

Outsourced Corporate Development: A Prudent Path to Successful Business Expansion

A Sikich Investment Banking White Paper

While acquisition as a path to increasing shareholder value is often **more efficient** than organic growth, it can be **fraught with challenges**.

Chief financial officers today are looking for new growth opportunities based on increasing market optimism, and they are finding a wide range of opportunities. As growth options are evaluated—whether through internal innovation or mergers and acquisitions—meeting your corporate development goals and increasing shareholder value while remaining conservative in a recovering market can seem like an overwhelming task.

Many businesses choose acquiring other companies or product lines over organic growth due to its efficiency and effectiveness as a strategy to meet growth objectives. Perhaps the company's core business is experiencing flat or declining growth. The primary market in which a company competes may be experiencing rapid change that has resulted in a mismatch or gap in a company's product portfolio or capabilities. In other cases, there may be

significant returns to scale that a company could achieve more quickly by acquisition than through organic growth. Companies may also need to achieve expansion in key geographies. Whatever the strategic imperative, a well-executed acquisition strategy can enable a company to achieve its goals more efficiently and effectively than with a solely organic growth strategy.

While acquisition as a path to increasing shareholder value is often more efficient than organic growth, it can be fraught with challenges. The economic considerations of executing an acquisition may be readily apparent, but getting a successful transaction across the finish line is rarely a straightforward endeavor. Working with the right outsourced corporate development partner can enhance a company's ability to achieve its corporate development goals, reduce risk and drive superior economic benefits throughout the process.

How an Outsourced Corporate Development Partner Adds Value

Acquisitions are often highly emotional for management teams and business owners throughout the process of getting a deal to closure. While very rational objectives are ultimately behind the decision to pursue an acquisition, the path to completion is rarely straightforward. A third-party partner can work to keep the deal on track and help both sides keep things in perspective. More broadly, because an outsourced corporate development partner is exclusively focused on transactions, their experience bringing deals to closure can provide a highly valuable perspective, which enables both improved efficiency of the deal process as well as potential to drive greater value.

Working with an Outsourced Corporate Development Partner During the Acquisition Process

Initially, an outsourced corporate development partner, usually an investment bank, can work with a company to define its goals and analyze strategic alternatives. A baseline strategic assessment of the company’s current growth prospects and positioning within the market is performed to focus the analysis and outreach priorities. Throughout this process, additional research can supplement the company’s understanding of the landscape to guide the decision on potential acquisition profiles. At this stage, clear objectives are set to gather market intelligence and define the research criteria to begin developing an acquisition candidate list. Once a list has been created, potential candidates are approached to gauge interest in discussions regarding a potential transaction. If both parties express interest in a potential transaction, an offer letter is drafted, which includes terms under which the company would acquire the candidate. Previous research conducted on the market opportunity is used to analyze a market-based offer for the candidate company. Assuming both parties are aligned on valuation expectations, more in-depth due diligence on synergies will ensue. Finally, a purchase agreement is drafted and negotiated, and the transaction is executed.

The Acquisition Process:



Some of the key ways that an outsourced corporate development partner can add value throughout the process are:

Strategic Assessment

The Strategic Assessment phase includes several work steps which may include:

- › Review of company-directed market research, if available
- › Review of any existing acquisition strategy documents that may have been prepared
- › Conduct interviews with senior management team to better understand objectives of an acquisition
- › Meet with current investors and other key stakeholders to discern goals and objectives
- › Review of strategic, financial, operational, competitive and risk management considerations

During the Strategic Assessment phase, an outsourced corporate development partner can provide needed objectivity. Perhaps a company was founded on a core asset that is critical to its overall identity, but that asset has become obsolete or significantly diminished in the market. Decisions to let go of or de-emphasize legacy assets and focus on emerging areas of growth or view the capabilities of a company in a new way are often difficult for business owners to accept without the engagement of an objective third party. In these situations, it can be difficult for stakeholders who built the company to view the future of the business taking a different direction. Outside advisors can add objectivity to the conversation, using market data to identify which course of action will lead to the strongest future for the business.

Conversely, executives may be so focused on growing their business and managing the day-to-day activities or tasks in a demanding environment that they have not had an opportunity to step back and objectively look at the assets they have created and view those assets from the perspective of maximizing the overall long-term value of their company. An objective partner skilled in creating value through mergers and acquisitions can help business decision-makers view their company through a different lens.

What is the difference between a broker-dealer and a business broker?

As you explore your options for an outsourced corporate development partner, you may come across different classifications of groups. Broker-dealers and business brokers are some of them. **Both buy and sell companies, but some differences are:**

Registered Representatives of Broker-Dealers:

- › Have passed licensing exams and participate in continuing education;
- › Are registered with and regulated by the Financial Industry Regulatory Authority (FINRA);
- › Can participate in both M&A and capital markets activities; and
- › Are required to disclose any previous criminal behavior to their broker-dealer and FINRA.

Business Brokers:

- › May be licensed, depending on the state and compensatory structure of their practice (some may be required to have real estate licenses, as well);
- › Can broker the purchase and sale of businesses; and
- › Are not monitored by government agencies, but may participate in national or state associations.

Research

The primary purpose of the Research phase is to identify the universe of prospective targets and prioritize the outreach effort to those targets:

- › Define broad criteria for platform or add-on opportunities
- › Profile key targets to help an acquirer understand the nature of each opportunity (size, growth rates, expectations for valuation, etc.)
- › Conduct a comprehensive search of potential targets in the broader marketplace in both the core specification range, as well as in near adjacencies
- › Characterize and categorize targets to further refine search criteria
- › Create a stratified list of potential targets
 - Work with management to discuss strategic fit and business case for acquisition
 - Identify optimal initial contact point within target company
- › Work with management to prioritize and approve the target list

Good advisors have teams that are highly skilled at researching markets, connections and analyzing the ecosystems in which a company operates to provide new insights into potential growth areas or synergies. Outsourced corporate development partners also have access to information regarding typical transaction value multiples to guide expectations within a company for the relative value of potential sectors that may be of interest to a company.

One of the most daunting aspects for executives who are acquiring a company is the fear of closing a deal only to find that there was a better opportunity they missed. Having a team conduct exhaustive research on the universe of targets provides executives with the confidence to move forward knowing they have made a successful match based on all possible options.

Candidate Development

Once the company has agreed on a prioritized list of targets, the process of Target/Candidate Development takes place. Several steps are involved in this phase:

- › Develop a draft script and talking points for outreach calls
- › Conduct pre-marketing calls or research with industry groups or other resources to potentially identify events where a significant number of targets may be gathered
- › Draft an outreach letter for candidates that may not be reachable by phone
- › Initiate introductory phone calls with appropriate senior contacts within a candidate company
- › Adapt the target list as the buyer's interests change based on early feedback from potential targets
- › Qualify potential interest and identify the circumstances under which a candidate might consider an acquisition
- › Request additional information and secure non-disclosure agreements as appropriate once mutual interest is established
- › Discuss and agree upon a process for baseline due diligence
- › Introduce management team to priority candidates, as appropriate
- › Continually gauge interest in further dialog
- › Loosely establish the acquisition terms that would be of mutual interest
- › Set expectations and deadlines with both sides and solicit feedback on continued interest
- › Develop draft letter of interest, as appropriate

When a company's goals have been established and criteria have been set for searching for an appropriate acquisition candidate, the challenge often becomes engaging the candidate in discussions. A variety of candidates may be approached, from entrepreneurs to private equity-backed companies. Each will have different motivations for potentially engaging in discussions. Throughout the initial engagement period, it's important to skillfully position the company expressing interest in a cloaked fashion, meaning without identifying the buyer. A candidate may find early discussions with a prospective buyer intimidating and intrusive, but will be more willing to be candid with an intermediary that is skilled in encouraging the candidate to speak about one's company. Throughout the process, candidates may feel comfortable receiving sensitive information—whether it is feedback on the target's potential fit with the buyer's company or concerns raised in diligence—from a third party that is highly skilled in those types of conversations. Frequently, an entrepreneur may go through a series of challenging emotions as he or she considers the prospect of selling a company that may represent his or her life's work for the greater long-term benefit of the business. Frequently, there is a benefit for such entrepreneurs to process their emotions and be guided along the path by an independent corporate development partner, rather than an invested or future member of the company that will potentially become the new "boss" or owner ultimately.

Due Diligence

Once both parties have established interest in pursuing a transaction, the Due Diligence phase begins. The outsourced corporate development partner will:

- › Work with management to refine the business case for the acquisition
- › Prepare of Letter of Intent (LOI) for the target company that outlines the proposed terms of the transaction
- › Negotiate and execute the LOI
- › Work with management to prepare a detailed due diligence requirements list
- › Work with attorneys to support their development of a definitive agreement that incorporates the agreed LOI terms
- › Support management in analyzing the diligence items and determining whether data received will materially impact the terms of the definitive agreement

At this stage, a corporate development partner provides needed guidance on the impact of diligence findings. By this time in the process, both sides have begun to emotionally commit to the transaction and envision the candidate as a part of the company. However, issues can emerge during due diligence that require recalibration of the valuation or other terms contemplated in the agreement. An experienced partner can guide a company through those challenges and offer alternative solutions to the diligence findings. Further, as emotions may come into play at this point in the transaction, an intermediary with a history of working through such challenges can be invaluable in working with both parties to come to a successful resolution.

In some cases, either the potential buyer or target may not have a lawyer who is experienced in acquisition transactions. The outsourced corporate development partner will likely be able to recommend experienced counsel in such cases to either work independently on the deal or alongside the general counsel to ensure the deal terms and documentation are completed appropriately.

Case Study: REAL COMPANIES, REAL ACQUISITIONS

A multi-million dollar consumer goods company with global operations and strong retail channels wanted to penetrate a specific international brand that was not currently carrying its products. The company engaged Sikich Investment Banking to acquire a company that would allow entrance into that market.

Sikich Investment Banking identified and engaged several prospects until the most appropriate target was identified and diligence began. During the diligence process, the target's detailed financial statements were reviewed, and a misalignment between the original projections and the actual performance of the candidate was identified. This required a change in the structure of the agreement. At this point, both parties were invested in the outcome and it became beneficial for an intermediary to facilitate discussions on the necessary structural changes to ensure that both parties were satisfied. In addition, while the transaction was in process, the candidate entered into an unexpected agreement. The company had some concerns about the potential strategic

implications of the agreement and needed to pause discussions while the strategy unfolded. Ultimately, this agreement led to a modification of the definitive agreement as well, which ensured the protection of the company while rewarding the candidate for the performance that they expected based on the agreement. Again, the involvement of objective advisors facilitated a beneficial outcome for the company.

Having a third party in this case allowed the transaction to be structured and completed based on all relevant information from both parties. Sikich Investment Banking's experience in previous transactions enabled the deal teams to look objectively at the situation to determine whether, at various points during the transaction, the deal was still in the buyer's best interest.

The company was ultimately able to successfully expand into new product areas and channels through this acquisition.

Transaction Execution

In the final phase, as a transaction is negotiated, the primary focus of activities is in supporting the documentation review process:

- › Review documentation and definitive agreement drafts prepared by attorneys
- › Coordinate overall closing process with key stakeholders, including attorneys for both the buyer and the selling party, and other stakeholders such as ESOP trustees or other outside advisors
- › Participate in final negotiation meetings

In the final phase of the process, as the merger agreement is negotiated, it's helpful to have an experienced team knowledgeable in setting expectations with both sides for various activities that are required to complete the deal. A seasoned team can facilitate a smooth transition and efficient coordination of all the components required to get to closure and potentially reduce post-merger integration issues. A team exclusively focused on transactions has more experience with the different situations that may arise, and also brings specific knowledge about the current state of the market or ideas for alternative proposals that may better meet the needs of both parties to facilitate a successful closure.

Conclusion

The decision to grow a company by acquiring one or more businesses is often the first step down a months- or years-long path of evaluating targets, dismissing some and courting others through an exhaustive diligence process. The goal is a successful transaction and satisfied stakeholders. For all the ways a transaction can be a positive experience, there are as many or more ways that a deal can be negative—from missing key valuation statistics in diligence to inheriting a target company's financial or legal problems. Using an outsourced corporate development partner not only helps you identify and approach the targets that would most benefit your business's bottom line and growth objectives, but also brings years of transaction experience to your acquisition, with the knowledge and experience to identify current or future problems before you sign a definitive agreement. Growth through acquisition is an exciting and intense process, and having the right advisors can increase the likelihood of positive outcomes.



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