

M&A Market Update[®]

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About Us

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

Feature Article:

Negotiating Deal Price – Fitting The Pieces Together

By Brian A. Sullivan, CPA/ABV, CVA, CBA, CFE

Reported pricing multiples often are used in mergers & acquisitions (M&A) negotiations and they assist in developing an overall transaction price. A reported multiple represents the price paid for a business usually divided by some measure of earnings, typically Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) or Earnings Before Interest and Taxes (EBIT).

At the end of the negotiation process, the final deal price reflects the following elements: the buyer's ability to generate future cash flow from the target business, the amount of additional capital required to generate that desired cash flow, the cost of capital, and an acceptable, risk-adjusted rate of return (the explicit or implicit hurdle rate). The final price the buyer is willing to pay is based on calculations, which are generally hidden from view, that consider not only the target on a standalone basis, but the synergies that arise from the very acquisition itself.

Value also can differ markedly based upon the business and personal motivations of the parties involved. A particular business may be worth much more, or less for that matter, to a corporate buyer with excess capacity than to a pure financial buyer focused on achieving a rate of return by selling the company in five years' time. Sellers may be highly motivated to sell at a lower valuation given health or per-

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sonal issues, or equally likely to hold out for a higher valuation due to specific issues related to the needs of their investors or the owner’s retirement objectives. In the end, the multiple represents the nearly completely subjective desirability of the business to a particular buyer.

Since multiples can be gathered from independent third parties, they can help the buyer and seller obtain some preliminary perspective during early price discussions or preliminary assessments of possible deal ranges; however, as the transaction progresses, reported multiples should become less prominent in motivating a transaction through fruition. ♦

Expert Tips: *Credit Crunch – What Happened?*

By Neil Paschall, CPA/ABV, CVA, CFFA

Starting around 2005, enormous amounts of capital were raised by Private Equity Groups (PEGs) that began entering into larger transactions and paying ever-increasing acquisition multiples for target companies. This, in turn, increased the leverage (bank debt) on their deals. The banks were eager to stay in the good graces of their private equity clients by providing this leverage. The price of new debt substantially decreased, and the PEGs enjoyed a higher level of leverage and better terms from a covenant perspective up until the middle of 2007; however, the banks were not comfortable holding the credit risks on their balance sheets.



Simultaneously, institutional investors and hedge funds in search of higher yields were being forced into the debt markets by low interest rates and marginal returns in the stock market. This provided the backdrop for the creation of new Collateralized Loan Obligation (CLO) structures into which the institutional investors and hedge funds invested large amounts of capital. The CLOs then bought the debt from the banks. This structure made it easier for companies to refinance their debt at lower rates and allowed PEGs to reduce risk and boost returns through dividend recapitalizations.

Despite the sub-prime debacle in early-mid 2007, leveraged finance markets seemed pretty immune through the end of June; however, it turned out that many of the big providers of CLOs also were investors in sub-prime structures and other mortgage-related vehicles, so much so that financing for CLOs declined dramatically. As a result, many of the large deals the banks had committed to in the first half of 2007, with the intent of distributing the debt to CLOs, ran into trouble. Since the CLO buyers accounted for more than 50 percent of the leveraged transactions, the banks did not have anywhere to go with the commitments they had made.

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When you add to this the sub-prime effect on the overall mortgage market where the bid-ask spreads on high-quality mortgages doubled, it forced a de-leveraging in the system - there was the mortgage crisis coupled with \$300 plus billion of commitments that Wall Street could not sell.

As a result, expectations of the probability of a recession have increased dramatically to the point of not being a question of “if,” but “how deep?” This has led to a sell-off in equities and leveraged debt products. The recent actions of the Federal Reserve Board (monetary policy) and the government (fiscal policy) are designed to reduce the probability of a recession or to minimize the effect if there is one.

What does this mean for middle-market mergers & acquisitions (M&A)? Since less leverage is involved in these transactions, and private capital remains available, it is just about business as usual. We are beginning to see some widening in the bid-ask spread, but buyers and sellers are still at the table and deals are getting done. ♦

Trends To Act On: *Facing Middle Market Challenges*

By Whitney E.L. Weiss



Middle-market mergers and acquisitions (M&A) deal activity declined from 2006 to 2007 and is likely to face continuing challenges in 2008, with few industries posting increased deal activity. In microcosm, a look at January 2008 activity versus January 2007 may prove instructive (with data collected from Capital IQ for M&A transactions from \$5 million to \$500 million announced in the US during those two respective months).

In the middle-market sector as defined above, 147 US transactions were announced in January 2008 versus 235 in January 2007. While most industries faced decreasing transaction volumes, transactions in the healthcare industry increased. Transactions for which no primary industry was assigned also increased in January 2008 versus January 2007.

The value of transactions announced in January 2008 declined, but less dramatically than did deal volume: while the total dollar value of transactions announced in January 2008 declined by more than 53.5 percent, average deal values declined by only 16.5 percent. Average revenue multiples for deals announced in January 2008 declined by 1.7 percent versus January 2007 even as the average EBITDA multiple decreased by 45.1 percent.

Mergerstat Flashwire reported that the aggregate deal value for all US M&A market transactions in January 2008 was \$63.6 billion (752 announced transactions) versus \$69.3 billion (1071 announced transactions) in January 2007. ♦

Exit Planning: *When Should You Start Considering An Exit Strategy?*

By Enrique Brito, CFA, AVA, CM&A

An exit strategy should be part of your business plan from the moment you launch your business. It will act as a blueprint for many strategic decisions in operating your business and as a guide to ensure alignment between your personal and business objectives. Most importantly, it will allow you to exit your business when and how you desire. Therefore, one of your priority goals should be to create an exit plan as soon as possible and stick to it for as long as you remain in business.

The process of creating an exit strategy begins with defining two important components: a personal plan and a business plan. The personal plan sets the agenda for reaching your personal financial objectives. It serves as a blueprint for attaining financial security (financial plan), provides the means to continue your family's lifestyle in the event that something happens to you (estate planning), and outlines the terms and conditions to transfer the ownership of your business (buy-sell agreement) under certain events such as death, disability, bankruptcy and so forth.

The business plan, on the other hand, ensures that the value of the business is maximized through enhancing its key value drivers and cash flow. This plan includes such elements as: determining the value of your business, keeping and motivating key employees, implementing appropriate tax minimization strategies and creating an advisory team to help you with key decisions about how to grow your business and ultimately how to navigate the sales process. ♦



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.

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About The McLean Group

The McLean Group is a national investment bank providing mergers & acquisitions (M&A), capital formation, business valuation, litigation support, exit planning, and market intelligence and competitive analysis services. The McLean Group serves middle-market 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 a transaction 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.
- **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.
- **Market Intelligence & Competitive Analysis:** By leveraging superior competitive analyses, McLean, Markowitz & McNaughton provides 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.

