Evaluating Acquisitions in the Boardroom

November 10, 2016
Panelists

- **Steve Vazquez**
  Foley & Lardner LLP

- **Scott Sonnenblick**
  Linklaters

- **Paul McNicholl**
  Linklaters

- **Jeffrey Bradford**
  Grant Thornton LLP

- **Margaret C. (Peggy) Kelsey**
  Modine Manufacturing Company

- **Frank Jaehnert**
  Brady Corporation

- **Brent Smith**
  William Blair
Agenda for Panel Discussion

• Current M&A Trends
  o Market Overview
  o Structure Trends - “Locked Box” (i.e. fixed price based on signing balance sheet with no closing or post-closing adjustments) deals
  o Process Trends - Recent Post-Trados Delaware Board fiduciary duty cases regarding Board Process
  o Risk evaluation and mitigation
    ▪ Representation and warranty insurance
    ▪ Integration issues (including use of integration advisor)
    ▪ Managing, monitoring and reporting on success of deal and achieving value proposition that supported deal

• Board’s role in developing and evaluating an acquisition strategy
  o Governance procedures and controls for M&A
  o Establishing criteria for deals that can be completed without Board involvement
  o Use of third party advisors and the Board’s role in vetting and managing potential conflicts of interest
Current M&A Market Overview
(Prepared by William Blair & Company)
Current M&A Market Overview

Brent Smith
Head of Consumer & Retail Mergers & Acquisitions
William Blair & Company
Global Mergers & Acquisitions Activity

- Sustained growth in global M&A from 2003-2008 (mid-year)
- The global economic crisis had a meaningful impact on M&A activity
  - Deal volumes plummeted beginning in H2 2008
- Since 2009, gradual increase in activity has occurred as economies slowly rebounded
- Third Quarter 2016 saw number of deals down 16% and deal value down by 21%

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Deals</th>
<th>Deal Value ($ in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>31,367</td>
<td>$2,757.6</td>
</tr>
<tr>
<td>2006</td>
<td>36,938</td>
<td>$3,611.8</td>
</tr>
<tr>
<td>2007</td>
<td>42,876</td>
<td>$4,246.7</td>
</tr>
<tr>
<td>2008</td>
<td>41,537</td>
<td>$2,682.5</td>
</tr>
<tr>
<td>2009</td>
<td>36,642</td>
<td>$1,919.3</td>
</tr>
<tr>
<td>2010</td>
<td>41,311</td>
<td>$2,444.2</td>
</tr>
<tr>
<td>2011</td>
<td>44,392</td>
<td>$2,418.8</td>
</tr>
<tr>
<td>2012</td>
<td>42,747</td>
<td>$2,308.5</td>
</tr>
<tr>
<td>2013</td>
<td>37,171</td>
<td>$2,401.0</td>
</tr>
<tr>
<td>2014</td>
<td>40,401</td>
<td>$3,406.0</td>
</tr>
<tr>
<td>2015</td>
<td>38,738</td>
<td>$4,626.0</td>
</tr>
<tr>
<td>LTM</td>
<td>37,243</td>
<td>$3,630.4</td>
</tr>
</tbody>
</table>

Note: Year-to-date as of September 30, 2016.
Sources: Dealogic and William Blair's Mergers and Acquisitions market analysis.
### EV / EBITDA Valuation Multiples

**< $100M**
- 8.3x
- 9.0x
- 9.5x
- 9.0x
- 6.0x
- 5.5x
- 9.2x
- 9.4x
- 7.7x
- 8.5x
- 9.3x
- 8.8x
- 8.8x

**Mid-Cap**
- 8.9x
- 10.6x
- 10.9x
- 10.0x
- 9.4x
- 7.6x
- 10.0x
- 10.4x
- 9.6x
- 10.9x
- 9.8x
- 10.5x
- 10.0x

**>$1B**
- 10.4x
- 11.2x
- 11.9x
- 13.5x
- 10.4x
- 9.2x
- 10.2x
- 12.0x
- 10.6x
- 12.1x
- 13.3x
- 12.2x
- 12.0x

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**Note:** Mid-cap defined as transactions with values between $100 million and $1 billion.

Source: Dealogic and William Blair’s Mergers and Acquisitions market analysis.
The Balance Sheet Effect in the United States

- Strategic buyers have continued to be conservative since the economic downturn, “hoarding cash”
- Today, corporations have exceptionally strong balance sheets

Large Arsenal of Excess Cash⁽¹⁾

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash (in billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>$2,557</td>
</tr>
<tr>
<td>2002</td>
<td>$2,663</td>
</tr>
<tr>
<td>2003</td>
<td>$3,238</td>
</tr>
<tr>
<td>2004</td>
<td>$4,168</td>
</tr>
<tr>
<td>2005</td>
<td>$4,302</td>
</tr>
<tr>
<td>2006</td>
<td>$4,643</td>
</tr>
<tr>
<td>2007</td>
<td>$5,555</td>
</tr>
<tr>
<td>2008</td>
<td>$6,048</td>
</tr>
<tr>
<td>2009</td>
<td>$7,211</td>
</tr>
<tr>
<td>2010</td>
<td>$7,851</td>
</tr>
<tr>
<td>2011</td>
<td>$8,530</td>
</tr>
<tr>
<td>2012</td>
<td>$9,078</td>
</tr>
<tr>
<td>2013</td>
<td>$9,524</td>
</tr>
<tr>
<td>2014</td>
<td>$9,611</td>
</tr>
<tr>
<td>2015</td>
<td>$9,889</td>
</tr>
<tr>
<td>2016 YTD</td>
<td>$10,264</td>
</tr>
</tbody>
</table>

Improving Net Debt Ratios⁽²⁾

<table>
<thead>
<tr>
<th>Year</th>
<th>Net Debt Ratio (Weighted Average Net Debt / EBITDA multiples)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>1.4x</td>
</tr>
<tr>
<td>2002</td>
<td>1.3x</td>
</tr>
<tr>
<td>2003</td>
<td>1.6x</td>
</tr>
<tr>
<td>2004</td>
<td>1.8x</td>
</tr>
<tr>
<td>2005</td>
<td>1.3x</td>
</tr>
<tr>
<td>2006</td>
<td>1.3x</td>
</tr>
<tr>
<td>2007</td>
<td>1.6x</td>
</tr>
<tr>
<td>2008</td>
<td>2.0x</td>
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<tr>
<td>2009</td>
<td>2.0x</td>
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<tr>
<td>2010</td>
<td>2.0x</td>
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<tr>
<td>2011</td>
<td>1.6x</td>
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<td>2012</td>
<td>2.1x</td>
</tr>
<tr>
<td>2013</td>
<td>2.0x</td>
</tr>
<tr>
<td>2014</td>
<td>2.4x</td>
</tr>
<tr>
<td>2015</td>
<td>2.2x</td>
</tr>
<tr>
<td>2016 YTD</td>
<td>2.4x</td>
</tr>
</tbody>
</table>

⁽¹⁾ Limited to Cash and Cash Equivalents of companies on all U.S. exchanges.
⁽²⁾ Calculated as weighted average net debt / EBITDA

Note: Year-to-date as of September 30, 2016.
Sources: Capital IQ, FactSet Research Systems, and William Blair’s Mergers and Acquisitions market analysis.
Public Equity Markets Are Robust – Provides Currency for Deals & Confidence

Past Ten Years

Historical NTM P/E\(^{(1)}\) Multiples – S&P 500

<table>
<thead>
<tr>
<th>Average</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>16.7x</td>
</tr>
<tr>
<td>1 yr.</td>
<td>16.3x</td>
</tr>
<tr>
<td>3 Yr.</td>
<td>16.0x</td>
</tr>
<tr>
<td>5 Yr.</td>
<td>15.0x</td>
</tr>
<tr>
<td>10 Yr.</td>
<td>14.5x</td>
</tr>
</tbody>
</table>

Source: FactSet Research Systems as of October 18, 2016.

(1) NTM: Next Twelve Months as of most recent reported filings.
Public Markets Have Rewarded Acquirers Recently

- In the past four years, public strategic acquirers’ stock prices have risen following an acquisition, the first time since 1995
- After four years of the public markets rewarding strategic buyers for deals, the trend reversed in 1H 2016

Average Share Price Change of Strategic Acquirers\(^{(1)}\)

<table>
<thead>
<tr>
<th>Year</th>
<th>'95</th>
<th>'96</th>
<th>'97</th>
<th>'98</th>
<th>'99</th>
<th>'00</th>
<th>'01</th>
<th>'02</th>
<th>'03</th>
<th>'04</th>
<th>'05</th>
<th>'06</th>
<th>'07</th>
<th>'08</th>
<th>'09</th>
<th>'10</th>
<th>'11</th>
<th>'12</th>
<th>'13</th>
<th>'14</th>
<th>'15</th>
<th>1H'16</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
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<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Source: Dealogic and William Blair’s Mergers and Acquisitions market analysis.

(1) Represents acquirers’ share price change between the trading days immediately preceding and immediately following announcement per "Takeovers Put Fuel in Stocks’ Empty Tank": WSJ published May 5, 2014. Analysis updated as of 9/30/16.
Significant Private Equity Dry Powder

U.S. PE Capital Overhang

($ in billions)

Source: Pitchbook (through 3/31/16).
Within the United States, leverage multiples as measured by Debt-to-EBITDA remain at some of the highest levels since 2002.
Cost Synergies in Select Food & Beverage Transactions

Announced Cost Synergies as % of Target LTM Sales

<table>
<thead>
<tr>
<th>Food Median</th>
<th>6.6%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Median</td>
<td>7.0%</td>
</tr>
</tbody>
</table>

7 of the 10 Largest Announced Synergy Deals have Occurred in the Past 3+ Years

Median Time of Estimated Cost Synergies: 3 years\(^{(2)}\)

Weighted Average (Realized/Estimated) Cost Synergy\(^{(3)}\): 117%

Source: SEC filings, management presentations, analyst reports and press releases.

(1) Does not include beverage transaction synergies.

(2) As of transaction close date, includes 16 data points based on available data.

(3) Weighted average cost synergy calculated as (sum of realized cost synergies/sum of estimated cost synergies); includes 13 data points based on available data.
Notable Trends in M&A

• “EU Style” Deals are Becoming More Common
  – Vendor Due Diligence Packages
  – Reps & Warranty Insurance/Public style contracts
  – Lock-Box Mechanism to handle working capital, cash, debt, etc.

• Due Diligence has grown even more intensive

• Quality of Earnings on most deals

• Rep & Warranty Insurance
  – Savvy sponsors used R&W Insurance to differentiate their bids
  – Now commonplace, such that Strategics need to adopt in order to compete
  – Buyers are paying the premium
  – Minimized exposure for sellers
Additional Board Considerations

**PRE-ACQUISITION**
- DISCUSSIONS AND DEVELOPMENT OF ACQUISITION STRATEGY

**ACQUISITION**
- EVALUATE PROPOSALS & INTEGRATION STRATEGY

**POST-ACQUISITION**
- EVALUATE COMPLETED ACQUISITION & IMPROVE PLANNING
Board involvement in the acquisition process should begin before any specific acquisition is proposed.

In pre-acquisition discussions, the Board and management should discuss the company’s acquisition strategy, including acceptable transaction and risk metrics, potential acquisition targets and opportunities, risks associated with certain types of acquisition targets, and potential funding sources.

- The Board should make its expectations regarding the acquisition process clear (e.g., when the Board expects its involvement to begin and the type and level of information that the Board expects to receive).

The company’s acquisition strategy may include the engagement of a buy-side financial adviser, or parameters for determining if and when the company will engage a financial adviser.

- Prior to engaging a financial adviser, the Board must consider any actual or potential conflicts of interest.
- The Board should be directly involved in establishing the terms of the engagement.
By having an acquisition strategy in place and by proposing acquisitions that are part of that acquisition strategy, it will be easier for management to get the Board “up to speed” when an acquisition opportunity arises.

Pre-acquisition discussions will provide the Board and management with a common framework for evaluating proposed acquisitions.

Management should periodically update the Board regarding transaction metrics in the industry so that when a “good deal” comes along, the Board is aware of recent transaction metrics and can make an informed decision more quickly.

– This practice is also beneficial in the event that management proposes a transaction that is not completely in line with all aspects of the company’s acquisition strategy.
When evaluating a proposed acquisition, the Board must be mindful of, and act in accordance with, its fiduciary duties:

- **Duty of Care** – Requires directors to inform themselves of relevant and available facts and, so informed, to act with due care
- **Duty of Loyalty** – Requires directors to put the best interests of the company and its shareholders over those of the directors
- **Business Judgment Rule** – Protects Board from judicial scrutiny so long as Board decisions are made in good faith by disinterested directors exercising their duty of care

The Board must:

- Ask the “tough questions”
- Maintain the appropriate level of skepticism
- Help to identify, evaluate and address the key risks
- Determine whether the company should move forward with a proposed acquisition
Among other transaction-specific issues, the Board should consider the following:

- How does the proposed acquisition fit into, support and/or advance the company’s acquisition strategy?
- What benefits will the company realize from the proposed acquisition?
- Is the proposed acquisition the best use of the company’s resources?
- What assumptions are being used by management and/or the company’s financial adviser in evaluating and/or valuing the proposed acquisition? Are those assumptions realistic?
- What projections are being used by management and/or the company’s financial adviser in valuing the proposed acquisition? What is the basis for those projections?
- What are the risks associated with the proposed acquisition? How can those risks be mitigated / addressed? Consider business risks, as well as legal / litigation risks related to process, structure and transaction terms.
- What are the benefits to be received by the company from the proposed acquisition, and will the proposed acquisition increase shareholder value?
- Is the structure of the proposed acquisition the best structure for the company? Would another structure be more beneficial to the company?
- What synergies can be achieved through the proposed acquisition? How will those synergies be achieved? When will those synergies be achieved?
- Would it be appropriate to use data analytics and/or social media analysis in evaluating the acquisition target?
Board action to evaluate and/or approve a material acquisition should be taken at an *in-person meeting of the Board*, and the meeting agenda and materials should be provided to the Board sufficiently in advance of the meeting.

Among other things, directors should consider and/or review the following when meeting to take action on a material acquisition:

- Fiduciary duties
- Summary of material contract terms and copy of purchase agreement
- Negotiations to date and material open issues
- Extent and nature of business and legal due diligence review and any material due diligence findings
- Valuation of the business being acquired
- Fairness opinion of financial adviser, if applicable
- Management recommendation
- Director indemnification and D&O insurance coverage and limitations
Evaluating Proposed Integration Strategy

Because the success or failure of an acquisition often relates to the company’s ability to integrate the acquired business, the Board’s evaluation of an acquisition should focus heavily on management’s proposed strategy for integrating the acquired business.

In considering the proposed integration strategy, the Board should consider the following issues:

– Who is responsible for the implementation of the integration strategy? Will a specific team be formed for this purpose? (It is important that someone has a vested interest in ensuring that the integration is successful.)

– Will key employees of the acquisition target be retained to assist with the integration process? Have steps been taken to retain such key employees? Have those steps been successful?

– What business issues must be addressed in integrating the acquisition target? How will those business issues be addressed?

– How long is the integration process expected to take? What is the proposed timeline?
The company’s acquisition strategy should include a process for measuring / evaluating the success of each acquisition—This process should focus on whether certain key metrics have been met.

If an acquisition fails, it is often a result of internal factors, such as lack of cohesion, conflicts, and failure to integrate the acquired business.

In most cases, if an acquired business is well integrated with/into the existing business of the acquiring company, the acquisition will be considered successful.
Breakout Session II (10:20 a.m. – 11:20 a.m.) Evaluating Acquisitions in the Boardroom

Steve Vazquez, Partner, Foley & Lardner LLP | Scott Sonnenblick, Partner, Linklaters | Paul McNicholl, Partner, Linklaters | Jeff Bradford, Partner, Transaction Services, Grant Thornton LLP | Margaret C. (Peggy) Kelsey, Vice President, Legal and Corporate Communications, General Counsel & Secretary, Modine Manufacturing Company | Frank Jaehnert, President & CEO, Brady Corporation (retired), Board Member | Brent Smith, Managing Director, Head of Consumer & Retail M&A, William Blair

1. Current M&A Trends (10:20am—11:00am)
   a. Market Overview (Brent to start)
   b. Structure Trends - “Locked Box” (i.e. fixed price based on signing balance sheet with no closing or post-closing adjustments) deals (Peggy to start)
   c. Process Trends - Recent Post-Trados Delaware Board fiduciary duty cases regarding Board Process (Steve to start)
   d. Risk evaluation and mitigation (Jeff to start)
      i. Representation and warranty insurance
      ii. Integration issues (including use of integration advisor)
      iii. Managing, monitoring and reporting on success of deal and achieving value proposition that supported deal

2. Board’s role in developing and evaluating an acquisition strategy (11:00am—11:20am)
   a. Governance procedures and controls for M&A (Frank to start)
   b. Establishing criteria for deals that can be completed without Board involvement (Paul or Scott to start)
   c. Use of third party advisors and the Board’s role in vetting and managing potential conflicts of interest (Brent to start)