

The Fork in the Road

Succession and M&A in the Middle Market



Jacob M. Katz, CVA
UHY Advisors, Valuations Group
Detroit, Michigan
586.843.2587
jkatz@uhy-us.com

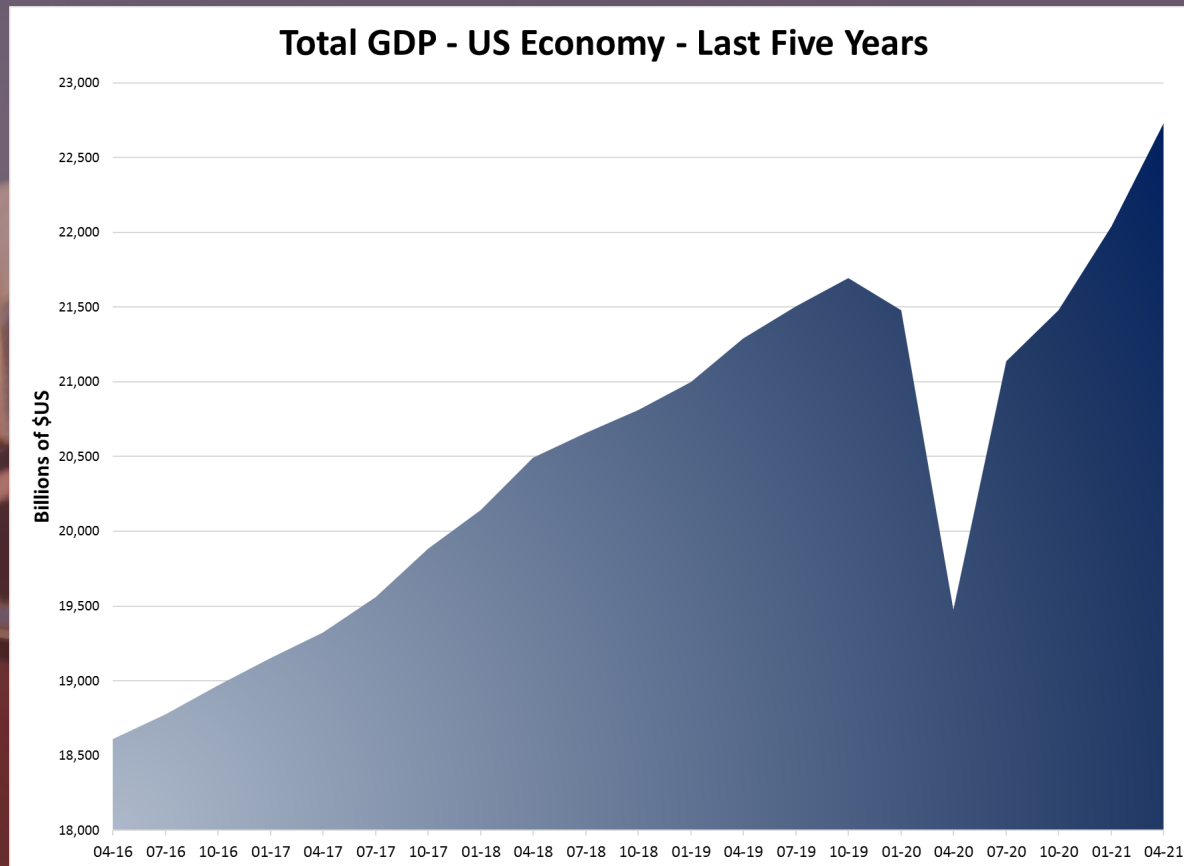


Overview

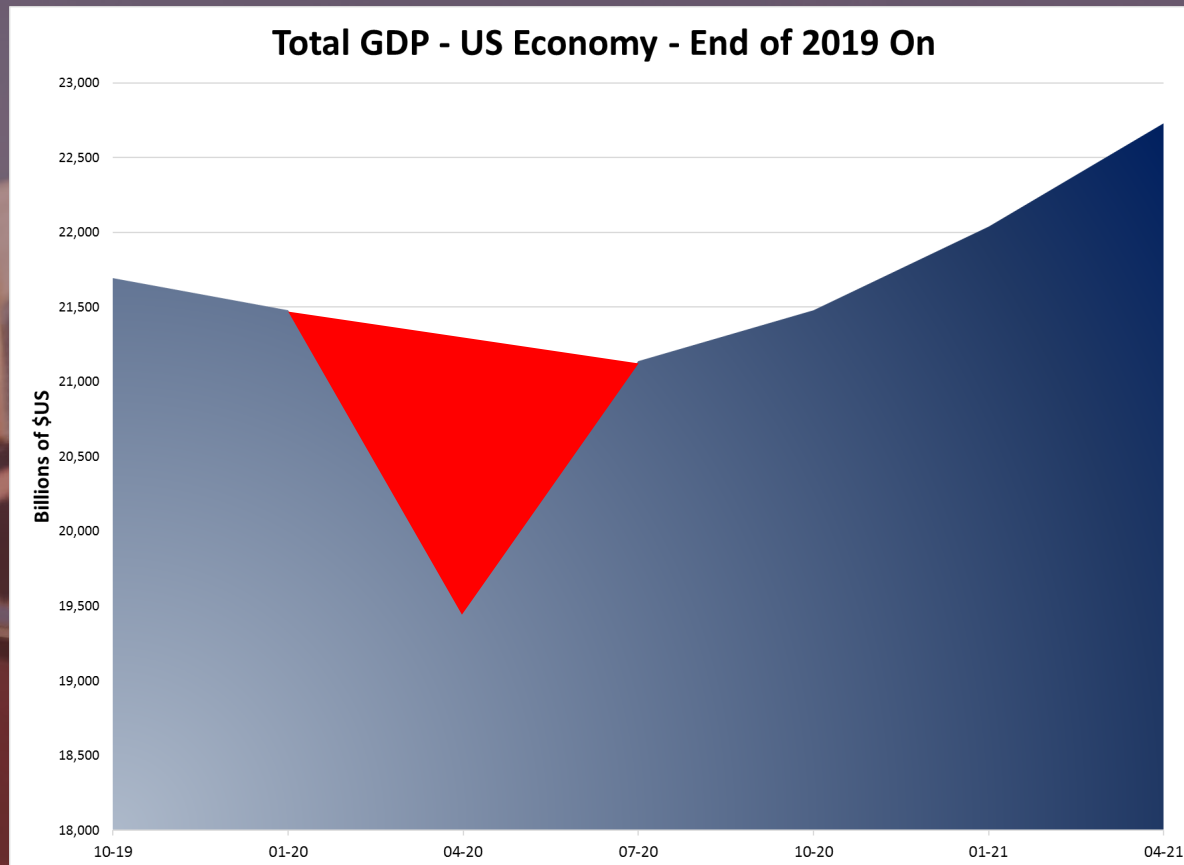
Goals for today:

- Describe the State of the Economy
- Talk about difference between succession and M&A
- Keys to Succession Planning
- Keys to M&A
- What not to do

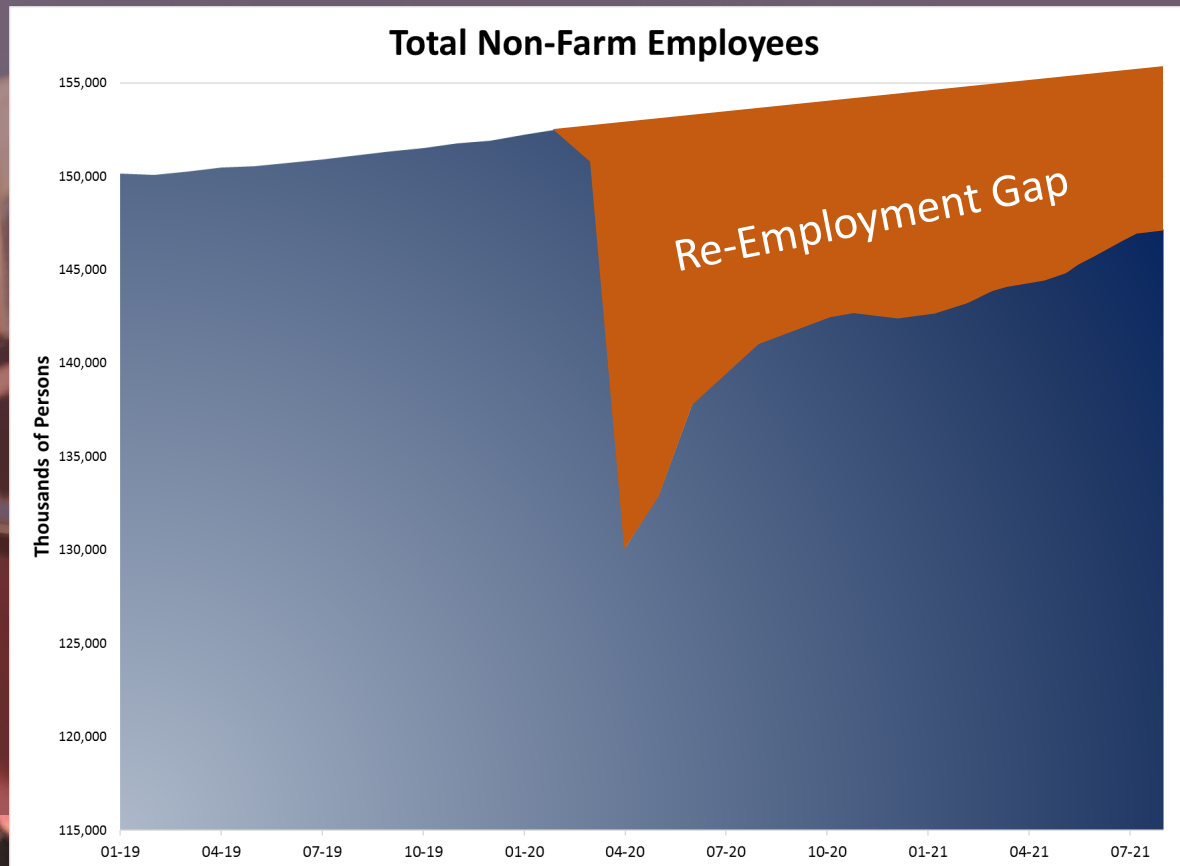
State of the Economy



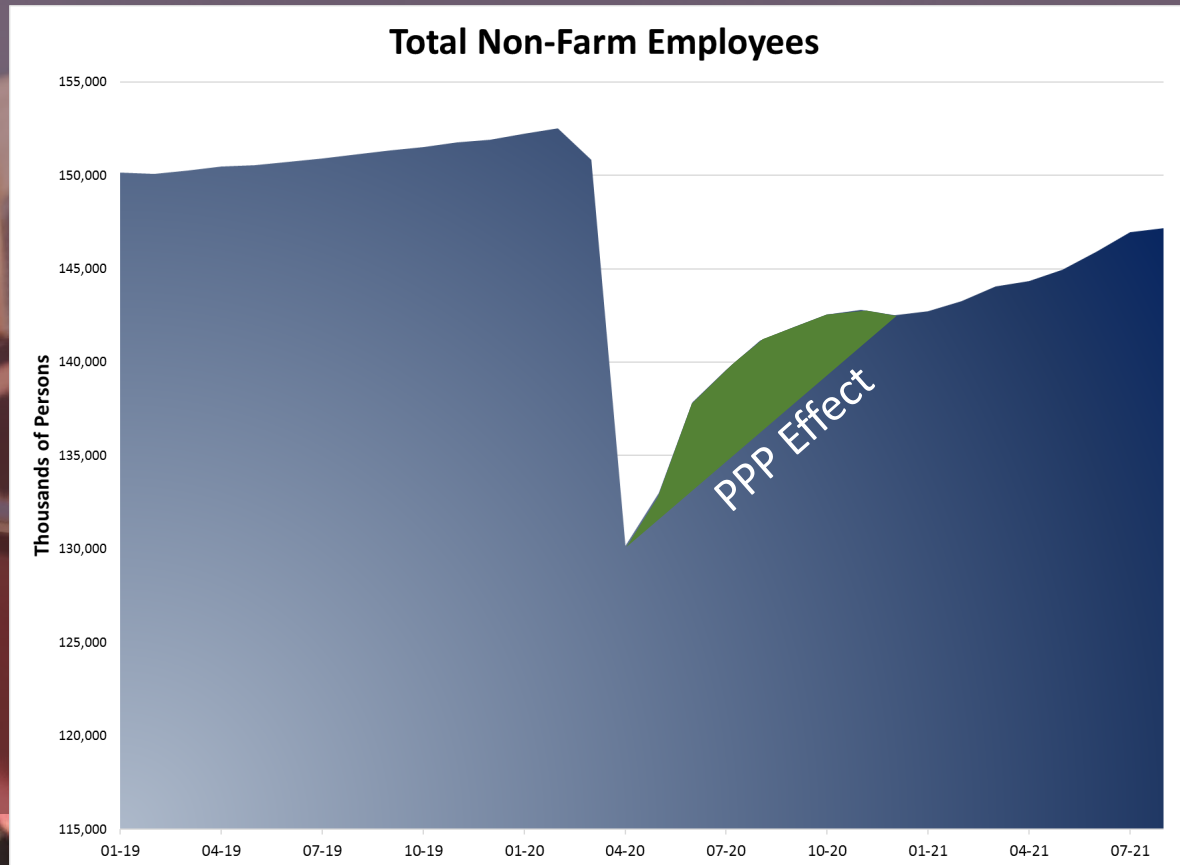
State of the Economy



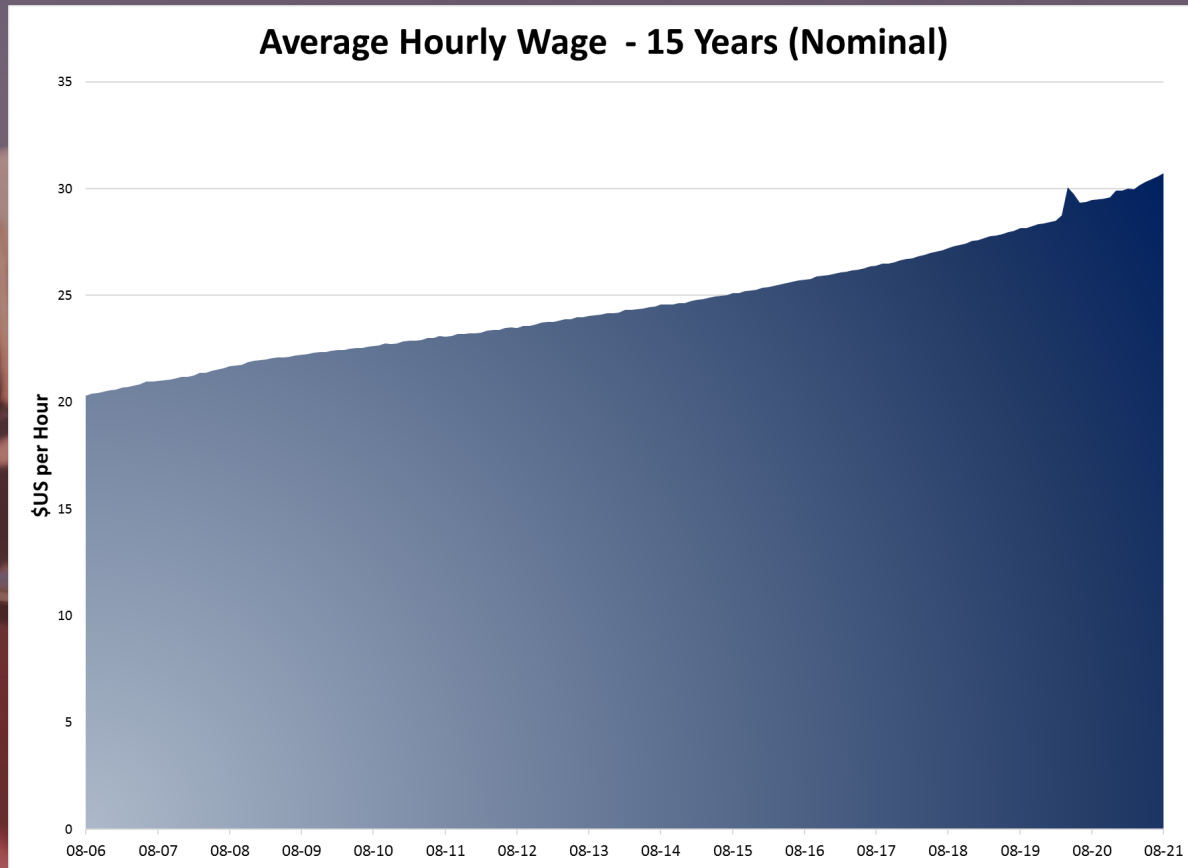
Employment Situation



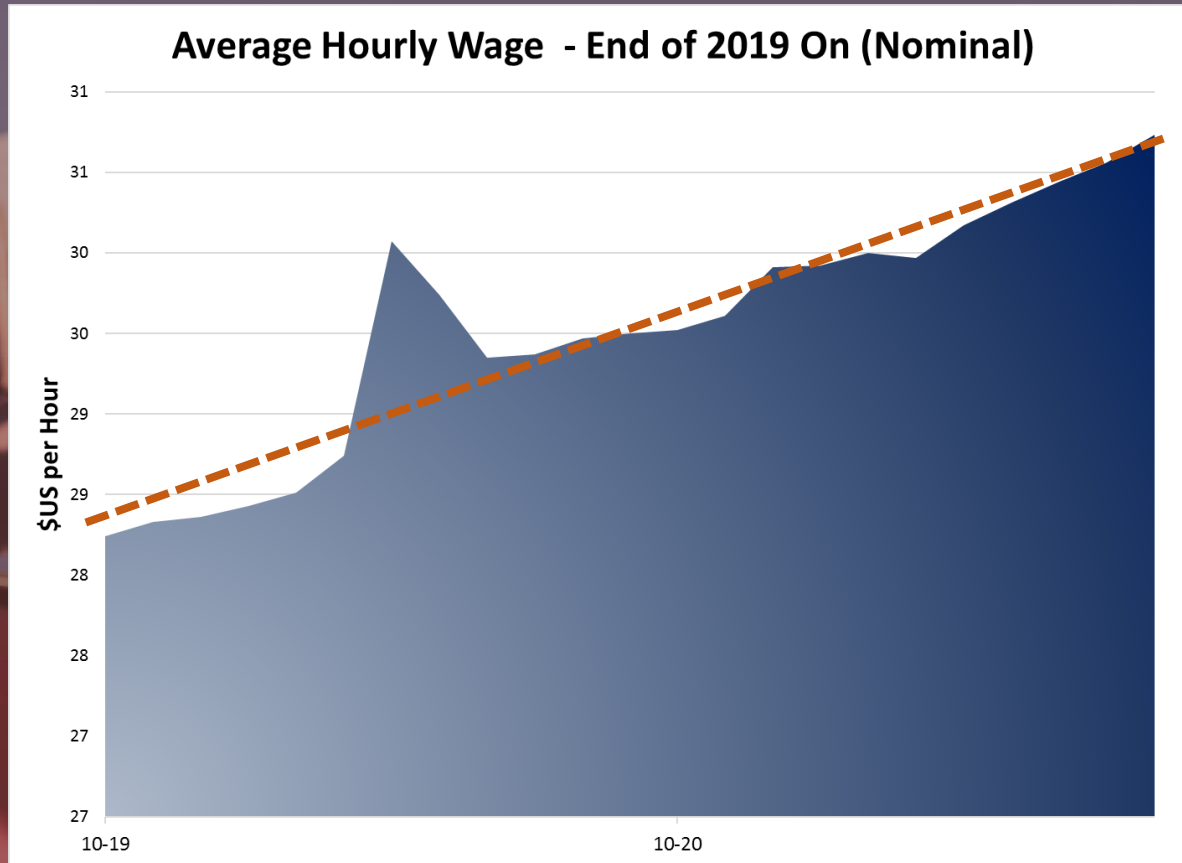
Employment Situation



Employment Situation



Employment Situation



The Great Resignation

Why the 'great resignation' of 2021 is -

NEWS
US manufacturing sector expected to surge, hiring difficulty

NEWS
As Labor Day approaches, record-high number of jobs available in South Dakota

EMPLOYMENT
Plenty of job openings in Fall in New Bedford area but not enough interest

NEWS
Your Food Prices Are at Risk as the World Runs Short of Workers

NEWS
Austin area employers facing stiff competition for workers amid recovering economy

NEWS
Employers in Dodge City continue to search for the right candidates

Difficulty hiring and keeping workers

...area employers struggle with labor shortage; here's what they can do

A Look at the Staffing Industry

Last Summer

IT Staffing

23% YOY Growth

Industrial Staffing

29% YOY Growth

Office Staffing

47% YOY Growth

Healthcare (Traveling Nurse) Staffing

100% YOY Growth



A Look at the Staffing Industry

End of 2021

Industrial Staffing

14% YOY Growth

Office Staffing

19% YOY Growth

IT Staffing

32% YOY Growth

Healthcare (Traveling Nurse) Staffing

100% YOY Growth

Succession Planning

The Marketplace



Valuing a Company

Starts with Cash Flow

Revenue

MINUS

COGS

EQUALS

Gross Margin

MINUS

Operating Expenses

PLUS

Depreciation and Interest

EQUALS

EBITDA



Succession Planning

Things to Consider



Succession Planning

Preparing for the Next Generation

- Start with Valuation
- Engage your entire team
 - Attorneys
 - Accountants
 - SBA Bankers
- Understand the hand off
 - Family?
 - Staff?
 - Both?



Succession Planning

Preparing for the Next Generation

Start Today

Comparison of Business Asset Taxation at Death

	Today's Tax System	Potential Tax System
Value of Business	\$ 68,000,000	\$ 68,000,000
Ordinary Capital Gains	-	(200,000)
AFP Capital Gains	-	(29,078,000)
Estate Tax	(22,520,000)	(10,808,800)
Total Taxes Owed	<u>(22,520,000)</u>	<u>(40,086,800)</u>
Effective Rate	33.1%	59.0%

Succession Planning

Preparing for the Next Generation

Start Today

Up to \$12M in Credits
for Gifts Available
Today

If married, that's over
\$24 million to plan with
today that could be
gone tomorrow.

Succession Planning

Preparing for the Next Generation

- Financial records
- Strategic direction
- Income Approach:
 - Capitalization of Earnings – Look back
 - Discounted Cash Flow – Look forward
 - Know when to use each one

Succession Planning

Preparing for the Next Generation

- Market Approach
 - Public comps – size adjust!
 - Precedent Transactions – Make sure they're comparable
- Begin With the End in Mind
- Be Defensible, one day you may have to talk to...
 - IRS
 - Attorneys

Succession Planning

Preparing for the Next Generation

- Gifting within Family?
 - Minimize value
- Selling to Family or Employee(s)?
 - Transfer Fair Market Value
- Selling to Third Party
 - Maximum Add-Backs

Succession Planning

Who Is Going to Buy You Out?

Perfect Manager

- Understands Culture
- Knows Client/Industry
- Knows Employees
- Values Legacy

But...

- Can She Afford Your Price?
- Can She Get Financing?
- Will the SBA Be An Option?

Sometimes the Perfect Fit Doesn't Work Out

Strategies for Succession Planning

Discounts

Lack of Control



**A Plane You Share
VS
A Plane You Own**

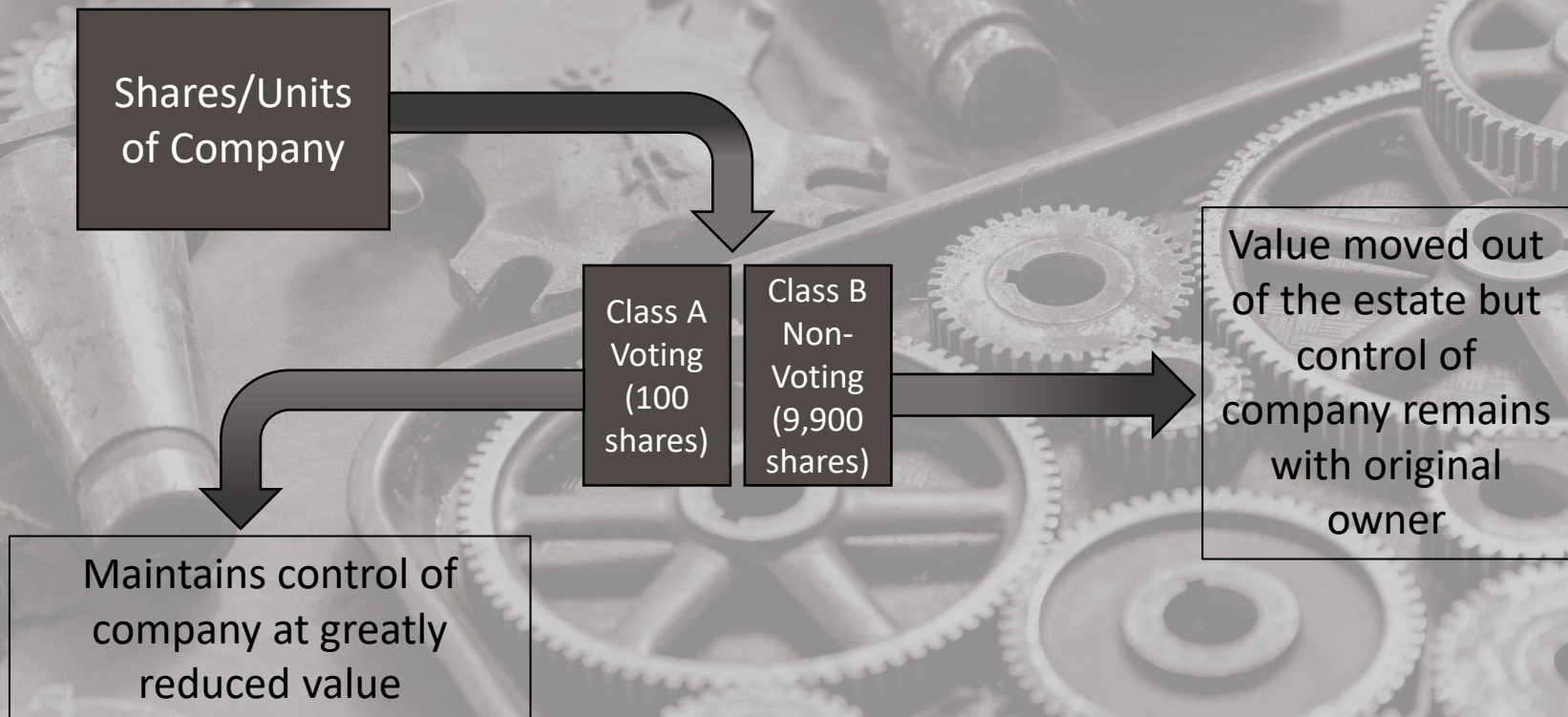
Lack of Marketability



**A \$40,000 Chevy Camaro
VS
A \$40,000 of GM Stock**

Strategies for Succession Planning

The Power of Share Classing



Strategies for Succession Planning

The Power of Share Classing

Assume Company Was Valued at \$10,000,000

Option 1

Shares Outstanding	10,000
Value Per Share	\$1,000
Value of 49%:	\$4,900,000
Discount LOC	(490,000)
Discount LOM	(882,000)
Value to Transfer	<u>\$3,528,000</u>
Effective \$/Share	\$720

Option 2

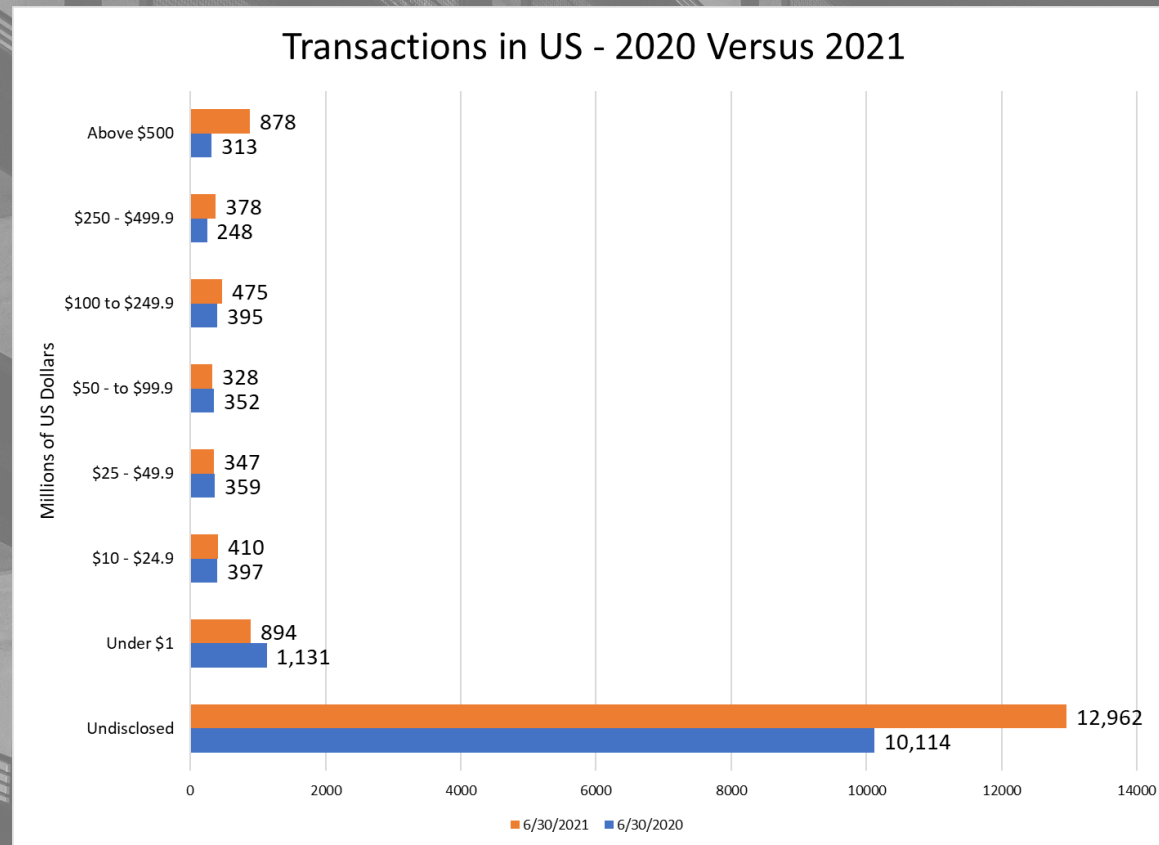
	Class A Shares	Class B Shares
Shares Outstanding	100	9,900
Value of Share Class	\$100,000	\$9,900,000
Value of Non Control	N/A	\$9,900,000
Discount LOC	N/A	(990,000)
Discount LOM	N/A	(1,782,000)
Value to Transfer	<u>N/A</u>	<u>\$7,128,000</u>
Effective \$/Share	N/A	\$720

Selling Your Company

Things to Consider



Transactions – The 2021 Recovery



Transactions – The 2021 Recovery?

Logistics - 2021



Storm Clouds?



Primary Steps

- **Make sure your financial information is clean**
 - Some buyers may perform a Quality of Earning analysis
 - Cash-based accounting is doable, but expensive
- **Do not sign the LOI unless you are willing to sell**
 - The #1 reason for sales not closing is seller regret
- **Let your sell-side advisor do the negotiation**
 - Attorneys/Financial Advisors/Brokers can be the “bad guys”
- **Understand your add-backs**

Add Backs

Scenario 1

Revenue	\$12,500,000
COGS/SG&A	(11,950,000)
Operating Income	\$550,000
Depreciation	\$35,000
Interest	15,000
EBITDA	\$600,000
6.0x Multiple	\$3,600,000

Scenario 2

Revenue	\$12,500,000
COGS/SG&A	(11,950,000)
Operating Income	\$550,000
Depreciation	\$35,000
Interest	15,000
Add Backs	300,000
EBITDA	\$900,000
6.0x Multiple	\$5,400,000

Scenario 3

Revenue	\$11,500,000
COGS/SG&A	(10,994,000)
Operating Income	\$506,000
Depreciation	\$35,000
Interest	15,000
Add Backs	300,000
EBITDA	\$856,000
6.0x Multiple	\$5,136,000

Every Dollar Your Find = \$4 to \$7 in your pocket

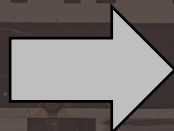
Add Backs

- **Primary Add Backs**
 - Compensation
 - Legal disputes
 - One-time accounting fees
 - New facility / move company
 - Non FMV rents
 - Repairs and Maintenance
 - “Management Fees”
 - Personal perquisites
 - Charitable donations
- **Primary Negative Add Backs (Take Aways)**
 - Compensation
 - Non-recurring revenue (along with expenses)
 - Unrelated business activities

Add Backs

- **Payment Protection Plan**
 - Most buyers will require you to remove this income
- **But analyze your expenses**
 - Primary question:
 - If not for PPP, what would your expenses have been?

Revenue	\$12,500,000
COGS/SG&A	(11,950,000)
Operating Income	\$550,000
PPP Income	\$500,000
Depreciation	\$35,000
Interest	15,000
EBITDA	<u>\$1,100,000</u>
6.0x Multiple	<u>\$6,600,000</u>



Revenue	\$12,500,000
COGS/SG&A	(11,950,000)
Operating Income	\$550,000
PPP Income	\$0
Depreciation	\$35,000
Interest	15,000
EBITDA	<u>\$600,000</u>
6.0x Multiple	<u>\$3,600,000</u>



Revenue	\$12,500,000
COGS/SG&A	(11,450,000)
Operating Income	\$1,050,000
PPP Income	\$0
Depreciation	\$35,000
Interest	15,000
EBITDA	<u>\$1,100,000</u>
6.0x Multiple	<u>\$6,600,000</u>

Asking Why

**But...
Why?**

Purpose

**Standard of
Value**

Succession
Planning

Maintaining
Direction

Next
Generation of
Leaders

Fair Market
Value

Selling
Business

Exiting

Maximizing
Value

Investment
Value

Summary

Gift to Family

No Control

A and B
Class Shares

Minimize
Add Backs

Selling to Employee(s)

Control

Appropriate
Add Backs

Who Can
Afford It?

Selling to Third Party

Control

Maximize
Add Backs

Structured



Structuring

Structuring

Cash

- Seller Notes
- Earn Outs
- Holdbacks

Future Payment



What To Do

- **Prepare your finances**
- **Ask yourself, what are your goals?**
- **Determine the value of your company**
- **Review your management team**
- **Engage your advisors**

What Not To Do

- **Talk only about EBITDA**
- **Sign an LOI without an attorney**
- **Expect smooth sailing**
- **Assume good faith**
- **WAIT!**

Thank you