AVONDALE STRATEGIC PARTNERS

Inc. 500

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Avondale focuses on value-maximizing activities that help grow shareholder value for businesses. To do this, we believe that a firm must have solid leadership, strategic direction, and engage in thoughtful analysis. To that end, we would like to provide our perspectives on these three key competencies that we hope provide your business with a fresh way of thinking to build value. In addition, we share our latest firm happenings and news.

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Align Your Management Team to Accelerate Growth

Growing a company is complicated. Sometimes, growth is inhibited simply because your management team can't agree on the right plan to grow the business. The key to breaking the logjam is getting your leadership group to agree on a common view of the company's current state and the untapped opportunities to create value.

Achieving this type of alignment requires four basic steps. A word of caution: If your management team is misaligned in any of these areas, don't expect a change overnight. The alignment process can take up to three to six months, depending on your management team's priorities and whether you've historically worked together on a strategic plan.

Step 1: Align on the facts

The lack of a clearly defined strategy often begins when the members of the management team disagree on the key facts around the business. These different and often conflicting views - such as the growth potential of a specific market - can lead one executive to push for increasing investment and another to recommend an exit strategy. These perspectives are driven not by differences in philosophies, intellectual ability, or risk tolerances, but simply by a different view of the facts about the market.

For this reason, the first and arguably most critical step in the alignment process is to develop and agree on a common set of facts about the business and the markets in which you compete. ***A good fact base comprises three key elements:***

***Market Size and Growth by Segment*:** Estimate the market size and growth rate of the business' core market and each of its adjacent or emerging markets. Within each market, break out the size of relevant segments - geographies, demographics, products, distribution channels, or consumer attributes. Don't worry about decimal-level precision; the relative differences in markets and

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segments are what you're after here.

Current and Forecast Economics by Segment: One can identify many opportunities simply by understanding the basic economics of the business, particularly the concentration of revenue and profit across segments as well as what's driving those sales. In most businesses, the 80/20 rule applies–80 percent of the profit is generated by 20 percent of the customers (or products, geographies, or channels). It's critical to gain a clear view of the value drivers that define the differences between customer segments.

Competitive Position: Value in its purest form is defined by a business' ability to charge its customers more than its cost to serve those customers. But each business has a competitive position that it must understand and exploit. Competitive position is determined by 1) offering, 2) pricing, and 3) operating or cost relative to competitors and substitutes. Building a fact base around where your business is advantaged, at parity, or disadvantaged relative to customer alternatives is generally accomplished through customer surveys and competitive research. The best information, however, often comes from talking to your customers, your sales force, and your sales channels, because they have the best understanding of how your product or service compares with competitive offerings. Once you understand the key differences between your business and your competitors, you can identify ways to exploit these differences and increase (or regain) your advantage.

> ***"Value in its purest form is…a business' ability to charge its customers more than its cost…"***

Step 2: Align on the Management Agenda

A management agenda defines the top three to five opportunities that will contribute most of the value growth going forward. Often, these opportunities can and should be quantified, in terms of the potential value they would bring to the business.

Retaining a top customer, for example, can be compared with entering a new market or improving sales force productivity. Aligning the team on the highest-value agenda items should be driven by the common fact base you developed in Step 1.

Step 3: Align on the Investment Choices

Each item on the management agenda has an investment choice or set of choices. For some, the choice may be simple; for example, if expanding geographically is a high-value agenda item, we need to determine which market to invest in. For others, such as improving sales force productivity, the choice may involve "investing" in a process or a technology that will enable the goal.

Step 4: Align on the Targets, Timelines and Accountabilities

Finally, when the team has aligned on the way to achieve value growth, it is essential to agree on the process. The most perfectly crafted strategic plan is worthless if the business doesn't follow through.

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Assign responsibility to each of the items on the management agenda. When the management team is aligned, it can take quick, coordinated action.

A growing company needs to be aligned on a logical, clearly defined strategic path that maximizes value for the business. Following this four-step exercise with your management team can put the entire organization on the right track to create long-term growth.

Finding Acquisitions that Create Value

Empirical evidence suggests the vast majority of acquisitions by public companies actually destroy shareholder value. There are a number of causes, ranging from overpaying to "win a deal" to poor integration. One way to avoid these value-destroying purchases is to improve the up-front process of identifying and vetting acquisition targets.

> ***"Empirical evidence suggests the vast majority of acquisitions…destroy shareholder value."***

Here are four tips companies should keep to ensure that potential acquisitions will create shareholder value:

1. Know your reasons. A haphazard acquisition search is bound to fail. Companies that are proactively seeking acquisitions should have a clear understanding of the broader strategy governing what types of companies to target. This includes a thorough review of why a firm is pursuing a certain market, product, technology, etc., and the ultimate goal of an acquisition. Building a roadmap can help companies ensure they pause during the fast-paced deal process to ask three key questions:

a. Does this fit into our strategy?
b. Why am I pursuing this acquisition?
c. Will this help me achieve my objectives?

2. Keep your options open. Companies can fall in love with a particular deal and forego all other opportunities, or consummate a deal because they have invested so much time and do not want to start over again - even if they have reservations about it. Following parallel paths with multiple companies allows firms to build a choice set of options to compare potential acquisition targets. While mapping out multiple options is subject to management resource and time constraints, the more alternatives you have, the more likely you are to find a target that is the right fit.

3. Build the right target list. Once you have laid out a strategy and defined criteria for which companies could help achieve that strategy, it is important to prioritize potential acquisition candidates to allow management to focus on researching high value targets. Canvassing an entire industry sector may at times uncover a diamond in the rough, but the process will waste significant time. The trade-off is rarely worth it.

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4. Diligence is up-front, not an afterthought. Diligence is not just a process to close a deal – it is the best opportunity you have to determine how an acquisition will fit into your organization and identify business risks and opportunities. If you cannot gain any insight into those areas during diligence, you should not close a deal. Part of the equation involves being realistic about what synergies you expect from any kind of acquisition. Overestimating the benefits is an easy and all-too-common way to overpay for a deal.

Every acquisition has risk, and the reality is that no matter how much diligence and strategic planning a company does, there is no guarantee of success. However, if you ignore these steps, an acquisition becomes more like a roll of the dice rather than a strategic investment. Building shareholder value should not depend on chance.

Dangers of Stock Price Goals

A few years ago, a client set an aspirational goal to reach a $100 stock price. At the time, the goal represented roughly doubling the company's stock price. The goal was tangible, unequivocal, simple, and a nice round number to boot. It immediately energized senior management and the board.

Shortly thereafter, the Great Recession hit. The company successfully retrenched and rationalized costs to the new reality. After 18 months of survival mode, management returned its attention to longer-term strategy and revived the $100 goal. But this time, the impact of the goal was quite different, as several issues became apparent.

Issue 1: Ambiguity

Everyone understood the $100 goal, but no one knew by when it should be achieved. $100 in three years is a much different goal than $100 in seven years. The goal was now 2+ years old and unchanged, amplifying the ambiguity over timeframe, and contributing to…

Issue 2: Irrelevance

The company restored profitability after the recession but not the stock price, which now stood at less than two-thirds its pre-recession level. $100 now represented tripling the stock price, not doubling. The goal became more of a dream. This could have been solved but for…

Issue 3: Disconnect from Plans

The $100 goal was top-down, but the strategy was bottoms-up. The two did not meet. Management knew the gap was large but assumed that acquisitions of more stable, higher margin businesses would close it. With no financial analysis to back it up, this assumption was largely a leap of faith.

These three issues turned the initial energy created by the $100 goal into confusion and cynicism in the organization. To address the challenges, we recommended the following:

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1. Set an appropriately aggressive relative share price goal, with clear timeframes. Doubling the share price is a clear and potentially galvanizing goal, but it must be based on where you are today, not three years ago. Better to establish an enduring objective relative to the overall stock market such as top-quartile total shareholder returns (TSR). Three-or five-year share price goals consistent with that objective can then be adjusted as market conditions change. Turns out, top-quartile TSR historically has been roughly equivalent to doubling the stock price every five years.
2. Financially link your strategies to your goal. Until you understand clearly the financial performance you have to deliver, and the future financial performance you must be in position to deliver, you cannot build a credible plan to get there. We showed our client that to close their $100 gap, the company would have had to quadruple the value of acquisitions in less than 4 years. On the other hand, just executing their existing organic growth strategy would have doubled their value in 5 years (see recommendation 1).
3. Iterate between your top-down value growth goal and your bottom-up strategies until everyone believes the two match. Start with an aggressive top-down goal to motivate creative growth strategies. Analyze the impact of those strategies and determine the gap to the goal. Create corporate strategies to close the gap, re-challenge the business units' strategies, and adjust the goal if necessary. The goal will not motivate unless everyone agrees that executing the accepted strategies will hit the goal.

Stock price goals are simple and understandable, and they enable management to calculate personal rewards easily. But to work as intended, they must also stay relevant to current realities and be backed by credible operational and financial strategies to achieve them.

Avondale's HEART Event

On May 3, Avondale hosted an event with the Humane Education Advocacy Reaching Teachers (HEART) at Avondale's Chicago headquarters. HEART is a Chicago-based non-profit organization that provides teachers and students with services focused on human rights, animal protection, and environmental ethics. The executive networking event and fundraiser included approximately 70 people, who were treated to delicious fair-trade chocolate and organic wine as they heard compelling stories from students about how HEART has improved their lives and changed their views of the world.

Avondale is committed to the Chicago community and encourages its team to be involved in causes and organizations they are passionate about. Avondale's Bradley Hoos serves as a board member for HEART focused on strategic direction and development.

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At the event, Tio Hardiman, Director of CeaseFire Illinois, spoke to the group about the importance of educating children about non-violent solutions to issues and alternatives to dog fighting, including dog-training events in low-income neighborhoods. Soon after the HEART event, CeaseFire Illinois was awarded an unprecedented one-year grant for $1 million from the City of Chicago to reduce crime in two police districts, one on the West Side and the other on the South Side of the city. Congratulations to Tio and CeaseFire.

Students involved with HEART have participated in many activities, including trips to Springfield, IL, to lobby the State Legislature, 12-week humane education classes, environmental clean-up efforts, and school assemblies addressing relevant topics such as bullying.

To learn more about HEART, please visit www.teachhumane.org.

Avondale News

Inc. 500

Avondale was recently listed in Inc.'s 2012 ranking of the 500 fastest growing private companies in the U.S. This is Avondale's second consecutive year on the Inc. 500 ranking and its second year as one of Chicago's top 10 fastest growing private companies.

Managing Directors Karl Stark and Bill Stewart author a column for Inc.com where they share their perspective on building and growing businesses at www.inc.com/author/karl-stark-and-bill-stewart.

About Avondale

Avondale is a strategic advisory firm that identifies and executes initiatives to drive sustainable value growth. Avondale's strategic and financial advice helps companies create value in their business and focus investment around the most profitable growth opportunities. Avondale partners with clients across three areas:

- Strategic Advisory
- M&A Advisory
- Principal Investing

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