

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 Kyle Orwick, partner, Eide Bailly; Ailana McIntosh, attorney, Hellmuth & Johnson; and Corey O'Connell, manager, Boulay Transaction Group. Dyanne Ross-Hanson, president, Exit Planning Strategies, served as moderator.

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MODERATOR



DYANNE ROSS-HANSON

President

Exit Planning Strategies

Dyanne Ross-Hanson is President & Founder of Exit Planning Strategies, LLC. A firm dedicated to helping business owners navigate the most significant financial transaction of their lives, exiting their business. She works with owners and their Advisory Team who are 3-10 years from divestiture in capital

and/or contribution. Helping to evaluate options and to create an Action Checklist. So that owners can depart on their terms, to their party of choice and for the dollars they deserve.

PANELISTS



AILANA MCINTOSH

Attorney

Hellmuth & Johnson

Ailana McIntosh is a partner at Hellmuth & Johnson. She has extensive legal and business experience representing clients in various transactional related matters, including commercial and residential real estate, for-profit and non-profit entity formation and governance, business mergers and acquisitions, and

commercial contracts. Ailana's clients include small, medium, and large businesses, financial institutions, service industries, professional advisors, real estate developers, non-profits, and individuals. Her experience as a former litigator, coupled with her entrepreneurial background, and her excellent negotiation and drafting skills prove to be valuable assets to Ailana's client's legal challenges and objectives. As a business owner who comes from a family of entrepreneurs, Ailana understands the realities of business management, the need to keep costs low, and the considerations involved with every business and legal decision. Her favorite part of practicing law is diving in to learn the ins-and-outs of her clients' businesses and becoming a partner in their journey to success.



COREY O'CONNELL

Manager

Boulay Transaction Group

Corey O'Connell is a Manager in Boulay's Transaction Group with a focus on business valuation and divorce financial services. He specializes in business valuations for small- to middle-market companies performed for a variety of purposes, including marital dissolution, shareholder disputes, estate

planning, M&A, SBA-lending, ESOPs, and management planning. Additionally, Corey's divorce financial services focus on complex marital dissolution matters involving self-employed individuals and closely held businesses. As a CPA with business valuation credentials, Corey leverages his accounting and finance background to bring valuable insights to his clients. In his free time, Corey enjoys spending time with his young family, golfing, and playing fastpitch softball and broomball. He is the treasurer and a board member for the Family Law League and is an active member of the Minnesota Association of Business Valuation Professionals and the American Society of Appraisers.



KYLE ORWICK

Partner

Eide Bailly

Kyle Orwick is a partner with a top 25 accounting firm, Eide Bailly. He specializes in transaction advisory with an emphasis on buy-side due diligence and sell side quality of earnings (QofE). He has 15 years of experience in public accounting with more than a decade of those advising private equity,

investment banks and strategic investors on mergers and acquisitions. Kyle spent three years in Germany working on cross border deals before returning to the United States and formalizing due diligences services for Eide Bailly. Typical deals Kyle advises on range in enterprise value of \$10M to \$250M. Kyle spends most of his time in manufacturing and distribution, business services, consumer products, construction, and healthcare. In addition to buy-side and sell-side QofE, Kyle advises throughout the transaction including net working capital and on the purchase agreement negotiations. Kyle's goal is to ensure his clients get a well thought out transaction.

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Dyanne Ross-Hanson: The M&A and financing markets experienced significant change in 2022 as companies faced financing challenges, interest rate increases, pullback on leveraged financing, and bond market jitters, and the possibility of a recession. The total value of deals globally in 2022 fell almost 37 percent from 2021's record-high M&A activity. That's the largest year-over-year percentage drop since 2001. Corey, have you seen economic conditions impact your firm's M&A activity?

Corey O'Connell: In the lower middle market, we are not yet seeing a drop in the number of deals going under Letter of Intent ("LOI"). Deals are moving slower with buyers becoming increasingly focused on recent periods and how current economic conditions may be impacting the business. Layering this on top of other common deal dynamics, such as working capital negotiations and deal structuring, is extending timelines and can result in deal fatigue for both buyers and sellers. However, we are seeing both parties remain motivated enough that deals are still getting done even in situations where a re-trade may be necessary.

Ross-Hanson: Kyle, how about you? Have you noted any major roadblocks that are difficult to overcome or can kill an M&A deal?

Kyle Orwick: We're seeing that a lot of deals are just moving slower, with buyers trying to be more patient in the deal process; often they are looking at financial information with two or three monthly or quarterly refreshes. A lot of times, results don't come in as planned and then there are buyers being more creative with the structure. They might re-trade the deal to have some of the

purchase price be based on earnouts or seller notes. Buyers may have to put more equity into it or may be looking for a second strip of equity from somewhere else. But things that might kill a deal - When you go to market with different value expectations, that can quickly turn a deal upside down. Other things could be cost increases [or] people's expectations of commodity prices and how that impacts other deal mechanics like working capital. There's a lot more moving parts now that can turn things sideways.

Orwick: If you were trying to sell a company in 2021, there was a high chance of getting the deal done. I think a lot of these deals are still going to get done; they're just taking an extra three to six months.

Ross-Hanson: Ailana, have you seen any change or trend in the activity in comparison to previous years?

Ailana McIntosh: M&A activity has slowed a little bit. We've been lucky enough to have had a few transactions where our clients were able to self-finance or negotiate seller financing. I've also seen this in the real estate sector; there have been more transactions involving seller financing, like contract for deeds. The slowdown is evident to our M&A group, but so far it hasn't impacted us too badly.

Ross-Hanson: While 2021 was, for many, considered a seller's market, many would identify 2022 as a buyer's market. Buyers were more cautious. Multiples also fell to a 10-year low in 2022. Corey, why is valuation such a significant part of the M&A transaction? And have private deal valuations also been impacted?

O'Connell: In an M&A transaction, the valuation process is conducted by both the buyer and the seller. The buyer wants the lowest price possible; the seller wants the highest price. It's such an important aspect of the deal because the buyer and seller have to come together on a value. Having realistic expectations of the value of the business helps them reach a final transaction price.



In terms of private deal values, I think it depends on the business. Multiples have definitely come down, but certain industries and very profitable businesses are still commanding high multiples.

Ross-Hanson: Kyle, what do buyers usually key in on while performing due diligence? Are there risks that buyers look at that could discount their price offer?

Orwick: Whether it's technology diligence, HR, financial, tax, legal, there's a plethora of diligence streams. A lot of times, we see buyers coming out of the gate with financial diligence. Before they turn all the advisers loose and incur a lot of costs, they want to make sure the economics of a possible deal makes sense. So, they're really keyed in on financials right away. How good are the numbers they're looking at; how much can they rely on them? Things that may discount or undervalue a business would be any types of concentrated risk - products, customer, maybe there's [a] supply chain risk. If the business isn't very well professionalized, they could be turning a lot of cash flow out. But maybe there's a high need for CapEx to take the business to the next level, which most buyers are looking to do. They could have a high need for

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- AILANA MCINTOSH

technology in parts of the business, or they might need to build a better and more professionalized management team.

O'Connell: Also, buyers want to buy a business that isn't dependent on the owner. So, the more professional the management team in place, the more desirable the business will be to buyers. However, it's much better for the company and for the owner if this independence happens before the company goes to market.

Ross-Hanson: Ailana, when should owners, buyers, or sellers consider getting their legal counsel involved in a transaction?

McIntosh: As soon as negotiations begin, ideally. Skilled M&A attorneys can assist with forming the proper deal structure, providing guidance on material terms and conditions that should be included in the letter of

intent, and identifying any risks or liabilities at very early stages, which will essentially help the parties avoid a lot of obstacles and heartburn later down the line.

Ross-Hanson: Why would the parties to an M&A transaction choose to utilize an executory period?

McIntosh: An executory period is the timeframe between when the parties sign a purchase agreement, and when they close on that transaction. The executory period might be necessary where you need to get third-party consent to the transaction. For instance, when there is a regulating body that oversees one or both of the parties, such as a financial institution. The NCUA or the FDIC may need to approve the transaction. Or you might have a material contract that needs to be approved before it may be assigned to the buyer. In those cases, the interested

third parties may want to see a signed purchase agreement and understand how the terms work before they consent to the transaction. If the purchase agreement scenario requires an executory period, counsel for the parties may incorporate into the purchase agreement certain contingencies upon which, once satisfied, the transaction would close. If the contingencies are not satisfied, the purchase agreement would terminate.

Ross-Hanson: It makes sense that these may be applicable within some industries more than others.

Orwick: We're working on one right now. A week before this deal was supposed to close, the financing backed out. So, they're going to secure the financing over the next couple months. It's going to be a delayed closing, and there are some contingencies if it doesn't come to fruition. Getting financing isn't as easy as it was before, even in healthy deals.

Ross-Hanson: Preparation for an inevitable ownership transition is essential. Corey, how do business owners best prepare themselves and their companies?

O'Connell: You likely can't just show up and say, I want to sell my

business next month. Ideally, you want to be thinking about it for years. What is your succession plan? Who would buy the business? Is it the next generation—are they looking to take over the business? A lot of millennials and Gen Z are not looking to take over the family business. What's going to happen to these businesses? There's an opportunity for buyers or entrepreneurs looking to make investments in these businesses, because right now, there is no one lined up to take over.

Orwick: There are certain things you should do when you're over two years in advance, when you're within two years, and [when you're] within six months. The longer [the] horizon of planning, the better you can prepare for things like for estate and trusts, getting more seasoned management teams in place, professionalizing your technology, and thinking about your potential buyer. Is it a strategic buyer that's just going to want your product line? Is it a private equity

group that's rolling up your segment or could you be a platform acquisition for them? Preparation should also include reading, going to conferences, and looking at some M&A advisers who can coach you through what an M&A process or a family business transition may look like. Surrounding yourself with a good team is first and reaching out to people you trust who can make introductions to people they trust is critical. The longer you have, the more you can make fundamental changes that will increase the likely proceeds and the buyer universe.

McIntosh: I second Kyle's comments about building a team of M&A professionals early on. Sellers should allow ample time to interview lawyers, CPAs, and other advisers. It takes a lot of time to build that team, and you want to select the right people. From a legal perspective, the seller should be cleaning up and organizing their documents and getting contracts and

other due diligence items that buyers would be requesting in order. Getting really organized on the front end is imperative, so that they can continue to operate their business while they're trying to sell their business.

Ross-Hanson: Internal transitions often take a three- to five-year runway, I find. As internal buyers are challenged by the fact that they rarely possess the financial ability to make acquisitions. Corey, given the current challenges in the M&A marketplace might there be opportunity for buyers?

O'Connell: I think there is. The fierce competition and high valuation multiples over the past few years has maybe stymied the efforts of companies looking to make acquisitions. M&A tends to slow down during times of uncertainty or market volatility, but it could be a great time to buy as valuations become more attractive. Plus, with deals done during an economic downturn, there's more runway. You can get a better return on equity, you can get maybe out-sized growth. But, I don't think you can really ever time the market. You just always want to be thinking strategically about the future of the business, and I don't think you can necessarily sit on the sidelines because interest rates are going up or valuations are high.

Orwick: From a buyer perspective, you have maybe slightly lower multiples, but there's still a lot of available capital, and buyers are looking to deploy that capital. The great companies are still going to go for high valuations no matter what interest rate market we're in. But the companies in that next tier, maybe they don't have a management team fully built out. A lot of the private equity groups we work with are looking to invest first institutional capital into the business. They're looking to grow that management team and bring them to the next stage. So, it gives them an opportunity to buy those companies at multiples that they feel confident in.

Ross-Hanson: If you could be so brave as to make a forecast for 2023 and beyond, what might you see going forward in the M&A market?

Orwick: The Fed only raised rates a quarter [percent] yesterday. I think Q3 and Q4 will open things up a little bit, not [to] where they were in 2021, but maybe an average of where it was over the last decade. Not as high of multiples, necessarily, but the activity will be healthier.

O'Connell: While we're no longer in a near-zero interest rate environment, interest rates are still lower than they have been historically. So there is reason to be optimistic. And interest rates don't drive everything.

Ross-Hanson: Any other words of advice for the merger and acquisition marketplace and our readers?

Orwick: Anytime you go to market — and this helps in the value expectations — know your growth story and your growth plan and projections really well, so you can relay that to buyers. Getting a sell-side quality of earnings as part of sale preparation is key because it outlines your growth story and what adjusted EBITDA is. Then, you can make sure you're in sync with any given buyer on that number, but you can also correctly outline how you got to that number, and where the sales growth and the mix has come from. In an environment like we're in right now, increasing prices across the board and how that has impacted the financials and whether that's repeatable or not, we find that critical for a successful sale. Maybe a business has been able to pass on prices quicker in advance of input prices going up. So, they mark up their end price to the customer, but that input price maybe doesn't hit them for two to six months. That's just one example. A really detailed analysis of earnings is critical so buyers can rely on that growth story and have a good indication of the future.

Ross-Hanson: You've all mentioned that having a team in place is important. What does an ideal M&A team look like, for our readers who haven't gone through this process before?

Orwick: It starts with people in your circle you've built trust with. What's critical is getting really specialized

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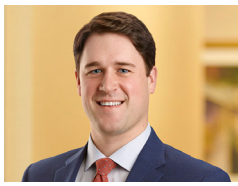
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expertise. I always give credit to investment bankers, broker, or sometimes attorneys as quarterback of the actual transaction. Then surround yourself with people who know transaction-related work, for example, accounting and finance.

O’Connell: The M&A world is just too complex, for even seasoned professionals to know everything. So, you have to have a strong team in lots of different areas. Investment bankers, CPAs, attorneys, ownership transition professionals; there’s just a lot to do. I know people don’t want to incur the cost sometimes, but their input is valuable to get the most out of your deal. Now is not the time to cut corners. Selling a business is probably the biggest transaction that anyone’s going to go

through, so you need the proper team in place.

Ross-Hanson: And typically, owner’s only have one time to get it right. For most owners, their business is their largest financial asset. Trying to do a DIY transaction just doesn’t make sense. Associated cost for the team is minor when compared to the leverage they bring to the process and ultimate sale price.

O’Connell: Right. And I would hire the exact same team of professionals. I wouldn’t be doing it myself, that is for sure.

Ross-Hanson: Absolutely. Any other concluding thoughts that anyone would like to share?

O’Connell: While M&A may be slowing, like we’ve said, quality

companies should continue to find interest. Any business owner looking to sell in the next two years should definitely be planning ahead. In general, owners and management always have to be thinking about what the company does and what the market is going to look like in the future. We can’t predict the future, but planning alone puts you a step ahead from other businesses, where they’re so busy running the business, they’re not thinking strategically.

Orwick: I don’t think we’re going to be in a buyer’s market for very long. Within the next two to three years, it’ll turn back to a seller’s market. So, take the opportunity now as a seller to do that strategic planning and preparation.

McIntosh: Timing and strategy are really important, particularly for

sellers. Sellers should be looking at their material contracts and deciding whether to time their market listings for when their material contract is going to terminate. I’ve worked on a few transactions where termination of a material contract was necessary but it was going to be extremely costly, and that was a roadblock to the transaction. I’ve had some clients that were considering posturing themselves for sale, but they only had one really strong financial year, and that can be difficult to sell. A strong financial track record of several good years will help a seller get more interest and a higher value for the business.

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