

# M&A Market Update<sup>®</sup>

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

April 2009

## Inside This Issue

### Feature Article:

*Focus on Fundamentals*

### Expert Tips:

*Top Ten Reasons Not to Sell  
Your Business*

### Trends To Act On:

*2009: M&A Challenges...  
and Opportunities Ahead*

### Exit Planning:

*When is the Best Time to Sell?  
Part 2*

## 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:

### *Focus on Fundamentals*

#### *"What Are You Seeing Out There?"*

By Kathi Crow, Managing Director

I get this question constantly from financial insiders throughout the industry and from others across the neighborhood. As our turbulent markets traverse territories uncharted in our lifetime, everyone is anxious to get a handle on *what is really going on*. While capital markets remain virtually frozen, middle market M&A transactions continue.

Early stage venture funding has all but dried up. True start-ups are hardest hit by this development: the risk-averse capital markets are unwilling – and for the most part, unable – to seed new companies. Venture capitalists report a substantial increase in companies seeking funding,  
*Continued on p. 4*

## Expert Tips:

### *Top Ten Reasons Not to Sell Your Business*

By Steve McNaughton, Senior Managing Director

Every business owner has a favorite reason for not selling. Having heard them all for more than 40 years, these are my favorites. Borrow them freely.

- #10 I want to continue not going fishing every chance I get.
- #9 I'm waiting till the business peaks again.
- #8 I'm getting ready to get ready.
- #7 Don't know where to better invest the proceeds.
- #6 Waiting for the kids' IQ to improve.
- #5 Can't spare the time.
- #4 There are plenty of interested buyers: I get called all the time.
- #3 Don't want to face what it's not worth.
- #2 I'm going to live forever.
- #1 I'm waiting to lose a few more options. I do best under pressure.

*Continued on p. 2*

**#10 I want to continue to not go fishing every chance I get.**

Having too much fun is a major problem. Some people have so much fun not selling their businesses that they don't know when to stop. It doesn't take much time to attend “getting acquainted meetings” arranged by others. In fact, being courted, flattered and wooed becomes addictive. The seller might even be surprised, “not for sale” sellers are acquired all the time by strategic buyers who see more value in their businesses than they do.

And, if the seller is one of those executives who plays well with others, please note that a surprising number of today's CEOs were once the owners of acquired companies.

**#9 I'm waiting till the business peaks again.**

Congratulations to the sellers who cling to this rationale: they're already too late! It will take 6 months to create the selling documents and eliminate the “tire kickers” among prospective buyers of their companies. It will take another 6 months to complete negotiations with several serious prospects before settling on one buyer with whom to proceed to the closing of a transaction. It will take another 6 months to complete negotiations and due diligence with the ultimate buyer. That's at least a year and a half – assuming smooth sailing. To maximize their sales price, most sellers agree to lower the buyer's risk by accepting a two year earn out or a partial stock deal with a two year selling restriction. That will bring the seller's time frame to three and a half years. Make no mistake: acquirers buy future earnings.

**#8 I'm getting ready to get ready.**

Sellers are right to get ready for the sale by building a longer growth history. That will build value because it is important to the buyer, especially when the seller does not yet have that growth history. But too often, in the time it takes a seller to build that strong growth history, the value created will be discounted by some other factor. As they say, “It's always something.”

For example, in 2006 a healthy 78 year old owned a Toyota dealership that boasted 20 years' uninterrupted sales and profit growth and a strong professional manager. When a prospective buyer approached, offering \$300 million – unsolicited – for the business, the owner refused the offer. The owner was certain the dealership would be worth more at a later date.

Within in a few months of the \$300 million offer, the owner experienced heart problems... and the dealership's professional manager was released for making “unauthorized

withdrawals.” Given these changes in circumstances, the owner re-evaluated his situation. He decided to re-connect with his former business suitor the following year.

The buyer remained very interested in 2007 as the two began exchanging information. Concurrently, the real estate market silently crumbled and oil traders began hedging their positions. Since there was only one buyer, negotiations stretched out for more than 9 months, by which time gas prices had doubled and auto sales had plummeted resulting in the dealership's first-ever posting of losses in back-to-back months. Under the circumstances, the buyer did not want to insult the seller by making an offer that reflected the dealership's true value in a dramatically changed business environment: no offer was made. The buyer graciously advised the foiled seller that the current financial crisis had made it difficult to raise the necessary capital to close a transaction. The truth is that the dealership the buyer would have paid \$300 million for in 2006 no longer was worth anything approaching that amount.

**#7 Don't know where to better invest the proceeds.**

Although even I would be hesitant to advise on superior alternative investments for prospective sellers of middle market companies (especially given the current economic climate), one thing is certain: anything is better than tying up one's entire net worth – or a very significant portion of it – in a medium sized, privately held business. Diversify! Sellers seriously should consider taking some (at least) if not all their money off the table.

**#6 Waiting for the kids' IQ to improve.**

Well, there are lots of people holding out hope on that one. It is certainly quite admirable that some sellers prefer to (eventually) entrust their retirement future to the hands of their children rather than dispassionate public company CEO highly expert at managing (and maybe even paying) billions of dollars. But is this the right thing to do for (or to) sellers' children? Or for (or to) sellers themselves?

**#5 Can't spare the time.**

There is no doubt about it: it does take a lot of time to sell a business, especially when the seller deals directly with the buyer. As a buyer becomes more serious, discussions will consume more and more of the seller's time, thereby restricting the time available to the seller to pursue talks with other potential buyers. Sellers who persist in personally managing the sales process run a serious risk of slipping into an endless pursuit of serial negotiations—beginning discussions with potential buyer #1, pursuing those discussions until they collapse for one reason or another, launching discussions with potential buyer #2,



and so forth. Additionally, buyers well know that unforeseen circumstances often arise that make every business owner seriously think about selling. Drawing out the get acquainted process increases the odds that unforeseen circumstances will intervene, transforming the casual looker into a serious buyer.

Sellers who truly are haunted by time considerations should consider the significant advantages of pursuing multiple, simultaneous discussions. An investment banker is most effective in orchestrating those multiple, simultaneous discussions because sellers already have a full-time job – running their companies. The investment banker, on the other hand, can make maximizing the sales price of a seller’s company his “Job #1.” Consider this: by hiring an investment banker, in less than the time it would take a seller to pursue discussions with one unsolicited suitor, the investment banker can have 100 strategic buyers review the seller’s company and prospects. From those 100 prospects, 10 serious potential buyers likely will emerge, requesting additional information, management meetings, and – for some of the 10

– submitting an offer. The investment banker can manage a process that allows the seller to quantify each suitor’s relative seriousness. The competitiveness of this process in turn will ensure that each buyer offers maximum value to remain competitive. Should the offers fall short of the seller’s expectations, at the very least the process will make the seller aware of the size of the gap between expectations and market reality, thereby enabling the seller to create and implement an appropriate action plan to achieve his financial objectives.

**#4 There are plenty of interested buyers: I get called all the time.**

Most active acquirers maintain a list of prospects they routinely contact. Active acquirers will do everything they can to avoid participating in an auction because the auction process drives up the price of acquisitions. If a business owner think there is even a 1% chance he might sell the business, consider this: The one thing buyers hate more than unrealistic sellers is the specter of other overly anxious buyers entering the picture. If the seller already have taken the first step – meeting with a potential buyer – and if the seller sees enough potential to consider taking a second step, then the seller’s third step should be to hire an investment banker who will help identify 10 to 20 strategic buyers to keep the process honest. Otherwise, by step four, the seller will find himself party to a “stand still” agreement with a single buyer, forfeiting the opportunity to entertain competing and potentially more generous offers.

For an investment of \$35,000 to \$50,000, an investment banker will produce a selling document and strategic buyer research that will save the seller 6 to 12 months of “getting ready” time. More important, the banker will help the seller increase the odds of hitting the narrow window to achieve an ideal sale that maximizes the value of the company and its potential fit with the ultimate acquirer.

Many variables beyond a seller’s control will limit the time that the window for an ideal sale remains open. For example, sellers have no control over interest rates which have a huge impact on what buyers can afford. When interest rates rise, buyers scale back their investments to maintain return on investment ratios. Alternatively, buyers may become inactive. The fewer active buyers in the market, the lower sales prices will fall. Stock indexes also have a major impact on valuations, especially when buyers plan to use stock in the transaction: no one pays a premium with undervalued stock prices. Strategic buyers come and go very quickly as do the perfect selling opportunities.

**#3 Don’t want to face what it’s not worth.**

Financial buyers use a discounted cash flow model to establish value based upon the cost of capital, the worst case scenario of a 5-7 year pay back, and also require that every deal be self-funding. Financial buyers add value by exercising greater financial control to improve profitability while seeking to identify a strategic buyer willing to pay a crazy price for the company in the next 5 to 10 years.

*Great works are performed, not by strength, but by perservance.”*

*-Samuel Johnson*

*“Top Ten Reasons...” continued from p. 3*

Strategic buyers use the same discounted cash flow model that financial buyers use, but strategic buyers tend to use it as a negotiation tool to keep sellers in a reasonable range. The valuation model buyers ultimately present to the board shows the return on the capital employed featuring some synergic benefits between the two companies and/or some cost avoidance showing the buyer making a killing. The bottom line is this: sellers never run into a price problem when buyers recognizes a greater value in the company than the sellers themselves see. While no two buyers will see the same value in any given company, at any point in time, every business is worth a premium to someone.

## **#2 I’m going to live forever.**

Besides that, most prospective sellers envision themselves riding a winning streak, and every gambler’s motto is: “cash-in later.” The plain, simple truth is that no one can know when he or she will be called to cash-in the chips.

What business owner want to leave the burden of selling the company to those he or she may leave behind? Expecting a widow and/or children to launch and manage the sale of a company from scratch, even when assisted by a good attorney, invites disaster. Under such circumstances, the seller’s heirs will be pegged as “desperate” sellers from the “get-go” by every suitor and offers will reflect such perceptions. Should the heirs balk at low-ball offers and seek alternatives, the longer a transaction takes to close, the worse these perceptions – whether of desperation or mismanagement of the process – will become. Meanwhile, the seller’s heirs will remain responsible for running the company, whether or not they are fully capable of doing so, as the company itself faces challenges from competitors eager to win new business from the seller’s established clientele. When – not if – the company falters, its value, to heirs and buyers alike, will plunge.

## **#1 I’m waiting to lose a few more options. I do best under pressure.**

If the seller’s market share is slipping, product line needs revision, key personnel are leaving, key customers are switching and/or revenues or profits are declining, what is that seller waiting for? The company’s entire business model to become invalid?

*Steve McNaughton is founding partner of McLean, Markowitz & McNaughton and Senior Managing Director with The McLean Group. Contact Steve at [smcnaughton@mcleanllc.com](mailto:smcnaughton@mcleanllc.com)*

*“Focus on...” continued from p. 1*

but for some time to come, VCs themselves will remain focused on shoring up current investment portfolios.

While the high-end market’s absence of transaction funding significantly has dampened enthusiasm (and capacity) to transact the megadeals that were commonplace up to two years ago, many large companies with access to cash have begun pursuing “growth through acquisition” strategies. Some have never found so favorable an environment to acquire new businesses. A decline in business valuations, coupled with a need to identify creative alternatives to achieve revenue growth are driving transactions in this space. Many companies report that some of their best acquisitions closed during prior market declines.

On the other hand, middle market deals – characterized as having a transaction size of \$5 million to \$500 million, are uniquely well-positioned in these hectic times, with the sweet spot being just below \$100 million.

Whether markets are in decline or full upswing, it always is critically important to *focus on fundamentals*. And today as always, the fundamentals that drive a company’s value include:

- Revenue growth potential,
- Market growth potential,
- A track record of profitability,
- Strong prospects for future profitability,
- A diversified customer base,
- Strong client, vendor and employee relationships,
- Deeply experienced management,
- Well-maintained company books,
- Well-maintained assets, and
- Owners who are not pivotal to the company’s long term success.

In these challenging times, the “hottest” companies generally are operating in such business sectors as: security, government contracting, energy, health care, and green technology.

Are the market conditions favorable to sellers? No, not really. But well-managed, profitable companies continue to be desirable acquisition candidates. Opportunities remain. Pursue them.

*Kathi Crow is Managing Director of The McLean Group and can be reached at [kcrow@mcleanllc.com](mailto:kcrow@mcleanllc.com)*



## Trends To Act On: *2009: M&A Challenges... and Opportunities Ahead*

By Sam Huang, Senior Analyst

**A**t *The Deal's 2009 M&A Outlook Conference*, Barclays Capital Head of Global M&A Paul G. Parker outlined key trends deal makers should watch for in 2009.

In the near term, Parker predicts:

- A rise in hostile transactions due to falling valuations
- A substantial decline in M&A transaction volume
- Continuing deleveraging at every level
- Difficulty determining accurate valuations, and
- Limited access to financing.

Parker believes that the most critical things to watch for in 2009 are:

- A rising default rate
- A capital structure/liquidity crisis, and
- Rescue financings and sales.

Companies facing manageable financial stresses aggressively will seek to clean up their balance sheets through spin-offs, carves-out and non-core asset divestitures. Companies having strong balance sheets – thereby unconstrained by credit markets – may well decide to follow Jack Welch's recent suggestion that “now is the time to buy or bury your competition.”

Going forward, corporate boards likely will exert more control and ask more questions of their CEOs and other senior executives. Additionally, executive compensation likely will face significantly increased scrutiny. Conflicts of interest also will receive much more attention than in recent years.

Issues threatening M&A activity in 2009 and beyond include:

- Increased regulation, and
- A likely backlash in response to M&A-related layoffs and job cuts.



*Quick Stat: “Contrary to expectations, middle market deal volume and valuations held steady from the third quarter to the fourth quarter of 2008.”*

Source: GF Data Resources

## Exit Planning: *When is the Best Time to Sell?* Part 2

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

**T**here is more than one way to answer the question, “What is the best time to sell?” Last month, we discussed value drivers and how they affect timing. Since timing often is everything in business, it also is important to understand critical distinctions among the terms time, timing and timeliness when it comes to planning and executing an exit. Let’s consider those three Ts and how a business seller’s close attention to them can help the seller realize the highest possible value for the business.

**Time:** To garner the best multiple of value, it is best to sell when the business is doing well and its prospects for continued growth are excellent.

**Timing:** A business owner considering the sale of her company should take into consideration where the company is in its business life cycle. If the path to growth has very strong potential to increase revenues, the owner might defer the sale for a few years to develop the company’s strong growth (and profit) potential. If the owner succeeds in doing so, she may realize a significantly higher price a few years down the road than she would realize by selling the company today.

The best way to capitalize on such Market Timing is to complete a comprehensive analysis of the business, industry, market and economic cycles that will influence a successful business expansion. A good, thorough analysis can provide invaluable insights into what steps the business owner should take to maximize the company’s potential future growth and increased profitability. Such an analysis also might suggest changes in the business, its sales efforts, expense management, marketing strategy or other efforts that may enhance the company’s prospects for success.

**Timeliness:** If a seller doesn’t follow a proven method for taking his business to market or follow a process that will keep the deal on track, the seller will lose value in the sale and very likely will lose qualified buyers as well.

Experience tells us that in most cases it is best to plan for an exit as far in advance as feasible. If the prospective seller can honestly apply critical measures to the business he has built, he is more likely to succeed in making the necessary operational changes to bolster the company’s potential value and will have a much higher probability of closing a sale at the price, terms and conditions desired. Unless market, industry or lifestyle issues dictate an earlier sale, developing and executing an exit strategy over time often is the best way to build value.

The first step along the exit strategy path involves obtaining a business valuation from an experienced valuation group that can demonstrate significant depth of knowledge, expertise and experience relevant to your business and industry. An expert valuation will outline and discuss all of the factors that will drive business value when the seller takes the company to market.

Meanwhile, there is no time like the present for prospective sellers to begin assembling a deal team (consultants, legal and accounting council, M&A advisors, etc.) that can assist the seller in developing and executing an exit plan.

*Greg Boucher is the National Director for The McLean Group’s Exit Strategies Institute and can be reached at 703-752-9022 or [gboucher@mcleanllc.com](mailto:gboucher@mcleanllc.com).*

*Part 1 of this article can be found at [www.mcleanllc.com](http://www.mcleanllc.com) in the News & Events section.*



## Office Locations:

Washington, DC (Headquarters)  
 Anchorage, AK  
 Atlanta, GA  
 Austin, TX  
 Baltimore, MD  
 Baton Rouge, LA  
 Boston, MA  
 Bozeman, MT  
 Cheyenne, WY  
 Chicago, IL  
 Cleveland, OH  
 Columbus, OH  
 Dallas, TX  
 El Paso, TX  
 Erie, PA  
 Halifax, Nova Scotia  
 Los Angeles, CA  
 Lubbock, TX  
 Miami, FL  
 Phoenix, AZ  
 Reno, NV  
 Sacramento, CA  
 San Diego, CA  
 Silicon Valley, CA  
 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

# 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.

