

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:

It's Not Value That Counts - It's Price

By Mark A. Dayman, CPA/ABV, CVA

At the end of the day, no one really cares much about *value*. What buyers and sellers do care about is the final price agreed upon when executing a transaction.

Who's My Buyer?

Although there may be some exceptions, price is controlled by two factors – 1) economic benefits, usually measured by Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), and 2) perceived risk. Different types of buyers view these two factors uniquely, and therefore will pay different amounts for the same business. For example, in a sale to family members or an Employee Stock Ownership Plan (ESOP), price is governed by tax law – Fair Market Value – one of the lowest value standards short of liquidation. At the other extreme, if you've developed a business to the point where synergistic or strategic advantages are easily defined, buyers will often pay much greater amounts.

Even in synergistic deals, EBITDA and rates of capitalization paradigm still rule. But the buyer normally modifies EBITDA to include a portion of the economic advantages of an acquisition. How much modification can a seller expect? We rarely see more than 50 percent of the added synergistic benefit going to the seller, and there could be as little to no benefit if the opportunities are poorly developed and defined.

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Expert Tips: Why Are Retainers So Important?

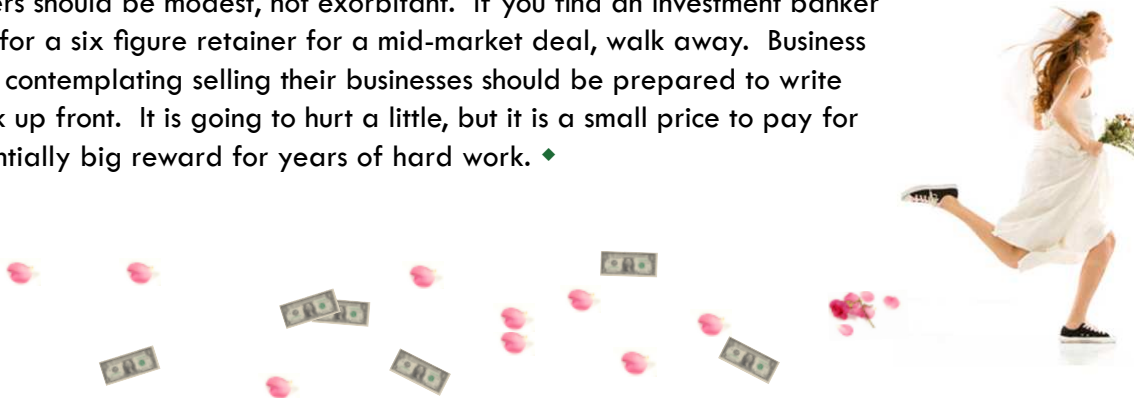
By Tom Swanson, Managing Director

One of the most sensitive subjects for investment bankers when discussing a potential engagement with prospective clients is the retainer fee. Many of these clients-to-be are entrepreneurs; they built their businesses from scratch with their own money and sweat equity over long periods of time. A primary reason for their success is they carefully watch every dollar that goes out the door. They ask, “Why the heck do I need to pay you a fee before starting?”

Here are three important reasons for the retainer:

- 1. The retainer needs to be evaluated in light of the entire transaction.** Retainers are generally a small fraction of the total success fee that bankers earn at the conclusion of a successful deal. Bankers are paid their success fees only at the end of consummated transaction. If no success, no fee. The process for a typical mergers & acquisitions (M&A) transaction 9-to-12 months. This is a long time between payments. The retainer partially offsets the cost of pursuing a transaction on behalf of a client. These costs are substantial, including back office support for “book” preparation, electronic due diligence “rooms,” buyer and seller databases, data mining and analysis software, and banker deal marketing expenses.
- 2. Consider other professionals who work on retainer.** Lawyers ask for a retainer up front plus a success fee. They work off the retainer, and then bill you for another retainer before proceeding further. You pay legal fees along the way, successful outcome or not. Clients can ring up huge legal fees and still lose.
- 3. It is a qualifier for bankers against the “Runaway Bride” syndrome.** Just like the movie made famous by Julia Roberts, many business owners sometimes engage a banker in a sell-side process, find out what their business is worth to a buyer, then say, “no thanks” at the altar of closing. Retainers help eliminate this issue. A retainer forces the business owner to think long and hard about selling. It hurts to write that check – and it should. By writing the check, an owner is mentally saying “I am ready to sell.” Although owners can still walk away at the end, it is not done casually but usually for a good business reason. It happens sometimes.

Retainers should be modest, not exorbitant. If you find an investment banker asking for a six figure retainer for a mid-market deal, walk away. Business owners contemplating selling their businesses should be prepared to write a check up front. It is going to hurt a little, but it is a small price to pay for a potentially big reward for years of hard work. ♦



“It’s Not Value That Counts...” continued from p. 2

More EBITDA Is Better Than Less

When it comes to EBITDA, bigger is better. As the equation works, the higher the economic benefits, given a fixed risk level, the higher the price. Higher EBITDA has an additional advantage beyond simple math. Markets perceive larger businesses as less risky than smaller businesses, and therefore more valuable per dollar of EBITDA. There are several reasons for this perception. Larger businesses are believed to have more depth in management and better market positions, enabling companies to position themselves in the markets with superior products, markets, customers, distribution channels, and lower capital costs, to name a few.

Transparency

Businesses need to learn to manage and minimize risk to increase price through *transparency*. Buyers need to be able to clearly see the business concepts and understand how they will profit from ownership. EBITDA should be easily determinable and financial records should be clear and clean. Information systems need to capture, manage, and readily communicate data about customers, markets, pricing, products and services, distribution channels, and results of performance. The closets need to be scrubbed of skeletons.

It’s Never Too Late

It can sometimes take two-to-five years for a business to ready itself for a successful sale. The goal is more EBITDA with more transparency, and you should be able to rely on your investment banker and adviser as a critical team member to help you get there. Do not overlook alternative opportunities for rollups and acquisitions to make your own company a larger and more significant market participant in advance of a sale in two-to-five years. ♦

Trends To Act On: Aerospace & Defense Weathers Economic Downturn



By Adam Crutchfield

The Aerospace & Defense sector historically has proved resilient in times of recession and it appears to be weathering today’s challenging economic conditions rather well. According to the National Bureau of Economic Research (NBER), during the last economic contraction – from May 2001 through September 2001 – defense prime contractors General Dynamics, Lockheed Martin, Northrop Grumman and Raytheon realized average stock price increase of nearly 19% while the S&P 500 plummeted 26%+.

These days, history appears to be repeating among major defense government contractors: As of the March 24, 2008 market close, an index of defense contractors (including Lockheed Martin, General Dynamics, Raytheon, Northrop Grumman, BAE Systems and Honeywell International) was outperforming the Nasdaq and S&P by 15.6% and 17.1%, respectively. The industry outlook remains positive with a \$51.5 billion 2009 DoD budget request representing 7.5% growth (a \$35.9 billion increase) vs. 2008.

Meanwhile, these defense government contractors’ strong cash positions have enabled them to pursue acquisitions almost as actively as in better economic conditions. During Q4 2007, 54 transactions closed vs. 49 in Q3 2007. Some 51 deals already have closed in Q1 2008, on track to meet or exceed the industry’s Q4 2007 performance. ♦

Exit Planning: *Transferring Ownership to Your Heirs*

By Enrique Brito, CFA, AVA, CM&A

The secret to a successful family business transition is structuring a comprehensive succession plan. The plan should address financial issues related to taxation and financial security as well as non-monetary aspects, such as the duration of the transitional period for the business' management, a developmental program for the new owner, and the careful definition of the appropriate roles for the family members involved.

When there is a single heir, succession planning is least complicated, particularly when the heir has the ability to and interest in running the business. When there are multiple heirs, however, experts suggest the planning process should involve a family council to define the responsibilities and qualifications for the successor and an outside advisor to identify the potential successors and keep the process moving forward. ♦



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 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' expansion, mergers & acquisitions, refinancing, recapitalization, leveraged buyout and shareholder liquidity objectives.
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- **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.

