



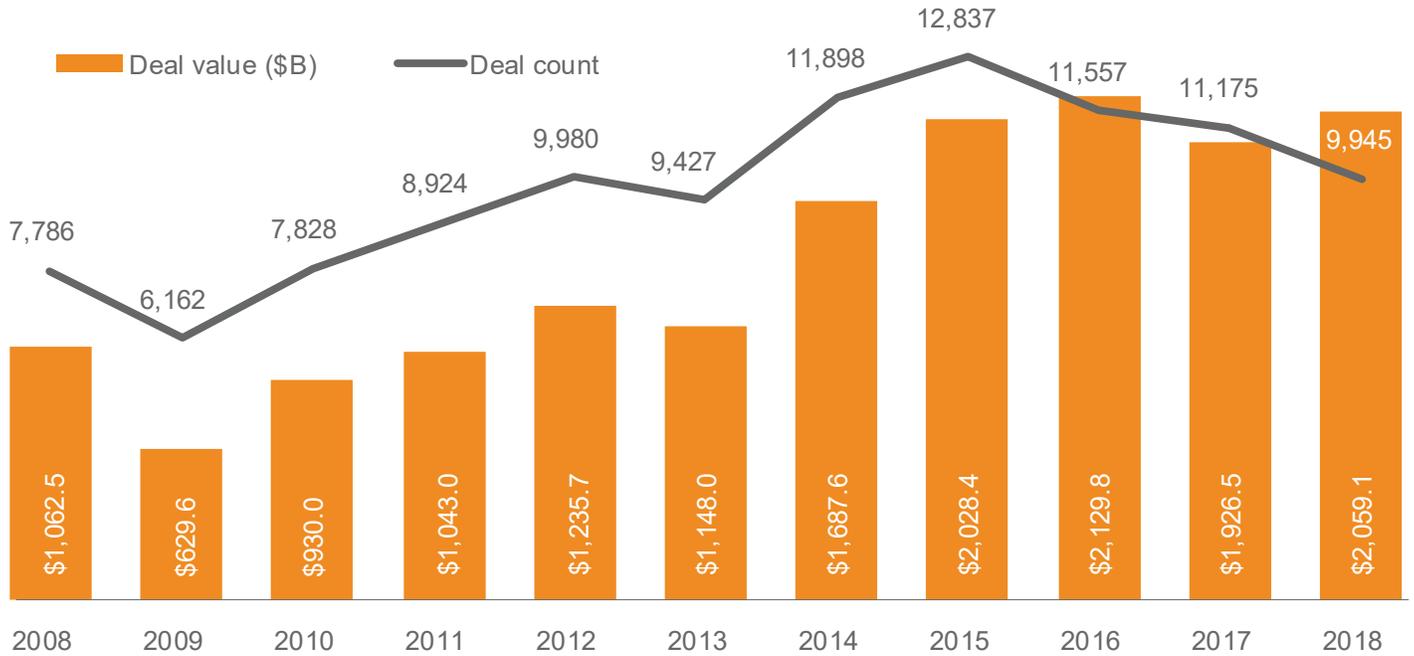
INSIGHT2PROFIT 
THE B2B PRICE & PROFIT EXPERTS

Dealmaking In-Depth: Analyzing the Competitive M&A Landscape

Data provided by  PitchBook.

Dealmaking

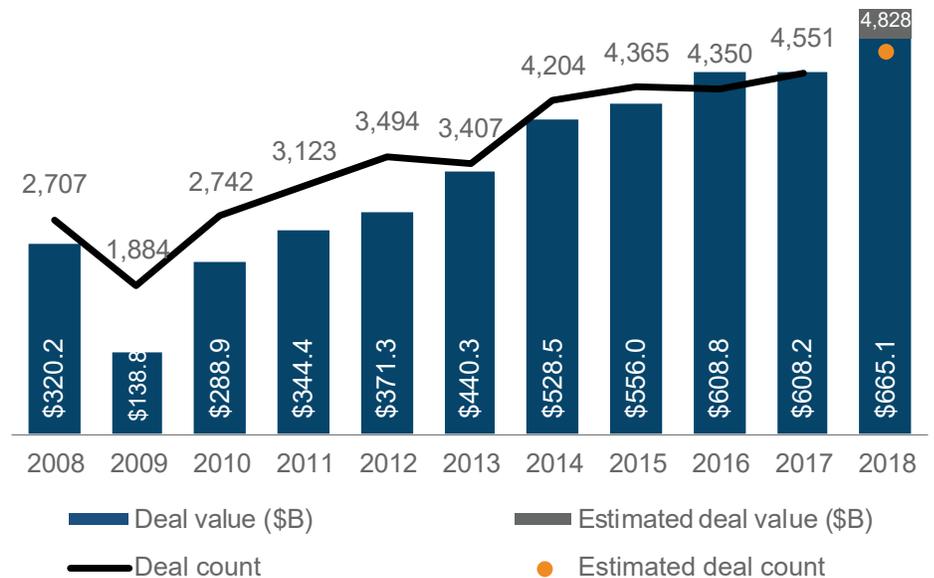
US M&A activity



Source: PitchBook

The US dealmaking landscape has rarely been as competitive as it is now. The broader M&A cycle has eclipsed over \$2 trillion in deal value for nearly each of the past four years, while only 2018 saw the tally of completed deals fall below 10,000 since 2014. Relatively low interest rates and a sustained bull market are important explanatory factors in this surge, but they aren't the sole drivers. Key to the dynamic dealmaking environment was the steady rise in the rate of US PE activity. Completing over 4,800 transactions last year, PE fund managers also shelled out \$700 billion+, a near-record sum that represents a high-water mark for the decade. The PE industry currently enjoys more capital committed to its funds than ever before; if anything, their growing participation in general M&A is helping to underscore the frothiness of the environment.

US PE deal activity

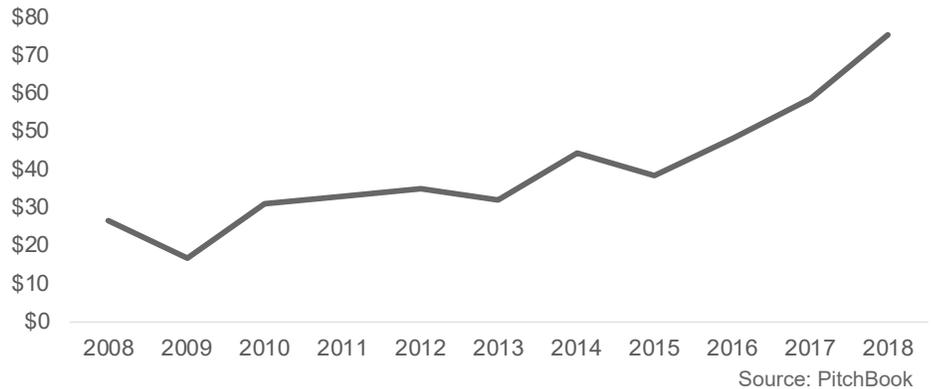


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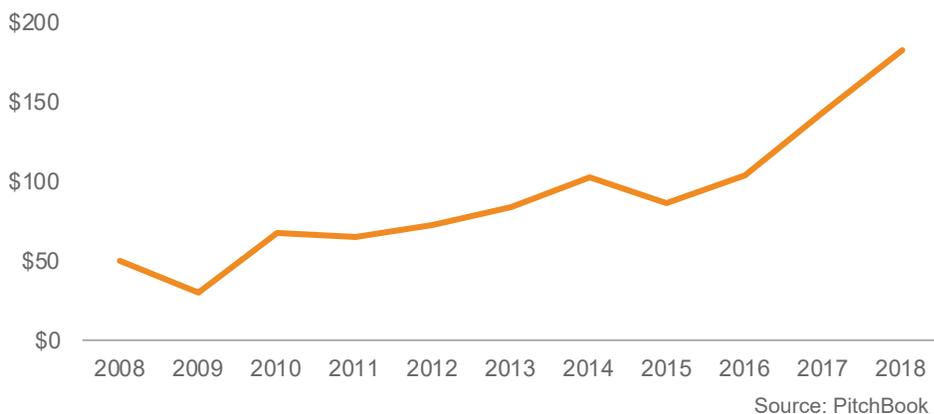
The data bears out just how much acquirers—whether financial or strategic sponsors—are paying for companies nowadays. Access to capital and aforementioned, relatively low interest rates have certainly contributed to median transaction sizes, which have surged to near-record levels. The general M&A size in the US alone has jumped to \$75 million in 2018, up from \$48 million just two years before. PE sponsors have had to pay up even more for US companies. The median PE buyout size in the US jumped to \$183 million last year, nearly \$80 million more than in 2016. Breaking down the types of multiples being paid currently, debt portions are not as low as they have been for some years in the past decade, but they are also still restrained relative to the 7x debt/EBITDA ratio notched in 2008 and 2014. Debt usage is hovering around historical means at 54%. Given the regulatory regime that has by and large held in place since the financial crisis, such levels make sense, yet have also compelled PE firms to pony up more equity. The four highest tallies of equity/EBITDA multiples occurred in the past five years alone, with 2017 observing the highest such mark at 5.8x.

It's clear PE firms are looking for as much potential value creation as swiftly and efficiently as possible, given the prices they are paying. Median buyout multiples have hovered above 10x since 2013, and while investors can blame market dynamics for higher entry prices, the onus is on them to produce higher exit multiples once those deals are signed. Hence the popularity of mitigating strategies such as add-ons and increased digitizing or outsourcing of due diligence processes to cut on costs and expedite bidding in heated contests for high-quality assets. Given the levels of dry powder and no significant shifts in markets or economic growth, this current state of affairs looks set to persist for the foreseeable future.

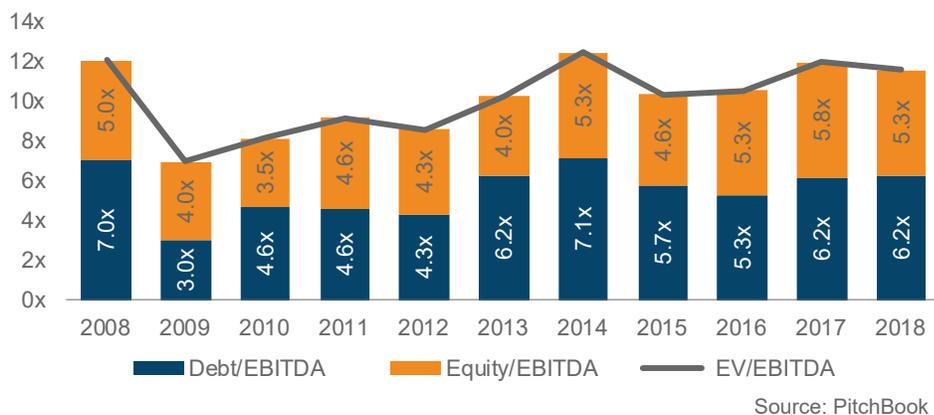
Median US M&A deal size



Median US PE buyout deal size



Median US PE buyout multiples



Q&A: How PE dealmakers are unlocking value



Andy Fauver
Vice President,
Transaction Advisory
Group

Given the broader conditions in the market, how are PE firms approaching prospective targets in collaboration with your firm currently?

Andy: Like others, we see a healthy level of competition resulting in historically higher valuations for the right kinds of assets, especially given the current amount of dry powder. Our PE clients are looking for an edge so that they can create competitive advantages during the deal process. We help them gain greater visibility into enterprise value creation opportunities in as little as two weeks. PE firms are looking for as much support of downstream growth strategy as possible and trying to drive as many decisions as possible with actionable knowledge. As such we identify strategic pricing and EBITDA improvement opportunities that our PE

clients may ultimately underwrite as part of their investment thesis.

With the proliferation of data and data availability in the M&A process, our data engineering capability, analytics technology platform and consulting expertise accelerates the time to insights and foundation creation for further discovery and hypothesis testing.

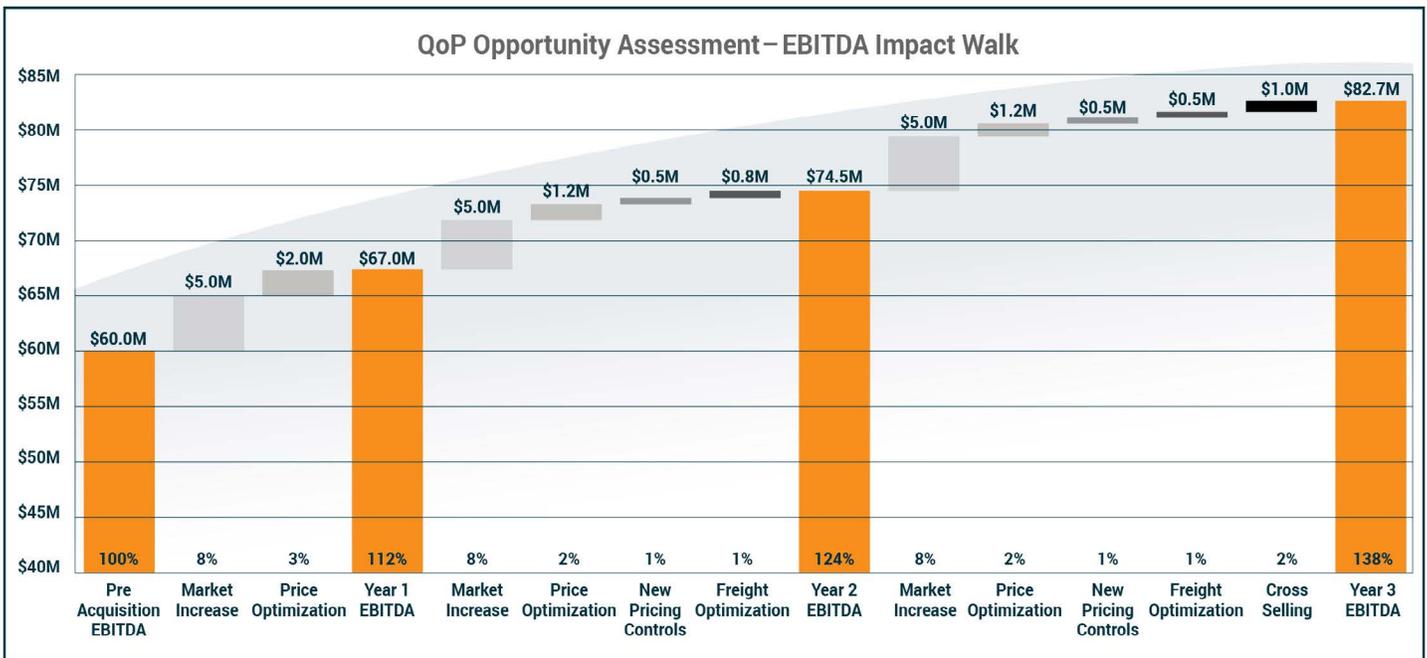
Can you walk us through the general approach, noting how you collaborate with PE firms, of pre-merger pricing your firm undertakes?

Andy: Yes, we launched an innovative offering branded Quality of PricingSM (QoP), as pricing is the strongest profitability lever in any business, and we bring unique expertise and capabilities to this topic. We work with PE firms from indication of interest (IOI) stage through letter of intent (LOI) and deal close to align the CIM, management presentation materials and management team discussions with analysis of data room contents to understand the drivers to and dynamics of the business and where EV creation potential and risks reside. Given current valuations, our PE clients utilize our Quality of Pricing services to find opportunities to accelerate value creation. In collaboration with the client, we focus on EBITDA improvement opportunities and risks, via strategic pricing and more broadly in terms of commercial excellence. Unpacking commercial excellence, we utilize our pricing expertise, data engineering and analytical tools to determine where profit can be optimized through enhanced customer and product

segmentation, identify customer churn and causes what margin leaks may be occurring, cross-selling opportunities and more. As an example, a scenario we've observed before is a customer shifting from branded OEM to generic or will-fit products which will typically exert downward pressure on margins and impact how PE firms will value the business and form growth strategies. As an objective third party, PE firms can use our analysis in discussions with their own third-party stakeholders (e.g. limited partners, lenders).

Can you give us a specific example?

Andy: Without divulging names, I can let readers know we have a broad range of PE sponsors as clients. In what is typically a two-week cycle, we identify key commercial dynamics in the target business and analyze that business for commercial improvement opportunities as well as testing hypotheses that our PE client may have. We recently worked with a PE firm assessing the acquisition of a \$300 million manufacturer; utilizing 24 months of transactional invoice files from the data room, we were able to identify \$7 million of EBITDA improvement opportunities in year one and a roadmap of margin improvement initiatives that would stack the EBITDA improvement year over year that yielded transformational impact on the business. Multiple factors can play into the impact potential of prospective improvement opportunities, though here are three that we often see. First, we correct for significant variation between prices that similar companies are paying, even though they are buying similar products. Second, we look at potential



Source: INSIGHT2PROFIT

to improve customer and product segmentation as well as identifying customer value drivers, so that the company can differentiate pricing – e.g., being more aggressive in pricing in regions, product categories or end-use segments where there is limited competition, or they have a truly differentiated offering. The third is when we help close margin leaks such as identifying smaller customers that are getting unearned discounts or freight/shipping is being waived. As these improvement areas are identified, we collaborate with PE firms to build a roadmap and prioritize these opportunities for implementation during their post-acquisition 100-day plan.

What are the key steps for PE buyers to undertake, in your opinion, about pre-merger pricing? What are the biggest hurdles you currently encounter?

Andy: PE firms should determine how they can leverage the contents of the data room to explore business risks and growth opportunities that others can't see. For example, we look at net customer churn – e.g., new and lost customers as well as changes

in existing customers' purchasing behavior such as changes in volume, price and mix of products, plus business segmentation – customer, product, channel, geography – to optimize pricing. Further, we help our clients assess the change management readiness of the target, so that the PE firm considers the path to implementation and prioritization of likely initiatives.

We're engaged by sponsors as an extension of their deal team, and they may not have the analytical or technical horsepower necessary, so we collaborate in different ways depending on the deal stage. We always caution our clients to be wary of averages and summary-level analysis as they often mask what is really going on in the business and the factors that are truly driving business performance. If they are at an IOI stage, as opposed to an LOI, we may provide a high-level assessment of margin improvement opportunity rather than detail analyses – looking at factors such as level of pricing power; margin improvement opportunities we've seen in similar businesses; likely change management enablers and challenges; and other commercial

dynamics we've observed in comparable situations. If it's an LOI stage, we go much deeper than the CIM and management presentation. We have developed a clear view of the company's value proposition and truly understand the business's drivers, so then can partner with our PE clients to dive deep into the analytics to determine what is driving or dragging profitability.

How do sector-specific items play into that?

Andy: Historically we've focused on B2B manufacturers and distribution businesses. That said, over the past several years we've broadened into business services and B2B2C, i.e. products that are sold to another business like Home Depot but ultimately end up with the consumer.

The concepts within our approach tend to be similar across industries, while commercial structures (such as elements to customer cost to serve like freight, payment terms or co-op marketing where margin leaks may occur) are likely to be the main shifting variables. Also, the industry structure such as long-term agreements, market

growth, supplier concentration and customer concentration dictate the level of pricing power

Can you discuss how your approach differs depending on the type of deal? For example, add-ons are quite popular as a strategy currently; how do you work with the PE client in those instances?

Andy: Once you develop a pricing strategy, customer and product segmentation, and framework with a platform company, and then also address all other elements of customer cost-to-serve such as discounts or promotional marketing, then you can often apply the same frameworks across any new businesses brought on. This commercial foundation allows the add-on acquisitions to leverage the structures and change management approaches to realize the EBITDA improvement opportunities more quickly. There may be variations in data between companies as well as overlapping SKUs and customers, so INSIGHT facilitates the commercial integration of pricing structures to maximize margin opportunities such as cross selling while mitigating risks of pricing variation to the same customer. With add-ons there is high likelihood of customers receiving different prices as add-on companies could have been previous competitors, so as the platform integrates acquisitions they need to communicate with customers and consider product position when they offer similar products to avoid “margin down” whereby the customer chooses or demands the lower price of the same or similar products.

To what degree is competition specifically affecting or relating to issues around pre-merger pricing, such as concerns on the part of other buyers? Or is a general perception of competition contributing to concerns?

Andy: Over the last two to three years, we've seen more and more

PE firms recognizing the advantage of pricing as part of their enterprise value creation playbook. Three years ago, we had to educate; now the market recognizes the power of strategic pricing as a value creation lever, but still few are underwriting pricing on the buy side. With speed to close remaining a differentiator for buyers, we have pushed to get our process into a two-week window, thus positioning our firm role as a trusted data analytics partner.

PE firms requesting Quality of Pricing services have extended into the sell side of the transaction, as companies are looking to take advantage of current industry multiples. On the sell side we help them map out how they have improved pricing and margins over time, and how they can improve going forward with a quantification of EBITDA impact to date and potential future improvement.

What other macro factors are your clients concerned about that is lending impetus to the focus on pre-merger pricing?

Andy: As the incidence of secondary buyouts increases, we work with many companies that have been owned by multiple sponsors, where much of the low-hanging fruit – so to speak – has already been harvested after the first round of institutional ownership. So, to achieve additional value we are extending beyond pricing, it can get very granular, down to the level of whether a company is optimizing their profit per production machine hour. That trend also plays into the fact that fund managers are looking to achieve significant growth even in the first year, given the prices they are paying for acquisitions. Pricing is a key lever to that rate of growth early in the hold period, as organic growth rates are hard to come by in most industries and the margin improvement impact of pricing compounds each year. Companies really need to make sure that they are optimizing price, that they are looking for cross-selling

opportunities, that they understand customer churn, and that they're able to bring all of that to bear post-close in order to achieve that 10%+ growth rate organically in year one, per a recent PitchBook survey.

Another macro dynamic is inflation, where companies have not seen inflation until the last year or so for a long time, so they lost the muscle memory of taking pricing increases to the market. Now with labor, material (in some cases) and freight inflation, not to mention tariffs, we are helping our clients with rebuilding this capability and training their customers to expect these conversations as our clients should be compensated for the value they are creating.

Please feel free to address any new items or expand on the topics enumerated above.

Andy: Just like we used to educate on the importance of leveraging pricing and related it to quality of earnings, in two to three years I anticipate focusing on Quality of Profit (i.e., extending beyond price). How strong is the business? What types of opportunities do they have to optimize profit? What are the levers that they must get beyond pricing, to get into those other elements, those margin leaks, the cross-selling, the segmentation? As PE firms look to bring more data into their decision-making processes and digitize as much as they see other traditional businesses doing, it's important to have data engineers or a data analytics partner help process structured and unstructured data into actionable formats and codifications.

The essential element to driving impact is utilizing this intelligence to create a feedback cycle that is fed into the portfolio company's tools and systems. The ultimate objective is to take all the data sources available and apply analysis to develop intelligence that informs and improves commercial decisions (e.g., quoting, inventory levels).

Quality of PricingSM

Differentiate and accelerate your due diligence playbook



30
M&A due diligence processes supported in 2018



200+
Clients served



\$1.5B
Enterprise value created in 2018



\$6.7B
Value of transactions supported/completed in 2018

Pricing expertise
Data analytics
Proprietary technology



40%
Compound Annual Growth Rate



79%
Employee growth since FY 2015



111
Wells donated in East Africa



75 Girls sponsored for secondary school in East Africa



56
Funds/PE firms served