

Reprinted with permission by Modern Distribution Management

A Different Exit Strategy

Distributor details option for owners not ready to lose control

Heritage Partners recently purchased a 49 percent stake in OneSource Distributors, a \$170-million electrical and utility product distributor based in Oceanside, CA. The transaction provides liquidity for shareholders while OneSource's co-founder maintains a majority stake in the company. President/CEO Bob Zamarripa details the process his company went through to find Heritage and offers tips to distributors seeking a similar option.

By Lindsay Young

The need for an outside investor struck OneSource Distributors' founders during one of its annual board meetings.

Two key topics arose that demanded the company's immediate attention: A sizable acquisition target was on the table; and co-founder Paul Judge, 13 years older than President/CEO Bob Zamarripa, said he was starting to think about retirement and cashing out his share of the company.

Additionally, OneSource has seen growth of 18-20 percent a year for the past three years, all of it organic. Combining these three issues, Zamarripa and Judge knew the company would be "strapped for cash" if they continued to grow at the current rate, pursued an acquisition and dealt with Judge's eventual retirement and desire for liquidity at the same time. "We couldn't do it. So we stepped back a little and developed a plan," Zamarripa says.

The Plan

The idea was to bring in an outside investor, such as a private equity firm or a business strategic buyer – someone who could provide liquidity and support for future growth and succession issues. Zamarripa and Judge had founded the company in 1983 – Zamarripa wasn't

ready to lose control of the business, and he wouldn't retire for at least five to ten years.

"I really didn't want to work for somebody. I hadn't done that for 23+ years so I didn't want to start now," he says. With that in mind, Zamarripa formed a six-point "wish list" to guide the company's search:

1. Zamarripa would remain the majority shareholder.
2. Shareholders would gain liquidity.
3. The outside investor would pay top-of-the-market multiples.
4. After transaction, OneSource would be in a strong financial position to continue its growth.
5. The company would be able to execute its current five-year strategic plan.
6. Key members of the senior leadership team and key associates would gain some form of equity in the business.

Finding an Investor

OneSource's first move was to choose an investment banker that would help it find an investor and broker a deal. According to Zamarripa, "Getting the right investment banker was critical."

OneSource found Comann & Montague, a small boutique investment banking firm in San Francisco, CA. The distributor provided Comann with its wish list, as well as a business plan, and together they prepared a highly detailed financial information package going back three years and looking forward five years. Comann then found a list of financial buyers that might be able to meet OneSource's criteria.

continued on next page

INSIDE

Distributor Faces Wage-Hour Lawsuit

C&S Wholesale Grocers, an \$18-billion grocery distributor, defends work teams concept as it faces a \$750-million class action.

Page 4

Fair Labor Standards Act Primer

What distributors need to know about state and federal wage-hour laws.

Page 5

Survey Reviews M&A Activity

Executives report M&A deals often fall short of expectations. No surprise? Here are some views on what actually creates shareholder value.

Page 6

Case Study: Inventory Efficiency

The power of demand planning. An exclusive excerpt from NAW's new *Distribution Value Map*™.

Page 7



Many potential investors struggled with what Zamarripa was seeking. "A lot of them wanted to have the controlling interest," he says. "Our goals narrowed the field pretty quickly." But the company did have a number of choices and ultimately settled on Heritage Partners. "It became very obvious that this is what Heritage does," Zamarripa says. "Our plan is their business model."

What's more, Heritage was more conservative than many of the other private equity firms. "We had a lot of firms we interviewed that concerned me because they wanted to make OneSource a billion-dollar business," Zamarripa explains.

But Heritage told OneSource that as long as it produces a strong return on investors' money, it will support OneSource's five-year strategic plan already in place. "They are as conservative as I am," Zamarripa says. "That's what I like about them. Heritage would support acquisitions if they fit within the company's current game plan."

Heritage's Model

With a traditional leveraged buyout (used by many private equity firms), in its most basic form, the financial buyer essentially writes a check to the owner for the value of the business with the expectation the owner will reinvest a small portion of the proceeds. The owner has a continuing minority interest in the company but the financial buyer ultimately takes control.

Heritage Partners' structure (created in

1987) on the other hand, gives private-business owners a way to retain majority control while at the same time taking in capital and gaining liquidity.

"We have found there are scores of successful entrepreneurs across the country that need liquidity for one reason or another but do not want to sell out the business," says Heritage general partner Mark Jrolf. "This gives us the opportunity to partner with a successful entrepreneur and earn a very sufficient return while helping to meet his needs."

OneSource's Strengths

OneSource qualified on several counts as a smart investment, Jrolf says. The key attraction was the distributor's investment in several markets.

OneSource sells to five segments: industrial MRO, institutional MRO, OEMs, municipal and industrial construction and utilities. Population growth in southern California, Nevada and Arizona has spurred the updating of schools, hospitals and other government institutions, as well as the construction of new buildings. The utility market is also booming for the same reason. OneSource entered the utility market in 2002 and it has been one of its fastest growing sectors.

"It was unusual to see a company dividing its revenue fairly equally among utility, industrial, commercial and OEM," says Jrolf. The company had \$170 million in revenues in 2005 and expects that to grow to \$215 million in 2006.

MODERN DISTRIBUTION MANAGEMENT

Founded in 1967
by J. Van Ness Philip

Publisher & Executive Editor
Thomas P. Gale
tom@mdm.com

Editor
Lindsay Young
lindsay@mdm.com

Contact Information

Questions, comments, article proposals, address changes or subscription service to:

Gale Media, Inc.
2737 Mapleton Avenue, #201, Boulder, CO 80304
Tel: 303-443-5060 Fax: 303-443-5059
Website: <http://www.mdm.com>

Subscription Rates

To subscribe to Modern Distribution Management, please call 303-443-5060, email tom@mdm.com or <http://www.mdm.com>.

Subscriptions are available by online delivery and/or first-class mail. Three-year archives of MDM are available online to subscribers. Previous-year archives are available at a discounted rate to current subscribers.

Published twice monthly; \$345/yr., \$365 U.S. funds other countries; \$169 each additional subscription to a company (\$189 other countries). For group subscription rates and site licenses, please contact Tom Gale at 303-443-5060.

Copyright © 2006 by Gale Media, Inc. All rights reserved. Modern Distribution Management® and mdm® are registered trademarks of Gale Media, Inc. Material may not be reproduced in whole or in part in any form whatsoever without permission from the publisher. To request permission to copy, republish, or quote material, please call 303-443-5060.

ISSN 0544-6538

MDM Editorial Advisory Board

David K. Barth
Member of the Board of Directors of the
Industrial Distribution Group

Kevin Boyle
Vice President Industrial Distribution and Channel
Management for the Loctite Industrial Division of
Henkel Technologies

Larry Goode
CEO of RT Dygert International, Inc.

Julia Klein
President and CEO of C.H. Briggs Hardware Co.

Stuart Mechlin
Vice President, Industrial Supply Division of
Affiliated Distributors

Walter W. Norton Jr.
President and COO of Norton Electric Wholesale

OneSource has also done a good job providing differentiated services for their customers, has “exceptional industry profitability,” and maintains longstanding customer and supplier relationships with a strong management team geared toward growth, Jrolf says.

“Customers increasingly depend on their distributors for more and more value-added services,” he says. Distributors who take advantage of that will become indispensable and more attractive to outside investors.

Surviving Due Diligence

After signing a letter of intent, the next step was to endure due diligence. “The due diligence is tremendous,” Zamarripa says. “The challenge you have with private equity investors is they’re really dealing with other people’s money. So you go through about three times the diligence you would if you sold to a strategic buyer. You need to be prepared for that.”

According to Zamarripa, “Your business plan should already be developed; you should segment your sales by customer types; you need to have a strong business operating IT system that you are comfortable with, and your accounting and internal operations need to be rock-solid.

“Every operational and financial reporting

flaw you have is going to be exposed and ultimately needs to be fixed.” He thinks the process will be good for business by improving the company’s financial reporting, its management and operations. “We should be able to squeeze more profit out of every dollar we sell.”

Communicate with Suppliers/Customers

Throughout the process, OneSource kept top suppliers and customers informed. Zamarripa says suppliers and customers were pleased with OneSource’s decision to bring in an outside investor. The key for them was that Zamarripa would retain majority ownership and ultimate control.

“The last thing our suppliers want is for OneSource to sell our business to a national strategic buyer,” he says. The suppliers felt strongly that the company would grow faster with its current business model. Customers were happy with the deal because it solidified OneSource’s presence in the market in the near future.

OneSource ended its search for an investor after nine months – Heritage was able to meet all six of OneSource’s goals. “There is not one thing on that list that’s not in place,” Zamarripa says.

Finding an Investor: Before You Begin

- ✓ **Put your goals down on paper** – What do you want to accomplish with a potential transaction? OneSource President/CEO Bob Zamarripa used his six-point wish list as his guide for finding investors. Investors who could meet his criteria were considered.
- ✓ **Find an investment banker tuned to your goals** – “They’ll tell you what you want to hear,” says Zamarripa, but what they promise isn’t always what they can do. Be diligent in making your choice. An investment banker is your broker, and you will depend on them to find investors who meet your needs.
- ✓ **Refine your business model for optimum return on investment** – The annualized return on capital investors will reap (12-15 percent is a good benchmark) plays a big part in how much they will invest in your company. The more you are able to return, the less likely they will want to change the way you do things.
- ✓ **Be prepared for due diligence** – Get all of your financial statements, accounting and business plans in order. “It really tests your patience as a private business person,” says Zamarripa. But the more you prepare, and the more details you can provide, the better off you will be.