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PMP PestManagement PROFESSIONAL

Merger Guide

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Our Merger with Arrow!

"Arrow perfectly matched the way I ran my company. Nader's was family-run for 21 years, and I always believed in promoting a family culture in my business through our hiring, training and our relationships with customers and employees. I sold my company to Arrow in 2010, and they followed through 100% on everything promised."

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

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

Call today for your confidential conversation.

Kevin Burns | 800-281-8978 | kburns@arrowexterminators.com

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The 4 fundamentals for a successful merger

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

More than 52 years ago, the Thomas family founded Arrow Exterminators. After completing more than 100 successful mergers, we're currently considered to be the sixth-largest pest management company in the country. We just finished our 2015/2016 fiscal year, and for the sixth consecutive year in a row, our team members achieved double-digit revenue growth. As a team, we are especially proud to be job creators. Over the past five years, we have created more than 630 new jobs.

To this day, Arrow Exterminators remains a family-owned company. We understand the hard work that goes into growing a business. We pride ourselves on the care the Arrow team offers owners, employees and customers during the merger process.

One question we often hear from our pest management professional (PMP) colleagues is how to make their companies more attractive to buyers. Let's start with the fundamentals of the business — the four legs of the chair, if you will.

1 **SALES.** Buyers will look at annual sales volume, what services are being sold and the value for those services. Buyers will look to see whether there is a selling culture in the company, and whether all team members are participating in the sales process.

2 **SERVICE.** Buyers will consider the tenure of service technicians, look closely at service tickets for thoroughness, and analyze completed and "unserviced" service orders in a given month. A company that is regularly completing all its service orders is more valuable than one that does not.

3 **COLLECTION.** Buyers will look at an accounts receivable (A/R) report to see whether the company is adept at collecting revenue for services provided, and whether said revenue is coming in the form of cash, check or credit card. The size and scope of the A/R report can be very informational to a buyer.

PHOTO: ARROW EXTERMINATORS

Kevin Burns, Chief Development Officer, Arrow Exterminators

4 **RETENTION.** Finally, buyers will count customer cancellations as a percentage of the overall total available, and will calculate customer retention for each of the services provided. Keeping customers happy is a priority for quality-minded companies.

As you read on in this Merger Guide, you'll find even more great advice from the pros, as well as data and analysis from surveys conducted specifically for our industry. Arrow is proud to be a sponsor of this information, which helps PMPs make informed decisions as they explore all their options while they consider their future. To get started, all it takes is a phone call or an email. You can reach me at 800-281-8978, 404-840-9100 or kburns@arrowexterminators.com.

Editor's Note: For more on Kevin Burns' take on the merger process, check out PMP's *exclusive interview online at* **PMPPestTalk.net.**

Mergers on the upswing

PMP's exclusive survey finds that merging with a larger company can offer many benefits.

BY **DIANE SOFRANEC** | Managing Editor

It was a record year for mergers and acquisitions in 2015. The *Wall Street Journal* reports that more than $4.3 trillion in deals went down last year. But would you jump at the chance to merge your company?

Pest Management Professional (*PMP*) surveyed readers to learn whether they plan to merge their businesses in the near future. We compared the data we gathered this year with the results from surveys we conducted in 2012 and 2014.

This year, our exclusive survey found that the majority of our readers have no immediate plans to merge. If that's how you feel, too, you may wonder why you should even think about mergers at this point in your pest management career.

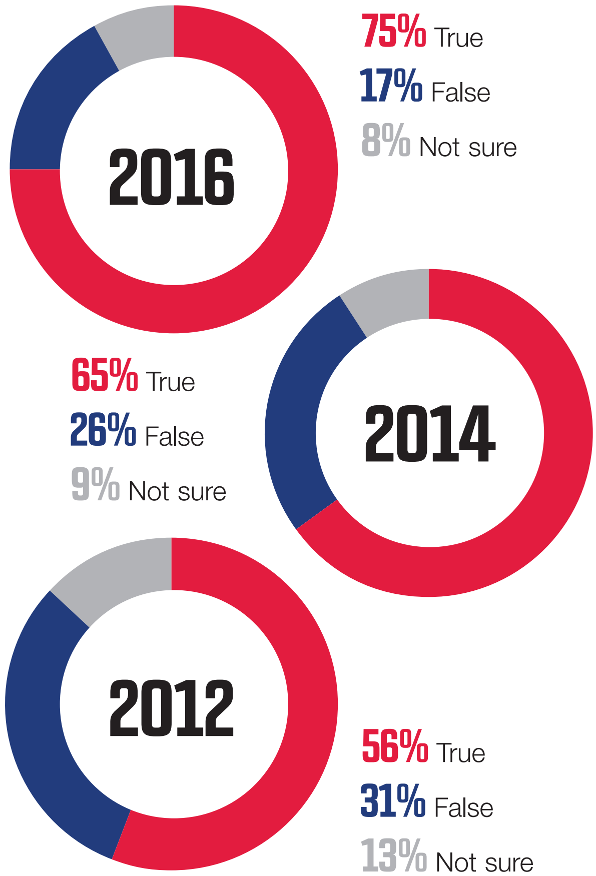
The reality is, planning for the future cannot wait. What will happen to the pest management company you worked so hard to create and maintain?

The economy certainly is a factor to consider when deciding to merge. A pest management professional who can prove the business is a success will have a better chance of making a deal with a company willing to pay top dollar. Respondents of each of our three surveys said they were less likely to strike a deal due to current economic conditions.

Despite that belief, the overwhelming majority of respondents agree that every business owner has a price. Even if you're not actively seeking to merge with another company, our surveys show you will jump at the chance if the price is right. And what better reason is there for planning ahead? You never know when a prospective merger partner might come knocking. PMP

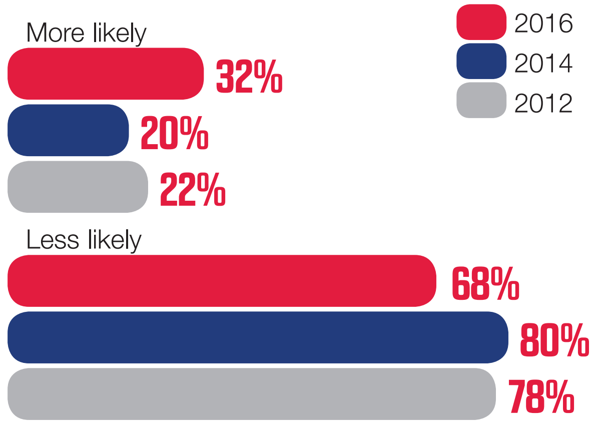
You can reach **SOFRANEC** at dsofranec@northcoastmedia.net or 216-706-3793.

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



Economic Conditions

Do current economic conditions make your company more or less likely to merge with a larger pest management company?



SOURCE: *PMP* MERGER SURVEY 2012, 2014, 2016

Tax Laws

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

	More likely	Less likely
2016	30%	70%
2014	24%	76%
2012	24%	76%

Processes and Policies

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

	Yes	No
2016	76%	24%
2014	52%	48%
2012	53%	47%

Career Opportunities and Retention

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

	Yes	No
2016	72%	28%
2014	58%	42%
2012	54%	46%

Bigger Brand and Budget

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

	Yes	No
2016	85%	15%
2014	76%	24%
2012	73%	27%

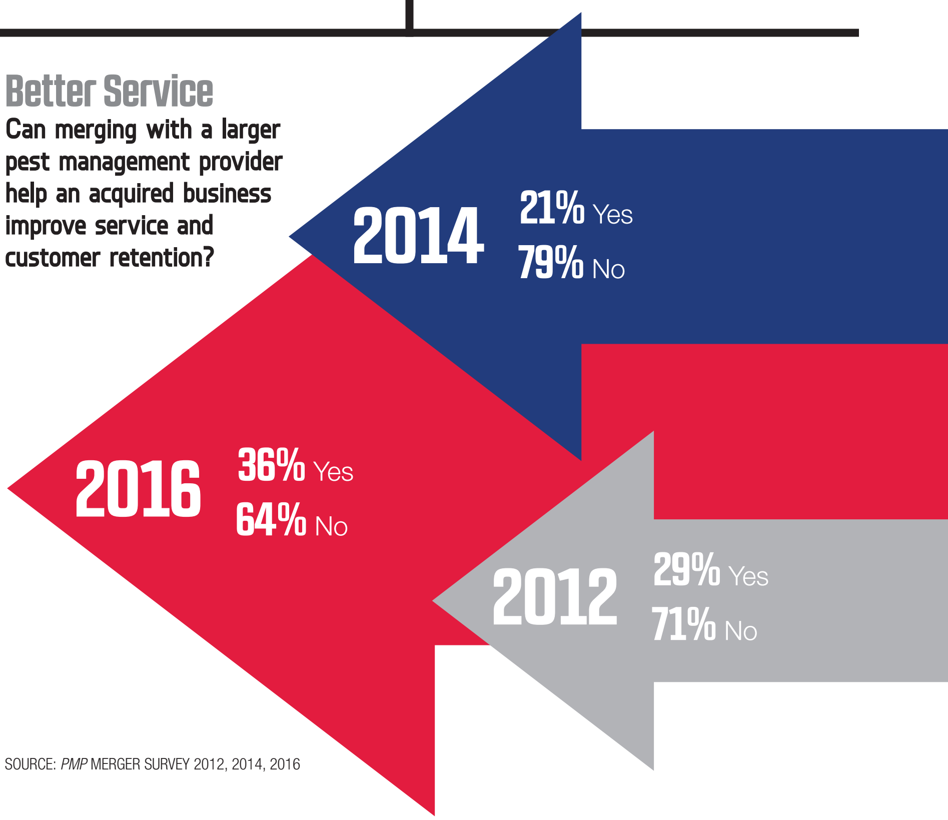
$4.3 trillion

Amount spent on global mergers and acquisitions in 2015, shattering the record set in 2007

SOURCE: *WALL STREET JOURNAL*

Better Service

Can merging with a larger pest management provider help an acquired business improve service and customer retention?



SOURCE: *PMP* MERGER SURVEY 2012, 2014, 2016

ILLUSTRATIONS: ©ISTOCK.COM

How to navigate the sale of your business

Properly preparing for and maneuvering through this once-in-a-lifetime process will have a huge impact on its outcome. BY **LANCE TULLIUS** | Contributor

Most pest management professionals (PMPs) start their business with an eye on the future. As the years progress, they operate and manage it with that same eye on the future.

That future represents the point at which they will sell their business, and presumably (or rather, hopefully), reap ample benefits for all that they've put into their business. But by no means is it a guarantee that they will, in fact, sell their business for a huge profit, let alone any profit.

Many variables and circumstances have to fall into place for a business to be sold successfully. Some of these are within the PMP's control; some are not. We'll focus on those within your control.

Let's break the process of selling a business into two steps:

STEP 1

PREPARING AND POSITIONING FOR A SALE

As with any major milestone objective, proper planning and preparation are vital. If you haven't already begun to do this, no matter how far a sale might be into the future for you, it's never too early to start.

There are many questions to ask yourself, but two are particularly significant:

1. How can I build or shape my business to have the greatest appeal to the buyers that will be the best candidates to buy my business?
2. What type of corporate structure will allow for the best transaction outcome?

I'll address the second question first, given its general simplicity: With a privately owned business, you will almost always have the greatest opportunity to sell the business successfully when the business is incorporated as an S corporation. That's not to suggest it's impossible to do so under a different corporate structure, but simply much easier with the S election.

Without going into exhaustive detail (you should consult your accountant on this subject in any event), buyers overwhelmingly prefer to purchase the assets of a company rather than the stock. Selling the assets of an S corporation, given its nature, results in a tax event at one level: the personal one.

On the other hand, selling the assets of a C corporation, for instance, triggers two tax events: one at the corporate level and then another at the personal level when you remove the proceeds from the corporation. If you're already a C corporation and decide you want to change, which I think is a good idea, you must be mindful of certain "look-back" provisions that prevent you from capturing the full benefit of such a change for certain periods of time. (*Editor's Note: For more on the differences between S corporations and C corporations, see "Why are S corporations so popular?" January 2016, p. 66.*)

As to the first question, when I refer to planning and preparing for a sale, I'm not suggesting you need to determine the date at which you will likely sell your business. In fact, the more flexible you can be with respect to that date, the better. And some might say they never plan to sell. But it's a fact that none of us will be around forever; at some point, someone else will own your business. Regardless of whether that's going to be a family member, someone you know or a third-party buyer, it behooves you to construct a business that is as valuable as possible. Therefore,

It's a fact that none of us will be around forever; at some point, someone else will own your business.

you should focus on building your business to have maximum appeal to the market.

As an absolute starting point, you have to be able to validate the appeal of your business. That means you have to be able to produce timely, accurate and relevant data. To do that, you need systems and protocols. Like it or not, data and analytics in this day and age drive value. If you want a premium value for your business, you must have them.

This does not mean you have to be a technological expert, only that you must access people and talent who are. These days, plenty of these folks are out there. Pest management businesses should have systems and protocols in place that allow them to most efficiently design and redesign service routes, input customer transaction data in real-time, sort this transaction data into meaningful analytics, and measure costs at numerous levels. Then, you must diligently manage the process for inputting data and, of course, use the data. Systems and reports mean absolutely nothing if they're not managed and used properly.

STEP 2

EXECUTING THE SALE

Let's move on to the process of actually selling your business. Many, if not most, business owners go through at least one failed attempt to sell their business prior to actually closing a deal. In addition, many of the deals that close end up being the ones that the business owner regrets for various reasons. Do whatever you can to avoid ending up in this lot. A failed transaction, either before or after it closes, can cost both financially and emotionally.

To maximize your opportunity to achieve a successful sale, I have two recommendations:

- Hire a quality, experienced advisor to help you navigate the process. No matter how experienced and skilled you might be in selling or acquiring businesses, this move will almost certainly pay huge dividends. As a business owner, you have a heavy emotional investment in your business, which likely has been built up over many years. A good advisor facilitates business transactions like this every day, and will bring the valuable objectivity you need to secure the best transaction possible.
- While it might seem counterintuitive, you don't need to contact tons of buyers to generate the best deal. In fact, I would argue the opposite. There's a fine line between too many and too few buyers, and there's more risk with more buyers. Perception is reality in this regard, and if it is perceived that your business is being aggressively and widely "shopped," it's possible that interest will diminish. The best outcomes result when prospective buyers perceive the business owner has taken a deliberate and thoughtful approach as to who will represent the best pool of potential buyers.

This absolutely can be done without adversely affecting the competitive nature of the process. Another benefit to this approach is that it's easier to manage confidentiality, which should be important to every business owner. PMP

TULLIUS is a partner at Tullius Partners, an investment banking firm that specializes in providing merger and acquisition and financial/strategic advisory services to companies operating in select industries, including pest management. He can be reached at lance@tullius.com or 858-832-8043.

FOR SMOOTHER SAILING...

While there is much more that could be discussed to selling a business successfully, here are two more critical points to keep in mind:

1. TIMING IS EVERYTHING. It's not necessarily important that you have a timeframe in mind for exactly when this event will take place. In fact, flexibility in this regard gives you strength in that it allows you to be able to take advantage of great market cycles and sell when the going is great. Remember earlier when I said some things are within your control and some things are not when it comes to successfully selling your business? The economic climate and market conditions at any given time are *not* within your control. If you have the flexibility to take advantage of a good market, you will be better for it.

START WITH GOOD PLANNING AND PREP WORK. You really do have the opportunity to almost scientifically construct a business that is exactly what the market that will pay you for it wants most. Don't miss this important concept. If you nail the preparation part of the process, the sale itself will be far easier and the outcome much more satisfying.

The power of setting objectives

Begin your exit planning process early, and you and your family will be better off.

BY **PAUL GIANNAMORE** | Contributor

Small children quickly learn it's easier to solve a maze by working from the exit to the entrance. In the same way, the exit planning process involves getting out your crystal ball and trying to envision your ideal future. You may envision running your business until you retire to Florida, or working for another four years and then joining the Ultimate Fighting Championship circuit. Whatever your end goal is, it is here that we begin.

Give serious thought and consideration to your desired outcomes and goals. Remember, these are not written in stone, but they absolutely should be written somewhere on paper. Your goals may be a moving target, and that's OK. It's better to aim at, and miss, goals than to not aim at anything at all. At least if you're aiming at something, you can learn from it and make adjustments.

HOW TO BEGIN

To begin the exit planning process, you need to answer three questions.

1 HOW LONG DO YOU ANTICIPATE WORKING BEFORE EXITING YOUR BUSINESS? One more year? Five years? Ten years? If you are 50 now and you want to sell your business when you are 55 to pursue other interests, write 2021 as your target exit date.

For some, this is a financial question. You are saving for your retirement and will be ready to sell when you have enough money. That's fine. But for now, humor me and write down a date that would be ideal for you.

Business owners who are clear and concise about an exit date, and give themselves a deadline, tend to focus their efforts on increasing value in their businesses to hit this goal. Pest management professionals (PMPs) who define "proximate objectives" early will be more likely to hit them than those who don't.

2 HOW MUCH MONEY DO YOU NEED FROM THE SALE OF YOUR BUSINESS TO SUPPORT YOUR POST-EXIT LIFESTYLE? A better way to phrase this question is: What amount of money will you need on an after-tax basis per year to maintain your current lifestyle, or the lifestyle you envision for you and your family after you exit your business?

Assume you make $300,000 per year in a combination of salary and dividends from your pest management company. Will you need to continue making $300,000 per year once you exit your business? Will you need to make $1 million per year? Or will $100,000 suffice?

Notice I didn't ask, "For how much do you need to sell your business?" Although you will most likely end up with a lump sum of money when you sell your business, it is your annual income requirements that will help determine the amount of money you need from a sale.

Your financial advisor will guide you as to the total after-tax proceeds you will need to receive from the sale of your business to support your post-exit income requirement. For example, say you want to earn $165,000 per year in perpetuity (meaning when you pass on, the original principal amount will be left to your heirs) after you retire. Your financial advisor might tell you he needs to invest at least $3.9 million to meet that goal. Now we know what we need to receive, after taxes, from the sale of your business.

3 TO WHOM WOULD YOU ULTIMATELY LIKE TO SELL YOUR BUSINESS? For most PMPs, three main categories of exit options exist.

- Internal transfer — Sell to your management team or employees (management buyout or employee stock ownership plan/ESOP), perhaps in partnership with a private equity firm.

- External transfer — Sell to another pest management company (strategic buyer) or a private equity firm or individual (financial buyer).
- Family succession — Sell or transfer ownership to the next generation through gifting and/or a sale.

Each of these exit avenues will entail different planning measures. However, for this step in the process, it's important to choose the one that is most appealing to you now. For example, you may want to sell your business to your children, but if they are only 8 and 11 now, you can't even be remotely sure whether they'll have any interest in being involved in the family business. It doesn't matter because we are worried about your goals and objectives right now. We'll worry about everyone else's — including your children's — later in the exit planning process.

If you own a sizeable business, there is a high likelihood that your children will not have the resources to buy it from you outright.

SET REALISTIC GOALS

The goal-setting phase of exit planning is the cornerstone of the process. In fact, if you are writing down your goals on paper right now, you are far ahead of the overwhelming majority of business owners on the planet.

Although goals and objectives will drive the planning process, it's very important that your goals are realistic and achievable. For example, your goal of having $10 million in cash and retiring four years from now is not very realistic if you've got $50,000 in the bank and your business is worth $500,000. In this case, you are going to have to exit your business much later than four years from now, or you will have to dramatically lower your $10 million goal.

To focus your efforts and channel your energy into hitting your goals, choose an exit date, a financial target and an exit option (internal, external or family succession) today. Without them, you're likely to drift along like a rudderless ship at sea.

PLANNING PAYS OFF

For those of you who have business partners or adult children working in your business, it is in this phase that you need to have frank discussions with them about your goals and desires. Oftentimes, children assume they will be taking over the family business. They forfeit other opportunities in their lives to "stay faithful to the family business," and in return, expect Dad and Mom to pass the gavel to them after the retirement party. Sometimes, this promise is explicit. But more often than not, it's an implicit understanding on behalf of the children that one day the business will be theirs.

One of the worst situations parents can find themselves in is to have an adult son who expects his father to pass the business on to him, but reneges once the child has devoted his life to the business. This is an extremely common occurrence, and it tears families apart.

If you own a sizeable business, there is a high likelihood that your children will not have the resources to buy it from you outright. When retirement time comes and you haven't put a plan in place for your child to buy the business, it's going to be very difficult to hand him the keys to the company when an acquirer comes knocking with a $9 million check. (Without fail, I deal with this situation a few times a year, every year.)

For parents who are seriously considering passing on the business to the next generation, there are many fantastic exit-planning tools, such as annual exemptions of Federal Gift Tax and non-qualified deferred compensations plans. However, unless you utilize these tools early (at least five years before a transfer), many of them become ineffective.

For those of you who intend to sell your business to a strategic acquirer, there are countless ways to increase the value of your business to an acquirer by 20 percent to 30 percent per year. They also require careful planning, however.

Don't let the business you've worked your entire life to build cause you frustration, estrangement from your family and partners, sickness, or premature death. Consult an investment banker or mergers and acquisitions advisor who helps PMPs plan for their exits — and do so right away. The sooner you plan, the better off you will be. PMP

GIANNAMORE, a partner at the Potomac Pest Control Group, advises shareholders and managers on creating value in their businesses and advises sellers on the sale of their businesses. He may be reached at paul@potomaccompany.com or 215-525-0689.