The McLean Group
INVESTMENT BANKING

M&A Market Update©

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The McLean Group is a national, middle market investment bank serving businesses generating up to $500 million in annual revenues. For more information, visit www.mcleanllc.com.

Feature Article:
The Critical Role of M&A Auctions in Maximizing Your Business Value

By Enrique Brito, CFA, AVA, CM&AA

The efficiency of any market is primarily based on the availability of price discovery mechanisms that enable a potential buyer to determine whether or not the price being paid for an asset represents a fair value. In the United States, the securities markets are considered to be highly efficient because the prices are set daily by the forces of supply and demand in a process that is transparent to all participants. Indeed, whether we are buying stock in a publicly traded company or government bonds, we always are assured that the price paid is the result of an open auction process in which buyers and sellers freely agree to transact.

In other markets, however, such as the one involving the purchase and sale of private middle market businesses, each deal stands on its own with seemingly little objective referential criteria for purchase and sale prices; however, this informal and subjective market can be quite efficient if certain rules are followed. In fact, when sellers are able to implement an effective auction process it is quite possible to craft a deal that can result in the realization of maximum value in what seems to be an inefficient market.

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Expert Tips:
The Ins and Outs of CIMs

Confidential Information Memorandums, or CIMs, are an integral component to the successful sale of a middle market business. Through its success in presenting the company's key selling points, strengths and opportunities, the CIM sets the tone for the sales process. Hence, it is no surprise that CIMs require careful consideration and intense collaboration by both the seller and investment banker.

From the investment banker's perspective, the most integral aspect of the CIM is the opportunity to gain in-depth knowledge about the client and the company. It is a chance to ask the client about the company's strengths and weaknesses, opportunities and competitive threats.

From the seller's perspective, the most integral aspect of the CIM is sharing the company's story, which includes providing concise answers to such questions as, "What are your company's core strengths?" and "What is the essence of your company?" This is where the investment banker comes into play: he/she should help the seller formulate the ideal pitch that captures the company's key successes, challenges and opportunities.

In addition to developing succinct answers to central questions, the seller should provide supporting documentation and help the investment banker edit the document to ensure the correct message is implied. The following components are generally included in CIMs to help set the tone:

- An executive summary of the CIM itself with brief financial highlights
- An overview of the seller's business (i.e. what products and/or services it provides)
- A detailed description of the seller's industry, including competitors
- A history of the seller's business (i.e. when it was founded, corporate structure, etc.)
- A summary of the seller's technology and special processes
- A description of the seller's strengths, opportunities and weaknesses (it is important to identify weaknesses before prospective buyers have the opportunity to do so)
- A summary of the seller's contractual commitments that the buyer should know about
- An organizational chart of the seller's work force (include titles but not employee names)
- A description of major contracts and customers (again, do not include names)
- Normalized and recast financial statements, and
- Appendices that include financial statements prepared by independent Certified Public Accountants (CPAs) and perhaps recent tax returns.

Once the CIM is created, a process that generally takes one to two months, it is distributed to prospective buyers by the seller and his/her investment banker, prefigrinring the negotiation process. As negotiations proceed, each consecutive draft of legal documents will trace its roots, at least in part, to the CIM.

Trends To Act On:
Private Equity's Troubles Could Translate into Triumphs for Strategic Acquirers

By Michael Keith

Private equity firms have begun to recognize that the complex financial engineering strategies that had yielded unprecedented returns in recent years are no longer operative. At a private equity conference in late October, buyout magnate Henry Kravis, of Kohlberg Kravis Roberts & Co., asserted that going forward, firms must be more thoughtful and conservative. This may suggest that, given uncertain markets and the likelihood that the current economic downturn may persist for some months, funds may prefer to sit on cash at hand or invest some of that cash into their own portfolio businesses to keep them afloat, rather than pursue new acquisitions. With that in mind, owners of middle market businesses seeking exit strategies may find strategic acquirers to be more attractive prospects in the near term.

In any case, owners of middle market businesses should ensure that their businesses are fully prepared to pursue a successful exit (i.e. ensuring that their financials are in good order, their business strategies are well-executed, their cost structures are well-managed, and their own business prospects are strong). In challenging economic times, attractive middle market businesses remain likely to realize strong values in an exit if their owners are well-prepared and well-represented in any prospective transaction. Now more than ever, middle market investment banks can offer significant value to such businesses as they pursue exit strategies.

Exit Planning:
Is Your Exit Plan Realistic?

By Scott T. Wait, CPA

Without thoughtful review of reasons to exit the business, owners can be setting themselves up for a painful, costly experience in time and money or even worse consequences. The keys to successful exit planning include several steps, one of which is to determine the owner's succession and exit objectives.

The owner's exit objectives need to be clear and realistic in order for the exit process to be successful and to overcome challenges the owner will face during this process. Owners who have plans for other business ventures, charitable causes or productive activities after the sale provide stability in this time of change.

During the exit plan process, the owner's and his/her family's financial well-being and comfort is at stake. There are many business exit plans that fall apart due to unclear, vaguely committed owner objectives. The owner may have all necessary financial questions answered and documents in place, but the exit strategy may fail due to unclear, uncommitted or impractical objectives.

Once an owner's exit objectives are clear and achievable, the next steps include reviewing his personal financial review and business review. The business review includes obtaining an independent business appraisal. The steps after the business review summarize the best method to exit, and then how to optimize the business's value. Optimum business value depends on the business's lifecycle and its industry as well as determining the best qualified buyer, be it a competitor, a financial buyer or individual buyer. For more information on these issues, link to my recent interview on these planning issues at www.mcleanllc.com/scottwait.htm.

The Exit Strategies Institute

The McLean Group's Exit Strategies Institute works with business owners to develop a multi-year program that provides a road map to maximize the business' value at the time of exit. In this comprehensive process each business is evaluated at three levels: business strategy, value proposition and current execution. Each of these levels is carefully evaluated to develop an action plan outlining specific steps to capitalize on the business' strengths to enhance its value and marketability. For more information, please visit www.PlanYourExit.org.

"The Critical Role of M&A Auctions..." continued from p. 1

In essence, orchestrating an effective auction in the M&A market involves getting two or more buyers simultaneously interested in a company. However, before that point is reached, a series of well-designed steps must be carefully implemented. The first step is to find actual as opposed to apparent buyers. This involves making sure that the buyers are qualified in terms of having the proper financial resources to carry out the transaction. It is not uncommon in M&A deals to find apparent buyers who are just interested in learning more about the details of the business and how it operates rather than committing themselves to the transaction; hence, making sure the owners are dealing with qualified buyers, who are both committed to the deal and who have the financial backing to close the transaction, is essential.

The next step in an effective auction is to avoid pricing the business. It is inevitable that very early in the negotiation process a buyer will want to know the seller's expected price. However, the seller and its advisors cannot be certain what the actual value of the company will be. The only way to find out is to test the market, as investment value from one buyer to the next will vary widely. Frequently, if the idea that the actual value is unknown is expressed openly and earnestly, a certain level of comfort and rapport may be established between the seller's advisors and the buyer. This is not to say that the seller's advisors should not prime the pump a bit when the occasion calls for it by saying something like: "We have seen deals in this sector with multiples of trailing EBITDA ranging from six to 12." Once a buyer is in, it is a lot easier to let the auction persuade the buyer as to the true market value of the business.

The final step in the process is for the seller and seller's advisors to evaluate the relative attractiveness of each of the offers received. At this stage it is important for the seller to be concerned with the difference between price and actual transaction value. The broad range of consideration mixes that can be offered in a deal can easily confuse the distinction between these two factors – so it is necessary for the seller to develop a framework by which to evaluate the various offers. One such framework, which can be very effective when comparing price and value, consists of considering the time value of money and the probability of collection associated with each offer. The time value of money analysis is subject to fairly objective calculations using market interest rates for each particular type of deferred obligation. The probability of collection is a somewhat subjective estimated percentage that is applied to the time value of money calculation. Although this approach is as much art as it is science, it provides sellers and their advisors with a quantitative approach to consider the total deal value associated with each offer.

Auctions have important implications for both sellers and buyers. The seller's advisors must be proficient in running the auction process so that they find the right buyer for the business and maximize transaction value. Buyers, on the other hand, must be careful not to be caught up in a bidding war that results in overpaying for the business. Many of the drivers behind the increase in the frequency of middle market auctions are unlikely to disappear soon and both buyers and sellers need to be aware of all the issues that they will face when entering these situations in M&A transactions.

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Contact Us:

The McLean Group
7900 Westpark Drive, Suite A320
McLean, VA 22102
(703) 827-0200 phone
(703) 827-0175 fax
www.mcleanllc.com

About The McLean Group

The McLean Group is a national, middle market investment bank providing mergers & acquisitions (M&A), capital formation, market intelligence, business valuation, litigation support and exit planning services. The McLean Group serves businesses generating up to $500 million in annual revenues. Headquartered in Northern Virginia's technology, communications and government contracting corridor, the firm is among the largest independent middle market investment banks in the Washington, DC area. The McLean Group is a FINRA Registered Broker/Dealer and Member FINRA/SIPC.

- **M&A:** The McLean Group uses its considerable expertise in a wide variety of industries to identify the most probable and suitable candidates to complete transactions under the most favorable terms for its clients.

- **Capital Formation:** The McLean Group arranges private equity, venture capital, senior debt and subordinated debt in amounts ranging from $5 million to $250 million to support clients' expansions, mergers & acquisitions (M&A), refinancings, recapitalizations, leveraged buyouts and shareholder liquidity objectives.

- **Market Intelligence:** By leveraging superior competitive analyses, the firm provide business executives with comprehensive market intelligence reports, which give the market insight and analytical expertise required to reduce risk and uncertainty in strategic decision making.

- **Business Valuation:** As a core competency and complement to its M&A business, The McLean Group provides business valuation services, including intangible asset and financial security valuations for a variety of transactions, financial reporting and tax purposes.

- **Litigation Support:** From quantifying economic damages to valuing a minority interest in a business, the firm has the business valuation experience and credentials to support cases involving a variety of legal issues.

- **Exit Planning Services:** Based on its extensive experience advising owners of middle market businesses, The McLean Group has developed a proprietary process that analyzes more than 60 value/risk drivers that can have a significant impact on the value of a business.

The McLean Group
Investment Bankers to the Middle Market