

Wiley Finance Series

SECOND EDITION

MIDDLE MARKET M&A

Handbook for Advisors, Investors,
and Business Owners

**KENNETH H. MARKS, CHRISTIAN W. BLEES,
MICHAEL R. NALL, THOMAS A. STEWART**



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ADDITIONAL PRAISE FOR *MIDDLE MARKET M&A*

“As a business owner who has done several M&A deals, and as a former Chair of the Global Entrepreneurs Organization (EO), where I knew many business owners who did M&A deals, I found the information and practical advice in this book very helpful. We all read about the big deals that happen, but understanding the truths about small to middle market M&A is very different. *Middle Market M&A* is a great guide to navigating the entire process.”

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Founder of several businesses, EO Arizona member

“It’s great to see a book recognize the middle market like *Middle Market M&A* does. Having owned and eventually selling a middle market company I sometimes felt we were, until now, the forgotten segment in the business world. This book is full of knowledge and insight and after reading it I no longer feel like the forgotten company owner!”

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“All business owners will eventually exit their company. For those that want to proactively plan and know their options, *Middle Market M&A* is the go-to guide for understanding the process and

gaining insights into how deals work and having an edge in getting the most value. Even if your exit is to the next generation, this handbook provides a perspective on value creation and making the succession and transition easier. *Middle Market M&A* should be a required read for every owner and entrepreneur.”

—Bill Buxton, Vistage Chair

“Having participated in middle market M&A over the past 25 years, I’ve learned how successful transactions hinge on many factors, beginning with the initial idea of a deal—to getting it closed. This handbook provides a rare and unique overview of the spectrum of topics and concepts critical to understanding and optimizing the outcome.”

—Lanny D. Bynum, CPA
Thompson, Price, Scott, Adams & Co. P.A.

“An owner’s business is often their largest asset. This handbook helps entrepreneurs and business owners properly consider their goals and objectives to enable them to present their company in an intentional manner to maximize the value of an asset they have often spent a lifetime building.”

—Terry J. Carlton,
Managing Partner, Jordan Price Wall Gray Jones and Carlton, PLLC

“The new edition of this handbook for advisors, investors, and business owners on middle market M&A is an outstanding update for anyone involved in mergers and acquisitions. It is a comprehensive, well-written, and stellar contribution to the M&A literature and to the M&A practice. It is a *must*-buy for businesses, investors, and advisors, not only for middle market M&A but for anybody interested in the field more generally.”

—Professor Sir Cary Cooper, CBE
Co-editor, *Advances in Mergers and Acquisitions* Series
Alliance Manchester Business School, University of Manchester, UK

“Whereas similar efforts barely manage to scratch the surface, the *Middle Market M&A* handbook represents a thoughtful and comprehensive treatise on topics of relevance to stakeholders across the transaction spectrum. An equally must-have resource for serious M&A professionals and the clients they serve.”

—Michael C. Gillette
Shareholder, Polsinelli PC

“For the M&A market, sellers, buyers, and advisors alike can find a lot of helpful information here. This highly readable guide is especially relevant for the middle market space, where mom-and-pop meets the highly resourced, sophisticated worlds of corporate finance and private equity. This reference contains a detailed survey of M&A guidance including areas such as: reviewing seller’s goals and aspirations; understanding of market segments, types of buyers, and proper valuation; optimizing finance and capital structures; finding buyers; and structuring a deal so both sides can succeed. All of it is delivered in plain English, with practical thoughts on updated technology, ethical standards, and best practices. Well done!”

—Chris Hostetler
Financial Advisor, Hilltop Wealth Advisors

“It is wonderful to see the second edition of *Middle Market M&A*, particularly in light of all the significant changes in this market over the past 10 years! As an M&A attorney, mainly on the sell-side, I frequently point my clients to this resource so that they are more knowledgeable about the M&A process. I am confident that these clients who delve into the handbook have better outcomes and fewer surprises in their transactions.”

—Fred D. Hutchison
Hutchison PLLC

“Great collection of the how-to’s of M&A. No BS advice. Highly recommend.”

—Bharat Kanodia, ASA
Founder and Chief Appraiser, Veristrat LLC
Inc. Magazine contributor

“Having practiced corporate law for almost 20 years and teaching M&A to law students for the past 5, I have come to appreciate the complexity and nuance around M&A transactions. *Middle Market M&A* provides a well-organized and thoughtful journey through all of the key elements of a middle market M&A transaction. I have found the clear and detailed presentation of the material to be accessible to both seasoned practitioners and novices alike, whether in the legal, accounting, tax, or investment banking profession.”

—Geoff Krouse, JD
Assistant Dean for Alumni & Development and Senior Lecturing
Fellow at Duke Law School; Of Counsel at Smith Anderson LLP

“This updated second edition of the *Middle Market M&A* handbook is a great resource for owners and advisors involved in the M&A process. It covers all the important topics in working through sell-side and buy-side deals, especially at the lower end of the market.”

—Brent Kulman

Managing Director, Business Development, Five Points Capital

“As an entrepreneur having sold my landscaping business to a large industry leader, understanding the terms and concepts outlined in *Middle Market M&A* was highly valuable. This handbook is a great tool to have as you think about selling your company.”

—Don W. Long

Best-selling author, speaker, and transformational leader former; owner of Long Brothers Landscaping

“Often overlooked or discussed only as an afterthought, Marks and his co-authors have focused on an increasingly important part of the vibrant M&A market—the so-called middle market where indeed the most deals take place. This market is huge as are the implications for buyers of mid-sized companies, their founders and sellers, the myriad advisors, investors, and business school students. This book should be on the bookshelf of every one of those groups. This handbook provides not just an overview of the necessary elements for success in mid-market dealmaking, but is a rigorous and, importantly, up-to-date compendium of the broad range of issues that anyone dealing in this market will encounter.”

—Professor Scott Moeller

Director, M&A Research Centre

Bayes Business School (formerly Cass), City, University of London

“It is not a question of if, but when, you will sell your business . . . and when you do, this handbook should be front and center during the process. Entrepreneurs are the best at growing businesses . . . the guidance in *Middle Market M&A* by these experts is what is needed to translate your hard work and passion into valuable business building and successful M&A!”

—Randy H. Nelson, Serial Entrepreneur

Author of the *Decision Series for Entrepreneurs*

“Understanding how private businesses access capital for growth and successful owner transition is one of the most critical and least understood parts of the small- and medium-sized business economy. This second edition of *Middle Market M&A* is a must read for anyone who needs to master the ever-evolving dynamics of the private capital marketplace. There is no better reference book for equity investors, private company owners, and the advisors that unite them.”

—BRETT PALMER, President Small Business
Investor Alliance (SBIA)

“A valuable M&A handbook. This edition of *Middle Market M&A* provides readers with a solid understanding of where the middle market and private capital markets currently sit while going into best practices from a sell-side and buy-side perspective. The technical section covers vital information and doesn’t just scratch the surface, but goes into detail that all M&A practitioners, whether they have 2 or 20 years of experience, will find beneficial.”

—Kison Patel
CEO and Founder of M&A Science

“I have been doing mid-sized M&A deals for over 30 years and *Middle Market M&A* is the most comprehensive guide I have come across. The glossary alone, with its extensive definitions, could be a book itself. As the authors suggest, there is often an “asymmetry of knowledge” in the middle market because most entrepreneurs only sell their business once, whereas buyers can be frequent practitioners of the art. Readers of *Middle Market M&A* can minimize this disadvantage when armed with this impressively complete book.”

—Reed Phillips,
CEO of Oaklins DeSilva & Phillips and author of QuickValue

“The authors and contributors to this second edition provide practical guidance in the planning and execution of M&A transactions for founder-led and family-owned businesses. Their experience and approach shine through in *Middle Market M&A: Handbook for Advisors, Investors, and Business Owners.*”

—Gerald Roach
Firm Chair of Smith Anderson; corporate, securities, and merger and
acquisition lawyer; and

—Byron B. Kirkland,
Managing Partner, Smith Anderson; corporate, private equity, and
mergers and acquisition lawyer

“I am often asked whether there are any differences between a middle market deal and a traditional upper market deal. I just say ‘Read This Book.’ It has everything you need to think about in structuring, negotiating, and closing a middle market deal from the advisors I would hire to lead the deal.”

—Margaret Rosenfeld
Chief Strategy and Legal Officer, Deltec International Group

“*Middle Market M&A* is a superb reference for C-suite members and professionals serving the middle markets. The authors provide a unique perspective on how to structure transactions and manage organizations to maximize enterprise valuations. This book is full of terrific guidance for understanding and maneuvering within the middle markets, with clear and cogent advice on managing to a timely and certain closing and transaction.”

—Larry Robbins
Partner, Wyrick Robbins

“*Middle Market M&A* is a must-read and a valuable practical resource for anyone who spends all, or any part, of their day in middle market corporate transactions—whether as an advisor, investor, buyer, seller, or student. It doesn’t matter whether you’re a veteran or a rookie, this book will help you navigate the always changing and challenging world of M&A. In fact, this is not just a book to read; it’s a book to use. Make notes in the margins, dog-ear the pages, skip around out of order, keep it nearby as a handy reference, and refer to it often whenever you’re faced with old and new problems to solve. This is the one book to have in an increasingly overwhelming array of M&A resources.”

—Mike Saber
Partner, Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, LLP

“*Middle Market M&A* provides a comprehensive and approachable overview of merger and acquisition transactions. That is not surprising to me, as it reflects the real-world insights and experiences of the writers in getting deals done.”

—Randy Whitmeyer
Partner, Morningstar Law Group

Middle Market M & A

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*Handbook for Advisors,
Investors, and Business Owners*

Second Edition

KENNETH H. MARKS
CHRISTIAN W. BLEES
MICHAEL R. NALL
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WILEY

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Preface

Deal markets go through cycles just as the broader economy does. The volume of deals flows or ebbs, influenced by interest rates, overall economic conditions, demographic or industry trends, the availability of capital, and other factors. These factors also affect the price of deals (i.e., the average multiple of revenue or EBITDA [earnings before interest, taxes, depreciation, and amortization] a buyer is willing to pay), which also rises and falls. The need for guidance is constant, however, whether the mergers and acquisitions market is bullish or bearish, whether it favors sellers or buyers. As you will see in this book, middle-market capital markets, which are mostly private, are fundamentally different from public markets. Transactions are different in private markets. The participants—buyers, sellers, and the advisors who help each party—also tend to be different; many big investment banks do not do deals in the middle market, for example. Most sellers (and many buyers) are inexperienced—selling a founder-led business is almost always a once-in-a-lifetime event. Acquisitions involving private companies are largely unregulated by groups such as the Securities and Exchange Commission.

For all these reasons, the body of knowledge for middle market M&A differs in critical ways from what is taught in corporate finance classes and practiced by global enterprises, big investment banks, stock exchanges and their regulators, and others who are involved in deals that make headlines. Middle market M&A rarely moves markets or rates a mention on CNBC. But it makes all the difference to a founder and a founder's family; it can lead to an infusion of capital that transforms the economic life of a community; it can give employees a whole new range of opportunity; it can create large fortunes; it can transform a niche player into an industry powerhouse. Or it can be bungled.

If you own, operate, or advise a middle market company, one with \$5 million to \$1 billion in annual revenues, understanding middle market M&A is important for you and your clients when thinking about shareholder liquidity or selling or buying a business. How can you evaluate different options and opportunities? How can you improve the odds of getting a deal done? If you are the prospective buyer of middle market companies,

how can you better understand sellers, and how can you make offers structured so that, once you close a deal, you can make it successful afterwards?

Middle Market M&A: Handbook for Advisors, Investors, and Business Owners is a foundational reference for those advisors, leaders, and executives involved in the lifecycle and process of M&A transactions. This is the second edition of this book. The first, published in 2012, was based on the program for the Certified M&A Advisor® (CM&AA) credential originated and led by the Alliance of Merger & Acquisition Advisors (AM&AA). When it was published, the market for private companies was beginning to come back as the financial crisis of 2008 faded and the subsequent Great Recession slowly began to release its grip on financial markets and a long drought in M&A activity was coming to an end.

This edition appears after a very different economic shock: the sudden stop-and-restart impact of the Covid-19 pandemic. That event and its extraordinary human cost brought deal making to an almost complete halt in the first half of 2020. With employment and economic activity plunging, no one could have anything more than a gambler's instinct for the short- or long-term prospects of a company or the true value of a deal. While Covid-19 itself persisted (and persists, as of this writing), its impact on the deal market disappeared almost as quickly as it arrived. By the second half of 2020, middle market M&A activity was not just back, but at a record pace, and that pace continued into 2022, though we now face a potential recession.

But while the volume of activity is back to (or above) “normal,” the nature of middle market M&A has changed in fundamental, structural ways. Some of these changes were sparked or accelerated by economic shocks, but others are the result of long-term trends. Five stand out.

First, middle market M&A has become a much bigger business. In 2021, the total global investment in middle market M&A was nearly \$5 trillion, compared to just under \$2.5 trillion in 2012. That is just the money that was put to work in deals. As of this writing, there is an estimated \$1.3 trillion in “dry powder”—capital held by private equity funds, family offices, pension funds, and others whose owners are looking for middle market companies. The recent jump in the number of deals may be partly driven by pent-up demand after the Covid shock, but it has long-term causes, too, including the massive intergenerational wealth transfer now underway as the Baby Boom generation retires and boomer-owned companies come on the market.

It is not just that the pool of capital has grown; a second major change is in who is providing the capital and who is making deals. A decade ago, institutional investors such as pension funds included private equity as a relatively minor part of their portfolio of so-called alternative investments. Today middle market M&A is mainstream, not alternative, and there is

scarcely a pension fund that does not have a separate asset category for middle market private equity investing. In 2012, more than 75% of middle market M&A was with strategic buyers—companies acquiring other companies to fit in or beside their existing business. Since then, the number of sponsor-backed (i.e., private equity) deals has approximately doubled, and these account for nearly 40% of the total deals in 2021. For these financial buyers, as we call them in this book, the primary goal is to invest in a company that they will later sell. These buyers are not making acquisitions with the intent of integrating the target into a larger enterprise (although some are completing “add-on” acquisitions as we describe in this book). Rather, these private equity investors intend to grow and develop their portfolio companies into stand-alone valuable enterprises.

Third, with the expansion of the industry has come an increase in professionalism, process, and standards. Ten years ago, this book was needed as a guide to a “Wild West” where best practices were only beginning to emerge and become known and where the quality of the advice available to middle market sellers and buyers varied enormously. To take just one example, a “quality of earnings” analysis (see Chapter 12) was rarely part of the due diligence process then; now it is routine. As the industry has become more professional, we have in this edition attempted to capture, codify, and update best practice, and in some cases expand it.

The professionalization and standardization of middle market M&A will continue as the role of private capital in the U.S. economy expands. The number of U.S. publicly traded companies is about 3,500, half what it was at its peak in 1996. Initial public offerings are fewer and bigger. In 2017, according to Morgan Stanley,¹ companies raised \$3.0 trillion in private markets, twice as much as they raised in public markets. While private capital markets remain unregulated by and large, their sheer importance in the economy means that bankers, brokers, investors, and sellers will expect and demand more consistency and adherence to the practices this book describes.

Fourth, the owners and managers of middle market companies are themselves becoming more skilled and professional. A decade ago, the middle market was the “neglected middle child” of American capitalism, largely ignored in academic research and business-school curricula, not in the target market of those big advisory firms that do research as well as consulting, and mostly left to its own devices to discover and apply ideas to maximize enterprise value. While the knowledge gap persists, today’s middle market leader can be part of peer advisory groups for CEOs, CFOs, and others, which provide research as well as networking and can enroll in programs designed to help mid-sized companies scale up and help entrepreneurs build an operating system for their enterprises. For some middle market

companies, management expertise is provided by private equity owners—occasionally in operations and strategy, and certainly if they prepare for a sale or wish to make an acquisition themselves.

Fifth, digitalization has transformed middle market M&A, at least in part, as it has so much else. There has been a proliferation of online, self-service tools for business valuation that owners, investors, and advisors can use. In the past decade, online marketplaces have arisen where companies, investors, and buyers can discover each other. Cybersecurity has become an important element of due diligence. And the whole transaction process has evolved as it has become more digital—think of the use of virtual data rooms to secure confidential information, to take just one example. We added Chapter 10 about technology in M&A to provide a primer on the topic.

Today, with capital more plentiful than target companies, the market is complex. The most attractive targets are in demand from strategic and financial buyers alike and can command prices that are extraordinarily high by historical standards—so much so that private-equity-firm returns to limited partners are declining. The scarcity of these companies has driven buyers to consider smaller and earlier-stage companies, or to develop a “platform strategy” of buying several lower-middle market companies with the intention of combining them into one substantial entity, or to take partial positions en route to a complete acquisition. Often multiples for these smaller companies lag well behind, and some companies find no buyers at all. As buyers’ strategies have evolved, sellers have many more options to consider when thinking about liquidity, exit, or other transitions. And they have many more tools to use, as do sellers, advisors, and every other participant in the middle market M&A ecosystem.

Thus, the quandary: How does a seller seek and achieve the best possible outcome? What is the typical middle market company to do to create a partial or complete exit for its owners? This challenge creates an opportunity for resolute leaders and executives as well as for innovative and trusted advisors. With more money at stake, more ways to buy and sell, and more professionalism on the part of buyers, sellers, and their intermediaries and advisors, the need for this book, we believe, continues to grow.

Who generally wins at the deal table? The one with the most knowledge and experience! Historically, there exists an enormous asymmetry of knowledge, most often to the detriment of middle market company owners. Some experienced big buyers willingly admit to being bullies. That is why smart owners, investors, and advisors should arm themselves with any possible source of expert knowledge, reduce the asymmetry, and level the playing field.

This handbook is meant to be a practical guide and reference for practitioners, owners and operators, buyers and sellers, and educators and

students. The term *M&A advisor* is used throughout the text as a reference to the many professionals involved in the M&A process, including investment bankers, M&A intermediaries and specialists, CPAs and accountants, deal and transaction attorneys, valuation experts, wealth managers and investors, and consultants and business advisors. The intent is to provide a holistic overview and guide concerning mergers, acquisitions, divestitures, and strategic transactions for middle market companies. It covers pretransaction planning, deal execution, and post-transaction considerations, and addresses the processes and core subject areas required to successfully navigate and close deals in the private capital markets. *Middle Market M&A* can be thought of as providing a horizontal perspective for the many participants in the process, which typically bring expertise in one or more vertical subject areas.

The main content is divided into four parts, with Part One being an overview of the middle market, private capital markets, and private company valuation. In the first edition, this market perspective was heavily influenced by the work of Robert Slee, a co-author, whose insights then continue to shape the discussion.

Part Two, new to this edition, hones in on M&A from the owner's perspective. It is written to help owners think through the issues of transition, succession, and exit planning from both personal and enterprise perspectives, and to help understand practical steps they can take that will enhance the value of their business to prospective buyers—and its performance in the meantime. This part is not for owners alone, of course: successful advisors on both the buy and sell side know that understanding owners' aspirations is a key to unlocking the best deals.

Part Three focuses on the M&A processes and practice management. It addresses sell-side, buy-side, and merger processes and introduces a framework for professional standards and ethics. In keeping with the growth and professionalization of middle market M&A, this part has been considerably rewritten and expanded.

Part Four delves more deeply into the technical subjects. Each chapter is a stand-alone treatise on a specific topic. Together, they provide the supporting details to begin understanding the subtleties and intricacies in making a deal or transaction work. Keep in mind that this handbook is a guide. It is not intended as an endpoint in the search for understanding and clarity about M&A, nor is it a substitute for professional advice (from attorneys and tax specialists, for example); instead is a quick start to understanding the topics and processes and determining where more in-depth knowledge and experience is required.

The authors of this handbook are Kenneth H. Marks, lead author of the *Handbook of Financing Growth*; Christian W. Blee, chair of the CM&AA credentialing program and a key instructor in developing its content; Michael

R. Nall, CPA, founder of the Alliance of M&A Advisors and the MidMarket Alliance; and Thomas A. Stewart, former executive director of the National Center for the Middle Market at The Ohio State University. Although our names are on the title page, we also endeavored to generate and capture ideas, knowledge, and experiences from many industry and subject matter leaders to provide a holistic, practical, and balanced perspective. As you scan the list of contributors and reviewers involved in creating this edition, you will notice that the breadth and depth of experience, expertise, diversity, and backgrounds is vast, and we are deeply grateful to them for their help.

M&A is a careful blend of art and science. On the one hand it is multi-disciplinary, complex, and analytical. On the other, it is all about people, relationships, nuances, timing, and instinct. This dynamic produces opportunity coupled with conflict, ambiguity, and challenges, all supporting an exhilarating business ripe for those seeking to create or capture value.

We invite you to send your comments, questions, and observations to us at: khmarks@HighRockPartners.com, cblees@biggskofford.com, mnull@midmarketplace.com, and stewart.thomas.a@gmail.com.

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