

**The Ties That Bind: M&A Challenges for Buyers of  
Family-Held or Founder-Owned Businesses**

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1. PowerPoint

## The Ties That Bind: M&A Challenges for Buyers of Family-Held or Founder- Owned Businesses

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## Agenda

- I. Anatomy of a Deal – The Sale of an American Icon**
- II. Tax Structuring Issues**
- III. Key Deal Considerations – When Price Is Not Paramount**
- IV. Preparation For the Sale**

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## Anatomy of a Deal – The Sale of an American Icon

HILLERICH & BRADSBY CO.

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### Hillerich & Bradsby Co., 131 Years of Baseball

- JF Hillerich opened his woodworking shop in 1855 – made stair railings, porch columns, and butter churns
- In 1884 John “Bud” Hillerich made a bat for Pete Browning, who played for the Louisville Colonels
- In 1905 Honus Wagner was signed, becoming the first major league player to endorse a bat
- During WWII, H&B transitioned to rifle stocks and billy clubs for the U.S Army
- Diversification into aluminum bats, composite bats, fielding gloves, batting gloves, protective gear, bags, and more



HILLERICH & BRADSBY CO.

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## Hillerich & Bradsby Co., Recent History / Challenges

### Recent Timeline:

- 1990s: Competitors begin to offshore production, H&B slow to respond
- 1999: Litigation of Batted Ball cases begins
- 2000: Pro players (i.e., Barry Bonds) begin to shift preference to Maple vs Ash, H&B slow to respond
- 2000: DiMarini acquired by Wilson
- 2002: Wood Bat competitor Marucci founded
- 2003: Standards put in place for Non-Wood Bats, commoditizing performance
- 2005: IOC votes to drop Baseball and Softball from Summer Olympics as of 2012
- 2006: Easton acquired by Fenway Partners
- 2008: Aluminum and Composite manufacturing moves to Asia
- 2012: Slugger Fast Pitch bat recall: Treated the customer right, but impact to balance sheet was significant

## Hillerich & Bradsby Co., “Adapt or Die”

PAST



Family  
Follower  
Manufacturer

FUTURE



Team  
Innovator  
Product Marketer

## Tax Structuring Issues

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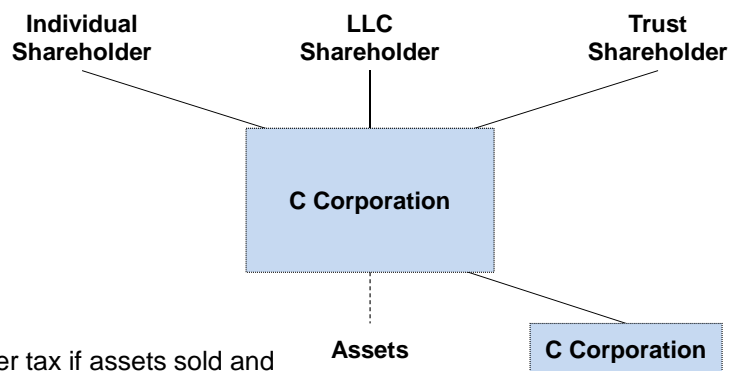
- **Acquisition of privately held company may present range of structuring options**
- **Potential for stepped up basis in assets (including amortizable goodwill)**
- **Value of stepped up basis to buyer vs. tax costs to seller**

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- **Structures**

- **Asset purchase**
  - State transfer tax issues
- **Stock purchase**
  - C corporation
  - S corporation—with or without 338(h)(10) or 336(e) election
- **Purchase of LLC Units**
  - 100% or some lesser percentage?
  - Pre-acquisition conversion of S corporation into LLC—useful where less than 100% purchase or concerns about validity of S election
- **Tax-free reorganization if there is stock consideration?**
- **Purchase price allocation**

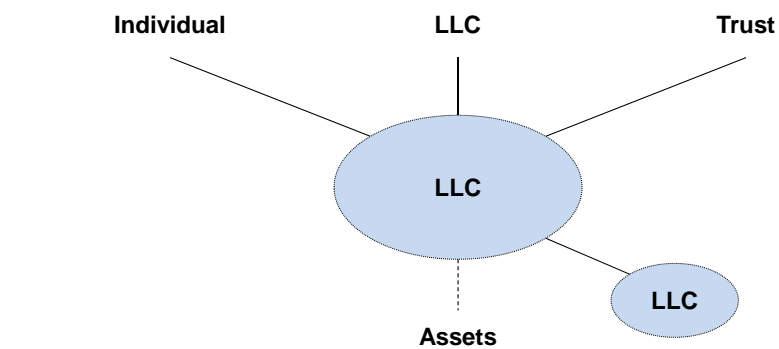
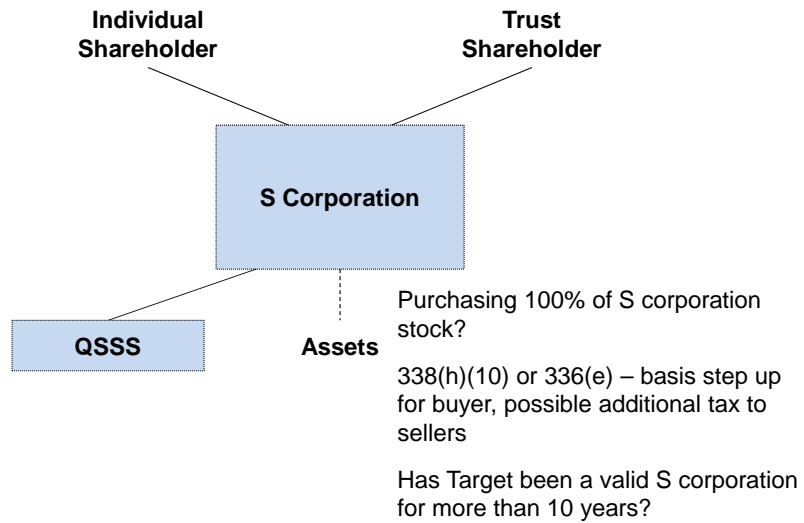
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Two-tier tax if assets sold and corporation liquidated

No basis step up to buyer in stock purchase (possible exception: sale of subsidiary)

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Basis step-up for buyer

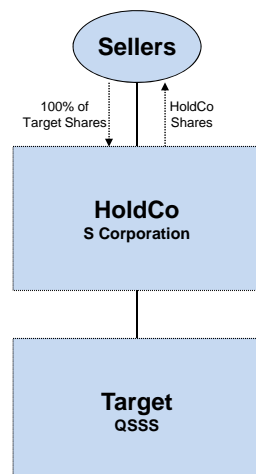
## Conversion of S Corporation to LLC

### Example:

1. Buyer has agreed to buy all of the stock of Target S corporation; parties have agreed to make Section 338(h)(10) election to treat the transaction as an asset sale/purchase.
2. However, Target has faults in its S election that could jeopardize the Section 338(h)(10) election.
3. In order to ensure that the transaction is treated as an asset purchase, Seller agrees to convert Target to LLC before closing.

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## Step 1: Formation of HoldCo



Sellers contribute all of their Target S corporation shares to HoldCo in exchange for HoldCo shares.

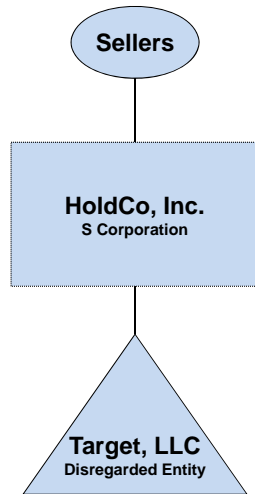
HoldCo makes an election to be treated as an S corporation.

Target makes an election to be treated as a qualified subchapter S subsidiary.

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## Step 2: Conversion to Target, LLC



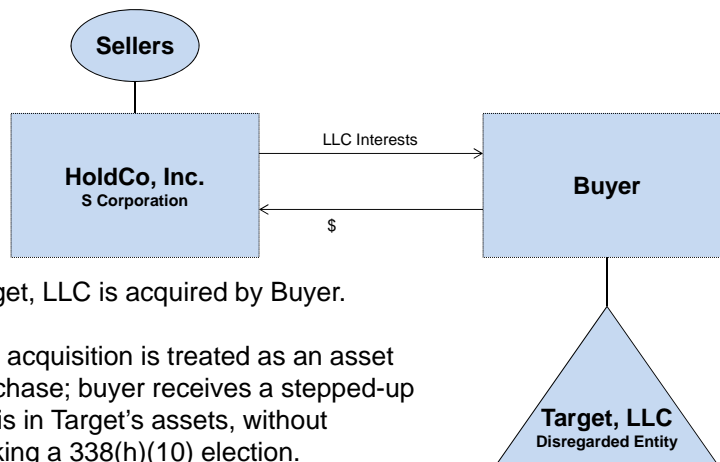
Target is immediately converted to a limited liability company (with no check-the-box election).

Step 2 is treated as a Section 332 tax-free liquidation of Target, and Step 1 and 2 together are treated as tax-free “F” reorganization.

No gain is recognized by Target, HoldCo, or the Sellers.

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## Step 3: Purchase of Target, LLC

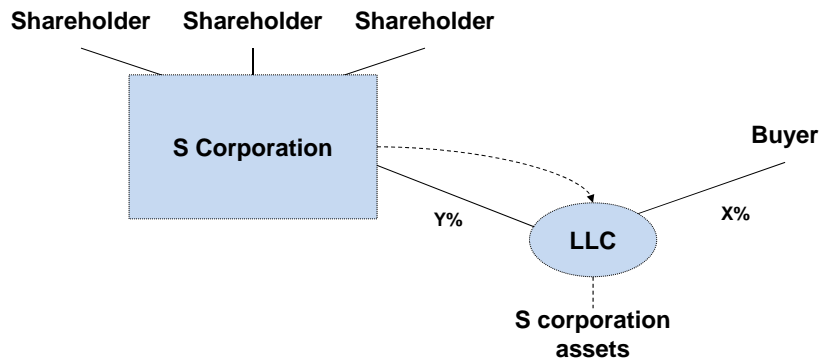


Target, LLC is acquired by Buyer.

The acquisition is treated as an asset purchase; buyer receives a stepped-up basis in Target’s assets, without making a 338(h)(10) election.

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## Conversion of S Corporation to LLC (simplified)



S corporation contributes substantially all assets of S corporation to newly-formed LLC

Buyer purchases X% of LLC interests

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## When Price is Not Paramount

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## Hillerich & Bradsby Co., Stakeholders

- Did the structure of the deal maximize shareholder value?
- Did the sale of the LS brand make sense for the family?
- How did the sale impact employees?
- Did the sale provide on-going value for the city of Louisville?



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HILLERICH & BRADSBY CO.

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## Preparing for the Sale

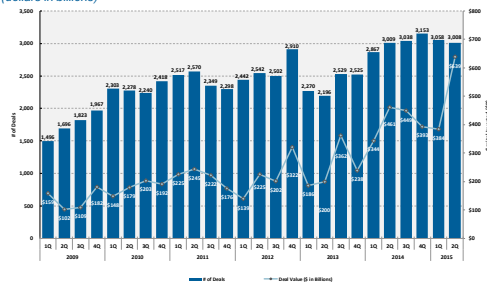
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M&A Market Update

U.S. M&A market – overview

- M&A deal activity has increased substantially since the recession of 2008-2009 and remains extremely strong.
- The M&A market continues to draw strength from hungry strategic and financial buyers, buoyed by strong lending conditions:
  - Strategic buyers are seeking growth opportunities once again as companies are sitting on large levels of cash – near the highest levels in 40 years
  - Pent-up demand from financial buyers with deep pockets
- The pace of transactions in the first half of 2015 is above the same period in 2014.

U.S. M&A Activity by Quarter 2009 to Q2 2015  
(dollars in billions)



- ✓ Number of deals in Q2 2015 stayed nearly consistent over the same period in 2014
- ✓ Deal value in Q2 2015 up nearly 39% over the same period in 2014



Source: FactSet Mergerstat

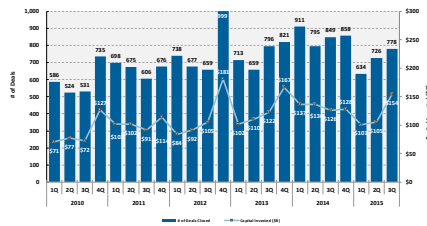
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M&A Market Update

U.S. M&A market – private equity

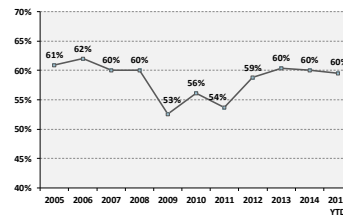
- Private equity continues to drive a significant amount of the deal – as buyers and/or sellers in a large percentage of transactions.
- Deal activity involving private equity is expected to remain strong through the end of 2015 with a high-level of dry powder and continued fundraising strength. The \$523 billion of capital invested in 2014 was the highest amount since 2007, providing an enormous pool of cash for acquisitions.
- In deals where private equity is a buyer, debt represents 60% of the purchase price on average.

U.S. Private Equity Deal Flow by Quarter 2010 to Q3 2015  
(dollars in billions)



Source: Pitchbook.com

U.S. Private Equity Median Debt Percentage 2005 to Q3 2015



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M&A Market Update

U.S. M&A market financing – historically low interest rates

- Continued strong liquidity in debt markets along with robust cash flow loans in the middle market:
  - Last twelve months characterized by unprecedented excess liquidity, which is expected to continue throughout 2015
  - More aggressive lending at the lower end of the size spectrum, specifically, decreasing EBITDA thresholds
  - Slight tightening in credit markets for deals with "hair" as lenders are flush with deals and year-end is looming
- Commercial banks are facing increased competition for assets from an ever-expanding universe of non-bank lenders without federal reserve capital restraints.

Current Leveraged Cash Flow Market Trends

Deal Component	Current Leveraged Cash Flow Market Trends	
	September '15	
CF Senior Debt / EBITDA	<\$7.5MM EBITDA 1.50-2.50x	>\$10MM EBITDA 2.5-3.5x
Total Debt / EBITDA	<\$7.5MM EBITDA 3.00-4.00x	>\$10MM EBITDA 3.75-4.50x
Senior CF Pricing	L+2.5%-3.5% (bank) L+4.0%-6.0% (non-bank)	
One-Stop Pricing	<\$7.5MM EBITDA L+ 8.0-11.0% floating; 1.0% floor >\$10MM EBITDA L+6.0-9.0% floating; 1.0% floor	
Subordinated Pricing	<\$7.5MM EBITDA 12.0%-14.0% >\$10MM EBITDA 11.0%-13.0%	
LIBOR Floors	No LIBOR floor for most bank deals 1.0% for non-bank deals, second lien and floating rate one-stops	
Minimum Equity Contribution	25.0%-35.0% total equity (including rollover); minimum 10.0% new cash combined with rollover or seller notes	

Source: SPP Equity Sponsors Middle Market Leveraged Finance Update



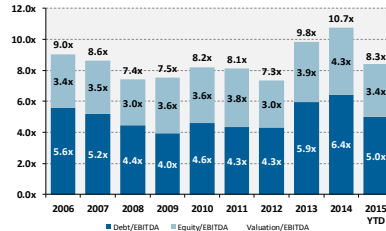
M&A Market Update

U.S. M&A market – private equity

- The heated investment environment has led to a slow rise in multiples over the past few years, along with a rise in debt usage. Competition for quality targets, as well as the increasing prevalence of auction-type deals, has led to increased prices as buyers bid strongly for the best companies.
- Data so far this year indicates a slight decline in valuation-to-EBITDA multiples, prompted by a combination of slightly lower quality companies for sale and somewhat less aggressive lending.

U.S. Private Equity Median EBITDA Multiples for Buyouts

2006 to Q3 2015  
(dollars in billions)

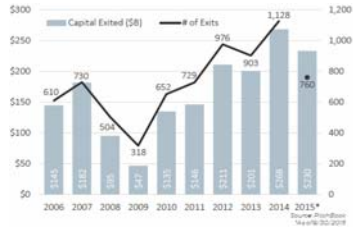


Source: Pitchbook.com



**U.S. Private Equity – Exits by Type of Deal**

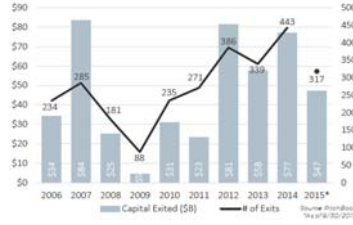
**U.S. Exit Flow by Year**



**Corporate Acquisitions by Year**



**Secondary Buyouts by Year**



**U.S. PE-backed IPOs**

