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Inside This Issue

Feature Article:

How to Prepare Your Business For Sale - Even If It's Not On the Market

Expert Tips:

A Sleeper Issue

Trends To Act On:

Weather the Storm and Come Out on Top

Exit Planning:

Earnouts: The Art of Building Bridges in M&A Negotiations

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.

Feature Article:

How to Prepare Your Business For Sale - Even If It's Not On the Market

As your middle-market business starts to grow, keep in mind the importance of a successful exit strategy that will help you realize your business' value. There are several steps to take to ensure that you achieve the maximum value for your business when it's time to sell – even if you're not ready to sell your business in the near future.

First, you should ensure that your business is monitored on a regular basis, and obtaining a periodic valuation analysis is one of the easiest ways to do so. Valuation analyses serve as a frame of reference for you to monitor your business, and perhaps even reconstruct it if needed. Knowing the strengths of your business will allow you to use such strengths to your advantage when it's eventually time to sell.

Second, consider the three major methods used in selling middle-market businesses and then select which route you want to take for your business. The major methods are:

- **The Distant Approach** - Preparing your business for sale three to four years in advance.
- **The Intermediate Approach** - Planning for a sale 12 to 18 months in advance.
- **The Fire-Drill Approach** - Planning a sale in the immediate future.

Continued on p. 4

Expert Tips: *A Sleeper Issue*

By Dennis Roberts, Senior Managing Director

Management transitions are rarely discussed as a factor in successfully selling middle-market businesses, which is perhaps why they are often forgotten about when planning exits.

Successful management transitions are necessary before buyers consider pulling the trigger on an acquisition. In brief, successful management transitions entail: keeping the right management on board; preventing management from pilfering your business' customers after a deal is completed (all buyers will ensure the right preventative measures are in place), and avoiding the blackmailing of a seller by management that feels entitled to special compensation for their contributions toward building the business.

In order to ensure such key elements are in place and avoid major management transition problems, consider these rules:

1. **Retain key employees to a point sometime after the sale.** This means arranging stay bonuses. Make sure to properly time bonuses and avoid overpaying so they do not cause early departures.
2. **Arrange for noncompete agreements with key employees.** Noncompete agreements not only protect your business from the loss of valuable employees, but they also protect your company from losing sensitive business information or trade secrets. If one of your employees has access to such information, he or she has the potential to destroy your business' value.
3. **Be specific with promises and immediately document them.** It may seem unjust when a key employee brings up a casual conversation from several years ago, when you promised that you "would take care of him or her when the company was sold." Seems outlandish? Not nearly so. Most M&A professionals have dealt with this on numerous occasions.
4. **Avoid long-term absentee ownership.** This is especially true as management employees become more involved with running the business. Absentee owners who rely on key management to run their business can almost be assured that when the business is sold, key management will feel entitled to ask for a bigger share than the owner may feel they are entitled to. The problem is that the owner, in the absence of well-documented agreements designed to induce key management to stay or to protect sensitive client relationships, may find themselves in a weak negotiating position. ♦



Trends To Act On: *Weather the Storm and Come Out on Top*

By Sam Huang



Raising capital is more challenging due to current market conditions. As a result, many investors have become more proactive in managing their portfolio in an attempt to cut cost and conserve cash. Renowned Silicon Valley angel investor Ron Conway suggests the following ideas for navigating in the new economic realities:^{*}

- **Aggressively pursue mergers and acquisitions (M&A).** Companies should aggressively pursue M&A opportunities to maintain critical mass vis-a-vis funding, customers, market share, cash, synergies, etc.
- **Accelerate fund-raising and cost reductions.** Companies should raise at least six more months of funding as soon as possible while implementing cost reductions in labor, marketing, operational and other expenses. Should capital markets seize up, it may be difficult for even the most attractive firms to attract the capital they require from willing investors.
- **Talk to anyone with cash.** Do not ignore certain VCs because they may not be considered “top-tier investors.” Many top-tier VCs may be experiencing bandwidth constraints, so for markets with limited liquidity, it is essential to secure funding from any possible source. Companies requiring capital at this time should note: investors holding cash will exercise their leverage in any transaction.
- **Accept valuation realities.** Valuations will fall. Be realistic and focus on survival because survivors may position themselves for greater success in the recovery that inevitably will follow.
- **Seek partners.** Look for corporate partners that will invest so you can raise more capital. ♦

Exit Planning:

Earnouts: The Art of Building Bridges in M&A Negotiations

By Enrique Brito, CFA, AVA, CM&AA

Differences of opinion between a seller and buyer as to the amount, growth potential and likelihood of the business’ future earnings create contentious price negotiations. To bridge the perceived gap between the seller’s and the buyer’s respective projections, earnouts sometimes are used, particularly in the case of young companies.

An earnout, whether confirmatory or incentive, is a contingent form of payment that is dependent on the acquired company’s achievement of certain performance targets after the transaction closes. However, earnouts can be complicated to structure and may lead to opportunistic behavior on the part of buyers once they control the company. As a result, the earnout targets that the business must achieve need to be structured in such a manner so as to prevent manipulation, whether intentional or otherwise.

Many investment bankers advise buyers and sellers alike to consider using gross margin or gross profit as a neutral metric. Although it is far from perfect because it neglects to consider bottom-line earnings (the buyer’s main consideration), it constitutes a good compromise. Another approach to selecting earnout metrics involves blending two or three of these metrics (revenues, gross profits and net profits).

Although earnouts can be a useful tool in bridging the seller’s and buyer’s differences of opinion as to the business’ future earnings performance, they must be approached with caution as they involve risks. Careful negotiation and documentation can go a long way toward minimizing or eliminating such risks while helping minimize the odds of legal disputes in the not too distant future. ♦



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 www.PlanYourExit.org.

^{*}Arrington, M. (2008, October 8). Angel Investor Ron Conway E-mails His Portfolio Companies Over Financial Meltdown. Message posted to <http://www.techcrunch.com/2008/10/08/angel-investor-ron-conway-addresses-his-portfolio-companies-over-financial-meltdown/>. Retrieved October 13, 2008.

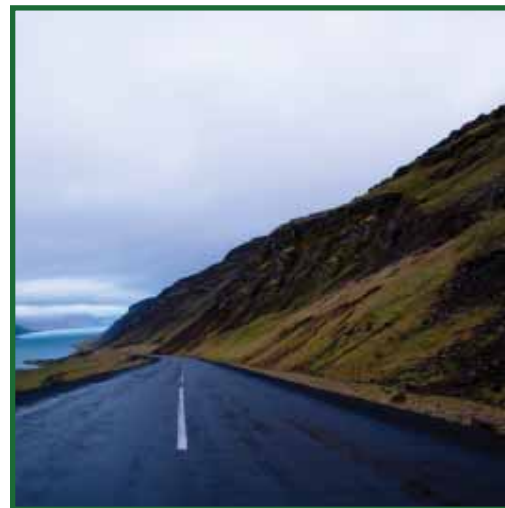
“Is This a Good Time to Make Acquisitions?”...continued from p. 1

1. **The Distant Approach**

Most middle-market business owners spend a lengthy amount of time contemplating their business strategy and potential for growth, and such business owners should spend no less time considering how to build and achieve investment value. Analyze your business and identify issues that should be fixed or enhanced to make your business more profitable, and ultimately, more attractive to buyers.

You should also develop a series of metrics that will maximize your investment value to a group of several prospective buyers in an auction. Such metrics include:

- Steady or increasing growth rates in revenues and profitability
- Product/service leadership within your industry
- Barriers to entry that discourage competitors
- Experienced, self-sufficient management teams
- And a broad client base that minimizes risks of relying solely on one major client.



2. **The Immediate Approach**

There is a fine balance when it comes to making decisions to prepare your business for a future sale and making decisions to run your business in the present. The tricky aspect is avoiding postponing essential changes for your business, yet also avoiding any major changes in your business’ infrastructure.

If you decide to take The Immediate Approach and sell your business in the upcoming 12 to 18 months, you can embark on a number of pre-sale initiatives that will augment your business value and still maintain a fine balance. Such initiatives include:

- Hiring a CPA to straighten up your business accounting and tax records (one of the major causes of deal failure is the buyer’s fallout after mistakes found in accounting records)
- Developing an experienced, responsible management team to successfully handle the post-aquisition transition
- Registering trademarks, patents and copyrights
- Increasing your PR initiatives to obtain favorable coverage for your business
- And solidifying important customer and supplier contracts.

3. **The Fire-Drill Approach**

The sale of middle-market businesses is not a quick process, and generally takes six to 12 months to close a deal. Add the fact that many issues can hinder the progress of a deal (i.e. changes in the economy, sudden changes in the business’ own financial performance), and it’s logical to conclude that closing a deal is by no means certain.

That being said, if you decide to take The Fire Drill Approach remain flexible and keep your alternatives open. Avoid signing a new, long-term lease for an office; avoid expanding your marketing budget, and avoid undertaking major projects that are not essential to your business’ value.

In Conclusion

It is impossible to foresee all complications that may arise during a deal close, but following the initiatives discussed will help prepare you for the sale of your middle-market business. Consider each component critical to a potential sale and consult with trusted advisors to ensure that your decisions benefit your business’ long-term future. ♦

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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' expansion, mergers & acquisitions (M&A), refinancing, recapitalization, leveraged buyout and shareholder liquidity objectives.
- **Market Intelligence:** By leveraging superior competitive analyses, we provide 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.
- **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.

