Synergy™ INSIGHTS

SUPPLEMENT

HOW TO MAXIMIZE RESULTS WHEN SELLING A BUSINESS

In order to optimize results when selling a business, we must first define what an optimal outcome would be.

In this *Synergy Insights Supplement*, we will define optimal results as:

1. Achieving the highest possible price for the asset being sold
2. Selling to a buyer who will be a good and supportive owner
3. Achieving the sale while maintaining utmost confidentialty

Synergy Insights Supplement is a companion newsletter to Taylor Advisory's business journal, *Synergy Insights*. For more information about *Synergy Insights*, please visit www.tay.com/publications.

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1. Achieving the highest possible price for the asset being sold

The Proper Intent

Before discussing the specific methodology to maximize the sales price for a divestiture, it is important to note that having a specific stated intent to extract the most value is critically important. While this might seem obvious, there are circumstances that could keep value maximization from being a principal goal of a sale.

For example, there may be such an acute need to sell a business quickly, that maximizing the sales price becomes a secondary consideration. Also, sellers often buy into the foregone conclusion that the characteristics of the business being sold are such that achieving a high price is unlikely. Due to that pessimistic assumption, sellers might not even attempt to achieve optimal results. In other words, conventional wisdom suggests that a poorly performing business, cannot garner a high selling price. However, Taylor knows from experience that an asset that lost its value for the current owner might still create tremendous value for a new owner in a slightly different capacity.

Finally, the most common circumstance preventing sellers from even attempting to maximize the sales price is their lack of a methodology specifically engineered to extract the most value. Simply stated, one is less likely to pursue a specific outcome if he lacks a process capable of consistently producing that outcome. As relates to divestitures, many businesses know how to sell an asset but they lack the specific expertise and tools to maximize the price for that asset. However, the firm that does possess a methodology capable of repeatedly obtaining the highest price, has a critical competitive advantage because it is empowered to pursue optimal outcomes rather than just hoping to close a deal.

Appropriate Methodology

Implicit in the discussion so far is the belief that there is a methodology capable of consistently delivering higher prices, and that it is possible for some firms to seamlessly execute this methodology while others struggle. In order to objectively determine whether a firm deploys a successful process or not, one has to critically evaluate a firm's historical track record as it relates to prices obtained for actual businesses sold. Washington, DC based Taylor Advisory, has consistently averaged getting a 70% premium over private equity comps for the businesses they have divested. Not only does Taylor always maintain a strong focus on optimal results in its divestitures, but they also employ a methodology specifically designed to repeatedly maximize the value for businesses being sold. The specific key characteristics of Taylor's purpose designed process include:

A. A thorough synergy based analysis of the sellers business.

This allows the seller to identify all potential buyers who are likely to achieve a high degree of synergy with the seller and who, therefore, can afford to pay higher prices.

i. Synergies pursuable through a divestiture exist to the extent that the seller's weaknesses or strengths can be counterbalanced by a buyer's corresponding strengths or weaknesses. This matching of one party's strengths to the other's weaknesses and vice versa, is how synergy is created.

ii. The synergies available to potential buyers have additional economic value beyond the stand-alone value of the business being sold. This additional value can exist irrespective of the business' stand-alone value. For example, even a business approaching or in bankruptcy can be seen as quite valuable in combination with an acquirer with whom it has synergies.

iii. Step A allows the seller to understand at a granular level what synergies are achievable and it leverages that understanding to proactively identify potential buyers to whom these synergies would be meaningful. This ensures that there is a concentration of potential buyers in the process who can afford to pay more than the stand-alone value of the business being sold.

B. Discrete initial contact with the potential buyers to vet their intent to acquire a business like the one being divested and to determine the actual synergy potential inherent in the proposed transaction.

i. Any particular business to be divested can offer various different synergy creating opportunities to potential buyers. This means that there can be a large number of different synergistic buyers for the business being sold.

ii. However, experience shows that not every buyer with a theoretical potential for synergy will be interested in bidding on the deal. Therefore, to avoid wasted time and effort, the potential buyers identified in step A are contacted in a confidential manner, to narrow down the list to only those buyers that have confirmed their interest. That way, a very well qualified and highly motivated group of synergistic buyers is marshaled forward into the sale process. Having such highly motivated parties in the process fosters confidentiality since everyone involved will be spurred by serious intent rather than mere curiosity. This effectively prevents any leaks by the potential buyers due to a fear of suffering broader competition in the bidding process.

iii. Each buyer's M&A function is interviewed in such a way that the identity of the seller cannot be determined. During each interview, confirmation is gained that the buyer:

a. Is interested in acquisitions of the same general type as the business being sold.

b. Is interested in obtaining the synergies inherent in the transaction.

c. Will do an acquisition at least as large as the business being sold including a reasonable premium.

d. Will in principle pay a premium for synergy in a deal.

e. Is ready to proceed in the desired time frame.

C. Further vetting of each buyers synergies with the ultimate key decision maker.

i. A confidante of each buyer's ultimate key decision maker (KDM) confidentially informs the KDM that the deal is available. The KDM is contacted, and the synergies are vetted with him/her to verify that the vision of the M&A function and the KDM are aligned. At this stage, additional synergies may be identified that are unique to the KDM's perspective.

ii. The relationship between the confidante who introduces the deal and the KDM is one characterized by trust and respect. Therefore, indication by the confidante to the KDM that the deal is highly confidential will be honored.

iii. First presenting the opportunity to the KDM garners maximum attention on the deal as it is referred down by the KDM to the M&A staff. Additionally, an established channel to the KDM is critically important in the event that roadblocks are encountered that can only be effectively resolved at the highest level.

D. Provision of a customized information memorandum to all potential buyers that compellingly portrays the vetted synergies pertinent to that buyer.

i. Based on the synergy vetting accomplished in steps B and C, a confidential information memorandum (CIM) is provided to each buyer interested in pursuing the deal.

ii. The intent is to provide the buyers with the information necessary to understand the business being sold. Further, the memorandum serves to highlight the characteristics of the seller and buyer that will create extra economic value beyond the divestiture's stand-alone value.

iii. Each memorandum is customized so that it clearly communicates each buyer's unique synergies to the decision makers (see example on next page). A dual confidentiality agreement is signed by each buyer to first obtain the name of the business being sold, and to secondly obtain the memorandum itself. Use of a two-stage agreement underscores the need for utmost confidentiality.

Example of customized CIM

substantially lower product costs as it combines the procurement activities and enhances bulk buying leverage.

The specialty food distribution industry has experienced rapid growth during the past 10 years which has resulted in a fragmented industry. The opportunity for Kehe to combine with TOL will create a very strong company that is uniquely positioned to continue to consolidate the industry through additional bolt-on acquisitions. The acquisition of TOL will provide Kehe with an ideal platform upon which to make additional acquisitions resulting in increased scale and improved efficiencies.

An acquisition of TOL by Kehe will result in significant cost savings synergies. These potential cost savings synergies are listed below:

- Given the proximity of Kehe's distribution centers to TOL's, there is a significant opportunity to rationalize distribution centers and optimize delivery routes. The optimization of distribution centers will also result in cost savings related to reduced headcount at the distribution centers
- Efficiencies and reduced costs similar to those TOL experienced as a result of its nationally centralized and efficient corporate infrastructure
- Consolidation and rationalization of the combined category management functions
- Integration of ASPEN, TOL's state-of-the-art real-time handheld inventory management device into Kehe's operations may improve performance in the areas of inventory management and customer support, leading to greater efficiencies, improved margins, and greater customer satisfaction
- Reduction in net product cost due to the combination of inbound freight and improved bracket opportunities
- Combination of sales and support organizations, resulting in decreased costs without any reduction of effective sales coverage
- The technology associated with the Auxiliary Power Units (APUs)

Taylor Companies

Synergy 7
Obtaining future benefit of industry consolidation

Synergy 9
Benefits of acquiring a competitor to Kehe

Synergy 25
Acquiring TOL prevents a competitor from doing so

Synergy 1
Eliminating overhead and improving utilizations

TAYLOR COMPANIES — CONFIDENTIAL PAGE 23

E. A management presentation to each buyer that further vets the synergies and establishes the channels of communication necessary for the buyer and the seller to collaboratively finish studying the synergies achievable on the deal.

i. During each management presentation and subsequent dinner, the seller's staff engages their counterparts in the buyer's company in Q&A and discussions regarding the synergies and estimated values. Further refinement of the understanding of the synergies is accomplished which allows for concrete values to be computed.

ii. This step allows the discipline heads of both parties to begin to establish the rapport that will support a fair estimation of the value of the buyer's synergies on the deal.

F. Focused work by the appropriate individuals from both seller and buyer to quantify the values of the vetted synergies.

i. Between the management presentations and the second round of bids, key individuals from both the buyer and seller work together to achieve mutually accepted estimates of the buyer's synergies.

ii. The friendly push and pull between buyer and seller results in estimates that are ultimately credible to all parties.

iii. The buyers are motivated to participate in the synergy vetting process as a means of thoroughly understanding their synergies and thereby maximizing their chances of winning the deal.

iv. Compared to common divestiture processes where the intent often is to limit the degree of information made available to potential buyers, the intent here is to provide as much information as is necessary for the buyer to fully vet the synergies. This increases the buyer's ability to pay more without overpaying for the deal, thereby minimizing his risk on the deal.

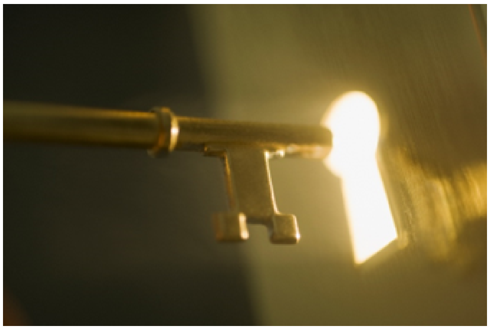
G. Education of the most synergistic buyers as to the vetted magnitude of their synergies and as to how much of the synergies will need to be paid for in order to win the deal.

i. The KDM of each finalist buyer is presented with a breakdown of his/her synergies on the deal including the depth of analysis performed by the seller as well as the KDM's own staff.

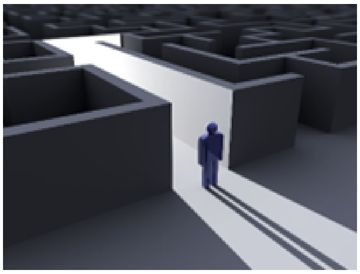
ii. The KDM is advised on how much of the synergies will need to be paid for to remain competitive in the bidding.

iii. All final bidders are advised simultaneously which drives up the bids. The buyers are kept informed of any bid increases so that they can always further adjust their own bid upwards until the maximum sales price is reached.

The Key to Maximizing the Price



In review of the process outlined above, it becomes apparent that the key to maximizing price is in the strategic sequential order of each step as well as the clear intent underlying the entire process. Each step builds and depends on the preceding step. Nonetheless, this methodology is not just a purely linear process. Rather, inspired by the primary goal of maximizing price, different purposeful actions may have to be taken at any time to meet specific needs of different sellers and buyers or to mitigate unique roadblocks along the way.



Pitfalls in Merely Getting the Business Sold

It is common today for pieces of companies to be sold by investment banks that also support the owner's balance sheets. Frequently these businesses are sold to Private Equity firms (PE) that will pay the most that can be expected from financial buyers. The prices likely to be paid by such acquirers are less than what would typically be paid by strategic buyers. This is due to the fact that purely financially oriented PE firms cannot access the full range of synergies that might exist in combination with a highly strategic buyer. Even in the case that PE firms consider synergies that might exist with other companies in their portfolio, only a very narrow range of synergy categories is typically identified.

This disparity between purely financial buyers and strategic buyers clearly portrays why the formerly described methodology, which is highly focused on synergy, achieves superior results compared to common processes that merely intend to close the deal as quickly as possible.

The latter methodology is not proactively focused on maximizing price. Thus, while high selling prices might still occur following this method at times, it will be more a matter of coincidence rather than design. Some of the factors making the standard process less well suited to achieve the highest price include:

- The list of buyers is not intentionally concentrated on the most synergistic acquirers who can afford to pay the most without overpaying.
- The buyer list often includes buyers that lack serious intent. Merely curious parties do not feel urgency and are, therefore, less likely to pay a premium.
- The buyer list is much broader than one that only includes buyers with a confirmed stated interest. This might lead to wasted time and effort, as well as distraction from running a process focused on maximizing price.
- The opportunity is normally initially introduced to the buyer's M&A function rather than the KDM. Since the M&A function always reviews numerous other transactions simultaneously the deal must vie for attention and work its way up to the ultimate decision maker.
- The standard process generally uses a generic information memorandum focused primarily on the operational aspects of the business being sold. This does not sufficiently focus the buyer on any potential synergies that could be achieved. However, synergy is the only thing that justifies high premiums.

- Conventional processes often do not include ongoing continuous vetting of the synergies and, therefore, the sellers are largely left in the dark as to what the full synergy potential might be.
- In typical processes the seller's intent is to limit the flow of information to the buyer, making it difficult for the buyer to study the synergies sufficiently enough to overcome any fears of overpaying, and to comfortably make a well vetted synergistic offer.
- Because the necessary information regarding synergies is not available in standard processes, the buyer and seller cannot effectively work together and derive a mutually agreeable understanding of what each buyer's synergies are worth. Therefore, the seller and his M&A advisor have no objective basis for asking for a price higher than what the top bidder is offering based on his own analysis.

2. Selling to a buyer who will be a good and supportive owner

By the time the current owner of a business decides to sell, he typically already decided that the business is no longer core to the owner's strategy or no longer an entity in which the owner wants to make investments. This lack of attention or investment by the current owner is likely to adversely impact the business' ongoing performance and may have already contributed to dampened enthusiasm among the employees. Under such circumstances, the business will have a difficult time achieving its full potential.

However, the current owner is not to blame as they are doing the right thing in diverting attention and investment to the other parts of the portfolio that are deemed to be more pertinent to the core strategy. In deciding to sell the "orphaned" business, there is a great opportunity for it to be placed with an owner that values it as core and worthy of investment.

A sale methodology capable of reliably achieving the highest price for a business being sold, will simultaneously also be the one that will result in a sale to a good and supportive owner. This is due to the fact that the highest price will invariably be paid by strategic buyers who, due to their synergies with the business being sold, are able to afford to pay the most. This category of buyer is buying because of the potential for synergies. To achieve those synergies the owner will be working closely with the acquired business and investing whatever is necessary to rapidly achieve the synergistic returns on the investment made in buying the business. Achieving the synergies will also expand the stature and capability of the acquired business beyond what might have been possible under previous ownership. As a result, the acquirer will be viewed as a good and supportive new owner by the employees and by the market.

3. Achieving the sale while maintaining utmost confidentiality

The sale methodology outlined in this article includes several features which collectively serve to foster a high degree of confidentiality during the divestiture process. Factors that underlie such a unique degree of confidentiality include:

- Due to the focus on strategic buyers, all parties in the sales process are well qualified and highly motivated. Having such a group of potential buyers with serious intent fosters confidentiality because they will be incentivized to prevent leaks that the business is for sale out of fear of suffering broader competition in the bidding process. The buyer list of conventional processes does not exclusively include buyers with serious intent. Instead, the process can include many merely curious parties who may not have a vested interest in keeping the deal secret.
- Each potential buyer's ultimate key decision maker (KDM) is approached by a confidante who discretely informs the KDM that the deal is available. The confidante informs the buyer's KDM that the deal is a secret and that its existence must be kept strictly confidential. The integrity and good will of the relationship between the confidante and the KDM ensures that confidentiality is maintained. Certainly, the KDM will include his M&A team in the vetting of

the opportunity, but he makes it known to his staff that confidentiality is of utmost importance. The staff will keep the deal secret to avoid embarrassment and disappointment of their KDM.

- Before any information about the business being sold is transmitted to a potential buyer, a dual non-disclosure agreement (NDA) is used. As such, to learn the name of the business being sold, a first NDA must be signed. Subsequently, a second NDA must be signed to get the business' detailed information contained in the Confidential Information Memorandum. Use of a two-stage agreement further underscores the need for confidentiality.

Confirmation of the effectiveness of the foregoing protocol in successfully maintaining confidentiality is a matter of record. In the several decades of using this approach subsequent to having originally developed it, Taylor has never experienced an unintended disclosure that a sales process was underway.

In Closing

Since sale process designs are directly related to project outcomes, it is possible to examine each service provider's effectiveness based on their statistical track record related to:

1. Achievement of price premiums for assets sold
2. Sale to buyers who are good and supportive owners
3. Maintenance of utmost confidentiality

The owner of the business to be sold should consider such results as they rationally and objectively consider which firm to use in a sale being contemplated.

WE WELCOME READER FEEDBACK

We are interested in your feedback and examples of synergy applied in acquisitions and divestitures with which you may have been involved. To share examples, or if you have questions, comments, or are interested in seeing a specific subject discussed, please contact us at SynergyInsights@tay.com, attn: Warren Bellis.

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