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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 revenue. For more information, visit www.mcleanllc.com.

Feature Article:

M&A : The Recession's Only Financial Opportunity?

By Dennis Roberts, CPA*/ABV, CVA

Recession or no recession, American businesses are (for the most part) in need of some kind of financial restructuring to improve returns on equity. In light of the credit crunch, companies must seek alternative options.

In his article "Pressure on Companies to Spend Again," Liam Denning cites three options for business owners: capital expenditures, dividend payouts and mergers & acquisitions (M&A).

Some economists predict a surge in capital expenditures. These usually occur after companies initially cease spending, experience diminished industrial capacity and invest in fixed assets to recuperate losses.

Denning believes this pattern will not evolve during the current recession given that large corporations reliant on government aid have insufficient capital to invest in fixed assets. Additionally, low sales diminish the necessity for companies to invest.

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Expert Tip:

How Capital Gains Tax Increase May Impact Middle-Market Business Owners

By Joe Golden, Senior Managing Director

Let's face it: President Bush's tax cuts will probably expire on January 1, 2011. Despite President Obama's promise in his December 8th Jobs Creation and Economic Growth Speech to "build[...] on the tax cuts in the Recovery Act [...] and eliminate[...] capital gains taxes on small businesses," House Democrats voted to more than double such taxes one day later.

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In lieu of capital expenditures, companies may turn to shareholder payouts (dividends). However, this may possibly worsen companies’ financial standings as shareholders already struggling with low yields rarely reinvest in their companies’ stocks. Scott Davis of Morgan Stanley surveyed the buy-back records of 26 companies, concluding: “more than half made a zero or negative return on those purchases” since 2000.

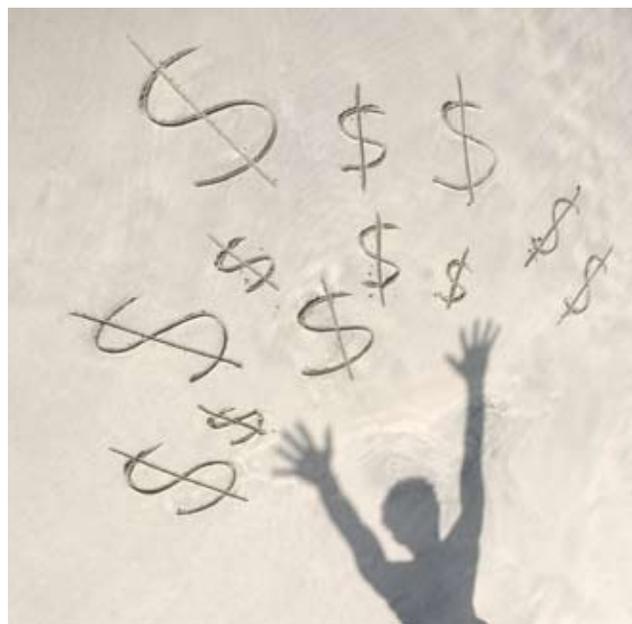
Mergers & acquisitions are, therefore, the ideal option for businesses. Unlike capital expenditures, M&As’ inorganic growth easily allows companies to trim fat and increase technology capacities. Conglomerates’ stable earnings constitute another advantage to investing in M&As. Usually, even underperforming conglomerates ultimately enjoy high or at the very least secure earnings once they are acquired.

While buying the competition generates much publicity, it also creates anxiety for investors who may view conglomerate M&A activity as risky and potentially value depreciating. Yet industrial conglomerates recently have sold at price/earnings ratios that are comparable to large corporation multiples, proving that mergers & acquisitions are anything but value depreciating. Interested buyers are likely to find bargains as Private Equity’s relative inactivity may have temporarily softened sellers’ asking prices.

Bob Filek, Partner with PricewaterhouseCoopers Transaction Services, states, “Companies have taken aggressive actions on costs; the low-hanging fruit is gone, and to drive further efficiency they will look to combine with similar players to drive scale and enhance productivity. The ‘merger of productivity’ will be a driving force in 2010 as companies look to drive revenue growth and enhance margins.”

Today’s economy has created an abundance of potential M&A transactions. Buyers should capitalize on what may be the recession’s only financial opportunity and invest in an acquisition. Not only are they more sound investments than capital expenditures and dividend payouts, but they also have greater earnings potential.

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The proposed tax hike may encourage business owners who are already contemplating selling their businesses to do so within the next year. Though these propositions still must pass the Senate, the likelihood that the capital gains tax will at least revert to the pre-Bush rate is high. Talk on Capitol Hill about an additional 15% to 19.6% increase may further prompt owners to sell.

Since 2003, the capital gains tax rate has been 15%—a five percent reduction from the previous 20% tax rate. That’s an extra \$500,000 in an owner’s bank account on a \$10 million sale. However, in certain cases the proposed 35% - 39.6% capital gain tax would impose an additional \$1.5 million to \$1.96 million cost on a \$10 million sale on top of the forfeited \$2 million in taxes at the original 20% rate.

In summary, most pundits agree that capital gain rates will increase at least 5% after 2010. The sale of a middle market company generally consumes at least six to nine months (and sometimes more.) If you are considering selling your business, we recommend you discuss the impact of the capital gains tax with your tax and merger & acquisition advisors.

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Erie, PA
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Halifax, Nova Scotia
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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.

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