjustments, offset by an anticipated \$15.0 Million NPV tax benefit over 15 years along with additional consideration contingent on meeting specific revenue growth targets through 2025. This acquisition was a cash purchase transaction. Pulse Technologies' estimated 2023 sales and adjusted EBITDA were approximately \$42.0 Million and \$11.0 Million respectively.

Integer Holdings Corporation financed the acquisition through borrowings from its existing credit facility. Following the acquisition, the company expected to maintain a leverage ratio within the 2.5x – 3.5x target. Pulse Technologies' team of 250 associates will remain with the company post-acquisition.



Target Company

Founded in 1993 and headquartered in Quakertown, Pennsylvania, Pulse Technologies is a company specializing in advanced technology, engineering, and contract manufacturing for medical device components and assemblies. It focuses on micromachining medical device components, serving markets such as structural heart, heart pump, electrophysiology, leadless pacing, and neuromodulation. Additionally, it provides proprietary technologies such as Hierarchical Surface Restructuring (HSR), Scratch-Free Surface Finishes, and Titanium Nitride Coatings.

Acquiring Company

Integer Holdings Corporation is a Texas-based medical device outsource (MDO) manufacturer, serving the cardiac, neuromodulation, vascular, portable medical, and orthopedics markets. Additionally, it develops batteries for high-end niche applications in energy, military, and environmental markets. It is listed on the NYSE with the ticker symbol: ITGR.

Objective

The acquisition of Pulse Technologies supports Integer Holdings Corporation's growth strategy to enhance its capabilities and capacity in targeted markets. The deal's objective is to strengthen Integer Holdings' end-to-end development capabilities, while also expanding its manufacturing footprint in the targeted markets. This deal is expected to allow Integer Holdings to better serve its customers by shortening their product time to market.

The acquisition of Pulse Technologies by Integer Holdings enables it to leverage Integer Holdings' scale and industry-leading capabilities, thereby accelerating its growth opportunities.

Source: "Integer Holdings Corporation Announces Preliminary Unaudited Sales Results and Acquisition of Pulse Technologies" – Integer

Limbach Holdings Acquired KIM For \$15.0 Million

Overview

Limbach Holdings announced the acquisition of Kent Island Mechanical, LLC ("KIM") for an initial purchase consideration of \$15.0 Million on September 03, 2024.

The purchase consideration was completely made using the available cash with Limbach Holdings. An additional \$5.0 Million earn-outs will be paid over the next two years upon achieving certain performance-based targets.



Post the transaction, KIM's founder Mark Bowen retired from the company, and Kyle Benjamin, the Director of Operations of KIM, joined the leadership team of Limbach Holdings for the Mid-Atlantic region.

Target Company

Founded in 2002, Kent Island Mechanical, LLC is a provider of mechanical construction and HVAC services intended for healthcare, life sciences, information technology, federal, institutional, educational, and hospitality industries. It offers full-service mechanical contracting, cooling tower installation & replacements, system evaluations, sheet metal & ductwork installation, etc.

Acquiring Company

Limbach Holdings is a building systems solutions company that collaborates with building owners and facilities managers overseeing mission-critical mechanical, electrical, and plumbing infrastructure. It specializes in the design, modular prefabrication, installation, management, and maintenance of HVAC, mechanical, electrical, plumbing, and control systems. It is listed on the NASDAQ with the ticker symbol: LMB.

Objective

Limbach Holdings' management expects the acquisition of KIM to strengthen its capabilities in design, engineering, maintenance, capital projects, and emergency mechanical solutions across key markets such as data centres, healthcare, life sciences, and higher education. The objective of the acquisition is to enhance Limbach's existing Mid-Atlantic operations and support its strategy to expand direct relationships with owners of mission-critical facilities in core sectors. KIM is expected to contribute approximately \$30.0 Million in revenue and over \$4.0 Million in EBITDA annually, starting in 2025.

This acquisition enabled Mark Bowen, founder of KIM, to transition into retirement and plan for succession.

Source: "Limbach Holdings Acquires Kent Island Mechanical" – Business Wire

Vishay Intertechnology Acquired MaxPower for \$107.5 Million

Overview

Vishay Intertechnology, Inc. announced that it will acquire a 100% stake in MaxPower Semiconductor, Inc. for \$107.5 Million on October 28, 2022.



The purchase price included cash consideration of \$50.0 Million and contingent payments of up to \$57.5 Million, payable upon the achievement of certain technological milestones and the occurrence of certain non-operating events.

After the acquisition, MaxPower Semiconductor will be incorporated into Vishay Intertechnology's MOSFETs reportable segment.

Target Company

Founded in 2007, MaxPower Semiconductor Inc. is a fabless power semiconductor provider delivering technologies that optimize power management solutions. Its products include custom-discrete power MOSFETs, standard, discrete power MOSFETs & dies, wafers, and assembled product sales. Its proprietary technologies provide improved efficiency, performance, and cost-effective power semiconductor products. It has an IP portfolio of over 100 patents.

Acquiring Company

Vishay Intertechnology, Inc. is a manufacturer of discrete semiconductors and passive electronic components. Its products are used in the automotive, industrial, computing, consumer, telecommunications, military, aerospace, and medical markets. Vishay Intertechnology, Inc. is listed on the NYSE with the ticker symbol: VSH.

Objective

The acquisition of MaxPower Semiconductor aligns with Vishay Intertechnology's expansion strategy to grow by acquiring technologies that expand its product portfolio. The objective of the acquisition is to collaboratively develop products for markets such as electric vehicles and further solidify Vishay's leadership in MOSFET technology. This acquisition is expected to enable Vishay Intertechnology to support customers in the advanced development of high-voltage electrification applications, thereby allowing it to offer its customers a complete product portfolio.

Source: "Vishay Intertechnology Acquires MaxPower Semiconductor for \$50 Million" – Globe Newswire

Phoenix Brio Acquired ArthroSurface for \$10.0 Million

Overview

Phoenix Brio announced that it had acquired ArthroSurface, Inc. from Anika Therapeutics, Inc. for a purchase consideration of \$10.0 Million on October 31, 2024.



The purchase consideration includes an earnout payment of \$3.0 Million cash, dependent on Arthrosurface's future sales performance. The remaining \$7.0 million were paid in the form of a ten-year non-interest-bearing promissory note.

Phoenix Brio was formed after the executive management of Primo Medical Group and others, joined forces to acquire Arthrosurface, Inc. Following the acquisition, Phoenix Brio became the parent company of Arthrosurface, and both companies are now headquartered in West Bridgewater, Massachusetts.

Target Company

Arthrosurface is a medical technology business that develops surgical alternatives for the treatment of orthopedic joint disease. It offers anatomic, minimally invasive joint replacement solutions clinically proven to help patients stay active by increasing their range of motion and reducing pain. Its products are designed to restore natural joint function while preserving surrounding bone and tissue.

Anika Therapeutics, Inc. is an orthopedic medicines company. It develops, manufactures, and commercializes therapeutic products for tissue protection, healing, and repair. It is a company listed on the NASDAQ with the ticker symbol: ANIK.

Acquiring Company

Established in 1953, Primo Medical Group is a privately held company that develops, manufactures, and assembles medical devices and precision machined components. It offers comprehensive outsourcing solutions to the medical device market, including OEM product distribution services, engineering services, precision component production, finished goods assembly, refurbishment of medical devices, reusable surgical kit management, and complete supply chain management.

Objective

The acquisition of Arthrosurface supports Primo Medical Group's mission to develop and provide innovative medical solutions that meet current clinical needs. Arthrosurface will operate under Phoenix Brio and thus it is expected to ensure no disruption in product availability or customer service. Furthermore, two former leaders of Arthrosurface have joined the Primo Medical Group executive team as part of this strategic acquisition to help drive Arthrosurface's ongoing success in the orthopedic joint preservation market.

Anika Therapeutics' assessment of Arthrosurface concluded that Arthrosurface products were not an optimal fit for Anika but could create value for other businesses. The divestiture of the Arthrosurface



business is expected to allow Anika Therapeutics to streamline its operations and capitalize on growth opportunities within the hyaluronic acid and regenerative solutions markets.

Source: "Anika Announces Strategic Update of Business with Sale of Arthrosurface and Plan to Divest Parcus Medical" – Anika Therapeutics, Inc.

Watsco Acquired Gateway Supply For \$103.0 Million

Overview

Watsco, Inc. announced that it had acquired Gateway Supply Company, Inc., for a purchase consideration of \$103.0 Million on September 6, 2023¹.

The acquisition was funded by a mix of cash and common stock, each amounting to \$4.0 Million and \$99.0 Million respectively¹. Gateway had approximately \$180.0 Million in annual revenue¹.

After the acquisition, Gateway's leadership team, consisting of Chris, Sam, and David Williams, remained at the helm of the company.

Target Company

Founded in 1964 and headquartered in Columbia, South Carolina, Gateway Supply is a distributor of plumbing and HVAC products. It operates through an online store and physical showrooms in South and North Carolina offering a wide range of products, including bathroom fixtures, faucets, kitchen essentials, hardware, and lighting.

Acquiring Company

Founded in 1956 and based in Miami, Florida, Watsco Inc. is a distributor of air conditioning, heating, refrigeration equipment, and related parts and supplies in the HVAC/R distribution industry serving over 125,000 contractor customers in 692 locations. It is listed on the NYSE with the ticker symbol: WSO.

Objective

The acquisition of Gateway Supply aligns with Watsco's strategy to invest and grow through acquisitions. The objective of this acquisition was to strengthen Watsco's market position in the \$50.0 Billion² HVAC industry and expand Gateway Supply's business by leveraging its customer-focused digital technology.

The acquisition was anticipated to allow Gateway Supply to take advantage of Watsco's scale, capital, industry connections, and entrepreneurial culture to better serve customers in the coming years.

Source: ¹"Watsco Acquires Gateway Supply for \$103M" – Modern Distribution Management

²"Watsco Acquires Gateway Supply Company" – Globe Newswire



CECO Environmental Corp. Acquired Compass For \$12.5 Million

Overview

CECO Environmental Corp. ("CECO") announced that it had acquired Compass Water Solutions, Inc. ("Compass") for \$12.5 Million on May 10, 2022.

The acquisition was funded by a mix of cash and debt, with approximately 70% paid at closing and the remainder scheduled for payment over the next two years. Compass had roughly \$11.0 Million of revenue in 2021 with double-digit EBITDA margins.

After the acquisition, the Compass leadership team continued to work with the company.

Target Company

Founded in 1973 and headquartered in Tustin, California, Compass Water Solutions, Inc. designs and manufactures water treatment equipment, including oily water separators, reverse osmosis freshwater makers, industrial waste treatment systems, and the associated filtration and separation components. It is a global supplier of membrane-based industrial water and wastewater treatment systems that help customers comply with water discharge regulations. It serves clients in the marine, offshore oil & gas, chemical, and industrial markets.

Acquiring Company

Founded in 1966 and based in Dallas, Texas, CECO Environmental Corp. designs and manufactures air pollution control technology, products, and services for energy, industrial, and other niche markets. It helps companies grow their business by providing technology and application expertise. It is listed on the Nasdaq with the ticker symbol: CECO.

Objective

The acquisition expanded the CECO addressable industrial water technology market by over \$250.0 Million. CECO's international sales resources, U.S. Navy expertise, and global engineering and production footprint were expected to enhance synergies from Compass's acquisition. The objective of the acquisition was to add critical engineered solutions to CECO's growing industrial water capabilities.

Source: "CECO Environmental Acquires Compass Water Solutions" – PRNewswire



Acacia Research Corp. Acquired Deflecto For \$103.7 Million

Overview

Acacia Research Corporation ("ACTG") announced that it had acquired Deflecto Acquisition, Inc. ("Deflecto") for \$103.7 million on October 21, 2024.

The acquisition was funded by cash on hand and borrowings under a new senior secured credit facility guaranteed by certain subsidiaries of Deflecto. Deflecto generated revenue of roughly \$131.0 million in the trailing twelve-month period ended August 31, 2024.

Post-acquisition, Deflecto continues to be led by CEO Ross Pliska and its pre-acquisition management team.

Target Company

Founded in 1960 and based in Indianapolis, Indiana, Deflecto is a manufacturer of extruded and molded plastic products for consumer and professional applications. It offers chair mats, bicycle reflectors, dryer venting, sign and literature holders, and office workspace accessories. It manufactures its products at nine manufacturing facilities across the United States, Canada, the United Kingdom, and China.

Acquiring Company

Founded in 1993 and based in New York, Acacia is a company that is focused on acquiring and operating attractive businesses across the mature technology, energy, and industrial/manufacturing sectors. Acacia evaluates opportunities based on the attractiveness of the underlying cash flows, without regard to a specific investment horizon. It is listed on the NASDAQ with the ticker symbol of ACTG.

Objective

The acquisition of Deflecto aligns with Acacia's investment criteria. Deflecto fits in with Acacia's target size range, it sells diversified and necessary goods and has an excellent management team. Additionally, Deflecto's strong cash conversion capabilities and low capital requirements made it an appealing target for Acacia. The transaction is anticipated to generate immediate and substantial revenue for Acacia, while also being accretive to its free cash flow and earnings per share. Acacia expects Deflecto to generate approximately \$128.0-\$136.0 Million in revenue in 2024.

The acquisition is expected to improve Deflecto's financial and operational performance.

Source: "Acacia Research Corporation Acquires Deflecto" – Business Wire