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INVESTMENT BANKING

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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:

Six Questions To Ask Yourself About Customer Relationships Before Selling

By Joe Golden, Managing Director

It seems that I have read hundreds of articles and books on how businesses can better market to, sell to and serve customers, yet I have seen very little literature on how to hand customers to a buyer.

There is no cash flow without customers, so it is reasonable for business owners and executives to make substantial investments in order to develop a customer-centric enterprise. While there are exceptions, current and projected cash flow are the most closely examined attributes for middle market transactions when the transaction price and terms are determined.

Current and projected cash flow are generated by customers. When a prospective buyer and its advisors scour the books and records of a selling business, they often identify potential roadblocks and problems with respect to a seller's relationship with its customers. The following six questions are issues to consider in order to avoid such problems:

1. **Who "owns" the key customer relationships?**
   Buyers often are worried that customers will walk away when the owner sells, so if possible, owners need to create redundant relationships with their customers' multiple team members. Otherwise, buyers will insist on paying much of the purchase price in the form of an earn-out payment, or perhaps even worse, they will discount the purchase price in order to address this risk.

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Expert Tips:

Due Diligence: Preparing for the last step of a transaction should really be your first step

By Cameron Hamilton, AVA

While it might seem counter-intuitive, one of the most important steps when preparing for the sale of your business is to start considering due diligence. Your investment bank may run the most successful auction, which results in dozens of interested parties and the execution of a well-negotiated and thoughtful letter of intent; however, if you are not prepared for the trials and tribulations of the confirmatory due diligence period, there is a strong possibility that both parties will not make it to a closing dinner.

This is the largest risk area in a transaction for which you can proactively plan. With proper preparation for the process, you can shave weeks off the time needed to close and keep all parties excited about the transaction.

Due diligence is a risk area that has been growing for the past year and will continue as long as we face an economic slowdown and general pessimism across the marketplace. While certain events like Sarbanes-Oxley added to the pressures of due diligence, it is in a down economic climate such as the one we are currently facing that buyers become increasingly risk-averse. This directly translates into longer due diligence periods driven by buyers' wishes to ensure that they have identified all possible risks. Buyers will ask for not just more historical documents, but additional analyses of trends and financial statements that often require significant legwork by the seller. They seek counsel's opinion on more matters and add additional representations and warranties to the purchase agreement. Conversely, when the economy is booming, buyers are much less concerned about a few small things going wrong as they expect to have plenty of other things that will run smoothly.

So what can you do to prepare yourself? As you start planning for your exit event, here are five tips:

1. **Ask your counsel for a sample due diligence list.**
2. **Begin to scan and digitize any documents that are only in paper form.**
3. **Recognize the holes and begin to fill them.**
4. **Start an organized electronic filing system that will allow you to easily determine what is missing and a buyer to see what is available.**
5. **During the sales process, force yourself to revisit the data at least once every month and update documents where appropriate.**

Selling your company is a draining enough process as it is, so why not remove as much time, effort, and headache from the process? Proactive preparation for due diligence is the best way. ◆

"Six Questions To Ask Yourself..." continued from p. 1

2. **Do your customer relationships create recurring revenue?**
   From the perspective of a buyer, customers who generate recurring revenue have much higher value than those that do not. Consequently, businesses with recurring revenue generally (all other facts being equal) have higher value than those that do not. Can you create recurring revenue streams in your business?

3. **Do you have CRM software or other data bases that carefully track the characteristics of, and dialogue with, customers and prospective customers?**
   The use of these tools may seem tedious at times, but buyers often covet this information and ascribe significant value to it. In certain cases, a buyer will want to cross-sell its own products and services into your markets. You can increase the value of your business by having your sales and marketing team keep careful, methodical records related to prospects and customers. What is the state of your customer/prospect database?

4. **Do any of your customers constitute more than 10 percent of your revenue?**
   While 10 percent is somewhat arbitrary, buyers start to have anxiety when they see customer revenue concentrated in one or just a few customers. This is not a deal killer, but because buyers will perceive it as a risk, they will often push for fewer dollars paid at closing and more dollars paid in the form of a future earn-out.

5. **When practical, do you have contracts with all of your customers? How easily can your contracts be cancelled? What are your payment terms? Are all key terms detailed in the contract? Do your customer contracts address the sale or assignment of the contract?**
   Contracts that are non-cancelable and long-term (six-to-12-plus months) or have volume purchase requirements, are obviously better than those that do not. Furthermore, concise, well-documented contracts that address all fundamental business terms are the best contracts. Keep in mind that if you do not address your business sale or contract assignment in your agreements, you may want to discuss this with your legal counsel.

6. **What is your reputation with customers? Do you have written customer testimonials?**
   In most cases, business owners want to keep the mergers and acquisitions (M&A) process confidential. On the other hand, buyers often want to understand the reputation a seller has with its customers. Do you have customers who can be trusted with the news of your impending business sale? Do you have written letters from key customers who praise the value and quality of your products or services? These letters can give buyers assurance while confidentially is maintained.

Addressing the issues and questions above can help you maximize the price and terms of your business when you sell.

Questions about this topic? Contact Joe Golden at (703) 785-5525 or call The McLean Group at (703) 827-0200. ◆

Trends To Act On:
Market Downturn an Opportunity for More Stock-for-Stock Deals and More Due Diligence

By Mitali Munshi

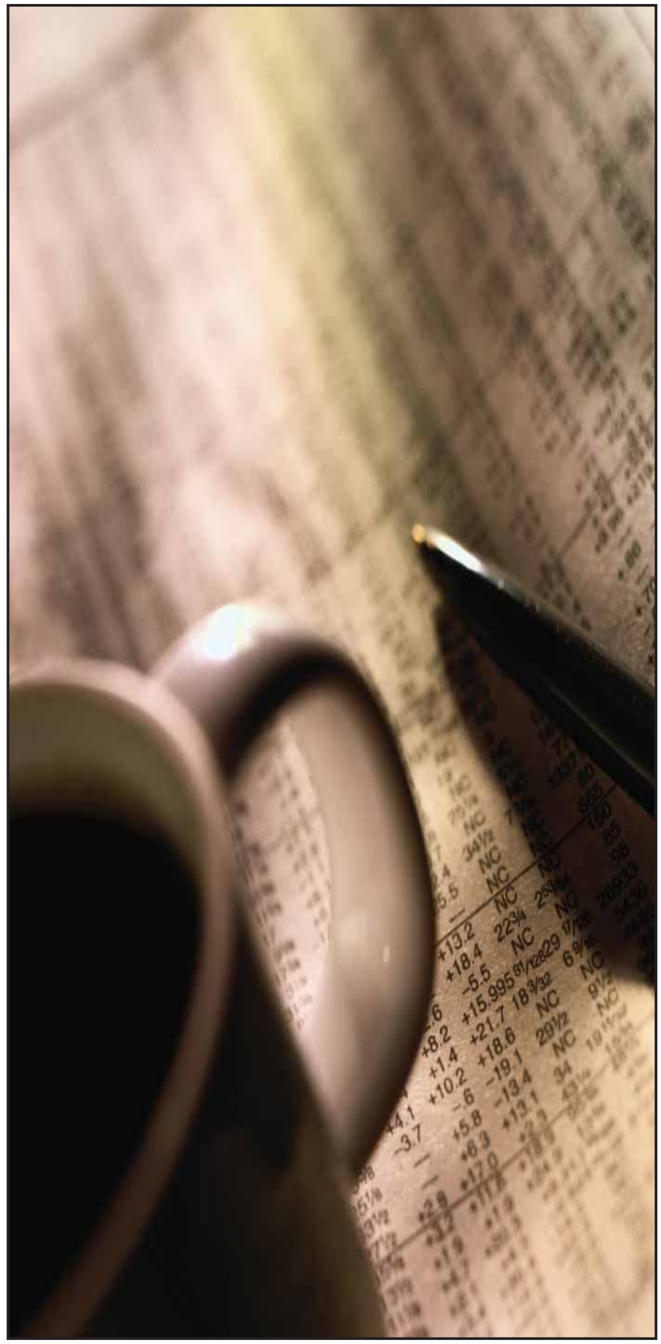
RW Baird reports that during the first three months of 2008, middle market deals dropped about 25 percent. Dealmakers hope that market conditions will improve somewhat during the remainder of 2008.

In 2000 and 2001, credit markets faced a similar downturn including a lending crunch and depressed valuations. Such conditions in the past have led advisers to suggest stock-for-stock transactions. Baird adds that during 2000, stock-for-stock transactions accounted for about 30 percent of deal volume versus 10 percent under normal conditions.

DF King and Co Senior Vice President Thomas Germinario projects an increased volume of stock-for-stock deals in 2008 and 2009 as history repeats, especially in the health care, technology and banking sectors.

The current credit crunch brings with it increased pressure for transaction due diligence. Acclaro Growth Partners' Christopher Lisle asserts that lenders are becoming increasingly cautious even to the point of requiring "third party diligence." More important, lenders do not always want to hear from loan sponsors that "everything is okay" but prefer to have a clear understanding of internal and external weaknesses and challenges up front.

Given the pressure for increased due diligence and other challenges closing deals, experts suggest that this may be a great time for deal-making as long as buyers and lenders in particular carefully analyze all aspects of the deal at hand. Under such circumstances, those deals that do close may prove to be very solid investments. ◆



Exit Planning:
Selling Your Business To Outsiders

By Enrique Brito, CFA, AVA, CM&A

When the decision is to sell to an outsider, the focus of the strategy is twofold: (1) maximize the value obtained from the sale and (2) find a buyer who can afford the business and who is qualified to run it. The price that the business will command in the market is a function of several factors such as: the business' future performance, returns on alternative investments, the buyer's unique needs and the market conditions for mergers & acquisitions. An important point to consider is that value is in the eye of the beholder. In other words, you will not know the true fair market value for your business until you negotiate the sale. In addition to an outright sale, your business could also be acquired in a merger-type of transaction, which could leave you with stock in the acquiring company.

A large percentage of business owners make the mistake of delaying the development of an exit plan until they are ready to exit their business. Unfortunately, once they reach that point most of the value that can be provided by developing and implementing an effective exit plan has already been lost. The time to begin developing an exit plan is today. This will require a significant investment in both time and resources but will be one of the wisest investments you may have made regarding your business. ◆

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 PlanYourExit.org.

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 Washington, DC's technology, communications and government contracting corridor, the firm is among the largest independent middle market investment banks in the region. 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 in order 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' expansion, mergers & acquisitions, refinancing, recapitalization, leveraged buyout and shareholder liquidity objectives.

- Market Intelligence: By leveraging superior competitive analyses, we 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.

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