THINKING AHEAD

A Guide for Owners of Closely Held Aerospace and Defense Companies

Alderman & Company Capital

INVESTMENT BANKERS TO THE AEROSPACE & DEFENSE INDUSTRY

Member Financial Regulatory Authority

Introduction

This paper is written for the owners of closely held aerospace and defense companies who are considering selling their businesses in the future. While we offer a range of succession and exit planning advisory services, this paper focuses exclusively on the sale process.

It takes two to four years for most privately held aerospace and defense companies to optimally prepare for sale. Once all necessary preparations are made, it takes six to nine months to make the sale, depending on the type of sale process utilized (see Appendix A). Accordingly, if you are considering selling your company in the next two to four years, now is the time to start planning and preparing.

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NOTICE

This document has been prepared for the clients and potential clients of Alderman & Company Capital, LLC, to provide general information about steps that might be taken to prepare a privately held aerospace and defense company for sale. Alderman & Company Capital, LLC, is a Connecticut limited liability company that is a broker-dealer registered with the Securities and Exchange Commission and a member of the Financial Regulatory Authority (FINRA). Alderman & Company Capital, LLC, is also a member of the Securities Investors Protection Corporation (SIPC). Alderman & Company Capital, LLC, provides investment banking, private placement, merger, acquisition divestiture and other securities related services. The material contained in this presentation is for general informational purposes only and is generic in nature. The material contained herein is not to be construed as specific advice for any individual client, potential client, company, shareholder or shareholder group. Alderman & Company Capital, LLC, developed this document from its professional experience and sources considered reliable; however, there is no guarantee as to the accuracy or completeness of the information provided within this publication as it relates to any specific company, person, or situation. No warranties, express or implied, are made, regarding the accuracy of this material. Officers, directors and members of Alderman & Company Capital, LLC, or its affiliates receive compensation that is impacted by overall firm profitability.

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WILLIAM H. ALDERMAN

This document was written by William Alderman, President of Alderman & Company Capital, LLC. Alderman & Company Capital is a broker dealer registered with the United States Securities and Exchange Commission. The firm is exclusively dedicated to the aerospace and defense industry. More than 75 percent of the firm's work involves selling privately held companies.

Mr. Alderman is a graduate of the J. L. Kellogg Graduate School of Management and Kenyon College, where he was an Academic All Conference Soccer Player. Mr. Alderman worked for General Electric Capital from 1990 to 1995, rising to the level of Vice President and receiving GE Capital's prestigious Circle of Excellence Award. Mr. Alderman serves on the boards of two defense contractors (AMEX: BZC and NASDAQ: TSTF), and a $200-million investment fund managed from London. Mr. Alderman is also a member of the advisory board of the Supplier Excellence Alliance, the aerospace industry's leading trade organization for Lean practices. Until its assets were sold in 2001, Mr. Alderman served on the board of the HM Bullard Company, a fourth-generation business founded by Mr. Alderman's great-grandfather. Mr. Alderman has served as a keynote speaker at industry conferences across the United States, Canada, and Europe, and has often been quoted in such leading media outlets as Bloomberg and CNN. He is a pilot and competes in sprint triathlons.

The following is a sample of recent company sales arranged by Mr. Alderman (client name in bold):

- Sale of **Shaw Aero Devices** to Parker Hannifin
- Sale of **Nasco Aircraft Brake** to K&F Industries
- Sale of **Hoffman Engineering** to Harris Watson plc
- Sale of **Aerotron Airpower** to Stork NV
- Sale of **GenMech Aerospace** to SPX
- Sale of **Metalcraft Technologies** to management
- Sale of **Tecometrix** to ESCO Corporation
- Sale of **Kratz-Wilde** to The Barnes Group
- Sale of **Dixie Bearings** to Wencor West

Through Alderman & Company Consulting, LLC (an affiliate of Alderman & Company Capital, LLC, by common ownership), Mr. Alderman also works with aerospace and defense clients on such matters as succession planning, strategy and general management.

The following is a sampling of management consulting clients:

- Aerotron Limited
- AGC Incorporated
- Alken Industries, Inc.
- Birken Manufacturing, Inc.
- CAT Aerospace, LLC
- Goodrich Corporation
- Harlow Industries, LLC
- John Hassall, Inc.
- Precision Machine Works, Inc.
- S & L Aerospace, Inc.
- UFC Aerospace Corp.
- Universal Aerospace, LLC

I. Hiring Professional Advisors

Successful business owners hire great people—that is, in part, how they got to be successful. They find the best salespeople, the best engineers, the best operations staff, and they spend years training and grooming their managers. Especially in the privately held business, managers become like family, and owners invest both time and money into these relationships. Business leaders are keenly aware of the need for human talent in order for their businesses to thrive and prosper. Not only do they know how to hire the right people, they also know how to build a team and manage people.

However, when it comes to selling their business, many owners retain advisors that are not up to the job. Often this decision is not based on merit, but rather on convenience and/or loyalty. They retain a loyal accountant, a friendly attorney, or a local business broker. Unfortunately, for what is most likely the single most significant event in the entire history of the ownership of the business, owners often hire out of comfort or convenience.

Second only to taking the time to properly prepare, the most important thing the business owner should do, in order to maximize the sale process, is to hire the right team of professional advisors. Many owners think that because selling their business includes finance, tax, and legal matters in which they are not expert, they cannot successfully hire the right talent or manage a group of professionals outside their areas of expertise. Our experience shows that nothing could be further from the truth. Almost all of our clients (who have ably built and run successful aerospace and defense companies) have had the skills needed to “manage the experts.”

You have gotten where you are because you have great leadership skills. Trust yourself and manage your professional advisors just like you managed your business leaders. The same management tools that you have used for many years to manage your management team are the same the ones you should use to manage your professional advisors:

- Hire the best.
- Lead your team.
- Establish clear goals, roles and responsibilities.
- Assign specific duties and deadlines.
- Hold individuals accountable.
- Foster teamwork.
- Hold frequent meetings with the entire team.
- Reward excellence.

Professional advisors are expensive.

Not using the right professional advisors is very expensive.

PROFESSIONAL ADVISORS

While each company is unique and will have unique advisory needs, most privately held aerospace and defense companies will want the following advisors on their "sale team."

1. Trust and Estate Counsel
2. Auditors
3. Transaction Legal Counsel
4. Contingent Liability Consultants
5. Investment Banker
6. Asset Manager

TRUST AND ESTATE COUNSEL

The first professional advisor you should retain when you begin to consider selling your business is a highly qualified trust and estate attorney. Your trust and estate advisor does not need to have any experience in aerospace and defense. They must, however, be highly seasoned in working with owners like you and sensitive to your needs and plans, and the unique dynamics of your family and estate plans. While there are no silver bullets to eliminate taxes, there are a number of intelligent ways to plan for your retirement and the well being of your dependents. Good trust and estate counsel will securely guide you through this work.

The reason we advise clients to start with trust and estate counsel is that it can take a year or more to design and implement a sound estate plan. Furthermore, there may need to be transfers of assets and/or shares associated with the plan. Often, estate planning counsel will advise you to transfer assets or shares among family members or family trusts well in advance (potentially a few years) prior to selling the business. Accordingly, we consistently advise our clients to retain trust and estate counsel first and well in advance of a potential sale.

AUDITORS

A potential long lead-time issue to be addressed is the retention of auditors. If your company already has audited financial statements prepared on an annual basis, then the retention of auditors is not a long-lead time issue for you. However, if you do not already prepare audited statements, you will need to retain an auditor not less than three years prior to your intended sale date. Not only do buyers want to see three years of audited financial statements, but auditing standards typically require that your auditor use both starting and ending inventory data when issuing an audit for the given year. Accordingly, if you want to have audited financial statements in 2010, you will need to have your inventory audited at the end of 2009. While your auditors need not have experience with aerospace and defense companies, they must have experience auditing companies of your size and type (e.g., distribution, manufacturing, etc.) and, most important, they must have substantial experience selling companies like yours to the types of buyers that are most likely to be your buyer (e.g., public corporations, private equity funds, etc.).

TRANSACTION LEGAL COUNSEL

The second professional you should hire should be legal counsel that will advise you in regard to the mechanics of the sale of your business. A great deal of expense and aggravation can be avoided, if transaction legal counsel is retained long before the formal sale process begins. While most clients have good records and can efficiently gather their most critical business records, nearly all clients will need substantial time working with legal counsel to identify shortcomings and address and/or resolve various legal issues prior to a sale.

Examples of some legal issues we have seen that should have been handled by transaction counsel prior to sale include:

- Compliance (EEOC, OSHA, ITAR, FAR, etc.)
- Contingent liabilities (such as litigation and environmental clean-up)
- Corporate minutes and stock ledgers
- Contracts administration

The counsel you retain should have substantial experience in selling aerospace and defense companies. They must know what questions to ask of you, and what areas to look for to help identify, mitigate or remediate potential problems—before a buyer finds them. While it may be comfortable to retain a long-time loyal attorney, you must resist the urge to act based on emotion. You have too much at stake, and selling your business is no simple affair.

Issues must be identified, quantified and, wherever possible, remedied prior to the sale. This can be efficiently done in the ordinary course if you retain transaction counsel well in advance of a sale. When left until too late, minor issues quickly become major issues in terms of both cost to remediate, and in terms of sale transaction negotiations. To avoid putting yourself at a competitive disadvantage in the most important business transaction of your life, retain the right counsel and allow them to conduct thorough due diligence on your company prior to the sale.

Your legal counsel can also help you manage the process of selecting an investment banker and negotiating investment banking fees. As discussed below, your investment banker will manage the sale process and, typically, investment banking fees will be the single largest expense of selling, other than taxes.

CONTINGENT LIABILITY CONSULTANTS

If your transaction legal counsel identifies any significant contingent liabilities, you will want to retain professional advisors to assist you in quantifying and/or remediating those liabilities. In the aerospace and defense industry, one of the most common examples of contingent liabilities is environmental.

Unless your company and the facilities you occupy have never handled any materials that might be classified as hazardous, you should assume a buyer of your business will conduct a thorough review of your environmental liability exposure. Typically, most buyers will do a Phase II Environmental Site Assessment. Phase II studies are expensive and can take one to three months to complete, depending upon the complexity of your operations. The exact timing and cost will depend on an array of variables, including, but not limited to, the age of your facilities, the chemicals and processes currently and historically used by your company, known prior land use, zoning, geology and hydrology. Not only is the lead-time a significant issue when selling your company, but more important, you do not want to enter due diligence and price negotiations when you don't know if you have any environmental exposure. To give yourself advance knowledge of what will (or will not be) found and empower yourself to negotiate from a position of strength, we highly recommend that you retain environmental consultants at least a full year prior to when you intend to sell the business.

In the event your transaction legal counsel identifies other potential contingent liability concerns (such as litigation, ITAR compliance, etc.), you will want to retain the right professionals and take the appropriate actions.

INVESTMENT BANKER

You should plan to retain an investment banker nine months prior to your intended sale date, assuming you have taken all of the steps noted above, in advance. If you are well prepared, your investment banker should be able to develop the requisite sale documents and begin soliciting bids within three months. Assuming a healthy mergers and acquisitions market for aerospace and defense companies, meaningful interest in your company, and limited regulatory hurdles, you should be able to complete the sale of your business six months after receipt of the initial qualified bids.

Your investment banker should have substantial experience in selling companies just like yours. Aerospace and defense is a highly specialized and unique industry. Retain a firm that has a proven record and stellar reputation in the industry. Also, find the right size firm and one with a style that matches your own. You will spend many long hours with your investment banker, and you will face numerous stressful and difficult decisions together. Select a banker who not only is an expert in the technical aspects of selling aerospace and defense companies, but also understands you and has a work ethic and style that matches your own.

ASSET MANAGER

For most owners of private aerospace and defense companies, their business represents their single largest personal investment. Accordingly, once the business is sold, you will want to reinvest the proceeds from the sale in a manner that is consistent with your needs and objectives. Ironically, after spending a lifetime of very hard work to create this wealth, many owners then turn to loyal friends and acquaintances to manage their wealth.

While you may wish to give friends or acquaintances small amounts of capital to manage, the vast majority of the wealth received from the sale of your business should be managed by highly respected, experienced, and trustworthy professional asset managers. Once your business is sold, your asset manager will have more impact on protecting and growing your wealth than any other factor. Accordingly, you should carefully consider this decision and, just as you did with all of the key employees in your business, you should take your time and make the effort to recruit and hire the right people for the job.

II. Key Managers

Once your team of professional advisors is established, you will next want to consider how many members of your management team should be aware of your plans to sell the business. Depending on the size of your company and your management style, you may wish to keep this to a very small group of one or two individuals, or you may wish to inform a larger number of senior executives.

Buyers gain great comfort and confidence in your business when the management team is an integral part of the sale process and when information flows directly from management to them, as opposed to being filtered through you or your professional advisors. When all information flows through your hands (or the hands of your advisors) before it gets to buyers, it raises “red flags” about the credibility and integrity of the information. Their concerns often spread to include uneasiness with: (1) the openness and effectiveness of your corporate culture; (2) the robustness of the information you are providing; and (3) the potential loss of value to your business when someone who is “too central” to the business (i.e., *you*) retires.

As will be discussed in Section II, the price that you will receive for your business is usually driven by the buyer's perception of the expected future cash flows of your business. The greater the level of confidence the buyers have in your management team (and the ability of your business to succeed in the future without you), the higher a price you will probably receive.

While each client is unique, we recommend that all clients consider including the following members of management on your team:

- President/Chief Executive Officer
- Senior operations manager (such as Vice President of Operations)
- Senior financial staff member (which may be a Chief Financial Officer, a controller or bookkeeper, depending on the size of your organization)
- Senior sales person (such as Vice President of Sales)
- Senior contracts administrator (which may be an in-house attorney or a contracts administrator)
- Senior human resources manager

As noted above, each client situation is unique, and each client will need to find its own optimal balance between having a broader group that will create a more open and efficient process and a smaller group that will create a more discrete and controlled process.

MANAGEMENT RETENTION/BONUS AGREEMENTS

While your professional advisors will each have their own engagement agreement with a very clear understanding among the parties regarding services and fees, your management team probably has nothing in place regarding their added obligations during the sale process and the potential rewards for these efforts.

Once you have determined which managers will be on your sale team, you will need to decide when to inform them of your intention to sell the business and assure them that their jobs will not be at risk and that the sale represents a positive financial opportunity for them. You will also need to decide if you will be asking them to enter into retention/ bonus agreements. These agreements provide assurance to you that your key managers will work to achieve your goals, and assurance to the buyer that the key managers will remain with the business after the sale. Buyers will place a discount on the business if they fear key managers will leave the business when it is sold. While some clients elect to sell their companies without any retention/ bonus agreements, the vast majority of out clients put such agreements in place before they initiate the sale process.

Retention/bonus agreements usually have many of the following components: (1) an agreement that the employee will work diligently to assist in the sale process; (2) a bonus to be paid at the time of sale, which may or may not be variable based on the sale price; (3) an agreement to continue working for the buyer at their existing level of compensation, if requested by the buyer; and (4) a severance package in the event of termination without cause by the buyer during a predetermined time period (typically one year after the sale).

III. Determining Value

Before you sell your business, you should have a good sense of what your business is worth. In the event that the (current) market value is below your expectations, then you should not be a seller. More importantly, if the value of the business is substantially below your expectations, you should learn why.

Most investment bankers provide valuations as a service offering. This is a service provided by Alderman & Company Capital, LLC. While each investment banker has a unique way of developing valuations, the methods developed by Alderman & Company Capital, LLC, are based on the three separate valuation models that we see most frequently used by buyers in the aerospace and defense industry. Clearly, the value of your business will be different to different potential buyers, depending on numerous factors, including strategic fit. By employing the valuation models most often used by buyers in this industry, we are able to gain a market-based view of what the active buyers are likely to offer for your business.

These three models are as follows:

- **Income Method**
- **Market Method**
- **Replacement Method**

THE INCOME METHOD

The *Income Valuation Method* is built on the assumption that buyers acquire businesses in order to generate future income (a.k.a. free cash flow). This is by far the most often cited reason why strategic buyers make acquisitions in the aerospace and defense industry. Accordingly, this is the model most often used by strategic buyers for valuing aerospace and defense companies.

This method of valuation is highly sensitive to subjective assessments of the future performance of a business and to the discount rate to be used to discount those cash flows. Clearly, the buyer's view of the company's future performance is the single most critical variable under the income valuation method. Income Method valuations are only accurate in predicting buyer behavior when the projections utilized in the valuation assessment are similar to those that would be utilized by the likely buyers. Our experience is that a substantial majority of buyers in the middle market of the aerospace and defense industry utilize the Discounted Cash Flow (DCF) model as their model of choice in developing valuations under the income method. There are a number of other less frequently used Income Valuation Method models in the aerospace and defense industry, including IRR, ROI and ROA.

THE MARKET METHOD

The *Market Valuation Method* assumes that there exists a market for companies similar to the subject company and that the subject company should trade at a comparable price. The greatest difficulty with this method is identifying and obtaining financial information about companies that are highly similar to yours and that have recently been sold. While this information is typically available for public companies, it is often very difficult to obtain for private companies. Our firm exerts considerable effort to track mergers and acquisitions of middle market companies in the aerospace and defense industry to maintain a substantial database of these transactions.

This valuation method is commonly referred to as the *Comparable Transactions* method or "Comps." Based upon the fact that most buyers of middle market aerospace companies use multiples of trailing 12-month EBITDA (earnings before interest, taxes, depreciation and amortization) and multiples of trailing revenue, these are the two market value methods utilized by Alderman & Company, LLC.

EBITDA Multiple: Adjusted EBITDA x (∑Price/∑EBITDA)

Revenue Multiple: Revenue x (∑Price/∑Revenue)

Most buyers spend substantial time and effort analyzing the trailing 12-month trailing EBITDA figures of a seller, and typically make substantial adjustments to develop a view of the EBITDA that would have been available to them had they been the owner of the company during the relevant period of time. Adjustments that are often made to EBITDA include, but are not limited to, officer/owner compensation and benefits, warranty costs, inventory obsolescence, uncollectible accounts receivable, environmental reserves and transactions with affiliates.

REPLACEMENT COST METHOD

Most strategic buyers will also consider the possibility of "building" a business similar to yours rather than paying a "premium" to purchase your business. Using the language utilized in most aerospace and defense corporate development departments, they perform an "organic versus acquired" analysis of your business. When the perceived cost of replacing (or building) your business is equal to or below your asking price, you may find substantial price resistance from the market.

Often, the complexity in developing a valuation under the replacement cost method is in dealing with intangible assets, including but not limited to, goodwill, trade names, intellectual property, patents, proprietary technology and knowledge, customer relationships and customer lists. You will want to work with an investment banker who can manage these complexities with relative ease.

IV. Financial Reporting Requirements

In addition to having audited financial statements prepared (as discussed in Section I), you will also want to have monthly budgets and five-year projections prepared each year for no less than two years prior to the sale.

MONTHLY PLANS AND REVIEWS

Buyers will want to see that you have been preparing detailed monthly plans each year. Each month, you should be reviewing how you did versus your plan (actual versus budget), with variance analyses that explain why you have been ahead of (or behind) plan each month. These reports should consist of complete monthly financial statements, including income statements, balance sheets, cash flow statements, and EBITDA calculations. In the event that your company incurs shareholder expenses that are not integral to the business, you should add-back those expenses to your operating income to derive adjusted EBITDA each month.

FIVE-YEAR PROJECTIONS

Buyers will also want to see detailed five-year projections and see how your actual financial results have compared to your projections over the past years. They will also want to see your detailed projections for the five-year period after the sale date. In the event that your past projections have proven to be accurate (actual performance closely matching projected results), buyers gain confidence in your planning and become more willing to "trust" your post-sale projections. Conversely, in the event that you have never done five-year projections before, or your past projections have proven to be unreliable, then buyers will lose confidence and meaningfully discount your projections (which could have a significant negative impact on price).

V. Facility Upgrades

We cannot overstate the importance of the appearance of your physical plant. No matter what business you are in (manufacturing, distributing, MRO, or services), the appearance of your physical plant will have a substantial impact on value. If you do not currently have a 5S program in place, put one in place at least two years prior to your intended sale date. If your operations are not based on Lean, consider taking steps to implement Lean well in advance of when you seek to sell your business (see below).

If tiling or carpeting is old, replace it. If walls are dirty, paint them. Consider epoxy-coating factory floors. If bathrooms are outdated, update them. Discard unused equipment. If your lighting is not optimal, upgrade it. If the parking lot needs to be paved, pave it. While you may be laughing out loud as you read this, don't laugh too hard. It may seem too simple to be true, but we have seen dozens of companies sold for much less than they were worth because the owners didn't think it mattered and didn't want to "waste the money" on clean-up. If you only take one piece of advice from this entire paper, take this one: invest the time and money into cleaning up your facility prior to selling, and keep it tidy and shiny during the sale process.

Obviously, some of the items noted above have a long lead-time and can be very expensive. We are not advocating wasting money. But we are very strong advocates of spending your money appropriately to ensure that your facility shows optimally. Experience proves to us that clients get very handsome returns on these types of investments. Of note, to preserve cash flow, you may want to speak with your bank about financing these upgrades. Often banks will provide facility upgrade financing on a long-term repayment schedule, depending on the specific improvements.

5S PROGRAM

5S is not an expensive program to put in place and it does not take long to implement. Not only will a 5S program make your facility look better and likely result in a higher price for your business because of improved appearance, but it is also likely that a 5S program will directly enhance profitability, which will result in a further increase in sale price, as discussed in Section II.

5S is a system originally developed in Japan to reduce waste and optimize productivity through establishment and maintenance of an orderly workplace with visual cues to achieve consistent operational results.

The 5S pillars, in English and in Japanese, are:

- Sort *(Seiri)*
- Set in Order *(Seiton)*
- Shine *(Seiso)*
- Standardize *(Seiketsu)*
- Sustain *(Shitsuke)*

LEAN

Lean is a method for managing a business by removing waste from systems and processes. Lean is widely utilized by the world's leading aerospace and defense companies, and has become the industry standard for efficiency and productivity. There are a number of ways Lean can be implemented in an organization, including hiring employees with Lean training, training in-house managers, retaining consultants or joining Lean-based trade associations. Our firm is a strong proponent of SEA (the Supplier Excellence Alliance at *www.seaonline.org),* a Lean-based trade association, where Mr. Alderman is a member of the Advisory Board.

VI. Due Diligence Preparation

As noted in Section II, the buyer of your company is most likely going to determine value based substantially on their view of your projected future cash flow.

While the projections that you establish for your business may not be the same set of projections that buyers will use to make their determination of value, buyers will look to your projections as the starting place for their own projections. Most buyers will accept your projections at face value early in the sale process (such as during initial bidding) and then go to extended lengths to test and challenge your projections during due diligence. In most sale processes, due diligence is a 90-day period that starts upon execution of a Letter of Intent, during which time the buyer thoroughly investigates, confirms, evaluates and analyzes your business (legal, accounting, environmental, regulatory compliance, etc.). While not always the case, some buyers will actively seek to find reasons to renegotiate (downward) their price agreement with you, claiming "issues identified in due diligence."

To protect your interests, you should assume that all buyers will use their in-house staff and retained experts (consultants, accountants, attorneys) to go through your due diligence information and projections with the intent of finding "problems" to assist them in getting you to agree to sell at a lower price. While not all aerospace and defense buyers will go into the same level of analysis and depth in challenging your information and projections, almost all will make "testing your projections" their highest priority during due diligence.

In due diligence, most buyers typically use many of the following analytic tools to test your projections:

REVENUES

- Comparing projected revenue growth to past years and current industry trends
- Building their own bottom-up unit forecast based on the following studies:
  - Firm orders in hand
  - Committed releases and release dates
  - Material on hand and on order
  - Capacity and historical through-put
  - Studying historical sales for each major class of revenue, such as:
  - (1) true (legal) backlog; (2) expected (likely) backlog; and (3) unproven backlog (speculative) or spot sales
- Building their own bottom-up revenue matrix, based on units shipped
- Reviewing the pricing in all of your major customer contracts
- Comparing historical unit pricing to forecast unit pricing by line item

GROSS MARGINS

- Comparing past years' gross margins and competitor margins to your forecast
- Analyzing changes in projected margins against industry and major customer trends
- Reviewing customer contracts and tying program and/or unit pricing to your gross margin projections
- Conducting cost accounting studies to confirm allocations and sustainability of cost of goods sold expectations

SELLING GENERAL & ADMINISTRATIVE EXPENSES

- Comparing past years' SG&A and competitor SG&A levels to your forecast
- Reviewing changes in forecast SG&A levels (as a percentage of sales)
- Testing specific line items for reasonableness

INVENTORY LEVELS AND TURNS

- Validating your inventory and investigating excess and obsolete inventory
- Studying historical turnover rates, often with exacting detail
- If your projections include a reduction in days inventory (e.g., an improvement in inventory turns), the buyer will want to see substantial documentation and analysis supporting your argument.

ACCOUNTS RECEIVABLE LEVELS AND TURNS

- Analyzing Accounts Receivable and quantifying potential uncollected receivables
- If your projections include a reduction in collection days inventory (e.g., a decrease in days receivable), the buyer will want to see substantial documentation and analysis supporting your argument.

A MINDSET OF DEFENDING YOUR PROJECTIONS

One of the most common reasons deals die in due diligence is that the buyer finds "problems" with the seller's projections and demands a price reduction, to which the seller will not agree. There is no better way to protect yourself from this risk than for your five-year projections to be highly credible and supported by contracts, market data, and other relevant, objective facts. The greater the level of detail that your management team utilizes in building your projections, the better they will be able to "defend your projections" in due diligence.

Here are a few good examples of how to support projection assumptions:

> *"We are forecasting a $12MM increase in revenue next year because we just won a major contract with customer XYZ. Under this contract, we start shipping on January 1 and ship $1MM per month through December—on a firm committed backlog basis. The contractual pricing in the contract provides to us a 30% gross profit margin, based on our standard costing from last year with a 3.5% escalation included for increased labor costs. An analysis of our costing for this contract is set forth in schedule A1. A copy of the contract with customer XYZ, including unit shipment dates and unit pricing, is set forth in schedule A2.*
>
> *"We are forecasting a reduction in Days Inventory from 145 days last year to 141 days next year as a result of changing our procurement practices whereby we are no longer sending the major assemblies 1526-7, 1345-8, 1456-9, and 1877-9 out for anodizing. This is because we have just completed the construction of our in-house anodize line. While the total cost of anodizing is expected to remain constant (see cost analysis schedule D3), our in-house time studies show that this in-sourcing will result in a net savings of more than 21 days saved on these 4 major items, which will have an aggregate impact on system-wide inventory turns of 4 days. A detailed analysis of this time savings and its impact on aggregate inventory turns is set forth in schedule C3."*

VII. Closing Remarks

It can take two to four years for a privately held aerospace and defense company to prepare for a sale. There are numerous steps to be taken, professional advisors to be hired, and plans to be made, long before the first potential buyer has been met. Like so many things in business, proper planning and thoughtful preparations are the keys to future success. We hope this short guide is helpful to you, and we wish you blue skies and tailwinds in the years ahead.

Appendix A

Often, clients ask us whether they should sell their companies by soliciting interest from one buyer (which we refer to as a Preemptive Sale Process) or multiple buyers at the same time (which we referrer to as a Competitive Sale Process). The following is a brief summary of the differences and benefits of a competitive sale versus a preemptive sale.

DEFINITIONS

Preemptive Sale: A sale process by which a seller enters into exclusive dealings with one buyer and contractually commits not to have discussions with any other buyers during a period of exclusivity—typically 60–120 days.

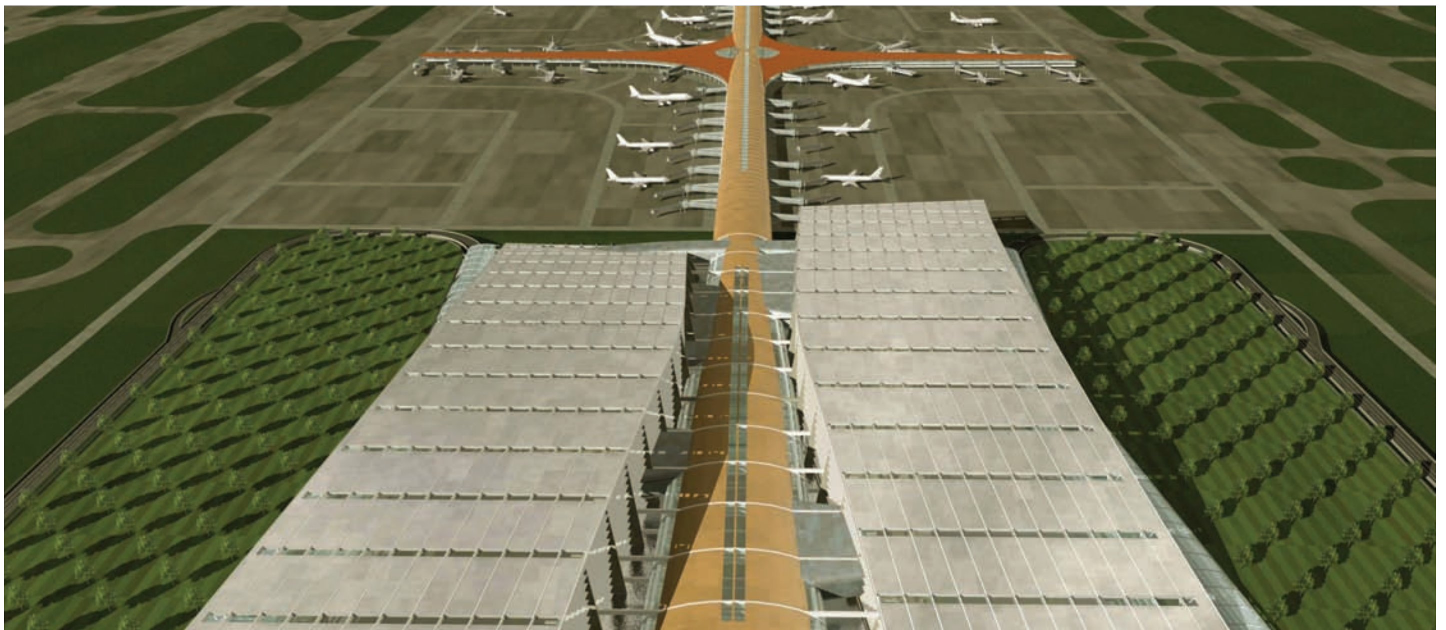
In most cases, the preemptive buyer makes an offer to buy the company at a premium. For example, if your company is trading at $20.00 per share, a typical preemptive offer might be $24.00 (a 20% premium).

Competitive Sale: A sale process by which a seller enters into simultaneous discussions with a number of qualified potential buyers.

It is obvious, but worthy of stating, that the single most important difference between a preemptive sale process and a competitive sale process is the fact that in a preemptive sale the buyer has no competition.

COMMENTARY ON PUBLIC VERSUS PRIVATE TRANSACTIONS

Because there is no independent "trading" price for a privately owned company, preemptive sales are much more difficult to accomplish in the private market. Buyers and sellers of public companies can determine, with great confidence, if a preemptive offer is at, above or below the current market value of the company (by simply looking at yesterday's closing stock price). In sharp contrast to this, private business buyers and sellers can never gain comfort that a preemptive offer is at, above or below the current market value for the business (because there is no market for the company's stock).



PREEMPTIVE SALE

The following are some of the critical risks and benefits for buyer and seller when entering into preemptive discussions regarding the sale of a privately held aerospace and defense company.

Green: indicates a favorable item from that perspective
Red: Indicates a negative item from that perspective

	SELLER PERSPECTIVE	BUYER PERSPECTIVE
TIMING	Less time to complete than a competitive sale process	Less time to complete than a competitive sale process
PRICE	Likely to obtain a price below market. Unable to determine how price compares to market value	Lower price than in a competitive sale
TRANSACTION COSTS	Costs lower than a competitive sale, if successful	Costs similar, but greater certainty fees will be for a deal that closes
CONFIDENTIAL INFORMATION	Less distribution of seller's confidential information	Less distribution of seller's confidential information
TERMS AND CONDITIONS	Buyer has substantial leverage to negotiate buyer favorable terms, due to lack of competition.	Buyer has substantial leverage to negotiate buyer favorable terms, due to lack of competition.
CERTAINTY OF CLOSURE	Much less certainty of closure, due to lack of competition	Much greater certainty of closure, due to lack of competition

COMPETITIVE SALE

The following are some of the critical risks and benefits for buyer and seller when entering into competitive discussions regarding the sale of a privately held aerospace and defense company.

Green: indicates a favorable item from that perspective
Red: Indicates a negative item from that perspective

	SELLER PERSPECTIVE	BUYER PERSPECTIVE
TIMING	More time to complete than a preemptive sale (Red)	More time to complete than a preemptive sale (Red)
PRICE	Certainty in determining market value and in obtaining the highest price (Green)	Price will be driven up by competition (Red)
TRANSACTION COSTS	Higher fees than a successful preemptive sale (Red)	Costs similar, but run the risk of incurring fees and losing the deal to competition (Red)
CONFIDENTIAL INFORMATION	Greater distribution of seller's confidential information (Red)	Greater distribution of seller's confidential information (Red)
TERMS AND CONDITIONS	Seller has leverage to negotiate more favorable terms, due to competition. (Green)	Seller has leverage to negotiate more favorable terms, due to competition (Red)
CERTAINTY OF CLOSURE	Greater certainty of closure due to competition (Green)	Much lower certainty of closure due to competition (Red)

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INVESTMENT BANKERS TO THE AEROSPACE & DEFENSE INDUSTRY

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