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Considerations When Pricing an Acquisition

So, you are looking at acquiring one of two companies in the same industry. Each has $20 million of revenue generated from 100 clients, and $2 million of earnings before interest, taxes, depreciation and amortization (EBITDA). They should be at or very close to the same value, right? Just slap on the same earnings multiple and you have your purchase price. If that is all you look at when deciding what to pay for a business, then you are not alone. But - you might be severely overpaying for one of these companies, or missing a good opportunity on the other.

Let's take a closer look.

Company A has 100 clients. Their top client generates 75% of annual revenue; the remaining 99 clients generate 25% of annual revenue. Company B also has 100 clients, but no client accounts for more than 20% of total revenue. Which business represents less risk and in turn would be of more value? Consider what Company A would be worth if it lost its largest customer, and how that would compare to Company B if it, too, lost its largest customer.

in this issue

Another consideration...

Company A generated $20 million of revenue last year, $25 million of revenue the year before and $30 million of revenue three years ago. Company B generated $20 million of revenue last year, $15 million of revenue the year before and $12 million of revenue three years ago. At the same purchase price, which of these two enterprises looks like a more attractive acquisition? Despite generating the same revenue in the last year, revenue of Company A has been on a declining trend while Company B revenues have been increasing. Which is likely to generate more revenue going forward?

One mistake often made when valuing a business is to put too much emphasis on past performance and not enough on anticipated future cash flows. While the past can be a strong indicator of future performance, past earnings have already been collected by the current owner(s) and are of no value to a buyer. As a buyer, you are paying for future earnings and as such, you should dig deep into the financials of your target to ensure you are receiving what you are paying for. You do not want to take on any excessive unknown risks.

Regarding earnings…

Don't overlook the importance of having your accountant assess the quality of earnings of the business you are looking to acquire. Revenue or earnings listed on a tax return could be misleading. Your accountant should test the earnings disclosed to ensure there are no misinterpretations and you know exactly what you are getting (e.g. elimination of intercompany transactions, assessment of non-recurring revenue, differences in accounting policies, etc.). On the flip side, if you are selling your business, you should anticipate that any sophisticated buyer will include this assessment as part of their due diligence and plan accordingly.

The bottom line:

Obtaining an accurate value of a business you wish to purchase might not be as straight forward as it seems – in fact, it can be complicated. Trusting an investment banker with business valuation expertise to assist in your acquisition considerations can help decrease your cost and increase the value you obtain.

business lines

By Steve Jacobs

Buyer Perspective

The current market is very favorable to either buy or sell a business. Funding is readily available for good transactions at very attractive terms. Business owners looking to grow their market share or brand, or looking to reduce costs, often look to mergers and acquisitions as an efficient way to achieve these goals. This strategy is a way to reduce the amount of resources required to achieve organic growth. With mergers and acquisitions, growth occurs by finding complementary businesses to acquire. Significant benefits are associated with a successful merger or acquisition, but potential risks dictate due diligence before closing a transaction, including quality of earnings analysis and thorough evaluation of other key value drivers.

Synergistic Fit

One of the key concepts associated with mergers and acquisitions is synergy. Companies operating in the same sector, for example, must have some degree of alignment in terms of competitive situation, strategy, organizational culture and leadership style. Greater overlap of these attributes between organizations creates a more conducive environment for merging two separate companies into a single entity. Although many factors play into these alignments, company leadership facilitates these elements and, therefore, contributes the greatest influence among them.

Growth and Loyalty

Guardedness over market share exists between competitors operating within the same sector. When the opportunity to combine operations presents itself, however, company leaders see a probable growth in market share on the horizon and/or a greater diversification of customer base. Whether combining operations turns out to be as profitable as planned, however, depends on how well the merger or acquisition is executed.

Strengths and Weaknesses

Understanding the strengths and weaknesses each company brings to the table is another element in determining the real benefits of potential mergers and acquisitions. Big companies with strong balance sheets and little debt make an attractive partner in terms of capital. Smaller companies with nimble management might be perfect for quickly implementing growth strategies and/or new product development. Too much debt or a questionable employee base factors heavily into a successful integration.

M&A Motivation

Leadership studying the potential of mergers and acquisitions are well-served in understanding the motivation of the parties involved. During the deal-making process the motivation of both the buyer and seller can affect the transaction value. A buyer going into negotiations who is particularly convinced of a company's value, for instance, is likely willing to pay a higher price to close the deal, or an especially motivated seller might settle for a lower price as a means of getting the deal done.

Whatever your plans (to buy or sell), it is essential to have the right advisory team in place to help you navigate through the process to achieve success!

Excerpts from "Factors Influencing Merger & Acquisition" by Romona Paden, Demand Media

BCC Shares Expertise

BCC principal **Steve Jacobs** shared his expertise at the **2013 Iowa M&A Conference** held in Des Moines. Sponsored by Faegre Baker Daniels, this half-day conference delivered timely and practical insights on deal execution from investment bankers, private equity professionals, strategic acquirers, attorneys and accountants from around the Midwest. Steve provided an update on the current state of M&A including issues specific to the Iowa market.

Jim Nalley (Vice President), **Lindy Ireland** (Senior Financial Analyst), and **Tom Cavanagh** (Transaction Adviser) represented BCC Advisers at the **2013 Iowa Association of Business and Industry's Annual Conference** held in Okoboji, Iowa. The conference included opportunities to connect with business leaders from across the state, as well as breakout sessions in unique venues on issues affecting Iowa and Midwest-based businesses. Jim co-presented a session titled "My Plan is Miles Ahead" which addressed how business harmony exists with succession planning, proper valuation and financial trust.

BCC principal **Al Ryerson** was a speaker at the **23rd Annual Iowa Association for Justice Family Law Seminar** held in Riverside, Iowa. Sharing his expertise in the area of financial and valuation matters in marital dissolution actions, Al co-presented "When Should You Employ a Financial Professional?" to attorneys from across the state attending the seminar to enhance their knowledge in the marital dissolution arena.

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When Opportunity Knocks…
An Accelerated Acquisition Story

Sometimes strategic business moves aren't planned, but instead come as unexpected windfalls. When a buyer understands the strategic value and engages a team of seasoned advisors able to employ creativity in structuring a transaction, even in a short time frame, a rewarding transaction can result.

Six months ago no one at Hobby Makers, Inc. (HMI)*, a Midwest, multi-generational, family-owned supply manufacturer to the hobby industry, was thinking about acquisitions. But key business opportunities can present themselves unexpectedly. So when HMI had the chance to purchase a competitor company within their industry, which only has a handful of significant players, they knew they had to move quickly. Having no experience with acquisitions, HMI reached out to BCC Advisers taking advantage of a 20-year relationship with BCC's valuation division.

When Southern-based Leisure Tools* decided to consider competitor companies as potential buyers for their business, they held a common concern. Though it is necessary to divulge certain confidential information as part of the due diligence process, a business owner doesn't want to give away competitive advantages to a rival company should the transaction not happen. By engaging an investment banker to assist with the transaction, HMI demonstrated to Leisure Tools' owner that their interest in the business was genuine, and they weren't just "kicking the tires." This helped HMI gain the confidence of Leisure's owner, moving HMI's inquiry forward for primary consideration.

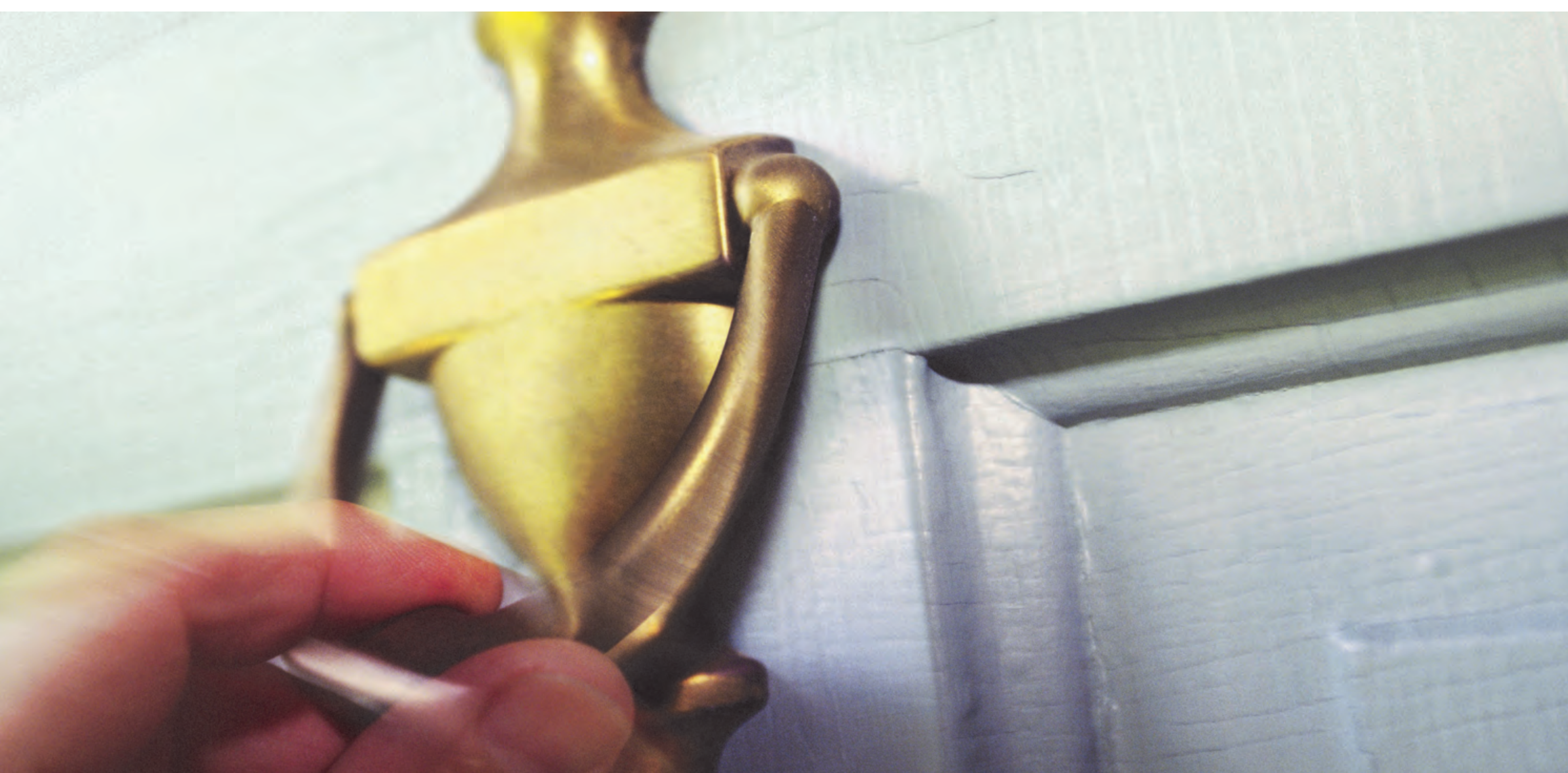
"This opportunity, though exciting and full of anticipated strategic value, was a challenging process from every angle. Having the expertise of BCC Advisers to guide our team of attorneys, accountants, and HMI's management was invaluable to the success of this transaction."

- President of HMI

Though HMI's complete product line includes a multitude of assorted supplies and spans several different industries, acquiring Leisure would be a significant move opening up new customer relationships and diversifying HMI's product offerings. Having a successful production facility in the Midwest with capacity for growth, HMI could assume the manufacturing of Leisure's products currently produced in the South.

The hobby arena has become a lifestyle for the owner of Leisure Tools and an industry that he loves. Though he is ready to give up the responsibility of owning his company, he will continue to work with HMI to promote both Leisure and HMI products at tradeshows around the country.

**Actual company names have been changed.*



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Agriculture Attracts Investment Capital

In its search for new and promising investment sectors, investment capital is gaining greater knowledge and confidence in agriculture as a new asset class for investing. New pockets of institutional capital are seeing opportunities to create above-market investment returns in enterprises that are closer to the farm gate. These companies are helping producers create more with less. With limited land and water resources, genetics, new technology, services and equipment are helping farmers increase yield, reduce costs and improve on farm efficiencies. This, combined with the positive outlook for farming in general, is creating a new paradigm for long-term agricultural investing. As such, the ability to raise growth equity capital, and selling and buying businesses in agriculture, has never been better.

The amount of excess liquidity in the market today is staggering - over $1.0 trillion of available debt capital for lending, over $1.0 trillion of unspent corporate cash to invest and/or buy other businesses, and over $350 billion of private equity available for growth and merger and acquisition investing. Over $2.25 trillion of capital (excluding public equity and bond securities) is available today. As a result, strong and growing businesses are able to get low cost financing and high valuations for their businesses.

How are the above capital market dynamics affecting agriculture specifically? Niche markets for both traditional agribusiness and specialty segments (organic/natural foods and ancient grains, to name a few) are of particular interest to investors. As such, new businesses are forming and existing businesses are adjusting their strategic direction to take advantage of new growth and profit opportunities.

To understand the current dynamics in agri-business and how the abundance of capital can help companies grow, acquire other businesses or sell all or a portion of their operations, BCC Advisers can help. With over 20 years of transaction experience and knowledge of the entire U.S. food supply chain - producer to consumer - BCC Advisers can be an invaluable partner in your search to maximize shareholder value for your business.

on the dotted line

Some Recent BCC Advisers Transactions:

Advised a hobby products manufacturer on the acquisition of the same.

Advised a family-owned retail spice company on a management buyout transaction.

Prepared a fairness opinion for the purchase of a Midwest bank.

Prepared a fair market valuation of a Midwest company for the redemption of shares.

Advised an Iowa food service company on a shareholder buyout transaction.

Prepared a fair value purchase price allocation of an ethanol plant for financial statement reporting purposes.

Prepared a fair market valuation of a Midwest transportation company to assist in consideration of establishing an ESOP.

The Market Front

Some opportunities available through BCC Advisers:

Global agricultural equipment manufacturer - *is seeking buyer.*

Midwest commercial truck dealership - *is seeking a buyer.*

Litigation support services company - *is seeking a buyer.*