TABLE OF EXPERTS

MERGERS AND ACQUISITIONS

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The Minneapolis-St. Paul Business Journal held a panel discussion on mergers and acquisitions. Panelists included Sharon Olson, president and founder Olson Wealth Group; Alec Sherod, partner, Hellmuth & Johnson; Ben Hangge, senior VP of Commercial Banking, Highland Bank; Rohit Subramaniam, partner, Transaction Advisory Services, RSM; and Cory Markling, partner, Eisner Advisory Group. Dyanne Ross-Hanson, president and founder, Exit Planning Strategies, served as moderator.

Dyanne Ross-Hanson: When we take a look at the M&A market, it was markedly slower in 2023; total deal value fell 11 percent in the US, 18 percent globally. While many forecast that merger and acquisition activity will improve in 2024, the market continues to face challenges. Please share your insight into the mergers and acquisition market today?

Alec Sherod: We serve the lower middle market, say from $20 million to $200 million of enterprise value. Maybe it is dumb luck, in that our clients have been attractive to private equity, and there are still a lot of private equity rollups in certain industries. My anecdotal experience is, the M&A market has been pretty active. Due diligence has been more thorough and more deliberate in the last year. Multiples have definitely calmed down. People are still doing deals. Obviously, there will be places where it is still stuck — commercial real estate — but my outlook is rosy.

Rohit Subramaniam: There was a lot of uncertainty in the market in 2023. Anytime there's uncertainty, I think that's when the slowdown of volume and deal size happens. And I think that uncertainty was fairly obvious, driven by the interest rate environment as well as inflationary environment coming out of COVID, it was unclear where prices were going to settle for a lot of businesses. For buyers and sellers that was an important aspect: Is what I'm buying or selling going to be able to sustain or change? Then of course, interest rates also impacted the environment, and uncertainty around rates slowed the market down. We saw this when credit was cheap and deal volume was high and deals were competitive. We've seen that moderate a lot in the last 12, even six, months, which may impact valuations or at least deal structure. Whether that's earnouts that come on the back end or some of the post-closing true-ups, a lot more rigor around all that process, and that's affecting the way banks underwrite as well.

Cory Markling: Private markets participants are still adjusting to the fed rate cycle. It's not just the level of interest rates that matter, but the speed of which those rate increases happened. Investors are forward looking, and sellers tend to focus on the historical results, expectation differences can lead to a temporary disconnect on valuations. So, it's true, yes there is less liquidity in the marketplace, but transactions are getting closed. We are seeing more structure in deals, higher amount of rollover equity, lower amount of debt, earnouts etc. risk shifting mechanisms that help bridge that valuation gap. With that being said, we believe it's going to be another 6-12 months for valuations expectations to normalize and liquidity to work its way back into the private markets.

Ben Hangge: As the group mentioned, last year interest rates increased at the fastest pace that we've seen in history, and that changed things for financing providers. When the cost of capital goes up, the formula for fixed-charge coverage and other covenants stays the same, making covenants more challenging to achieve. As a result, we saw deal structures change quickly, decreased EBITDA multiples, more equity, more subordinated debt, additional reps and warranties, earnouts, and other creative structuring. As the macro environment continues to normalize, 2024 appears like it will be a solid year for M&A activity. Given the election year, looming tax sunsets, geopolitical uncertainty, and mixed economic indicators; 2024 could see an increase in the supply of companies hitting the market. We continue to hear that private equity dry powder is at or near all-time highs, so there will be plenty of demand in 2024. Senior and subordinated financing continues to be available at reasonable terms and if interest rate cuts materialize this year, the M&A market should see a spike in dealmaking.

Ross-Hanson: Sharon, are there any ideas or advice that you can offer for preparing before and/or after a sale for a business owner?

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> **BEN HANGGE**
> Highland Bank

Sharon Olson: Every business owner should prepare an exit plan. Creating an exit plan is mapping out the end game, to begin with the end in mind. Developing a clear understanding of personal, financial, and business goals is an important first step. You have to know what you want personally, financially, and for your business. These are the three legs of the stool, setting the destination before you start driving. Getting there involves a detailed process. Think of it as putting together puzzle pieces – you want your personal and business goals to fit together seamlessly. A successful plan not only sets you up for retirement but also boosts your business's value along the way. Timing is key. You don't want to wait until you are itching to sell to start planning. It can take years to get everything in place, depending on the type of business, 3-10 years. Working with professionals early on is crucial. Think financial advisors, lawyers, CPAs – an entire team to seamlessly carry out your plan! Audited financials are necessary and add a layer of professionalism to build confidence in potential buyers that you have your financial house in order. An exit plan improves the odds a transaction will close. Only a fraction of business sales, 25-30 percent, actually close. Often it is due to owner preparedness, particularly around finances or for what is next. Replacing your business income and making sure you're left with enough cash after taxes when you do sell create a big mental shift. And, most importantly, prepare emotionally! Do not underestimate the range and depth of emotions that can be associated with the sale of your business. Your identity and life may be so intermeshed with your business that it can be difficult to envision what your life will look like post transaction. Sometimes partnering with a life coach can help tackle some of these emotional questions and issues. An exit plan fills in the gaps and makes sure both the deal and post transaction life works. Assembling and utilizing your advisor team assures everything runs smoothly. So, bottom line: start planning early, get your team together, and make sure your exit plan lines up with your goals.

Sherod: It is organization on a couple of different levels, and it sounds trite or easy, but it is knowing your financials, knowing your business, and being organized. General organization of contracts, knowing where

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CORY MARKLING, CFA
Eisner Advisory Group LLC

they all stand, or where you stand with all your suppliers and customers, and knowing your issues. No sophisticated buyer is going to come in and expect a business to be spot-free; every business has issues. Instead of being defensive, having an answer for those issues is the best way to go. My diligence theorem is: disclose everything, but have a plan to explain the issues.

Markling: The stats show that businesses who hire professional advisors to advise and guide them through the transaction have a much higher success in closing that transaction than doing it with minimal advisory assistance. You need financial help, wealth management help, tax planning help; all these workstreams will affect how the transaction gets structured, the valuation, the after-tax proceeds. You can't do it by yourself and expect to get an optimal outcome.

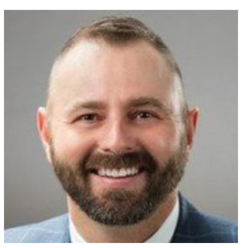
Sherod: Getting that advisor team on board also gives owners the time to run their business during a sale process.

Olson: A word of caution, many business owners assume that their existing team, who have been with them through thick and thin, will handle exit planning smoothly. It may be difficult for business owners and their teams to understand, but exit planning might call for a different set of skills or expertise. You could outgrow some of your current team members in this process.

Appointing a Quarterback for the team, a central coordinator is essential in making sure all the players on the field – your professional advisors, lawyers, CPAs, and other specialists – are coordinated and working together towards the same goal. It is all about ensuring everyone has the correct information and is on the same page, marching towards that end goal for the client.

Subramaniam: I completely agree with Alec and Cory on the organization point, but I'll add this word as well: Emotions is what, more than anything, kills a transaction. It's the actual stakeholders themselves, and their disposition towards the whole process. All these things we're talking about, being organized, having good data, disclosing information, having good advisors, those all make the process easier, but the core of it is if you can't control your emotions as an owner, but if you don't have a way to check yourself, before you wreck yourself, you will end up in that 67, 70 percent that does not close a deal. A lot of sellers overlook the fact that they may be the lucky ones who get to the 30 percent to close a deal, but 60 percent of all deals that actually get done fail. But there's a percentage within a percentage there that it doesn't work out even further, and sellers forget that once the deal closes, they're now in bed with the party that bought them, and everything that happened in the due diligence process, people have long memories and people hold grudges. Now you're trying to work together after you've been essentially adversarial and

MEET THE EXPERTS:



CORY MARKLING, CFA
Partner
Eisner Advisory Group LLC

Cory Markling, CFA, is a Partner at EisnerAmper, a global advisory and CPA firm and a leader in the firm's transaction advisory services group. Cory has 20 years of experience in financial, tax, and investment due diligence serving closely held companies, private equity funds, investment banks, and family offices.

Cory's unique experience has enabled him to advise on more than 200 successful middle-market transactions and $4 billion in capital. Additionally, Cory's background includes leverage finance, global capital markets, and institutional equity research. He has the expertise and versatility that enables him to provide key insights and an understanding of various markets and verticals from both a macro and micro point of view.

Cory is a frequent speaker as well as an Adjunct Professor at Hamline University where he teaches graduate programs on strategy and finance courses to students.

ROHIT SUBRAMANIAM
Partner Transaction Advisory Services
RSM

Rohit provides financial due diligence services to private equity clients, private equity portfolio companies, family funds and strategic corporate buyers (both public and privately held). In his current role, Rohit leads RSM's transaction advisory services practice in Minneapolis, is a national leader and specialist in sell-side due diligence, and also leads the US-India (USI) TAS team.

Through his experience on approximately 200 transactions, Rohit has proficient knowledge and experience in assisting clients with many aspects of the M&A process.

Rohit received his Masters of Accounting from the University of Southern California Marshall School of Business and his Bachelor of Science in accounting from the University of Kansas School of Business.

BEN HANGGE
Senior Vice President of Commercial Banking
Highland Bank

When it comes to business banking, Ben Hangge is the commercial banker you need in your corner. With 20 years in the industry, Ben has a deep understanding of commercial financing and M&A transactions. Ben attended college at Bethel University, receiving a Bachelor's Degree in Economics, Finance and Marketing. Starting his career as a credit analyst, Ben quickly transitioned to a commercial lender, where he honed his expertise in M&A financing. Ben's approach as a relationship banker allows him to be a strategic advocate and create unique financial solutions, as evidenced by the $250 million in new financing he has provided for clients throughout his career.

Ben dedicates his continued growth and success to the mentors that have helped him along the way. He pays it forward by serving as a mentor through Bethel University's BethelBiz mentorship program and volunteering as a youth basketball coach.

ALEC SHEROD
Partner
Hellmuth & Johnson

Alec Sherod, a partner at Hellmuth & Johnson, represents public and privately held companies across many industries. In his practice, Alec assists buyers, sellers, and financial advisers in a wide variety of domestic and international M&A transactions. He represents clients in financing transactions, including advising issuers and investors in securities law compliance; handling acquisition financing for lenders, borrowers, and investors; and representing clients in private placements of equity and debt. He is also an experienced CPA (inactive) who leverages his accounting background when handling sophisticated financial transactions. Alec was recently recognized by Minnesota Lawyer as a 2024 POWER 30 Mergers & Acquisitions Lawyer. POWER 30 examines the power brokers who lead and influence various parts of the Minnesota legal community.

SHARON OLSON, CFP®, CEPA®
President and Founder
Olson Wealth Group and Inspired Life Family Office®

Sharon Olson, CFP®, CEPA® is the Founder and President of Olson Wealth Group and Inspired Life Family Office®, a multi-family office and independent wealth management firm focused on legacy planning, business succession, and family office services.

Growing up on a farm in southeastern Minnesota instilled deep-seated resilience and strong work principles. Today, she is a distinguished specialist in family office services and wealth, retirement, estate, investment, and business succession planning, emphasizing smart strategies and solid values.

Sharon is a member of Women President Organization (WPO) and Young President Organization (YPO). She serves as a moderator of the YPO Family Office Forum and a board member of the YPO Financial Services Network. Sharon is very active in several non-profits, including Board Emeritus for Ann Bancroft Foundation dedicated to empowerment for girls and Wings for Widows helping widowed men and women navigate the trauma of loss to regain financial stability.

MODERATOR

DYANNE ROSS-HANSON
President & founder of 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 divesture 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.

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> RSM

working against each other. Disclose and be upfront about what you have or don’t have. What you may view as a seller as a negative or a detriment, a buyer may actually see as an opportunity for improvement and extracting more value, which helps everyone post-close.

Sherod: I just want to make sure everybody knows, and that the transcript shows that Rohit quoted Ice Cube.

Ross-Hanson: Ben, what’s your suggestion as far as how soon or when to actually select the senior lender in this M&A process?

Hangge: As early as possible. Right now, I’m working with sponsors that are still raising their fund or assembling their capital group and don’t have an identified target company to purchase yet. Certainly, early in the process is more important if a sponsor doesn’t have established senior lender relationships already, but regardless, earlier is better to ensure a quick and smooth process for everything from deal structuring, to unforeseen changes, to senior and subordinated lenders structuring agreements.

Ross-Hanson: Sharon, how would you help owners maximize value in anticipation of a transaction?

Olson: As a Certified Planning Exit Advisor (CEPA), we apply a checklist of 54 different areas of the business to analyze and use good sound judgment in terms of where that business is against identified benchmarks. The type of buyer will also impact the valuation for the business. Why is that buyer interested in your business? Of course, you should look at your business through the lens of a buyer and convince them that your business is attractive and has a narrative and the numbers to show why.

As it relates to the business owners themselves, we take them through a series of questions and considerations to develop a Personal Readiness Score (PRS) to help


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them determine how ready they are to sell their business from a personal perspective, not just a purely business perspective. Some factors we consider in developing a PRS include whether the business owner has in place a written personal plan, a personal financial plan, a personal estate and tax plan, family awareness of the plan/business, and an established team of advisors, among other considerations.

Ross-Hanson: Alec, there is a lot of discussion around valuation gaps; how do you advise addressing those valuation gaps between buyer and seller?

Sherod: I think those gaps are going to become more prevalent, because with tightening diligence and markets, people are expecting X and getting Y. The typical ones that we have all heard about, earnouts, seller financing, will become more common. Even in deals that have earnouts, as a seller, you don’t really want it to be a huge percentage of your purchase price. The ideal purchase price is that which gets paid at closing, but the construction of earnouts is very important, as that’s the main solution for valuation gaps. EBITDA is kind of the typical measure, but if you can get one on revenue as a seller, that’s ideal, because it’s very easily calculable. As an attorney, I have to focus on making sure that the EBITDA definition in the purchase agreement correct. But seeing deals with 50 percent of the purchase price contingent on earnouts is not a thing anymore. It is usually 10, 20 percent at the most. It is important but sellers are not living and dying on it.

Ross-Hanson: We've all heard that the further down the entry on the financials that your earnout is measured, the less control a seller is going to have. Cory, when we talk about negotiating a transaction or even the terms, any insight from your perspective?

Markling: I think it helps to take a step back. We talk a lot about maximizing purchase price, but we don't talk about maximizing the utility of the transaction for the seller itself. What do they want out of that transaction? Do they want to maximize price? Do they have a preference for the type of capital partner coming in? Is there a philanthropy piece that they want to figure out? Is there real estate involved? All those factors can drive the price and also negotiation. It goes back to understanding what you want in a transaction and what's important to you in that transaction. It's hard to start that journey inside of a transaction, which is why pre-transaction planning is so important because then you know what you are negotiating for.

Olson: The best buyer, often isn't recognition of the top value, it's the after-tax value that a client will put in their pocket that you want to consider as the final offer. A Certified Exit Planning Advisor (CEPA) and financial advisor will advise both business owners and investors on opportunities to maximize wealth, increase investment return and minimize taxes. From a business owner's perspective, growing a business with the end goal of a sale often provides the primary source for their future retirement income. Managing the tax liability when the business is sold can result in a significant increase in net capital and fill financial gaps to help meet their retirement goals. For example, investors and business owners who own highly appreciated stock in a small business, under certain qualifications, there is an opportunity to avoid 100% of federal capital gains tax upon the sale of such stock or business. The qualified small business stock exclusion, also referred to as the QSBS exclusion, allows investors and owners of a small business or startup to exclude up to 100% of U.S. federal capital gains tax upon the sale of the stock. Internal Revenue Code Section 1202 defines this qualified exclusion and permits a stockholder to exclude capital gains recognized on QSBS as long as it is held for at least five years and does not exceed $10 million or 10 times the basis of the initial investment, whichever is greater. If gains exceed $10 million, while not all gains will be excluded, the tax savings can still be significant.

Ross-Hanson: And in fact, professional buyers always seem to start with an unrealistic offer simply to get an owner's attention. Then the difference between that offer price, and what hits their checking account can be significant. Rohit, what do you find some of the biggest deal killers coming out of due diligence?

Subramaniam: One is that gap between purchase price and the after-tax value. But even before you get to that step, unsophisticated sellers often think that the enterprise value number, which is the EBITDA times the multiple or whatever valuation is written in the LOI, they think that's the number they're going to get. They don't understand that there's a walk from that to pre-tax purchase price, which involves all the true-ups related to net working capital, indebtedness, and cash, as well as some of the other components of transactions structuring that we've discussed, like earnouts, the way you negotiate escrows related to the transaction, any other holdbacks. So, understanding that walk, sellers often don't, especially a lot of sellers in the lower middle market. Probably the single biggest deal killer out of due diligence is non-income-tax related exposures: the sales taxes, the use taxes, the property taxes, the payroll taxes, issues around employer and worker classification. Those liabilities often have very long or no statutes of limitation, and different jurisdictions can take wildly varying interpretations of what applies and what their exposure is.

Ross-Hanson: Yeah, absolutely. When you talk about due diligence, it essentially identifies risks, issues, liabilities that may affect the deal value or feasibility. Ben, are there any best practices for negotiating a deal?

Hangge: Quality of earnings reports can impact the value up or down if something unexpected arises or there are differing views on add backs. I'm seeing more sell side quality of earnings reports, so that sellers are able to proactively identify and address issues and can ultimately be more confident in the valuation and negotiation process. With the rise in cybercrime over the past several years, I've also seen more cybersecurity due diligence recently as cyber issues can impact feasibility. Over the past few years on the bank side, in addition to typical due diligence, we've done more target company diligence on foreign exposure,

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supply chains, inflation sensitivities, customer pricing adjustments, and employee attraction/retention. Given the macro environment over the past few years, these factors have become more important and can impact feasibility.

Ross-Hanson: Common mistakes in merger and acquisition deals are overpaying for the target company, overestimating synergies, weak due diligence practices,


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> Hellmuth & Johnson

and lack of cultural integration.

Markling: We run into situations with sellers that don’t want to spend the money on a sell-side quality of earnings because it’s just “another cost”. It’s unfortunate because they’re going to be at a disadvantage throughout the entire process as the investor or buyer is going to almost certainly going to do one with their due diligence firm. It’s also going to slow the transaction down with no way of knowing if those findings are indeed real transaction points or the buyers are just using it do push down the purchase price or re-negotiate the terms of the letter of intent. It’s also going to drive the working capital and debt and debt like items in the purchase agreement, so it holds quite a bit of weight in the transaction process.

Olson: Just as important as getting the valuation of the business right and the financial part right, is really looking at the next step for the business owner, helping them determine what’s important to them, what’s going to give them purpose when they have invested all of their time and efforts into building their business, which was their purpose and now that purpose has gone, what will replace it. We actually had [clients] plan for a year to take pickleball lessons and do other things that will help them build out their afterlife. Those are the kinds of things historically that have caused the business owner to say, I don’t think I’m able to close on this deal.

Hangge: Having the right set of experienced M&A advisors is critical. Certainly M&A deals have closed without an investment banker or other experienced M&A advisors involved, but it’s possible the seller left money on the table, or the deal structure could run into issues down the road if an M&A attorney wasn’t involved. Also, working with the right senior lender that has M&A experience is critical so there aren’t delays or changes in the financing process.

Subramaniam: Most of us have gone through the joy and tribulations of getting married, and some of us have gone through divorce as well. Going through M&A is like doing both at once, because you’re marrying a party that’s buying you, and you’re divorcing a company that was literally your life. If you’re not ready for that, you’re not ready to do M&A.

Sherod: Due diligence goes both ways. In 50 percent of my deals, the seller rides off into the sunset. In those deals where the seller gets buyer equity, they need to do diligence on the buyer as well. That’s kind of the emotion part that Rohit brought up, figuring what’s my life going to be like in three to six months. Instead of pickleball I’m going to be working for this PE behemoth. The private equity deals of the past were a lot different than they are now. Before, you might slash and burn and take it public or sell the scraps. Now, it’s like we’re buying a team. We want the employees to be happy, we want the seller to be happy. We don’t operate valve companies, they do, so they know what’s best. So there’s been a lot more respect for sellers, then maybe there was 25 years ago with private equity buyers.

Ross-Hanson: Cory, what tips can you offer business owners for selecting the right professional advisors for their M&A team?

Markling: Start with your attorney and start with your accounting representatives and ask for referrals. Who have they used in the past? Who do they trust, who have they had success with or not had success with. Then sit down and interview them and have a 20 -30-minute conversation about the transaction, what their experience is, in what ways the can assist, and the cost of that assistance.

Olson: We have a group of professionals, including life coaches, lawyers, and CPAs, that we will bring to the table if the client does not have any existing relationships. Otherwise, we will also work with the selections that our client has made. It all begins and ends with what is best for the client.

Hangge: Making sure your advisors have M&A experience and that the deal team works well together from an approach and personality standpoint. Also, working with advisors that have large networks is a plus so that they can help introduce other advisors for the transaction and other situations that might arise after closing.

Subramaniam: Interviewing or having a chance to speak with advisors before you hire a firm is super important. M&A is technical and it’s complicated and its why people who are good at have been doing it for a very long time. Getting a sense of, are they good technically, emotionally, negotiating wise, is super important.

Sherod: I get asked for recommendations all the time. You give them three and let them make the choice. You make the introductions, and make sure you’ve got experience with those folks.

Ross-Hanson: I always tell clients that this is a multi-disciplinary process and requires the expertise of a very diverse group of advisors. You want to try to honor existing relationships but having that network to bring to the process as necessary is critical.

Sherod: And convincing your client in a way that says hey, you’re great at running this business; you’re not an M&A person. Not to say that you should take our advice blindly. It’s our job to give you the right questions or right answers and you choose.

Ross-Hanson: Again, the cost associated with experienced advisors in relation to the benefit obtained, is just so insignificant that it just makes sense to bring the best to any transaction.