The McLean Group
INVESTMENT BANKING

M&A Market Update©

Your source for information about today's mergers & acquisitions market December 2009

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

Buy the Book:
Dennis Roberts' book, *Mergers & Acquisitions: An Insider's Guide to The Purchase and Sale of Middle Market Business Interests,* is still available at Amazon.com.

Feature Article:
Who Will Buy This Company?
Identifying a Type of Buyer for Your Business

By Dennis Roberts, CPA*/ABV, CVA

Participating in an acquisition event is a stressful and labor intensive project. While most business owners and professionals can identify common buyer types, there are other types that may be overlooked. Sellers need to be aware of the variations between different buyers types when planning an exit. The following reviews these different buyer types and the motivations that some buyers hold.

Active Middle Market buyers can be sorted into six basic categories: Consolidators or roll-up promoters, strategic industry buyers, private equity group (PEG) buyers, non-strategic industry buyers, management buyouts and offshore buyers. Strategic industry buyers are obvious by definition but let's take a look at the other types.

Consolidators or roll up promoters:
Consolidators or roll-up promoters are quite different from strategic industry buyers. This particular type of buyer is seen less frequently than it was in the late 1990's. Unlike strategic buyers, consolidators do not pursue acquisitions that complement their established enterprise. These buyers "roll-up" or

Continued on p. 2

Expert Tip:
Win-Win Transactions
Keys to Successful M&A Negotiations during Tough Economic Times

By Chuck Andrews

The term "Win-Win," like many business terms, is excessively used to describe a negotiation's ideal conclusion. Because of this, we feel the need to provide two caveats.

The "size matters" caveat: the larger the deal the more resources both parties have available to influence the outcome. This article will focus on transactions in the $10 million to $100 million range.

Continued on p. 3

"Buyer Types..." continued from p.1

purchase many companies often within a fragmented industry and combine them into one company. Transactions are often completed somewhat hastily in anticipation of a planned initial public offering (IPO) and result in large premiums for sellers and profits for consolidators at the IPO. New investors in the IPO typically suffer financial losses as the IPOs are launched before expected synergies are proved to be achievable. Nevertheless, owners whose businesses are in an industry that is being rolled-up should seriously consider the financial benefits of selling, but heed one caveat: insist on receiving the bulk of the selling price in cash—not stock.

Management Buyouts:
Another option for sellers is a Management Buyout of which there are basically two types: informal and formal. This can be a relatively risky option having an uncertain chance of success. One challenging aspect of management buyouts is financing which is often difficult to obtain unless the sellers are willing to offer a significant portion of the purchase price in promissory debt notes to management buyers. Typically, management must be capable of investing at least 20% to 33% of the business's value in order for third party debt sponsors to be willing to provide the additional funds necessary to close the transaction. Additionally, the business' purchase price can only be determined in somewhat of a vacuum since there is only one buyer whereas other selling scenarios might involve a competition between several buyers. This competition provides a better gauge as to the actual value of the business. Despite these obstacles, management buyouts can under the right circumstances provide a good exit opportunity for an owner. This is especially true if management is the only prospective buyer.

The formal type of management buyout is an Employee Stock Ownership Plan (ESOP). ESOPs can purchase the company with a trust that is created and then funded through contributions to qualified retirement and pension plans. The buyers essentially purchase the business with the business' profits and sellers are rewarded with tax deductions (at marginal tax brackets approaching 40% or more). However, ESOPs, like management buyouts, have significant downsides. In the absence of an auction and the presence of the IRS and Department of Labor, sellers are unlikely to maximize the true value of their business. Because of this, ESOPs should usually only be considered when all other options have been exhausted.

Nonstrategic industry buyers:
Nonstrategic industry buyers (buyers who are in a similar or related industry but have not mounted a formal acquisition program) are usually only willing to consider acquisitions that are presented at a minimal price. These bottom feeders capitalize on their own indifference toward the prospective acquisition. They are unmotivated buyers who extract substantial price concessions from prospective sellers who are unwilling or unable to look further ahead at potential strategic buys. Sellers usually turn to nonstrategic industry buyers in the presence of a distress sale (divorce, death, health problems, etc.) and when poorly advised by inexperienced intermediaries or advisors. To an extent, possible sellers should avoid this buyer at all costs!

Now let's move on to **PEG buyers**:
Pegs account for approximately 25% to 33% of Middle Market deals. They actively invest in all transaction stages and though most investments in the private equity funds themselves are made through college endowments, large pension plans, insurance company portfolios, family office funds, etc., some PEGs raise money through the public sale of stock.

Venture capitalists are types of PEGs that are usually involved in early stage investments or start up businesses. They invest funds that can only be used to grow an enterprise and typically do not allow founders to take money off the table. Portfolio funds and recapitalization funds, on the other hand, invest in more mature, post-start-up businesses. Portfolio funds routinely buy the entire company while recapitalization funds allow the original owners to retain significant minority, and sometimes, majority interests. It is imperative that recapitalization transaction sellers are involved with a PEG that has the means for further expansion since the seller will be retaining a stake in the company. Furthermore sellers under these circumstances should be prepared to evaluate the consequence of third party debt that will likely end up on their company's balance sheet post transaction.

Offshore buyers:
Offshore buyers may be PEGs or strategic buyer types. These buyers are frequently overlooked by sellers, particularly when individuals and amateur consultants attempt to sell a business. However, these buyers account for a significant part (perhaps 25%) of M&A activity in the Middle Market especially following the decline of the US dollar. Sellers should not limit themselves to American buyers and instead broaden their selling opportunities overseas.

Though it is beneficial for sell-side owners to be knowledgeable of buyer types, it is still advisable that they consult an investment bank before time of sale. These firms are equipped with the information and tools capable of identifying and locating suitable prospective buyers and investors for their sale-side clients' businesses. They also offer professional and technical expertise during auctions and negotiations for complex Middle Market M&A transactions.

"Win-Win..." continued from p.1

The "time matters" caveat: the two most common phrases in the transaction world are: "time is of the essence" and "deals that drag out don't happen," so acknowledge the impact of timeliness. Usually, it's easy to recognize delays in the negotiation process when both parties prioritize completing the deal. Delays are red flags and may indicate a ploy or lack of original motivation (more on this later).

We are living in one of the most difficult times to be in the M&A transaction business. Not only have the number of deals decreased, but traditional valuations seldom apply. It is a buyer's market; however, buyers still need to put themselves in sellers' shoes. The following is what we ask sellers prior to accepting an engagement:

• Can you answer the question, "Why are you selling" and "What will you do after you sell" with little or no hesitation?

• Do you have a team of advisors that is experienced in selling businesses and will you include it in the planning process?

• Do you understand why a fair market valuation is important to establish a benchmark for a minimally acceptable deal?

• Are you focused on "Cash at Closing" or do you understand the value of "Deal Structure" and its impact on negotiations?

• Is this the best time for you to sell to leverage tax benefits, market conditions and the buyer's financing challenges?

Today's buyers must follow a process that will allow them to find the right business, meet their financial objectives, and achieve forecast goals.

Both buyers and sellers should follow a process that prepares them for a "Win-Win" transaction:

1. *Establish a Reasonable Price on the Business*
The seller should pick a minimum price that he or she expects to receive.

2. *Allow the Seller to Carry on "Business as Usual"*
Do not allow the client to become too preoccupied with the transaction. Distractions may cause the client's attention to waver from day-to-day demands and negatively affect sales, costs, and profits.

3. *Engage an Expert Intermediary*
Their platform for maximizing a transaction's success is rooted in confidentiality and efficiency.

4. *Prepare for the Sale Well in Advance*
Preparation is the most effective negotiating tool for minimizing wasted time, maintaining credibility and shortening due diligence.

5. *Anticipate Information that Sellers May Require*
This is the first step to putting yourself in the seller's shoes.

6. *Achieve Leverage through Competitive Analysis*
Understanding the target seller's competitors, alternative acquisitions and industry conditions can significantly improve your position.

7. *Be Flexible*
An intermediary should inform you of the areas where flexibility will impact both price and time to close.

8. *Negotiate—Don't Dominate*
The negotiating process you have previously used to acquire businesses or products is an asset and provides you with the knowledge to understand the give and take of deals. However, the stakes (and emotions) that are involved are higher and require assistance from your advisors.

9. *Keep Time from Dragging Down the Deal*
To maintain the momentum, work with your advisors to ensure that the target seller sticks to a schedule. Advisors should also make certain that the seller's offers and counter-offers progress quickly.

10. *Recognize that Terms are just as Valuable as Price*
Employ the proper use of Earn-outs to bridge value differences. Also, be open to methods of calculation that maximize the seller's ability to meet your terms.

It is important to understand the process of successful M&A negotiations and to candidly share your motivation with your advisors. Motivation is the non-negotiable element for both sides of a transaction and too frequently becomes the deal killer. Most deals do NOT have both buyers and sellers walking away from the closing feeling like they have won. That feeling usually occurs some months later. What is important at the closing table is to feel that both parties' needs were satisfied in a fair and equal manner. Finally, it is important to recognize the most powerful tool in successful negotiation is the tool of quality preparation.

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 provides business executives with comprehensive market intelligence reports, which provide 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.

- **Wealth Management:** A fee-only wealth advisory practice providing financial planning and investment management services. Through McLean Wealth Advisors, clients have access to unbiased advice, institutional-level investment management and highly personalized level of service to assist them manage their financial futures.

The McLean Group
Investment Bankers to the Middle Market

Our Locations:

Washington, DC (Headquarters)
Anchorage, AK
Asheville, NC
Atlanta, GA
Austin, TX
Baltimore, MD
Baton Rouge, LA
Boston, MA
Bozeman, MT
Buffalo, NY
Chicago, IL
Cleveland, OH
Columbus, OH
Dallas, TX
El Paso, TX
Erie, PA
Hartford, CT
Halifax, Nova Scotia
Los Angeles, CA
Lubbock, TX
Miami, FL
Phoenix, AZ
Reno, NV
Sacramento, CA
San Diego, CA
Silicon Valley, CA
Tulsa, OK
Wooster, OH

Contact Us:

7900 Westpark Drive
Suite A320
McLean, VA 22102

(703) 827-0200 phone
(703) 827-0175 fax
www.mcleanllc.com