

## INSIDE THIS ISSUE:

Featured Article: 1, 3, 4  
*So You Want To Sell Your Company To A Private Equity Group*

Expert Tips: 1  
*Should you inform your employees about plans to sell the company?*

Trends To Act On: 2  
*M&A Activity and Spending Slows, But Higher EBITDA Multiples*

Exit Planning: 2  
*Transferring Business Ownership*

## So, You Want To Sell Your Company To A Private Equity Group

By Neil Paschall, CPA, CVA, CFFA

This is the third and final article on the subject of selling a business to a Private Equity Group (PEG). In the first article we discussed PEGs' enormous presence in the M&A market, how PEGs are organized, and the principle motivations driving PEGs to make deals. In the second article we discussed how to prepare your company, how to manage the sell-side process, and how to position yourself to obtain maximum value. In this final article, we will discuss some key deal points and some general rules of the game when dealing with PEGs.

*Price, timing, and certainty* are at the heart of any merger or acquisition transaction, and any effective strategy for selling your company to a private equity firm must continually return to those three terms.

Everything a PEG negotiates for in this context is motivated by the desire to pay the lowest price and have the greatest degree of control over the timing and certainty of the transaction. From the perspective of a PEG, it would be an ideal outcome to have a complete option to purchase a company without any corresponding obligation, and to set a maximum price but wait to see whether they can buy the company for less.

Of the key deal terms, price is likely to be at the top of any seller's list. But how do you ascertain what the price actually is in a deal? It is simple, of course, if you conduct an auction; do not provide any potential buyer with an option or exclusive right to negotiate; enter into a definitive agreement with a simultaneous closing of the sale; and have an all-cash purchase price and no post-closing adjustments to the purchase price from accounting

*(article continued on page 3)*

## EXPERT TIPS

### Should you inform your employees about plans to sell the company?

By Steve Lebischak, NASD Registered Rep.

Many business owners preparing to sell their company to a strategic or financial buyer face the same tricky question: *Should they inform their employees of their plans to put the company on the market?* There are several benefits and risks associated with the decision to keep the acquisition a secret or to reveal the acquisition to employees.

#### Why keep it a secret?

- ◆ There is a chance that some employees of a venture-backed firm may have signed on expecting or even hoping for a liquidation event; however, many employees would find the ups and downs of the sales process distracting, and even discouraging, if left at the altar by a potential buyer.
- ◆ By informing your employees about the decision to sell the company, you are increasing the likelihood that word will leak to the outside world. In a highly competitive industry, competitors may find a way to take advantage of the news and poach employees. Since you cannot "un-ring" the bell, it may be prudent to keep your plans confidential.

*(article continued on page 4)*

## TRENDS TO ACT ON

---

### M&A Activity and Spending Slows, But Higher EBITDA Multiples

By Zubin A. Patel

In the wake of subprime credit markets-related turmoil, U.S. mergers and acquisitions activity in September 2007, and overall mergers and acquisitions spending, fell to its lowest level in 15 months, according to FactSet Flashwire News.

Mergerstat's U.S. Mergers and Acquisitions Market Index reports that deal volume and aggregate deal value slowed to June 2006 levels, with the volume of trailing 12-month transactions valued at \$25 million to \$250 million, falling 10 percent in the past 12 months (to 1,350 transactions). Transactions valued at \$10 million to \$24.9 million fell 19 percent during the same period (to 578 transactions).

At the same time, those transactions that are closing appear to be commanding higher EBITDA multiples than those that closed a year ago. As Matthew Quinn reported in Financial Week, "*... valuations have been pushed up. For all middle-market transactions across all industries over the past 12 months ending in April (2007), the median multiple was 10.3 times EBITDA, compared with 9.7 times a year earlier and 9.7 times for all of 2006, according to research from Baird.*"

Mergerstat reports that 2007 P/E multiples trended higher than comparable 2006 data, exceeding 30 times during the 2007 and 3Q07, but falling to 28.2 times in the three months ending during September 2007. Similarly, throughout 2007, average EV/EBITDA figures exceeded 11 times, versus 2006 EV/EBITDA figures that averaged in the high 9 multiples.

## EXIT PLANNING

---

### Transferring Business Ownership

By Richard E. Wait, CPA, CVA and Scott T. Wait, CPA

Many owners avoid the critical task of transferring their business to the next generation of owners. But procrastination may cause severe loss in your business's value or cause the transition to fail, resulting in discounts of 60% percent to 80% percent of your company's value.

Here are four critical steps that you should take in order for your exit plan to succeed:

- ◆ **Determine your personal priorities and approximate date of transition.** This includes determining your financial needs, estate plan, and contingency plans.
- ◆ **Evaluate the company's readiness for transfer.** This includes determining the value of the business, performing preventive maintenance (financial and legal), keeping and motivating key employees, creating an advisory team, and designing tax minimization strategies.
- ◆ **Review the best options for your exit.** This includes maximizing the value of the business, as well as determining how to leave behind a strong management team and the types of consideration at sale (cash, stock, deferred compensation, non-compete agreements, earn-outs, etc.).
- ◆ **Formulate the best plan for transfer.** This includes the following options: transfer to heirs, sale to insiders, or sale to outsiders.

By implementing these steps and consulting a trained professional, you can ensure a successful transfer of your business and maximize the return on your investment.

# So, You Want To Sell Your Company To A Private Equity Group

(CONTINUED FROM PAGE 1)

adjustments, future performance, or any indemnification as a result of a breach of representations and warranties.

Occasionally, a deal like this takes place in private company acquisitions, but not often. You may have to choose between taking a lower price, all in cash, with fewer risks of that price being reduced, and getting a higher price with more conditionality. It is this tension that often leads buyers and sellers to close a valuation gap by adding more complexity, such as including an “earn-out” (having some of the purchase price contingent upon future performance) or selling some of the company at one price and hoping to sell the rest later, for more.

When comparing proposals, a good investment banker will assist you by taking into account the financial and other deal terms, in order to determine which proposal is more financially lucrative.

The definitive agreement should only be signed after all business and legal due diligence has been completed. There are representations and warranties in the agreement so that assumptions about the business, disclosed in the due diligence, can be verified. Ideally, as a seller, you would like as little conditionality to closing as possible. Usually, there is not a simultaneous closing with the contract signing, and you are at risk that the deal will not close during this period. Two particular hot buttons when negotiating closing conditions with PEGs are: obtaining necessary debt financing, and entering into agreements with continuing management.

Management arrangements are vital to typical private equity fund purchasers because they need management to run the business post closing. There is a tension here for the company owner, who may not want to involve his or her key management in the contract negotiating process, but also may not want the risk of signing a sale agreement with the possibility that management will not reach a deal with the buyer before closing.

Indemnification is always a hot button in acquisitions. When PEGs sell portfolio companies they tend to take a hard line on indemnification, often refusing to provide any or limiting it to an escrow of perhaps 10 percent of the purchase price for a limited period of time (a year or two). This same approach will often work for a seller to a PEG, but it depends heavily upon competition, the results of the due diligence investigation, the level of comfort with the owner and management, whether the business owner will have a continuing stake in the company, the pricing of the deal (if there is any room for error), and of course, negotiating skill.

Another key term of the contract will be the covenants. Covenants are promises made by the buyer and seller that determine how they will act between signing and closing, and sometimes after closing. A buyer will seek to require that the business is operated “in the ordinary course” between signing and closing. What that means, specifically, is subject to significant negotia-



### 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

### ABOUT THE McLEAN GROUP

The McLean Group is a middle-market investment bank providing merger and acquisition, business valuation, capital formation, executive advisory and litigation support services. Its focus is on serving middle-market businesses generating between \$5 million and \$300 million in revenues. The firm has a widespread practice with particular expertise in IT services, technology, telecommunications, government contracting, staffing, and travel and hospitality sectors. The McLean Group is a registered broker dealer.

### CONTACT US: THE McLEAN GROUP

1660 International Drive  
Suite 450  
McLean, VA 22102

(703) 827-0200 Phone  
(703) 827-0200 Fax  
www.mcleanllc.com

## So, You Want To Sell To A Private Equity Group

(CONTINUED FROM PAGE 3)

tion. A set of covenants that are too restrictive may make it impractical for the seller to comply, particularly if the period between signing and closing is longer than expected, which is often the case. The consequence of that is having to go back to the buyer for a waiver, which may provide it with an opportunity to seek a price adjustment or terminate the deal.

As my brief discussion illustrates, the key deal terms – *price, post-closing adjustments, earn-outs, representations and warranties, indemnification, closing conditions, covenants, and timing* – are all interrelated. A contract that provides an attractive price but essentially gives the buyer a number of ways to escape the deal may, in effect, create not much more than an option for the buyer.

Alternatively, by working closely with your investment banker and deal team, and paying careful attention to the terms as well as whom you are doing business with, you can dramatically increase the chances of maximizing value.

## EXPERT TIPS

(CONTINUED FROM PAGE 1)

### Why *not* keep it a secret?

- ◆ Employees are critical to the company's future and oftentimes, a buyer wants to know how employees will react to news of an acquisition. If employees are fully aware and onboard, you can provide a definite answer to the buyer and appease him or her.
- ◆ Through your candidness about the acquisition, you can build company loyalty.
- ◆ Informing employees about the acquisition allows you the opportunity to reduce the shock your employees may feel when they suddenly learn there is a new owner. One way to reduce shock among employees is to convey that the lifecycle of any business includes consolidation through mergers and acquisitions, and that it is in the company's best interest to actively drive that process.

### In The End

Whether or not the business owner decides to inform his employees about the acquisition, all employees will eventually find out about the decision to sell the company. It is up to the discretion of the owner to weigh the benefits and risks and, in turn, decide whether or not to keep the acquisition a secret.