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## FEATURE ARTICLE

### Be Quick, But Don't Hurry

By Tom Swanson, NASD Limited Registered Representative

At The McLean Group, we specialize in managing multiple potential acquirers through a sell-side evaluation process for our clients. Many times, we have to manage clients' expectations through the sales process. Clients often want to cut to the chase, take the best offer and start negotiating. This is never a good idea, especially when under time pressure to sell. As John Wooden, the great UCLA basketball coach always said, "Be quick, but don't hurry."

I was reminded of this at a recent successful sell-side engagement: the client was under pressure to sell, and the board wanted The McLean Group to find a buyer and consummate a transaction in three to four months. This is well under the average of six to nine months we typically observe across all industry verticals.

In this case, The McLean Group identified 75 potential acquirers, solicited non-binding Letters of Intent (LOI) and received ten LOIs within 45 days of project launch. We evaluated the offers and recommended to the board the continuation of discussions with three firms. Of the three, only one was a legitimate buyer, having an all-cash offer and an accelerated close preference. The other two buyers had to raise additional debt on their balance sheets to finance the purchase (always a time-consuming and risky process for sellers under duress). And of course, the legitimate buyer was the lowest offer by a wide margin.

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## EXPERT TIPS

### When Two in the Bush are Better than One in the Hand

By Greg Boucher, CBI, CMEA

For most owners or shareholders of lower mid-market businesses, the majority of their net worth is tied up in the business. As such, it is vital that owners set clear departure objectives that will provide them with financial security once they sell the business. Unfortunately, many owners are not prepared to sell.

When buyers approach sellers, sellers often believe they are at a negotiating advantage because the buyer appears to be more motivated to complete a transaction. This "Fallacy of the Unsolicited Offer" – a common seller's misperception that, "If I [the seller] get an unsolicited offer from another company that knows the strategic value of my business, it is seeking me out because it has an interest, and therefore, it will pay the highest price for my business."

While this is a widespread misperception, it is quite understandable. Overtime, average sellers become quite familiar with highly publicized mega-deals, involving publicly-traded companies. What sellers may not know is that most such companies they read about are marketed through highly competitive auctions.

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## TRENDS TO ACT ON

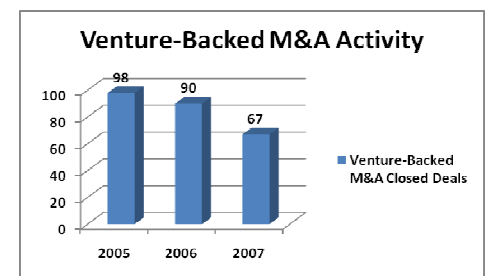
### Opportunity for Strategics as Financial Buyers Feel the Crunch

By Geoffrey A. Nattans

The recent shake-up in US debt markets leaves many financial buyers a “dollar short” for M&A transactions, while simultaneously presenting strategic buyers with an opportunity to become more competitive.

The Association for Corporate Growth (ACG) reports that as the cost of capital for financial buyers (who typically leverage part of the purchase price with senior and/or subordinated debt) increases – via cost of debt and equity – investors and sellers face a considerable challenge. Investors must reduce their expectations of return, or sellers must cut their price/value expectations. Conversely, strategic buyers typically have their own sources of capital, enabling them to avoid this ROI/price dilemma and consummate a transaction while financial buyers potentially are sidelined by valuation adjustments.

Meanwhile, Thomson Financial observes that debt markets turmoil does not seem to have impacted significantly the dollar value of venture-backed M&A activity. Total disclosed venture-backed M&A dollar volume during 3Q 2007 reached its highest level since 1Q 2001. Furthermore, the average deal size for disclosed venture-backed M&A transactions during 3Q 2007 was the highest on record since 4Q 2000. Venture-backed M&A activity may be softening somewhat as 67 venture-backed M&A deals closed during 3Q 2007 versus 90 in 3Q 2006 and 98 in 3Q 2005.



ACG concludes that – given current market uncertainties – many companies are simply worth less today than they were two months ago, a fact that will disappoint sellers and prospective sellers alike. Still, many industry experts remain optimistic about 4Q 2007 M&A growth, viewing recent market fluctuations as healthy, rational corrections that ultimately will play an invaluable role in re-pricing risk.

## EXIT PLANNING

### Using Stock-Based Incentive Plans to Retain Key Talent

By Enrique Brito, CFA, AVA, CM&A

One of the key elements in implementing a successful exit strategy is the ability to motivate and retain key employees. Although there are various ways to accomplish this objective, one of the most effective tools to motivate key employees to work more effectively and to remain with the company is the use of an equity-based incentive plan.

In a broader sense, employee incentive plans help business owners accomplish several objectives:

- Retain key employees through the business' transition
- Motivate employees to increase the value of the company
- Reward employees for improved performance, and
- Make employees feel and behave like business owners

Equity-based incentive plans take many forms including: employee stock ownership plans (ESOPs), qualified and non-qualified stock option plans, stock bonus plans, restricted stock awards phantom stock and 401(k) plans, among others. The foundation of a successful long-term incentive plan is to constantly review its performance against the objectives of the organization. The tax impact of each plan also must be considered, as each alternative has a different effect on the business' bottom line.

## EXPERT TIPS

### When Two in the Bush are Better than One in the Hand

(CONTINUED FROM PAGE 1)

An auction is usually the best method for sellers of mid-market businesses. When multiple buyers actively and simultaneously pursue an acquisition for a company, its business value will increase. Keep in mind that the best buyers in mid-market business auctions are strategic. The reason is simple: Buyers (including companies and, sometimes, private equity groups) that have a strategic objective for purchasing are likely to receive a higher return on their investment if they realize the synergies they project. As a result, strategic buyers are typically inclined to pay a higher price for a business.

But there is a flip side of selling through an auction. Active strategic buyers routinely employ teams that scour the market for good buys, and many strategic buyers hire professional investment banks to assist them. Active strategic buyers often simultaneously approach several companies to identify the best deal. If the seller cannot quickly lock up an exclusive deal with a buyer at a good price, the buyer may move on to another business that offers a better deal.

Here are some other important factors to consider when ensuring the right path when selling your business:

- The best buyers often have experienced deal teams, so sellers lacking significant deal experience are at a serious disadvantage.
- Experienced buyers know how to evaluate a company during the due-diligence process and how to value business' assets and potential.
- Sellers dealing with only one buyer do not have leverage or recourse if the deal does not go through. This is problematic for three reasons:
  1. A seller has no place to go if an offer comes in low.
  2. A considerable amount of time and resources can be wasted on financially qualifying a buyer who will not make a bid that meets the seller's needs.
  3. The seller must share the business' historical financials, strengths and weaknesses, opening the door to potential confidentiality leaks.



The bottom line: Ultimately, the seller is not in control when dealing with only one buyer. The better alternative for the seller is to achieve the highest price through buyer competition. This can be a bit tricky. Setting up an auction must be handled delicately and should not be attempted by novices. It is best left to experienced investment bankers who can deftly handle multiple buyers and create a competitive situation to position a business to realize the best transaction value. Overall, it is essential that business owners plan their exit, remain in control of the sales process, and build a team of experienced professionals that can advise them how to avoid the trips and traps that may arise in a deal.

## INDUSTRY SPOTLIGHT

### Defining the Value of a Government Contracting — Business Science, Art or Alchemy?

By Greg Boucher, CBI, CMEA

When a shareholder of a small- or mid-size government contracting business initially considers an exit strategy, the first-order issue inevitably involves setting the business' value. Valuing a business is not an exact science, but it is not purely an art either. It is a little bit of both — a kind of an alchemy. For centuries, alchemy was used to define elements that appeared combine forces to create an outcome. Elements of science, like chemistry, with art and astrology were used together to define the physics and behaviors of ancient world. Today, we can quantify a business' value with industry conventions or approaches, methods and formulas, but the price that a business is sold for depends on fundamentals that are inherent aspects of the business, as well as aspects that are not directly tied to the business' economic value. The business' future economic capacity as seen through the acquirer's eyes is the determinant of value that sets the price. Capturing those future intangibles is the art of alchemy.

Elements known as *value drivers*, which are specific to a business or industry, have a marked impact on value. These value drivers are where a shareholder can focus his or her resources to best prepare the businesses for sale. The value drivers that any particular government contracting business possesses are where acquirers conduct most of their analyses.

The questions acquirers will attempt to answer in their analyses include:

- What financial, operational or strategic benefit will we gain by making a particular acquisition (these are the financial and operational synergies that an acquirer will project to see a return on investment [ROI])?
- What is the company worth? What is it worth to us?
- What is the top-end price we will pay at our requisite hurdle rate (required ROI)? What's our low-end?
- What are the risks associated with the acquisition? Are the target company's services a commodity? Is the target company a "body shop"? Does the target company have a defensible position, technology or service in the market? How long can it maintain its competitive foothold?
- If in a competitive bidding situation, and the cost to acquire is at or above the indicated requisite hurdle rate's top-end value, is there a strategic advantage (i.e.: gain in market share, lock-out of competition) that can be gained through the acquisition that supersedes initial hurdle rate guidelines?

The value of a government contracting business is driven by several identifiable value drivers that are grouped into the following five factors:

1. Financial Performance
2. Growth
3. Contracts and Customer Relationships
4. Management and Human Resources, and
5. Market Differentiators

We will look at how each of these value drivers impact value. Some are probably obvious. Some may not be as imperative for current operations, from a shareholder's perspective. Keep in mind that when preparing a business for sale, your target is: *to look through the potential buyer's viewpoint.*

**THE MCLEAN GROUP'S  
LOCATIONS:**

Washington, DC  
 Atlanta, GA  
 Austin, TX  
 Baltimore, MD  
 Baton Rouge, LA  
 Boston, MA  
 Bozeman, MT  
 Charlotte, NC  
 Cheyenne, WY  
 Chicago, IL  
 Cleveland, OH  
 Miami, FL  
 Orlando, FL  
 Reno, NV  
 Sacramento, CA  
 San Diego, CA  
 Silicon Valley, CA  
 St. Louis, MO  
 Tulsa, OK  
 Wooster, OH

**Have A Question?**

Please submit any topics of interest to [egins@mcleanllc.com](mailto:egins@mcleanllc.com) with the subject: "M&A Market Update Topics" and we will try to address it in the next issue!

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**FEATURE ARTICLE****Be Quick, But Don't Hurry****(CONTINUED FROM PAGE 1)**

Our strategy was to leverage the two other buyers against the legitimate buyer to induce the legitimate buyer to bid more money. To accomplish this, we coached the employees of the seller to avoid any informal communications any prospective buyers during on-site due diligence. All communications were to be directed only through The McLean Group. This accomplished many things, the least of which was keeping the buyers guessing as to who they were competing against.

When The McLean Group requested binding LOIs to purchase, the legitimate buyer did not have any inside information as to who was competing for the company. In a competitive situation, a buyer's natural tendency is to want to win. The legitimate buyer upped its offer by 50 percent, but it remained the lowest offer.

This is where The McLean Group earns its fee. While simultaneously negotiating with all three buyers, we focused heavily on the legitimate buyer. Such discussions are never easy. You have to balance pushing too hard (in which case the buyer could walk away) against the need to get the buyer to step up "just a little bit more" to win. Meanwhile, the clock is ticking, because if you lose your primary buyer, you will need a Plan B, with the debt markets deteriorating for your other two buyers (in this case, it was sub-prime mortgage meltdown time).

When we requested best and final offers, our legitimate buyer raised its bid again, literally doubling what it had bid initially, with an all-cash, 30 day close. The McLean Group managed both parties through a mutually satisfactory due diligence and closure within 120 days of the project launch.

When under duress and needing to sell quickly, never rush to negotiate with just one party. Leverage your banker, and keep your options open. You can be quick, and still get to the finish line without hurrying!

**ABOUT THE MCLEAN GROUP**

The McLean Group is a national investment bank providing merger and acquisition (M&A), capital formation, business valuation, and exit planning services. The McLean Group serves middle-market businesses generating up to \$500 million in annual revenues. While The McLean Group's diverse client base spans numerous industries, the firm has several industry specialties, including: information technology, government contracting, financial services, telecommunications, transportation, travel and hospitality, and renewable energy. The McLean Group is a FINRA Registered Broker Dealer.