

Investment Banking

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**For my soulmate,
Svitlana Herlache**



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About the Author:

Michael Herlache was the Co-Founder of AltQuest Group, an SMB & lower middle market M&A advisory firm that he started while in business school at Texas A&M University after going through Investment Banking Institute & Wall Street Prep's training programs. He lives in his home in Scottsdale, Arizona with his wife, Svitlana. Michael has an MBA in finance from Texas A&M University. He is passionate about progressive values like diversity, equity & inclusion as well as helping others find their own unique voice.

For those interested in going through a formal M&A advisory training program associated with this text, the Investment Banking University (www.InvestmentBankingU.com) course's syllabus is based upon the content of this book.



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Preface

There are many investment banking texts out there that claim that financial modeling and valuation is the core work of the investment banker. This is simply not the truth. The core work of the investment banker is origination, mandate/target matching, deal structuring & closing. It should follow that a text/course on investment banking should be based upon the same thing. It is the good fortune that the reader has encountered such a book/course. Front Office Investment Banking explains origination, mandate/target matching, deal structuring & closing (i.e. how investment bankers actually make their money).

For those new to investment banking, you are first going to want to clarify whether you would like to work on the sell side for a few years or actually pursue a career in investment banking. The skills that you will need to get started in investment banking (data science & analytics) are different than those that you will need to have a long and successful career in investment banking. The role in investment banking transforms from one that is research, financial modeling & valuation based into one focused on origination and the facilitation of the M&A process. M&A (Mergers & Acquisitions) is the core product of investment banking, and the other products, advisory & capital-raising,



simply support this. We founded Investment Banking University (www.InvestmentBankingU.com) to prepare students for bulge bracket & middle market investment banking career opportunities as well independent M&A groups.

We see a paradigm shift occurring in the field of investment banking. The idea that you need to spend three years of your life as an analyst doing 80+ hour workweeks building financial models to become an investment banker is a faulty paradigm. The real value add of an investment banker is not financial modeling & valuation, but rather origination, mandate/target matching, and deal structuring & closing. You don't need Goldman Sachs' permission to be an investment banker just like you don't need McKinsey's permission to be a consultant. Investment banking for private companies in the lower middle market and middle market is a great way to build your initial coverage and career as an investment banker without sacrificing a family life or your health.

If there is anything that I want you to get from this book, it's the development of a Managing Director (MD) mindset. I want you to think in terms of dealmaking and begin to proactively research where an investment banker's services can add value to a corporation's strategic goals. The ability to conceptualize and model this value concept will serve you well in whatever investment banking role you decide to pursue.



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I wish that I was armed with this book when I was first getting started with AltQuest Group in graduate school at Texas A&M University. I remember going to the campus library to read finance textbooks & do IBI and Wall Street Prep trainings in my off time and then applying the concepts in team meetings after B-school classes. The path that I took was not traditional, I realize that. But it was one I was passionate about and it allowed me to develop an MD mindset. The ability to think at a higher level and have conversations with other high level strategic & financial executives is an invaluable skillset.

Ultimately, I ended up writing the book I could only have dreamed of when I initially first started building out the advisory firm. As such, the book represents almost a decade of trial, error, learning and success. May the lessons contained in these pages save you time, energy & resources and allow you to build a long & successful career in investment banking.

THE ULTIMATE TAKEAWAYS OF THIS BOOK ARE:

The development of an MD Mindset

1. Understanding the strategic intent of coverage companies and where potential gaps that need to be filled with capital, M&A, or growth advisory



2. What sort of capabilities & functionality are the markets rewarding with a higher multiple/lower multiple as this may present an entry/exit opportunity for clients
3. Understanding the entirety of the front office investment banking process rather than simply having a deal support project focus of an analyst/associate

Data Science as the Context for Financial Analysis

1. Understanding context of the analyst role by learning Data Science & Analytics at a higher level

Markets & Valuation as Dynamic

1. What makes line items, margins & multiples expand or contract
 2. What are the trends in said line items, margins, and multiples and what are the implications for these trends on the products you sell (M&A, capital, growth advisory) and clients you serve
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PART I: FRONT OFFICE INVESTMENT BANKING PROCESS



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Chapter 1: Front Office Investment Banking Process

What is Front Office Investment Banking?

Front office investment banking speaks to the process and role of the senior banker, the one responsible for landing the engagements with clients and being a dealmaker. The front office investment banker spends their time building and maintaining relationships within their coverage area and for their specific financial product. Ultimately the senior banker explores strategic alternatives with their clients in order to win mandates to implement the strategic alternative and generate fees for the investment bank.

Front Office vs. Deal Support

The front office is referred to as 'client-facing' while deal support (analysts & associates) does the work to create the deliverables for the marketing materials and deal materials. If you want a long and successful career in investment banking, it makes sense to get front office investment



banking experience even if it is in the lower middle market and middle market.

Front Office Investment Banking Methodology

In order to build a career in investment banking, it is essential to know and practice the Front Office Investment Banking Process. Whether one's career track is in a bulge bracket investment bank, middle market M&A group, or as a lower middle market M&A advisor, it is crucial to know the primary process of the investment banker.

- 1) **Coverage** – Coverage gives us the basis for research and marketing material that we use in origination and other forms of marketing/analysis. The Coverage Process is the following:
 - a) Choosing Coverage
 - b) Vertical & Subvertical Coverage
 - c) Index Building
 - d) Metrics
 - e) Benchmarking
 - f) Marketing Material

- 2) **Mandate/Target Matching** – After building out one's coverage, the investment banker can then begin matching the investment mandates of strategic & financial buyers to potential targets within their coverage. The Mandate/Target Matching Process is the following:
 - a) Identifying Strategic & Financial Buyers



- b) Obtaining Investment Mandates
 - c) Structuring Buy Side Engagements
 - d) Identifying Targets
- 3) **Origination** – Once we have built out buy side relationships within our coverage area, we can then begin outreach to targets for our buy side partners. Origination is the primary work of the investment banker in order to keep the pipeline of deals full. The Origination Process is the following:
- a) Identifying Decision Makers
 - b) The Cycle of Origination
 - c) Initial Outreach
 - d) Preparing for the Pitch
 - e) Pitching
- 4) **Fee Structuring & Winning Mandate** – In order to get paid, the investment banker has to land the engagement. Once the fee is agreed upon, the investment banker puts the fee structure in something called an engagement letter. The Fee Structuring & Winning the Mandate Process is the following:
- a) Type of Fee
 - b) Size of Fee
 - c) Sell Side & Buy Side Representation?
 - d) M&A Engagement Letter



- 5) **Underwriting** – Underwriting aids us in understanding the intrinsic value of the target company and pricing the company under various scenarios & methodologies. The Underwriting Process is the following:
- a) Gathering Historical Financials
 - b) Building the Financial Statement Model
 - c) Finding Adjusted EBITDA
 - d) Deriving Valuation from the Three Methodologies
 - e) Building the Valuation Football Field
 - f) Customizing the Financial Statement Model for Specific Transactions
- 6) **Packaging** – After underwriting the financial product (ex. M&A), we can move forward with packaging in the form of various marketing material including a teaser & Confidential Information Memorandum (CIM). The Packaging Process is the following:
- a) Teaser Creation
 - b) Confidential Information Memorandum (CIM)
- 7) **Buyer List** – After landing the M&A engagement, the investment banker will need to build a buyer list and then begin outreach to the buyer list to generate interest. The Buyer List Process is the following:
- a) Database Utilization



- b) Strategic Buyers
 - c) Financial Buyers
 - d) Initial Outreach
- 8) **Deal Structuring** - After building & executing on a buyer list, it is up to the investment banker to work with the buyer and seller to structure a deal. This means negotiating the valuation range and deal terms. The Deal Structuring Process is as follows:
- a) Valuation Range
 - b) Deal Terms
- 9) **M&A Process**
- a) IOI From Buyer
 - b) Buyer Seller Meeting
 - c) Purchase Agreement Given to Seller
 - d) Signed Purchase Agreement with Different Terms
 - e) Enter Due Diligence
 - f) Complete Due Diligence
 - g) Closing & Flow of Funds



Chapter 2: Getting Started in M&A

Getting Started in M&A:

For those just getting started in investment banking, it is preferable to start with the SMB & lower middle market building relationships with financial and strategic buyers as well as potential targets. This means building your rolodex. Obtain the investment mandates from the strategic and financial buyers and establish a fee arrangement for buy-side deals. This will most likely end up being the Lehman scale for the fee on the buy-side.

For example, with AltQuest Group, I chose to cover manufacturing. If you are starting in the lower middle market, the goal is to get 10 sell side engagements at any given time. It took me one year to get 10 sell side engagements working 40 hours per week and not on weekends. Further, it is going to take you 6 months to one year to close a deal so stay proactive with origination and mandate/target matching.

As you get better and establish a process, your email conversion rates will go up and you will be pitching more



and your ability to win sell side engagements will go up. I am at the point now that if a seller is interested in selling, I will either win the sell side mandate or I will structure it as a buy side deal and receive the fee from the strategic/financial buyer.



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Chapter 3: M&A as a Product

Since M&A (Mergers & Acquisitions) is the core product of investment banking, discussions around investment banking typically relate to M&A. M&A is the selling of a minority or controlling interest in company.

Financial and strategic buyers have what is known as investment/corporate M&A mandates which detail the size and industry of prospective targets for acquisition. The investment banker takes these mandates and matches them with targets and takes a fee for doing so. Investment bankers typically focus on one industry and provide what is known as coverage by building an index of public companies and tracking changes in targets relative to the index in terms of:

- Revenue
- EBITDA
- Multiples



The investment banker monitors trends in these variables and determines the optimal time to sell (when multiples are strong) or acquire (when multiples are weak) and advises target management accordingly. When a target agrees to sell via an investment banker, this relationship is known as a sell-side mandate and an M&A process will be led by the investment banker.

During the M&A process, there are definite steps and deliverables including a teaser, CIM, and management presentation. The M&A process can include many prospective buyers (broad auction) or few prospective buyers (targeted or negotiated sale).

The real work of M&A is origination, mandate/target matching and deal-structuring. Financial modeling and valuation is merely for decision support and deals often get done simply based upon precedent transactions analysis. Thus, the priority of the investment bankers is to obtain a base level understanding of financial modeling & valuation but then to immediately start originating sell side and buy side mandates.

Investment bankers explore strategic alternatives (value creation opportunities) with corporation's CEO's/owners according the company's strategic priorities. Questions like:



- What businesses should we be in? (Answer: where multiples are higher and/or will be increasing in the future)
- What businesses should we not be in anymore? (Answer: where multiples are lower and/or will be decreasing in the future)
- Should we buy or build to enter those markets? (Answer: the result of a buy vs. build analysis)
- If we should buy, what are some acquisition targets in order to buy our way in?
- If we should sell, what are some reasonable acquirers?



PART II: COVERAGE



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Chapter 4: Coverage

Why Begin with Coverage?

Coverage provides the base knowledge for the investment banker that he/she will use to position himself/herself as an expert dealmaker in the field. Coverage defines the breadth and depth of his/her focus. This will include at an advisor level, group level and even firm level.

Coverage gives us the basis for research and marketing material that we use in origination and other forms of marketing/analysis.

Coverage Process

1. Choosing Coverage
2. Vertical & Subvertical Coverage
3. Index Building
4. Metrics
5. Benchmarking
6. Marketing Material



Chapter 5: How to Choose Coverage

First, the investment banker is going to choose what size of companies he/she is going to cover (ex. Public co's, middle market, lower middle market, SMB). At least initially, the investment banker is going to want to start small and scale up from there. Even if it means focusing on the SMB market to get your process down. The key is going to be mastering each of the steps in the investment banking process.

Vertical & Subvertical Coverage

From there, one needs to decide the vertical(s) that will be covered which is usually a function of the experience that one has had in the past. For example, if you have experience in manufacturing, you will be able to speak to the concerns and metrics of the industry. The idea is to be able to speak credibly to both the buyers and sellers in the industry. Geography is also a relevant consideration when choosing coverage. You can start at the city level and then scale up to the state, then region.



Chapter 6: The Lower Middle Market & Middle Market

The Lower Middle Market & Middle Market:

The majority of companies are in what is known as the lower middle market (LMM) & middle market (MM), a classification for small-sized and mid-sized companies. This is where the majority of the transactions occur and where the average investment banker will make his living.

M&A Market Breakdown:

Because of the wide range of company sizes within the definition, the M&A market can be further broken down into the following:

SMB Market: <\$5 million of revenue

Lower Middle Market: \$5 - \$50 million of revenue; Companies with EBITDA below about \$10 million (lower middle market) are typically family or entrepreneur owned..



Middle Market: \$50 - \$500 million of revenue; and the core middle market as companies with \$10 to \$75 million of EBITDA.

Upper Middle Market: \$500 million - \$1 billion of revenue.

Upper middle market companies typically have \$75 million of EBITDA or more, and are often publicly held or sponsor backed.

Further Defining the Middle Market:

Pitchbook defines the middle market as companies with total enterprise value between \$25 million and \$1 billion and the “core middle market” as between \$100 million and \$500 million.



Chapter 7: Index Building

Index Building

After choosing your coverage, the investment banker is then to build an index for each of the verticals and sub-verticals made up with the public comps. The index and the changes in the index are going to provide a measuring stick within which to evaluate targets against.

For example, the vertical may be manufacturing and the sub-vertical could be healthcare.

Metrics

Regarding the vertical index and sub-vertical index, the investment banker ultimately tracks trends in:

- Growth rates
- Margins
- Multiples

Changes in these metrics (expanding or contracting) lead to changes in the behavior of firms when it comes to capital raising & M&A.



Benchmarking

The investment banker takes the index and establishes tiers which turn into peer groups. This is why we pull comps, to build an index and benchmark against the comps. The indexing and benchmarking that is done for a target company is going to serve as the basis for advising on strategic alternatives. One should build indexes at the vertical level, then sub-vertical level and finally sub-vertical by product level.



Chapter 8: Coverage Reports & Marketing Material

The metrics that we track within our indices and the benchmarking that we perform serve the basis for further analysis in the form of sector reports that are distributed to companies in the origination process.

By demonstrating our expertise on what is happening in a given industry, we position ourselves as a go to resource for advice.

Marketing material may be distributed on a monthly or quarterly basis and can serve as a reason to have touch points with various clients.

Applying the Coverage Methodology:

The investment banker will often focus on a product group (i.e. M&A) and/or an industry (industrials, healthcare, technology). Proper coverage comes in the form of



maintaining a coverage index for a sector and its sub-sectors which is broken down in the following manner:

- Industry macroeconomics
- Industry spending
- Sub-sector spending
- Stock market performance of industry
- Public sub-sector financial and valuation performance
- Sub-sector index
- Sub-sector index: financial performance
- Sub-sector index: public market multiples
- Sub-sector index by product category
- Sub-sector index by product category: financial performance
- Sub-sector index by product category: public market multiples
- Industry M&A Market Update
- Industry M&A deal volume and spending
- Industry M&A exit multiples
- Sub-sector M&A deal volume and spending
- Sub-sector M&A exit multiples
- Sub-sector M&A deal volume by product category
- Sub-sector M&A exit multiples by product category

Appendix

- Sub-sector index key metrics
- Sub-sector index key metrics by product category



- Industry most active buyers
- Sub-sector most active buyers
- Sub-sector most active buyers by product category

In the lower middle market and middle market, for each target geography (ex. Florida, New York, California, Texas) and each vertical, the investment banker is going to want to build his rolodex to a sizeable number. This means having:

- The name of the company
- Name of the CEO or owner
- Email of CEO or owner
- Phone number of CEO or owner
- Initial contact (ex. Yes, no, timeline)

The investment banker is going to want to inquire as to whether the company is open to evaluating their strategic alternatives every six months as new scenarios emerge within the coverage companies which change entry/exit dynamics (ie strategic actions).

After getting the initial contact, the investment banker can begin providing coverage to the individual company which includes providing sector and sub-sector coverage including:

- Industry macroeconomics



- Public sub-sector financial and valuation performance (public comps)
- Industry M&A market update

From this data and information the investment banker can advise on strategic alternatives including capital raising, M&A and growth advisory. Key questions include:

- Which way are multiples going?
- Whom are likely acquirers?
- What are likely multiples for the acquisition?
- What precedent transactions can we point to in order to justify a premium valuation?

Coverage Marketing Material

When maintaining coverage of an industry or sector, one prepares a newsletter to be sent to prospective sell side clients in the industry or sector. Investment bankers use the index information to create this newsletter. The newsletter is about 2 to 6 pages.

Industry or Sector Newsletter

The newsletter does not go into as much depth as a report. The newsletter can be a few pages.

Industry or Sector Report

When maintaining coverage of an industry or sector, one prepares a report to be sent to prospective sell side clients



in the industry or sector. The report goes more in depth than the newsletter. The report can be about 15-20 pages.

Pitchbook

When we have built out our industry indices and began coverage, we can begin to pitch our M&A services to particular businesses to win M&A mandates. This means building a pitchbook for an individual target to model out an M&A case under different scenarios.

Rolodex Building

As an investment banker it is important to establish relationships with the strategics & financials in your coverage group as well as relationships with targets and their potential buyers. After building the index containing relevant strategics, one should go to RocketReach.co and find the email addresses for each of the CEOs, CFOs, and/or corporate M&A department head for the potential acquirer.

Vertical & Geographic Coverage

When building out your coverage for your investment bank, if your coverage begins at \$5M revenues on up in manufacturing, then there should be about 1,500 firms per state.

Building the Pitchbook



As mentioned earlier, the pitchbook is an origination document meant to win sell side business for the investment bank.

There are two main types of pitchbooks that are created.

Introduction & Market Overviews

Introducing the investment bank and giving market updates to potential clients. This is origination work and is associated with then allowing you to pitch different strategic alternatives for the company.

1. IB structure and coverage
2. Relevant deals that you have worked on in the sub-sector
3. Market overview with recent trends and deals in the market and data on how public comps have been performing

Mandate Deal Pitches

To win sell-side M&A & buy-side M&A mandates.

Sell-side M&A Pitches:

1. Bank Overview
2. Situation / Positioning Overview
Attractiveness as an acquisition target and how it would be positioned to an acquirer:
 - Growth story
 - Operational improvement story
3. Valuation Summary



Valuation football field with range and methodologies

4. Potential Buyers

Likely buyers with summary:

- Strategic
- Financial

5. Summary & Recommendation on Process

Timeline of prospective M&A process along with the steps/deliverables

6. Appendix

Buy-Side M&A Pitches

Lists the potential acquisition candidates and includes profiles of the companies. Also contains short information about valuation multiples of targets.



Chapter 9: Financial Data Sources

Financial Data Sources

If you are at a larger investment bank, you will have various paid data sources at your disposal. These include:

- Bloomberg
- CapitalIQ
- FactSet

For those that are not at a larger bank, one can use the free sources of financial data including:

- Yahoo Finance
- Google Finance

Yahoo Finance and Google Finance get their EBITDA numbers from CapitalIQ and their analyst EPS consensus estimates from there as well.

Investment banks typically do not want you to use the EBITDA from CapitalIQ, Bloomberg, FactSet and would



prefer that you spread the comps individually to get to EBITDA.

We are ultimately using the financial data sources to build and maintain our various indices associated with our coverage group.



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PART III: MANDATE/TARGET MATCHING



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Chapter 10:

Mandate/Target Matching

Why Mandate/Target Matching?

After building out one's coverage, the investment banker can then begin matching the investment mandates of strategic and financial buyers to potential target within their coverage.

Mandate/Target Matching Process

- I. Identifying Strategic & Financial Buyers
- II. Obtaining Investment Mandates
- III. Structuring Buy Side Engagements
- IV. Identifying Targets



Chapter 11: Identifying Strategic & Financial Buyers

Now that we have defined our coverage, we can go about identifying strategic & financial buyers consistent with that coverage.

We can use various database services and platforms to screen for these buyers which will end up being corporate M&A departments (strategics) or financial buyers (private equity).

Obtaining Investment Mandates

Strategic and financial buyers will have criterion within which they invest. For example, they have certain industries and sub-verticals that they focus on.

Criterion will specify:

- Geography



- Revenue
- EBITDA
- Vertical & sub-vertical

Structuring Buy Side Engagements

After obtaining the investment mandates and discussing with strategic and financial buyers, most of them will have some sort of boilerplate agreement to source deals for them in a buy side capacity.



Chapter 12: Identifying Targets

Identifying Targets

Now that we have investment mandates from strategic & financial buyers, we can go about screening for targets from databases such as Salesgenie.

After pulling the list of potential targets we then need to go in and analyze further each of the potential targets.

Applying the Mandate/Target Matching Methodology

The Mandate/Target Matching Methodology is the following:

1. Build relationships with strategic and financial buyers in a given industry sector or subsector (Use Mergr.com as a database within which to understand investment mandates and contact information)
2. Indicate your interest in sourcing deals on their behalf and obtain their investment mandate. This will usually



be detailed in a one-page teaser or presentation that they will send to you

3. Screen for companies that match the mandate(s) in Salesgenie.com and obtain CEO/owner emails and phone numbers
4. Begin emailing and calling CEO/owners and soliciting interest in exploring strategic alternatives
5. Structure as a sell-side engagement or a buy-side engagement depending on CEO/owner's level of interest in buying/selling
6. Collect historical financial data for the last three years
7. Introduce the financial and/or strategic buyer to the opportunity with the summary financial information and have them sign an NDA
8. Have a call with the financial and/or strategic buyer and then make the formal introduction to the CEO/owner and have a buyer/seller meeting



PART IV: ORIGINATION



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Chapter 13: Origination

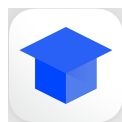
Why Origination?

Once we have built out buy side relationships within our coverage area, we then begin to source targets for our buy side partners. Origination is the primary work of the investment banker in order to keep the pipeline of deals full.

We can source targets for buy side engagements or structure a sell side engagement if appropriate.

Origination Process

1. Identifying Decision Makers
2. The Cycle of Origination
3. Initial Outreach
4. Preparing for the Pitch
5. Pitching



Chapter 14: Identifying Decision Makers

Identifying Decision Makers

After pulling a list of target companies within our coverage area consistent with buy side mandates, we need to get an understanding of the ownership structure of the target companies:

Owner vs. Management team

Owner vs. Management team

Obtaining contact information for the appropriate decision makers:

1. Rocketreach
2. Salesgenie
3. FastPeopleSearch or PeopleSearchNow



Chapter 15: The Cycle of Origination

The Cycle of Origination

In order to properly originate deals, we need to establish sell side relationships by giving market updates to executives, telling them what is going on in the M&A and capital markets. As the relationship is established, you can then pitch them strategic alternatives including selling their company.

Throughout the relationship building process, there will be lunches and dinners to catch up on what the target has been doing and their strategic plans.

Initial Outreach

1. Email origination strategy
2. Open to exploring strategic alternatives?
3. Exploratory Call
4. Introduction
5. Explaining coverage & buy side relationships
6. Timeline for an exit



7. Exploring strategic alternatives
8. Target valuation



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Chapter 16: Pitching

Preparing for the Pitch

From the initial exploratory call we are going to gather information at a high level in order to prepare a formal presentation exploring their strategic alternatives and what the sell side process would look like. Preparing the pitchbook occurs here as well.

Pitching

Walking the DMs through the pitchbook in order to explore what a sell side process would look like:

1. Timeline
2. Likely buyers
3. M&A landscape
4. Valuation



Chapter 17: Strategic Management & the Investment Banker

Investment Bankers identify the business opportunities that can generate the high equity valuations and work to coauthor strategic plans with C-level executives in order to take advantage of those opportunities. Investment bankers first analyze strategic alternatives and then pitch them to management after discussing the current status of the market in regular quarterly market update meetings. The market review discusses the status of the M&A market in general, financing, value chain of the industry, where ROA is coming from in sub-sectors of the industry, and what the equity markets are currently rewarding with a higher multiple.

This process means that in some capacity the investment banker is getting involved in the strategic management process as led by the C-suite of the firm. Strategic alternatives include identifying when to sell



opportunistically, when to get acquisitive, and identifying advantageous sources of financing. This helps the C-level avoid mistiming the market for large strategic actions taken by the firm.

The C-level should connect with their investment banker on a quarterly basis. The senior team can address strategic priorities with the investment banker and be briefed on strategic developments within the industry or sub-sectors. The banker keeps a pulse on the market and is a trusted advisor to the C-suite. When the banker identifies new developments relevant to the firm, the client and banker then work to coauthor strategies to deal with the new development.

Typically, the firm will meet with the banker for an annual review of strategic alternatives before its annual strategic planning process in order to incorporate the alternatives into planning if appropriate.

During the quarterly updates the banker uses their coverage indices broken down by sub-sector to identify where in the value chain the ROA is coming from and what the equity markets are rewarding with a higher multiple.

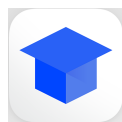
Essentially, investment bankers determine the valuation of the company under a number of strategic alternatives using comp companies, precedent transactions, DCF, LBO analysis and M&A analysis. The investment bank is usually



asked by a company or pitches the prospect of reviewing strategic alternatives for the company. The investment banker then recommends a process to be run by the investment bank in order to execute on the strategic alternative.

Consulting, KPIs & ROI

Consultants try to determine which KPIs are most connected to ROI (value drivers) and then make recommendations for turning the dial on those KPIs to drive ROI.



Chapter 18: Aligning Strategic Alternatives to C Level & Board Level Priorities aka Executive Alignment

Strategic Alternatives are Added to Close Gaps in C- Level & Board Level Strategic Priorities:

Before meetings with the client, the investment banker needs to do their research & preparation to understand the top C-level or board level priorities. They do this by reading the MD&A portion of 10k, earnings calls, and interviews with the media.

These strategic priorities ultimately have an expansionary or contractionary impact on line items in the financial statements (ex. Increase revenue, decrease costs). These changes in line items impact ROI which is why executives care about P&L and the line items on it. If you can drive



more revenue, decrease revenue churn, or decrease expenses, then you can make an adequate business case for a strategic alternative.

Key Questions:

1. What are strategic priorities?
 - EBITDA margin expansion
 - How many points of EBITDA margin expansion are they promising to the Street/investors?
 - Are we in an EBITDA margin contracting or margin expanding environment?
 - EBITDA growth
 - Multiple expansion

2. What goals have they targeted for their strategic priorities?
3. What KPIs are they using to quantify their strategic priorities?

Then align strategic alternatives to these goals & KPIs.
This is executive alignment.

Key Strategic Alternatives Question:

Where is the ROA coming from in the value chain and vertical/subvertical?

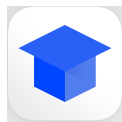


As in what functionality is being rewarded with better margins and a better multiple. This would be a key starting point when evaluating and planning corporate strategy. This will tell the C level what businesses they should be in or not be in.



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**PART V: FEE
STRUCTURING &
WINNING THE
MANDATE**



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Chapter 19: Fee Structuring & Winning the Mandate

Why Fee Structuring & Winning the Mandate?

In order to get paid, investment bankers have to land the engagement. Once the fee is agreed upon, the investment banker puts fee structure in something called an engagement letter. In the lower middle market to middle market, most investment bankers work on a success fee basis meaning that they only receive compensation on a deal when it actually goes through and closes.

Fee Structuring & Winning the Mandate Process

1. Type of Fee
2. Size of Fee
3. Sell Side & Buy Side Representation?
4. M&A Engagement Letter



Chapter 20: M&A Fee Structure

M&A Fee Structure:

Regarding fees, here is a simplified understanding of fee structure for sell side engagements. The key to remember here is that you do not make your money when you quote your fee, you make your money when you close the deal. The point is that I would rather win an engagement and give up 1% to 2% of the fee than have the seller think that I am not being fair. The Lehman scale simplifies this a bit but often times the seller will want to know the exact % that they will be paying you.

- Large cap – Lehman scale
- Mid cap – Lehman scale
- Small cap – Lehman scale
- Middle market – Double Lehman structure
- Lower middle market – 3% to 10%
- SMB: 10% to 12%



Chapter 21: Structuring the Fee

Type of Fee

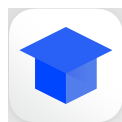
The category of the target and thus deal is going to drive the type of fee used by the investment banker. For SMB & lower middle market deals, you are usually going to see a success fee only. Middle market and above can be retainer plus a success fee.

Success Fee vs. Retainer + Success Fee

Size of Fee

In the lower middle market to middle market, fees usually are the following:

- 6% for <\$5M TEV
- 5% for \$5M-\$7M TEV
- 4% for \$7M - \$10M TEV
- 3% for >\$10M TEV



As you move higher than \$2M in EBITDA, the Lehman Scale appears and this is the preferred method for pricing the fee.

M&A Success Fee

In the SMB & lower middle market, most investment bankers work on a success fee basis meaning that they only receive compensation on a deal when it actually goes through and closes.

Buy Side & Sell Side Representation?

In the SMB & lower middle market, it may be possible to represent both the sell side and the buy side. This is less/not likely on larger deals.



Chapter 22: The Engagement Letter

M&A Engagement Letter

In order to get paid, investment bankers have to land the engagement. Once the fee is agreed upon, the investment banker puts the fee in writing in something called an engagement letter.

M&A engagement letter structure

The typical M&A engagement letter structure outlines the following:

- Term
- Exclusivity
- Size
- Other services
- Valuation



PART VI: UNDERWRITING



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Chapter 23: Underwriting

Why Underwriting?

Underwriting aids us in understanding the intrinsic value of the target company and pricing the company under various scenarios & methodologies.

Underwriting Process

1. Gathering Historical Financials
2. Building the Financial Statement Model
3. Finding Adjusted EBITDA
4. Deriving valuation from the three methodologies
5. Building the Valuation Football Field
6. Customizing the Financial Statement Model for Specific Transactions



Chapter 24: Model Building Concepts

There are three components of every financial model which correspond to each of the steps in order of building the model.

1. Descriptive portion of the model - the portion of the model with the last 3 to 5 years accounting data for the financial statement. The historical data is considered descriptive analytics.

2. Predictive portion of the model - the portion of the financial model projecting forward for the explicit projection period including terminal year. The projections are based upon previous years performance with ratios held constant or sensitized (drivers). The pro forma data is considered predictive analytics.



3. Prescriptive portion of the model - the portion of the model focused on optimization. This is where you find out the ROI & sensitize assumptions to determine how to achieve the highest ROI (ex. LBO model, football field's median line recommended valuation price). The optimization data is considered a prescriptive analytic.



Chapter 25: Data Science & the Analyst/Associate Role

Finance is an application in the Data Science & Analytics field. Where we take descriptive, predictive and prescriptive analytics and use them to make optimal ROI decisions. It follows that investment banking, being a field of finance would too be categorized under Data Science & Analytics.

Data Science & Analysis

Data analysts – examine information in order to find out actionable insights (patterns that lead to business outcomes).

Data science & analytics done in Excel & Access – create actionable insights to drive C-level decision making to improve business outcomes.

Need to clean, organize, model, analyze data to turn data records into meaningful Dataviz.



Clean dataset and model data, identifying patterns in data using analytic methodologies and Dataviz to display this pattern that affects business outcomes.

Data Science is on a project-by-project basis just like investment banking's deal by deal basis.

Pivoting Data – crosstab, building a pivot

- Field headings tables
- Insert pivot table
- New worksheet

Starting with Data Analysis

- a. Discover need
- b. Determine the business rules
- c. Find the data that fits the need and the rule
- d. Build the dataset
- e. Analytic methodologies to use
- f. Dataviz to show pattern or actionable insight that affects business outcome

Where did the data come from? Access tables file in MS Office

Investment Banking Application:

- Analysts & associates are the data science & analytics roles of investment banking
- They clean, model, apply analytic methodologies, and Dataviz for actionable insights



- Functions & formulas to get data when they don't have it in Excel
- Analysts & associates must know syntax or the language of Excel
- Ultimately investment banking is a combination of
 - Dealmaking (VP and above)
 - Data Science & Analytics (Analyst & Associate)

Syntax

Programmers must know the language of the programming platform they are using

How to write formula and functions (ie the language of Excel) ex. =EDate (,)

Knowing how to calculate data you don't have with formulas and functions is half the battle.

Analysis Process:

1. Descriptive Analytics
2. Predictive Analytics
3. Prescriptive Analytics
4. Dataviz

Excel for Data Analysis

Analytic methodologies to answer certain types of questions (typically related to a business issue)

Intro to Excel

- Excel is an electronic spreadsheet program (application)
- Store, organize, manipulate data



- Data goes into cells organized into rows and columns to then apply analytics methodologies and dataviz after that
- Each cell has its own address ex. A1
- Formulas for custom calculation and functions for prebuilt analytics
- Highlight data and headers applicable then recommended charts
- Pivot tables to view data from different perspectives, each sheet has its own tab in the workbook, Designing applied analytics to data sets and formatting for data viz to understand trends and relationships in the data
- Data analytics in Excel: with new data set, discover the facts about it by determining:
 - Mean
 - Median
 - Mode
 - Variance – one measure of error (distance of individual values from mean or average)
 - Standard deviation – sq root of the variance as a measure of polarity around mean
- How two sets of data vary in relationship to another, covariance of two data sets
- 0 means two data sets don't vary together
- Positive means move in same direction, more is stronger
- Negative means moves in opposite directions
- What is the covariance of that data pair (=COVAR), is the Covariance significant?



Chapter 26: Financial Modeling & Valuation Steps

- 1. Gather Historical Financials**
- 2. Build the Financial Statement Model**
- 3. Find Adjusted EBITDA**
- 4. Derive Valuation from the Three Methodologies Using Adjusted EBITDA**
- 5. Build the Valuation Football Field**
- 6. Customize the Financial Model for Specific Transactions & Find the Prescriptive Analytic**

1. Gather Historical Financials

Once the M&A mandate is won, we must now underwrite the deal. In order to underwrite the financial product, M&A, one needs to gather historical financials. This typically means trailing 3 years at minimum and ideally last 5 years. This will aid us building a financial statement model, explicit forecast, and ultimately a valuation football field to determine a final purchase price.



A Note on Accounting: Attribution & Proving Out ROI

Being able to attribute cost to investment and marketing decisions via accounting is important in terms of being able to compute and prove out ROI of investment decisions.

Accounting ultimately equals attribution. Without proper cost and revenue attribution its much harder to compute/trust ROI.

Accounting is about the proper attribution of revenue and cost in order to be able to prove out ROI of a set of investment decisions aka a business. Without proper attribution, business intelligence derived from data science and analytics is less/not possible. Accounting via its system of attribution rules allows us to score an investments ROI. Accounting is ultimately the standardized rules of attribution.

The rules of attribution lead to the formation of the standardized integrated financial statement model which will be the basis for ROI analytic analysis.

2. Build the Financial Statement Model

Once we have historical financials we can build the financial statement model which will be the basis for modeling various scenarios ultimately driving valuation.

3. Find Adjusted EBITDA

After receiving the financials for the target, the investment



banker must calculate adjusted EBITDA. EBITDA and Total Owners Benefits (TOB) are proxies for cash flow but not true cash flow of the business as there will be CAPEX and working capital deducted to get to true cash flow. Total Owners Benefit adds back taxes, interest, depreciation and owners benefit. This analytic will be the basis for extrapolating a valuation using the three methodologies.

4. Derive Valuation from the Three Methodologies Using Adjusted EBITDA

After arriving at adjusted EBITDA, the investment banker will determine public comps and extrapolate a multiple for the target company adjusting for size of the company. From there, precedent transactions will be spread to determine a mean multiple.

DCF Method:

Most Accurate Benefit Stream That Reflects the Nature of the Economics of the Enterprise: Free Cash Flow

Free Cash Flow = Cash flow from operations on SCF financial statement - CAPEX. CF Operations includes taxes and working capital already removed.

Getting from EBITDA to FCFF = tax effecting EBITDA(1- tax rate), adding back depreciation(tax rate), removing CAPEX, removing working capital

5. Build the Valuation Football Field

Finding the midpoint of the valuation methodologies can be



used for determining valuation but the range is often communicated to the client or potential buyers.

6. Customize the Financial Model for Specific Transactions & Find the Prescriptive Analytic

After building out the financial statement model, we can build the transaction specific model related to particular buyers that have expressed or may have interest.



Chapter 27: The Analyst Process

An analyst provides actionable insights from data to tell the ROI story.

1. Plan - Strategist to plan out which KPIs or value drivers in the process drive ROI

2. Collect - How to collect the KPI data regarding the process from attribution sources

3. Analyze – Within the analysis process we have the subprocess which is: a. Descriptive analytics b. Predictive analytics b. Prescriptive analytics to model the data from the KPIs to determine relationships and trends in the data and how to optimize given the relationships and trends

4. Report - A concept known as Dataviz (infographics) to create visually appealing actionable insights from the data



STEP VII: PACKAGING



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Chapter 28: Packaging

Why Packaging?

After underwriting the financial product (ex. M&A), we can move forward with packaging in the form of various marketing material including a teaser and Confidential Information Memorandum (CIM).

After finding adjusted EBITDA and determining valuation, the investment banker can build the marketing material for the target company which includes a teaser and a CIM. The teaser is a summary of the client's key selling points.

Packaging Process

1. Teaser Creation
2. Confidential Information Memorandum (CIM)



Chapter 29: The Teaser

Teaser

After creating the teaser, the investment banker goes into greater detail in a marketing document called a CIM. This document is distributed to buyers after the teaser and is for the serious buyers to do an in depth analysis of the target.

Building the Teaser

The teaser is a summary of the client's key selling points. The teaser can be broken down in the following manner along selling points including:

1. Overall financial profile: three years of historical revenue and EBIT/EBITDA and at least two years of projected revenue and EBIT/EBITDA
2. Indicate type of transaction
3. Indicate sustainable growth potential based upon competitive advantage:
 - a. Customer entrenchment and high switching costs
 - b. Long term contracts



- c. Brand recognition
- d. Intellectual property
- e. Stable management teams
- f. Culture



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Chapter 30: The Confidential Information Memorandum (CIM)

Confidential Information Memorandum (CIM)

The CIM is the primary marketing document associated with sell side M&A. The document is filled with information on the target company including products/services, financials and markets. The teaser comes before the CIM and the NDA must be signed in order to get the CIM.

Building the CIM (Confidential Information Memorandum)

After creating the teaser, the investment banker goes into greater detail in a marketing document called a CIM. This document is distributed to buyers after the teaser and is for the serious buyers to do an in depth analysis of the target.



The typical breakdown of a CIM goes along the following lines:

- 1) Overview and Key Investment Highlights
- 2) Products and Services
- 3) Market
- 4) Sales & Marketing
- 5) Management Team
- 6) Financial Results and Projections
- 7) Appendices

As an investment banker, you are going to want to demonstrate the following:

1. Future prospects are growth oriented
2. Opportunity for operational improvements
3. Now is the ideal time
4. Annual growth rate strong
5. EBITDA margins good
6. Relatively low CAPEX and WC
7. Strong FCF
8. Leadership in market/sub-market
9. Growth in market size
10. Defensible business model
11. Experienced management
12. Nature of the revenue:
 - Diverse customer base
 - Recurring
 - Long term agreements



PART VIII: BUYER LIST



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Chapter 31: Buyer List

Why Buyer List Creation?

After landing the M&A engagement, the investment banker will need to build a buyer list and then begin outreach to the buyer list to generate interest. In order to build a buyer list, the investment banker uses a database service to pull a list of likely strategic and financial buyers along with contact information in order to run the M&A process and build a market for control of the business.

After finalizing the buyer list from the database, the investment banker can then begin contacting each prospective buyer in the list. Contacts should be to the corporate M&A representative for large corporations or CEOs and owners for lower middle market companies.

Buyer List Process

1. Database Utilization
2. Strategic Buyers
3. Financial Buyers
4. Initial Outreach



Chapter 32: Buyer Profiles

Buyer Profile: Individuals & Search Funds

Individuals and search funds like to be in the 3x to 4x range. Be sure to qualify these individuals ahead of time. You realistically only want financials and strategics talking to the seller for deals with approx \$1M of EBITDA up. Deals south of \$1M EBITDA, you start to get into the individual buyer range of reasonability.

You still may want to qualify individual buyers to make sure you are talking with PE and strategics for deals approx. \$500k EBITDA up. Individuals and PE search funds should be looking at smaller deals where their multiple expectations of 3x to 4x are in line with the size of the company.

On solid deals, the seller is willing to wait for a strategic buyer even if it takes a longer time period.

Individual buyers are looking for companies that they can run passively and work on growing the business instead of working in the business doing the manufacturing, building



the product etc. They do not want to be operators in addition to owners. Unfortunately, their multiple expectations of 3x to 4x are very close to only qualifying them to speak with owner/operator businesses.

Buyer Profile: Lower Middle Market Private Equity

Comes in at about \$1M of EBITDA and wants to be in the 5x range. Sets your buyer floor. LMM PE funds typically look at deals in the \$1M to \$3M of EBITDA range.

Buyer Profile: Middle Market Private Equity

Minimum EBITDA of \$2M for a platform to pursue a roll up in the space. 7x EBITDA up from there.

Buyer Profile: Strategic Buyers

Strategic buyers come in at ~\$500k of EBITDA and provide a valuation floor of 5x EBITDA.

Lower Middle Market & Middle Market M&A Multiples

It is crucial for investment bankers to understand the M&A marketplace in the middle market and particularly for the industries that they cover. In M&A, everyone goes off of multiples of adjusted EBITDA.

It is important for the investment banker to have a strong understanding of multiples in the M&A marketplace in general and then in his/her sector and sub-sector. In general in the middle market, we typically see 7x - 7.5x EBITDA



for companies that are larger than \$25M in TEV. For companies that are smaller than \$25M in TEV, we typically see 5x - 5.5x EBITDA. There are adjustments that need to be made for size and predictability of revenues as well as for certain sectors (ex. software).

In the lower middle market to middle market, multiples usually are the following:

- 4x for <\$1M EBITDA
- 5x for ~\$1M EBITDA
- 6x for \$1M - \$2M EBITDA
- 7x for >\$2M EBITDA

This is the method that we use at AltQuest Group to quickly value companies on the back of a napkin in discussions with CEOs and owners of companies. It can help set expectations with CEOs and owners and provide a roadmap to increasing valuation to meet a target (for example, \$5M or \$10M in Total Enterprise Value (TEV)). Additional services can be provided to the company to move the company through the different phases of growth in addition to M&A such as growth advisory (management consulting).



Chapter 33: Tapping into the Buyer Database

Database Utilization

The investment banker has by now, built up a database of likely strategic and financial buyers in the industry along with their Investment mandates. The key question is:

Which of the strategic and financial buyers' investment mandates are consistent with this M&A opportunity?

Strategic Buyers

Since the investment banker has been doing coverage in a select vertical and has the investment mandates of the top players in that area, they are going to have an idea of the most likely top buyers including:

1. Larger competitors
2. Suppliers
3. Customers
4. Related industry



Financial Buyers

Is the M&A opportunity consistent with investment mandates?

Financial buyers include private equity groups that make an acquisition in an industry and then grow that business through add-on acquisitions.

Evaluate an acquisition based upon financial characteristics like cash flow.

Plan to own company for 3 to 8 years and then exit to a strategic buyer or financial buyer.



Chapter 34: Outreach to Buyers

Initial Outreach

Initial outreach follows a pattern where the high level teaser will be distributed to generate interest in learning more. From there the investment banker will get an NDA signed with the buyer to then review the CIM.

- I. Distributing the teaser
- II. Signing the NDA
- III. Confidential Information Memorandum (CIM)



PART IX: DEAL STRUCTURING



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Chapter 35: Deal Structuring

Why Deal Structuring?

After building & executing on a buyer list, it is up to the investment banker to work with the buyer and seller to structure a deal. This means negotiating the valuation range and deal terms.

Deal Structuring Process

1. Valuation Range
2. Deal Terms



Chapter 36: Valuation Range & Deal Terms

Valuation Range

Deal structures initially involve a rough range of valuation to make sure that both parties are in the sphere of reasonability. Reasonable deals typically look like the following:

- 4x <\$1M EBITDA
- 5x ~\$1M EBITDA
- 6x \$1M - \$2M EBITDA
- 7x >\$2M EBITDA

Deal Terms

From there we should get an understanding of whether this is:

- Asset Sale vs. Stock Sale
- Cash vs. Stock vs. Cash & Stock
- Going to be a majority or minority ownership deal



- Whether the owner plans on staying as a CEO after the transaction or whether there is existing management in place
- Owner financing is available
- Earn outs

Asset Sale vs. Stock Sale

An asset sale in M&A does not mean distressed but rather is where a buyer acquires the assets of a company rather than the stock.

In a stock sale, the depreciation schedule is transferred to the new buyer.

Purchase Price Allocation

The purchase price allocation forms points of negotiation where hard assets are stepped up to the purchase price.



Chapter 37: Dealing with Sellers in the Lower Middle Market/Middle Market

Most sellers that are interested in having a discussion are 1 to 5 years away from actually selling. They either are waiting for a strategic buyer or simply need to grow a few more years to hit a target valuation to be in line with the lower middle market/middle market valuation spectrum:

- \$500k to <\$1m is 4x
- \$1m is 5x
- \$1m to \$2m is 6x
- >\$2m is 7x

Since sellers are likely a few years away even if you get a fee agreement in place, getting questions answered and a buyer/seller call will take time. Sometimes a year. Patience is the key here as M&A operates on an entirely different



timeline that the rest of business. A business owner will sell his/her business once in a lifetime so 3 to 5 years is about the standard for an exit once he/she responds that he/she would be willing to explore his/her strategic alternatives.



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Chapter 38: Dealing with Buyers in the Lower Middle Market/Middle Market

When waiting for financials from the seller, go for a buyer/seller call in the interim to move the process forward. If the buyer wants to wait for financials, then request that the buyer write out their questions of the seller in an email and then forward these questions to the seller. This should set up the next step which is the buyer/seller call. After which financials will be more forthcoming. In fact, it is better to not even ask for financials from the seller until after having the buyer/seller call. Business owners feel more comfortable handing over financials to individuals that they have actually spoken to. If the buyer is only concerned with the numbers, the questions can be regarding top line and EBITDA for last three years; this will serve as the questions which will then set up the call.



Qualifying Buyers

When buyers inquire through M&A marketplaces often times they only appear as individual buyers which typically only pay 3x to 4x EBITDA. Since our LMM/MM Valuation Guide will generally require a higher multiple, it is important to screen out these individuals by saying the following:

“Sure, I’d be happy to. Would you be buying the company individually or on behalf of a corporation”

Since most sellers do not have to sell, they are willing to wait for the right strategic buyer to purchase their company in line with the LMM/MM valuation guide.



PART X: M&A PROCESS



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Chapter 39: M&A Process

Why M&A Process?

Since M&A is the primary product of the investment banker, it's important to understand that the M&A process. The M&A process refers to the defined process of buying/selling the controlling ownership of a company.

M&A process may be different at different deal sizes.

M&A Process

- I. IOI From Buyer
- II. Buyer Seller Meeting
- III. Purchase Agreement Given to Seller
- IV. Signed Purchase Agreement with Different Terms
- V. Enter Due Diligence
- VI. Complete Due Diligence
- VII. Closing & Flow of Funds

I. IOI From Buyer



After reviewing the teaser and summary financials, the buyer will notify you that they are interested in purchasing the company (IOI).

II. Buyer Selling Meeting

After submitting the IOI, you will arrange an in person meeting with the seller which is called the buyer seller meeting. If the buyer is unavailable due to distance or timing, a phone call can be set up.

III. Purchase Agreement Given to Seller

After the buyer seller meeting, you prompt the buyer to submit a purchase agreement and then give this purchase agreement to the seller.

IV. Signed Purchase Agreement with Different Terms

After the seller reviews the purchase agreement they will either sign the contract or counter with different terms. They are to sign the contract with the contingencies written into the contract.

V. Enter Due Diligence

After receiving the counter, the buyer can sign the agreement which makes for a legally binding purchase agreement contingent to the items that will now be explored during the due diligence period. As items are explored, the buyer signs off that the items are no longer in question one by one.



VI. Complete Diligence

After all the items in the due diligence list are completed, due diligence is now completed and the closing can be scheduled. The documents are sent to the closing agent with instructions as to the M&A fee as well.

VII. Closing & Flow of Funds

After the both the buyer and seller sign at the closing, the checks are cut and you receive your M&A fee and bring it to your bank or have the fee wired to your account. Make sure that your firm is on the Flow of Funds document to ensure that you get paid.

Letter of Intent (LOI)

The LOI is non-binding except for a few terms:

Non-disclosure

No shop clause

LOI states terms of what the deal will look like and then allows the buyer time to verify the information presented and creates a roadmap for attorneys to craft the final purchase agreement.

Price and structure should be settled in the LOI without negotiation left afterwards.

Details should include:



- Seller note
- Earn out
- Compensation agreement for seller if staying on
- Status of net working capital items
- New ownership cap table is seller is retaining ownership

Purchase Agreement

After the strategic or financial buyer decides to draft an LOI and proceed with an acquisition of a given target, the purchase agreement will need to be drafted. In the LMM, the investment banker may draft the agreement himself/herself, but as transactions get larger, M&A attorneys will be involved and take the lead with the creation of the purchase agreement. The investment banker will stay actively involved in the drafting of the agreement.

While due diligence is going on, attorneys take boilerplate purchase agreement and modify them to include items of the LOI.

Once due diligence is complete, the purchase agreement should be done for closing.

Due Diligence

LOI to accept price and terms.



Due diligence is open book time where the buyer investigates the business to see if it is how the seller represented it.

SMB due diligence:

Standard asset purchase agreement is provided by M&A professional and contingencies for due diligence placed in the contract.

A buyer agrees to purchase the company provided the conditions are met. Due diligence items are checked off in writing as they are dealt with and a binding contract is remaining so you are ready to close.

Ex. The “book check” is done by the buyer or CPA

You can use Dropbox or Google Docs

LMM and MM Due Diligence:

Begins with IOI or non-binding LOI. The definitive purchase agreement is not created until after due diligence.

Use V-rooms or Firmex

Usually takes 60-90 days

The definitive purchase agreement is written to address issues discovered in due diligence, otherwise is boilerplate.



Minimum Financials to Do a Deal

The minimum amount of financials to get a deal done is the following:

- Last three years P&L
- Year To date (YTD) P&L
- Last Twelve Months (LTM) adjusted EBITDA to price an offer

This should be easy to get if the owner has QuickBooks or another accounting software.

M&A process in MM and above:

1. Teaser
2. NDA
3. CIM
4. Term sheet
5. LOI
6. Due diligence
7. PSA - purchase agreement
8. Closing & flow of funds



APPLICATIONS



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Chapter 40: How to Break into Investment Banking

How to Break into Investment Banking

Instead of taking the traditional route into investment banking, Investment Banking University advocates taking a different route. Instead of becoming solely a master of financial modeling & valuation in order to hopefully get a chance to become an analyst, IBU advocates getting experience working in an SMB & Lower Middle Market M&A group or forming your own M&A firm in the SMB or lower middle market in order to gain experience actually running the front office investment banking process.

The individual that has actually done the work of a senior banker successfully at a smaller level can scale up into larger and larger deals and ultimately enter investment banking from a position of strength rather than weakness.



Chapter 41: How to Land Your First Buy Side Relationship

How to Land Your First Buy Side Relationship

In order to land your first M&A deal, it is going to be important to internalize and execute the front office investment banking process which is defined in this book. This means that the individual will establish their own coverage by region, size, and vertical. From there the individual will, consistent with their buy side coverage, reach out to corporate M&A departments and financial sponsors to establish buy side relationships.



Chapter 42: How to Land Your First M&A Engagement

How to Land Your First M&A Engagement

Once the individual understands the buy side mandates and has the relationships in place, the individual can determine targets consistent with those mandates and then begin the origination process by reaching out to the owners of the target companies to gauge whether they are open to exploring their strategic alternatives. The individual can then negotiate their fee with the business owner which will most likely be structured on a success fee basis.



Chapter 43: How to Build a Lower Middle Market/Middle Market M&A Practice Methodology

How to Build a Lower Middle Market/Middle Market M&A Practice Methodology:

In order to build a lower middle market (LMM) or middle market (MM) M&A practice, the investment banker will ultimately be undertaking the front office investment banking process at the firm level. It's going to be important to define the investment product that one will be utilizing (i.e. M&A, financing, growth advisory) along with the vertical coverage. From there, the firm needs to build its own index within its coverage vertical to begin tracking developments that will affect the M&A market (multiple, margin & growth rate tracking). In addition to indices, the firm will need to transform this data into coverage



marketing material in the form of teasers and reports/presentations.

Decide on the industry/industries that you will cover, read/research the value themes/players/multiples in the industry on the following levels:

- Large cap
- Mid cap
- Small cap
- Middle market
- Lower middle market
- SMB

Pick an initial vertical and sub-vertical to cover. For example, an advisory firm can use:

- Manufacturing
- Software
- Business Services
- Healthcare

After choosing your coverage, the investment banker is then to build an index for each of the verticals and sub-verticals made up with the public comps.

Manufacturing

- Durable consumer



- Non-durable consumer
- Aerospace & defense
- Building products
- Industrial
- Medical

Software

- Traditional software
- SAAS
- Internet

Business Services

- Education & Training
- Business Process Outsourcing
- Facility Services and Industrial Services
- Human Resources
- Information Services
- Marketing Services
- Real Estate Services
- IT Services
- Specialty Consulting

Healthcare

- Dental Product
- Dental Providers
- Medical Devices & Products
- Medical Product Distribution
- Specialty Providers



- Pharma Services
- Practice Management
- Provider Services
- Long Term & Behavioral Care

The investment banker then spreads each public comp and the financial data feeds into the median and average for the vertical and sub-vertical which ultimately ends up in the research (industry report, newsletter), pitchbooks, and CIMs of the investment bank. For investment banks with an equity research department, financial statement models will be built for each public comp that is being covered and consensus EPS data taken from research reports will be used to establish the value of the public comp.

The investment banker ultimately uses the vertical index and sub-vertical index to perform proprietary research and develop industry reports and newsletters which will aid in coverage and ultimately origination. The research, which we will go into greater detail on later in the book focuses on vertical and sub-vertical trends in margins, multiples, and M&A.

After establishing one's coverage and then building an index for the vertical and sub-vertical as well as establishing relationships with strategic and financial buyers within the vertical and sub-vertical, the investment banker may begin advising targets on their strategic



alternatives using information gleaned from the vertical and sub-vertical indices. Regarding the vertical index and sub-vertical index, the investment banker ultimately tracks trends in:

- Growth rates
- Margins
- Debt to Equity
- Multiples

The investment banker takes the index and establishes tiers which turn into peer groups. This is why we pull public comps; to benchmark a target against the comps. By comparing a target's level of performance to its peers and the industry in general the investment banker can determine when it is ideal to exit the business (when multiples) and when it is not (when multiples are weak). This is how investment bankers advise on strategic alternatives.

