

A man in a tan work jacket and red shirt stands in a workshop, holding a tablet. The background shows large metal pipes and industrial equipment.

Transition Planning in Turbulent Times

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Who We Are



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Sessions Today:

This two part session will touch on thoughtful planning in company transitions and the current state of the M&A market.

Part 1 – Lisa Horn

- Understand why now may be a good time for a business transition
- Learn the key considerations when planning a transition (internal/external)

Part 2 – Robert Harrod

- State of M&A markets and impact of current environment
- Optimal preparation for ultimate transaction

Why Do You Believe Now Might Be a Good Time to Transition Your Business?

Enter your responses into the chat box

Possible Reasons:

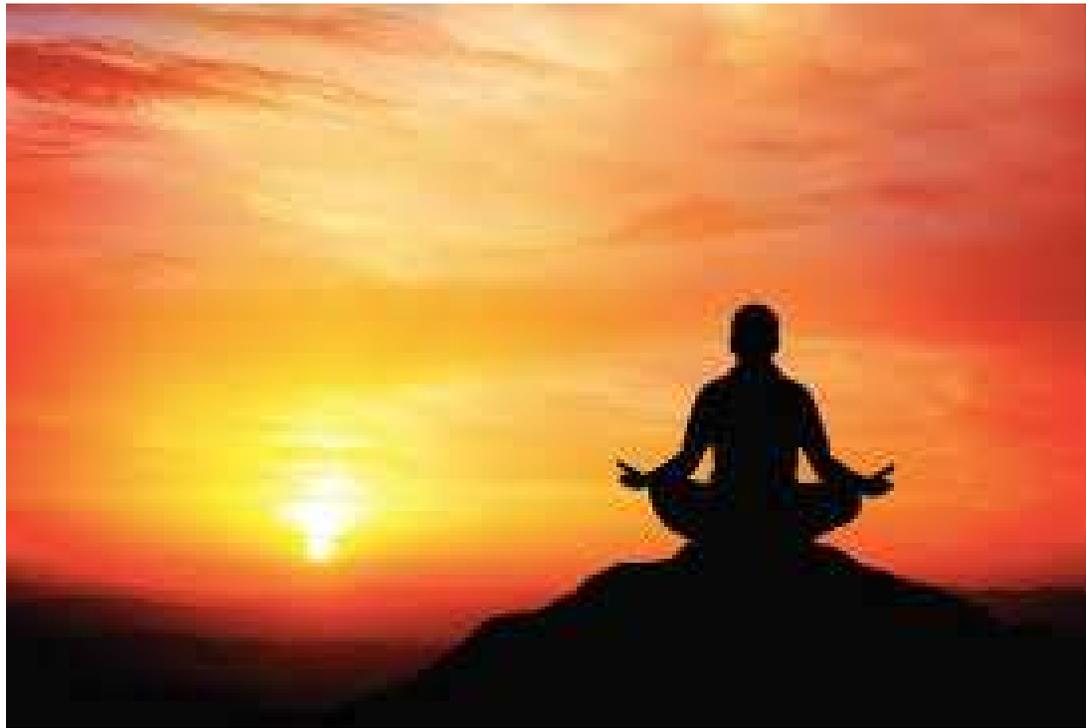
- Historic opportunity to transfer all or part of the equity in a family owned business, before the possible changes in relevant laws next year.
- Despite COVID middle market M&A did not completely dry up, the market has begun to bounce back sooner than expected
- Private equity has a lot of cash waiting to be reinvested (so do corporate buyers)
- Owners are shifting their strategies (some booming, some hit hard)

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Key Considerations When Planning Your Transition

“Peace of Mind”



Enter Your Answers Into the Chat:

- What is the definition of peace of mind to you?
- What words come to your mind?

Imagine in the Future That You:

- Will sell your business for maximum value.
- Will have realistic expectations about the value of your business.
- Will have the next generation prepared to run the business.
- Will have personal financial freedom when you transition.

Imagine in the Future That You:

- Will have a plan post transition (3rd Act).
- Will know that the values that the business was founded on are protected.
- And all key stakeholders (Family, owners and management team) are aligned on the business vision, mission and values.
- Will celebrate your transition – BEST DAY EVER!

Imagine in the Future That You:

Are in control of the outcomes of what can happen to you and your business versus the outcomes controlling you.....

Transition Planning

Is a process not an event.

- Personal readiness (3rd act)
- Personal financial readiness
- Business financial readiness and attractiveness
- Family/owner/management issues



Understanding Your Options

Inside:

- Intergenerational transfer
- Management buyout
- Shareholder buy-sell
- Sale to employees

Outside:

- 3rd party sale
- Minority equity sale
- Recapitalization
- Orderly liquidation

With Thorough Transition Planning

- You and your business are prepared to transition at any time
- You have realistic expectations
- Your family business has the ability to survive into the next generation
- The amount of regrets are minimal

It is Attainable



Part 2 – Robert Harrod

- State of M&A markets and impact of current environment
- Optimal preparation for ultimate transaction

Business Transition Considerations in Current Market

- Impact of COVID-19 pandemic on M&A markets and business valuations
- Considerations for “transition” options not involving an outright sale
- Regardless of transaction type or timing, COVID-19 has changed the due diligence evaluation process for businesses, and proper preparation for liquidity event will be critical
 - Operational preparation
 - Financial/Other preparation

Proactive preparation will be important in ensuring a smooth process and maximizing value

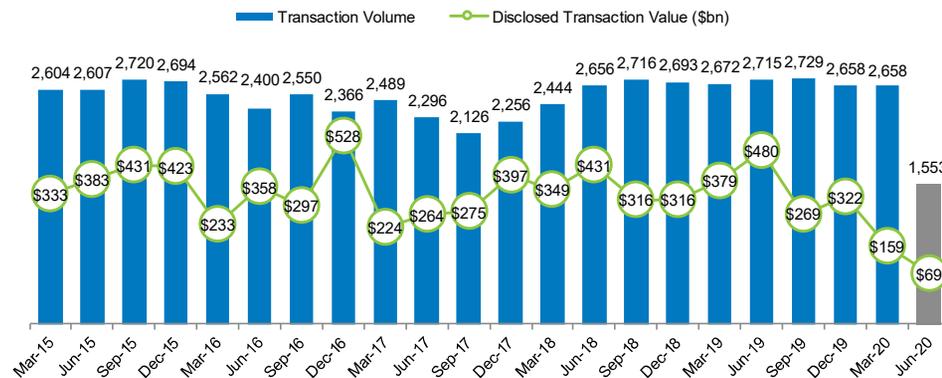
M&A Market Backdrop

- The COVID-19 pandemic has had a sobering effect on M&A markets
 - Business uncertainty, necessity for preserving liquidity, tough operating decisions and day-to-day survival have engendered “internal” focus
 - Impact on both sides of transaction – buyers more internally focused and/or looking to be opportunistic; sellers sitting tight, dubious of getting appropriate value
 - While sector-specific, business valuations overall have declined; outlook remains uncertain
 - For buyers, access to financing more difficult, with more stringent credit parameters... seeing higher volume of equity consideration & contingent structures (e.g., earn-outs, seller notes)
- Overall, uncertainty/internal focus, risk aversion, financing challenges and valuation misalignment have all contributed to broadly reduced M&A activity

M&A Market Backdrop (cont'd)

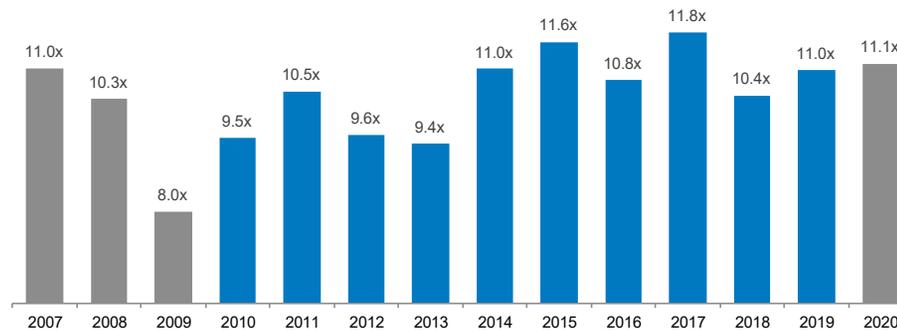
QUARTERLY ANNOUNCED M&A TRANSACTIONS

- M&A volume in Q2 2020 was down significantly due to the pandemic
 - Transaction volume for the second quarter of 2020 was the lowest since 2009, and was down ~43% Y-O-Y
 - Aggregate disclosed transaction value was also the lowest since 2008, and was down ~86% year-over-year



MEDIAN EV / EBITDA TRANSACTION MULTIPLES

- During the Great Recession, transaction multiples substantially decreased from a median EV / EBITDA multiple of 11.0x in 2007 down to a median of 8.0x in 2009
 - However, transaction multiples increased to near pre-recession levels within two years of the bottom in 2009
- There likely could be a short window of time during the current crisis to make acquisitions at discounts to bull market multiples
 - Therefore, now is a good time for companies with available liquidity to re-examine their list of potential M&A opportunities



M&A Market Backdrop (cont'd)

- Reasons for optimism - there is light on the horizon!
 - Green shoots have started to appear - deal volumes, although still depressed, have started to trend upwards compared to first few months of pandemic
 - Substantial capital remains waiting to be deployed, including private equity dry powder, which is near all time highs
 - Lending appetites will return, with more favorable terms
 - Quality assets will be in demand and competed for by both strategic buyers and private equity
 - Abundance of supply when the outlook improves - sale processes that were put on hold will restart, new companies will come to market
 - **However, timing of return to “normal” markets is anyone’s guess**

Considerations for Non-Sale Transition Options

- For transition/liquidity options representing an alternative to an outright sale, challenges exist as well in this environment
 - Transactions such as dividend/equity recapitalizations or leveraged share repurchases generally attracting lower levels of leverage... lenders view transactions as “non-productive” uses of capital
 - ESOPs (full or partial) – financing available for the right situations, but lenders generally more cautious
 - Minority equity sales – similar valuation dynamics as outright sale; also face issues relating to effective control and patience of capital
- Business owners should consider prudence of leveraging their company in this uncertain environment for “non-business” purposes that don’t contribute to either business viability or growth

Impact on Transition Process; Importance of Robust Preparation

- Regardless of transition option being considered, COVID-19 has changed the due diligence process, perhaps forever
 - Buyers conducting diligence with broader focus, enhanced level of rigor
 - Near term - operational and financial impact of COVID-19 will need to be delineated
 - Longer term - heightened focus on existence of business continuity plans to mitigate future uncontrollable events
 - Diligence may have to be curtailed, or conducted remotely
 - Flows directly into views on risk sharing, as further manifested in valuation, structure and legal terms/conditions
- **Proper preparation for a transition event is more critical than ever to ensure the optimal outcome**
 - Now is time to proactively think ahead and prepare for a transition in order to maximize value once the markets return
 - Demonstrate that business is strong, and built to weather future events

Transition Preparation – Operational

- Businesses should focus on **building or upgrading key aspects of their operations** in preparation for a transition event... build greater flexibility
 - Management team – lock down strong and committed team; upgrade if necessary; have succession plan in place
 - Establish strong contingency/backup plans for supply chain ecosystem; evaluate new geographies to diversify
 - Ensure that IT systems are bullet-proof, redundant and built for higher levels of remote work and online sales
 - Consider mix of full and part-time employees
 - Evaluate physical footprint of business (particularly if have non-US operations) - initiate plans for change if necessary
 - Establish clear plans/policies to ensure worker safety
 - Evaluate options for business interruption insurance

Transition Preparation – Financial

- In addition to operational preparation, **proper financial preparation is critically important** in anticipation of a transition event
 - Isolate financial impact of COVID-19 in current year (whether +/-)
 - Prepare multiple sets of 3-5 year financial projection scenarios, with ability to show impact of COVID-19 on growth, margins
 - Upgrade financial systems (reporting, inventory mgmt, AP/AR, etc.)
 - Show discipline in considering discretionary investments (capex, M&A); be opportunistic if have the resources
 - Consider executing on any accounting “clean-up” items (goodwill impairments, other non-recurring charges)
 - Monitor any recent tax or accounting rule changes that may offer relief related to COVID-19
 - Quantify non-recurring items or other adjustments

Transition Preparation – Other

- If have outstanding PPP loan, consider potential impact on deal structure and/or process timing
 - Transactions where >20% of common stock or >50% of assets are sold or transferred may require SBA approval and/or escrow
- Begin to consult with/engage outside advisors
 - Tax - optimal timing of a transition in context of upcoming election... both business and personal considerations
 - Accounting - begin work on quality of earnings analysis; identify and quantify financial adjustments, COVID-related or otherwise
 - Financial – if transition is full or partial sale, map out timing/scope of process
 - Discuss go-to-market strategies and potential acquirers/investors
 - Begin to develop marketing materials
 - Understand scope of diligence materials, evaluate dataroom providers
- If necessary, internal conversations to ensure shareholder alignment