M&A Transactions In The Logistics Sector Are Forecast To Increase In 2013:

Are You Ready For It?

Norman N. Bluth, Esq., nbluth@mklawnyc.com

Based on the latest industry intelligence gathered at Air Cargo 2013, there is strong evidence that we will see a significant increase in the sale of logistics companies in 2013. This expected increase is due to a number of factors, including (i) growth of the economy overall, (ii) capital waiting to be invested, (iii) customers seeking a one-stop transportation vendor, and (iv) the ever-increasing cost and complexity of doing business in this industry (the latter two are factors fostering consolidation). Consequently, if you are the owner of a logistics company who wants to keep all of your options open, take action now to place yourself in the best position to close a deal if and when an opportunity presents itself.

There are, of course, different types of buyers. This article concentrates on two such buyers, namely Private Equity Group buyers ("PEGs") and Strategic buyers ("Strategic"). The decision whether to sell to a PEG or Strategic buyer will affect not only how you present your company but the proceeds you receive from the sale. Every transaction is different, and you should be working with a team of experienced and qualified advisors, including an accountant, a lawyer, a valuation advisor, and an estate planning professional before you enter into detailed sale discussions with anyone.

The variables between a PEG and Strategic transaction are presented below in two sections. The first addresses the investment goals of each type of buyer and the second explains how each type structures a transaction.

Investment Goals: PEGs and Strategics approach investment opportunities very differently as each has different goals. The major differences are:

Strategies: When positioning your business for sale, remember that PEG and Strategic buyers require different positioning strategies. The thrust of your materials, conversations, and presentations should be very different for each. Strategics will be interested largely in how your company will fit into theirs. Can your products be sold to their customers? Do you have technology or other intellectual property that can build their business? Are there synergies? Are you active in markets that they'd like to enter? Generally speaking, they place less importance on factors like the strength of a company's IT infrastructure or the prospect of losing some current management in the transaction - they already have senior executives and infrastructure in place. PEGs, by contrast, will be looking at your company as a stand-alone investment that must be able to grow and create value of its own accord. The thrust of the conversation with a

PEG is around your management's vision of the future – how the company fits into broader industry trends, how its business model will evolve and grow, details on your sales and marketing tactics, and how the company will deal with a major downturn in the industry or economy. PEGs often want to understand your M&A capabilities, the pipeline of potential M&A targets already identified, and management's view of the right profiles of M&A targets.

Return on Investment: Strategics often value a business on both financial and strategic metrics. PEGs, by contrast, base their valuations on the likelihood that a company will be larger, more profitable and, therefore, more valuable at the time when they would like to exit. A PEG will have a target Internal Rate of Return (IRR) of 25% to 35% over their four-to-seven year investment horizon. Based on this required return, they can determine exactly how much revenue and earnings growth is required to meet their targets. Consequently, before talking with a PEG, you should consider creating a financial model that compares IRR results in several growth scenarios to better understand how investors will view your business.

Exit Strategy: While Strategics plan to own an acquired business indefinitely, PEGs generally have an investment time horizon of four to seven years. This means that PEGs are particularly sensitive to cyclicality in a business while Strategics are more comfortable with any inherent cyclicality.

Investment Structures: As a result of the very different investment goals and approach of PEGs and Strategics, the deal structures utilized by each are, likewise, very different. The important differences to keep in mind when comparing PEG and Strategic deals are:

Control and Governance: One key benefit to using a PEG as your exit vehicle is that you can realize partial liquidity while maintaining some level of control over your company post-acquisition. Control and governance approaches vary widely, even between PEGs, so it is important to dig into these details. Another major benefit is that PEGs typically allow the business to continue running normally, with the same employees, the same facilities, and the same culture whereas Strategics often immediately implement cost-cutting and integration programs with the new owner. Business owners who are concerned about job security for their employees, maintaining their name on the business or otherwise preserving their legacy often find that selling to a PEG mitigates these concerns. If you choose the private equity route, however, be prepared for an expanded board. In a majority transaction, the investor will usually install a sufficient number of new directors to give the PEG a controlling vote on the board. In a minority transaction, the company's management team may get to keep a majority of board seats. Board meetings often become more formal and are held on a more regular basis than they might be in a typical middle market business. While you and your team remain in charge of day-to-day operating decisions, your board and PEG will have input (to varying degrees) on broader strategic questions, including product line and geographic expansion, key management hires, acquisitions and other financing events.

Valuation and Net Proceeds: One very important factor is economics. Strategics can typically afford to pay more because they will benefit from synergies between their organization and the acquired company. Additionally, Strategics will often buy your entire company outright, in a single transaction. PEGs, by contrast, normally buy only a part of the company. As a result, your immediate proceeds will usually be smaller in a private equity deal than in a strategic one but, long range, you may end up with more money.

Management's Post Acquisition Role: Another factor to consider is your own ongoing employment commitment. Management teams may wish to exit their businesses, either to retire or do something else. A Strategic will generally provide that option – usually with some type of transition period in place (a typical range is from six months to two years). Conversely, a PEG will not only want management to stay, they often want to see an equity investment by the management team as part of the transaction.

Risk and Leverage: In a standard sale to a Strategic, you tend to leave yourself with little or no execution or industry risk going forward (unless you agree to an earn-out as part of your deal). In a private equity deal, however, you continue to hold execution and industry risk along with the additional risks associated with shared governance and control.

Debt: In most cases, companies that take on private equity will reconfigure their capital structure, adding leverage to their balance sheets. That is one of the major differences between selling to a PEG and a Strategic. From a capital structure perspective, PEGs can enable entrepreneurs to prudently use leverage to minimize dilution and increase their long-term equity value. However, leverage - and the regular payments of principal and interest that debt entails - can be a double-edged sword. If there is too much leverage, some entrepreneurs may not be comfortable, causing them to take actions like cutting costs and running the business differently. With a PEG, you can still run your business independently but the leverage may constrain what you can and can't do.

Structure and Tax Implications: Every transaction tends to have its own unique structure and tax challenges, regardless of the buyer. That being said, private equity transactions tend to be more complex, involving multiple tiers of stocks (including preferred stocks with significant dividends and potential liquidation preferences) and complicated post-acquisition governance issues. The additional layer of debt often used to fund the private equity transaction adds another layer of complexity to the due diligence process, the drafting of legal documents, and the approval process.

Now that you have a better understanding of the investment goals of and structures offered by PEGs and Strategics, what is the right transaction for you? Are you ready to engage in the sale process? The clock is ticking.

About the Author: *Norm Bluth is a Partner with McBreen & Kopko, a full service law firm with offices nationwide. He co-chairs McBreen & Kopko's Transportation and Travel Group. Norm has spent his entire career immersed in the Transportation and Travel Law business, practicing privately with recognized transportation law firms and as in-house counsel for both Trans World Airlines, Inc. and a structured finance firm specializing in the acquisition and restructuring of transportation-related companies worldwide. With both in-house and outside counsel experience, Norm has developed a 360-degree perspective, allowing him to facilitate both business and legal solutions.*

For additional information on McBreen & Kopko and Norm Bluth, please visit, www.mcbreenkopko.com