It's a Buyer's Market: This Is the Year to Expand Your Business Via Acquisition

June 23, 2020

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A FEW NOTES

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QUESTIONS

If you have questions during this presentation you may submit them through the Q&A button or email them directly to aschroeder@dcapartners.com

AGENDA

1

Speaker Introductions

2

Preparing the Team and Setting Goals

3

Typical Process

Post COVID19, the typical process will be different

4

Post-Close Integration

5

Financing Options

6

Questions

WHY MAKE ACQUISITIONS?

Offensive

- To acquire market share
- To access new markets
- To expand distribution
- To gain economies of scale
- To obtain intellectual property or talent
- To broaden product / service offering
- Vertical or horizontal integration
- To leverage core assets
- To expand capacity

Defensive

- To eliminate a competitor
- To acquire "Brand" equity
- To gain technological superiority / avoid obsolescence
- To diversify your risk profile
- To avoid IP infringement
- To ensure continuity of key business partner
- To back-fill strategic voids
- To ensure long-term competitiveness (scale)

" CEOs, CFOs, and heads of strategy and corporate development need to think strategically now about the 'new normal' and which acquisitions would be accretive to their current business models."

E&Y, May 2020

WHY NOW?

- Availability of inexpensive capital
- Market-driven valuations are down 15-20%
- Many would-be competitors are looking inwardly, as opposed to searching for opportunities,
    - however, some highly opportunistic competitors will use this as an opportunity to gain an advantage over you.
- Many highly-strategic acquisitions may be:
    - Less expensive due to both earnings AND multiples being lower
    - More amenable to exploring a sale given financial and emotional strains
    - Need to sell, i.e. accelerate exit planning, due to changing market conditions / near-term balance sheet stress
- Operational and strategic synergies

" Businesses are, or should be, examining their existing lists of potential acquisition targets and should be prepared to act, as deal premiums are likely to come down and assets that companies had been reluctant to sell may become available

But the window for maximizing value could be relatively short, if history is any indication…".

- Harvard Business Review, May 2020

WHY NOW?

Deal Multiples, 2000–2020

An examination of deal multiples — the ratio of enterprise value divided by EBITDA that is used to determine a company's value — during the 2008 financial crisis suggests that valuations that have or will decline during the current downturn are likely to bounce back somewhat quickly.

Note: EBITDA — short for "earnings before interest, taxes, depreciation, and amortization" — is a measure of a company's financial performance.
Source: EY analysis and Dealogic

HBR

" History suggests, that there will be a relatively short M&A window that opens as the Covid-19 crisis ends, during which bargains will be had by those with the liquidity and the risk tolerance to move quickly, and who have done their homework in advance."

- HBR, May 2020

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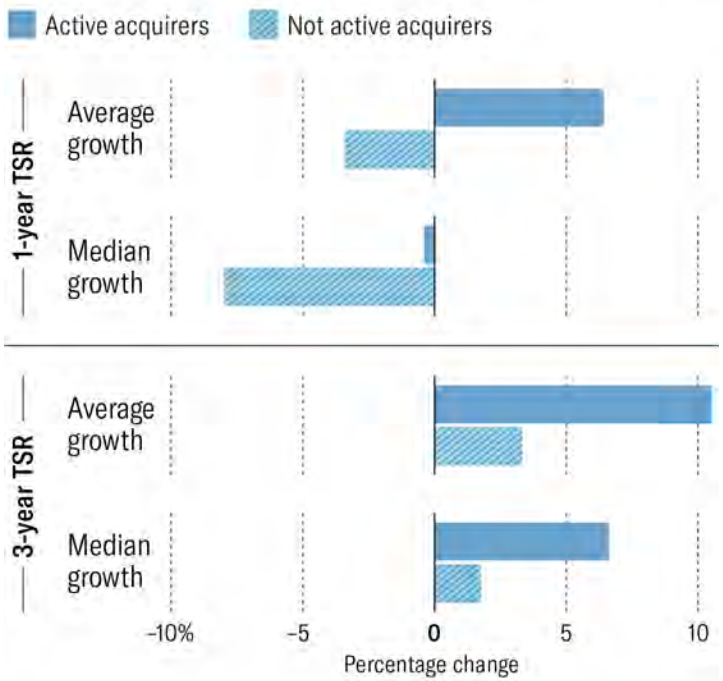
WHY NOW?

Total Shareholder Return (TSR) Growth by Acquirer Type, 2007–2010

Firms that made significant acquisitions during the 2008 financial crisis outperformed those that did not.



Note: Analysis of companies on the 2008 Fortune 1,000 list; excludes financial services, real estate, and companies where the share price was unavailable on Jan. 1, 2007 and Jan. 1, 2012
Source: EY analysis, Capital IQ, *Fortune*

HBR

- Companies that made acquisitions totaling at least 10% of their market cap from 2008 through 2010 (active acquirers) had an average TSR of 6.4% from January 2007 through January 2008, compared with negative TSR for less active companies.
- The trend continued over the period of January 2007 through January 2010, when average TSR was 10.5% for active acquirers, vs. 3.3% for less active companies.

- HBR, May 2020

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AVOID THE TRAP OF ONLY LOOKING AT COMPANIES "FOR SALE"

Many companies simply respond to "for sale" solicitations as opposed to pursuing a deliberate, strategic acquisition process

THIS RARELY LEADS TO OPTIMAL RESULTS

To Maximize Results:
Acquisitions should be **<u>Strategic</u>** and not just Opportunistic

STRATEGIC ACQUISITION PROCESS

Managing the key stages of a successful acquisition process

1. Set the Goals and Scope
2. Target Search, Screening and Outreach
3. Negotiate the Terms
4. Identify and Mitigate Risks
5. Closing and Integration

DEFINE YOUR OBJECTIVES

1 — 2 — 3 — 4 — 5

Key Elements

- Identify the strategic benefits desired
- Build a solid business case for investment
- Gain internal buy-in and consensus
- Develop ideal target profile
- Identify show-stoppers
- Establish budget and financing sources
- Assemble team
- Establish evaluation criteria and process

Role of M&A Deal Team

- Facilitate strategic discussion and exploration
- Develop ideal target profile
- Conduct financial modeling and assess available capital
- Assist company in identifying alternative financing sources
- Develop project plan and reporting cadence
- Prepare for legal requirements of the deal including purchase agreements and regulatory hurdles

SEARCH, SCREENING AND SOLICITATION

1 — 2 — 3 — 4 — 5

Key Elements

- Identify potential Targets using databases, relationships, store walks, institutional calls, 3rd party data sources , trade show visits, known targets/competitors, etc.
- Analyze attractive Targets to determine best angle to pitch a sale
- Agree on outreach/contact program
- Develop Buyer Profile, Teaser, and Marketing Documents
- Select the top Target companies and pursue aggressively via multiple channels
- Develop methodology to quickly qualify / disqualify interested Targets

Role of M&A Deal Team

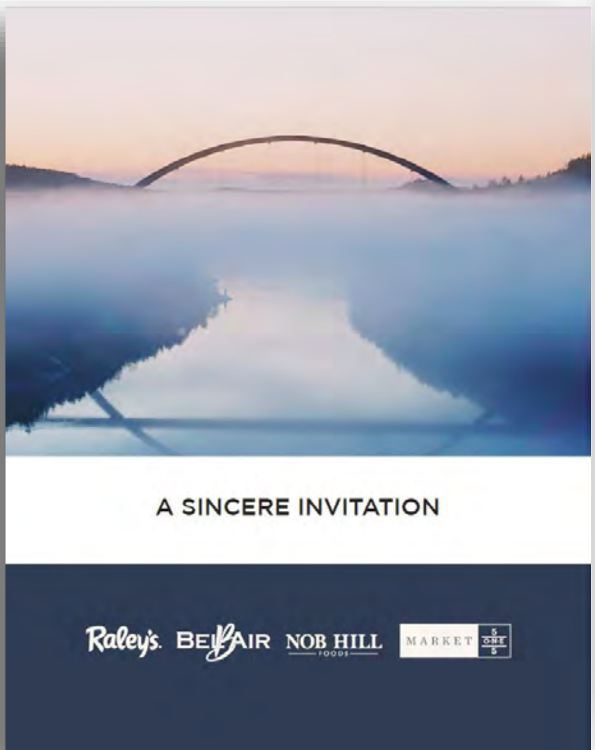
- Provide list of attractive Target categories, companies and/or products
- Research Targets and understand likely motivations to sell
- Effectively craft and articulate buyer value proposition
- Develop an efficient feedback loop for vetting potential Targets
- Conduct outreach to interested Targets
- Facilitate site visits and management meetings – Post COVID19, much of this may be done virtually
- Provide tracking lists, follow-up cues, and process updates

EVEN WHEN YOU ARE BUYING, YOU ARE SELLING!

Most sellers do not know what the process looks like or how to pursue it…make it easy for them

Most sellers care about the type of Company they sell to, and what that Company's plans for the future look like

At DCA, we have found that one of the most effective acquisition tools is a compelling "Company Overview" to help tell your story, explain your strategy, and outline the benefits of selling to you—and the process for pursuing it.



NEGOTIATE THE TERMS

1 2 **3** 4 5

Key Elements

- Understand both Buyer and Seller objectives and priorities – especially if sellers are exiting
- Structure the economic deal including non-cash consideration
- Price (and allocation thereof)
- Form of consideration and term of payout
- Representations and warranties
- Holdbacks and indemnities
- Balance sheet considerations (i.e. cash and working capital)
- Contingencies and walk-away provisions
- Employment and non-compete agreements
- Earn-out provisions
- Cash Free, Debt Free including liquidity considerations

Role of M&A Deal Team

- Understand what items are most important to management, and which items you can be flexible on
- Build relationship with Seller so difficult conversations are less adversarial
- Work to negotiate LOI terms with optimal Buyer terms that are also fair to the Seller
- Insulate Buyer and Seller from direct interactions which could become emotional and jeopardize the deal, or personal goodwill
- Help educate both Buyer and Seller on what "is reasonable" and bridge perception gaps
- Manage emotional aspects of selling

IDENTIFY AND MITIGATE RISKS

1 2 3 4 5

Key Elements

- Predictability of future performance – COVID19 Considerations
- Concentration risk (product, distribution, supplier or talent) - COVID19 Considerations
- Intellectual property (process, formulation, brand, etc.)
- Confidentiality
- Culture
- Hidden or contingent costs and liabilities
- Management Team is key, including who is staying
- Existing infrastructure
- Integration issues
- Legal issues
- Employment issues
- Macro trends

Role of M&A Deal Team

- Define key concerns and business risks
- Provide market knowledge and creative solutions to assess (and mitigate) business risks
- Organize due diligence data room to contain Seller disclosure of all material items
- Engage highly competent advisors with significant M&A experience to assess / mitigate other risks:
  - Legal, IP, accounting and tax – familiarity with each other is best
  - Environmental, employment and regulatory
- Negotiate representations and warranties to protect against identified risks and deficiencies
- Help assess integration and culture challenges
- Help structure indemnifications, earn-outs, escrows, holdbacks, offsets, etc.

ACQUISITIONS DURING A PANDEMIC

Deal making is anything but "business as usual"

Understanding what you are actually buying

- Adjusting earnings for COVID-19 impacts – Seller should prepare QoE or similar, Buyer needs to be prepared to analyze this report
- Adjusting earnings for PPP and other non-recurring items (positive and negative)
- Differentiating situational vs. systemic changes
- Evaluating both supply chain and distribution channel anomalies
- Understanding post-COVID restrictions and changes to business practices

Conducting Due Diligence

- Likely to take longer and be more restrictive
- Need to add evaluation of paradigm shifts and systemic changes to business models, supply chains and consumer behaviors

Post-Acquisition Integration

- Employees more likely to stay post-closing due to softer labor market
- They will also likely be more sensitive to the possibility of potentially losing their jobs, adding anxiety
- Integration may take longer
- Consider possible impacts (which may be positive) of remote and distributed workforce

CLOSING AND INTEGRATION

1 — 2 — 3 — 4 — 5

Key Elements

- Discuss and plan for integration well before Closing – should be part of the business case for investment
- Cultural fit and emotional management
- Strategic fit (not forced or opportunistic)
- Ensure a fair price at ALL points on the spectrum of potential outcomes
- Mitigate risks by getting Seller to absorb / insulate you from them
- Hold back enough of purchase price to protect against surprises
- Secure IP and intangibles
- Alignment of interests post-closing
- Secure key personnel, distribution, suppliers and customers
- Thoughtful/well-executed integration strategy

Role of M&A Deal Team

- Assist with Implementation and Integration plan
- Ensure thorough completion of due diligence and competent legal documentation
- Assist with financing plan
- Coordinate with external resources (legal, tax, insurance, wealth management, etc.)
- Continue to reaffirm benefits of sale to Seller; most deals die at least once along the way
- Continue to reassess merits of the deal to Buyer; don't let momentum make you close!
- Manage emotions related to the sale and negotiation process

FINANCING OPTIONS

- Balance Sheet Cash
- Line of Credit
- Standby Acquisition Credit Facility
- Company stock (or LLC interests)
- Seller carry-back notes
- Seller equity rollover
- Royalties
- Earnouts

WHO SHOULD LEAD THE CHARGE

- **In-house team**
  - Possesses the most industry knowledge
  - Targets less likely to disclose financial information directly to a competitor
  - Many companies can’t dedicate time and effort to assignments such as building a target list, conducting outreach and undertaking thorough due diligence around other responsibilities
  - Process and key deal points are not always thoroughly understood
- **Corporate development manager**
  - Potential option for companies that plan to commit several years to multiple acquisitions
  - Has experience with process and key deal points
  - Most common in dominant industry leaders
  - Requires the most financial resources (salary, health benefits, etc)
- **Investment bank**
  - Opens doors more effectively due to industry “anonymity”
  - Leverages management participation and communication to maximize results
  - Dedicated resource with M&A are their ONLY job (as opposed to a side job)
  - Presents legitimacy, allowing targets more comfort disclosing financial information
  - Demonstrates that the company is serious about making acquisitions, and not just “kicking the tires”
  - Can be terminated at will, and therefore the lowest risk
  - Often the toughest negotiator

CONCLUSION

- **Acquisition should be strategic and not just opportunistic**
    - Much as the BEST employees are not looking for a job, the BEST companies are typically not for sale
- **Many high-quality companies are considering selling during this time of uncertainty**
- **Valuations of selling companies are down, but may not stay down for long**
- **Debt is plentiful and cheap, driving enhanced returns for acquiring companies**
- **Companies that expand during market downturns outperform those that hunker down**
    - Overperformance is both near-term and long-term
- **Having the right team is critical**
    - Investment Banker, Attorney, Tax Adviser, Accountant, etc.
    - Critical in helping to attract the ideal targets and engage them in discussions
    - Critical to think through how to best structure the transaction
    - Critical in helping to conduct thorough and thoughtful due diligence
    - Critical to help negotiate attractive terms
    - Critical in getting the transaction over the finish line
- **The window of opportunity is open now…in times like this, strong companies become dominant companies**

QUESTIONS?

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