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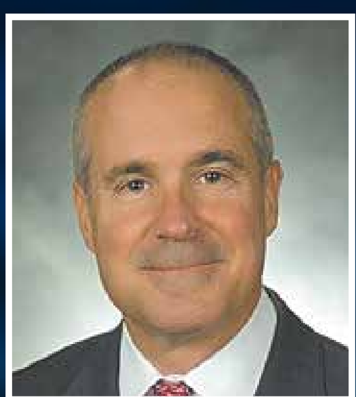
MERGERS & ACQUISITIONS

FORUM DISCUSSION

PANELISTS



GEORGE CALFO
SunTrust
Robinson Humphrey

KEITH CARLSON
VonLehman

TRACEY PUTHOFF
Taft Stettinius & Hollister

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The Courier's Mergers and Acquisitions Forum will help business owners enhance the value of their businesses in advance of a sale. Editor Rob Daumeyer recently sat down with a panel of experts including George Calfo, Managing Director, SunTrust Robinson Humphrey, Tracey Puthoff, Partner and Industry Chair, Taft Stettinius & Hollister and Keith Carlson, Director of M&A Advisory Services, VonLehman to discuss a variety of important topics, including how to prepare for a sale, why we're in a seller's market and how to avoid deal killers.

COURIER: Thank you all for coming. We are going to get started so we can get you out of here at a respectable time this morning so that you can go make money for your companies. I'm Rob Daumeyer, the editor at the Cincinnati Business Courier. The Courier does a lot of events in this space at the Taft Center and they all do very well. Thanks again to the Taft. We've probably done at least 100 events here, and it's always great. So, we'll get started. To make sure you're in the right place, this is the Mergers and Acquisitions discussion. If you're here for water polo or the Reds, you're in the wrong building. What we'll do is I will have everyone introduce themselves on the panel, tell who they are, what they do and where they work, and then we'll go right into the questions. We'll go for about an hour and then we'll open it up for a time of questions. So, save those for the end. George let's start with you.

GEORGE CALFO: Good morning. I'm George Calfo. I work at SunTrust Robinson Humphrey. I've been in the business for 32 years, I'm a managing director in our mergers and acquisitions business. SunTrust Robinson Humphrey is the investment banking division within the broader SunTrust organization. I would like to introduce Ben Willingham, who is our market president here in Cincinnati. He joined the company a year ago, and is off to a terrific start. Let me just introduce Ben. He is our leader, and I'm delighted to be here today.

TRACEY PUTHOFF: I'm Tracey Puthoff, and I'm from Taft Stettinius & Hollister. So, welcome to the Taft Center if you haven't already been here before. I'm a partner at Taft. I've been in the general corporate, business and finance group since 1995, when I got out of law school. Prior to that, I was an engineer, so it was a big switch to go from engineering to law. But, here I am. I've been doing this for over 20 years. It's changed a lot, so we'll have a lot to talk about

KEITH CARLSON: I'm Keith Carlson with VonLehman, and I'm the Director of M&A Advisory Services. I help lower middle-market companies and their owners sell their business, acquire other businesses, or raise capital. I've been focused on M&A my entire career and I've closed over 100 deals at this point, mostly in the lower-middle-market.

COURIER: Generally, when I ask the questions, I'm asking everyone. If I have a specific question for one of you, I will make sure I'm clear about that. If you have questions for each other that's great, too. The first question I have, which is probably very obvious to most of the audience, but I think it's important for us to set this up. What's the current state of the M&A market right now? Is it a buyer's market, or a seller's market and why?

CARLSON: It's clearly a seller's market right now. The multiples are at an all-time high, whether the Company is in the lower-market, the middle-market, or even in the upper-end of the market. I'd also say that capital markets are wide open to Companies and buyers. That is important because the lending environment couldn't be any better for would-be or potential acquirers, so there's plentiful capital to be used in deals. This is a key ingredient for strong M&A trends. The lending environment is not irrational as it was back in the 2008 time frame but it is still strong. There's lots of money out there willing to go towards high-quality deals

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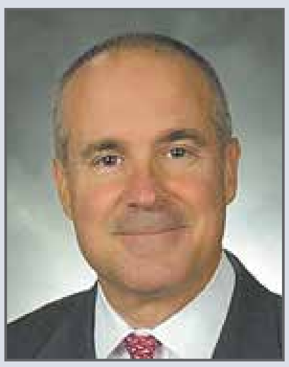

George Calfo

Managing Director, SunTrust Robinson Humphrey

George is a member of the leadership team within SunTrust Robinson Humphrey's Mergers and Acquisition (M&A) division. In this position, George is responsible for the management and development of the M&A business within SunTrust's Commercial and Wealth Management client segments.

Prior to his present position, George spent 5 years leading SunTrust Robinson Humphrey's Industrials Investment Banking business. Before SunTrust, George spent 8 years with Citigroup in various positions; including, Head of Diversified Industrials Investment Banking, Head of Industrials Corporate Banking and its Mid-Cap and Commercial Banking organizations.

Previously, George spent 18 years with First Union/Wachovia, where he successfully led several banking divisions and regions with its Corporate and Investment Banking and General Banking organizations.

George is a graduate of the University of North Carolina at Charlotte where he earned a B.A. in Business Administration.

Keith Carlson

Director of M&A Advisory Services, VonLehman

Keith Carlson is the Director of VonLehman's M&A Advisory Group. Prior to founding VonLehman's M&A Advisory practice, Keith spent over a decade in principal investing, corporate development and investment banking roles focused on a wide array of company sizes and industries.

Keith began his career in Charlotte, North Carolina, as an analyst within the Industrials group at Wachovia Securities, the investment banking arm of the former Wachovia Bank. In this role, he was able to assist deal teams and corporate clients with a vast array of M&A advisory and capital raising solutions.

Following the completion of his analyst program, Keith joined a leading lower-middle-market Southeast based private equity firm, Capital Investment Advisors (f/k/a CapitalSouth Partners - ~$1BN AUM). Keith began his private equity career primarily devoted to the underwriting and execution of Capital's investments in lower-middle-market companies, but his role and responsibilities quickly expanded. Keith went on to play an integral part in the firm's portfolio monitoring, investor relations and staffing operations.

With a desire to reconnect with his family "roots", Keith and his wife moved back to his home state of Kentucky and eventually combined both his passion for a) advisory and assisting companies, with b) a pure focus on lower-middle-market companies.

In total, Keith has participated in over 100 successfully closed transactions and has amassed significant capital markets, advisory, principal investment and corporate finance / strategy experience. He is highly skilled in the areas of structuring, company positioning, negotiations, diligence, and financial modeling.

Tracey Puthoff

Partner, Industry Chair, Taft, Stettinius & Hollister

Tracey is a member of the firm's executive committee and chairs the firm's Technology industry team. Her extensive M&A and finance experience involves both publicly-traded corporations and privately-held companies in diverse industries. She is able to provide sophisticated advice in complex transactions at Midwestern rates – providing a remarkable value proposition in transactions typically staffed out of New York and other financial centers. Tracey attended law school and became a transactional attorney after a career in engineering at GE Aviation and McDonnell Aircraft Company (now Boeing).

Tracey is the current president of the Hamilton County Board of Health and a board member of the Cincinnati May Festival and the Hearing Speech & Deaf Center of Greater Cincinnati. She is also a member of Leadership Cincinnati USA Class 34. You might find Tracey negotiating a deal, sitting in a board room or a committee meeting, attending a Bengals, Xavier or St. Louis Cardinals game or having lunch downtown at Via Vite.

Due to her background in engineering and involvement on community boards, Tracey understands all aspects of an M&A or finance deal – from financing to intellectual property to addressing the interests of every stakeholder. She is always looking for innovative ways to advance client goals. Tracey practices the advice she gives new associates every day: be fast, accurate and communicative in responding to clients' needs.

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with good buyers. All these things have created what is a clear seller's market.

PUTHOFF: I agree. We've been seeing engagements on both the buy and the sell side, and there's a lot of them. Many of the business owners that didn't get to exit 10 ten years ago, started being able to exit a few years ago. Since the beginning of 2018, we've been extra busy thanks to the new tax law. Some people were deferring their deals until they knew what was going to happen, and then when it did happen to the extent they were a C-Corp, they wanted to wait until 2018. It's a whole lot better than it was. There's a lot of money available, especially in the private equity space.

CALFO: To add another dimension to this, if you think about the statistics – valuation, available capital and what have you – we would say the most important barometer to the M&A market is confidence. Our business owners are feeling very confident. Interestingly, our data would suggest that people feel the most confident about their local economy, (and) where they are operating. They feel equally confident, but just a little bit less, in the national economy. They also feel very confident in the global economy, but that's also a notch less as well. All three of those dimensions, though, are in record territory in terms of confidence. So, people are feeling very good about their position (with) their business and the outlook. In conjunction with the Ohio State University, we do a Business Pulse Survey every quarter, and it measures how people feel about their business, their plans for capital expenditure, their plans for hiring and all of those statistics. And, the collaboration, the National Center for the Middle Market, which is what it's called has been around for about eight years or so. These statistics are at record levels for this survey period, since we've been doing it. So, people feel very good, and (if) you layer on top of that, liquidity, which has been mentioned, and you also think about cash positions and the availability of funding. (Those are) other big drivers People look out, and they are looking at moderate growth, organically. They are thinking about M&A as a lever to drive growth, particularly on the buy side.

COURIER: Keith, I want to touch on something you mentioned. You said this is not exactly the same as (or as) irrational as the last time we had a market like this. What are the differences that you see?

CARLSON: In the 2005, 2006 and 2007 timeframe I was on the buy-side. I was working within a private equity fund doing transactions, investing in and acquiring lower-middle-market companies, and I think the biggest difference that I see now vs. then is that banks are definitely staying more disciplined than they were at that point in time. Meaning, in 2005, 2006 and 2007, "diligence light" was more prevalent on a lot of these transactions. Banks were doing deals that were what we call "cov-lite", which gives Companies very large leeway in terms of grace periods before covenants would be put into place on deals. Right now, those things don't exist. Lenders are staying disciplined; they are chasing good deals. The capital that's out there is plentiful, but they are staying somewhat disciplined with regard to how they are structuring the deals within the documentation. In my opinion, this keeps the M&A market somewhat regulated, whereby not just any buyer can go out and acquire a company and buyers have to use caution when thinking about structure.

PUTHOFF: We saw the same parallels with our clients that are buying and selling. Back in 2005, 2006, and even in the late 1990's, which is when the irrational exuberance came about, some would just throw money at a deal without doing any (due) diligence. They would call up and say, "Look, we got to get into this deal. I'm just going to send the money and we'll deal with the documentation later." As a lawyer, you get hives over that, because you know something is going to be bad and you are going to have to deal with it later. But, that's what was going on. It was a crazy atmosphere. What's interesting, you mentioned that the banks have stayed very structured and disciplined, and what our clients as buyers are finding, is that they are moving back to being a little more like, "We've got to get this done," and the banks are holding them up in their view. Their "know your customer" requirements are really strict. They continue to be that way, and especially if you have foreign buyers, there are a whole lot more hoops you have to jump through. So, it's interesting that the banks are staying on that narrow track, whereas the buyers are getting more to-

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ward, "We want to get this done faster than the banks are helping us and they are slowing us down." Now, the private equity, they're so close with their banks, they get a lot more leeway, because they might have an amount of money available to be borrowed, and they only have to call their banker to get it done. They don't have to go through all the same hoops as a buyer that doesn't already have that set up ahead of time. So, it's interesting to see the parallels, but also the contrasts.

CALFO: That's a fantastic point. We do see from a leverage level perspective, so if you look at transactions, primarily private equity transactions, leverage levels right now are not at the all-time high, but they are quite high, relative to the EBITDA, so if you look at that measurement, we are in the high-fives at this point. If you look back, quarter over quarter, at the top of the market it was six. So, we're approaching those levels and EBITDA depending on the sector. The EBITDA are quite good. We've had a moderate input cost environment for quite some time. So, margins have been able to expand for many companies, and so we are levering on top of the EBITDA levels, which are quite good. Rob, to your question, we went back and looked, and tried to figure out recently what is different, and is today any different than any other boom time? And, I'd like to add to the comments here. There have been other periods where things have been very, very good like the mid-2000's, late 1990's, late 1980's, and what's different today, interestingly, is the proliferation of private equity. So, the amount of private equity, the amount of liquidity in the system, chasing transactions, we haven't seen that dimension before. And, these are professional deal people looking to transact. It's interesting. Today, we believe there are (about) 7,400 private equity firms and there are about 3,400 public companies just for perspective. So, these are firms that have raised unprecedented amounts of capital, largely on historical returns. By the way, (which is) about six-hundred billion dollars in the last three years. (This) is an unprecedented amount of capital that has been raised in any time in history over a three-year period. So, that is a different dimension today than we've seen in previous boom times. But, we've seen a lot of these characteristics before.

COURIER: I want to talk about each side of the transaction, individually. Let's start with the buyers. Listening to everything you have been saying, it feels like there are some pitfalls. Everybody's chasing something. Slowing down and making sure that it's right seems like it might be a challenge. (If you don't, you aren't really serious about it?) Maybe you can talk about what buyers need to do to make sure that they everything right in today's market.

CARLSON: That's a great question. If I was back on the buy side right now, I would shift focus and try to avoid guys like me that are selling businesses, creating competitive selling processes, and those who can go out and command a premium for a high-quality Company or asset. I would try to avoid investment bankers, and I would focus all of my efforts on trying to source proprietary deal flow. There are a few of my clients that hire me to source proprietary deal flow. This essentially means finding a Company that could be thinking about selling but hasn't really gone through the steps of hiring advisors. Proprietary deals certainly have pitfalls; going after deals that are not represented or don't have an investment banker or an M&A adviser, in many cases, are much more time consuming and challenging because you're dealing with an unsophisticated seller that you have coach and take baby steps with, but, these situations are where you will find your value. Otherwise, you're going to end up falling in line; you're going to pay the premium, and you're going to go with market trends, which is higher valuation right now. If you're okay with that, that's one thing; if not, and you want value, proprietary deal flow is probably the answer.

PUTHOFF: I was going to add that from the buy side, we're seeing that there are these really high multiples, and in some cases there's some overvaluing, like what you're saying. I think our buyers, and what I'm seeing, they're pretty much attuned to that. They generally stay in a specific space, like we have a PE client that is mostly in the metals and chemicals space. So, they know it, they know what the multiples are, they know what they should be looking for. And, in some cases, they're saying now, that they don't even want to be in an auction situation. They don't want to go after a company where they're going to be bidding against any-

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body else. And, they'll tell us. We'll have clients on the sell side and we'll say to them, "Hey, we have these private equity connections and other people, do you want us to introduce you?" And, we'll talk to our PE fund clients and they'll say, "If it's an auction, I'm not interested." Even if it's right within their space. Because they don't want to deal with what you're talking about. They don't want to have to overpay for it, they don't want to have to bid it up, and they don't want to have to deal with the back and forth. As far as other things like pitfalls for them to look for and things like that, or red flags, one to look for is a would-be seller that is reticent to give you the diligence that you're interested in, and you'd be surprised how many sellers, not just because it's a competitive situation, like if it's a strategic buyer, will hold back certain competitive information, etc. like that. But, even when I'm talking about either a financial buyer or someone that's not a true competitor, some sellers won't have their ducks in a row. They don't have the diligence ready and sometimes the buyers will be in like what we talked about, too much of a hurry, and that has problems later. I would say, try to tell them to slow down to the extent that they can. We're partly there to save them from themselves, and sometimes, we can't do that. So, we deal with it later.

CALFO: The comment earlier about trying to avoid investment bankers is precisely why you need to have a banker. That is precisely why it is in the client's (best) interest to have a banker there. But, I do think that from a buyer's perspective, we do see that with some degree of frequency. Folks get into this deal fever. And, that usually doesn't work out to their benefit. And, so really remaining disciplined around the original thesis and doing the diligence required to prove out as much as you can, which may mean losing the transaction by the way, can be very difficult, particularly when people have this fever. We try to get folks to be very deliberate.

COURIER: How does that help people catch that fever? Who is it? Is there a specific type of person and company or an ownership structure that you have seen that gets the fever going? You're asking people to slow down to make sure we do this the right way. Obviously, that doesn't happen all the time.

PUTHOFF: Where I've seen it from the legal side, especially on the PE side, is you'll have a PE fund or some kind of venture capital fund that's looking to invest, and they go out to look for co-investors, so they'll start talking it up, and then if it's an investor, either a VC or co-investor that you've worked with before or, they're on one of the coasts, because that's deemed to be really cool to be with the ones on the coast. Then, they'll say, "I really want to be in on that." If they're going to put their money up I know it's going to be good, So, I want to put my money up. So, that's part of what I've seen. I haven't seen it from the IB side but, I did want to point out, I knew you were going to ask about investment bankers, and why should you have one. Personally, I am a fan of the investment bankers. But, they come in on the sell side, generally, maybe I'm just not seeing it on the buy side, but on the sell side, they come in and the reason is because they're the ones handling the negotiations that the seller doesn't want to deal with. The seller doesn't want to go back to the buyer and hassle over the earn-out and things like that. If the investment banker's really in the middle, he is there to have these conversations that the seller doesn't want to have, or to always be able to have it in your back pocket, "Well, I've got to go back to the seller," or "I've got to go back to the client." I think investment bankers have a role in pushing the deal forward and keeping the deal moving. So, I'm a fan in most cases. If it's too small of a deal, candidly, it doesn't make any sense for the seller to hire an investment banker. And, we always get that question, from a seller-client, "Should we be hiring somebody?" And, we give them names and we give them contacts and so forth. And, oftentimes, they just decide they'd rather do it on their own. The other thing that investment bankers do is they run the data room, which is a wonderful thing, nobody wants to do that.

PHOTO: MARK BEALER

"We would say the most important barometer to the M&A market is confidence... People are feeling very good about their position (with) their business and the outlook."

– George Calfo, SunTrust Robinson Humphrey

COURIER: Can you define a data room?

PUTHOFF: It used to be in the old days, and this is when I started practicing, we would send young associates, which was me at the time, out to wherever the seller was if we were the buyer or if we were the seller. If you were the seller, you would go and set up the data room. Literally, the data room was a conference room, full of boxes, full of paper. And, it literally was everything that the buyer asked for in the diligence. So, financial statements, leases, contracts and everything under the sun. You would sit there for days on end, as the buyer's counsel and read everything, and look for problems with the deal, and if you were the seller's counsel, you'd sit there and catalog everything, because you had to come up with what's called a disclosure schedule, and the disclosure schedule goes with either your stock purchase agreement, or your asset purchase agreement, or your merger agreement, or whatever it is. Basically, it discloses everything that's in the data room. Nobody does that anymore. Today, they're all virtual data rooms, VDRs or electronic data rooms, and there are wonderful companies that set these up, but typically, the investment banker would be the one to put everything into the data room. It takes a lot of time to upload all these documents that would normally be in a conference room full of boxes. So, the fact that we don't have to do that I find to be a wonderful benefit. We don't have to be the one's doing that, so that's one thing I like about investment banking. They are working hard for the fee as are we.

COURIER: So, let's switch over to the sell side. While we talk about what sellers should be aware of, maybe you could also talk a bit about is this market being as hot as it is drawing out a different kind of a seller, who normally you wouldn't see? Is this reaching down to a different kind of company?

CALFO: I'll take a crack at that. I don't believe it's the market that is driving folks, other than it's hard to get away from the fact that virtually all asset classes are at elevated levels. You turn on the TV, you try to find an apartment for your daughter to rent, you go to buy a car, it seems like everything is elevated. Interestingly, we run some statistics on this. We believe that on average, our business owners are getting pinged in an unsolicited way once a week. So, they are receiving inbound interest, on average, about once a week. And it has to do with the liquidity that we talked about earlier and people trying to find proprietary situations. But, what is particularly interesting, or what I find fascinating is that most private businesses are owned by and run by Baby Boomers, many of whom lived through the financial crisis and it has taken them a decade or so to get to a better place than they were in 2006 or 2007. So, people are getting constantly pinged. People are getting reminded that valuations are elevated. Then, we have this whole generational dimension that doesn't have a runway that looks like 10 more years, or 15 more years, or 18 more years, depending on where you are in the Baby Boomer cycle. So, they've got this finite horizon, and they're thinking, Wow, maybe now is the right time. So, they're getting pinged, and they're listening, and it sort of starts (this momentum,) which is actually one of the things that we observe as one of the real things to avoid. We see a number of situations. These are sell-side situations, where folks have gotten into the transaction in a way that is not optimal for them. So, they got pinged, they heard something, they heard a value, which sounded very attractive, and it gets them into the transaction. The company is not prepared, the books and records aren't prepared, the management team isn't prepared, and on and on. Then, they fall into the slippery slope of the transaction, and they're dealing with in many cases professional deal makers, who know exactly what to say. They do it every day. So, that dimension, Rob, is a little bit different. The demographic dimension is really starting to show itself, and some of this is people don't know. You can watch the news, and say well, there might be another shoe that is going to drop. I don't know what it is or when it's going to happen, but maybe now I need to start thinking about it.

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COURIER: What do you think, Tracey and Keith?

CARLSON: The market is bringing out a slightly different type of seller in addition to the usual crowd. More and more these days, I'm seeing sellers in their late 40's and early 50's who, quite frankly, know their business is worth more if they sell today than if they sell five years from now just due to timing. When I was on the buy side, it seemed rare that you'd see the 45 or 50-year-old business owner bringing a deal to market, or, if you did see that, you'd think, "What the hell is wrong with this company? Why is he selling right now when he's got 10 years of runway left?" More often, you're seeing people who make calculated, intelligent decisions about correctly timing the market. It is smart.

PUTHOFF: I'm not seeing a trend in either direction. I've seen both. I mentioned earlier that there were a lot of business owners that wanted to get out before the crash, but they had to wait. Most of the ones I've worked with have now figured out a way to get out. So, they're happy. But it took a long time for those multiples to rebound, and not just to rebound, to rebound to a place where they were comfortable, because some of them, to be fair, had, I wouldn't call them irrational, but maybe unreasonably high valuations of their own company, and they weren't necessarily open to the independent valuation that says, "No it's really only worth this much." So, they waited, and now a lot of them have been able to get out. But, I have seen both. We have a client right now, her company is up for sale, she's in her mid-40's and mostly, she's just tired of the family dynamics. A lot of these are family owned businesses. So, there's all kinds of reasons why they're getting out. However, I wouldn't say that I've seen any specific trend with our clients.

COURIER: At the end of the day, if a deal should happen, and in your jobs making a deal happen is the point, but in your experiences, and it doesn't have to be in this hot market, but is there a number one, most common deal killer or something that in your experiences that you've seen more than anything else. Regardless of whether the deal should happen, this thing will (show up.)

PUTHOFF: Environmental. I've had more deals die over environmental investigations than literally anything else. I think you'll see a whole smattering of them, but that is a big issue. It's always a big issue, especially when you have any kind of manufacturing business, foundries, or anything like that. The other thing that I've seen more than I would have expected is the management team either not wanting to go along or not jelling with the buyer. The buyer gets uncomfortable with the status of the management team, and/or the negotiations between the buyer and the management team on employment agreements, or non-compete. They don't necessarily kill the deal, but they definitely add a dimension of delay that I don't think sellers are often prepared for. But, if I had to think about a deal killer it's generally the environmental diligence, if there is any.

CARLSON: I think the number one deal killer is inadequate representation. Harkening back to my buy-side days, when we were hunting for proprietary deal flow and encountered inadequate representation we knew there was a high risk that the transaction may not close. For example, if a seller was using the family divorce attorney to guide them through an M&A process, this attorney isn't in tune with market trends and could completely sabotage a process. Inexperienced advisors or attorneys that aren't in tune with common provisions that get proposed and these types of deals and that lack of familiarity can cause huge problems. Deals could get killed that way, where someone digs their heels in on something that is not normal. That's why I always say, "You can try like hell to save a lot on professional fees, but it could cost you in the end." It's very true in the M&A world. If you cut corners, and you don't use people that have expertise in the M&A world, whether it be on the legal side, the tax side of things, or investment banking – that to me is the number one deal killer.

PUTHOFF: That's why you should hire Taft! I had to put a plug in for the firm.

CALFO: I couldn't agree more with what's been said. The only thing that I would add is frequently folks aren't clear on what they actually want to get out of the transaction. So, they go in thinking one thing and then as the transaction develops it's clear that they have other (priorities, or concerns. Whether it's the employees, it's the maximum value, or it's protect the name (of the business) and it shifts.

COURIER: Tracey mentioned the management team, but how big of in internal team should a company have in this? The more people you have involved in something, the more complicated it gets, or if you have somebody in the corner who wants to blackball something. I've heard over the years that you want to make it a fairly small team. Honestly, I don't know if that's correct. I'm sure it's not a one-size-fits-all, but I would like to hear your opinions on that.

PUTHOFF: Always the CEO, of course, and the CFO, because they are going to be helping with all of the financial due diligence, doing modeling and that sort of thing and working with any outside accountants, or tax people that are involved. I would say you need the CEO, the CFO, maybe the H.R. person, because the reason you need these people is not so much for negotiating the documents, the purchase agreements and so forth, but for the diligence, that if you're on the sell side and the buyers going to send you a 10 page diligence request list, somebody has to pull all of that information together, and so you have to figure out "who am I going to bring under the tent?" Because on the one hand, you've got some sellers who are happy to tell everybody that they're doing this deal, which we try to get them not to do. Then, there are sellers who don't want anybody to know that they're selling. And, a lot of times there's this Baby Boomer generation or whoever, who have been there a long time, who have long term employees, and they don't want them to get upset, etc. But, you can't really avoid having your senior management team involved and their administrative assistants. Sometimes, I think people overlook having those people involved, because a lot of times they're the ones that know where everything is. So, we work a lot of times with people's assistants. I think you need at least those people. It depends, if you've got multiple facilities, you might have to have plant managers involved, because there's going to be stuff at those at those facilities. Sometimes, if the clients are trying to keep things quiet, they'll say to employees that "the bank is looking into something. "We like to blame things on banks, (laughing), so we'll say, "Well, the bank is looking into something. There's going to be somebody coming out to the facility." Then, if that's going to be your environmental site inspector, or it's going to be somebody looking at the equipment, they don't need to know that it's a deal. So, I don't think they bring a lot of people under the tent, but I think you need at least the people who are going to know what to respond to as far as diligence, and who's going to be able to answer the questions that the buyers inevitably are going to ask.

CARLSON: I'm focused on companies with 2 to 15 million of EBITDA; truly lower middle market companies. As a result, the management teams, or the organizational structures are inherently much leaner. The business owners tend to be the 'chief, cook and bottle washer' as well. They know the ins and outs of their business like nobody else. In many cases, they can and must help. They need to be involved every step of the way. Like Tracey said, the CFO is also vital during these processes. For an investment banker to get a process done and to get a book produced and rolled out, two thirds of the information that's needed to build a quality book that would satiate most of a buyer's requests is going to come from the CFO or Controller. You're leaning heavily on the CFO from day-one all the way to close. Outside of that, it's very much ad hoc and one-off type requests, and who has to help with the answers depends on who knows what within the area of the organization. That said, the sell-side deal team should be lean as possible to prevent rumors and to control the internal distractions that could come from gossip and over reaction. Then, on the on the buy side, I really think the deal team should stay somewhat confined to the CEO / owner level assuming you are also using an investment banker to guide the process. I suggest confined to these two until there's definitive interest; definitive interest means you're getting to the point when a deal is close to converting over into an actionable deal. On the buy side, some lower middle market companies can get distracted with the pipeline concept of deals that are there on the plate and being contemplated, when in reality, if you've ever spent any time on the buy side, you're going to have success rates on these deals anywhere from one percent to ten percent on targets that you're chasing throughout the marketplace. You don't want your management team to get distracted with peripheral noise or deals that likely won't close. That's why I always suggest bringing deals to a certain point at the top of the organization, and then bring in people that you need to know on your management team to help vet the opportunity and the target's organization.

PUTHOFF: You might want to explain about the deal books in case people don't know what that is. Does everybody know what the deal books are?

CARLSON: When you go to market, and you utilize an investment banker, they put together a confidential information memorandum, and that book basically contains every piece of information that a would-be buyer should need to know to make an educated decision about choosing to bid on that particular company and if they do choose to bid, what that bid would look like. It's a very exhaustive book containing everything from facts about your company to financial performance to the growth prospects and the investment highlights

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and its management team. For all intents and purposes, it's a glorified marketing document about your organization that's released to the market, but it's also extremely informative. If you hand that over to a private equity company and it has been properly constructed, the level of detail needed to make a decision and how much to bid will involve little effort on an owner's part unless they have obscure follow-up questions that your banker cannot answer. The hope is that when the book finally is in the market, there's maybe two or three additional items they need to get to the point where they're submitting an indication of interest or a letter of intent to acquire the stock or assets.

CALFO: That's a good description. It is comprehensive marketing document. It does highlight the business, and they're typically distributed with an expectation that folks are going to read that, believe everything in it, and they're going to bid based on that material. And based on that, then they will either proceed or not, to the next stage of the process.

COURIER: Are there ways to enhance a deal that people will often miss, and then to go along with that, how far in advance as a company, either as a buyer or a seller have to have that in their minds or as a part of the flow for it to be successful. In other words, to not miss out on something, how early in the process do you have to find it?

CALFO: I'll try to answer that question. Rob. So, the two things that we find that folks typically underestimate in any process, particularly on the sell-side is they underestimate the requirement to prepare the company for a transaction. So, getting everything ready, identifying who's going to be on the team, so the preparation phase, people typically underestimate. Then, the second part is that people typically underestimate is the diligence phase, and the amount of diligence that folks are going to do on their respective business. They typically underestimate that and it's logical when you think about it. Many business owners have been making decisions about their business, risk-reward decisions, in an incremental way, in a real time way for years and it's logical at the time, and so it's of part of their business and they really haven't thought through what it would be like to have somebody come in and prosecute all of those decisions in a small amount of time. So, they underestimate the amount of diligence that actually is going to be required for a company to be interested in transacting.

PHOTO: MARK BEALER

"There's a lot of money available, especially in the private equity space."
– Tracey Puthoff, Taft Stettinius & Hollister

So, those are the two areas that I would say that are going to be underestimated.

PUTHOFF: I agree. I would also add the amount of time it takes to get to closing. I think a lot of people, and for some of the reasons you just said, they know this business already, so they think, "Surely we can close in 30 to 60 days." And, sometimes, candidly, the investment banker might encourage that. So, we the lawyers, will sound like downers when we say, "Okay, well, it might take a little bit longer than that." I think they also underestimate the amount of distraction that it provides, and you mentioned distraction on the buyer's side, but this takes a lot of time from the people that are under the tent, the CEO the CFO, it takes a lot of time away from their real jobs, and in a lot of cases they're trying to do this without other people finding out. So, it's difficult for them. I don't think they expect how much time it's going to take to respond, to explain, and for example, if there's going to be representations and warranties insurance, there are phone calls with the insurer. You have to respond to requests from the lenders. That's something they don't think about ahead of time. We will warn them of it, and give them the heads up of "here's what you can realistically expect to happen," and a timeline for that. Another good thing about investment bankers is they provide these fancy colored timelines that are great. We like those very much, and the clients love them, too, because it gives people like real deadlines and so forth. But anyway, I digress. I do think that those are two things that are absolutely underestimated.

CARLSON: If given enough time, one of the most overlooked value enhancers (again, I'm speaking to the businesses that have 2-10 or 2-15 million of EBITDA) is 'who's my successor within the business'? A lot of people who approach the topic of selling their business, think about it through the lens of a strategic acquirer, which probably isn't the best way to think about it. They believe the buyer is going to go in and run this business immediately. What many sellers fail to address or concern themselves with is that a lot of private equity sponsors actually require a good succession plan and a solid management team bench behind the current owners as they have little desire to parachute new management into a business post close – its just to risky. If you don't have that the succession plan and management strength, many buyers will run. If you've got people running from transactions, that's going to suppress your value and nobody likes a suppressed value. A simple thing companies can do in advance is to start thinking about their middle level management. Ask yourself: Are there people on your team that can take your spot at any given point in time? If you don't have that person on your team, ask yourself: do you need to bring someone in to start alleviating some of the tasks that you have on a day-in and day-out basis? Another thing, again, this is assuming you have enough time and you're not going to your investment banker saying, "I've got to sell today," is proving your earnings out via your third-party providers that can provide you with a review or an audit. You can even take that to the next level, which is obtaining a quality of earnings report prior to going to market. Having both a solid owner succession in place and proof of quality of earnings are both great value enhancers.

CALFO: That is so true. It's not too early to start. So, 100 percent of companies will transition at some point. Within the family, to an external management or whatever, so 100 percent are going to transition. It's never too early to start thinking about succession and transition and what are the dimensions of that transition that need to be implemented.

PUTHOFF: And to the extent that this is a family-owned business, I'm going to put a plug in here for the estate planners, because to the extent that you do any kind of business succession planning, you need to coordinate that with whoever does your estate plan, because those two things go together when the business is being transitioned, either within or outside of the family. And, the problem I find with business succession planning and estate planning is most business owners don't want to do it. They don't want to think about it. They don't want to think about dying. They don't want to think about retiring. A lot of people like to say, "Oh I can't wait to retire and go fish, do whatever." Then, when it comes down to you asking them, "so what is the succession plan" and what's in place, they don't have one or it's very ephemeral. They'll say I'm sure so-and-so is going to come along or one my kids, my daughter, is going to come into the business and etc.. But, it does focus them on that when they're talking about an exit event that comes to them maybe that they weren't seeking. Then, they have to start thinking about it. And like you said, they haven't done anything to start the succession within the business or with the family. So, having those conversations can sometimes be difficult, because they don't want to have that conversation.

COURIER: In a hot market, or any market, it seems like rationality would be one of the first things that would walk out the door. How do you make sure there is a reasonable, rational valuation of a company, especially in a market like this?

CALFO: Part of the benefit of having professional advisors is to provide that kind of discipline to the process. Really, in all aspects of the transaction, because the reality is, particularly for middle market companies, who are very good at operat-

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ing their businesses, doing M&A is not a core part of their business. And it's quite difficult, it's quite detail oriented and it takes a long time. So, we have a funny saying, "It's sort of like living in New York City." Everybody knows that living in New York City is expensive. But, until you live there, you have no idea. And, it's the same way with transacting. So, having professional advisers instills a degree of discipline that we think is helpful to get to the ultimate conclusion, whatever that is.

CARLSON: I think rational expectations are, quite honestly, set on the front end. I think any good investment banker or M&A adviser that's assisting with clients is going to spend the first 30 to 45 days collecting and gathering tons of information. Any good M&A adviser or investment banker that has a track record and has been doing these deals can aggregate all of the information, all the qualitative facts about the business, all the true facts about the business from a financial perspective and then give the client a reasonable expectation of what value is going to come to them after they launch into the market. If you're not getting that from your M&A adviser or your investment banker, you should press them on what their thoughts are, because the last thing you want to do is to not have an expectation set, go to market, and then the offers come in and they wildly disappoint you with regards to where they are coming in. I also find that people, sometimes on the front end of these processes, will go out to what I call professional valuation firms (accounting firms or other one-stop valuation organizations) and set their expectations off that. I caution you on that. If your valuation adviser hasn't bought or sold businesses for a living, be cautious, because there is an academic approach and a real-world approach to valuing these businesses.

PUTHOFF: There are some good valuation firms here in Cincinnati, and that's all they do, and they are in the market all the time. So, they are very good. Typically, we will refer clients to those people, but again, it's a matter of the timing. A lot of times our clients won't come to the lawyers until they've got a deal, or they're further down the line than we would have preferred, just because they may have given up things that they shouldn't have given up at that point. You work with the cards that you're dealt, but if they come and they say, "What should I do first?" My statement is first you need to make sure you get a good valuation. You need to hire good accountants, if you don't already have a good accountant, that's going to work with your internal accounting personnel, whoever that is, But, the valuation firm is exactly that – it's going to be the only thing that they do. The investment bankers can do that as well. But if this is the client that doesn't want necessarily to hire an investment banker, that's the route I would send them to. Again, it gives them a level set, and I tell them "do not go in with any kind of expectation. Do not tell them what you think it's worth." Now we can't say that in a way where they interpret it as "don't tell them what you think, because you're way too high and you're unreasonable." We can't tell them that, obviously, because what do we know? But, I don't like them to assume what is going to come back, because then they may be disappointed with what the valuation expert comes back with. So that's important to get that done, early on. And what you were saying about putting your affairs in order, and getting good financial statements. If the financial statements are unreliable, your buyer is going to walk away. They're just not going to trust the business, the way it's been run. If they are not reliable, then they're going to come in and diligence those financials pretty hard. They're going to look behind all the numbers, and if they can't find the backup, or they can't get comfortable with the financials, they're not going to hang around. So, getting that in order, and getting books and records, and things like that, that people don't necessarily want to do until they have to. Those are the kinds of things where we're sometimes the bearer of the bad tidings. I have to say, "If you're going to go down this path, these are the things you're going to need to do. We can help you. That's what an investment banker can help you with, your other advisers, but getting good advisers in place earlier on than maybe you would prefer." I know it sounds self-serving because, of course, we're the lawyers. We want to be hired early, but I can tell you I've had clients come to me after they've signed a letter of intent and that's a very bad idea. The letter of intent is clearly nonbinding, but that doesn't mean that the buyers and the sellers are not going to say, "Hey, well it was in the letter of intent, or it wasn't in the letter of intent." And they may have already agreed to some tax structure that's really bad or something like that, but getting tax and accounting done early on is important.

COURIER: How much does place impact a deal? Obviously, we're in Cincinnati, so what does that mean here for our discussion? Is it different?

CARLSON: I'm happy to tackle it first. With respect to companies that have greater than two or three million of EBITDA, I don't think place matters. There's plenty of buyers locally, and there are plenty of buyers that are in surrounding geographies like Charlotte, Indianapolis, Chicago, or New York who are hungry and willing to come to Cincinnati to put money to work. It's important that whoever you enlist on the M&A advisory side has contacts outside the city. If you're less than that two million EBITDA mark, I think it's a tougher market here in the Cincinnati-area because we do lack in terms of quantity of buyers. We do lack a great number of institutional buyers and what I would call a dedicated effort for higher net-worth investors and buyers in this particular area. There is a little bit of a disadvantage there because of that. Also, on the buy side (this is based off of my five years of living here, so keep that in the back of your mind when I tell you this) so many companies in and around Northern Kentucky and Cincinnati trade hands internally or trade hands to management, more so than when I was in Charlotte, where it was a much more rare phenomenon for a company or business owner to sell to their family members or management team. Here, it's the other way around; it seems to be much more prevalent. Buyers are somewhat disadvantaged by the willingness or the openness of business owners to allow a third party, who is truly independent, to come in and acquire their business.

CALFO: The only thing I would add to that is when you start to think internationally, location does play into the equation, because of the regulatory environment, the legal structures can complicate transactions.

COURIER: We have time for two more questions before we open it up to the audience for questions. Let's start with when or whether buyers and sellers should obtain insurance?

PUTHOFF: For those who don't know what rep and warranty insurance is, this is a fairly new product. Within the past several years, it's become prevalent, especially in the private equity space. So, a private equity buyer that's paying more than 20 million dollars. I would say 20 million maybe is close to the cutoff. If the deal is under that amount, rep and warranty insurance is probably not going to make sense, because of the cost of it. But, above that amount, pretty much every private equity firm now wants rep and warranty insurance. It's an insurance policy that the buyer will take out and it will backstop the seller's representations and warranties in the purchase agreement. What it allows the buyer to do is then say, "Okay, I'm going to require a lower escrow amount as a buyer." I'll probably get broader reps and warranties than I would otherwise get from the seller, because I've got this insurance policy to go to. Then in the purchase agreement, we will have a waterfall on liability that says the first amount is going to go to the retention, and the next amount is going to go to this insurance, and then eventually, the sellers will be on the hook for some amount, way up here. But the threshold for the rep and warranty insurance is such that that's going to cover that middle piece of liability. And it's something that seven or eight years ago was very new, very expensive and very difficult. Now, it's very common. There are a lot of insurers out there that have this product. It's much easier to get. It's much less expensive. I will say I have never had a claim against a rep and warranties insurer. So, the big question out there for me and for some of my colleagues is, what's going to happen when you actually have a claim, because now instead of fighting with the seller, as a buyer you're fighting with the insurance companies. So, what's going to happen. We don't know. I don't have any visibility yet. Maybe you do in regard to what the insurance company is going to pay out. Of course, it's an insurance company, so it's in their best interest not to (laughing). Just kidding of course.

CARLSON: From my perspective, to piggyback on that as a sell side adviser, I'm first telling my clients, "Let's ask for it. Let's grab it." If they say, "No, this is too expensive," we use it as a negotiating chip within the documents to lower the thresholds on the exposure to the sellers and the actual dollar amount within the document. It's a good negotiating point right now. Speaking of a seller's market, it's not just valuation out there right now; it's not just higher multiples. We've talked about when it's the right time to bring in an adviser and when it's not the right time to bring in an adviser. Sometimes, I'll get the seller that comes in with the LOI in hand, and a lot of people are focused on the big number – the Purchase Price. But throughout the LOI, it's littered with other areas that you can negotiate and enhance for a potential seller. This area, in particular, is one of those.

CALFO: Our experience is this is becoming much more common practice. There's certainly more insurers. We would say that of about half the time the buyer pays the premium. The other half

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the time, it's joint. So, it's a negotiated point of who is going to pay the premium for the rep and warranty insurance. Most times, and the vast majority of times, the insurer is going to want skin in the game. So, they're going to want to cover above some threshold amount that the sellers are putting forth. But, as competition continues to heat up in this area, it is not unprecedented for folks to not require skin in the game. That's unusual. It's larger deal. But as competition has escalated and more insurers are providing the coverage, we're starting to see that show up.

COURIER: So last question for you. It's a big one, but I'll try to boil it down.

The rhetoric out of Washington over the last couple of years has been loud. Out of anybody you could talk to, such as you three, it's more important that you cut through the noise and make sure that you stay on track. Do politics impact this market? If so, why?

CALFO: The short answer is we haven't seen it at this point. I would say, generally speaking, the rhetoric has been business friendly. So, reduced tax rates and lower regulation are sort of pro-business themes, which has been quite positive, and it has continued what has been a very attractive market to transact in. Because, confidence is such a big driver in our view to the M&A business, the more things that are negative like trade, the more discussion, the more coverage on things that are anti-business starts to erode confidence. Now, everybody's filtering out, okay they're the words and then there's the action. It seems like folks are waiting for the action. Interestingly, the only anecdote that I would have is I had a conversation with the company last week who is nervous about the possibility of tariffs and the impact on their business, which was interesting to me. It's only one company, but it was the first time that somebody actually wanted to talk about it. We haven't seen that affect behavior at this point, because, fundamentally, things are still quite attractive.

PUTHOFF: I haven't see any issues yet with Washington politics. Of course, people want to talk about politics, but I don't see it affecting the deal flow, or the deals that I'm working on. It's interesting you said that about the tariffs, because we do represent a company that makes steel products. They buy steel. So, with all the talk about tariffs, we did talk about that, but only to the extent of how it is going to affect this particular business, and whether it's going to be a good thing or a bad thing. Otherwise, I haven't had to deal with any politics.

PHOTO: MARK BEALER

"There's a lot of money out there willing to go towards high-quality deals with good buyers. So, it's clearly a seller's market."

– Keith Carlson, VonLehman

CARLSON: The rhetoric coming out of Washington is driving the higher confidence. The confidence that's trickling down to the business owners, in some of the conversations I'm having, is psychologically motivating them to hang onto their business for a little while longer because they're believing, "I want to continue to ride this wave. I can do this. We're in a great business operating climate." That's also one of the things that's underpinning some of the uptick in the M&A markets from a purchase price multiple perspective. It's all about supply and demand. There's a lot of demand from buyers looking for good deals, but some of this confidence that business owners have right now is going to push supply down, despite the Baby Boomer phenomenon that should be filtering into the supply. It's an interesting circular reference. There is a lot of confidence in the marketplace, and I think it's suppressing some of the seller activity that's out there right now.

COURIER: We covered a lot here, but we didn't cover everything. If you have a question, raise your hand and we're happy to hear it.

AUDIENCE QUESTION: What advice would you give that younger business owner about the conceivably increasing enterprise value, year over year, that you talked about, who is still worried that the capital market and valuations will look different in five to ten years.

PUTHOFF: The first thing I would ask is what's the goal? Does this person have a long-term goal? Does this person have in mind what they want to do with the business? Are you saying they're just worried that the valuations will be down when they're ready?

AUDIENCE QUESTION: Even though they have increasing fundamentals, year over year. If the company were to exit today in a healthy market, the fundamentals could be improved over the next five years, but if the market's different, would the company still get the same dollar figure five years out?

PUTHOFF: I guess I'd see first, what's the psychological connection to the business. And if this is the kind of thing that the person doesn't want to lose, and wants to hang onto, I would say keep riding it out and make your money while you have the business. It never hurts to look, even if you don't get an actual independent evaluation, to at least talk to people that are in this space and say, "I'm open for business." There's no crystal ball for anyone, and sure enough, if one person holds they're going to do great, and if another person holds they're going to lose, so there's no good answer. But it never hurts to look.

CALFO: I will echo that. It depends on the business owner's goals. At the end of the day, we're talking about financial tools and process tools to enable folks to achieve whatever that goal is that they're trying to achieve. For folks that look at these attractive markets, and by the way, not all businesses are attractive to buy. That's another dimension that folks sometimes don't appreciate. But for someone who has an attractive business and is enjoying it and growing it. I think selling today is more of a by-product of what their objective is than the actual product.

CARLSON: My opinion is for the business owner that's contemplating, "Should I do something or should I not do something?" In light of a growing enterprise value, because of earnings, I would encourage him or her to seek strategic advice from someone that can help out with more of an analytical assignment to show them several different alternatives. Selling 100 percent of your business isn't the only option for liquidity (of your business). You can do a minority equity sale right now, and that's very popular. You can take advantage of the M&A market and the trends without giving up control of your business, or because of the credit markets, you can do a debt-funded dividend recap. Take advantage of the credit markets and accelerate some of your equity out the door. Then, there's the partial recapitalization, where you sell maybe just two thirds or three quarters of your business and stick around for the second bite of the apple. The possibilities are endless, and before you decide about what you should do, or even if you're just curious about what you should do, it's probably better to get away from some of the white board discussions and get into the weeds of the technical aspects of it.

AUDIENCE QUESTION: With the higher multiples, are you seeing higher levels of seller financing than you normally would?

CALFO: We're not seeing that. We do see earn-out structures in about a quarter of the transactions and (with) earn-out structures, there are different drivers to include in an earn-out, some of which is to bridge valuation gaps between the buyer and seller. Others are that there's been a fundamental change in the business and the seller wants to get credit for that and the buyer doesn't believe it. And, they structure it such that there is a prove-out dimension. We do see that there is a small component, where financing is driving the desire for an earn-out, the inability to lever the business sufficiently to get to the valuation, but we're not seeing a material change just because of valuation, at least in the businesses that we're involved in.

PUTHOFF: I see earn-outs a lot. Does everybody know what an earn-out is? I see that in a lot of deals. I haven't seen seller notes in a while, and I think that's part of the market doing so well, and the

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confidence, so that these deals now are all cash and, in most cases, they're not expecting the seller to finance any of it.

CARLSON: In some cases, I've actually seen the opposite. There's a fight to put money to work right now between the lenders and the private equity sponsors, so I'm definitely not seeing more seller participation. It's almost decreasing because you're in a seller's market right now where sellers can rule the day and ask for more cash at close. That component is either staying steady or shrinking just so people can get money to work.

AUDIENCE QUESTION: What are your thoughts on valuing intellectual property as far as the overall deal value?

PUTHOFF: One of the things that I think people don't recognize in their business is the value of their IP, and if they monetized it, or any portion of the IP, how that can be an added value to the company. There are firms that specifically do IP valuations, particularly if you have a very strong brand, and that is one of the things that's driving the value of your company. You can certainly get valuations done of your IP, but it's much easier if you at some point monetized it, if you have some sort of licensing stream, or somewhere out, there someone's already paying you for it. It's much easier to value it that way.

CARLSON: My opinion on it is this: every industry is different, and every industry's IP is going to differ. In a lot of cases, when you're performing or someone's performing these valuations, you're giving the client a range of what you can expect within a reasonable degree, and that would include the entire company. It would include your intellectual property, your assets, your accounts receivables, everything but your debt and your cash, generally speaking, in the lower middle market. There's generally not this separate one-off consideration paid for intellectual property, which is a conversation I find myself having somewhat frequently with business owners. I've even had some go as far to literally take me to a drawer where they've got all their drawings and they say, "Hey what about all this intellectual property?" Well - that's an asset that's being assumed within the valuation. Your intellectual property is one item, and depending on the strength of it, it can swing you from one end of a valuation range to the other, depending on how valuable someone feels it is when they're evaluating your company. But it is usually not going to be a consideration that is paid separately. It's the job of your investment banker or your M&A adviser to flaunt that if it is truly special, and it can get your valuation towards the higher end of the spectrum.

PUTHOFF: I agree. The other thing is if your business is all about the IP, for example, we have a lot of clients in the tech space, and the proprietary software is the company. They have software as a service, or they're doing something where that's the entire business model. In that case the value of the business is the IP rights and the valuation of that is going to go back probably to more of a traditional valuation, like some sort of EBITDA multiples or something like that. Again, the licensing of that is important.

AUDIENCE QUESTION: Along those lines, are you seeing rapidly changing technology and the tight labor market impacting how deals are done?

CALFO: As it relates specifically to technology, it's really company specific, and it's the assets that make up that company that drive the value. As we were talking about earlier, IP can be a big driver of that. But I don't think that there's anything in particular as it relates to technology that's different today. The expectations for growth are very high and so multiples are very high. So, to the extent, there is an impact to that, that could have a material impact, but we don't we see very high expectations from that sector in particular.

PUTHOFF: The tech space is not as insane as it was in the late 1990s when you had companies that had never made a dime go public, and have insane valuations, or sell at these really high multiples, without ever having been profitable. I don't see that as coming back quite so dramatically, but we still do have a tech sector and a tech space that is very fast growing with high expectations for growth and therefore high expectations for a high valuation without any underlying assets other than maybe proprietary software or IP. I do see that piece as sort of the same as it was in the 1990s in the mid- 2000s.

As far as the tight labor market, I'm not seeing that as having an impact on the deals, other than, the deals that I do, obviously if there's a PE fund that's the buyer, because they don't have anybody to come in and run the business. So, they're relying on the management team, and the people that are already there. They generally take all the employees, and if they don't take the employees, they use this as an opportunity to maybe take the ones that the management team says that we should, and maybe not the ones that they shouldn't. But, if you're doing a stock deal, you're pretty much taking all the employees anyway. So, the tight labor market is more a matter of what are the projections, and are there projections reasonable based on their ability to get the job done, and do they have enough people to meet those projections.

CALFO: This is not related to technology. I do see that the labor market dimension shows up, particularly in the trucking and logistics space. So, we do see that driver dimension influencing the M&A activity. The ability to acquire drivers is an attractive element in that segment. We do see that.

CARLSON: Piggybacking off of that comment, here in Cincinnati, I'm seeing more and more manufacturing distribution clients that are out there acquiring companies right now. They're talking about how they don't have the capacity from a facility and labor perspective to fulfill the demand that's out there. I've got several buyers, and there's a couple folks in the room who I know we are working with, where the underlying thesis for buying the company is just that. They don't have any labor; they have a capacity problem; so now they are acquiring a company.

AUDIENCE QUESTION: George, you said confidence levels are at record highs, not only nationally, but internationally and it came up a couple times during the conversation. When we look at current interest rates, we're approaching an inverted yield curve. Are those two sentiments in conflict with each other?

CALFO: Theoretically, they could be. It's important to note that in the vast majority of our M&A situations, the yield curve isn't part of the discussion. Having said that, I do think that global liquidity, so central banks across the world, have a significant impact on interest rates, and interest rate expectations. When you look further out, I think there is a view that growth will continue to be modest, globally, although it's improving, growth should be modest. At the same time, you've got certain central banks that are trying to rebuild their war chest in the event that they need to act to support their economies. So, there is an influence into the yield curve, in particular, which we believe is broader than the typical drivers for the rate environment, and the risk/reward expectations for the future. So, we think liquidity is influencing the shape of the curve. So, we're not sure that there is necessarily a yellow light being flashed, just by looking at the yield curve versus confidence.

AUDIENCE QUESTION: What did the M&A world look like in a down economy, and as a service provider, how did you continue to generate income and add value?

PUTHOFF: It was grim. There's no doubt about it. The early 2000s - 2001, 2002 - and then of course, 2009 and 2010, we didn't have a whole lot of work. That's a great thing about being in a partnership. Our partners that were in different areas kept us going. Now, I'm only half kidding. For me personally, I was fortunate that when I was an associate, I did a lot of M&A work for our bankruptcy group. So, when they did deals buying assets out of bankruptcy, I did those deals for them. So, when we ran out of M&A deal flow after the crash, the bankruptcy group went out of sight. They were insanely busy for a number of years, not just in bankruptcy area, but workouts, restructurings and that sort of thing. I was able to transition into that. But we were waiting for things to get better, and they did. Things came back, and the pendulum went the other way, because right now it's insanely busy and the bankruptcy group doesn't have much to do now.

CARLSON: A lot of people view a down economy or a downswing in the economy as an opportunity to buy. When I was in the private equity world, we tended to pull back in this kind of market and say, "Hey, we're going to put our chips there on the side, and we're going to wait." Sometimes we would have a very defeated attitude because you're seeing all deals get done by others, but, when you go into a downswing and start to come out of it, you see companies with earnings that are expanding, and that is the perfect time to buy vs. when they are at their peak. You can actually find extremely good value in these companies because not only have earnings declined, but multiples have to due to the economic contraction. There's a certain amount of guts that goes with that because you're trying to call the bottom on when earnings are going to stop declining. You watch it go down all the way to the bottom, and as soon as you feel like you're starting to see a slight uptick, many say that's when it's the time to go back again. Opportunistically, it's a great time to be a buyer in a down market.

MERGERS & ACQUISITIONS

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PUTHOFF: I want to add one thing. The thing, though, that was different in this market after the crash was that the availability of capital wasn't there. Contrary to other markets before that, at least my recollection is, in this market even when the M&A of deal flow was lower, or the deals got good for buyers, they couldn't raise the capital. They could try to get it from their investors, but their investors were worried about their own personal accounts, and the banks just weren't lending. There was just no money available, or very little money available after 2009 and 2010, even if you wanted to do deals. So, the people that did deals were the ones that had this big heavy cache of cash. They had the money and they could be very opportunistic, but a lot of them did not have any access to the capital that they have now or had prior to that. The banks were under siege. They couldn't lend money. The rules and regulations went out of sight. That's when a lot of regulations were put in place for good reasons, but maybe they went a little too far in some of our opinions. But they couldn't lend the money and now they're still very careful about it. They're very strict, and that's good from an economy perspective, it's good for the consumer, but maybe not so much good for the companies and service providers who really want to get the deal done.

CALFO: It is interesting. If you look back 25 years at the M&A volume, so the number of transactions closed, of transactions less than 500 million dollars in value, it's amazingly stable just the number of transactions every quarter. About 500 transactions, which are publicly disclosed, I should say. So, it is amazingly stable. What does change though are deal terms. And it's a function of liquidity for sure. You will end up seeing more seller financing and different mechanisms to affect transactions. You do see when the shift becomes more of a buyer's market, multiples come down. But the fact of the matter is folks still transact. Sometimes, it's because they have to. Usually, that's driven by liquidity, or something outside of the business. But, the liquidity need in the business, or something outside, but the structures are what changes, but the volume is relatively stable. It does go down but it's relatively stable even in good and bad markets.

AUDIENCE QUESTION: I have a question on the comment that was made earlier on the environmental deal killer, and I'm in the environmental space. What do investment bankers and lawyers do from an education standpoint. It can often be a scary concern, an 800-pound gorilla so to speak. How do you make that gorilla not as scary? Who do you rely on?

PUTHOFF: Well, we're all about "boxing the risk" – that's the phrase that we use, so pretty much every deal we do involves a Phase I environmental site assessment. And so, if we're the buyer, we pay for that and we go we hire an environmental consultant and there are environmental consultants, very good ones here and they're all over the country. So, it doesn't really matter where your target is, there's going to be a consultant available to you to do the assessment. And, then for example, if you know for sure this company is going to have issues like if it's a foundry, and it's been a foundry for 80 years, you know it's going to have stuff in the ground. You go in with the idea that says, "Look we're going to pay this price based on what we know now, but that's subject to change based on the results of our diligence," and that's true with every deal, but particularly when you know that you have a manufacturing business, or a facility that could have an issue. So, we'll do the assessment, and then if the consultant comes back and recommends any sort of testing then you move into what's called a Phase II environmental assessment. And that's generally negotiated between the buyer and seller, because the seller doesn't necessarily want you drilling on their property, because then they become "pregnant with the knowledge" so to speak. But the only way that the buyer, generally, is going to get comfortable is to get those reports back and find out, "Is this in the groundwater?" They'll test the wells on the property if there are wells, they'll figure out, "What do we think the risk is?" Then, you go a number of ways. You're always going to have your general indemnity. In a lot of cases, you're going to require a separate environmental escrow. You'll require a separate environmental indemnity for a longer period of time than your regular indemnity. Those are the ways that the buyer versus seller will work it out. If it's an asset deal, you're in better shape because you're not taking those liabilities. In a stock deal, the company is stuck with that liability, whether you like it or not. And, God bless the government, the EPA and the state EPA can come in whenever they feel like it. And, that could be 10 years down the road. That's the kind of risk that's hard to box. There's environmental insurance available much more so than there used to be. It's much more affordable than it used to be, but it's going to have lots of exclusions like the rep and warranty insurance will. So those are the options that we give to a client if we think that there is an environmental issue. Most of the time, we can work it out. I don't have a lot of deals that die. I had a lot of deals die back during the crash. But nowadays with deals, we generally can work it out, but I've had several die because of environmental factors, mainly because they couldn't get comfortable with the risk. Particularly, in the cases where it died, some were next to a residential area, and in that case you know you've got serious risk in terms of, not just the risk of the cleanup, but the publicity risk and the risks to the actual individuals who live there and the residences. It's pretty scary.

CARLSON: From an M&A advisory perspective, when you have a business that's inherently more dirty than another one, typically speaking, that's going to go to the hands of a strategic acquirer who is super familiar with the types of environmental concerns that the business encounters on a day-to- day basis. A dirty little secret, no pun intended, is that private equity buyers tend to shy away from big risks like that. Sellers with these types of Company risks should be cautious about using an uneducated M&A adviser or an investment banker and I think this is where my experience of investing in or acquiring businesses actually comes in very handy for sellers. Someone that may not have this experience may take an inherently dirty business and spend a lot of time showing it the 50 to 100 private equity buyers only to waste time, or worse, get a deal signed up only to have the private equity buyer back out in the 11th hour due to real risks, but ones that are inherent to the industry. Private equity funds in these cases will send in an environmental consultant to do the phase one and phase two, and then they say, "We had no idea what we were getting into." You've got to address those things on the front-end, and look at the nature of the business. Ultimately, your adviser can help you decide the types of buyers you're going to take the deal to and why.

CALFO: I want to echo that it's all about understanding that on the front end and communicating it.

AUDIENCE QUESTION: Early on you touched on the tax situation. Has that changed under the current administration? (The tax cut and jobs act that just passed.)

CALFO: Generally speaking, for most companies this is a positive cash flow component to the business, which should have a positive implication to the cash flow stream the company can generate and therefore (it can add) value.

AUDIENCE QUESTION: Anything specific as it relates to mergers and acquisitions?

CALFO: I think I understand the question. There's nothing specific. It is driving value, because it does have a cash flow impact, but not as it relates to mergers and acquisitions, if I'm understanding, correctly.

PUTHOFF: I don't think there's anything that I know of in the act that really targeted that space, but I'll reiterate that it's critical for any business owner who is looking to sell to get good tax and accounting advice on the front end, because you can structure a transaction that's very favorable from a tax perspective. And you can do the opposite as well, if you don't get good advice and it's like the example of your divorce lawyer doing a deal. If you have an accountant who's never done any kind of this sort of M&A work, they may not be as familiar with the rules. And if you don't hire someone or have someone who can analyze the tax situation upfront, then that's where expectations can get out of sync. Because you may think I'm getting 30 million dollars and I'm going to get this much after taxes and that number is what you want, and then lo and behold, your tax structuring was wrong and you don't get that. Then, there's going to be some unhappy people. So, it's worth the money to get good tax and accounting advice. But I'd say that the tax impact of the deals is about the same as it was before unless you're a C-Corp.

CARLSON: One thing I noticed, when the act was passed, was a cap on the deductibility of interest payments as it relates to the companies and businesses that are acquired. Lower middle market companies are somewhat insulated because they're not going out and getting six times leverage to buy these deals so this cap does not come into play. But, for the true middle market, upper middle market, or the upper end of the market, they are actually getting six times leverage. Some companies are being capped in terms of what they can deduct for interest expense.