TABLE OF EXPERTS

MERGERS & ACQUISITIONS

BY HOLLY DOLEZALEK, CONTRIBUTING WRITER

The Minneapolis/St. Paul Business Journal held a panel discussion recently on mergers and acquisitions. Panelists included Scott Hislop, president and owner, Transworld Business Advisors of Minnesota; Alec Sherod, partner, Hellmuth & Johnson; Matthew Crane, partner, Boulay; and Michelle Bonahoom, CEO, VisionOne High Performance Group. Dyanne Ross-Hanson, founding principal of Exit Planning Strategies, served as moderator.

MODERATOR

Dyanne Ross-Hanson
Exit Planning Strategies

Dyanne Ross-Hanson is president and CEO of Exit Planning Strategies, formed in 2005 after 30 years in the financial services industry. Exit Planning Strategies helps owners of closely held businesses plan for and execute successful exits: achieving financial freedom, creating a sustainable legacy, and exiting on their own terms. Ross-Hanson shares her expertise and knowledge, as a speaker, with a variety of professional and trade associations, CEO and peer groups, including Vistage International. Ross-Hanson is a published author of numerous articles on above referenced specialties.

PANELISTS

Michelle Bonahoom
VisionOne High Performance Group

Michelle Bonahoom, CEO of VisionOne High Performance Group, has over 20 years of experience in advising leaders through buying and selling in the business world. Her M&A expertise comes from working with over 100 different companies, holding her Bachelor of Science in international business and her MBA in entrepreneurship and private equity, as well as her involvement as a local chapter leader of the Association of Merger & Acquisition Advisors. Bonahoom believes in meeting an organization where they are at, identifying a plan, and staying dedicated to a customizable process that has consistently proven to lead to a successful transaction. The reputation of VisionOne is shown in the collaboration of each of the services within value growth and transition planning. VisionOne not only consults a client as they prepare to buy or sell, but they imbed their knowledge into the business and approach it with passion as if it were their own.

Matthew Crane
Boulay

Matthew Crane joined Boulay in 1999 and became a partner in 2010. He specializes in providing business consulting, audit, tax and accounting services to clients in a variety of industries, including construction, manufacturing, distribution, professional services, renewable energy, software and media. He helps private, public and ESOP companies with various business challenges, such as stock and debt offerings, mergers and acquisitions, analyzing organization risks, and developing strategies to reduce potential losses, compliance with various SEC filing requirements, and cash flow budgets, long-term cash flow projections and forecasts. Crane works with his clients to help analyze business operations and makes recommendations for enhancing overall performance. He is a graduate of Gustavus Adolphus College and received his MBA with an emphasis in strategy and finance from University of Minnesota's Carlson School of Management. He lives in Bloomington with his four kids and wife and enjoys coaching hockey and wakesurfing.

Scott Hislop
Transworld Business Advisors of Minnesota

As president and owner of Transworld Business Advisors of Minnesota, Scott Hislop assists business owners to market and sell their businesses. He brings more than 30 years of owner and operator experience to the role, giving him a unique perspective for business brokerage. As the sixth-generation owner of a family farming business Hislop has personal knowledge of the challenges involved in transferring the family business from one generation to the next. He understands the effort, sacrifice and dedication that goes into running a successful business. He's passionate about helping other business owners accomplish their goals. Those looking to buy or sell a business come to Transworld for its knowledge of financial information, how businesses operate, and what makes them successful. Understanding the goals of the buyer and seller and crafting creative solutions to accomplish both is what the team at Transworld does.

Alec Sherod
Hellmuth & Johnson

Alec Sherod, a partner at Hellmuth & Johnson, represents public and privately held companies across many industries. In his practice, Sherod assists buyers, sellers and financial advisers in a wide variety of domestic and international M&A transactions. He represents clients in financing transactions, including advising issuers and investors in securities law compliance; handling acquisition financing for lenders, borrowers and investors; and representing clients in private placements of equity and debt. He is a trusted adviser and key contributor in analyzing legal and business issues. He has been a member of the Twin Cities legal community for more than a decade. He began his legal career in the corporate department of a large New York City law firm and later served as general counsel for a family office, private equity group in Colorado. He is also an experienced CPA (inactive) who leverages his accounting background when handling sophisticated financial transactions.

Dyanne Ross-Hanson: Almost a year ago, the business world as we knew it was turned completely upside down by the Covid-19 pandemic. The risks that the pandemic posed seeped into all facets of business, including mergers and acquisitions. Orchestrating an M&A transaction in a normal year can be challenging in its own right, but the pandemic served to exacerbate those challenges. Remote work, travel restrictions, face-to-face interaction, due diligence, site visits, etc., all contributed to a challenging year. Matthew, share with our readers your perspective of M&A activity in 2020.

Matthew Crane: We saw a pause early on, particularly in May and early June, and then it really ramped back up again. There had been a lot of money on the sidelines, looking to invest in companies, and shortly after, we saw a lot of people who were eager to get back in and get deals started again.

Alec Sherod: I was very busy in March and April with three or four deals, and there was real uncertainty involved with getting those deals to the finish line. Those transactions thankfully closed, and after the initial concern about whether the world was going to end, once it didn't, things have picked back up. Obviously, with a few industry sectors excepted – hospitality, airlines, casinos and gaming, and that sort of thing – it was a busy year through the end of 2020.

Ross-Hanson: Baby boomers have lived through three economic cycles, this pandemic included, and if their businesses have held up or were only slightly impacted by Covid, they are ready to sell. Covid is getting would-be sellers off the bench. Yet statistics indicate dismal outcomes for successful transactions. Michelle, share with us what business owners can do to increase the likelihood of a successful acquisition or sale.

Michelle Bonahoom: A majority of business owners either don't have a plan or don't have a communicated plan and haven't necessarily readied their business for sale. What we went through over the past year has opened those business owners' eyes to the need to be ready. Most of our companies that were wanting to sell focused on slowing things down over the past year and looked at how to improve the performance and get the business ready for sale. We also had other clients who were looking at growing through acquisition.

Ross-Hanson: Scott, how do you think business owners can best prepare for a transaction?

Scott Hislop: Starting three to five years ahead of when they want to sell is the best way. Good books and records, of course, for every business is important; standardized accounting so we have three to five years of very standardized accounts, positive trends with consistency. Inconsistency is probably the biggest detriment to value. Not having the owner needed in the daily operations of the business is important. The businesses that have the highest value have owners who can sign checks one day a week and then they're on the golf course the balance of the week, as compared with owners who are needed for daily operations 60 to 70 hours every week. These businesses will have lesser value, because buyers are buying the business, not the owner. Oftentimes we see business owners who wait too long before deciding to sell, and the business has declining revenues and profitability. We still sell these businesses, but we could have sold it for a higher value when the business was at its peak performance.

Crane: I think Michelle and Scott were right on: Having a leadership team in place is key, having a group that can run the business without a day-to-day, hands-on business owner involvement is key. Knowing from an owner's perspective what they want from a sale process. They could be looking for a strategic buyer who could help supplement what they have internally, or someone who can take their products or know-how and expand it into segments that they're not currently in. The owners who are concerned about employees being taken care of, are often looking at ESOPs, employee stock ownership plans, where employees can buy the company in stages.

Avoiding distractions and staying focused on the business during sales process is extremely important. I heard a private equity group say, "We like it when the process is delayed, because management takes their eyes off daily operations, the business suffers, and the valuation goes down. As soon as we buy in, the business improves, and the valuation rises for the new owner." I was shocked, because a lot of people may think that, but they don't often verbalize it. Again, stay focused on running your business.

Know what exit structure works best for your situation. Business owners may see growth ahead but still want to take some chips off the table right now. In this case, an earnout might make sense. Whereas if the business results are consistent year in, year out, the sellers don't need an earnout or material contingencies. The nature of the business and what you're projecting will impact how you get out.

Sherod: I always think of organization and really how can we best make the due diligence process efficient and thorough both for the buyer and the seller. It could be as simple as keeping good corporate records. Contract administration always seems to be the biggest issue that comes up day to day, because it hits a lot of different areas, for example, third-party consent issues. I'm thinking of a couple of deals we've done in the past year, where we've had an auction process that got put on hold. It gave the client an opportunity to get super organized and when they restarted, being organized really helped the process.

Ross-Hanson: Often clients ask, "How soon? If I want to get my company ready for sale, how soon should I begin this process?"

Bonahoom: In an ideal world, from the day of inception. I work with quite a few high-growth, startup companies, and we build that exit planning process in from day one. But ultimately, that's not the case in a lot of businesses. So we generally say, first of all, if they're transitioning to the next generation of leadership, if they're not ready, you're going to need more time to get them ready. A general rule of thumb is five to 10 years if you are transitioning to a less experienced "next-generation" leader or leaders and three to five years for others.

Hislop: I think one of the things that prohibit sellers from pulling the trigger is that they're scared of due diligence. I've talked to a couple of sellers who have been through a terrible time and the transaction didn't go through and they come back and say, "I'm not doing that again." So part of that preparedness is not being so afraid, and getting the business ready and knowing what to expect in the due diligence period.

Ross-Hanson: A major challenge business owners face when selling a business is not knowing what to expect during the process. Which likely contributes to the low percentage of actual successes from companies going to market.

Crane: I was working with a company this week that is projecting its sale 12 years out. Most companies don't do that, because the valuation of the business often changes dramatically or accelerates. A rapid valuation increase creates the opportunity that now is the right time to exit the business, or a realization that someone else is better able to take it to the next stage, because they are at the limit of how big we can grow the company. Often, these business owners are serial entrepreneurs. They will want to pursue other ideas and businesses that they can drive and grow, as well.

Bonahoom: If you build a mindset around continuously understanding and increasing value into the strategic planning process, then those leaders are used to thinking about it even though they may not be ready.

Hislop: Econ 101 is"buy low, sell high." When the business is going really well and is very profitable is when sellers typically don't want to sell. When things aren't so rosy, and the business is less profitable is when they decide to sell, and that is the opposite of what they should do to get the maximum value for the business.

There's no better example of that than December 2019, pre-Covid. We had discussions with several large multimillion dollar restaurant owners who weren't quite ready yet, because business was booming. Today, post-Covid, we are discussing selling as an asset sale for pennies on the dollar. That missed opportunity brings a tear to your eye.

Crane: A lot of times, when a seller is involved in a process like this, they don't take all their chips off the table. They're reinvesting maybe 25 to 30 percent, in rollover equity, allowing them to stay in the game, but also securing their financial future.

Ross-Hanson: What are some common mistakes to be aware of when contemplating a transaction or exit?

Bonahoom: There are three key areas business owners overlook when they're trying to buy or sell. The first is that they might think about their goals but not the goals of the market or the target customer after that transaction. That's particularly important when there are earnouts. The seller needs to be invested into the long-term strategy and growth of the company. I think the second area is thinking about integrating both cultures and market segments. I have seen many integrations cause significant challenges because the buyer and seller weren't intentionally thinking about how to effectively integrate these two areas after the sale. The third area is the avoidance of the softer side of the transaction. The process gets very emotional. It is important for the owner or owners to really make sure they're thinking through the vision after that transaction, and how they are readying their hearts and minds for something different. If business owners spent more time thinking about those three things, we probably wouldn't see as much friction as we do during and after the sale.

Sherod: I think it goes back to due diligence. Issues raised in due diligence can certainly negatively affect the transaction. It's good to identify those issues as early as possible; we've worked on deals where a negative issue comes up later on in the process, and that's never good timing, because people have already factored in what they see as the material issues.

Hislop: Every business has its flaws, and I guess it is probably human nature to not want to disclose those prematurely. So for example: If a business lost a major customer and the owner decided to not disclose that fact to the buyers until the very end of due diligence, the buyer might decide to back out of the deal or want a substantial discount, as compared to disclosing it right up front before an offer is made, [the buyer] might say, "Not an issue; I still want the business." I guarantee you the longer the period of time before disclosing problems the bigger negative financial impact.

Crane: I think problems are a little bit like salad: They don't get better with age. Due diligence processes now are so sophisticated that with any reasonable deal team, they're going to surface those issues. Thinking that you'll bury them is just not realistic anymore. We help sellers identify and correct these problems through sell-side quality of earnings assessments.

Having a seasoned deal team is very helpful. Selling a business is not a routine thing in life. You bring in professionals because they are experts. They also can do things for you that you can't or don't necessarily want to do. When you need to work with the buyer after the sale, you want somebody like Scott or an investment banker negotiating on your behalf. Sellers want to preserve their relationship with the buyer.

There is a lot of anxiety about life after a sale at some point. Sometimes it's enough to get them to talk to other people who have sold their business, so they have an idea of what happily ever after looks like. And often, your advisers can connect you with people who have been in your position.

When sellers don't run a process, they tend to suffer deal fatigue. They get locked in with one buyer, without a plan B or

C. They don't feel like they can change course. By running a professional process where you have multiple buyers or bidders in the process, it often leads to the best results.

Hislop: Another thing along with that is breach of confidentiality. You get to the three-yard line and there's a breach, and word gets out to your people, employees or customers, it's like you're committed to that buyer and probably not for the same price you agreed to.

Ross-Hanson: So when you talk about deal fatigue, does it differ by industry or age? What is the general timeline before we start to lose our negotiating position?

Hislop: I think the important thing there is to keep your options open, and keep competition. The best thing to prevent deal fatigue is knowing that there's somebody else at the door. When you're at an impasse with a buyer or seller, the ability to say, "I have another option," goes a long way.

Bonahoom: A lot of deal fatigue comes because the buyer and seller are at a standstill due to stubbornness or lack of a clear vision from either side. The business owners who have taken the time to prepare typically don't experience that deal fatigue as much.

Sherod: Having professional advisers on all sides of the transaction just helps that process. I always ask early on who's representing the other side, because I want competent counsel on the other side for that reason.

Ross-Hanson: Owners are sometimes hesitant to bring the necessary expertise to the table. How do we help owners get past those hesitations to divulge their true objectives or hire the expertise they need?

Crane: Successful entrepreneurs have run their businesses very well, gone against trends, and become the experts in their business. Sometimes it's hard to let other people in, because they're so self-reliant and often cost-conscious. They're looking at some up-front fees or what the cost may be, but when you're talking about a multiple of five or seven on EBITDA, small things you do have a significant impact. Positioning your business is crucial. Without getting professional advice, you effectively give money to the buyer.

Hislop: Life goals are something I always ask about: What are your goals after you sell your business? Some people will be very detailed on what they want to do with the next five or six years, and others say, "I hadn't thought about it." Most business owners are good about setting goals for their business, but not so good about setting goals for their own life.

Sherod: For me, it's finding the trusted adviser, and it may be a financial adviser or an attorney who doesn't have M&A experience but has a close personal relationship with the client. Being able to explain to the client the value that you're bringing, the value that the investment banker is bringing, because it's a team effort.

Ross-Hanson: How do you advise business owners to handle those unsolicited offers?

Sherod: Do you have the time to be distracted from your business to entertain those discussions? Because they're not typically just over a lunch. They're a commitment, however far it goes. At the end of the day, you don't want to get distracted from the task at hand, which is running your business.

Crane: There's a lot of people and a lot of money that are fishing and looking for deals. Somebody will approach them with an offer, offering few details and sellers go exclusive. That gets things rolling, due diligence begins before sellers realize their true value and that they really should run it through a process. Sellers start to feel like they're too far in and don't want to back out. That's where the whiplash comes into play, the deal fatigue. If they had run a process on the front-end and been more strategic when it comes to identifying the right buyer, they can get a better result. Consider your options. Is it a strategic relationship that would help you grow and expand your products, improve delivery and logistics? Private equity appeals to many sellers as they build platforms around sellers' business. Hiring an investment bank also lets buyers know you are serious about selling and that a deal will likely get done.

Ross-Hanson: I had one client who passed along an email from a solicitor and he said, "Too bad I don't have the value where I want it." Michelle, what are some primary ways for an owner to prepare or enhance value before, during or after the transaction?

Bonahoom: The biggest thing is having a sense of what your endgame is. What do you want it to be after you're out of the organization? How do you need to align the market? What are the right value drivers? Are you emotionally ready to transition? I have clients, too, who want to respond to these opportunistic inquiries, and that might be healthy in some cases, because they can be educated about the process, especially if they do have a transition team supporting them. But without that clarity of what they want, then it becomes very emotional quick, and then it becomes about this transaction that they maybe weren't ready for. If you don't know what you want at the end, you're going to pull the wrong triggers and spend too much time and resources building your organization in the wrong way. I always recommend that clients start with what they think they want. Then go from there and get it 80 percent right, and then when you're really ready, make sure you have that team in place.

Hislop: My daughter told me the other day, "Dad, logic took a hit in 2020." Business owners need to be logical. Is it logical

that someone's going to pay me 15 times multiple of EBITDA for my business? Is it really worth that? Unless there's a strategic advantage for the buyer that makes two plus two equal 12, buyers want three things: a return on their cash invested in the purchase, to be able to service the debt on the money that they've borrowed to buy the business, and if they're going to work in the business, a decent salary for their time and effort. If the historical cash flow of the business does those three things, the business is probably priced right and will sell. If it doesn't, it probably will not.

Ross-Hanson: I read the other day that private equity firms had more than $1.7 trillion of dry powder heading into calendar year 2021. And that the most common obstacles to deal flow going forward include economic and political uncertainty, the availability of quality acquisition targets, buyer competition, and valuations. What are your predictions for M&A activity going forward?

Sherod: I'm bullish on deal flow, valuations, all of the above. I think there's a lot of money on the sidelines. In a lot of the industries that have been hurt by Covid, the trend lines can only look better in 2021. A lot of my clients are in manufacturing, and in general, manufacturing has done very well over the past 18 months. So I look for continued strong deal flow and valuations, no big clouds on the horizon. I'm knocking on wood super hard.

Hislop: I share your optimism. We've never been busier with deal activity than we've been in the past month. As a state, we want to make sure we're business friendly and attracting and maintaining businesses. But in general, I agree. The financing opportunities we have and the chances that people have to buy and own or acquire a business have never been better.

Bonahoom: As a value growth and M&A adviser, I'm seeing quite a bit more opportunistic buying. From a selling perspective, I'm seeing sellers, potential sellers and business owners who are tired, and they're starting to think more seriously about transitioning out. Currently, I also am an interim CEO of a high-growth indoor ag tech manufacturing company. We're seeing a significant increase in the amount of investment dollars coming into that industry, so I'm excited to see the opportunities that didn't exist previously. Buyers and investors are being very opportunistic in high-growth industries and with companies that are ready. The biggest thing that business owners need to be cautious about is are they agile? Have they been able to pivot? I think investors are really going to be looking for opportunities to make one plus one equal 10, and there are definitely those companies out there.

Crane: I think 2021 is going to be a very busy year for companies that are selling. The past year has been challenging and stifling without seeing family or traveling. Owners are thinking about what's next in their lives and enjoying the next phase. Some of the potential tax law changes are going to drive sellers. The capital gains rate is potentially increasing almost 20 percent. So, selling before a tax law change could leave more proceeds for sellers, as well as fetch a higher valuation.

Being able to show how resilient your business was in 2020 is key, and some businesses have really prospered. It doesn't mean they've had a record year, but they weren't down by 30 or 40 percent. This is revealing. We're busier than we've ever been, helping owners and leadership teams evaluate their strategic alternatives.