

# M&A Market Update<sup>®</sup>

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## Inside This Issue

### Feature Article:

*Navigating Through  
the Economic Crisis  
in 2009*

### Expert Tips:

*The Perfect Buy*

### Trends To Act On:

*M&A Opportunities  
Exist in 2009*

### Exit Planning:

*When is the Right Time  
to Sell a Business?*

### Wealth Management:

*Is the Current Financial  
Crisis Different?*

## About Us

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](http://www.mcleanllc.com).

## Feature Article:

### *Navigating Through the Economic Crisis in 2009*

By Scott Wait, CPA

**A** crisis can be an opportunity disguised in the form of a problem. Now is the time to make changes to sustain your business through the current economic crisis. Here are six actions to navigate through the crisis:

- **Manage cash effectively: Credit used to be king. Now, cash is king:**

*Continued on p. 4*

## Expert Tips: *The Perfect Buy*

By Jen Jackson

**O**bservations by Dennis J. Roberts as published in his new book, *Mergers & Acquisitions: An Insider's Guide to the Purchase and Sale of Middle Market Business Interests*, and various other articles, include:

During every transaction, a seller seeks to have the "perfect" or at least "best" buyer. Knowing a little bit more about classic buyer types will allow sellers to understand the motivations and objectives that a buyer may have.

The classic types of buyers are:

- **Consolidators or roll-up promoters:** These tend to pay very high premiums for businesses, and traditionally buy several businesses up in anticipation of initial public offerings (IPOs). However, once acquired, the synergies and anticipated economies promised during

*Continued on p. 2*

*“The Perfect Buy” continued from p. 1*

the transaction are usually lost in transit. Additionally, the multiple companies acquired usually remain fragmented after the acquisition, but from the Sellers’ points of view the multiples paid are usually very high, provided the Sellers avoid taking stock in the new entity as part of the deal.

- **Strategic Industry Buyers:** Strategic industry buyers are among the best buyers for middle market sellers. They are highly motivated by possible synergies in the acquiring company or an entry into a new market that complements their current companies. Strategic industry buyers usually seek somewhat larger scale transactions, typically at least \$10 million or more. Their purchases usually are made as part of an overall plan to grow by acquisition.
- **Private Equity Groups:** PEGs account for approximately 25-35% of deals with investment deals at all stages from Venture Capital to later stage capital (Portfolio and Recapitalization funds) transactions and generally pay competitive values. PEGs fall broadly into three categories and in the latter two tend to pay values similar to strategic industry buyers:
  - **Venture Capitalists:** Early stage investors, historically have invested in start-ups. In a VC transaction the owners typically get no cash as all cash is used for expansion.
  - **Portfolio funds:** Tend to invest in more mature businesses than start-ups and then seek to grow business exponentially; portfolio funds tend to buy entire company.
  - **Recapitalization funds:** Usually seek to acquire less than total control of a target, allowing the owners to participate in a later sale of the business (usually within 3 or 4 years) and a second “bite at the apple”. Post acquisition balance sheets tend to carry additional debt burden and sellers should be alert to that.
- **Non-strategic industry buyers:** Usually the worst kind of buyer. Sellers may have to resort to such buyers when the business must be sold due to disaster or personal issue. Non-strategic buyers seek the lowest price possible, usually undermining what the company is actually worth. They are opportunistic buyers (usually bottom fishers) as they have not mounted a conscious strategic acquisition growth program but simply take advantage of whatever comes along.
- **Individual buyers:** Individual buyers are rare in the middle market marketplace. In addition, when they do decide to bid on a company, they rarely have the strategic motivation or resources to complete the transactions. If they do, their’s is typically “scared money” which makes deals hard to do. This rare buyer type is relegated to very small deals usually less than \$2.5 million.
- **Employee Stock Ownership Plans (ESOPs):** ESOPs have both benefits and downsides, but from a strictly financial exit point of view should generally be considered only when there is no other way out. For the sellers, they may not maximize the value of the company because valuation is based solely on the company’s financial performance. Furthermore, intense IRS and Department of Labor regulation of ESOP valuations may result in fairly conservative valuation results. While it may be easier to finance the deal because of the associated tax breaks, in most ESOPs the seller’s payout will be very long term (as long as 9 or 10 years).
- **Non ESOP management buyouts:** The problem with this type of buyer comes in two flavors: value and resources. In a normal M&A transaction with competing buyers, the price is set in the best of all possible ways by an objective market. This is not usually possible when selling to management and it hard to tell what may have been left on the table by the sellers. The other problem is the typical lack of resources that management has access to in order to finance the deal. In more cases than not, these MBO deals require the seller to take back a lot of deferred purchase money notes (always a risk). As with an ESOP, this form of deal can be a good approach when there is no other way out.
- **Offshore buyers:** There are many potential buyers in Western Europe and Asia. An experienced investment banker is vital in recognizing international opportunities for sellers. These strategic acquirers should not be overlooked (though currency flucturations can make a big difference).

While it may seem self-serving to say so, the best way to find the right buyer is to hire an investment bank or other intermediary with the resources to identify and engage the best potential buyer while understanding the subtleties of negotiating with the various buyer types.



## Trends To Act On: *M&A Opportunities Exist in 2009*

By Whit Stewart, Associate

**W**ith some positive signs opening in the credit markets, we are beginning to see a glimmer of light at the end of the tunnel. The government's injection of capital into banks has just begun to provide a loosening of credit, but the real benefit of the stimulus will not be seen until the second half of 2009. In the near-term, however, we are seeing the impact of tight credit on corporate earnings. Pundits believe that two factors potentially are dampening M&A markets: tight credit and the economy. However, if one studies private equity investments over the past 30 years, it is clear that internal rates of return proved most promising during economic slowdowns.

The prospect of a moderate increase in M&A activity over the next 12 months remains in a number of sectors. The financial services industry, in particular, is apt to experience continuing demand for capital and consolidation. Secondly, retail and consumer brand companies that failed to meet even revised (lower) earnings expectations during the holiday season, likely will require capital infusions or mergers/restructurings. The oil & gas and healthcare sectors are weathering the storm: many firms in these sectors are flush with cash. Traditional providers of capital – private equity firms and sovereign wealth funds – have been sitting on the sidelines. While they have deferred making new investments in recent months, they nonetheless must generate reasonable rates of return that their cash positions are unlikely to generate. As the credit crunch eases in the US financial markets, companies and private equity firms are likely to turn acquisitive in the second half of 2009. And while mega-billion dollar deals arguably will be less prevalent, middle-market M&A should gain momentum over the course of the next six to 9 months.

## Wealth Management:

### *Is the Current Financial Crisis Different?*

By Enrique Brito, CFA, AVA, CM&AA

**T**he disruptions caused by the current economic instability may appear to be unprecedented to investors given the depth of the downturn in both domestic and international financial markets. And, when one factors in the size and scope of the U.S. government's actions to avert a deeper crisis, and the fact that the financial turmoil has extended to the rest of the world, we begin to wonder if this time is really different.

Preliminary analyses conducted by economists and wealth management groups indicate that the current financial crisis is indeed different from other post-World War II recessions and bear markets in the U.S. Their main argument is that this time there has been a significant disruption to the financial system rather than an adjustment in the typical business cycle or a reaction to an exogenous shock. Nevertheless, they conclude that the current situation is remarkably similar to past systemic bank crises, both from qualitative and quantitative perspectives.

The bottom line: given similarities of recent events to past credit crises, when traditional credit metrics are applied to the current situation, they point to a deep economic recession. However, they also suggest a stock market whose prices already may have discounted such an outcome. And, if the recently enacted government measures prove more efficient than those of the past, then we may end up navigating this storm with less pain than might otherwise be expected.

For more information on wealth management services please visit: [McLeanAdvisors.com](http://McLeanAdvisors.com)



- Forecast cash flow monthly and bi-weekly when possible.
- Change your collection policies to reward early paying customers, and review customers’ financial strength monthly. Stay in touch with your customers to assess their needs and financial conditions.
- Review your vendors and make changes early when you discover financial trouble so that you can minimize interruption with products and services to your customers.
- **Modify your operations with recession in mind:**
  - Reward your employees for increasing and preserving cash flow.
  - To minimize anxiety and morale with your staff and customers, consider across the board wage reductions before layoffs. If employee cuts are necessary, layoff more than you think necessary - your team and your customers will adjust better to fewer cuts. If key employees must be furloughed, consider having them work as consultants to the company per diem or by project.
- **Review finance & lease agreements:**
  - Renew finance agreements early, including lines of credit or building loans, and have alternate plans for your financing needs. Some banks may not be lending in such industries as construction or real estate due to perceived risks.
  - Consider raising equity capital from investors. Advantages include that the equity funds can improve cash flow by lowering monthly principal and interest payments. One tradeoff is that you will be serving more “masters” as compared to your banker.
- **Renew lease agreements early:**
  - Office leases are at the lowest rates in ten years. By locking in agreements early, you will stabilize cash flow and property values.
- **Watch for business acquisitions:**
  - If you are a possible buyer, you have solid businesses that are now valued at a discount due to the current crisis. As a seller, you can stabilize cash flow by merging. Other options include joint ventures with competitors or vendors for business growth in this environment.
- **Change your product or service mix:**
  - Consider changing your focus on industries or customers who are more stable during the recession.
  - Make changes to provide more products with relatively short sale to cash-in-bank cycles.
- **Update your business plan with recession and recovery in mind:**
  - Evaluate every aspect of your business with financial projections for recession scenarios. Foreseeable revenue levels may be 10% to 20% below previous years. Prepare financial projections and operations that support various recession scenarios.
  - Update your business plan for an economic recovery scenario of one, three, or even five years into the future. Companies that have better alternative business plans and that take action effectively will prevail and prosper in these times.

## Exit Planning: *When is the Right Time to Sell a Business?*

By Greg Boucher, CBI, CMEA, Managing Director, Exit Planning Institute

The number one blind spot that business owners have as they begin the sales process is not preparing their businesses enough time in advance – before going to market. There are eight categories and 42 factors that should be reviewed in a readiness audit to determine where a company stands: each one will affect value. Some of the more prevalent include:

- **Financial**
  - Whether financial statements have been reviewed by an outside accounting firm (due to the high cost of due diligence, many acquirers will only look at companies with audited statements), and
  - How current are a company's payables and receivables.
- **Investments**
  - The quality and state of a firm's equipment and systems; as well as if they are adequate enough to compete efficiently in the market. (Buyers will assess the condition of a company's equipment and systems. If it is necessary to upgrade them, the cost to do so may impact value, resulting in a lower sales price.)
- **Growth (Competitive Analysis)**
  - Trends in growth and market-share,
  - Revenue & profit history, trends and projections, and
  - Innovation.
- **Products, Services and Customer Acquisition**
  - Are products and services competitive?
  - Is there a sales process that does not rely on the owner or one key individual?
- **Customers**
  - Diversification of customer base or contracts.
- **Management Team**
  - What type of succession plans have been developed, and
  - Whether there is a reliance on the business owner(s) or any key employees.
- **Employees**
  - What programs are in place to motivate and retain employees?
- **Other**
  - Status of any legal or tax issues.

Most businesses and business owners do not undertake a rigorous exit planning process prior to selling. If a business owner fails to focus on any of these areas, the owner likely will leave some, if not a substantial amount of money on the table.

For more information please visit [www.planyourexit.org](http://www.planyourexit.org)

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St. Louis, MO  
Tulsa, OK  
Winchester, VA  
Wooster, OH

## Contact Us:

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

