

GGI

Sell-Side Quality of Earnings Services



Sell-Side Quality of Earnings (Q of E) Services

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1. OBJECTIVES

- a. Highlight similarities and differences in buy v. sell-side Q of E
- b. Summarize typical sell-side areas of focus
- c. Provide example of approach and deliverable

2. SIMILARITIES

- a. Summarize accounting policies and practices
- b. Analyze:
 - i. Revenue recognition
 - ii. Margins by product, customer, etc.
 - iii. SG&A levels and trends
 - iv. Significant concentrations

1. Major customers
 2. Limited supply of key materials or components
 3. Sales by sales person or rep
 4. Labor and collective bargaining agreements
 - v. Receivables, inventories, PP&E and other relevant asset accounts
 - vi. Payables, accrued liabilities and other relevant liability accounts for those likely to be assumed by the buyer
- c. Identify potential contingent liabilities and describe likelihood and potential impact. Examples include:
- i. Environmental liabilities
 - ii. Potential product liability or warranty matters
 - iii. Pension obligations

- iv. Others that may financial impact the buyer even if the liability is excluded or indemnified
- d. Estimate required minimum working capital levels
- e. Address tax matters and risks relative to the likely transaction structure
- f. List, describe and evaluate the various EBITDA adjustments

3. DIFFERENCES

a. Audience

i. Buy-Side

1. Distribution typically limited to buyer and its advisors and lenders
2. Work paper access typically not provided to other parties

ii. Sell-Side

1. Distribution typically intended to include several potential buyers and their advisors
2. Work paper access may be provided to selected potential buyers and their advisors

b. Perspective/Approach

i. Buy-Side

1. Identify risks that client may use to:
 - a. Reduce purchase price or modify agreement
 - b. Use as negotiating points
 - c. Develop mitigation plans
2. Assess capabilities of target's personnel

ii. Sell-Side

1. Identify risks early to allow some combination of:

- a. Resolution before distribution of the CIM
 - b. Description of issue, impact and mitigating factors with seller having initial control of the dialog
 - c. Communicate early as part of vetting potential buyers
 - d. Allowing time to desensitize the issue
2. Assess and test the readiness of Company personnel
- a. Bolster where needed
 - b. Consult/guide
 - c. Serve as the primary point of contact if helpful
- c. Timing
- i. Buy-Side
 - 1. Typically between LOI and closing
 - 2. Usually time critical

ii. Sell-Side

1. Typically before release of CIM
2. Timing to allow for iterations and improvements before CIM

4. DELIVERABLES

- a. Formal, detailed report
- b. Access to various relevant data and analyses
- c. Additional insight provided verbally
- d. Other as required by the specific case