

Preparing for a Successful M&A Transaction

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Overview

- Laying the Groundwork for Maximizing Shareholder Value
- Knowing your Objectives
- Understanding Your Options
- Minimizing Disruption to the Business & Maintaining Confidentiality

Laying the Groundwork

- If possible, start positioning the business three years before you would actually expect a sale to occur.
- The value of a successful, profitable distributor is primarily a function of profitability measured by gross profit, EBIT, EBITDA and/or net profit. Premium valuations are assigned to premium performers.....

Gross Profit Margin: Above 25%
EBITDA Margin: Above 8%
Pretax Margin: Above 3%

Take actions to boost margins without sacrificing long-term performance.

Laying the Groundwork*(continued)*

- Because the value of profitable distributors is earnings based, turn excess book value into cash. That is, try to improve asset utilization, especially inventory turns and Sales/Net Fixed Assets.

Asset Utilization: Electrical Distributors Medians by Annual Sales

	<u>\$5-10 M</u>	<u>\$10-25 M</u>	<u>Over \$25 M</u>
Cost of Sales/Inventory:	5.9	6.6	7.5
Sales/Net Fixed Assets:	41.9%	43.6%	42.7%

Source: RMA

Laying the Groundwork*(continued)*

Illustration

	<u>Current Business</u>	<u>Potential New Business</u>
Gross Margin	25%	18%
EBITDA Margin	8%	5%
Annual Sales	\$25,000,000	\$1,000,000
Inventory (6.6 turns)	\$2,840,000	\$124,242
Receivables (7.5turns)	\$3,333,000	\$133,000
Enterprise Value (Based on 6 times EBITDA)	\$12,000,000 (.08 x \$25,000,000 x 6)	\$300,000 (.05 x 1,000,000 x 6)
Value Added by New Business		\$300,000 -\$124,242 <u>-\$133,000</u> \$42,758

Laying the Groundwork*(continued)*

- Make sure financial statements are in accordance with GAAP. Some income tax minimization strategies are OK; it doesn't make sense to pay unnecessary taxes. But limit it to relatively large, easily identified items.
- Ensure a professional approach to all aspects of the business:
 - Management team
 - Information systems
 - Financial controls
 - Employee benefits & policies

Knowing Your Objectives

- The sales process is time consuming and can be disruptive. Don't start the process unless you truly intend to complete a transaction at a realistic price and structure.
- Prioritize your objectives:

Personal

- Sales price maximization
- Retention of control
- Protecting the business heritage
- Protecting employees

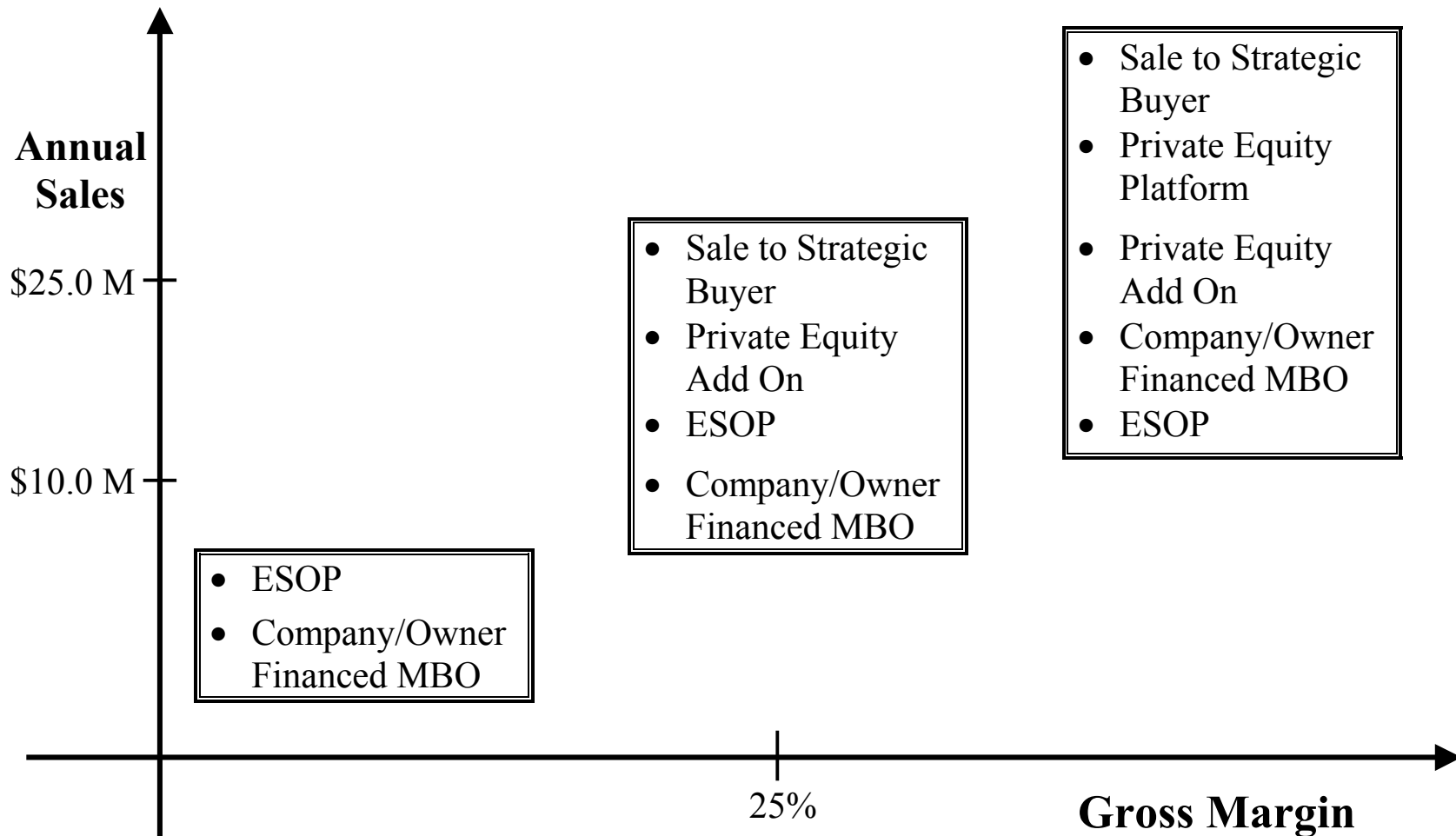
Business

- Access to growth capital
- Broaden product line
- Broaden geographic scope
- Increased buying power
- Access to sophisticated IT systems
- Ability to attract talent

Understanding Your Options

	<i>Control Retention</i>	<i>Sales Price</i>	<i>Growth Capital</i>	<i>Strategic Benefits</i>
ESOP	Yes	Low	No-uses company capital/debt capacity	No
Company\Owner financed MBO	Yes	Low	No-uses company capital/debt capacity	No
Private Equity- Add On	No	Moderate	No	Yes
Private Equity- Platform	Operating-Yes Strategic-No	Moderate-High	Yes	Yes
Strategic Buyer	No	High	Yes	Yes

Understanding Your Options *(continued)*



Understanding Your Options(*continued*)

Alternative Approaches to the Sale of a Business

Negotiated Sale	Targeted Sale with Preempt Option	Targeted Sale	Structured Sale
<ul style="list-style-type: none"> • Appropriate when one acquirer is clearly the best fit and has a demonstrated interest. • Seller has limited leverage. • Time consuming. • High risk of failure. 	<ul style="list-style-type: none"> • Appropriate when one acquirer is clearly the best fit and has a demonstrated interest. • Seller has excellent negotiating position. • Formal time frame expedites process. • Medium chance of success. 	<ul style="list-style-type: none"> • Appropriate when several parties (5-7) represent logical potential acquirers. • Seller is in an excellent negotiating position. • Formal time frame expedites process • Good chance of success. 	<ul style="list-style-type: none"> • Appropriate when many parties are logical buyers or when other approaches have failed. • Seller is in good negotiating position although some buyers may refuse to participate. • Good chance of success.

Minimizing Disruption & Maintaining Confidentiality

- In addition to providing expert advice on potential acquirers, valuation, and deal structure, a professional M&A advisor is key to maintaining confidentiality and minimizing disruption.
- Plan the process carefully. Your advisor should only approach those acquirers that you have authorized in writing.
- Do not approach more potential acquirers than is absolutely necessary. For most profitable, successful electrical distributors, approaching three to seven logical parties is sufficient. If the company is large enough to be an attractive platform, the number of potential acquirers will increase.
- In most cases, do not announce a transaction until a definitive sale and purchase agreement has been signed.

Conclusions

- Take steps to fine tune profitability and asset utilization.
- Prioritize your objectives.
- Research your options and develop realistic expectations.
- Plan and closely control the process.