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What is a Company's Actual Value?

By Dennis Roberts

Ask 10 business owners or executives if they believe their company should sell for its Fair Market Value and nine will answer yes ... and that answer would be, well, wrong. That is a good thing. Rarely does a company sell for Fair Market Value. For one thing, Fair Market Value is a narrowly-defined concept that effectively constitutes an average of what all buyers and all sellers in the market would agree to pay or receive for an all-cash transaction if all parties had the same information and there were no compulsion (call that extra motivation) to do a deal.

To begin with, in real life only about one in three transactions is "all cash." And business owners tend to be ambitious: who among them wants to sell a company that has taken years to build for an "average" price? A better term for the value realized in most transactions is "Investment Value" which is best understood by reference to the old saw, "Beauty is in the eye of the beholder." In any marketplace, there always will be a buyer who sees more beauty in the seller's business than any other. That buyer very often is willing – and highly motivated – to pay accordingly. This may be the buyer who has more knowledge of the target's potential than any other and who expects to realize the greatest synergies from the acquisition. The premium such a buyer can and will pay over Fair Market Value may be astronomical under the right circumstances. But what are the right circumstances?

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EXPERT TIPS

Letters of Intent

A Letter of Intent (LOI), although not legally binding, is critical to the successful completion of an M&A transaction. An LOI – usually is drafted by the buyer – outlines proposed terms of the deal. It assures the seller that the buyer is serious about completing a transaction and it provides a solid foundation to begin negotiations. The LOI is useful in M&A transactions because it allows both parties to acknowledge a "meeting of the minds" where key transaction issues are concerned.

Even though an LOI's major elements vary from deal to deal, most letters include several standard features: a description of what is being purchased (stock or assets), an offering price, terms of payment, assumed liabilities, exclusivity ("no shop") periods, procedures to deal with contingencies uncovered during due diligence and estimated time for closing. Such provisions as the exclusivity period and confidentiality are binding.

The biggest problem with LOIs: legally they are a lot like being "almost pregnant." They state that their provisions are non-binding before proceeding to describe agreed-upon deal terms. This is particularly perilous if the party that relied on the LOI suffers monetary damages. Hence, expert advice from an experienced investment banker is highly recommended.

TRENDS TO ACT ON

Private Equity Fueling the M&A Boom

Market observers are predicting that 2007 could set a new record for deal volume with both strategic and private equity firms' activities accelerating. In 2006, private equity participated in 35% of all M&A deals involving U.S. targets (versus 23% in 2005 and a 10-year average of 17%). With record numbers of large funds being launched, fund sizes hitting record levels, and competitive pressures from hedge funds elbowing in, unprecedented amounts of capital will be put to work in 2007.

One key question: are private equity's record levels of U.S. participation sustainable? Various experts believe the U.S. deal market may well be sustainable and may not yet have reached its peak. They note that private equity's prospects of increasing its influence on the U.S. economy are significant and growing. PriceWaterhouseCoopers reports that energy, utilities, healthcare, financial services, telecommunications, media and entertainment industries are particularly well-positioned for sustained M&A activity in 2007.

EXIT PLANNING

Determining Exit Objectives

In exit planning, the three main objectives common to nearly all business owners are:

1. Defining an appropriate timetable to leave the business.
2. Ensuring financial stability after leaving the business
3. Transferring the business to a particular party

Failure to set consistent and achievable objectives can leave a business owner without the means to exit the business. To maximize the business value received at the time of exit, business owners must formulate specific, consistent and attainable goals that become the foundation for all subsequent planning.

Few owners attain all of their objectives in a deal. Unfortunately, they frequently are so focused on running the business that exit planning is not a priority (and too often, owners don't know where to start). Exit planning is a process that begins in collaboration with experienced advisors including, at a minimum, financial and legal professionals with the requisite experience to help the business owner align personal and business goals to ensure a smooth transition.

For more information on exit planning visit The McLean Group Exit Strategies Institute [\[Click Here\]](#)

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What is a Company's Actual Value?

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Well, the right circumstances often arise when multiple buyers want to acquire the target. They almost never arise when the seller is dealing with a single buyer. How can a seller possibly identify the potentially highest-paying buyer in the marketplace at a given time if he or she has only one prospect at hand? The right circumstances arise when as many prospective buyers as possible are identified and engaged in the transaction. Surveying a marketplace to identify prospects involves a great deal more than simply locating and contacting likely buyers. Non-industry buyers often pay the highest prices because they have synergistic reasons for entering a new industry.

Furthermore, even when a seller is well-advised and has identified multiple buyers, the right circumstances often require an effective auction. No buyer will tell a seller his highest offering price without being pushed to the edge of his envelope by the fear of losing the deal. Most buyers have "walk away" prices that usually are much higher than what they are willing to admit. This is why well-orchestrated negotiated auctions deliver premium Investment Values to sellers time and time again.

We don't use the term auction very often as buyers sometimes find it offensive, but the most effectively-conducted M&A sales side transactions in essence are auctions. We have heard buyers say they dislike auctions but they themselves conduct auctions when selling their own companies or divisions so prospective sellers should not be dissuaded by such grousing. When a buyer grumbles about prospects of a negotiated auction, he often is seeking to talk the seller into negotiating with him alone. Whenever a client suggests negotiating a deal with a single buyer, the image of a shark always comes to mind. The single buyer is the shark and the seller is ... dinner. Sellers level the playing field by involving multiple buyers so the "sharks" compete to win the deal. Meanwhile, experienced sales side investment bankers often can comfort prospective buyers as to the overall merits – to all concerned – of a negotiated auction so as to keep them engaged.

On the other hand, sellers may suggest that the deal is not just about money but also about selling to the right company. True enough. But why not sell to the right company that is willing to pay the highest price? For most sellers, the deal at hand will be a once-in-a-lifetime transaction. The day the deal closes will be the day that years of hard work earn a well-deserved reward. Sellers who put their companies up for sale in the M&A marketplace without fully arming themselves with excellent professional advice and extensive preparation are being foolhardy ... and this will cost them dearly.