

M&A Market Update[®]

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

January 2011

Inside This Issue

Feature Article:

*Intangible Property
Drives Business Value*

Expert's Corner:

*Outsource Global
Acquisition Search Services?*

About Us:

The McLean Group is a national investment bank serving middle market businesses. For more information, visit www.mcleanllc.com.

Feature Article:

Intangible Property Drives Business Value

By Scott Wait, Managing Director, Reno, NV

Growing business value may be interpreted in many ways depending on one's point of view. To a business owner, it may mean increasing cash in the bank for a "rainy day fund" while keeping top employee talent busy and productive. To such outsiders as bankers or investors, growing business value is based on drivers that increase cash flow from operations. Short term financial buyers or strategic buyers look for ROI (Return On Investment) and payback time. From the perspective of bankers... investors or... prospective buyers, intangible property drives the business' value up or down.

Continued on p. 2

Expert's Corner:

Outsource Global Acquisition Search Services?

By Richard Wottrich, Senior Managing Director, International Desk, The McLean Group

As we slowly ease out of the recession of the last two years, major corporations are ramping up acquisitions. Thomas Lys, who teaches mergers and acquisition at the Kellogg School of Management at Northwestern University near Chicago, says, "This is the time to buy and position yourself for the takeoff, even if there is the risk of a double-dip (in the economy), no guts, no glory."

For example, IBM Corp. has made 15 acquisitions in 2010, up from eight in 2009. 3M Co. will spend \$2 billion on acquisitions in 2010, double the number closed in 2009. Its acquisitions include Ross Reels, a manufacturer of fly fishing reels, and Arizant, a maker of

Continued on p. 3

“Intangible Property...” continued from p.1

Common examples of intangible property include the business’ proprietary software, customer lists, customer loyalty and patented process(es). Other intangible assets that seldom surface in a business’ financial statements include its brand image, sales process(es) and product “know how.” The common element among valuable intangibles: they differentiate the company and drive up earnings.

Holland & Hart patent attorney Robert Ryan emphasizes the importance of Intangible Property (IP) based on the Ocean Tomo 2006 research on intangibles. In a recent presentation, Mr. Ryan observed that IP as a percent of cost (book value) in 1975 averaged 2%. By 2005, IP as a percent of cost (book value) had risen to 43%. In 1975, IP accounted for some 16% of market capitalization (public company value) on average. This figure rose to 80% by 2005. Wow!

In a May 6, 2002 Entrepreneur.com article, many business owners admitted that they did not have a good understanding of how intangible assets contribute to their companies’ value to potential buyers. As a refresher, intangibles can be valued using three methods:

The **cost approach** values the sum of actual costs the company incurred to develop the intangible asset, including development costs, patent application costs and prototyping costs.

The **market approach** compares the company’s intangible asset values to those of similar assets offered in the market. These market methods are similar to the real estate model of finding asset comparisons. The challenge presented by the market approach (and it can be a big one) is identifying relevant matches in the industry that also are comparable on the basis of the size of the marketplace in which the intangible asset is used.

The **income method** to valuing intangibles estimates the revenue and earnings that the intangible asset will generate over time to establish the intangible asset’s value. The income method takes a similar approach to the Internal Rate of Return (IRR) computation used to value investments. IRR is defined as a rate of return used in capital budgeting to measure and compare the investment’s profitability.

The income approach takes a few steps in computing the value of the IP. The first step is to determine the current

income stream produced by the IP. Next, the IP’s income is projected conservatively for five to 10 years into the future. The total projected income then is discounted monthly, quarterly or annually to the present. With such IP as brand names and customer loyalty, the approach compares the annual income stream to unbranded business, or to a company that has IP that is considered to be an industry median value standard.

Once the IP is analyzed by one method or another, the business owner may be pleasantly surprised to learn how to increase its value, or at least gain a better understanding as to how much that IP contributes to the company’s overall value. ♦

“Outsource Global...” continued from p.1

specialty medical products. Google has made 20 acquisitions so far this year, compared with eight the previous two years combined. Most acquisitions are in rapidly-growing areas like smart phones and social networking.

However as contrasted with the deal making of the 1990s and most of the 2000s, big-fee Wall Street blockbuster deals are not as numerous. Many deals in 2010 have been relatively smaller and driven by strategic decisions emerging from the recession.

Many major corporations are well-positioned and staffed with acquisition specialists and thus can move with speed to market. These internal experienced corporate development groups are expensive to maintain, but multiple acquisitions make them efficient expenditures in the long run.

But what of lower middle market corporations? What of companies that do not have the cash flow or the personnel to mount such an effort? What is the most effective and efficient method for smaller corporations to successfully conduct acquisition searches? Should you outsource global acquisition search services?

Mergers, joint ventures, technology procurement, strategic alliances, division divestitures and most importantly acquisitions represent a particular suite of skill sets that are not always readily available in the market place. M&A as a discipline presupposes that a company knows where it is

Continued on p. 3

“Outsource Global...” continued from p.2

headed, which often results in the creation of a Corporate Development C-Suite executive position to set M&A criteria. As strategic M&A issues are usually the prerogative of the board of directors and tactical M&A issues reside with management, there can be a built-in conflict in the process. For example, the board may wish to enter a new market ancillary to its current position. However, an executive who earns bonuses based on performance may wish to acquire companies that increase his division’s profitability.

The result is that the Corporate Development executive position often becomes primarily a planning function immediately followed by a general survey of the market in those specific SIC Codes that interest the company. A company can easily invest a million Euros or more in creating its Corporate Development C-Suite and subsequent acquisition criteria and is then left in the same position it would have been in had it simply mandated that criteria. That is, the C-Suite team must vet world markets and find a desirable company to buy. Where the rubber meets the road, the reality is often less than ideal.

The simple truth of M&A is that an investment banking firm is no stronger than its global network and access to desirable target acquisitions: “Global Reach – Local Access.” Research is easily available today on the Internet and elsewhere. Eager young MBA hires stream out of business schools. Computing muscle makes everyone an analytical genius at evaluating and pricing companies. The Holy Grail then is in that rare and valuable skill set - the ability to move quickly to the right people in a deal opportunity. Large and profitable M&A fees are generated because of the speed and timing of creative ideas and introductions that directly lead to profitable deals. The Corporate Development C-Suite may not be in a position to recreate these skill sets in a reasonable amount of time at a reasonable cost.

The alternative is to outsource strategic planning to an investment banking house inclined to serve the M&A needs of a lower middle market companies, what I call the globally-oriented middle market M&A firm. Wall Street and London’s Square Mile bulge-bracket firms usually demand retainers of €1,000,000 or more to even consider such assignments. Regional I-Banking houses charge less, but often they are transaction-oriented specialists and perhaps have little interest in the process unless it leads directly to an IPO or other significant underwriting event. While fees are the lubricant

of the investment banking industry, there can be high value added in building a relationship with a globally-oriented middle market M&A firm willing to invest time and energy in your global acquisition search.

The differences can be appealing from both a cost and a performance point of view. A globally-oriented middle market M&A firm usually will charge a per-month retainer for the duration of the assignment. If the fee is €20,000 per month for example, this compares favorably with a Corporate Development C-Suite that may have a €100,000 monthly budget. The relationship can be on flex-time as well; that is, the company may retain the M&A firm only when it wishes to. For example, after a large acquisition there may be several months of post-acquisition issues involved that preclude the need for any ongoing global acquisition search services.

Within our experience at The McLean Group, a middle market corporation can expect to save roughly 50% over time by retaining the services of globally-oriented middle market M&A firm such as The McLean Group.

This is primarily because any in-house C-Suite must of necessity approach and cultivate the same sources that are maintained by a globally-oriented middle market M&A firm. While the corporation may avoid paying a direct buy-side fee, in practice the corporation often ends up paying many of the same expenses it would have paid had it been represented by an M&A firm, but without access to its contacts and input. In other words, you may end up buying a company brought to you by an intermediary that charges a finder’s fee.

The intangibles in this comparison are access and results. Can the C-Suite be expected to have access and contacts in all markets in a global economy? Can the C-Suite team cover all markets of interest on a reasonable and timely basis? Can the C-Suite replicate proprietary M&A networks that have been built up over decades? Why would you want to?

The common purpose in either approach is in closing value-added acquisitions. Our conclusion is that only a seasoned globally-oriented middle market M&A firm with years of experience can be expected to have the ‘nose’ for the inherent strengths and weaknesses encountered in a deal in the corporation’s “sweet spot.” In that regard, retaining a globally-oriented middle market M&A firm can often be the most valuable strategic planning a company can undertake.

Our Locations:

| | |
|---------------------|--------------|
| Washington, DC* | 703-827-0200 |
| Anchorage, AK | 907-277-3725 |
| Asheville, NC | 828-606-1101 |
| Atlanta, GA | 678-461-0775 |
| Austin, TX | 512-687-3485 |
| Baltimore, MD | 410-799-2053 |
| Boston, MA | 978-475-2511 |
| Bozeman, MT | 406-586-9746 |
| Buffalo, NY | 716-489-2048 |
| Chicago, IL | 312-994-2550 |
| Cleveland, OH | 440-484-1060 |
| Columbia, MD | 410-440-3189 |
| Dallas, TX | 214-705-9724 |
| Erie, PA | 814-397-7737 |
| Fort Lauderdale, FL | 904-318-4658 |
| Hartford, CT | 860-255-0107 |
| Hattiesburg, MS | 601-671-4098 |
| Jacksonville, FL | 904-318-4658 |
| Lafayette, LA | 337-365-3979 |
| Miami, FL | 305-804-6181 |
| Milwaukee, WI | 262-646-6490 |
| Phoenix, AZ | 602-549-9946 |
| Reno, NV | 775-825-7637 |
| Sacramento, CA | 916-929-0900 |
| San Francisco, CA | 510-444-6195 |
| Silicon Valley, CA | 650-638-2310 |
| St. Louis, MO | 314-307-1090 |
| Tulsa, OK | 918-492-3388 |
| Tallahassee, FL | 904-219-5750 |
| Tampa, FL | 559-289-7878 |

* headquarters office

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. 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.

