The McLean Group
INVESTMENT BANKING

M&A Market Update©

Your source for information about today's mergers & acquisitions market July/August 2010

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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:
Today's Middle Market Buyer

By Brian Sulivan, Managing Director

Merrill Corp. and The Deal recently surveyed 150 middle market companies to identify firms' expectations for remaining 2010 M&A activity. The survey's findings revealed companies' outlooks on the current state of the economy and its imminent effect on deal flow, the most active industries, and companies' current and future engagement strategies.

According to pipeline.thedeal.com, middle market M&A activity has increased approximately 23% since 2009. Some 77% of Merrill Corp. and The Deal's survey participants expect M&A activity to increase further. Experts attribute this to a height-

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Expert's Corner:
Indentifying the Best Targets

By Zane Markowitz, Senior Managing Director

Finding good targets is never easy. You must continually define and evolve your view of your present and projected situation and the present and projected economics of the market. In turn, you must constantly reexamine your target to determine if it continues to be a good fit.

The most successful acquirers spend the bulk of their time contemplating the following questions:

- Is the target company the best that can be acquired in its arena?

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ened interest in valuations and waning apprehension over financing. Many businesses have more cash than usual and are not as concerned about obtaining credit to finance a loan. Brent Gledhill, Chicago-based investment firm William Blair & Co.'s global head of corporate finance, observes: "Concern about valuation is the best sign that these companies are no longer spooked [by the recession] and are ready to buy businesses again."

Gledhill adds, "Valuation […] remains high in China and Korea" and Asia's "best businesses have growth rates far higher […] than those in the US and Europe. Growth is the greatest determinant of value."

Survey respondents did not share Gledhill's optimism concerning cross-border deals, however: 23% believed cross-border transactions would be, "somewhat important this year" while 26% believed Asia most likely would experience high growth in 2010 middle market M&A. Survey participants' hesitancy towards overseas' transactions may reflect lingering economic wariness and should not diminish the fact that significant global M&A growth opportunities exist, particularly in Asia.

As the economy and businesses' confidence in it improve, companies will hone in on industries hardest hit by the recession that likely will recuperate in 2010. Healthcare, pharmaceutical, information technology and energy industries likely will be most active. Businesses expect to find the best "discounts" in these industries.

Passage of the healthcare reform act arguably influenced the 36% of respondents who anticipate that healthcare will be the most active sector in the second half of 2010, while 34% and 31% of respondents peg banking/finance firms and information technology firms, respectively, as second and third most active sectors. The IT sector likely will benefit from a surge in R&D reinvestment.

The survey also gauged buyers' "top criteria" when considering acquisition candidates. A whopping 58% consider the target business' "strategic fit" the highest priority. The strategic fit of well-matched companies can create invaluable synergies that enhance companies' worth and extend their longevity. Surprisingly, only 23% of those surveyed reported profitability as a primary concern.

A recent San Jose Mercury News article by Jordan Robinson cited a 1987 Harvard Business School study by Professor Michael Porter that recognized the critical importance of strategic compatibility between acquirers and target companies. Analyzing 33 large US corporations over a 36-year period, Porter concluded that buyers sold off many more acquisitions than they retained, thereby diminishing shareholder value. Since Porter's original study, several others conducting independent analyses have found similar results.

Identifying buyers that constitute good strategic fits requires more than an understanding of the marketplace. It requires a global understanding of the motivations and perspectives of buyers and sellers whom successful acquisitions ultimately benefit. Professionals who understand these interrelationships will maximize overall transaction value. ◆

Survey results and further discussion can be found at: http://www.thedeal.com/knowledge/img/Source_MM.pdf.

***About the Author: Brian A. Sullivan**, CPA/ABV, is the managing director at The McLean Group's Silicon Valley office. He has more than 25 years experience as a wealth advisor and investment banker. Mr. Sullivan also has authored numerous articles on business valuation and M&A and has served as a moderator, panelist and chair at several national conferences.*

Contact him directly with questions or comments at bsullivan@mcleanllc.com or 650.638.2310.

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- Do we really understand the target company's position within its competitive environment?
- Should we even be in this area of business?

These can be difficult questions because answering them involves uncovering a great deal of specific and sometimes hard-to-find information that pertains not only to the acquisition target but also to your own company. This is a primary reason why the acquisition process can take so long.

A good acquisition can be defined as one that an acquirer is still glad he/she made five years following the closing of the transaction. Unfortunately, such positive reflections are rarely a reality. Numerous studies show that the odds are about seven to one against making a good acquisition. Post-acquisition research indicates that most acquirers focus too much on price as a key criterion of acquisition success while failing to give due consideration to the terms of the transaction that are no less important. Additionally, the final negotiation of price and terms becomes much easier if all parties are confident in the final target choice.

Aside from post acquisition integration and corporate culture incompatibility failures, a Spitalnic Study reveals that the 10 most frequently cited reasons for acquisition failure are:

1. Slow or little market growth
2. Low industry or geographic margins
3. Target's market position falls short of what was expected
4. Tough competition
5. Inadequate, inaccurate or poorly defined pre-acquisition research
6. Weak management team
7. Narrow profit margins
8. Underdeveloped systems
9. Large post-acquisition capital requirements
10. Target lacked good strategic plan

Note that, "We paid too much" is never mentioned among the most frequently cited reasons for acquisition failure. However, if the acquisition failed to meet expectations, whatever was paid was too much. Also, no mention is made above of poor accounting or legal due diligence. These days accounting and legal professionals rarely miss anything.

The common theme for acquisition failure is unmatched expectations resulting from competitive analysis due diligence failure. The buyer found out too late that the acquired company could not sustain its earnings growth because it was not the best company in its competitor set to acquire. Or, it was a good company but its business sector turned out not to have the anticipated growth prospects.

Thus, investing in rigorous, meticulous and independent market intelligence, competitive analysis and competitive intelligence prior to completing an acquisition creates better odds of overall, long-term success. ◆

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Tampa, FL

Contact Us:

The McLean Group

7900 Westpark Drive

Suite A320

McLean, Virginia 22102

(703) 827-0200 phone

(703) 827-0175 fax

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.

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Investment Bankers to the Middle Market