valitas
CAPITAL PARTNERS

Strategic Acquisition Program Series Part IV: Frequently Asked Questions

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Value Unleashed

Outline

i. Fees/Costs/Engagement

a) We'll protect you on a buy-side success fee, but we're not willing to pay work fees.

b) We're not willing to agree to a "rack rate" fee in advance. Every deal is different and we'll determine fees on a case-by-case basis. I'm uncomfortable making a blanket commitment to you. I won't sign an engagement letter until you have a target that we want to pursue.

c) We'll pay you a finder's fee, but not a full acquisition advisory fee.

d) If someone brings us an idea we like and we close that deal, we're happy to pay a success fee. However, we don't pay people to search for targets.

e) We don't want to pay any fees. Get your fees from the vendor.

f) I don't want to enter into an open-ended arrangement. How do we maintain control over incurring fees? How do I ensure the scope is clear and the mandate has a well-defined end?

g) Aside from the fee schedule and management time, are there other costs?

h) How are the fees structured? I don't want surprises with the fees and I don't want to negotiate an engagement letter for each target.

i) If a target is auctioned, do I still pay Valitas a fee? What if a target is put up for auction sometime after we have approved it for the target list? What if you approached them and they pass? We should not have to pay you a fee if we close with them after they pass.

j) This looks interesting, but I'm concerned about making a commitment because I don't know how we're going to work together and whether I will see the benefits you describe.

ii. What Is the Value?

a) Your proposed approach doesn't make sense for everyone. Who would benefit the most from an SAP?

b) We don't use advisors to provide transaction assistance.

c) We don't use advisors to find targets. Just call us if you have something real. We don't want to pay somebody to run around chasing targets for us.

d) I don't see the value in your proposal and the hard costs can be significant. I just don't see enough benefits to justify the costs. Ethereal benefits, like EVA, don't justify the hard costs.

e) I don't want to incur fees and have nothing to show for it.

iii. We Already Have that Capability

a) We don't need an acquisition advisor. We already have significant in-house M&A expertise. We don't want to "pay twice" for acquisition advice.

b) We don't need help sourcing targets. Why would I hire an agent to approach a target when I can approach them myself? We're already in discussions with a number of targets.

c) We already have developed a target list. You can't develop better target ideas than we can. We already know who the most logical targets are for us. We have people working for us that know everyone out there because they've been in that industry for years.

iv. Industry Perception

a) I don't want people creating confusion in the marketplace with the parties we're already in dialogue with.

b) I don't want an agent to embarrass me or my company. How do we retain control over the process? How do I know you won't make me look bad?

v. Internal Perception of Corporate Development

a) I don't have the authority to commit to a mandate. My CEO will ask me what I'm being paid for if I propose this.

vi. Hassle Factor

a) We are too busy to work with you on this. It's not worth the trouble. Your process will require too much management time.

b) How do you qualify targets? I don't want to waste time on targets that aren't a good fit for us.

c) We are very selective. We don't want to approach dozens of targets.

d) We can't deal with too many opportunities at once.

e) Passive sellers are not committed. Active sellers are. Chasing passive sellers is a poor use of our time.

vii. Process

a) How do we assess whether there is a consolidation opportunity in our industry?

b) How many targets would you approach for us?

c) How are the targets selected and screened?

d) How do I know that targets you surface in my target universe will be exclusive to us? How do you manage conflicts?

e) Most of the targets are private companies that have no financial disclosure and very little useful disclosure on their business. How can we know if a given target is a good fit for us?

f) Would you disclose our name when you approach a target?

g) How do I know what you're doing? I don't want to be caught flat-footed if one of the targets you've approached contacts me. How is progress measured?

h) How much management time would it take if we worked with you?

i) Many of the businesses that are a good fit for us are subsidiaries of larger companies, many of whom are competitors. These businesses are not available.

j) How do targets respond when you approach them on behalf of your clients? What percentage of targets can we expect to engage in a sale discussion with you and share information (response rate)?

k) How is this process managed and who will be working on this? How much capacity do you have? What happens when you get busy?

l) What if you don't find anything?

m) How do we get started? What do you need from me?

viii. Mitigating Risk

a) I don't want to damage the company by making poor acquisitions. I want to ensure that there is ample time and access to conduct proper due diligence.

b) I don't want to overpay for acquisitions.

c) Your fees will reduce my EPS.

Frequently Asked Questions

i. Fees/Costs/Engagement

a) **We'll protect you on a buy-side success fee, but we are not willing to pay work fees.**

- We charge low work fees that only cover our costs on these assignments.
- We propose a milestone fee structure, where modest "progress" fees are triggered at key client decision points, such as:
  - Deciding to proceed after Valitas has qualified a target after receiving preliminary financial information;
  - Submission of an LOI to a target; and
  - Exchange of a draft definitive agreement between the client and a target.
- We have worked with many sophisticated acquirers who have responded positively to this structure because it reflects an equitable distribution of risk between the client and the advisor.
- We have the flexibility to adjust the trigger events and the fees associated with each.

b) **We're not willing to agree to a "rack rate" fee in advance. Every deal is different and we'll determine fees on a case-by-case basis. I'm uncomfortable making a blanket commitment to you. I won't sign an engagement letter until you have a target that we want to pursue.**

- An SAP typically surfaces a significant number of targets.
- Given the expected volume of targets, it is not practical to negotiate a separate engagement letter for each target:
  - Settling engagement letters is time-consuming for both our clients and us; and
  - It becomes a distraction, damaging momentum with a target at a crucial point in the "courtship".
- Our fee arrangements are completely transparent. This allows our clients to impute our fee into their overall acquisition costs and weigh their interest in proceeding based on the fully-loaded cost on an SAP target against the other available acquisition alternatives.
  - For context, our fee is between 0.1-0.2x EBITDA on a typical acquisition;
  - The valuation difference between an auctioned and a proprietary target is typically 0.5-1.5x EBITDA;
  - In addition to the expected valuation advantage, an SAP produces acquisition opportunities that our client would not otherwise identify;
  - The Economic Value-Added ("EVA") on an SAP acquisition typically exceeds our fees more than 10-fold and EVA net of fees can be quite material to the acquirer.

- We will have already delivered much of the value to our client by the time a target is "real" enough to negotiate an engagement letter (interest in negotiation, dialogue opened, information provided, size is known, pre-qualified, etc.).
- We choose our clients carefully and conduct ourselves in a transparent manner with those we choose to work with. Therefore, we require the same treatment from our clients.

c) **We'll pay you a finder's fee, but not a full acquisition advisory fee.**

- We dedicate significant firm resources and apply significant skills to SAP mandates in approaching, cultivating, and qualifying acquisition targets before we deliver them to our clients as actionable, proprietary acquisitions that would not otherwise exist.
- We earn a full M&A advisory fee by generating opportunities for our clients to generate significant shareholder value through acquisitions that:
  - Are reasonably priced;
  - Fit the acquisition criteria; and
  - Are more frequent.
- See "b)" above.

d) **If someone brings us an idea we like and we close that deal, we're happy to pay a success fee. However, we don't pay people to search for targets.**

- The differences between reviewing acquisition ideas on an ad hoc basis and engaging in an SAP are small. Where there are differences, the advantages outweigh the disadvantages.
- While an SAP does require some focused up-front effort and an engagement letter with modest milestone fees, this investment of effort results in a proactive, well-defined, and controlled process that surfaces a greater number of high-quality targets than an ad hoc approach:

Table 1: Comparison Between an Ad Hoc and Valitas SAP Approach

	Ad Hoc	Valitas SAP
Process	▪ Ad hoc ▪ Reactive	▪ Proactive ▪ Well-defined ▪ Controlled
Success Fee	▪ Market fee (Honour system)	▪ Market fee (Pre-negotiated formula)
Target Approach	▪ Sometimes prior to the client's confirmation of interest and authorization ▪ Often no confirmation that the target is interested in a discussion ▪ No/limited client control	▪ Target approached if the client is interested in exploring further and has authorized the approach ▪ Only approved targets and at the desired time ▪ Disclosure of client identity optional

	Ad Hoc	Valitas SAP
Pre-Closing Fees	▪ If the idea evolves into a full acquisition advisory mandate, a monthly work fee would typically apply ▪ If it's a finder's fee arrangement, only a success fee would apply	▪ Modest milestone fees triggered only by key client decision points ▪ 100% creditable agent success fee
Management Time Investment	▪ No up-front investment ▪ Time spent listening to ideas and assessing the proposed targets ▪ Hit and miss; Idea quality improves as the dialogue progresses ▪ Rarely a structured effort, so "learning" may be limited ▪ Negotiate ad hoc fee arrangement if it progresses	▪ Time to review and provide feedback on the proposed target list ▪ Time spent negotiating engagement letters ▪ Time spent confirming acquisition criteria and strategy ▪ Approval of approach letters and information request list ▪ No further time or effort until a target is assessed and qualified by Valitas after reviewing non-public information
Target Quality	▪ Varies by advisor ▪ Dependent on their knowledge	▪ Targets selected based on strategic aims and acquisition criteria
Hard-to-find Niche Targets	▪ Typically limited to first-hand knowledge ▪ Small targets are ignored	▪ Proactive, novel research with client guidance to unearth the unusual targets
Proprietary?	▪ More likely to be a process in place	▪ Rarely an auction in progress
Target Quantity	▪ Limited to the attention span of the advisor	▪ Typically submit 20-30 targets for approval at a time ▪ Often clients approve multiple lists over the course of a mandate
Target Size	▪ Varies, but typically large targets	▪ Can execute effectively down to $10 million in transaction size

e) **We don't want to pay any fees. Get your fees from the vendor.**

- In addition to "c)" above, if we receive fees from the vendor, we will act in the vendor's best interest. This may mean exclusive negotiations with one acquirer, but usually means conducting an auction.
- The target is no longer proprietary to the acquirer and something closer to an auction valuation should be expected. This typically means:
  - 0.5-1.5x EBITDA higher valuation;
  - Lower likelihood of closing (may not win); and

- Loss of control of the process. The vendor and their agent may not allow sufficient time and access to conduct fulsome due diligence.

- These disadvantages, among others, far exceed Valitas' fees, which typically translates to 0.1-0.2x EBITDA.

f) **I don't want to enter into an open-ended arrangement. How do we maintain control over incurring fees? How do I ensure the scope is clear and the mandate has a well-defined end?**

- Firstly, the fee structure is perfectly transparent and can be imputed into any acquisition our clients contemplate.
- Our clients have complete control over:
  - *When and Whether Fees Are Incurred*: Fees are triggered only when a client decides to continue past a given deal milestone and at close;
  - *Scope of Service on a Given Target*: While we add significant value throughout the process, we do not provide services that our clients do not want. Valitas' SAP is strictly additive and complementary to our clients' processes;
  - *Which Targets*: We only approach targets that our clients ask us to approach. We do not approach a target without our client's express prior approval; and
  - *How Long*: The engagement can be terminated by either party at any time. However, Valitas does retain market standard "trailer rights" on those approved targets that were part of the mandate.

g) **Aside from the fee schedule and management time, are there other costs?**

- The only other costs associated with our mandate are out-of-pocket expenses which are typically modest.
  - During the earliest stages, there is a lot of desktop work. Most expenses at this stage are courier expenses and fees related to supplemental research services as well as industry-specific lists and databases that our clients may request; and
  - At more advanced stages, such as due diligence and negotiation, our clients often request that we participate in site visits and negotiations with the target/vendor. During these advanced stages, travel-related expenses are incurred.
- Of course, there are other deal-related costs outside of our engagement associated with legal, accounting, and other external advisors. These are incurred later in the process and would be incurred independent of how the target is sourced.

h) **How are the fees structured? I don't want surprises with the fees and I don't want to negotiate an engagement letter for each target.**

- We structure our SAP engagements under a master fee agreement that applies to all targets that the client approves as part of the mandate:
  - Approved target lists are incorporated by reference into the engagement agreement;
  - Milestone fees are fixed dollar amounts formulated on defined milestones agreed between Valitas and the client, as a means to compensate Valitas for time and efforts;

- The success fee is based on a simple sliding percentage fee scale with a base dollar component.

i) **If a target is auctioned, do I still pay Valitas a fee? What if a target is put up for auction sometime after we have approved it for the target list? What if you approached them and they pass? We should not have to pay you a fee if we close with them after they pass.**

- If a target is on the approved list for engagement and it is pursued within the trailer period on the engagement letter, our clients are obligated to pay the milestone and success fees.
- While most targets we surface through an SAP have no interest in starting an auction for their businesses while our clients are in discussion with them, some may choose to do so. This is a particular risk for private equity-owned portfolio companies. Institutional sellers tend to be M&A-savvy and motivated primarily by value, as opposed to private vendors. Boards of public companies have fiduciary obligations to maximize shareholder value.
- While we cannot guarantee that all targets will be exclusive opportunities, at the very least we provide a significant, tactical, first-mover advantage.
- There is always value added by creating more strategic choices for our clients by surfacing opportunities that would not otherwise be accessible at that time.
- Trailer rights are absolutely critical in ensuring that we are not in competition with our clients. We will not work with parties that are unwilling to honour market-standard trailer rights.

j) **This looks interesting, but I'm concerned about making a commitment because I don't know how we are going to work together or whether I will see the benefits you describe.**

- Because of our milestone fee structure and the control that clients have over targets we contact, it's easy to start with a small trial list of targets. We recommend 10 targets for a trial list to allow us a large enough sample to assess target response rates.
- This allows both our client and us to assess how we are working together, preliminary target responses, and process refinements with minimal cost or risk.
- If our client sees benefits from the trial list, we can prepare a second, expanded target list for approval and move into a full-scale mandate. Conversely, if the benefits are less than expected, no further targets are provided for approval and the mandate ends.
- Our experience is that our clients typically seek to expand the working relationship once it has started.

ii. What Is the Value?

a) **Your proposed approach doesn't make sense for everyone. Who would benefit the smost from an SAP?**

- There are five key variables in determining how much value an SAP can add:
    - **Motivation:** Strategic motivation to acquire, at valuations that vendors can accept, on a continuous basis, ideally multiple acquisitions per year;
    - **Ability to Transact:** This includes the ability to fund acquisitions and effective management of other deal impediments;

- **Integration Competence:** Internal operational competence to effectively integrate acquisitions;
- **Origination Capability:** Internal proprietary acquisition origination capability. Specifically, resources, systems, and know-how; and
- **Target Universe:** Number of potential targets that make strategic sense for the company.

- An SAP is ideal for companies that are (i) highly motivated, (ii) can transact, (iii) have integration competence to drive synergies, (iv) want to see more proprietary acquisitions, and (v) where there is a large universe of potential targets to pursue.
- Our SAP process is an effective way to generate a pipeline of proprietary acquisitions. Valitas seeks to work with those clients who can derive maximum benefit from such a pipeline.

b) **We don't use advisors to provide transaction assistance.**

- Valitas' central value proposition with an SAP is generating proprietary acquisitions for those acquisitive companies that want to see more proprietary deals than they're seeing now – See value arguments re: ROI on our fees.
- Our clients choose which targets we will approach and when. They also maintain complete control over the pace, which means that our fees are only triggered when our clients choose to move the process forward.
- While we add significant value throughout the process, we do not provide services that our clients do not want. Valitas' SAP is strictly additive and complementary to our clients' processes.

c) **We don't use advisors to find targets. Just call us if you have something real. We don't want to pay somebody to run around chasing targets for us.**

- If you have more high-quality, proprietary acquisitions to look at than you can handle, you are not an ideal candidate for an SAP.
- We do not expect that you would use an advisor to source acquisitions:
  - This type of service is uncommon. There are few firms that provide acquisition search services as comprehensive as a Valitas SAP;
  - This service does not fit with the full-service investment banking business model:
    - The large investment banks view acquisition search as an undesirable business and very few actively pitch these;
    - The skills required to execute an SAP effectively don't match well with their core transaction advisory capabilities;
    - Executing an SAP is resource-intensive;
    - They typically have minimum M&A fees of $750,000 to $1 million and will not invest their time in developing acquisition ideas under $50 million; and

- As a result, they will often show large acquisition ideas to their larger clients on an ad hoc basis.

- If we were aware of a motivated target, our best choice as a firm would be to pursue a sale mandate, which often involves an auction process. Hence, this target would likely not be proprietary to you. You may be invited to the auction. However, if we chose to pursue an acquisition mandate with you:
  - Our proposed fee schedule would be almost identical to (perhaps a little more expensive) than the master fee arrangement we propose under an SAP;
  - There is no economic advantage in being reactive because there is no fee in either event until we deliver something actionable to our client; and
  - You lose the benefit of pursuing multiple acquisitions in parallel.

d) **I don't see the value in your proposal and the hard costs can be significant. I just don't see enough benefits to justify the costs. Ethereal benefits, like EVA, don't justify the hard costs.**

- The key benefit is identifying acquisition opportunities that our clients would not otherwise see. Even if our clients have targets to look at most of the time, they value the increased strategic choices resulting from incremental acquisition targets surfaced by our SAP.
- This principle of maximizing client choice and optionality is enhanced by Valitas' fee arrangement, where our clients only incur fees when they choose to act on a proprietary target.
- Proprietary acquisitions will create more economic value for an acquirer for several reasons:
  - They have more favorable valuations than auctioned acquisitions;
  - Better process and timing control allow for more effective due diligence and integration planning; and
  - Superior strategic rationale (chosen targets versus available targets) increases the likelihood of synergies and positive investor reaction.
- The relevant measure is the all-in acquisition cost. If the valuation advantages more than offsets the proposed fee (typically 0.1-0.2x EBITDA), our client may choose to look at other targets.
- The significant ROI on Valitas' fee can be demonstrated in several ways.
- The ROI analysis below is based on the $30 million acquisition example in parts I and II. In this example, the acquisition would create $7.5 million in EVA if purchased at an EBITDA multiple 1.5x less than the acquiring company's 7.5x EBITDA multiple. The target in this example has $5 million EBITDA, 15.0% EBITDA margins, and 20.0% contribution margins.

Table 2: EVA Method

EVA Method (see Appendix)	
EVA is the difference between the value of the target in the hands of the acquirer and the value paid for the target. Key drivers are multiple arbitrage and synergies.	
Without Synergies	**With Synergies**
EVA = $7.5MM Illustrative Fee = $0.7MM Times Fee Earned = 10.7x	EVA = $15MM Illustrative Fee = $0.7MM Times Fee Earned = 21.4x

Net EVA	
7.5 – 0.7 = $6.8MM in Net EVA	15.0 – 0.7 =$14.3MM in Net EVA

Table 3: Proprietary vs. Auction Multiples

($ in millions)	Valuation Advantage (x EBITDA)			
	0.5x	**1.0x**	**1.5x**	**2.0x**
Value	$2.5	$5.0	$7.5	$10.0
Fee	0.7	0.7	0.7	0.7
Fee/Value	28.0%	14.0%	9.3%	7.0%

e) **I don't want to incur fees and have nothing to show for it.**

- A milestone fee arrangement mitigates this risk significantly.
- Typically, no milestone fees are triggered until our client chooses to proceed with a target we have already investigated and qualified.
- The milestone fees are modest. If a client chooses to provide a draft definitive purchase agreement with a vendor, the cumulative milestone fees would amount to a junior executive assistant salary.
- Milestone fees are triggered at our clients' discretion. Milestone fees are negotiated on a case-by-case basis to fit with the desired process and our clients' specific needs. However, these milestones are designed to represent key client decision points in the acquisition process.
- Typically, we have three milestone events that are (i) clearly defined, (ii) confirmable, and (iii) client-driven:
  - Decision to proceed after confirmation by Valitas that the target meets pre-defined criteria. This qualification process is determined with our client on a case-by-case basis. It typically involves requesting and reviewing financial documentation and key information regarding products/services, end markets, and distribution channels;
  - Submission of an LOI to the target. This is when our client decides to take a non-binding proposal for consideration, after their further direct investigation of the target; and

  - Exchange of the first draft of definitive documentation. This is typically tabled by the acquirer after the completion of significant due diligence.

- Without question, this is not a risk on the success fee component because the acquisition is not completed. However, there is tangible value in progressing in discussions with a target:

  - Access to non-public information on a given target, including understanding their strategic motivations, provides a strategic information advantage;

  - Securing a "first look" at a passive seller before our client's competitors see the opportunity should the target become an active seller; and

  - The strategic choices created when target negotiations run in parallel increase negotiating leverage with all targets involved.

iii. We Already Have that Capability

a) **We don't need an acquisition advisor. We already have significant in-house M&A expertise. We don't want to "pay twice" for acquisition advice.**

- We do not duplicate our clients' internal resources or make them redundant. A Valitas SAP does the opposite by helping our clients get more value out of their internal resources. A Valitas SAP makes internal business development teams more effective by:

  - Generating more qualified, proprietary acquisition opportunities than they would otherwise see;

  - Providing the purpose-built resources and systems to effectively and efficiently identify, screen, approach, follow-up, cultivate, and qualify potential acquisition targets;

  - These resources are delivered to our clients at a variable cost, triggered only by results (versus fixed cost for internal resources), where activity levels are controlled and modulated by our clients to suit their needs and schedule;

  - This variable capacity allows our clients' internal teams to focus on areas where they add the greatest value, such as:

    - Selecting which qualified targets to pursue;

    - Due diligence;

    - Integration planning;

    - Negotiation of key business points; and

    - Post-acquisition integration.

- There are certain critical vendor approach and management capabilities that only a skilled third party can provide:

  - Our significant experiences with selling both private and public businesses enable us to skillfully approach vendors and communicate the most compelling value proposition from their perspective;

  - Valitas creates an effective buffer between the vendor and our client so that vendor trust can be built more quickly than if they are speaking with a perceived competitor; and
  - This development of trust facilitates smoother execution later in the process, should our client choose to proceed.
- If your internal teams are not seeing sufficient quality proprietary acquisition candidates, Valitas can "prime the pump" and increase their utilization and productivity.

b) **We don't need help sourcing targets. Why would I hire an agent to approach a target when I can approach them myself? We're already in discussions with a number of targets.**

- Not all companies will derive significant value from a Valitas SAP. If there are many high-quality targets and you are not missing the best of them, you are not an ideal client.
- All of the investment bankers may know what you're looking for and they may always call when they see something that you may like. However, seeing a lot of targets does not necessarily ensure strategic success – target quality is critical:
  - Are many targets auctioned?
  - What's your "win" rate on auctions?
  - Are you pleased with the valuations that you're paying?
  - Do you believe valuations would be more favorable for targets that are passive sellers?
  - Is there a large universe of potential passive sellers that you cannot access because you lack the capacity to pursue them?

c) **We already have developed a target list. You can't develop better target ideas than we can. We already know who the most logical targets are for us. We have people working for us that know everyone out there because they've been in that industry for years.**

- We do not claim to know any industry better than our clients. While we often add significant value by identifying targets our clients were not previously aware of, our most compelling value-add is in cultivating a list of potential targets into actionable opportunities that are proprietary and pre-qualified against your acquisition criteria.
- There are certain critical vendor approach and management capabilities that only a skilled third party can provide:
  - Our significant experiences with selling both private and public businesses enable us to skillfully approach vendors and communicate the most compelling value proposition from their perspective;
  - Valitas creates an effective buffer between the vendor and our client so that vendor trust can be built more quickly than if they are speaking with a perceived competitor; and
  - This development of trust facilitates smoother execution later in the process, should our client choose to proceed.

iv. Industry Perception

a) **I don't want people creating confusion in the marketplace with the parties we're already in dialogue with.**

- Because we only approach targets that our client explicitly approves and report regularly on the status of the acquisition pipeline, confusion about target status and coordination with our clients is never an issue.

b) **I don't want an agent to embarrass me or my company. How do we retain control over the process? How do I know you won't make me look bad?**

- This is a valid concern, which is why choosing the right advisor is so important.
- Clients may choose that we do not disclose their identity until the target has been qualified.
- Valitas' team has significant vendor management skills and we conduct ourselves with the utmost integrity and professionalism while treating others with respect.
- We have not had any clients raise this as a concern and we would be pleased to provide client references if you would like to hear directly from them.
- Our clients maintain complete control over who is approached, the pace with which they are approached, and the triggering of fees.

v. Internal Perception of Corporate Development

a) **I don't have the authority to commit to a mandate. My CEO will ask me what I'm being paid for if I propose this.**

- We do not duplicate our clients' internal resources or make them redundant. A Valitas SAP does the opposite. We help our clients get more value out of their internal resources. A Valitas SAP makes internal business development teams more effective by:
  - Generating more qualified, proprietary acquisition opportunities than they would otherwise see;
  - Providing the purpose-built resources and systems to effectively and efficiently identify, screen, approach, follow-up, cultivate, and qualify potential acquisition targets;
  - These resources are delivered to our clients at a variable cost, triggered only by results (versus fixed cost for internal resources), where activity levels are controlled and modulated by our clients to suit their needs and schedule.
  - This variable capacity allows our clients' internal teams to focus on areas where they add the greatest value, such as:
    - Selecting which qualified targets to pursue;
    - Due diligence;
    - Integration planning;
    - Negotiation of key business points; and

    - Post-acquisition integration.

- There are certain critical vendor approach and management capabilities that only a skilled third party can provide:
    - Our significant experiences with selling both private and public businesses enable us to skillfully approach vendors and communicate the most compelling value proposition from their perspective;
    - Valitas creates an effective buffer between the vendor and our client so that vendor trust can be built more quickly than if they are speaking with a perceived competitor; and
    - This development of trust facilitates smoother execution later in the process, should our client choose to proceed.
- If your internal teams are not seeing sufficient quality proprietary acquisition candidates, Valitas can "prime the pump" and increase their utilization and productivity.
- We can provide you with white papers and other resources to help you communicate our value proposition to those who have approval authority. However, the best approach would be for us to schedule a meeting to allow for an informative Q&A session.

vi. Hassle Factor

a) **We are too busy to work with you on this. It's not worth the trouble. Your process will require too much management time.**

- Supporting an SAP does require some internal management resources for approving target lists, monitoring the acquisition pipeline, and assessing opportunities once they have been qualified by Valitas.
- The rest of the process is similar to any other acquisition process, except that our clients enjoy more process control on proprietary acquisitions than in auction processes.
- Our process improves the effectiveness of your internal resources. See above.
- Investing some time in an SAP is often a worthwhile proposition given the tremendous value created by a well-conceived strategic acquisition.

b) **How do you qualify targets? I don't want to waste time on targets that aren't a good fit for us.**

- The first step is to gain intimate knowledge of our client's strategic aspirations and acquisition criteria so we can properly qualify targets. This includes developing the target information request list and assessment templates with significant client input.
- Valitas assumes responsibility and day-to-day carriage of the approaching and qualifying process:
    - The majority of targets initially generated from third-party databases are private companies with limited or no financial disclosure;
    - We do not rule out targets until we confirm the key facts, which requires contacting them and asking for information to allow us to qualify them;

- However, they often don't want to share too much, too quickly. We typically commit not to share anything with our client without the target's prior consent. Often, they will not share information without an NDA in place. This moves the process along and builds trust with the vendor(s);
- We typically confirm some basic information over the phone during the initial approach phase to determine whether it is worthwhile for Valitas to send a formal information request (and sign an NDA with the target, if requested);
- The information request list is sent to the target and Valitas walks them through it to confirm the actions required;
- Valitas follows up with the target to ensure the information is provided; and
- Valitas synthesizes the information required for client review using the pre-agreed assessment templates.

- Our client then reviews this concisely packaged target profile to determine whether they choose to proceed now, proceed later, or decline to continue.

c) **We are very selective. We don't want to approach dozens of targets.**

- The more selective you are, the stronger the rationale to proactively pursue only those acquisitions that make the greatest strategic sense. The challenge is the resources required to qualify these targets when little information is publicly available.
- Valitas handles the initial part of the process, from researching names for approval to qualification. We only show qualified targets that meet our clients' criteria.
- If you are concerned about how you would be perceived:
  - Valitas conducts these processes with the utmost integrity and professionalism;
  - Our clients control which targets we approach, including how many are approached; and
  - Our client may choose that we do not disclose their identity until we have qualified the target.

d) **We can't deal with too many opportunities at once.**

- Valitas' SAP provides leverage for our clients' internal resources to make them more effective and productive by freeing internal capacity to focus on areas where they add the greatest value.
- There is significant value-add in our target qualification process and we also are capable of providing extensive transaction support in those areas our clients desire.
- Our process facilitates pacing activities and sequencing targets optimally for our clients.

e) **Passive sellers are not committed. Active sellers are. Chasing passive sellers is a poor use of our time.**

- There is a trade-off between:

- Wasting time on unqualified targets that may decide not to sell at an advanced stage of the process; and
- The risk of expending significant resources in assessing an auctioned asset and losing the auction.

- We assume much of the risk associated with qualifying targets for our clients.
- Our vendor management skills and the trust we build as an intermediary help our clients mitigate closing risk.
- This compares favorably against the risk of losing auctions at higher valuations than proprietary deals.
- Active sellers are often not the most desirable targets. Their motivation to actively sell their business may stem from neglect or a poor performance outlook.

vii. Process

a) How do we assess whether there is a consolidation opportunity in our industry?

- There are several factors to consider, some of which include:
    - High degree of fragmentation;
    - Significantly lower cost of capital for larger players and superior access to capital for industry consolidators;
    - Structural changes that create an advantage for larger, centralized operators that can provide a nation-wide sourcing solution, versus smaller niche players that serve their local markets;
    - High operating leverage, economies of scale (high fixed costs and high margins on incremental sales) and hence significant cost savings through integration;
    - Scalable operations, including standardized back-office systems; and
    - Standardized, automated customer interfaces where customer relationships aren't closely tied to key people.
- We assess segment fragmentation initially by developing filtered database searches with third-party database providers. This typically gives us a preliminary indication of the extent of fragmentation and the size of the target universe.

b) How many targets would you approach for us?

- The client decides, subject to certain constraints, including the size of the target universe, target response rates, and our own level of satisfaction with the working arrangement.

c) How are the targets selected and screened?

- To generate potential targets, we start with the fragmentation assessment described above, select a target size range based on disclosed revenue and/or employees and research each name. This preliminary research typically includes:

  - Reviewing the database disclosure, including business description, products, services, end markets, distribution channels, and geographies against our client's criteria. Afterwards, we confirm ownership details;
  - Reviewing the target company's website, including any product catalogues, strategy, vision and mission statements. and information on ownership, founders, etc.;
  - Reviewing recent news releases and media references; and
  - We often supplement these sources with other materials, such as distributor catalogues, industry trade show lists, trade publications, and industry-specific databases.
- These large lists are distilled down to a proposed target list of no more than 30 names that we believe may be of interest to our client.
- We review this target list with our client to determine which targets to approach. The target list is then finalized and presented as the "approved list" for the client's final approval.
- Once we have progressed through the initial target list, we assess with the client whether we should repeat the process and develop another target list. We often work through several target lists with our clients.

d) **How do I know that targets you surface in my target universe will be exclusive to us? How do you manage conflicts?**

- Any targets on the approved list are exclusive to our client. This is enshrined in our engagement letter.
- We will only work with one consolidator in a given sector at any point in time. Hence, we choose our SAP clients carefully.
- If a client passes on a qualified opportunity and the target is motivated to sell, we may request the client's permission to pursue a sale mandate with that target.

e) **Most of the targets are private companies that have no financial disclosure and very little useful disclosure on their business. How can we know if a given target is a good fit for us?**

- In many cases, you cannot know if a target meets your criteria without approaching them and asking for non-public information.
- This can be a very time-consuming initiative that often fails to produce a qualified opportunity.
- We assume this risk. Much of the value that our SAP process adds is the information gathering and qualifying that takes place with minimal investment of our client's time or resources. Our clients do not waste time pursuing targets that have not been qualified.

f) **Would you disclose our name when you approach a target?**

- Ultimately, this is our client's choice. We carefully weigh the pros and cons with them as they decide.
- We encourage our clients to allow us discretion in disclosing their identities in cases where the target is unlikely to engage with an agent who's playing "hide the ball" with them.

- In sectors where initial response rates are as low as 15%, disclosing the identity of our client can materially improve response rates. This is particularly true of US targets, who tend to be heavily canvassed by investment bankers and private equity funds.
- Each sector is unique. While it is typically helpful to disclose who we're working with to demonstrate transparency and build vendor trust, it helps more in certain situations than in others.

g) **How do I know what you're doing? I don't want to be caught flat-footed if one of the targets you've approached contacts me. How is progress measured?**

- Valitas provides regular, bespoke progress reporting in a form that works for you and your team. Typically, we schedule a weekly call where we walk through a customized "dashboard" report showing:
  - Conversion metrics;
  - Pipeline status;
  - Progress to date;
  - Activities and follow-ups for the coming week; and
  - A clear list of items and/or time required from our client's team.

h) **How much management time would it take if we worked with you?**

- Modest client time would be spent on the front end of the process:
  - Ensuring we thoroughly understand our client's strategy and acquisition criteria;
  - Finalizing our engagement letter;
  - Each proposed target list is sent in advance and typically reviewed over the phone in an hour or less;
  - Less than an hour per week to review progress, pipeline status, and next steps with the Valitas team;
  - Review of target profiles we prepare on qualified targets to determine whether to proceed to further qualification or an LOI;
  - Some clients find it useful to conduct a Q&A call with the target to further qualify them prior to preparing an LOI; and
  - The time investment post-LOI submission would be typical of any other acquisition process and would require more management involvement.

i) **Many of the businesses that are a good fit for us are subsidiaries of larger companies, many of whom are competitors. These businesses are not available.**

- Sometimes they are. However, it requires specialized skills to understand the corporate divesture decision process and to develop a value proposition that meets the parent company's objectives.

- A corporate vendor can be easier to deal with, as they are often more rational and sophisticated than an owner-operator.
- Unless a subsidiary was bought in the last five years, we encourage our clients not to rule them out.

j) **How do targets respond when you approach them on behalf of your clients? What percentage of targets can we expect to engage in a sale discussion with you and share information (response rate)?**

- Response rates vary significantly depending on industry:
  - We've generally experienced response rates of 25-30% in most industries;
  - The lowest response rate we've seen is 14% for HVAC and plumbing manufacturers; and
  - The highest we've seen is almost 80% for "asset-light" logistics targets.

k) **How is this process managed and who will be working on this? How much capacity do you have? What happens when you get busy?**

- Because we have purpose-built systems and a specialized team, Valitas is capable of efficiently meeting the requirements of an acquisition program.
- We do limit the number of SAP mandates we take on at any given time to ensure a high level of client service and responsiveness.
- Because of the high level of skill required to interact with and manage vendors, we dedicate senior team members at Valitas to lead this aspect of the project. This tends to be our effective constraint.
- The preliminary target generation and screening is handled by more junior research staff, with proposed target lists reviewed by a Partner before it is sent to a client. The junior resources are more flexible and can easily be scaled as required.

l) **What happens if you don't find anything?**

- In the event that no acquisitions are completed during the course of an SAP, there are some ancillary benefits:
  - Gathering proprietary market intelligence:
    - Ability to access target information that is not publicly available;
    - Enhanced understanding of which industry players are sellers (and when they are sellers) versus which are consolidators; and
    - Assess the best practices employed by targets through due diligence.
  - Provides valuable market intelligence on the future extent of the consolidation opportunity. If we 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:

    - Continue to pursue acquisitions and secure financing and other resources to support them; or
    - Shift the strategy if the consolidation opportunity has been fully explored and is more limited than originally thought.
- If no information is exchanged with any target, no fees are incurred. The only cost would be out-of-pocket expenses.
- If definitive documentation is submitted to the vendor and the deal fails to close, the cumulative milestone fees would amount to a junior executive assistant salary.
- This worst-case scenario is modest in relation to the potential shareholder value creation from a successful SAP.

m) **How do we get started? What do you need from me?**

- If we are at this stage, we probably already know your acquisition criteria.
- All we need to start is:
    - Valitas will send you the first target list to review and approve;
    - We will need to settle the engagement letter before we launch the SAP;
    - Determine your internal team, clarify proposed roles, and confirm internal approval process; and
    - We will schedule a launch meeting or call to review the final checklist before we initiate contact with the first target list.

viii. Mitigating Risk

a) **I don't want to damage the company by making poor acquisitions. I want to ensure that there is ample time and access to conduct proper due diligence.**

- Several conditions need to be present for a consolidation to be successful. Not all companies have the attributes to be successful consolidators.
- However, proprietary acquisitions will be less risky than auctioned targets because:
    - Valuations are lower;
    - They are more likely to make strategic sense; and
    - There is more process control and hence better opportunities to conduct fulsome due diligence and negotiate structural protections with the vendor, when warranted.

b) **I don't want to overpay for acquisitions.**

- It's much harder to maintain valuation discipline with auctions than it is with proactive acquisitions.

c) **Your fees will reduce my EPS.**

- It's true that under IFRS, acquirers can no longer capitalize M&A fees.
- However, most acquirers will disclose adjusted EPS to their shareholders and guide them in assessing the acquisition on that basis. Investors and sell-side analysts look past non-recurring EPS items, particularly those that relate to transaction costs.

Appendix

i. EVA Method Calculations

a) EVA calculations are shown below for both a no-synergies case and for a synergies case where there are cost synergies and distribution synergies.

EVA Without Synergies (in $ millions)	
Target Value at Acquirer's Multiple (EBITDA x Acquirer's Multiple)	37.5
Target Purchase Price (EBITDA x Target Multiple)	30.0
EVA (Target Value at Acquirer's Multiple – Target Purchase Price)	**7.5**

EVA With Synergies
EBITDA margin improvement is 2.0%
Revenue increase is 5.0%

1)

Combined Synergies (in $ millions)	
Cost Synergies:	
Implied Target Revenue (EBITDA/EBITDA Margin)	33.3
Cost Synergies (Margin Improvement x Implied Revenue)	0.7
Distribution Synergies:	
Contribution Margin (Margin + Versus Margin)	20.0%
Revenue Increase (Implied Revenue x Revenue Increase)	1.7
Distribution Synergies (Revenue x Increase x Contribution)	0.3

2)

Post-Synergies EBITDA (in $ millions)	
Stand-Alone	37.5
Cost Synergies	0.7
EVA (Target Value at Acquirer's Multiple – Target Purchase Price)	0.3
Post-Synergies EBITDA	**6.0**

3)

Post-Synergies EVA (in $ millions)	
Post-Synergies EBITDA	6.0
Value to Acquirer	45.0
Acquisition Cost	30.0
EVA	**15.0**

About Valitas

Valitas Capital Partners is a relationship-focused merger & acquisition (M&A), corporate finance, and strategic advisory firm. We collaborate with ambitious owners of high-performing businesses with a potential value of at least $100 million, to discover, unleash, and realize their full business value potential.

Owners and their leadership teams rely on Valitas when they:

- Want to triple the value of their business in five years or less, but realize they lack the expertise and experience to achieve this alone.
- Want to sell their company now, assured they will look back after the transaction knowing they got the best possible outcome.
- Seek the peace of mind of taking some chips off the table now, to secure their family's financial future without giving up control or the future increased value in their business.
- Are anguished they had to say no to growth opportunities they worked so hard to create because their bank cannot keep up with the needs of their fast-growing business.
- Are frustrated at the lack of traction they are getting with their acquisition efforts, whether it is not seeing enough quality acquisition opportunities, or by wasting time and money coming up empty-handed in auctions.
- Are dispirited by the significant investments in expensive specialists, technology, systems, and financial modeling capabilities required to execute their audacious strategic goals.
- Are intrigued by the idea of selling their business to their management team over time but want to recognize the full value now, while getting their cash payments as quickly as possible.

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About the Author

Paris Aden, Partner

Paris Aden is the founding Partner of Valitas Capital Partners. Since 1994, he has been involved with more than 100 M&A transactions with an aggregate value exceeding $80 billion. He has advised clients at Morgan Stanley, Credit Suisse First Boston and RBC Capital Markets and has acted as a private equity investor at Clairvest Group where he served on portfolio company boards. Paris was also a co-founder of Alluence Capital Advisors, a mid-market M&A advisory boutique that focuses on cross-border transactions.

Paris is recognized as an expert in business strategy, M&A and corporate finance. Previous roles and speaking engagements include:

- Lecturer at the Stephen J.R. Smith School of Business at Queen's University in their Master of Finance (MFIN) program
- M&A subject matter expert for Moody's Analytics' Advanced Capital Markets Program for capital markets professionals
- Three-time expert panel moderator for the Toronto Business Transitions Forum
- TEC Canada "2018 Speaker of the Year" recipient
- Guest speaker for various industry and business leadership organizations

Paris formed Valitas to meet the unanswered needs of ambitious business owners seeking to:

- At least triple their business value in five years or less; or
- Are seeking an elite advisory boutique as their trusted advisor for their complex, mission-critical transactions.