VALUE ENHANCERS FOR COMPANIES THAT PERFORM SERVICES IN THE FIELD

WHY BUYERS ARE INCLINED TO PAY MORE FOR SOME COMPANIES VERSUS OTHERS

GREENWICH CAPITAL GROUP

GREENWICH CAPITAL GROUP

GREENWICH CAPITAL GROUP'S ("GCG'S") PERSPECTIVES ON KEY FACTORS THAT INFLUENCE COMPANY VALUATIONS

For owners of middle-market companies, the need to balance growth versus profits is a common decision point. At the same time, preparing for a sale of the business and positioning the company for greater value to buyers is important as well.

Positioning the company to achieve maximum value in a sale is difficult though. Since most owners have never sold a company before, they do not have the benefit of knowing how buyers view certain factors that play into the valuation. What personnel/systems to invest in; what areas of the business to commit more time and resources; and which growth opportunities are worthwhile to pursue, are just a few examples of important questions owners routinely come across throughout the stages leading up to a sale. Too often they are addressed based on the goal of maximizing short-term profitability versus the future sale value. Actions taken in that regard can often be a detriment to the value buyers might otherwise be willing to pay for the business.

GCG explores a variety of factors throughout this publication that are common to companies that perform services in the field or at customer facilities. They are relevant to most companies regardless of the specific types of services performed. Throughout each of the areas identified, GCG offers guidance and viewpoints on how buyers view certain characters that could enhance or detract from the value in a sale.

1. INVEST IN MANAGEMENT

Management is the most critical aspect for any company and developing a leadership team capable of professionalizing and growing the business can have a large impact on its valuation. Yet investing in management is often a point of resistance among business owners. For instance, owners of companies that are making good money, maybe even earning above industry average profit margins, tend to focus on the bottom line and maximizing annual distributions (the amount of money they put in their pocket every year after all expenses are covered). Often, the cost of hiring additional managers is considered counterintuitive to this effort.

While keeping overhead expenses low may seem practical, failure to invest in management can limit the company's potential. One – it forces a heavier reliance on ownership to drive the company's success; and two – it limits the bandwidth for a company to implement strategic initiatives, develop additional competitive advantages, capitalize on opportunities to grow, and navigate well throughout various market cycles. In the eyes of a buyer, the lack of quality management is a negative factor that can weigh heavily on the price it is willing to pay for a business. On the contrary, a company with strong leadership that has demonstrated the management team can work together cohesively, drive sales growth, improve profitability, and make good decisions that drive long-term strategies will be more valuable to a buyer.

What constitutes a strong leadership team? How many managers and what functional areas?

The answer is not always clear and can vary from business to business. The important thing is to find leaders that align with the company's objectives but also bring new ideas and perspectives to the table. Embracing the culture and working well together is a critical component as well.

In terms of functionality, having a clear Chief Executive Officer ("CEO") or President is important. This position can be held by an owner and oftentimes an owner is best suited for the job. This position does not need to be held by a shareholder though, and in many cases having a clear leader brought in from the outside can be valuable.

If the CEO or President is an owner, then that person's intention for after the sale becomes very important. If the owner intends to continue as the CEO or President after selling (3-5 years is a good guideline to follow), buyers view that as a positive. Alternatively, if that owner is looking to retire or focus their efforts elsewhere, most buyers will view the position as a hole to fill, unless the owner has groomed someone internally to step into the role. Even grooming a replacement CEO or President carries transition risk, so to the extent possible, effecting this leadership change by promoting the

A company with *strong leadership* that has demonstrated the management team can work together cohesively, drive sales growth, improve profitability, and make good decisions that drive long-term strategies **will be more valuable to a buyer.**

replacement and slowly phasing the owner out well before the sale can help mitigate the perceived risk to the buyer. Essentially, the goal is to demonstrate enough of a track record with the replacement CEO or President to prove the change has been effective.

A Chief Operating Officer ("COO") or Director / VP of Operations is another key management position for field service companies. The title is less relevant, but having a leader focused on enhancing the operational side of the business and enabling the CEO or President to focus on other strategic initiatives can be valuable. A Chief Financial Officer ("CFO") or Controller with a strong accounting background is an important leadership position as well. The areas of financial management and accounting are often underappreciated by owners, especially ones that are focused more on top-line growth. As such, they tend to underinvest in these functions. Substantial value can be created though when decision-makers have a better pulse on the bottom line. A strong CFO or Controller is also worth well beyond their cost when the company is undergoing a sale process, given that financial and accounting due diligence is one of the most important aspects of the transaction. Weak accounting can potentially lead to a detraction of value in the transaction and potentially a loss of interest from the buyer to continue pursuit of the deal.

Beyond these top three positions, some field service companies have a Director of Marketing or Business Development. This position can vary based on the nature of its customer development processes, but companies that have a leader proactively driving new sales growth and increasing brand awareness are viewed as more valuable, especially when buyers perceive there to be less meaningful investment required under their ownership to grow the customer base. Other functional leadership areas that may be important to some companies include HR/Recruiting, Technology, Quality Control, etc. These are just a few examples of management positions that can add value to the business and the cost versus benefit will vary from one company to the next.

Based on GCG's experiences, companies do not necessarily need the most comprehensive management team that covers all functions. In many cases, fewer managers wearing multiple hats can be just as effective, so long as there is a leadership focus on areas that are relevant to driving the business forward. The key is that developing a management team, even if there are still some holes to be filled, will make the company more valuable than a scenario where the business must rely on the owners for most strategic decisions.

2. DEVELOP CENTRALIZED INFRASTRUCTURE AND REPEATABLE PROCESSES

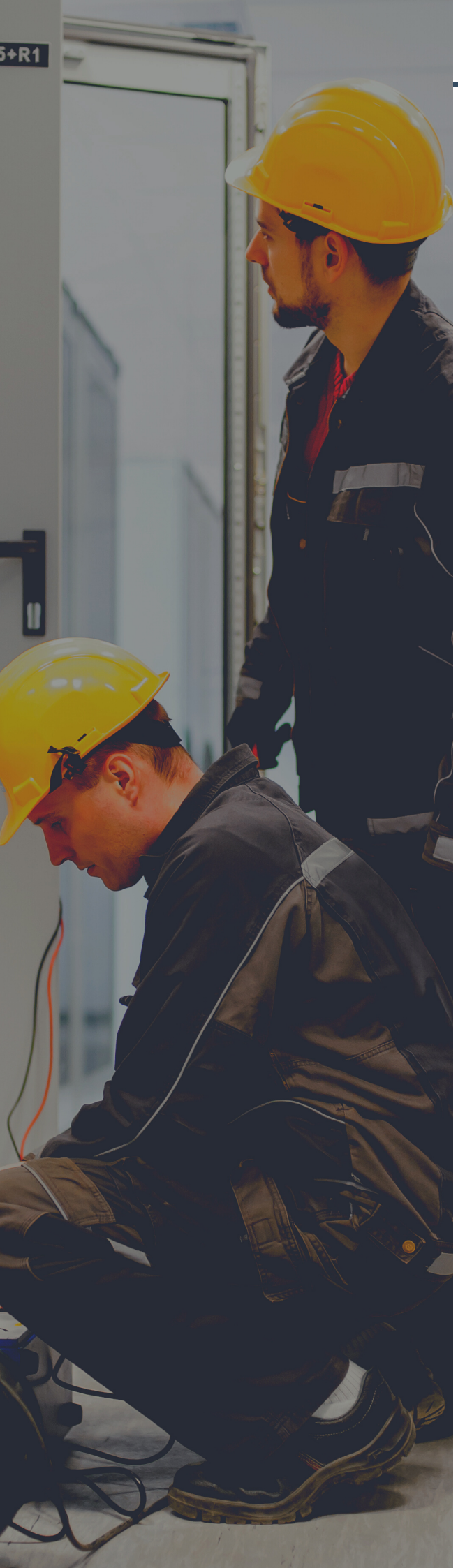
A primary avenue for future growth that buyers of field service companies seek is geographic expansion. The concept will often be an important underlying thesis supporting a buyer's interest in an acquisition target. The pace at which the buyer believes it can enter new markets will likely have an impact on valuation. Consistency of systems and processes, and an infrastructure that can be replicated across more than one location helps companies capitalize on market expansion opportunities faster. Thus, buyers view a strong centralized infrastructure as a positive. On the other hand, companies with disconnections across market locations or that have not invested in a scalable infrastructure to support such expansion will be considered less valuable.

Centralization starts with a cohesive senior leadership team focused on the company's overall objectives rather than having leaders of individual markets or business segments driving their own initiatives. GCG believes that leaders should be responsible for the operating activities, customer relationships, management of employees, and performance of their individual markets. However, they should also report to a centralized operations leader, such as a COO or Director of Operations and manage their market in accordance with company-wide objectives.

It is also important that market leaders embrace the culture of the company set forth by senior leadership and manage their operations in accordance with the same principles. Cohesive leadership and market management enable best practices to be repeatable and increase the likelihood of success in future geographic expansion.

Operating systems are also important for companies that desire to grow and build scale. For example, a centralized Enterprise Resource Planning (ERP) system utilized to manage operations, accounting, and other key functions, that can support a multi-location business, will enable more effective integration of essential information for workflow management and reporting. Having the information of all locations handled under one system accelerates the production of financial statements, processing of payroll, development of key performance indicators ("KPIs"), etc., enabling a faster assessment of important decision-making information. Greater visibility into KPIs and other performance factors across markets is better enabled as well.

In summary, consistency in leadership, systems, and processes allow for greater transparency across the business. Companies that adopt these practices and develop a centralized infrastructure to grow and manage more locations will be viewed as scalable, and will enable buyers to justify paying a higher price.



3. RECRUITMENT & RETENTION OF LABOR SHOULD BE A POINT OF EMPHASIS

The recruitment of quality and reliable personnel for fieldwork is a consistent challenge for companies. Even pre-pandemic, difficulty in acquiring labor has impacted the pace at which businesses can grow. Companies have been challenged to attract labor in new markets to support geographic expansion opportunities as well.

Similarly, retaining qualified technicians is a challenge for most businesses that often limits growth and leads to higher costs for hiring and training replacement personnel. As a result, companies that can find a way to turn the recruitment and retaining of personnel into a strength can create significant value for themselves.

While management of personnel at the local level is important for companies that have more than one location, it is essential to have a centralized focus on recruitment and HR and a team dedicated to these efforts. Numerous benefits exist when there is a deeper and firm-wide focus on (i) developing relationships with national, regional, and local employment agencies, economic development groups, recruiting agencies, universities, and other trade schools (ii) tracking market-based labor rates and KPIs that help to attract talented people and increase labor efficiencies, (iii) creating training and safety programs that give personnel more skills to be successful and safer in the field, and (iv) building awareness and motivation across the organization towards ongoing personnel development and advancement opportunities. Having leaders that are routinely on top of these initiatives can create a competitive advantage for companies and position themselves to take market share from other businesses that struggle to find and retain labor. Buyers tend to value companies that have demonstrated strong recruitment and employee retention higher as well.

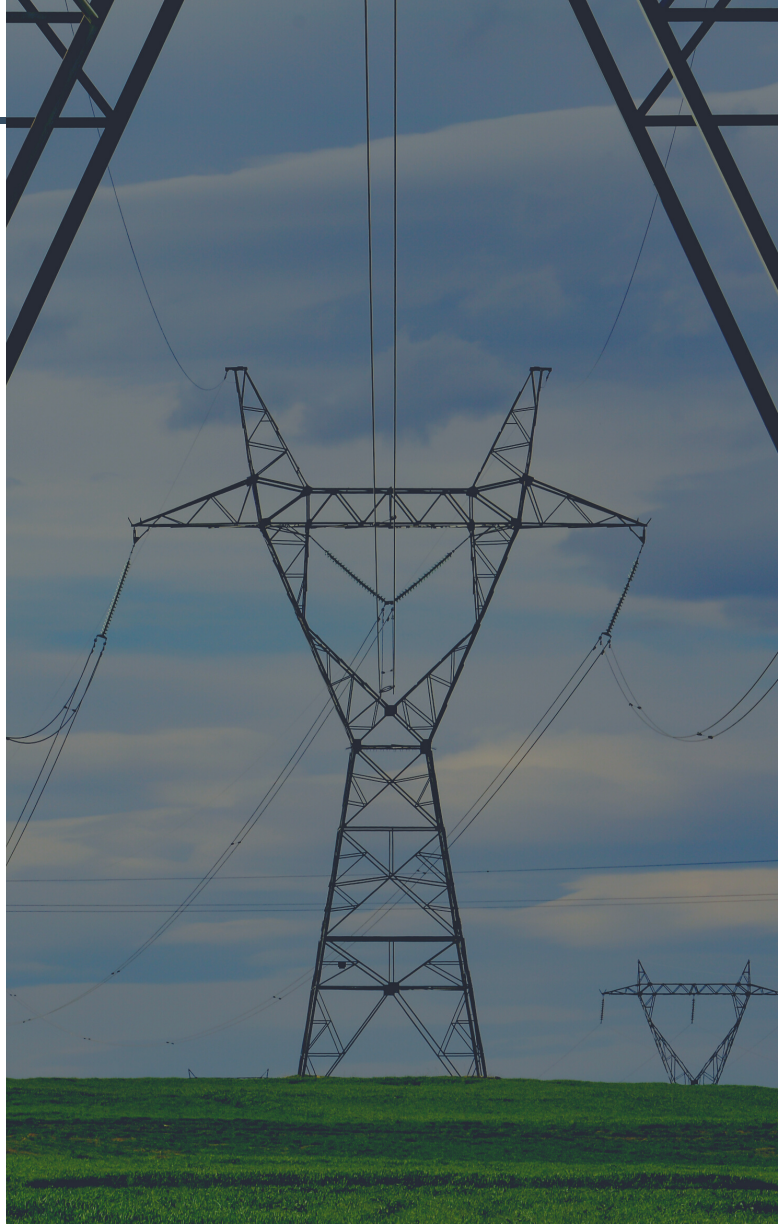
4. PURSUE GROWTH OPPORTUNITIES MORE PROACTIVELY, EVEN THE ONES WHERE ANTICIPATED PROFITS MAY FALL SHORT OF THE DESIRED LEVEL

Companies with higher growth expectations are better positioned to attract premium valuations. There is no better way for buyers to gain confidence in the growth prospects of a business than by the company demonstrating it has grown successfully in the past. For example, proving that the company has entered new markets, launched new services or capabilities, expanded into ancillary end markets, etc. illustrates to buyers that similar future growth is viable.

GCG hears too often from owners that they had a chance to move into a new market and did not because the expected profit margin was not quite as high as the levels earned in other areas of the business, or that the company would have needed to hire a new manager to lead the efforts and the increased overhead expense were a deterrent. Similarly, GCG hears that companies thinking about launching a new service or capability end up deciding not to, because at the end of the day they are making good money and enjoying a nice lifestyle, and the incremental profits just didn't seem worth the additional effort. The concept of controlling growth this way certainly seems logical, as managing profits is just as important as growing sales. However, if the owner is planning to sell the business at some point in the future, there can be substantial value by taking on growth that the company may have otherwise chosen against. For anecdotal purposes, GCG often observes that all else equal, companies generating higher annual cash flows (say $3 – $5 million for example) at a lower margin (say 20 – 25%) will likely sell at a higher valuation multiple than a similar company with only $1 – $2 million of annual cash flows, even if that company's profits are resulting from margins in the 35 – 40% range. The reason is buyers are normally willing to pay more for companies that have size, scale, and more diversity. Buyers are also normally skeptical and assume that higher margins at lower cash flow levels will not be sustainable, especially if additional overhead will be required to grow the business.

To elaborate further on this concept, if future expansion into new markets is a growth opportunity the seller is presenting to the buyer, there is no substitute for proving that the

company has entered new markets in the past and has grown them profitably (even if the profit margin in the new market is lower than the overall company level). Credibility is gained by businesses that demonstrate they understand the cost structure associated with personnel, equipment, real estate, and other items that are required to effectively build out a new market, and that they have been successful in gaining traction with their brand across unfamiliar customers, prospects, and vendors. Similarly, demonstrating that new services or capabilities have been successfully launched and grown profitably in the past leads to credibility that offering new services to the market is a viable opportunity for future growth.



5. DIVERSIFY AWAY FROM HIGH CONCENTRATIONS

Companies that have a large percentage of their sales or profits generated from one or only a few customers, a particular service offering, or one geographic market are more likely to experience a discounted valuation. Buyers view high sales and profit concentrations as risky, and the level of concentration that is viewed as higher risk can vary drastically from one buyer to the next. The perception of the level of risk associated with the concentration can also vary substantially. For example, some buyers may view 20-30% of total annual sales with one customer as highly concentrated, whereas other buyers might not be concerned until one customer makes up 50% or more of annual sales. Similarly, some buyers might get comfortable knowing that “practically” there is no one else in the market that could do the work the customer requires and therefore the company may be irreplaceable, whereas other buyers will have too much heartburn with the risk that a new competitor could enter the market in the future and take the business away from the company. GCG understands that diversifying from a particular customer, service, or market can be difficult in actuality. Often, concentrated positions are the result of strong growth in these areas historically, and the same customer(s), service(s), or market(s) may continue to offer meaningful upside. GCG's best advice for owners is to proactively seek opportunities to diversify by pursuing growth with other customers (existing or new relationships) and to be more aggressive to capitalize on new opportunities outside of these areas or relationships that present themselves. This will require effort, but owners should be confident that by proving the business can diversify away from a concentrated position, even if doing so results in lower overall profit margins, the company will ultimately become more valuable.

6. BECOME A "METRICS-DRIVEN" COMPANY

Developing a comprehensive set of KPIs that enable companies to better evaluate specific aspects of their business can be extremely effective. While interim financial statements help assess current performance, KPIs more effectively focus on specific day-to-day, week-to-week, or even month-to-month data that management can review and make strategic decisions from. KPIs can be developed across a number of different categories, such as operating efficiency, labor productivity, profitability, safety, equipment utilization, employee turnover, and other categories that may be relevant to a particular business. Once the framework is implemented, KPIs can calculated and updated routinely, often in real-time or within a close proximity.

Buyers view companies that have adopted the practice of analyzing metrics and making decisions from them favorably. This demonstrates that management has a pulse on the business and is proactively managing for opportunities to reduce costs and achieve greater operating efficiencies. Typically, employing metrics analysis to the business is not a costly effort, and GCG recommends that all business owners adopt at least some level of this practice into their company.

7. POSITION THE COMPANY AS AN ACQUIRER

A growing thesis behind buyers' interest in acquiring field service companies is the scale and diversity the business can accomplish through executing future acquisitions under their ownership. Many field service-based industry segments tend to be fragmented, meaning there are no large players that control a significant percentage of the overall market. There may be some segments with larger national or regional players, but they still tend to have hundreds, and maybe even thousands of companies that are much smaller in size that control most of the market.

Because of this dynamic, private equity has continued to adopt what is known as a "buy-and-build" investment thesis. They seek to invest in a platform company, which is essentially their first investment in a certain market or industry segment. Typically, they are willing to pay a higher value to establish this initial platform investment, especially for a company that has scale and exhibits characteristics described throughout this publication. Then they aggressively pursue add-on acquisitions to bolt onto their platform company. When the market is fragmented and there are many potential acquisition candidates to pursue, companies can typically increase their cash flow growth faster through acquisitions versus organic means only. When executed well, private equity firms are rewarded with attractive returns that often exceed what can be achieved solely through organic growth. Owners that choose to invest alongside the private equity firm when they sell to them can greatly benefit from the high returns as well.

Because this "buy-and-build" model can be lucrative, there are an increasing number of private equity firms aggressively deploying this strategy, and companies that fit the profile of a high-quality platform investment, especially ones that demonstrate they have a management team capable of executing and integrating acquisitions tend to command premium values from buyers.

There are actions companies can take prior to selling to illustrate that they can be a candidate for a platform company capable of growing through add-on acquisitions. The best way of course is to execute one or more acquisitions before selling and prove that the company was successful in integrating the personnel, systems, and culture post-transaction.

The next best methods include the following:

One, develop a pipeline of acquisition targets that could be actionable. This can be done through strategy meetings where the management team discusses and identifies companies that fit the profile of an attractive acquisition candidate and starts reaching out to the owners of those companies to generate their interest in potentially selling.

Similarly, owners can leverage their networks across the industry. They often spend years getting to know owners of other companies at trade shows, conferences, through competition, or simply from general knowledge of them. As a result, owners are often in the best position to not only know which companies would fit strategically with their company but also which ones have the right ownership dynamic to make them worthwhile to pursue as an acquisition target.

Companies can create tremendous value by articulating themselves as "acquirers" and communicating to owners of other businesses that they could be an interested buyer when they are ready to sell. Normally it is a long-term process for owners to ultimately to sell but starting now and proactively developing a pipeline of potential targets that could be

When the market is *fragmented* and there are many potential acquisition candidates to pursue, companies can **increase their cash flow growth substantially faster through acquisitions versus organic means only.**

actionable at some point, and establishing dialogue with the owners sooner than later can provide a valuable head start. In fact, GCG encourages owners to try and find opportunities to advance these efforts when possible. For example, owners should suggest executing NDA's with potential targets and asking them to share financial and other information about the business. This signals that the owner is serious about selling, especially when they are willing to share confidential information and advance the discussions productively.

Two, incorporate dynamics into the business that are representative of integration. For example, companies that operate in more than one location need to integrate their satellite operations. That's effectively the same thing as integrating a company that is acquired, at least from a systems and process standpoint. As such, buyers tend to view multi-location companies as better candidates for effectively pursuing add-on acquisitions.

When possible, GCG also encourages companies to take advantage of "soft acquisitions". Soft acquisitions imply finding companies that have an attractive business with good customers but have an owner that is tired of running the company and doing everything. They could also be struggling to grow their company because they lack the infrastructure necessary to expand. These situations can often yield great candidates for the owners to bring their book of business onto the company's platform and continue working for them as an incentivized salesperson, while their headaches from running the business can be alleviated. GCG calls this a soft acquisition because while the company is essentially buying the business, they typically do not require a substantial purchase price or large cash flow outflow. The seller is not really in a position to command strong interest from other buyers at a reasonable valuation and their business can therefore be brought onto the platform at an effective cost.

There are numerous benefits of "soft acquisitions" including:

- The company can grow and take market share at little or sometimes no cost
- The company can bring on good salespeople with attractive customer relationships
- The company can demonstrate to customers (and buyers) that it is a market leader well-positioned to absorb struggling businesses
- The company proves that it can integrate external personnel into its culture.

To summarize, a track record of executing transactions is most effective, but demonstrating qualities that are indicative that a company can be successful in integrating future acquisitions can position a selling company for a higher valuation from buyers, especially from private equity acquirers that are in pursuit of the "buy-and-build" strategy.

Demonstrating qualities that are indicative that a company can be successful in integrating future acquisitions can position a **selling company for a higher valuation** from buyers, especially from private equity acquirers that are in pursuit of the "buy-and-build" strategy.

GREENWICH CAPITAL GROUP

IN CONCLUSION

In conclusion, business owners that are preparing their company for a future sale have many options in their playbook to try and set themselves up for a greater valuation. The ideas presented throughout this publication represent specific factors that GCG often observes as having an influence on the value its clients receive for the sale of their companies. However, there are other factors that could be relevant to companies that perform services in the field, which should also be considered by business owners. For additional information about the topics presented in this publication or other factors that could be relevant to your business, please reach out to GCG's Managing Director, Matt Melago. For more information, please also visit www.greenwichgp.com.

Matt Melago
Managing Director
45 East Washington Street
Suite 102
Chagrin Falls, OH 44022
Mobile: (704) 999-2738
mmelago@greenwichgp.com

ABOUT US

GREENWICH CAPITAL GROUP

Greenwich Capital Group ("GCG") is a middle market focused advisory firm offering a range of investment banking and consulting services to private companies, public companies and private equity investors. Our senior bankers have held leadership positions at global investment banking firms, bringing a wealth of experience to each of our clients. GCG operates with the highest integrity, providing credibility and an excellent client service experience through our proven transaction process. These core values are the common thread in establishing our extensive relationships with privately held businesses, private equity investors and publicly traded companies. With each engagement, GCG's senior bankers have a common goal. We strive to build relationships by representing our clients' long-term interests in order to earn ultimately their trust. It is our privilege to be called trusted advisors in the middle market.