**Food for thought: preparing a food and beverage company for sale**

Speaker 1: Welcome to Food for Thought, a podcast series designed to bring you bite-sized information on the latest trends and hot topics in the food and beverage industry. On today's podcast, we discuss what companies need to do get ready for sale in specific growth areas and trends emerging in the food and beverage industry.

Matt Petrucci: Hello, I'm Matt Petrucci. I lead Plante Moran's national transaction and advisory services practice. I'm joined today by Paul Jevnick, managing director of Mergers and Acquisitions at BMO Capital Markets. Paul, thanks for joining us today.

Paul Jevnick: Yeah, you bet. Thanks, man. I'm happy to be here.

Matt Petrucci: Paul, before we dive into our main topic, tell me a little more about your background and role at BMO.

Paul Jevnick: Yeah, happy to do that. I've been at BMO now a couple of years, but I've been in the M&A business for about 25 years, having spent time at Piper Jaffray in a small, boutique firm, sell-side focused firm called Greene Holcomb Fisher. All the while, I've been focused in the consumer sector and at BMO, I continue to be focused in that space. I sit within the middle-market M&A group and within that space, specifically focused on food consumer and retail businesses.

Matt Petrucci: Great. That's great background and a great segue into our first question. So, Paul, what are some of the things that companies should consider when determining the best time to sell their company?

Paul Jevnick: Great question. I think it comes down to three different things you need to think about. You need to think about the personal needs of the shareholders of the business, the owners. Maybe liquidity, wealth diversification, succession planning, estate planning, — a variety of different reasons why owners of a business are considering a sale. And it's important that that's taken into consideration, but you also need to consider the company and the state of the business.

Paul Jevnick: You want to sell when the business is performing well. You want to sell when it's growing, and buyers can see a clear path to continued growth. You need to think about milestones in the life of the business. Are there large, new customers that are about to place major orders? Gaining a large new customer might behoove you to wait for that. Changes that will dramatically impact the profitability of the business, might behoove you to wait for those so that you get credit for that greater level of profitability.

Paul Jevnick: Then, of course, in the background of all of that, there's also market timing. So, it's the owners, the company, and the market. I think it's safe to say that this is the best M&A market I've ever seen in 25 years. I think it's probably the best M&A market and continues to be so anybody practicing M&A today has ever seen, maybe the best in history. We don't see anything on the horizon that's going to bring a swift end to it, but this has been a strong market for longer than any other market cycle we've seen before.

Matt Petrucci: Yeah, no. That's great. And it sounds like the companies need to be somewhat balanced, certainly having a proven track record, good products out in the market, tested — maybe you've built a bit of a following with consumers, but obviously still have some room for growth.

Matt Petrucci: When taking a company to market, you guys often look at both strategic as well as financial buyers, meaning private equity groups and family offices. Can you talk to us a little bit about some of the differences there including maybe some of the differences that may exist both pre and post-closing that should be considered?

Paul Jevnick: Yeah, you bet. The first thing that I think most people think of when they think about strategic buyers is that they are traditionally...They're believed to be able to pay a higher price, a higher valuation for any given company. The reason being is they have strategic reasons for making the acquisition and synergies.

Paul Jevnick: So, synergies kind of come in two flavors. I think of them as top-line synergies, so ways you put two companies together, and it's one plus one equaling three or more. There may be cross-selling opportunities, selling one company to another where the acquired company has customer relationships, the acquirer doesn't have. By buying that company, gaining those relationships, they can also sell their products into that company. Those are top-line synergies.

Paul Jevnick: The other types of synergies are what I call hard synergies and these are cost takeouts. Perhaps you can consolidate manufacturing into a single plant and you can close a plant. There's some cost savings there. So because of both top-line and hard synergies, strategic buyers are oftentimes believed to be able to pay more.

Paul Jevnick: Private equity buyers are typically looking at underwriting a particular transaction or value by looking at the use of leverage and the growth rate of the business and forecasting that in determining how much can we pay. That is much more disciplined, oftentimes, approach, but these days, because of the availability of debt, debt is for strong businesses in terms of the acquisition target, readily available to private equity firms to support their acquisitions and on really attractive terms.

Paul Jevnick: There are higher leverage ratios than we've ever seen. So, a company that in normal times would have borrowed four times EBITDA may be able to borrow five or even six in the current market. That allows a private equity firm to pay a higher price. Also, private equity firms have a tremendous amount of equity capital that have been committed to these firms that has yet to be put to work. It's basically sitting on the sidelines. That's putting a lot of pressure on these firms to compete for deals and to be successful they have to pay higher prices.

Paul Jevnick: What they're really doing is lowering the IRR, the internal rate of return. All that is to say, that private equity is really competing with strategic buyers on some of these deals, and we're seeing private equity stepping up and paying some really attractive values.

Paul Jevnick: Apart from that, just how much can you pay? I think there are infinite number of differences between the two, but I think you really have to think of a strategic buyer as: They're coming in, they're buying 100% of a company, either 100% of its stock or basically the entire business by acquiring its assets, and they owners, typically the sellers, hand over the keys and —they don't quite walk away. There's probably some period of transition that they remain involved, but it's pretty clean in terms of a break from the business. That's attractive to some sellers.

Paul Jevnick: Other sellers, and this is really what brought about the advent of private equity, other sellers preferred an opportunity to take a bunch of chips off the table but continue with the business. Continue running the business and by taking some chips off the table, you kind of feel like you're playing with house money. Now, you might pursue even the more aggressive acquisition strategy or growth strategy including potentially acquisitions with the support of a private equity partner. Now you've, in this case, typically sold control of the company, but you're largely retaining a significant amount of control because you continue as management.

Matt Petrucci: Sure. And meaning, on that last point, that an owner who sells to private equity could, ultimately, get — I guess what's known as a second bite of the apple — when the private equity goes and sells the company again down the road.

Matt Petrucci: So, let's talk a little bit about getting a company ready for sale. We spoke earlier about the best time to sell, but prior to going to market, how early should a company really start planning for the ultimate sale?

Paul Jevnick: Well, I would tell you, Matt, that it's really never too early to start planning. There are a lot of things you can do. We love to be introduced to a potential company or to a potential client early and have time to consult with them about, "Boy, the market is really placing a lot of value on certain attributes, and if you can improve those attributes perhaps you could get a higher value." And so, those are typically things that can't be done overnight.

Paul Jevnick: There are also attributes that will detract from value. I'll tell you one that comes up a lot with food companies, is customer concentration. So, I'll just use an example. I had a client that had 50% concentration with Costco. They had a product line that got picked up as a Kirkland Signature product. And that's a great place to be, but it makes buyers nervous because they're worried that if something goes wrong in that relationship, they could lose 50% of their sales. And they just paid a premium price for this company. Now, they have a bunch of sales at risk. So, that typically detracts from value.

Paul Jevnick: If you're thinking about planning for an exit for a sale of the business, I would recommend, for example, taking a look at one of about 20 things you could look at or maybe even 50 things. There's really no limit to it, but an important one is customer concentration. But I think it's really common for people to really start focusing on concrete actions you can do to prepare for a deal, not just make the company more attractive. And those kinds of things, certainly a year out is not too soon to start planning for a transaction.

Matt Petrucci: Got it. Obviously, an important aspect of that is selecting the right advisors, and I think it starts with finding the right investment banker to help navigate this process, determine timing, and that sort of thing. So, what are some of the things that a seller needs to consider when selecting advisors and certainly when selecting investment banker, attorneys, accountants, and that sort of thing?

Paul Jevnick: Yeah, that's the core team that you just named: bankers, attorneys, accountants. I would encourage any company to reach out to investment bankers that have credibility in their sector, meaning experience in their sector. Begin asking questions. And maybe the first thing you can ask is, what could I do to improve the value of my business in the eyes of potential buyers?

Paul Jevnick: For investment bankers, I think the key is you want to find somebody who's got relevant experience. That means companies, the majority of the work they do is with companies of a similar size range. If the value of your company is about $100,000,000, you want to work with an investment bank that routinely does transactions between maybe $50 and $250,000,000. Working with investment banks that tend to focus on transactions of $1,000,000,000 or higher, A, you probably won't even get their attention, but B, if you do, you're going to probably get the B team and not a lot of focus. It's good to be a big fish in a small pond, I think, with investment banks.

Matt Petrucci: Sure.

Paul Jevnick: Then, industry expertise. You really got to do the research, find out who has done transactions in the specific sector that you play in in the recent past.

Paul Jevnick: When it comes to lawyers and accountants, I would say the same things are important. If you're a small firm, going to one of the Big Four accounting firms is not going to help you. You're just going to pay exorbitant fees, and you're not going to get the attention you deserve. Also, working with a firm like Plante Moran that has specific expertise in food if you're a food company — really smart idea. There's a lot of additional benefit there.

Paul Jevnick: Even if you aren't working with Plante Moran today, but you're a food company and you're considering a transaction, I would definitely consider started a relationship there and switching firms to work with a firm that can not only handle a transaction for you but has industry-specific expertise.

Paul Jevnick: I think when it comes to law firms, again, big fish in a small pond is good, but you really need a firm that's got the kind of firepower in terms of resources whether it's areas of practice areas. If you might need a firm that has — Certainly, you've got to have good M&A capabilities and tax capabilities. That's every deal you need that. But, then you may need people with lay expertise in labor, environmental, food safety, and regulation. It could be any number of things. Going with typically a larger firm that has that expertise in-house can pay dividends.

Paul Jevnick: Those larger firms will also have the resources to go toe to toe with the biggest strategic buyers and their lawyers, which is really going to make a difference for you at the end of the day when it comes to negotiating a purchase and sale agreement.

Matt Petrucci: Yeah, no. That's great advice. Certainly, when it comes to the attorneys and the accountants, if it is a smaller company and they already have some of those resources, it doesn't mean that those folks need to get pushed aside. Your accountants and attorneys that will be helping you through the M&A process can still work and partner with your existing providers, but as you said, give them that specific M&A background and experience as they go and work with the buyers that will obviously bring those resources to bear.

Paul Jevnick: That's very, very important. Sorry to interrupt.

Matt Petrucci: Yeah, go ahead.

Paul Jevnick: I'm just going say, that's a really important point.

Matt Petrucci: No.

Paul Jevnick: If you have been working with a small law firm or small accounting firm, they're going to need to stay involved because they know, pardon the metaphor, but they know where the bodies are buried. That's critically important. That is typically what happens in a sales process is you may engage Plante Moran, but if you've got a sole practitioner who's been doing your book historically, then Plante Moran will need to work with that person to be responsive in due diligence and other things.

Matt Petrucci: Sure. Then, even on the investment banking side. You mentioned a lot of great things there. Certainly, thinking through the importance of familiarity with the industry, obviously, that's important for a lot of reasons, just understanding not only the size and the complexity of the business and everything that goes along with that but also just understanding who the potential buyers are in the market not only from a strategic but, again, from a financial perspective as well. It is very, very critical.

Paul Jevnick: That's a great point.

Matt Petrucci: And so, another important step in the preparation process is making sure that the financial information is ready to go. Talk to us about the need for audited financial statements and sell-side quality of earnings assessments.

Paul Jevnick: Right. Audited financial statements for businesses of a certain size are absolutely expected. If you don't have them, it will be sort of a red flag for buyers. I would just plan these days on having audited financial statements. Now, it's not always easy if you haven't had your statements audited historically. A lot of time, buyers are looking for several years of audited financial statements. I would say, however, it's never too late to start.

Paul Jevnick: Reviewed financial statements are fine, but audited are better. I would say 95% of my clients come to me with three years of audited financial statements. If they don't, doesn't mean we can't work with them, but it does make life a bit more challenging.

Matt Petrucci: Which again, comes back to that timing issue we spoke about earlier because if they don't have them, sometimes you do have time to get those audited statements done. Maybe it's just a year at that point. But again, even if they don't, sometimes then a sell-side quality of earnings assessment could, not necessarily take the place, but certainly be an important part of the process.

Paul Jevnick: Yeah, that's a good point. We use sell-side quality of earnings assessments in the vast majority of our transactions these days. A few years ago, you'd see them here and there, but today, it is industry standard practice in sell-sided transactions. Really, what we're talking about here is an accounting firm coming in and instead of focusing on the balance sheet, really proving out that the earnings are sustainable, that these earnings are not — There's not one-time in nature issues.

Paul Jevnick: We use both in terms of not only trying to show the sustainability of the company's earnings but also where there have been one-time issues that had a negative impact on earnings, we're typically looking to make an adjustment to add that back the show what would this business really look like if — What's the true operating performance of this business as if these one-time, extraordinary events hadn't occurred.

Paul Jevnick: There can be positive ones, and you might have a one-time transaction or sell of ... One that happens a lot in food business is you'll get channel fill. If you have a new product or you have a new customer, you may get a little bit of a bulge in the python because of channel fill, particularly if it's a really big customer and it's a first time sell. That's something where buyers are going to look at that with suspicion and try to back that off and say, "Well, you're really not as profitable as you think you are and therefore we should be able to pay a lower price." There might be some validity to that claim. You need to know that up front.

Paul Jevnick: On the other hand, there could be one-time events. There oftentimes are. There could be some sort of extraordinary event that has a negative impact on your margins for a brief period of time. It could have been a fire in a manufacturing plant and you had to move your manufacturing out to contract manufacturing and there was additional costs associated with it, but now, the repairs are made, the plant is back up and running.

Paul Jevnick: It's a one-time, temporary change in your margin. You can add that back, but having a quality of earnings assessment, having a qualified accounting firm come in and do the work to verify the level of adjustment that's being made will have a big positive impact eventually on the purchase price.

Matt Petrucci: Yeah, that's great. We've certainly been doing a lot more sell-side engagements, more and more each year thinking through the last three, four, five years. When we're doing it, we're typically taking a buy-side perspective meaning when we do buy-side due diligence — when we're doing sell-side, we're doing things. We're looking at the business in a very, very similar way, and we find that that provides the most value.

Matt Petrucci: Certainly, when you put that report along with all of the materials, Paul, that you and your team put together, it really allows for, what I'll say are better educated LOIs. That purchase price that they might put in that LOI has a lot more knowledge behind it, all of these adjustments that I'll just walk through, and it really avoids some of the surprises that happen at the 11th hour that can derail a transaction or cause, renegotiations of purchase price.

Matt Petrucci: It also gives the management team a dry run before the buyers come in. We get all the data organized, all of the skeletons are out of the closet if you will, all of the stories behind the numbers have been told. Going back to what we said before, it really gives everybody the opportunity to fix things if there things that need to be fixed before you go the market.

Matt Petrucci: We worked on a few of these where some of our findings caused the company to delay going to market because they needed some time to either fix some of these things or to have issues that were identified that sort of fall outside of the trailing 12-month period, which is typically a big focal area for folks.

Paul Jevnick: Yeah, I would agree with everything you just said, Matt. That's all part of it and just to pick up on one thing there, we really want to get all the skeletons out of the closet. We want to get all the facts that are material to any particular buyer's bid out on the table before the bids are made. Because the way our processes typically work, we have multiple bidders bidding for any given company, some strategic, some private equity bidders. They put their best foot forward. We don't give them a price that they have to hit, they're coming into this knowing that they're going to be competing for the asset really in the context of a blind auction, and they're going to have to put their best bid forward.

Paul Jevnick: If they put their best bid forward, and they're selected as the winner and then you move toward documentation, final diligence, and closing, and you start finding things, now, you've lost some bargaining power. Because your best bargaining power is when you have that competitive tension from having multiple parties at the table. Once you select a bidder and you begin to move forward with them, you do slowly begin to lose bargaining power. If at that point they're discovering fair reasons to reduce their value, it's very difficult to push back on that.

Paul Jevnick: We've had processes blow up over that because something was found out later. I will say that I think that happens far less frequently now that we are doing sell-side quality of earnings in almost every deal.

Matt Petrucci: Yeah, absolutely. Outside of some of the common financial issues that can cause a deal to get off track, what are some of the other things that are maybe more specific to food and beverage that can cause issues in getting a transaction closed?

Paul Jevnick: You can run into very specific types of things with food businesses. For example, if in final diligence they discover that you haven't properly documented the ownership of your intellectual property. For example, most companies, particularly employees that are involved in formulating products, developing recipes, you got to make sure you've got the right employment and intellectual property agreements in place with those employees as they come in the door. That kind of thing can throw things off, but there's a whole list of things, food labeling claims.

Paul Jevnick: If you're making claims that in diligence it's determined you can't support on a clean label perhaps. If you don't have good records of any food safety issues — And, food safety issues are a fact of the industry, it's a fact of doing business. They, in and of themselves, typically are not a huge problem, but if you don't keep good records that can be a red flag. A lot of these things aren't in and of themselves, any one of these a deal-killer, but when a number of these things start to raise their heads in final diligence, then it can become a problem for potential buyers.

Paul Jevnick: In addition to customer concentration. You can also have product concentration. If you're a one-product company, that's less attractive to buyers than if you have multiple products. Same thing for brands. If you're a one-product company, one-brand company, it may or may not be less attractive than having multiple brands. Again, diversification generally, whether you're talking about products even channels, diversification generally is viewed as a safer bet and therefore more valuable.

Matt Petrucci: I think that sort of takes care of what we really wanted to cover today. We wanted to thank everybody for listening.

Paul Jevnick: Yeah, thank you, Matt and thanks, listeners.

Matt Petrucci: Remember to check out additional food and beverage resources at plantemoran.com. You can also find additional information on Paul and BMO Capital Markets at bmocm.com.