
FOUR SEASONS HEATING & AIR CONDITIONING - CASE STUDY

Date Deal Closed: March 30, 2007

THE COMPANY

Four Seasons Heating & Air Conditioning, located in Newberg, Oregon, is one of the most professionally operated HVAC companies of its size. It supplies, installs, and services electric, gas, and oil furnaces, air conditioners and heat pumps for residential high-end new construction and retro fit. Customers are offered a range of equipment on the “good, better, best” model. By having diverse suppliers rather than being tied to a single vendor, the company is able to offer a wide array of products to meet customer needs. The company offers HVAC systems from four major national brands Ruud, Amana, Coleman, and Thermo Pride.

The company was incorporated in 1994 by the sole shareholder who had acquired the assets of a previously existing HVAC company that was operated for many years by the shareholder’s father-in-law. After purchasing the assets of the old company, the owner made significant improvements to the business.

The business has very lean operations and is highly efficient as the result of the development and use of strong systems and policies and procedures. Revenue grew nearly every year since the business was formed, and over the four years preceding the sale of the business the average annual growth rate was 36%. This high level of growth was the result of scalable systems, great retention of well-trained staff, large-company branding and marketing activities, and high population growth in the markets the company serves.

For the trailing twelve months prior to marketing the business, it had \$1,693,356 in revenue and \$197,325 in Earnings Before Interest Taxes Depreciation, and Amortization (EBITDA).

THE ASSIGNMENT

The owner of Four Seasons Heating & Air Conditioning, Inc. was nearing retirement age, and wanted to have more free time to fly his airplane, travel, and pursue other business interests. The owner also realized that the business was poised and positioned to be taken to the next level, but that in order to take the business to the next level would require a great deal of effort and energy. He wrestled with the idea of whether to put in the effort necessary to grow the business significantly, or to sell it to someone else who could grow it substantially. Ultimately, he decided that he wanted to sell the business.

Approximately a year before the owner contacted Codiligent, another broker was employed to assist with the marketing and sale of the company. The other broker did not have success with the sale.

SELLER'S GOALS

- Get out of active involvement with the business in a reasonable time frame
- Gain total liquidity from the sale – the owner did not want to carry any financing
- To locate a buyer who would treat employees and clients well and continue to provide high quality service consistent with the company's reputation.
- To locate a buyer who has the energy and experience to grow Four Seasons Heating & Air Conditioning into a much more successful company.

THE CHALLENGES

- This is a low barrier-to-entry business, so many acquirers may object to paying a premium for a company's goodwill when they could instead use that capital for organic growth.
- There are many HVAC companies in the markets that this company serves, and at any given time there may be a few others available for sale that would provide competition for potential buyers.
- The business is too small for many larger strategic acquirers to get excited about, but too big and unaffordable for many individuals within the industry who want to be self-employed.
- Many acquirers may want to have an earn-out or hold-back to ensure that there will not be a loss of clients or employees immediately after the transaction closes.
- Due to the competitive nature of the industry, there was concern that if other competing businesses learned of the desire of the owner to sell the business, that it could lead to an erosion of business due to predatory practices by competitors using the knowledge of the sale.
- The business has a limited number of tangible assets. Most of the value is for goodwill.
- With a slowing national housing market and the threat of increasing interest rates many buyers are concerned about acquiring a company that they perceive has growth that is tied to the housing market.
- The most logical acquirer for a business like this is someone who already has industry experience, so a challenge is how to reach the most logical acquirers.
- Because of the nature of some of the supplier relationships, insurance, and licensing issues it made the most sense to structure this transaction as a stock sale rather than an asset sale, and yet there are negative tax and liability consequences to a buyer in a stock sale.

PRICING STRATEGY DEVELOPMENT

The seller's primary goal was to exit the business by getting a favorable price in all cash in a reasonable time frame. Codiligent did a thorough analysis of the company to help the seller understand what factors were having the biggest impact on value and marketability of the company. While we discussed the possibility of pricing the business at a higher level, doing so would have likely significantly decreased the probability of attracting a serious acquirer in a reasonable time frame. Consequently, after determining an estimated range of value, the business was priced at a slightly aggressive but realistic level, and the decision was made to be fairly firm on price and terms. The price for the business was set at \$850,000.

POSITIONING & PACKAGING

There were a few primary ways that the business was positioned in the initial information package, the confidential package, and advertisements:

- The business has a long successful operating history with a strong local brand and consistent growth.
- The owner has implemented many lean systems that have made the business more efficient and profitable than many similar businesses, which provides a strong platform for future growth.
- Unexploited or under-exploited opportunities for growth were presented.
- That the geographic markets in which the company operates have strong demographics and growth trends/projections that should lead to continued demand for this company's services.
- The company has high and long-term retention of a decent size staff of well-trained, conscientious employees.
- Consistent and professional branding and marketing have been conducted that give this business the feel of a much larger company. For example, all vehicles have professional signage, employees wear uniforms with logos, and logos are on all printed materials.
- The business is priced fairly.

MARKETING METHODS

- Bound five-page Teaser Packages were sent to approximately 250 researched HVAC, Mechanical, and Plumbing companies. Some were companies that operated in other geographic areas where an acquisition would help them buy additional market share, some were companies offering complementary services that would make Four Seasons a good strategic fit, and others were competing in the same market.
- Placed web-based ads on five major national and international business sale websites.
- Contacted individuals in Codiligent's buyer database for whom this business appeared to be a good match.
- Offered to share commission with network of hundreds of other business sale intermediaries if they were the procuring cause of a buyer.

PROCESS & RESULTS

In August of 2006 Codiligent began having conversations with Four Seasons. The owner of Four Seasons was frustrated with the lack of results they had with another broker and was exploring options of whether to sell the business or grow it to the next level. After candid discussions about the business and the owner's goals, Codiligent discussed the pros and cons of selling the business at that point in time or instead growing the company to the next level and exiting later.

At the end of 2006 the owner of Four Seasons decided that they would like to move forward with sales representation by Codiligent. During December 2006 and January 2007, Codiligent worked with Four Seasons to analyze and value the company, establish a pricing strategy, develop a marketing plan, and research logical acquirers.

On January 26, 2007, Codiligent placed carefully developed advertisements on the top business sale websites, and contacted individuals in Codiligent's buyer database for whom the business appeared to be a potential match.

On January 29, 2007 Codiligent sent out approximately 250 bound teaser packages to researched logical acquirers.

Within the first week of active marketing a half dozen serious inquiries were received on the business. Two parties expressed strong interest in submitting a Letter of Intent. After getting a signed confidentiality agreement Codiligent met with one buyer, a former senior management team member of a publicly traded company and former CEO of two privately held companies, to review the confidential package on January 29th. On January 30th, Codiligent worked with this buyer to put together a full-price letter of intent. By February 2nd, only six days after active marketing began there was a full-price letter of intent in place not only for the business, but also for real property that was owned by the principal of the business that the business was leasing. Prior to accepting the full-price letter of intent, the other serious prospective buyer was given the opportunity to submit a higher-than-asking price bid on the business, but he declined. However, he was very interested in being notified if the proposed deal fell through. This provided a back-up opportunity that would help protect the deal from re-negotiation.

The letter of intent that was agreed to called for the deal to be structured as a stock sale, consistent with the seller's tax goals and to prevent issues that could arise out of an ownership entity change. However, after consulting with his attorney and CPA, the buyer was concerned because the stock sale deal structure negatively impacted his tax situation in a significantly disproportionate level to the seller's tax situation. The buyer asked if there was any chance that the deal could be structured as an asset sale rather than a stock sale, and agreed to compensate the seller for the seller's increased tax obligation that would result. The seller did not object to this conceptually but there were still concerns about some of the operational issues that could arise from having an ownership entity change that would result from an asset sale. Codiligent suggested that the parties may want to consider maintaining the stock sale structure, but making an IRS Section 338(h)(10) election. A Section 338(h)(10) election allows a deal to be structured as a stock sale but has a tax treatment that is similar to an asset sale (i.e. assets basis is stepped up to allow re-depreciation). The buyer discussed this election with his attorney and CPA. Ultimately both parties agreed to modify the deal structure to be a stock sale but with a Section 338(h)(10), and that the buyer would pay not only the seller's increased tax burden but also the cost for his CPA & Attorney's review of the implications of agreeing to the Section 338(h)(10) election. This provided the buyer with a tax benefit that greatly exceeded the cost of paying the seller's increased tax obligation and professional review fees – it was truly a win-win situation resulting from deal structure.

Codiligent managed the due diligence process, provided feedback on transition issues, provided review and suggestions of the purchase agreement to the seller's attorney, and helped manage and coordinate the closing process. The deal closed on March 30, 2007 only 63 days after active marketing began with all of the Seller's goals met: they exited the business within a very short period of time, received 100% cash with no seller-carried note, and located a buyer who they felt would treat their employees well, maintain the quality reputation of the company, and who had the energy and skill set to take the business to the next level.