White Paper

Part 1

NEVER LOSE ANOTHER AUCTION:

A Proactive Acquisition Strategy Works

Why Develop a Proactive Acquisition Strategy?

At Osprey Capital, we are in constant dialogue with shareholders seeking liquidity, strategic acquirers and financial sponsors. Over the last several years, we have seen an evolution in the marketplace toward (i) a growing universe of financial buyers that have been able to effectively compete with strategic buyers on valuation, and (ii) a proliferation of intermediaries that are continually extending their reach into an ever broader buyer universe.

As a result, more businesses are being sold in highly competitive auctions and proprietary deal flow is becoming increasingly challenging.

*This white paper is the **first in a three-part series** that addresses the significant challenges that strategic acquirers face.*

Osprey Capital Partners Inc.

Professional Investment Banking for Mid-Market Companies

Osprey Capital Partners

The Benefits

In response to the increased efficiency of the market for *active sellers* to maximize valuations, additional strategies are required. An Acquisition Program ("AP") that surfaces *passive sellers* at reasonable valuations works in concert with conventional sourcing strategies and can produce significant strategic and financial benefits. The benefits of developing a pipeline of proprietary acquisitions are manifested through superior valuations, strategic choice and increased activity levels.

A. Proprietary Deals are Superior to Auctions

1. *Reasonable Valuations Enhance Value Creation*

- For many vendors, price is not the sole consideration.
- The $30 million acquisition of a typical industrial company* would create $7.5 million in Economic Value-Added ("EVA") if bought at 1.5x below the acquirer's EBITDA multiple, *assuming no synergies*.
- This multiple "arbitrage" on that same company in auction would be much lower.
- If the acquirer can increase target margins through cost synergies and sales through distribution synergies, the EVA increases significantly:

EVA Under Synergy Assumptions ($ Millions)

Cost Synergies / Distribution Synergies

				Revenue Growth
7.5	10.0	12.5	15.0	**0.0**
8.8	11.3	13.8	16.3	**2.5**
10.0	12.5	15.0	17.5	**5.0**
11.3	13.8	16.3	18.8	**7.5**
15.0	15.0	17.5	20.0	**10.0**
0.0	**1.0**	**2.0**	**3.0**	**%**

Margin Improvement

2. *Draw "On the Fence" Targets into Dialogue*

- For various reasons, most companies have no knowledge of, interest in or desire to auction their company *today*. However, many of these are *passive sellers that would entertain an approach from a serious party*.
- Typically, at a given point in time, active sellers represent a fraction of the available acquisition opportunities.
- We have tracked target response rates and our experience suggests that 10-80% of a given target universe (depending on the industry and target size) are *passive sellers* who welcome an approach from a professional, motivated and well-funded suitor.

3. *A Proactive Versus a Reactive Approach*

- Focus on what makes strategic sense, not just what's available.
- Targets selected based on strategic priority and higher expected synergies.
- Reduced likelihood of the target being auctioned once an approach has been made.

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* Illustrative EVA analysis assumptions are:
- $5 million target EBITDA
- Acquirer trading multiple of 7.5x EBITDA and proprietary target valuation of 6.0x EBITDA
- 15% EBITDA Margin and 20% Contribution Margin (on incremental revenues from distribution synergies)

4. ***Control the Process and the Pace***

- The vendor and their agent drive the process for auctioned targets, including schedule and access.
- A proactive approach:
  a) Controls the pace of approaches.
  b) Controls the pace within each transaction process.
  c) Can sequence targets according to your priorities.
  d) Enables sufficient time to conduct proper due diligence and develop a relationship with the vendor(s) and management.

5. ***Flexibility to Apply Risk Mitigating Structures***

- In auctions there is little flexibility in terms of form and structure of consideration.
- A proactive approach may facilitate risk mitigation through structured consideration (VTB, earn-outs, other contingent structures), which can be an effective means to close any valuation gap with the vendor.

6. ***If You "Win" the Auction, Your Competitors Know Everything About the Target Business***

- If you were in the auction, most likely your competitors were as well.
- They will know the details of the business and may have an idea of how much you paid.

7. ***Auctioned Companies may not be the Best Targets***

- Why are the vendors selling? Is business deteriorating and the vendor is trying to salvage value?
- Has there been a lack of focus on the business over the last few years if the vendor has already decided to leave the business? Will there be leadership transition issues?

B. Significant Value Enhancement Through Creation of an Acquisition Pipeline

1. ***"Inverse Auction" Dynamics***

- Negotiating leverage is critical to valuation and terms.
- This is typically the advantage enjoyed by the vendor in an auction.
- An AP in full-swing will often generate a pipeline of proprietary targets, each vying for your time and focus.
- It is much easier to move past sticking points with vendors when you (and possibly they) know that others are in the queue. Conveying, whether subtly or directly, that you are reviewing many opportunities creates some competitive tension and urgency for the vendor.

2. ***Significant Value Creation on Each Additional Acquisition***

- If each $30 million acquisition creates $7.5 million in EVA, *before synergies*, any increase in acquisition volume (number of acquisitions), multiplies this effect.

3. ***Accelerated Consolidation Improves Return on Capital for the Platform***

- If the EVA from acquisitions is realized at a faster pace, IRR is enhanced.
- Faster completion of the consolidation phase benefits both private equity funds and public company shareholders:
  a) Private Equity: allows more time during the investor hold period to integrate the acquisitions and prepare the platform for sale. Shorter hold improves IRR.
  b) Public Company: surface shareholder value more quickly and gain first-mover advantage over competitors.

4. ***Maximum Strategic Choice and Optionality***

    - Where there is a pipeline or inventory of opportunities, you can decide when and where you will focus time and effort.
    - Targets can be sequenced optimally.

C. Ancillary Benefits

1. ***Gather Proprietary Market Intelligence***

    - Ability to access target information that is not publicly available.
    - Enhanced understanding of which industry players are consolidators and which are sellers (including *why* and *when* they are sellers).
    - Assess best practices employed by targets through due diligence.

2. ***Target Benchmarking***

    - Running parallel discussions enables comparison of one target against another (for example, financial and operational benchmarks and fit of product/service offering with the platform).
    - Facilitates prioritization of targets based on their attributes and strategic fit with your platform.

3. ***Provides Valuable Market Intelligence on the Future Extent of the Consolidation Opportunity***

    - If you can work through the target universe in 1 year with a proactive approach instead of 5 years with a more reactive approach, it informs decisions on whether to:
        a) Continue to pursue acquisitions and secure financing and other resources to support them, or
        b) Shift the strategy if the consolidation opportunity has been fully explored and is more limited than originally thought.

Conclusion

Seeing more proprietary acquisition opportunities that make strategic sense and/or are available at better valuations, while being able to significantly mitigate risk by having more control over the process, are some of the reasons to consider making proactive acquisition sourcing part of your growth strategy. However, committing to pursue such a strategy alone does not ensure success. Implementing a state-of-the-art process that maximizes results requires significant planning, resources and skill.

Process matters. Osprey's team has worked with some of the most successful industry consolidators and private equity funds and has approached well over 500 acquisition targets for some of the most sophisticated clients. We have seen first-hand the difference between processes that get results and those that disappoint.

Part II of this three-part series, ***Process Matters: Generating Proprietary Acquisitions*** provides a comprehensive walk-through of a field-tested architecture that an acquirer can use as a guide in building their internal capabilities.

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