THE M&A ADVISOR

THE M&A ADVISOR SYMPOSIUM REPORT

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Featuring

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The Power of Due Diligence - Strategic Value Creation

At The M&A Advisor's 12th Annual Mergers and Acquisitions Summit in New York late last year, industry veteran Mark Sirower, a Principal at Deloitte, moderated an insightful exploration of strategic value creation in due diligence and the post-financial crisis evolution of this critical stage in the M&A process.

A panel of active investors, consultants and key service providers to the M&A industry discussed the evolving emphasis on a streamlined approach to due diligence where strategic value creation is significantly affecting the consummation of a deal. This fast paced session addressed:

- The major issues differentiating corporate and private equity buyers vis-à-vis due diligence and value creation
- How targets can improve their valuation before the sale process begins
- The unique issues that arise in cross-border M&A transactions
- How elements for auditing operations excellence that drive strategic value can impact pre-deal integration planning
- Which diligence results are red flags for buyer board members
- How real estate is often misplaced as a Day Four issue during diligence
- The non-negotiable deal breakers
- How culture issues can be tested as potential problems

With the imminent return of M&A activity volumes to pre-crisis levels in the period ahead, understanding the evolution of the due diligence process is imperative for buyers, sellers and the professionals that counsel and guide them. This exclusive report puts a spotlight on the issues from which experts and newcomers, alike, will benefit.

Presented by

THE GORES GROUP & DTZ a UGL company

The Gores Group, LLC is a global investment firm focused on acquiring controlling interests in mature and growing businesses which can benefit from the firm's operating experience and flexible capital base. The firm combines the operational expertise and detailed due diligence capabilities of a strategic buyer with the seasoned M&A team of a traditional financial buyer. The Gores Group, which was founded in 1987 by Alec E. Gores, has become a leading investor having demonstrated over time a reliable track record of creating value in its portfolio companies alongside management. Headquartered in Los Angeles, The Gores Group maintains offices in Boulder, CO, and London.

For additional information, please visit www.gores.com. To learn more about The Gores Group and their expertise, contact Jennifer Kwon at jkwon@gores.com

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For additional information, please visit www.dtz.com. To learn more about DTZ and their expertise, contact Gerard Picco at 212 328 4248 or at gerard.picco@dtz.com

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EXECUTIVE SUMMARY

In M&A due diligence the dealmaker spotlight is moving from the traditional confirmatory role to strategic value creation. This evolving emphasis occurs in the current slow growth environment where most transactions need more than simple financial engineering to make economic sense for the buyer. In such an environment, streamlined due diligence and strategic value creation are often the difference between a deal's successful consummation and its failure.

INTRODUCTION

At the 2013 M&A Advisor Summit in New York, a panel of experts looked at the growing emphasis on strategic value creation in the diligence process and discussed the post-financial crisis evolution of due diligence.

The symposium participants included:

Mark Sirower, Principal, Deloitte Consulting LLP (Moderator)
Gregory Bedrosian, CEO, Redwood Capital Group
Leigh Brand, Founder and Chairman, Brand Consulting Group
Brent Earles, Senior Vice President, Allegiance Capital Corporation
Timothy Meyer, Managing Director, The Gores Group
Gerard Picco, Senior Vice President, DTZ

The panelists shared their thoughts about the evolution of the diligence process and about the growing emphasis on value creation. The session moved quickly as the panelists discussed a broad range of issues including:

• The major issues differentiating corporate and private equity buyers vis-à-vis due diligence and value creation

• The unique diligence/value creation issues that arise in cross-border M&A transactions

• The elements for auditing operations excellence that drive strategic value can impact pre-deal integration planning

• Is real estate misplaced as a Day Four issue during diligence?

• How can targets improve their valuation before the sale process begins?

• Which diligence results are red flags for buyer board members?

• What culture issues can be tested as potential problems?

• What are the non-negotiable dealbreakers?

Moderator Mark Sirower asked the panelists to describe the major issues that differentiate corporate due diligence and due diligence as practiced by private equity firms in the search for value creation.

Timothy Meyer, Managing Partner at The Gores Group, a global investment firm, commented that his firm maintains an operations orientation regarding value creation. Gores' functional experts, he explained, possess very deep knowledge in their respective areas and only rarely does Gores summon third party expertise to assist with value creation during diligence. "We're able to get across an asset fast. In that sense we approach diligence the same way a strategic buyer would, although the pace, depth and speed of our approach differs from a corporate buyer."

"(As a financial buyer) we're able to get across an asset fast. In that sense we approach diligence the same way a strategic buyer would, although the pace, depth and speed of our approach differs from a corporate buyer."
- *Timothy Meyer*

Gerard Picco, is a Senior Vice President at DTZ, a company which provides real estate focused due diligence. Many of his customers are private equity firms that turn to DTZ for value creation assistance in evaluating a target's assets and leases and to help build a strategy. The DTZ value-add, he explained, is the company's research capability, quick response time, and global footprint. "Our experience has been that real estate is often regarded as a Day Four issue during the diligence process; our task is to help bring visibility to target portfolios by focusing on risk and cost avoidance and by contributing to build a successful outcome." Picco acknowledged the accelerated pace of private equity M&A transactions and the service provider bandwidth needed to keep the pace. "This is where we excel and where private equity has the greatest need."

Allegiance Capital, the private investment bank where Brent Earles is a Senior Vice President, is active in lower middle market and middle market M&A transactions. Earles remarked that in a deal involving a corporate buyer – a "strategic" – the pace is faster than in a private equity deal because strategic buyers have ready cash. Plus, corporate buyers already know how they want to utilize the target. Based on the business they wish to enter, strategics outline their potential targets 24 - 36 months ahead of time. The result, he explained, is that strategics come to a transaction pre-loaded with their intent and target financial information, enabling them to evaluate target financials differently than would a private equity firm. In addition, Earles noted, "Private equity firms may be looking for a platform in order to break into a category where they possess overall expertise but lack in-depth expertise in a subsector of that category, a goal that may require additional education and a need for value creation during diligence." The size of a transaction, he remarked, attracts buyers that differ in their appraisal of value. "There's a great difference between a $5-$10 million EBITDA target and a $30-$50 million EBITDA asset in terms of the participating buyers; that difference becomes a critical component in value creation," Earles commented.

Moderator Sirower segued to investment banker Greg Bedrosian, Co-Founder, CEO and Managing Partner at Redwood Capital Group, an investment banking firm, to ask a question tailored to Bedrosian's considerable cross-border due diligence experience: What are some of the diligence issues that arise around specific issues in international M&A transactions? Bedrosian, who has spent many years living and working overseas, explained Redwood's dual identity: 1) half his firm is dedicated to an M&A advisory role, in which Redwood advises large strategic buyers and private equity firms on deals, many of which are cross-border; 2) the firm's co-investment arm invests alongside prominent private equity groups. Bedrosian notes that, "Cross-border deals differ from the comparatively vanilla U.S. counterparts because they involve layers of country- and region-specific tax and employment issues."

"There's a great difference between a $5-$10 million EBITDA target and a $30-$50 million target... that difference is a critical component in value creation."
- Brent Earles

Sirower directed a question at quality assurance consultant Leigh Brand, asking, "What specifically do you look for when auditing a company's operational excellence that drives strategic value and can impact pre-deal integration planning?" Brand, the Founder and Chairman of Brand Consulting, replied, "On behalf of a private equity firm we go into a target company and conduct an audit against an internationally accepted standard and then provide recommendations to address issues that may exist because a target may lack a management system. These issues might represent a no-go or too high a risk." Brand explained that to create value his company is asked by private equity firms to establish a management system at a target at the back end of a deal, post-close, to make the company more attractive to a potential buyer.

Sirower then aimed a question at Gerard Picco of real estate company DTZ: Given that real estate is the second largest expense for most companies, did Picco believe real estate was misplaced as a Day Four issue? Replied Picco, "For a manufacturing company, real estate is probably the third largest cost, behind the cost of raw materials. Regarding owned assets, we can develop a strategy involving sale leasebacks and portfolio positioning, hopefully in the pre-acquisition stage. If there's a bankruptcy involved, we can break up a lease and right-size the real estate footprint.

We see real estate as a lock on the equity. We regard value creation as the key that opens that lock."

Investment banker Brent Earles of Allegiance Capital often works on the sell side of due diligence, representing companies that are selling and seeking to get the maximum price with as few post-sale restrictions as possible. Sirower asked him what selling companies can do to improve their valuation before they go to market. Earles remarked that companies in the lower middle market sometimes lack sophistication, "They're run by successful entrepreneurs who sometimes don't know what they don't know." Bringing in a third party intermediary early on can help position such companies to optimize their value, Earles said. "We've brought in outside CFO services firms because it's not uncommon for entrepreneur-operated companies to lack the leadership and financial control needed to sustain a strong due diligence process." Some entrepreneur CEOs, he revealed, continue to write out and sign payroll checks, a practice that will not stand up under diligence scrutiny. A year earlier, Earles' firm summoned a third party to help prepare a healthcare company to go to market. "If we hadn't brought in outside assistance, that company would not have been able to have withstood the rigors of the full-on due diligence program that was necessary to close the transaction."

"We see real estate as a lock on the equity. We regard value creation as the key that opens that lock."
- Gerard Picco

Sirower next asked how firms like Earles' can best prepare a target for intense buyer scrutiny of the target's real market growth rate vis-à-vis its revenue line and margin line. "It's important to look at how fast the target's market and market share are growing," Earles replied. "A target whose market is growing at a faster rate than its market share is actually losing money," Earles noted. "When private equity firms see this scenario, their major concern is how to position the target for greater growth, not knocking down the target's valuation."

Private equity firms want to know what is driving this share dilemma, Earles commented. "As an intermediary, my responsibility is to encourage buyers and targets to carefully consider the best strategy to resolve this issue, on which the success or failure of a deal can hinge."

Sirower questioned The Gores Group's Timothy Meyer about the diligence results – and red flags – boards of directors are looking for. Meyer, who has sat on several boards, pointed out that his firm takes pride in its exhaustive diligence. "Probably the most important thing we can do as an investor or prospective buyer is to develop a very thoughtful and comprehensive point of view on what we would do with the asset. At the board level, we think about governance and direction. We look at independents who know the target's sector in depth. They can add value to our team that occupies the board seats." Also needed, he noted, is an understanding of the investment's downside and how the firm's capital can best be protected when the market or the asset fails to perform as projected.

Cost is a dominant factor in due diligence among strategic corporate buyers and private equity firms. "Elusive revenue synergies are often blamed for driving up costs," Sirower declared. He asked the panelists if there were ways to test for real revenue synergies that can provide uplift to the revenue line. "Much of what my company does is metric-based," replied quality assurance consultant Leigh Brand. "Measurements exist that can determine synergy revenue potential." Risk mitigation is one such measurement, Brand added. "We look for whether companies are incurring fines, if customer satisfaction is high and whether the Lean Six Sigma cost reduction system championed by Jack Welch is in place."

Culture has long received blame for deal snafus. Sirower asked the panelists, "What are the culture issues that can be tested to foresee potential problems?" Gregory Bedrosian cited the commitment of seller owners to being part of a multi-billion dollar conglomerate "as opposed to kings of their own fiefdom" as a prime indicator. "That element is often missed, even by some of the more savvy acquirers," Bedrosian commented. The result is an attrition spike around the close. Testing for cultural red flags, Bedrosian acknowledged, "is an issue that deserves more rigorous review."

"Testing for cultural red flags is an issue that deserves more rigorous review."
- Gregory Bedrosian

Sirower then asked Brent Earles how buyers can make certain that the target owners stay on and that attrition remains low after the close. Earles replied that half of his company's seller clients are family-owned companies, which can take on a dimension of emotion that many other businesses lack. "The owners may have run up their credit cards to build the company, bootstrapping from the beginning. They've made sacrifices." He recalled a client who had to choose whether to pay the mortgage on his house or pay the mortgage on the building that housed his company. "Those challenges become very difficult emotionally," said Earles. "The target is evolving in two years from, say, a $7 million EBITDA company to a $30 million EBITDA company." How do the operators of the business maintain some of the cultural fundamentals that helped fuel the company's pre-acquisition success – such as the close relationship between the employees and their founder -- and yet triple the size of the business? "Companies can check down and find some characteristics from the pre-deal target that made the organization successful and then allow the post-close company to take on its own new culture while inculcating those few fundamental elements," Earles noted.

Moderator Mark Sirower concluded the session with a final question for the panelists: What are the non-negotiable dealbreakers during the diligence process? For Gregory Bedrosian, a CEO writing payroll checks and employees using corporate credit cards that are not tied in to the company's accounting system are potential dealbreakers. "These actions that might have been tolerable from the entrepreneurial management perspective are not sustainable in an acquired company." The surprise, Bedrosian said, is that such practices are exposed during diligence even in mid-sized or large targets. For Brent Earles, the erosion of personal chemistry between buyer and seller is often a dealbreaker. "In a strategic deal, if the seller feels like his legacy is going to be lost, then the chemistry will break down. If it's a sponsor deal and the seller begins to think that his buyer counterpart is not going to be his partner, then the chemistry will break down."

"Actions that might have been tolerable from the entrepreneurial management perspective are not sustainable in an acquired company."
- Gregory Bedrosian

The session reflected a contemporary truth: while traditional due diligence is not on the endangered species list, the nature and role of diligence is evolving to meet the competitive imperatives of dealmakers in a slow-growth economy. In this environment, when M&A lags the rocketing equities markets and in which leverage ought to be a four-letter word, strategic value creation will become an even more essential element in the due diligence process.

The Power of Due Diligence - Strategic Value Creation

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Timothy Meyer
Managing Director
The Gores Group

Mark Sirower
Principal
Deloitte Consulting

Leigh Brand
Chairman
Brand Consulting Group

Brent Earles
Sr. Vice President
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To watch "The Power of Due Diligence - Strategic Value Creation" Symposium Session click on the photo below

For additional information, please visit www.gores.com. To learn more about The Gores Group and their expertise, contact Jennifer Kwon at jkwon@gores.com

For additional information, please visit www.dtz.com. To learn more about DTZ and their expertise, contact Gerard Picco at 212 328 4248 or at gerard.picco@dtz.com

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FACULTY PROFILES

Mark Sirower is a Principal at Deloitte Consulting LLP and a leader in the M&A Strategy practice. Mark has more than 17 years of consulting experience advising clients in growth, strategy and innovation, M&A process and strategy, target screening, commercial due diligence, valuation, investor relations, pre- and post-close merger integration and on governance issues related to M&A decisions. He has been active in helping industrial goods, consumer goods, financial services and pharmaceutical companies rethink and grow their businesses profitably through M&A. He focuses on transforming clients from merely reacting to growth opportunities to having the capability to proactively determine the best opportunities and grow shareholder value. Prior to joining Deloitte, Mark was global leader of the M&A practice at a major strategy firm and also led the M&A Strategy practice at a Big Four firm. His work has spanned across projects involving market analysis, strategy development and international acquisition search for technology division of a global tier-1 auto supplier, market analysis and strategic options development for world's largest international industrial cleaning company re-entry into the U.S. market, and competitive positioning and strategic screening of life-insurance acquisition options for a Fortune 50 financial services company. Mark is author of the M&A classic, The Synergy Trap, and his research and articles on best practice in acquisition performance have been featured in major business periodicals including Forbes, BusinessWeek, Fortune, the Economist, The Wall Street Journal and Harvard Business Review. An acclaimed speaker on M&A driven growth, he is adjunct professor at NYU's Stern School and regularly presents to groups of CEOs, CFOs and boards of directors.

Gregory Bedrosian is Co-Founder, CEO & Managing Partner of Redwood Capital Group, is responsible for the overall strategic direction and management of the firm and takes an active role in Redwood's relationships across the corporate and investment communities. Mr. Bedrosian is an award-winning and seasoned investment banker and private equity investor who lived and worked in Europe for over half of his 20 year career and whose experience spans both domestic and crossborder M&A and private equity transactions across the US, Europe and emerging markets. Prior to the formation of Redwood Capital, Mr. Bedrosian was a co-founder of Renaissance Capital, a leading investment bank focused on the emerging markets of Russia and Eastern Europe and co-founder and General Partner of The Sputnik Funds, a $1 billion private equity firm investing in the media, communications and other growth sectors. Mr. Bedrosian began his career in the merchant banking department of Credit Suisse First Boston in London and the leverage buyout group of Salomon Brothers in New York. Mr. Bedrosian is an active member of several foreign policy organizations including the Council on Foreign Relations (New York) and Chatham House (London). He serves on boards of educational institutions including the Harvard Business School Alumni Board of Directors and the Penn Engineering Dean's Advisory Board. Mr. Bedrosian has served on numerous corporate boards across the US and Europe and he currently chairs the Investment Committee of a $100 million New York-based foundation. Mr. Bedrosian holds an M.B.A. from Harvard Business School and a B.S. in Economics from the Wharton School of the University of Pennsylvania.

Leigh Brand is the Founder and Chairman of Brand Consulting Group, Inc. Leigh is an IRCA certified Quality Management System Lead Auditor (#A008984), a Senior Member of the American Society of Quality (ASQ). He is a graduate of Boston University (BA) and New York University (MA). Since the company's inception in 1995, Leigh has led the development of training, auditing, and consulting services for many of the world's most popular quality assurance and environmental management system standards. Leigh began his quality assurance career as the ISO 9001 Coordinator for a steel and aluminum processing company in Pittsburgh, PA. Since then, he has provided training for ISO 9001 to more than 7,000 people, including executives, managers, and union employees. He has consulted, trained, and audited organizations in a diverse group of industries including basic steel making, plastics, data measurement, respirator manufacturing, hardware products, chemical processing, healthcare compliance and healthcare providers, food and drug manufacturing, food safety and grading, information technology, medical devices, software developers, automotive, service providers which include banking, cashiering, disbursements, payroll, and payment processing, shipping and customs, logistics management, IT customer service and help desk support, telephone operations, facility maintenance, human resources, architecture and design, and environmental management. Leigh is the author or co-author of several leading articles on Medical Devices, Current Good Manufacturing Practices, ISO 9001 and Mutual Recognition Agreements. Under his leadership, the Brand Group is active in North America, South America, Africa, Europe, Asia, India, and Australia.

Brent Earles is Managing Director at Allegiance Capital Corporation. Brent has over 20 years of experience as executive strategic counsel to business owners, CXOs and Boards of Directors, and experience in macro business analysis, growth strategy, and brand development, negotiating and overseeing numerous multi-million dollar contracts. Brent is published author and ghostwriter of numerous books and articles, including H&R Block's "Just Plain Smart" book series with Random House Reference on tax planning and financial planning. Brent has led senior strategy development for some of the world's best-known companies, including H&R Block, AT&T, 3M, P&G, Unilever, Pennzoil, Motorola, Allstate, Sirius Satellite Radio, and Hughes DirecTV. In his role as strategic advisory, Brent has been involved in a number of M&A activities. When Brent led brand development for Sprint Corporation's $5B business division, he pioneered e-commerce strategies for the company, managed an $80M advertising budget, and leveraged multi-million dollar sponsorship agreements with the NFL and U.S. Ski Team. He also worked on the brand strategy team that launched Global One, an international telecommunications joint venture between France Télécom, Deutsche Telekom and Sprint Corporation. Brent has also worked with a wide range of small and mid-sized companies, including a number of startups and turnarounds. His business industry experience spans healthcare, retail, wholesale, consumer products, telecom, financial services, hospitality, travel & tourism, software, and education —with B2C, B2B and B2G experience. In addition to undergraduate studies at Missouri University and a B.A. in Theology from Calvary Seminary, Brent also has completed post-graduate MBA work from Northwestern University and SMU's Cox School of Business. Brent and his wife, Jane, operate a youth equestrian business, and they breed and sell fine Arabian show horses.

Timothy Meyer is Managing Director at Gores Group. Mr. Meyer is a member of Gores' investment committee and responsible for leading the Industrial vertical, providing portfolio company oversight and leading operational due diligence efforts. In addition, Mr. Meyer has served as chief executive officer for two Gores' portfolio companies. Prior to joining Gores, Mr. Meyer was Vice President of Sales Operations and General Manager of Business Services at Gateway, Inc. Prior to Gateway, Inc., Mr. Meyer spent five years with Bain & Company in the United States and Australia. From 1990 to 1996, Mr. Meyer served in various sales leadership and transformational positions with IBM and AT&T. Mr. Meyer serves as Chairman of the Board of Norment Security Group, Inc., Sage Automotive Group, Scovill Fasteners, Inc., and Cosmo Specialty Fibers. He is also Chairman of Stock Building Supply, and previously Chairman of Lineage Power/Vincotech and Director for United Road Services, and Wire One Communications. Mr. Meyer received a B.A. in Finance from Texas A&M University, where he was a Fellow in the College of Business, and an M.B.A. from The Wharton School of the University of Pennsylvania.

Gerard Picco is Senior Vice President at DTZ. Previously, Mr. Picco was a Senior Vice President at Cresa Partners from 2009-2011, and the Managing Director of Mohr Partners in New York, 2004-2009. With 26 years of brokerage and national portfolio management experience in commercial office, retail, industrial and warehouse assets, Mr. Picco's specialized areas of expertise encompass portfolio value engineering and consulting, new business development, leasing, investment sales and sale leasebacks. His various local and national client transaction projects are valued at over $500 million for numerous firms including XO Communications, SUNY Downstate Hospital, L-3 Communications, Source Interlink U.S. Legal Support Inc. and Banco Popular, NA. Gerard's background in building operations, construction, facilities and project management and tenant leasing experience, provides his clients a hands-on approach to problem solving and formulating strategic real estate solutions. Over the last two decades his experience has also included key roles as real estate manager for the U.S. Trust Company of New York and as an assistant managing director at Insignia/ESG. Gerard is a graduate of the State University of New York, Fredonia College, and is a member of CoreNet Global, Financial Executives International, the U.S. Coast Guard Auxiliary and the New York Historical Society.