RKJ PARTNERS
LOWER MIDDLE-MARKET INVESTMENT BANKING

RKJ Partners, LLC is an Atlanta, Georgia based investment banking firm designed to specifically assist dynamic, lower middle market growth companies in executing transactions less than $100MM.

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When Is A Merger The Right Move?

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While you may be thinking about selling your business, the timing may not be right for an outright sale. Perhaps the shareholders remain passionate about the business and want to increase its value prior to pursuing a traditional sale. A merger could be a good solution when a company has a solid foundation but may lack critical mass, may be facing cash flow challenges, or be lacking other key components. While this may impede a sale, acquiring companies may want to capitalize on synergies such as an expanded geographic footprint and/or increased services and product lines. Because there are generally many opportunities to increase profitability by eliminating overlapping or redundant overhead expenses in the merged entity, it is also likely to be more desirable as an acquisition candidate at a future date.

MERGER STRUCTURES

Mergers can be structured in many ways. However, the most common merger structures are forward, reverse, and triangular mergers. In a forward merger, the "acquiring" company (usually the larger company) is the surviving entity with the "target" company merging into the acquirer's corporate entity. The shareholders in the target usually receive stock in the acquirer in exchange for their stock, and the assets and liabilities are combined with the acquirer's company. In a reverse merger, the target is the surviving entity. Triangular mergers, also known as indirect mergers, are structured utilizing a newly created third entity. Both entities are merged into the merger subsidiary, with the subsidiary assuming all of the combined assets and liabilities.

Equity ownership in the new or combined company is typically the most sought after and contested aspect of the merger negotiation. Equity distribution is not a clear cut science as it is generally established based upon the ratio of the business valuations of each of the combining companies. Financial or operational value drivers used to determine the worth of each company typically serve as key determining factors. The most common value drivers include gross

revenue, adjusted EBITDA (earnings before interest, taxes, depreciation, and amortization), intangible factors (contracts, management capabilities), or a hybrid of factors. It is also impacted by the balance sheet of the respective companies, namely assets net of liabilities being contributed by the respective parties.

A desirable scenario is when both companies adhere to the same valuation criteria or benchmarks. The challenge exists when one company benefits in comparison to the other by having the valuation driven by one benchmark, while the other uses would benefit from a different methodology. For example, assume Company X had $10 million in gross sales yielding $1 million in EBITDA (adjusted earnings) and Company Y had $7 million in gross sales with $1.5 million in EBITDA. Company X would prefer using a valuation methodology most influenced by gross revenue and Company Y would obviously prefer an EBITDA driven methodology. It would be further complicated if one company was contributing a $2 million net worth or net asset value compared to a $1 million net worth by the other entity.

THIRD PARTY SERVICES

A professional business valuation firm will generally consider and employ multiple methodologies influenced by a combination of sales, earnings, net worth, and other operation intangible considerations such as recurring revenue streams and customer concentration.

In addition to utilizing an independent valuation firm, in any merger discussion it is very important to get specialized legal and tax advice. In many cases a tax-free or tax beneficial transaction can be structured; however, to the extent that there is non-stock or monetary consideration received by either party, it is likely to create a taxable event. Assignment and third party consent requirements (i.e. leases, contracts, etc.) will also vary depending on the deal structure.

PROTECTING COMPANY CULTURE

The most crucial consideration in the merging of two entities is the cultural fit between the companies. If two entities have very different cultures, these differences will be magnified and the merger will most likely not be successful. Since a merger will likely build corporate value, advanced discussions regarding future exit strategy options should take place before finalizing the transaction. These discussions and agreements avoid unnecessary conflict later on.

It is also imperative to address management responsibilities, authority, and control in the combined entity. Management skills in both companies must be carefully assessed. It is generally beneficial to utilize a third party to help assess employee and management strengths and weaknesses to deciding on the final corporate hierarchy that will propel the combined entity in a positive future direction.

Mergers can be very successful; however, they are also complex processes. It is critical to determine which outside professional services you will need to utilize, the type of merger structure you would like to enter into and agree on a fair equity distribution structure. You cannot underestimate the importance of a blended corporate environment post merger to insure the transaction will have the greatest probability for success and each shareholder will achieve their goals.

ABOUT RKJ PARTNERS, LLC

RKJ Partners, formed in 2008, is an established advisor to leading lower middle-market growth companies. We provide our clients with experienced-based solutions and unbiased advice. Our comprehensive array of strategic advisory and execution capabilities allows us to meet the needs of our clients and provide an outstanding level of service in connection with a variety of transaction processes, including:

- **CAPITAL ADVISORY**: RKJ possesses substantial expertise in assisting lower middle-market clients raise capital to fund growth strategies. Whether the capital source is senior debt, mezzanine/subordinated debt, private equity, or venture capital, RKJ has both extensive and relevant relationships within the capital community to enable the deployment of optimal solutions for our clients.

- **MERGERS & ACQUISITIONS**: RKJ serves as a trusted advisor in executing merger and acquisition transactions for lower middle-market clients. In addition to our significant investment banking transactional experience, RKJ's bankers have owned businesses and have served in interim CFO roles for clients. As a result of our experiences as business owners and senior level managers, RKJ's bankers are able to bring a unique perspective to the mergers and acquisitions process. RKJ's mergers and acquisitions services include:

  - Buy-side and Sell-side Advisory
  - Divestitures
  - Leveraged & Management Buyouts

- **STRATEGIC ADVISORY**: RKJ provides financial advisory services to owners, management, shareholders and their boards to assist in the evaluation strategic alternatives and options for extending and/or maximizing shareholder value. RKJ's advisory services include:

  - Business Valuations
  - Capital Structuring & Planning
  - Negotiating Joint Ventures
  - Strategic Business Development