A GUIDE TO

MERGERS, ACQUISITIONS & JOINT VENTURES OF FOODSERVICE AGENCIES

(An Outline of What You Need to Know)

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INTRODUCTION

Foodservice sales and marketing agencies are unique businesses, providing outsourced sales and marketing activities for their manufacturer/supplier clients. Members of the public generally don't grasp the services provided by foodservice agencies, and frequently, wrongfully considering them merely middlemen. In fact, foodservice sales and marketing agencies **syndicate** their vital services by representing multiple manufacturing clients, which outsourcing studies have determined save those clients on average approximately 23% over a direct sales force[1].

Frequently, sales and marketing agencies consider expanding their business by merging, acquiring, or forming joint ventures with other agencies to cross-market their services in other geographic areas.

OVERVIEW OF FORMATS FOR BUYING AND SELLING BUSINESSES

Mergers and acquisitions, sometimes referred to as "M&As", are the traditional forms for buying and selling businesses. In our experience, foodservice agencies prefer acquisitions rather than mergers, or enter into a hybrid known as a "joint venture". Each of these formats is described below:

Merger. A merger is the legal joining of one or more entities into another. The surviving entity continues in business, and the non-surviving entity no longer legally exists following the effective date specified in the Articles of Merger which are filed with the appropriate state governing body.

In a merger, the assets and liabilities of the non surviving entity become those of the survivor, unless some are spun off prior thereto. Mergers are typically used when there is non-cash consideration exchanged, like stock or ownership interest of the survivor, and there is no need to adjust the accounting bases of the assets or liabilities of the non-survivor. For foodservice entities, a merger can require difficult reconciliation of divergent benefit programs, compensation paid to key employees, and valuation of each entity's contribution to the survivor.

[1] See page 6 of the Executive Summary of ***"Maximizing the Impact of Outsourcing"***: by Bain & Company and page 3 of the Executive Summary of ***"Agency Sales or Direct Sales?"*** at www.asmcfoundation.org and fsmaonline.com/fsma-foundation.

Acquisition (Asset Purchase). In an acquisition, also known as an asset purchase, the Purchaser generally acquires all or some of the assets and liabilities of the Seller, limiting the Purchaser's liability and providing a new accounting basis for the acquired assets. An acquisition enables the Purchaser to mark up certain assets to the purchase price, which then can be depreciated.

Since most foodservice agencies have limited hard assets, in an acquisition the Purchaser assigns values to the agency/client contracts being assigned; employment/consulting contracts to be entered into, and/or certain contracts containing restrictive covenants not to compete and non-solicitation provisions. The remainder of the purchase price over these costs becomes goodwill on the books of the Purchaser, which is written off only if there is an impairment or loss in the carrying values.

Joint Venture. There are many forms of joint ventures, which generally involve two or more companies entering into business to share certain revenues and/or expenses. The joint venture parties usually remain as separate legal entities, but the joint venturer may choose to do business using a common name or just share back-office, billing, bookkeeping, or other expenses.

Oftentimes, entities initially enter into a joint venture in order to determine the feasibility of the entities combining all or a portion of their activities in one legal entity. Joint ventures generally require a written agreement among the parties and don't necessarily involve a filing with a state government, unless it is associated with trademarks or trade names in the relevant jurisdictions. Examples of joint ventures include sub-agency agreements, marketing partnerships and affiliation agreements, franchise agreements, and licensing/royalty agreements.

VALUATION OF THE FOODSERVICE BUSINESS FOR M&As

As noted above, foodservice agencies are unique service companies whose principal assets are the contracts that they maintain with their clients and the personnel servicing those clients. Some agencies or their affiliates also own the building in which the Seller does business and/or the furniture, fixtures, and equipment ("FF&E") used in the business. Hard assets like real estate and FF&E are generally valued at their fair market value. However, in an M&A transaction, if these assets are held outside the non-surviving entity, oftentimes, rather than being purchased, they may be leased by the surviving organization.

The valuation of a foodservice agency business is very complex, and there is no rule of thumb that applies to all transactions. In industrial companies and publicly held entities, the usual formula for price is a multiple of net earnings after taxes. A non-publicly held company may have a multiple of 7 to 10 times earnings, whereas publicly held entities, which generally are larger and have more scrutiny on their business and financial statements, have higher multiples.

In our experience, in the foodservice industry, sales and marketing agencies oftentimes use a formula of 1 times gross revenues (or some percentage thereof) or a multiple of 4 to 6 times earnings before interest, taxes, depreciation, and amortization ("EBITDA"). Since foodservice agencies are usually closely held, pass-through entities, these EBITDA formulas are

often adjusted to add back the compensation to executive officers who are not continuing with the surviving entity or, if they are continuing, for discontinuance of special benefits, like company cars and insurance coverages. The surviving corporation may also take into consideration the client contracts that may be gained or lost as a result of the merger or acquisition. Other issues, including the economies of scale and elimination of certain duplicative functions, factor into the surviving corporation's analysis.

The bottom line is that the parties to an M&A transaction negotiate their price based on the foregoing factors. However, ***payment terms also affect the price***. In a merger, the usual consideration is an interest in the surviving corporation, but cash may also be paid. In an acquisition, the normal payment is cash, but an interest in the surviving entity may also be part of the consideration. The terms for the payment of cash also affect the consideration to be paid. In an acquisition, a single lump-sum payment may be less than what would be paid in installments over time, but a Seller needs to be protected from default risk by the Purchaser when the payout is deferred.

The issues for the Seller are, what security do they obtain from the Purchaser to guarantee the installments will be paid, and what rate of interest should be paid because the consideration is deferred by the installments. Selling foodservice agencies should seek guarantees and retain liens on the assets being sold, to protect themselves in case of default of the installments. Further, if the Purchaser subsequently sells the acquired business to a third party, there should be a "due on sale" clause providing acceleration of the outstanding installments payments due to the Seller.

PRE-NEGOTIATION CONFIDENTIALITY AGREEMENTS

Before an M&A transaction is undertaken, the parties usually exchange select financial information and other proprietary information to determine whether they want to pursue additional negotiations toward a Letter of Intent. A standard form of Pre-Negotiation Confidentiality Agreement for such preliminary actions is attached at the end of this paper.

LETTERS OF INTENT AND MEMORANDUMS OF UNDERSTANDING

M&A transactions start with an outline of the terms for the merger or acquisition contained in a document known as a Letter of Intent ("LOI") or Memorandum of Understanding ("MOU"). The LOI or MOU is a *non-binding agreement* between the Purchaser and the Seller specifying the deal terms, including: the proposed purchase price; confidentiality during the negotiations; due diligence to be performed, and the proposed closing date.

The LOI/MOU also indicates that an M&A is contingent upon the drafting, negotiation and finalization of the terms for a definitive merger or asset purchase agreement. Thus, a Seller and a Purchaser may decide, after completion of due diligence or during negotiations for the terms of the M&A, that they would rather not close the transaction. In such event, both parties return the confidential information they exchanged, and the deal is off.

ASSET PURCHASE AGREEMENT

To assist foodservice agencies in understanding what generally is included, the following is an outline of the typical contents of the Asset Purchase Agreement ("APA"), including the schedules and exhibits contained therein:

A. The Asset Purchase Agreement.

1. Identity of Parties. The identities of the Purchaser and Sellers, including any parent or other control persons, are generally the parties to the agreement.

2. Assets and Liabilities. The assets and liabilities to be included and excluded are next identified, and schedules usually are attached to the APA to itemize each of these.

3. Contracts and Leases. The contracts and leases to be assigned and assumed are identified, and a schedule of these agreements is attached to the APA.

4. Closing Date. This section specifies the Closing Date for the agreement and the effective date on which the businesses transfer to the successor and the consideration is paid to Seller.

5. Purchase Price. This section identifies the consideration paid, including any installments or contingent payments.

6. Employment Agreements. This section refers to the contractual agreements with key Seller employees who are vital to the Purchaser, and schedules are attached to the APA with such Employment Agreements.

7. Leases for the Business Premises. This section identifies those leases of the Seller that will be assigned and assumed by the Purchaser, and schedules are attached to the APA with the leases. If there are FF&E leases, the terms of such leases are also spelled out and attached in schedules to the APA.

8. Seller's Representations and Warranties. Representations and warranties are enumerations of various material conditions that the Purchaser seeks and that the Seller contends exist. Typical representations and warranties include legal validity of the selling organization; authority to enter into the purchase and sale agreement; parties selling to Purchaser are the owners; no consents other than those contained in the agreement are required from third parties (for example, a lender); no conflicts will exist if the deal is consummated; title to the assets is free and clear of all liens; assets are in good working condition; Seller has all permits to engage in operations; all taxes have been paid; there is no material undisclosed litigation; the financial statements are accurate; all employees are identified; all employees under contract are identified; there has been no material undisclosed liabilities; there is no material change in the Seller's business; the Seller maintains adequate insurance; there are no material environmental issues; all trademarks of the Seller have been identified; Seller has received no termination notices from

material customers or suppliers; all property leased or owned by Seller is not in default and will be available for the Purchaser; and Seller has made full disclosure of all material facts.

9. Purchaser's Representations and Warranties. The Purchaser similarly makes representations and warranties to the Seller, including that it has authority to enter into the agreement, has received all consents needed, and has made full disclosure of all matters relating to its business operations.

10. Confidentiality and Public Announcement. This section normally requires that the information relating to the proposed acquisition be kept confidential and specifies how publication will take place following the Closing Date.

11. Indemnification. The Seller is required to indemnify the Purchaser for all claims that may exist prior to the Closing Date, at the same time; the Purchaser indemnifies the Seller for activities after the Closing Date.

12. Restrictive Covenants. This section of the APA generally outlines the restrictive covenants entered into by the Seller, which restrain the former owners of Seller from competing with the Purchaser or soliciting the former employees of Seller.

13. Miscellaneous Provisions. Various miscellaneous provisions governing notice to the parties; stating the agreement inures to the benefit of the successors and assigns of the parties; specifying which governing law and jurisdiction apply when there is a claim; providing dispute resolution by arbitration (strongly recommended); indicating that the parties will bear the respective costs of the agreements (generally the attorneys and accountants engaged to assist the Seller and the Purchaser); stating that the agreement is the entire agreement and cannot be changed without an amendment in writing; and affirming that there are no finder's or broker's fees owed as a result of the transaction.

B. Promissory Note. Where there are installment payments to be made pursuant to a deferred purchase price, a Promissory Note should be executed. This Note indicates the payment terms; interest rate; events of default; default rates of interest; security backing the promissory note; miscellaneous provisions similar to those found in the asset purchase agreement; and an indication of whether the Promissory Note is assignable. See page 3 (last paragraph of "Valuation") above for recommendations on securing Notes and events requiring prepayments.

C. Employment Agreements. Employment Agreements specify the duties of the executive in the new organization; the promised term of employment; the compensation and any incentive compensation proposed; provisions for termination for malfeasance and other reasons; confidentiality provisions, and agreement not to solicit or compete in the event of termination.

D. Bill of Sale. The Bill of Sale is normally a summary document specifying that the assets of Seller have been sold and confirming that Seller has have the authority and approvals needed to complete the transaction.

E. Other Documents. If the Purchaser is an LLC, then the Operating Agreement of the LLC is usually included as an exhibit to the APA. Other documents that may be included are UCC liens on the assets being conveyed and subordination agreements where required by the lenders.

ABOUT THE AUTHOR

Barry C. Maloney has represented sales and marketing agencies for more than 30 years, including having been General Counsel to the Foodservice Sales & Marketing Association ("FSMA"), the Association of Sales & Marketing Companies ("ASMC"), ASMC's predecessor the National Food Brokers Association ("NFBA"), the Sales Agency Committee of the Grocery Manufacturers of America now known as the Consumer Brands Association, and the Manufacturers' Representatives Council of the Automotive Aftermarket Industry Association, now known as the Auto Care Association.

He is the author of several legal manuals on agency law, submits various legal briefs for trade association newsletters, and has represented sales and marketing agencies in mergers and acquisitions and collection of unpaid commissions. In addition to being an attorney, Barry is a Certified Public Accountant, and formerly was Senior Branch Counsel to the Division of Corporate Finance of the Securities and Exchange Commission in Washington, DC.

He is currently the Managing Partner of his law firm, Maloney & Knox, PLLC, located in Washington, DC. He graduated second in his class at the Georgetown University School of Business Administration and graduated from George Washington University Law School, where he received the Outstanding Law Student in the Nation Award from the Delta Theta Phi legal fraternity.

Barry has represented various sales and marketing agencies throughout the US in their M&A transactions, including counsel to both the acquiring entities and the party being acquired. Because of the legal and accounting complexities of the M&A's, Barry's understanding of foodservice sales and marketing entities, and his legal, CPA, and M&A expertise, he is in a unique position to assist entities and work with their CEO's, CFO's, and local counsel and accountants, as well as their counterparts on the other side of the transaction. His expertise has assisted his clients in negotiating excellent selling prices, terms of acquisition, and ease of transition. Free consultation and M&A references are available upon request.

PRE-NEGOTIATION CONFIDENTIALITY AGREEMENT

THIS AGREEMENT is entered into this _____ day of _______________, 20___, by and between the parties identified below.

WHEREAS, for the purpose of considering a possible affiliation, the parties hereto desire to mutually exchange certain proprietary and confidential customer, product, financial, marketing, organizational, technical, and other information and data relating to each other's business, including written information and also information transferred orally, visually, electronically, or by any other means (hereafter referred to as "Confidential or Proprietary Information"), and

WHEREAS, the parties request that all such information be kept confidential in accordance with the terms of this Agreement;

NOW THEREFORE, in consideration of the premises and covenants contained herein, the parties hereby agree as follows:

1. Each party agrees to keep confidential all disclosures received from the other party identified as "Confidential" or "Proprietary".

2. In accepting such Confidential Information, each party agrees that, except for their own internal purposes of evaluation, they will not, without the written consent of the disclosing party, use or disclose such Confidential Information to any persons inside or outside its organization who are not directly involved with the evaluation of the Confidential Information for the above stated purpose.

3. Each party agrees to hold Confidential Information of the other party in confidence, but such agreement shall impose no obligation with respect to any portion of the received Confidential Information which:

    a. is now or hereafter becomes publicly known or available through no act or omission on the part of the receiving party;

    b. is known to the receiving party at the time of the receipt of such Confidential Information;

    c. has been or is hereafter furnished by the disclosing party to a third party without restriction on disclosure;

    d. has been or is hereafter furnished to the receiving party by a third party who has obtained such Confidential Information without restriction on disclosure;

    e. has been or is hereafter disclosed pursuant to the requirement of any Government entity; or

f. has been or is hereafter independently developed by the receiving party or a third party.

4. All Confidential Information delivered by the disclosing party pursuant to this Agreement shall be and remain the property of the disclosing party, and any copies thereof shall be promptly returned to the disclosing party upon written request, or destroyed at the disclosing party's option.

5. This Agreement shall remain in effect for 2 years from the date first above written.

6. In the event of the invalidity of any provision of this Agreement under any applicable law, such invalidity shall not affect the validity of the remaining portions of this Agreement, and the receiving party further agrees to substitute for the invalid provision a valid provision which most closely approximates the effect and intent of the invalid provision.

7. This Agreement and the rights and obligations of the either party hereunder may not be assigned, delegated or transferred in whole or in part, without the written consent of the other party. Such consent shall not be withheld unreasonably in the event of the purchase, take-over or merger of a party hereto with another firm or other organization.

8. This Agreement is made in and shall be governed and construed in accordance with the laws of the party claiming a violation of this Agreement.

9. Any alteration or amendment of this Agreement must be in writing.

10. The person or persons executing this document for and on behalf of the parties represent that they are fully authorized to do so for and on behalf of their respective principals.

IN WITNESS WHEREOF, the parties hereto have set their hands as of the date first above written.

Name of Company:

____

By:_____________________________

Authorized Party Signature

____

Title

Name of Company:

____

By:_____________________________

Authorized Party Signature

____

Title