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MERGER GUIDE

INSIDE:

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Randy Nader,
Business Development Manager
Former owner of Nader's Pest Raiders

As veterans of over 100 mergers in our 50 year history, we have built a solid reputation within the industry and regularly talk to PMPs across the country. Whether you are ready to sell or just exploring some options, we'd love to talk.

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4 steps to a rewarding M&A deal

BY **KEVIN BURNS |** Chief Development Officer, Arrow Exterminators

PHOTO: ARROW EXTERMINATORS

Atlanta-based Arrow Exterminators was started in 1964 by Starkey and Imogene Thomas. Fifty-three years later, Arrow is the second-largest family-owned pest management company in the country. In our 2016-2017 fiscal year, we recorded double-digit revenue growth for the seventh consecutive year — and over the past five years, we've added almost 900 new jobs, one of our key measurements at the company.

The No. 1 reason for our success is our family culture. We treat each other like brothers and sisters, and celebrate life's wins, births and milestones together. We also mourn and comfort each other in times of death, loss and failure. We treat each other respectfully, fairly and professionally, and are there for each other. This same family culture provides the backbone for how we treat owners, employees and customers during the merger process.

The subject of mergers and acquisitions can be difficult to understand, given the complexities of the process and the accompanying emotion involved by a pest management professional (PMP) considering the sale of his or her business. A typical deal can be broken down into four steps, which all overlap:

1 **DEAL DEVELOPMENT.** Buyers and sellers get together to determine whether there is mutual interest by both parties, and whether there is a good cultural fit. Buyers will discuss why they are the right acquirer for the business, while sellers will make their case for a high valuation and keeping their employees. During this step, basic financials are provided to the buyer by the seller, and the purchase price and deal structure (cash, down payment, terms, etc.) are discussed and negotiated. A fully executed letter of intent (LOI) is the ultimate goal of deal development.

2 **DILIGENCE.** Buyers start this step by requesting a significant amount of information about the company, including ownership; key financial statements; service record summaries; tax returns; banking records; employee information, including tenure, compensation and benefits; and fleet details; as well as information on a variety of other topics. A site visit is scheduled in which in-person diligence is performed by the buyer's diligence team, followed by a period of time to review findings and then revisit with the seller as necessary to complete the process.

3 **CLOSING.** Buyers and sellers negotiate the specific language of the final agreement, including the allocation of payments and a detailed communication plan, and ultimately execute the closing documents.

4 **MERGER INTEGRATION.** Finally, buyers and sellers schedule an employee meeting to announce the deal. Typically, the buyer will schedule one-on-one meetings with each employee to discuss position, job duties, compensation and benefits. A good integration will minimize business disruptions and the impact on the employees, and will facilitate the realization of the value of the business.

As you read on in this Merger Guide, you'll find even more great advice from the pros, as well as analysis from a survey conducted specifically for the pest management industry. Arrow is proud to be a sponsor of this information, which helps PMPs make informed decisions as they explore all their options while they consider their future.

Make me an offer

Merging with a larger company holds appeal when the price is right, *PMP's* exclusive survey shows.

BY **DIANE SOFRANEC** | Managing Editor

Many pest management professionals (PMPs) dream of the day a company will swoop in and offer them millions of dollars for the company they worked so hard to build.

But is this scenario realistic? Can you put a price on a venture into which you've poured your heart and soul?

Pest Management Professional (*PMP*) surveyed readers to find out. When asked whether there is any truth to the statement, "Every business is for sale; the only real question is, for how much?" Sixty percent of survey respondents said there was.

Of course, the reasons for merging or selling a business are as varied as the PMPs who own them. Many PMPs reach a point when they are ready to retire and relax. This is especially true for owners and operators who have taken on the majority of the responsibilities a successful business requires, and are ready for a much-needed break.

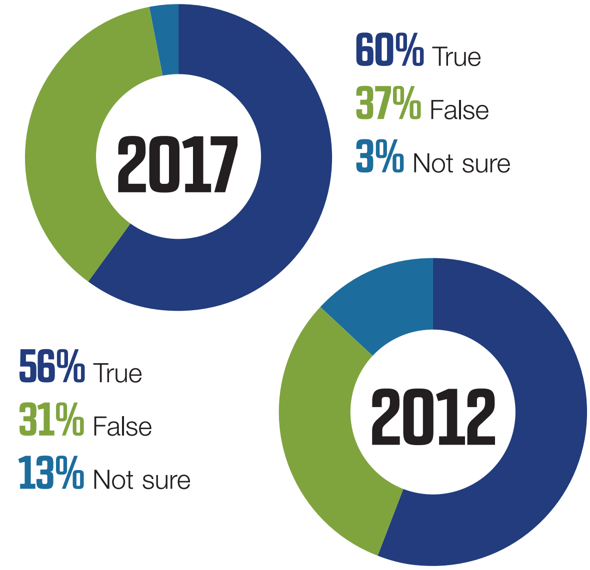
Some work side-by-side with their devoted children or valued managers, and decide to reward years of dedication with the keys to the company.

Others want to grow their businesses by merging with a larger company. Survey respondents believe merging with a larger company can improve marketing efforts, employee retention and career opportunities, as well as access to proven processes and policies.

The amount of money spent on mergers and acquisitions in 2016 trailed only 2015 and 2007 as the highest on record, according to banking and financial services company J.P. Morgan Chase & Co. It's further proof that when the price is right, every company is for sale. PMP

You can reach **SOFRANEC** at dsofranec@northcoastmedia.net or 216-706-3793.

Name Your Price Every business is for sale; the only real question is, for how much?



"Do... teach employees the new policies and listen to the concerns of all employees."

— BOB SHIMANEK, PRESIDENT, GUARANTEED BUG CONTROL, LONGVIEW, TEXAS

Bigger Brand and Budget

Can merging with a larger pest management provider help an acquired business improve marketing with the power of a bigger brand and budget?

Yes
No

SOURCE: *PMP* MERGER SURVEYS

"Don't... avoid hard questions."

– DEREK FLAKE, GENERAL MANAGER, MIDWEST PEST CONTROL, NORTH LITTLE ROCK, ARK.

$3.9 trillion

Amount spent on global mergers and acquisitions in 2016, the third-best year on record following 2015 and 2007.

SOURCE: J.P. MORGAN CHASE & CO.

Career Opportunities and Retention

Can merging with a larger pest management provider help an acquired business improve career opportunities and employee retention?

	Yes	No
2017	58%	42%
2012	54%	46%

"Do... Communicate, communicate, communicate."

– JIM SWAYNE, PRESIDENT AND CEO, SAFER HOME SERVICES, CLEARWATER, FLA.

"Don't... forget to be patient and open to changes."

– DAREN HORTON, ACE, OWNER, GECKO PEST CONTROL, MARSHALL, TEXAS

Tax Laws

Do current tax laws, or proposed changes to tax laws, make your company more or less likely to merge with a larger pest management company?

	More likely	Less likely
2017	19%	81%
2012	24%	76%

Of 1,000 corporate executives and private equity investors, **75%** say deal activity will increase in 2017.

SOURCE: DELOITTE M&A TRENDS REPORT 2016, YEAR-END EDITION

Processes and Policies

Can merging with a larger pest management provider help an acquired business access, and implement, more proven processes and policies?

	Yes	No
2017	54%	46%
2012	53%	47%

SOURCE: *PMP* MERGER SURVEYS

Sell when the time is right

Knowing when it's time to sell your company depends on many factors; here's why one PMP struck a deal.

BY **DIANE SOFRANEC** | Managing Editor

Thirty-two years after starting his pest management company, Gary Maschmidt knew it was time to sell Gary's Quality Pest Control.

"I had a friend who, three days prior to his departure to come visit me, found out he had Stage IV cancer," he says. "So looking at things in a broader picture gave me a different perspective on how I would prefer to live the final chapter of *my* life."

Maschmidt reached out to a broker who guided him through the sales process of his company, which serviced residential and commercial customers in the Cape Coral, Fla., area. He and 14 employees also offered subterranean termite control, construction pretreats and termite inspections, as well as lawn and ornamental care.

"My broker put a package together and I signed off on it," he says. "Prior to that, I prepared a lot of paperwork for him; not as much as I was going to once I got into the LOI [letter of intent]."

The deal progressed quickly; within 12 hours Maschmidt agreed to sell his business to Arrow Exterminators, which was eager to break into the Fort Meyers area. Plus, the company was family-owned and had the same values, he says.

Maschmidt's business and personal finances were in a good spot, which helped the sale progress smoothly. "I am by no means exorbitantly wealthy, but I saved a lot of money in business and made some great choices," he says. "I didn't spend money when business was booming, I banked it. Just because your company is making money doesn't mean you have to spend it."

Indeed, Gary's Quality Pest Control enjoyed consistent growth: 8 percent to 10 percent for the past 5 years, and 4 percent during the recession.

Maschmidt says his employees were an asset. "That's really what makes your company successful," he says. "Without them, I would not be where I am today."

Customer retention is critical. Maschmidt had customers from day one that he still serviced 32 years later.

"I worked with three generations of families," he says. "A lot of them have been customers for so long, you know so much about them."

Buyers look at recurring revenue — that is, the customers a company is contractually obligated to service on an ongoing basis. Recurring revenue plays a huge role in the valuation of a company, he says. For that, Maschmidt can take credit. He says he took care to provide what customers asked for, and was very attentive to their needs.

GARY MASCHMIDT

"When you gave a customer your word, you had to deliver on it," he says. "I think that was part of our success."

He made himself personally available to his clients, a move he says helped his company stand out from all the others. But that meant the self-described workaholic didn't take many vacations or spend enough time with family.

"I was somewhat burned out, and that probably was a fault of my own," he says. "I was very hands-on — top to bottom — which is good and bad."

Since he sold his company in May, Maschmidt has had time to do the things he put off for so many years. He says he plans to spend more time with his grandchildren and his 82-year-old mother, who still lives in his hometown of St. Louis.

Maschmidt relocated to Florida at age 21 with just $250 in his pocket. He helped transport a boat from St. Louis to Fort Myers, and never left. "It was a great choice, just an adventure," he says. "The way things turned out, it was one of the better decisions I've made in my life."

Taking the advice of his brother, a financial advisor, turned out to be a good decision, too. He told Maschmidt to sell when you *want* to, not when you *have* to.

"My mom, my brother, and my friend's situation all played a role in my decision," Maschmidt says. "I turned 60 years old last December, and I felt it was time for me." **PMP**

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What makes a company valuable?

5 factors may lead to a bigger payoff when it's time to sell.

BY **LANCE R. TULLIUS** | Contributor

In the midst of one of the strongest-running merger and acquisition markets the industry has ever seen, pest management professionals (PMPs) want to know what makes a company valuable. Keeping in mind that a company's valuation is subjective, and that no universally regarded foolproof means for valuing a business exist, the question is not easy to answer. But there are characteristics and traits that drive a company's value. And while most may seem obvious, many business owners don't understand or appreciate the context within which the market — or a particular buyer, for that matter — views and prioritizes these factors.

1 HAVE WHAT SOMEONE WANTS

The most basic value driver is having a business that someone else wants to own. In today's market for pest management companies, where valuations have reached great heights, that means one of two things:

- You must have a well performing business that is similar in nature to your potential buyer's (inspiring that buyer's motivation to add more of an already good thing); or
- You must have a well performing business that may not be completely similar to a buyer's business, but is complementary (thus providing a strategic motive for the acquisition).

This may be a generic and vague characteristic, but no other measure of value matters without it.

MORE ONLINE
Need more clarification about EBITDA? Visit **PMPPestTalk.net**.

2 EBITDA DRIVES THE DAY

Assuming you have a desirable business, arguably the single greatest characteristic or metric that translates value is profitability, or earnings before interest, taxes, depreciation and amortization (EBITDA).

When applying rumored valuation multiples to their own revenue streams, sometimes business owners fall victim to significant misconceptions of value. While revenues do hold relevance, they generally do so second to profitability.

3 GROW, GROW, GROW

Now that you have the impression that revenues take a back seat to EBITDA (which they do), let's stress the importance of revenue trends. Simply put, buyers almost never pay premium valuations for businesses that show flat or declining revenue trends. Investors make investments with the intent for those investments to get bigger. While returns do come from profits, those profits come from revenues. And if revenues aren't growing, your profits are essentially capped. You must look for ways to sustain revenue growth, and balance that growth with consistent — if not growing — profit margins.

4 THE HUMAN FACTOR

The pest management business is a human one. To date, and for the foreseeable future, it has not been automated. Therefore, the ability to grow for businesses of all sizes and capitalization levels depends on their ability to access and retain quality people. Sophisticated and experienced buyers are highly motivated to acquire businesses largely for the sake of securing additional talent. Developing a culture that focuses on training and advancement, and providing a quality work environment, will better position you to maximize the value of your business.

5 OPERATE BIG

To secure a big payday for your business, you must be able to objectively validate the performance of your business in-depth and on various levels. You have to install and use systems, procedures and protocols that track various aspects of your business' performance. Operate bigger than you are. Run your business as if you have to adequately report its performance to outside investors, rather than to yourself or your immediate family. Financial and accounting systems generally come to mind first, but tracking customer, labor, productivity and supply metrics also are high on the list. PMP

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What's the 'intent' of the deal?

A letter of intent spells out the intentions of both buyer and seller in an all-encompassing document.

BY **KEMP ANDERSON** | Contributor

Most owners sell one business in their lifetime. But selling a business is very different from selling anything else you may own.

To maximize the sale, the seller should understand the process of a sale or transaction. Sellers typically start with a simple thought or urge to sell: "I'm ready to sell" or "I want to sell." From that point, how do you prepare? What's involved? As you move through the process, what documents will you see?

One of the first and most important documents you will see is called the **letter of intent (LOI).** This is the backbone of the deal. This document can be described as a deal in principle that sets up the **asset purchase agreement (APA),** which is the deal in detail. The LOI is typically three to five pages, whereas the APA can be 10 to 100 pages. The LOI has several basic components for which you should prepare.

The following items are fairly standard in LOIs for the pest management industry:

✓Buyer's assumptions (the best guesses the buyer has made to make the offer that gets proven by the buyer during due diligence). The standard and general assumptions to be proven are:
- Revenue and profit.
- Customer base and related details.
- Recurring base of business.
- Fleet data.
- Assets.
- Employee-related data.
- Accounts receivable.

Buying is based on these primary assumptions. After due diligence, the offer may go up or down. If you are prepared with sound information prior to going to buyers, your offers should be stable or go up.

✓Deal structure (either asset or stock purchase; in almost all cases asset). Without limitation, the buyer will receive at close, and allocate value to:
- Goodwill (customer lists and details — all active, pending and canceled accounts).
- Company names, websites, etc.
- All supply related to the business, such as inventory and equipment, furniture, software, computers and intellectual property.
- All accounts receivables.
- Fixed assets and fleet.

✓Excluded assets (items the seller is not selling). These should be disclosed up front and can include:
- Seller's cash and securities.
- Insurance rights and policies.
- Property.
- Seller's personal belongings, such as vehicles, phones and assets.

✓Purchase price and terms. This critical part of the LOI may include:
- Cash paid at close.
- Money paid in a note for a number of months at an acceptable interest rate.
- An agreed amount for accounts receivables (A/R) — usually dollar-for-dollar under 90 days paid at close based on an A/R report run the morning of close.
- Money for non-compete of owners (all buyers require non-compete clauses).
- Money for transition services or a consulting agreement with the seller.
- Rents and utility if applicable, and other assets.

✓Human resource (HR) liabilities. Some HR liability where the company or seller owes the employee benefits can include:

To maximize the sale, the seller should understand the process of a sale or transaction.

- Vacation owed.
- Sick pay owed.
- Savings plans and pensions transferred.
- Accrued compensation from seller.

Any employee liability should be determined during due diligence, and is typically a credit to the buyer to satisfy with employees after the deal closes.

✓Specific employee matters will be addressed and include items such as:

- At close, the buyer will typically offer all employees employment based on the employee passing the buyer's best practices — drug testing, motor vehicle report/driving record check, criminal background check, etc.
- Consulting agreement, which the seller could address as well. This includes pay per month, hours per week, duration (six to 12 months is standard), and benefits (such as medical, dental, car, phone, vacation) offered to the seller in a consulting capacity if any are offered.

✓Termite retreatment obligations after the deal closes may be addressed. If there are any possible retreatments, and retreatments after the close exceed an agreed determined amount, the seller will be notified immediately prior to the retreatment and that amount will be credited to the buyer from future funds. This is a very rare event that can be negotiated.

✓Buyers will be responsible for ongoing business-related liabilities (such as rent, utilities, uniforms, printers, software, internet, phone directory advertising, etc.) that are specifically and legally transferred to the buyer.

✓Fleets may be delivered debt-free, which is a standard requirement. If the seller has a fleet lease, it can be transferred to the buyer.

✓A non-compete clause for sellers is a standard requirement. Keep in mind the non-compete clauses should be written based on the state statutes that exist in the state(s) where the business is owned and operated. Non-compete clauses can be negotiated, but the size of the sale will dictate the buyer's flexibility on the agreement.

✓The time and location for due diligence is specified. Typically, this process is completed within 60 to 90 days from the signed agreement of the LOI, but the size of the deal can influence this timing.

✓The closing date should be in the LOI, with a definitive date for close. It is typically 60 to 90 days post-LOI or sooner. A date is needed for the accountability of the buyers and to demonstrate clear intent from both parties.

✓Exclusivity is almost always in the LOI, with a no-shop provision for the seller.

✓Confidentiality, whereby both buyer and seller agree to keep the transaction and terms confidential until close, is a safety mechanism for all involved — just in case something happens and the sale fails.

✓Once the LOI is signed and agreed to, the APA typically comes from the buyer's attorney and reflects the terms of the LOI in detail. It typically is parallel to due diligence.

It is important for all involved to keep in mind that an acquisition is a process, and the LOI really reflects the intent for both a buyer and a seller. The LOI is the backbone of all the other documents that will follow, from the APA to schedules and exhibits and the like. LOIs can be different based on the deal and the buyer; however, these components are standard and help all involved understand what is being sold and purchased, what the compensation is, what the timing is, and what may be excluded. It is strongly suggested that an LOI be a foundational part of any sale. PMP

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