ACQUISITION PROCESS OVERVIEW

A PRESENTATION OF THE METHODS AND PRACTICE INVOLVED IN A CORPORATE BUY-SIDE M&A ENGAGEMENT

WHITEHAWK ADVISORY

Comparison of Alternative Approaches to Inorganic Growth

Most companies have a sense for whether their primary strategy for achieving return objectives is based on "organic", or internally generated, revenue growth or other types of "inorganic" organizational initiatives such as strategic partnerships, mergers or acquisitions. If the management team or shareholder group determine that organic growth will be insufficient to meet return objectives, the next step is to decide whether strategic partnerships or M&A give the company a better chance to achieve desired shareholder returns.

STRATEGIC PARTNERSHIP

Advantages:

- Generally less risky and expensive than making an acquisition

Disadvantages:

- Incentive alignment can be difficult to achieve
- Under-resourced – large % of strategic partnerships do not attain critical mass

Examples of Technology-based Partnerships

- Integration of a key piece of technology/product targeted to a specific customer set
- Shared utilization of R&D resources
- License of technology, patent portfolio or other IP

Examples of Distribution-based Partnerships

- Exclusive distribution of product line
- High-level designation for distributor/superior economics or resources provided by OEM
- Co-branding and packaged sale opportunities

Examples of Cross-functional Partnerships

- Joint Venture focused on specific geographic or customer market

MERGER OR ACQUISITION

Advantages:

- Conveys control over acquired organization – management can determine how to allocate and deploy these resources

Disadvantages:

- Risks of integration and achieving required shareholder return for acquisition generally fall on the management team of the Buyer

Examples of Stimulus for Particular Acquisitions

- Opportunistic (reactive) acquisition
- Acquiring against a defined roadmap of product or market development
- Outcome of buy-vs.-build analysis for specific desired capability
- Defensive acquisition to deprive competitor of ability to acquire an asset
- Reaction to actual or perceived change in the market
- Signaling a change in the acquirer's focus/business strategy to the market or to customers

Acquisition Rationale and Their Impact on Deal Structuring

After management determines the primary needs they are seeking to address in an acquisition, the next steps are to identify potential acquisition targets that successfully meet those needs, and to reach an agreement with the target companies which maximizes the probability of realizing acquisition objectives.

ACQUISITION RATIONALE

Examples of Asset-based Acquisition Rationale

- Patents/Licenses/Intellectual Property
- Cash/PP&E/Other hard assets
- Products

Examples of Earnings-based Acquisition Rationale

- Below-market valuation of earnings stream
- Opportunity for synergies through cost consolidation
- Increased negotiating leverage with vendors or customers, other types of economies of scale

Examples of Market-based Acquisition Rationale

- Name brand/Reputation
- Market share consolidation
- Distribution footprint
- Customer base (or access to a specific customer)
- Achieving marketing economies of scope

Examples of People-based Acquisition Rationale

- Processes and Methodologies
- Management/Culture
- Research/Technical staff

COMMON TYPES OF ACQUISITION CONSIDERATION

- Cash
- Property or other tangible assets
- Marketable or non-marketable Securities
- Securities subject to time-based or performance-based conditions
- Relief from debt, assumption of risk or defined liabilities
- Royalties, time-based revenue sharing
- Cash payments subject to meeting performance conditions or requirements of tenure

ALIGNMENT OF INCENTIVES BETWEEN BUYER AND TARGET

Each party to an acquisition transaction enters into the negotiation believing that something is to be gained from the transfer of business assets or the transformation of ownership interest.

The process of due diligence and negotiation is primarily about the identification and allocation of risk. Even given perfect information regarding the state of things as they are today in each of the acquiring and acquired businesses, the two parties must agree on how they are to share the relative risks and rewards of uncertainty. The decisions involved in trading-off these risks and rewards is a dynamic process, and one subject to a complex and nuanced set of negotiating protocols.

Types of Acquisition Analysis; Determining the Right Deal Team

Given the decision to pursue an acquisition strategy, it is imperative that management select and internally communicate their methods for: (a) deciding to pursue a particular acquisition, and (b) measuring whether the acquisition was successful. In addition, management must determine if they internally have the capability and the focus to execute these activities without external assistance, or whether augmenting internal resources increases the probability of success.

ACQUISITION TYPE/METHOD OF FINANCIAL ANALYSIS

Acquisition

- Contribution Margin Analysis
  - A relatively low threshold for return analysis, but one that can be used in conjunction with performance-oriented earn-out agreements
- Cash-on-Cash Return
  - Relatively rare for control-oriented strategic acquisitions, but may be used for a minority-ownership strategic investment
- Internal Rate of Return
  - Fairly common as a general concept for corporate acquisitions
  - Subject to large number of variable definitions in earnings, cost of capital, residual valuation of entity

Merger or Share Exchange

- Accretion-Dilution Analysis
  - Can include “Ability to Pay” analysis that justifies to Board how much the Buyer can afford to spend
  - Multi-period accretion-dilution analysis can be used to communicate to public market at what point the acquisition is expected to be accretive to the Buyer (e.g. “immediately accretive”, “accretive this year” or “accretive next year”)

WHY WOULD AN ACQUIRER USE AN INVESTMENT BANKER

Information

- Understanding of non-public information regarding specific companies
- Insight into industry trends and strategies, ability to be a partner in evangelizing management’s perspectives to internal stakeholders

Relationships

- Ability to leverage existing relationships or create new relationships with management of potential acquisition targets or their financial advisors

Discretion and Efficiency

- Third party advisor can conduct discrete conversations to gather high level information regarding large group of potential targets efficiently and without signaling buyer’s potential acquisition strategy prematurely

Expertise

- Ability to quickly conduct relevant financial analysis and deliver credible acquisition presentation to other shareholders or the Company’s Board of Directors
- Augment internal resources in the areas of due diligence or negotiation

Acquisition Planning and Execution Process Overview

Corporate Development Advisory

Corporate Development Strategy

- Develop understanding of Company operations and competitive position
- Understand shareholder objectives for growth and returns
- Achieve consensus on process with shareholders and Board

Corporate Development Planning

- Define tools or metrics for determining achievement of growth or return objectives
- Evaluate acquisition and partnership alternatives as means to achieving growth objectives
- Determine scope of process, identify and address potential weaknesses

Acquisition Advisory

Identification & Planning

- Determine acquisition criteria and target profile
- Create reporting and evaluation framework for information received from targets
- Finalize list of potential targets
- Gather high level information about potential targets to determine fit with acquisition strategy

Analysis & Valuation of Targets

- Utilize initial information to narrow potential candidates for further due diligence
- Coordinate analysis of targets with internal deal team members
- Determine target valuation and proposed deal structure based on client's defined return benchmarks
- Identify potential integration risks

Internal Communication & Approval

- Conduct due diligence on selected target(s), identify merger - related synergies
- Enhance and present financial analyses based on due diligence information
- Determine acquisition financing strategy
- Present acquisition analysis and proposal to Board, identify negotiating constraints

Transaction Negotiation

- Negotiate definitive agreements
- Create financing package if debt required to finance transaction
- Complete confirmatory due diligence requirements
- Obtain necessary approvals and execute legal documentation

WHITEHAWK
ADVISORY