White Paper

Part 3

ADDRESSING THE CHALLENGE:

Surfacing Proprietary Acquisitions

How Can Internal Capabilities be Leveraged ?

This white paper is the **final instalment of a three-part series** that outlines the benefits of an Osprey Strategic Acquisition Program ("SAP"). Part III serves as a strategic overview of the sourcing challenges and the value an Osprey SAP provides.

At Osprey, we seek to seek work with our clients to leverage their internal capabilities to align them with their strategic aspirations. Our experience and skill in advising owner-operators on selling their businesses allows us to provide an effective buffer between our client and the vendor(s), including managing information flow and taking the lead on qualifying targets before our clients expend their time and effort.

This white paper outlines how an Osprey SAP delivers value and allows our clients to maximize the productivity of their internal M&A resources.

Osprey Capital Partners Inc.

Professional Investment Banking for Mid-Market Companies

Osprey Capital Partners

The Challenge

How do I Best Leverage My Internal Capabilities?

An acquisition strategy is not sensible in many cases. In many cases, acquirers that lack core competencies in (i) sourcing, (ii) executing, ad (iii) integrating acquisitions will destroy shareholder value. Conversely, significant shareholder value can be created for those companies that have committed the resources to develop these competencies.

The most successful companies are those that appropriately align their resources with their objectives. This is equally true for those companies that are not interested in acquiring and have no internal resources as it is for those active acquirers that have the resources to execute their strategy. However, issues arise when there is a gap between motivation and capabilities:

Capability	Strategic Motivation for Acquisitions: Low	Strategic Motivation for Acquisitions: High
Low	• No proprietary deal flow • Limited to no resources expended on reactive approach to auctioned assets • Not a bad outcome, no gap between aspirations and capabilities	• Not seeing as many opportunities as desired (auctioned or proprietary) • Reacting to auctions. "Lumpy" activity levels, often urgent timing with higher valuations and low close rates • Lack of proprietary deal flow • Limited time split between travel to conferences, cultivating investment banking relationships, assessing deals and non-M&A internal responsibilities stretch thin internal resources, resulting in inconsistent execution of acquisition strategy • Aspirations exceed capabilities: sub-optimal use of available resources and hence inferior return on internal resources
High	• Overstaffed with corporate development and M&A personnel • Overinvestment in systems • Many bona fide acquisition leads generated and qualified, but low closure rate • Ability to respond quickly to auctions, but may not be contacted for all of them if inactive • Capabilities exceed aspirations: poor return on internal resource investment	• Significant proprietary deal flow. Multiple successfully integrated acquisitions per year • Steady activity, controlled pace • Significant shareholder value creation • Credibility with targets and intermediary community re: ability to close and perceived as a "go to" consolidator • Significant return on internal resources 1. EVA on acquisitions far exceed the costs 2. Specialized roles and knowledge within team and purpose-built systems produce scale and scope benefits • No gap between aspirations and capabilities

For those companies that possess the core competencies, there can be significant economic value-added ("EVA"), even from a small acquisition. For example, the $30 million acquisition of a typical industrial company would create $7.5 million in EVA if bought at 1.5x below the acquirer's EBITDA multiple (i.e. 6.0x EBITDA vs. 7.5x), assuming no synergies. This multiple "arbitrage" on that same company in auction would be much lower because of the higher purchase price. If the acquirer can increase target margins through cost synergies and sales through distribution synergies, the EVA increases significantly (see adjacent table).

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

This paper focuses on those situations where there is a gap between a desire to make proprietary acquisitions and the resources available to effectively execute the strategy, particularly the sourcing aspect.

Typically the most challenging aspects of developing a core competency in acquisitions are in sourcing acquisitions and integrating them. Applying external, purpose-built resources to the sourcing effort can generate a greater and more consistent flow of proprietary acquisitions, while freeing up internal resources for planning and execution of the integration. Significant time, resources, and skill are required to execute a comprehensive sourcing strategy and the needs will likely change over time. A comprehensive sourcing strategy entails:

- Researching and identifying targets that advance the company's strategic objectives;
- Approaching targets in a professional manner and maintaining a reliable, consistent target follow-up program;
- Developing and executing a qualification protocol, including a preliminary financial assessment, that balances confirming the most relevant information that a target can easily provide with ensuring that due diligence resources are not wasted on poorly-qualified targets;
- Maintaining momentum with and sequencing multiple targets while negotiating or conducting due diligence with another target; and
- Managing document and information flow with multiple targets, including follow-up on information requests and execution of agreements.

How Osprey Adds Value

Osprey has developed an Acquisition Program ("AP") that surfaces (i) more passive sellers (ii) that make strategic sense (iii) at reasonable valuations. The expected result is the accelerated cultivation of a proprietary acquisition pipeline and maintenance of that pipeline.

Our significant expertise and resources are applied to a process that is complimentary to your existing acquisition strategies and effectively manages the early stages of vendor interaction to allow you to focus your internal resources where they add the greatest value.

A. Effective Process And Depth of Resources

1. *Committed, purpose-built resources*

- Osprey has a full team on each AP with each member specializing in different aspects of the program.
- We have done many of these and have continually enhanced the process, making improvements based on careful, continuous, empirical evaluation.
- Significant investment in custom systems for target databases and contact management.
- These projects are resource-intensive and we limit the number of these projects we will execute concurrently to ensure a high level of service and responsiveness.

2. *Professional, systematic coverage, monitoring and follow-up*

- Oftentimes, the response is neither "yes", nor is it "no". The response is often, "not now".
- Osprey maintains contact as called for by the circumstances.
- If the target wants us to follow up in the summer three years from now, we have the systems in place to ensure that happens.

3. *Effective management of conflicts*

- When Osprey commits to pursue a defined target list on a client's behalf, any targets within that defined universe are exclusive to our client during the course of our engagement.
- We do not take on more than one client in a given target segment.

B. Expertise in Managing Vendor Dynamics

1. *Vendor approach expertise*

- Osprey carefully assesses the shareholder structure of the target.
- Publicly-listed targets require varying approaches depending on their listing jurisdiction and shareholder composition.
- Private company strategy depends on the number of shareholders and the nature of their interaction.
- How active the shareholders are in operation of the target impacts strategy.

2. *Positioning a proposal with the vendor*

- We understand how to best present our client's value proposition with the vendors.
- As seasoned divestiture advisors, we understand vendor psychology and how to anticipate and assuage their concerns.
- We know how to position a strategic buyer versus a private equity buyer and vice-versa

3. *Creating a buffer and building vendor trust*

- We conduct ourselves with the utmost professionalism, respect and integrity
- We maintain vendor confidentiality and will not share anything with our client without the vendor's express consent. We offer to execute an NDA if desired by the target.
- This establishes trust and respect with the vendor and allows us to open a meaningful dialogue quickly.
- This open dialogue and exchange of information allows us to effectively qualify the target.

4. *Management of vendor ensures smoother execution*

- The trust we build with the vendor helps us to intervene if the vendor behaves outside of M&A market norms.

C. Complimentary to Existing Efforts

1. *Thorough understanding and appreciation of your objectives*

- Through our extensive M&A and strategic advisory experience, we understand the importance of strategic fit in the context of your overall strategic objectives.
- We invest significant time and energy to understand your objectives and acquisition criteria.
- This ensures that our clients do not waste management time on targets that don't fit.

2. *Focus internal M&A resources where they add the greatest value*

- We often identify targets that are not on our clients' radar screens, but not always
- Our expertise is in converting names on a list into actionable opportunities.
- We enhance "coverage" of a given target list by cultivating it into qualified targets that are motivated to sell at reasonable valuations.
- Only once the target is qualified and the vendor provides consent to disclose information does our client spend time on, or come into contact with, the target.
- Additionally, Osprey's management of information gathering, preliminary financial modeling, preparation of letters of intent and support with due diligence, negotiations and documentation frees significant management time for our clients to focus on business due diligence, negotiation and target transition/integration planning.

3. *Regular, bespoke reporting*

- Osprey provides concise, informative, and regular progress reporting.
- Typically, we schedule a weekly call where we walk through a customized "dashboard" report showing:
  a) conversion metrics,
  b) pipeline status,
  c) progress to date,
  d) activities and follow-up for the coming week, and
  e) a clear list of items and/or time required from our client's team.

4. *Process control and risk mitigation*

- In a proactive process, regardless of how many actionable targets are in the pipeline, our client controls the process. The process is not controlled by the vendor, their agent or other bidders as in an auction process.
- Only those targets that the client approves are approached. Hence, there is no interference in any existing target dialogue.
- The worst outcome is spending a lot of time and money assessing and negotiating with a target, then failing to close. Our approach yields less risk of "losing" as is often seen in auctions.
- Having greater process control minimizes risk by allowing more complete due diligence and assessment. Better access and sufficient time to conduct the review.
- Our vendor management skills reduce closing risk

5. *Our client controls the pace and determines sequencing of targets*

- There is discretion over the pace and timing of approaches.
- For proprietary deals, there is more timing flexibility within the process, which allows greater time for due diligence and some ability to speed up or slow down.
- This ability to adjust pace on individual targets within a pipeline of acquisitions

allows our client to optimize the sequencing of the targets.
- This is particularly useful when internal resources cannot accommodate parallel processing of targets.

D. Significant Resources Available When You Want Them at No Fixed Expense

1. *Avoid risks associated with building significant internal acquisition sourcing resources*

- Hiring the right people, then training and retaining them is time-consuming and risky.
- Typically hired as permanent employees with salary and bonus. Difficult and slow to adjust staffing levels up or down.

2. *No risk of incurring expenses with no identifiable benefit*

- There can be a long unproductive ramp-up period as the team is built and trained and systems are developed.
- The majority of these expenses are fixed and are not tied to results.
- Osprey fees are only incurred when tangible results are achieved.

3. *Flexibility to adjust resources and expenditure to desired activity levels*

- Easy to increase and decrease activity levels based on your strategic needs.
- Avoid having internal capacity management issues drive acquisition sourcing decisions.

E. M&A Advisory Expertise

1. *We can assist with financing strategy and execution of the financing plan*

- We can anticipate financing issues and help ensure that financing does not become an impediment to closing acquisitions.
- Our financial modeling tools are useful in assessing financing needs and in supporting credit applications and/or investor presentations.
- We have helped clients change their investment banking relationships when they received inferior service from their incumbent bankers.
- In some cases, capital providers have indicated that our involvement provides them with comfort that the acquisition process is being professionally managed.

2. *Sophisticated assessment tools*

- We employ the assessment techniques used by the most sophisticated investment banks and private equity funds
- Some techniques include: EPS Accretion/Dilution Analysis, Unlevered IRR, Discounted Cash Flow (DCF), credit capacity, dynamic analysis of projected credit ratios and interaction with covenants, Economic Value Added (EVA) analysis, synergy and integration risk analyses.

F. Compelling Value

1. *Significant ROI on AP fees*

- Per the example above, the EVA from more favorable acquisition valuations far outweighs the fees charged on an AP.
- In the earlier EVA example, the EVA is approximately 11 times Osprey's fee, assuming no synergies.
- If the acquirer can increase target margins by 2% and sales by 5%, the EVA doubles to $15 million (approximately 20 times Osprey's fee).
- Net of fees, each incremental acquisition with these characteristics

would create $6.8 million in EVA ($14.3 million with synergies).
- Any increase in acquisition volume (number of acquisitions), multiplies this effect.

- ***Transparent fee structure where our clients maintain complete control over when fees are incurred***

- Milestone and success fee formula are agreed in advance under a master engagement letter.
- The engagement letter only applies to targets that the client explicitly approves.
- All fees are only triggered at client decision points, such as submission of an LOI, sharing a draft definitive agreement and of course, closing.
- No surprises

Conclusion

Acquiring a company that makes strategic sense at a reasonable value can create significant shareholder value. The combination of controlling the pace of the process, having unfettered access to due diligence and having the flexibility to structure the consideration paid to the vendor, can significantly mitigate the inherent risks in acquiring that company. For the most active consolidators, having the additional benefit of having many such opportunities available in parallel brings further benefits. Using our prior example, if a typical acquisition adds $7.5 million in EVA, pre-synergies, the ability acquire more targets, more often, creates more shareholder value. Targets identified based primarily on strategic fit provide the added benefit of synergy potential, which further multiplies the effect. There are other tangible benefits that manifest from the negotiating leverage our clients enjoy in those cases where qualified targets are abundant.

Osprey has developed a process that works and has the purpose-built resources to execute it effectively. We accelerate our clients' acquisition plans by generating additional acquisition targets that our clients would not otherwise see. We do this in a way that is not only complimentary to our clients' internal capabilities, but that leverages these internal resources to make them more productive. Our fee structure is transparent and our client controls when any fee is triggered. Clients generate economic value many times greater than the fees we earn. An Osprey AP is a complex service. We have developed a comprehensive Frequently Asked Questions [Link] ("FAQ") document for those who would like additional information. We have finite capacity to execute these projects and we only work with one client in any given industry at a point in time. Please don't hesitate to contact us if you would like to explore how we might work together.

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This national platform is extended globally though our membership in Globalscope, a leading international group of corporate finance and business advisors, with over 40 members operating on every continent, supporting clients in cross-border transactions.

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