

Maximizing Opportunities in Today's M&A Market



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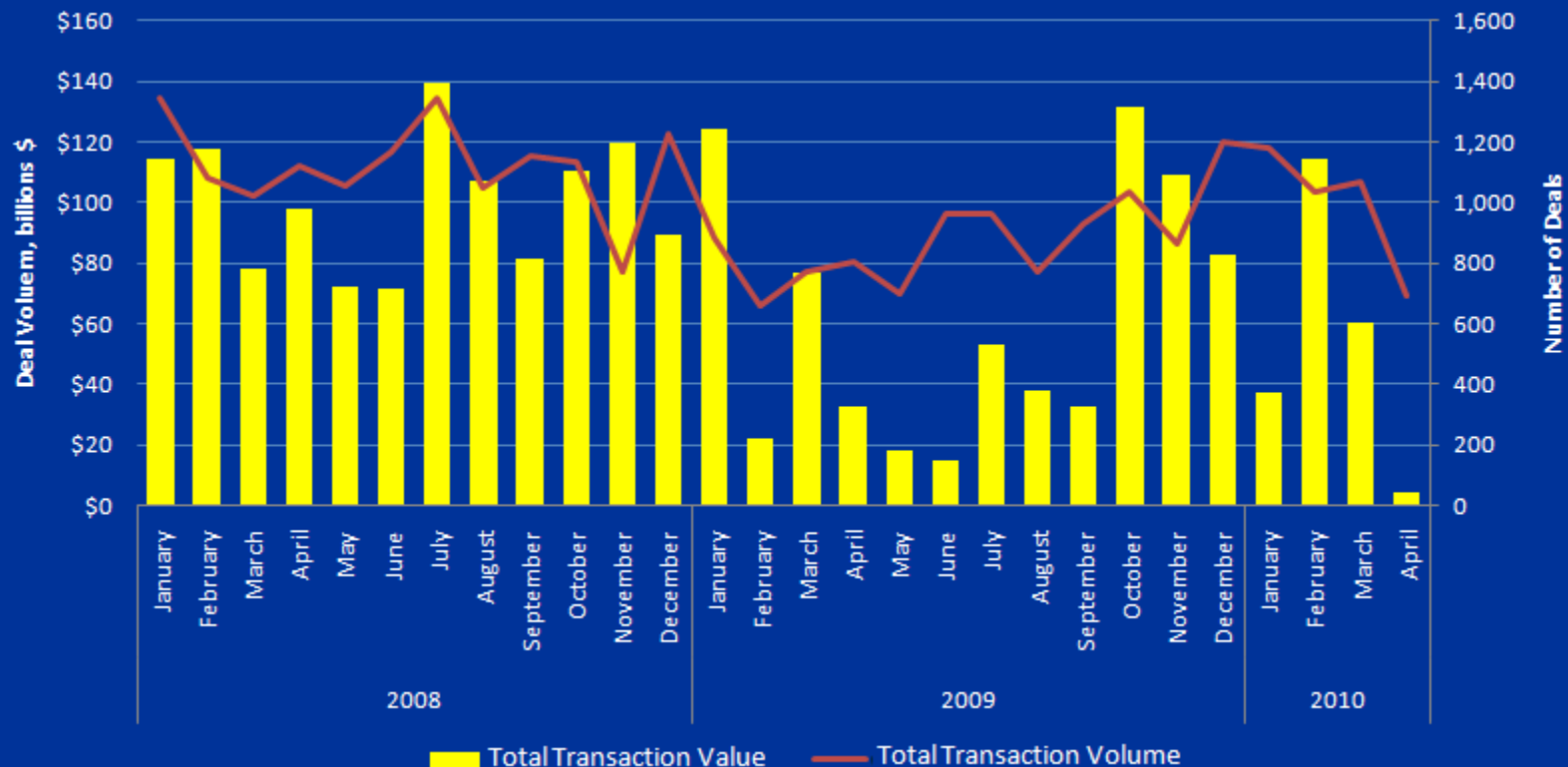
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Agenda

- Overview of Current M&A Market
- Update on Credit Market and the Impact of Credit on Business Valuations
- Moderated Business Valuations and Their Relevance to Estate Planning
- How to Prepare a Business for Sale
- Considering Acquisitions As a Growth Strategy

Deal Volume 2008 – April 2010

All M&A transactions involving a North American buyer or seller

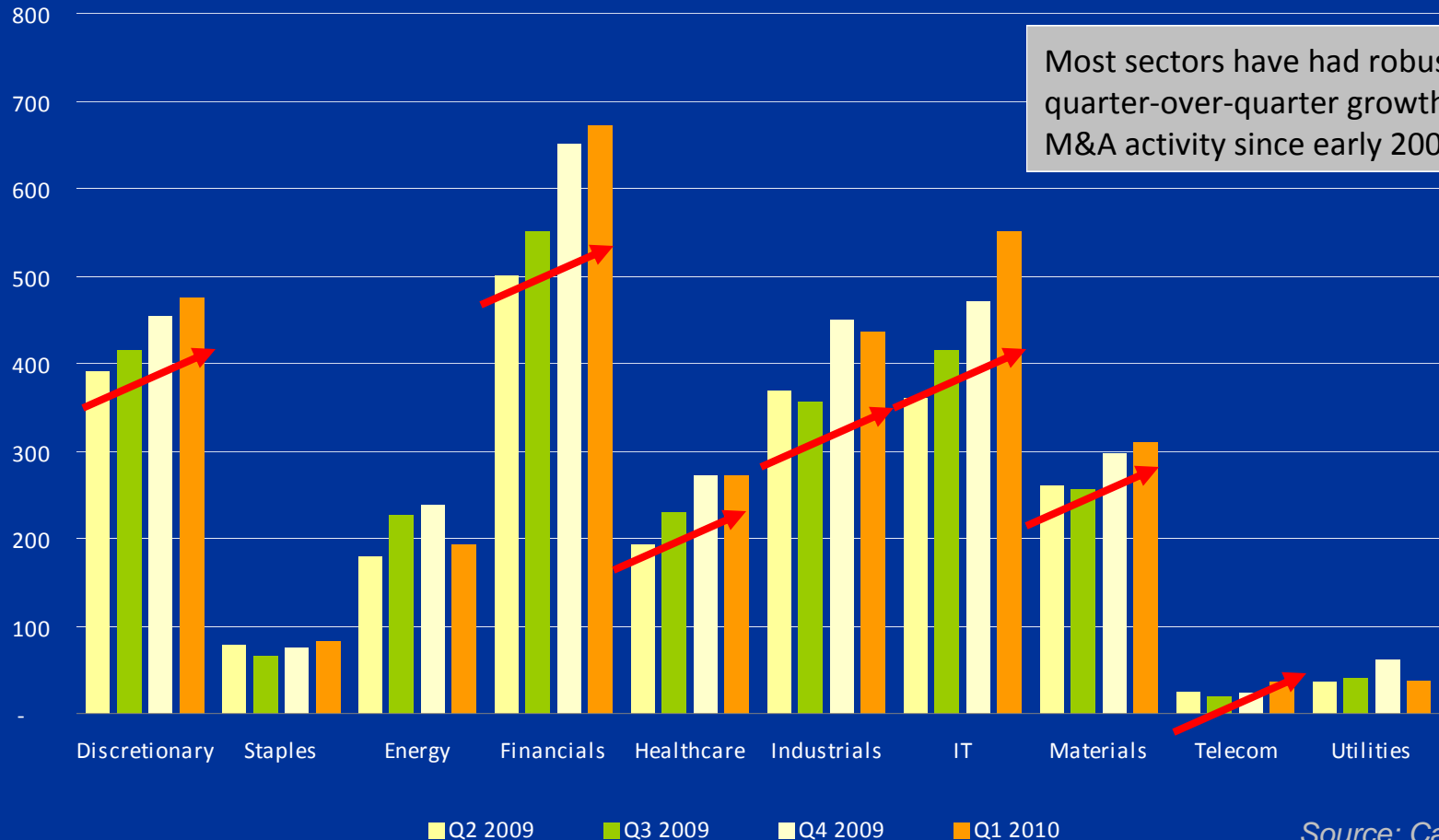


**May '09 – April '10 compared to May '08 – April '09:
 Number of Transactions down by just 5.2%
 Total Transaction Value dropped by 32.6%**

Source: Capital IQ

M&A Activity by Industry (LTM)

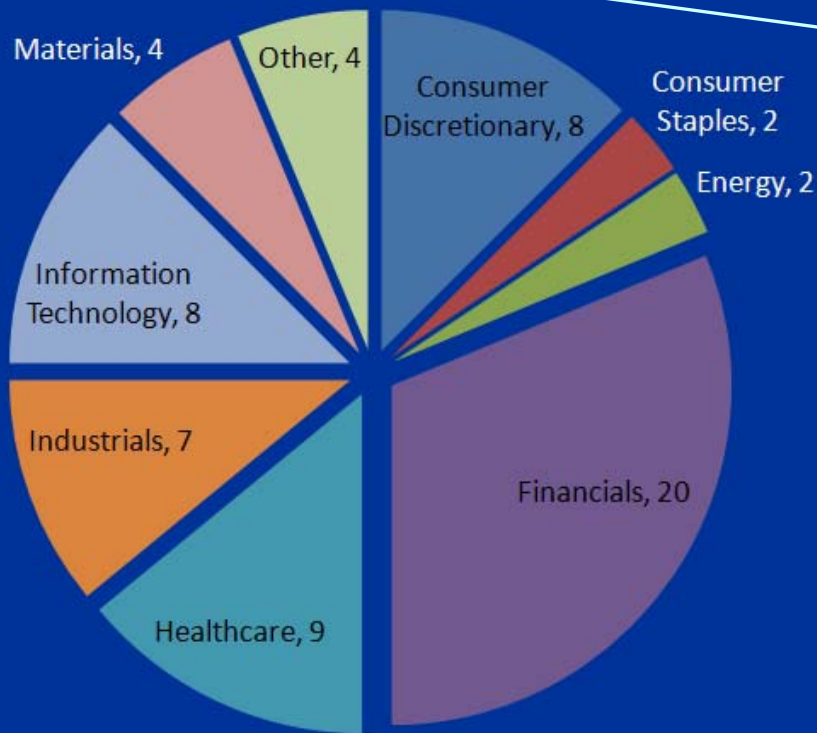
All M&A transactions involving a North American buyer or seller since April 1, 2009



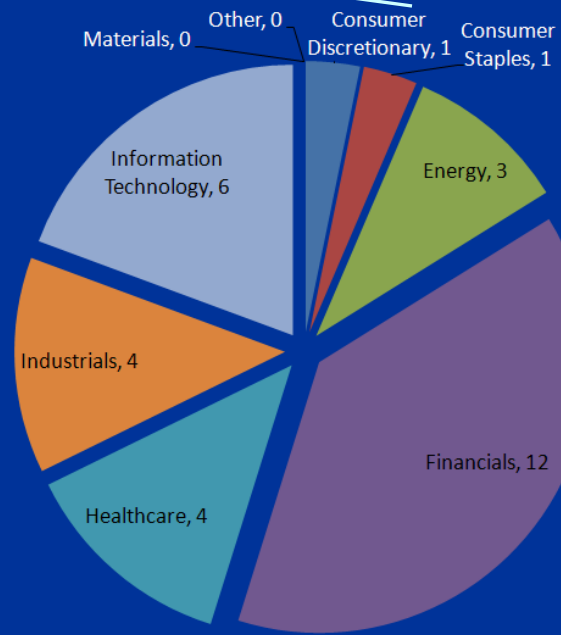
Source: Capital IQ

IPO Market 2009 vs. YTD 2010

64 New Offerings in 2009



31 New Offerings YTD 2010

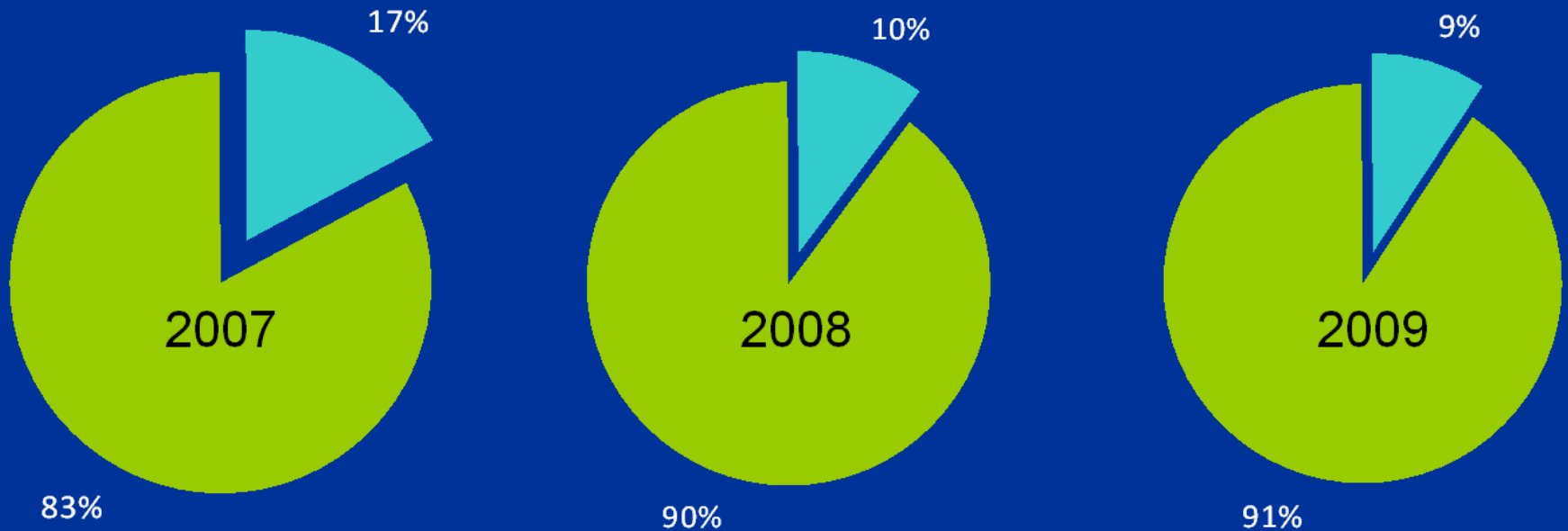


Sources: Dealogic, Hoovers

Strategic M&A vs. LBOs

All M&A transactions involving a North American buyer or seller

- Number of Financial Buyer / "LBO" Transactions
- Number of Strategic Buyer Transactions



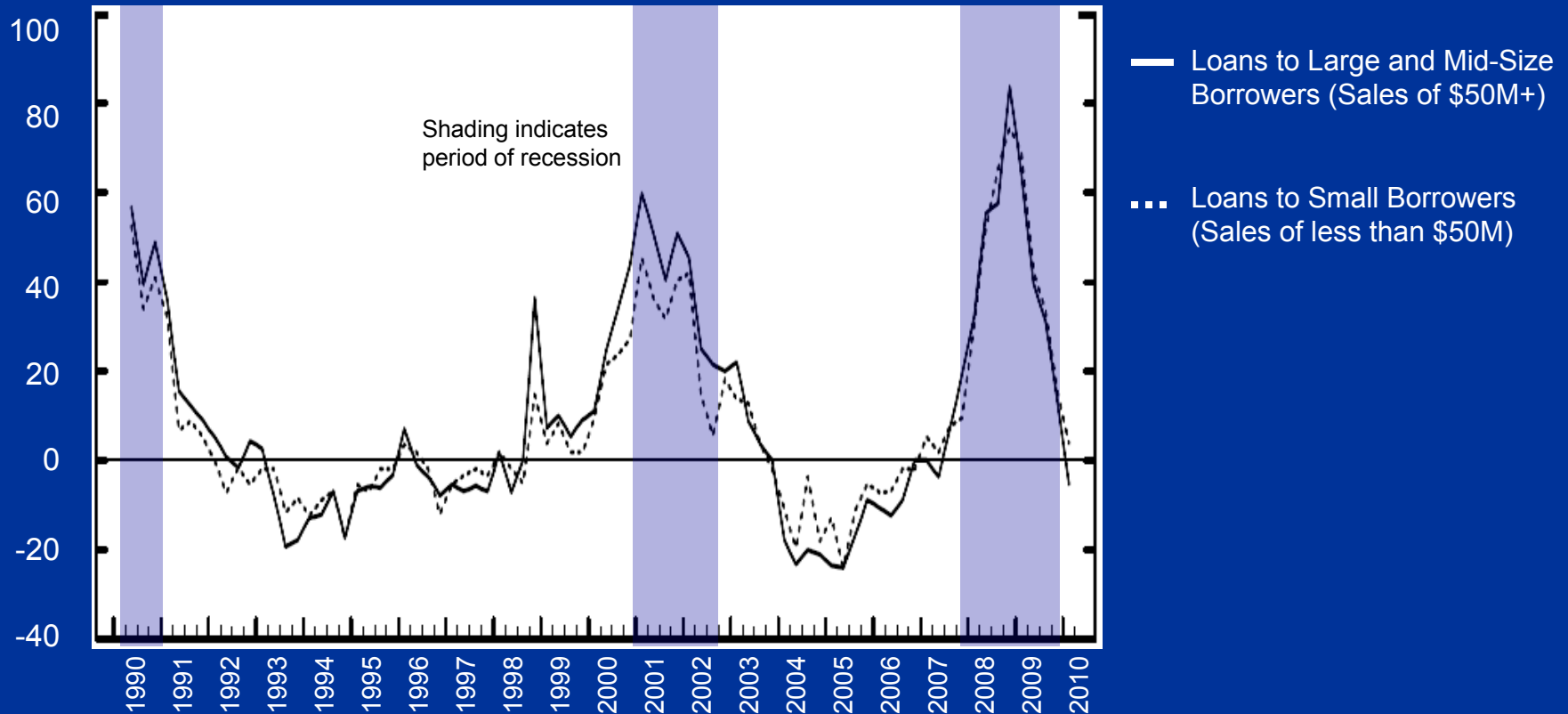
Source: Capital IQ

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Credit Market: How Tight Is It?

Net percentage of U.S. banks that indicate tightening credit standards on corporate loans

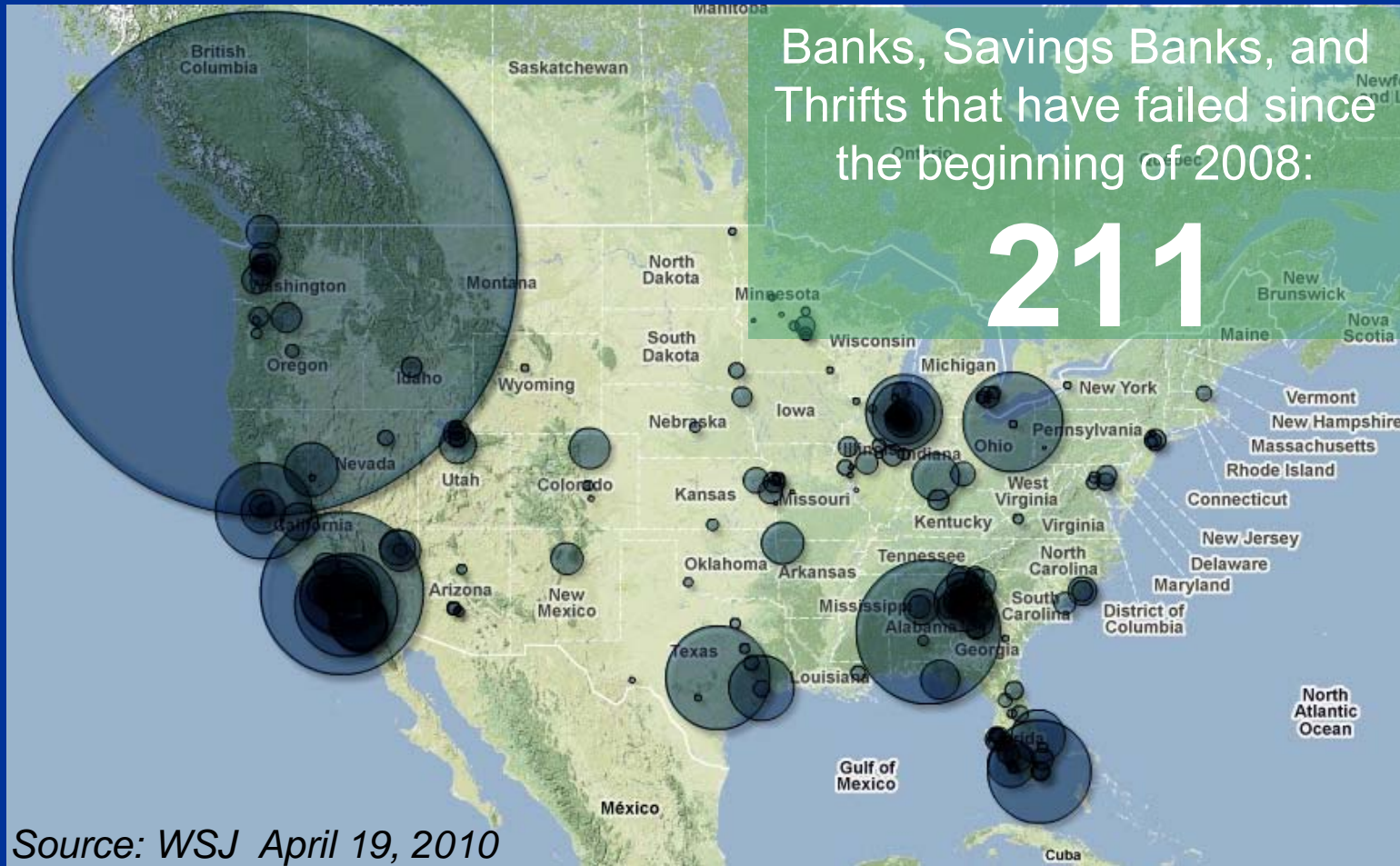


Source: Federal Reserve (January 2010 Senior Loan Officer Opinion Survey)

Credit Market: How Tight Is It?

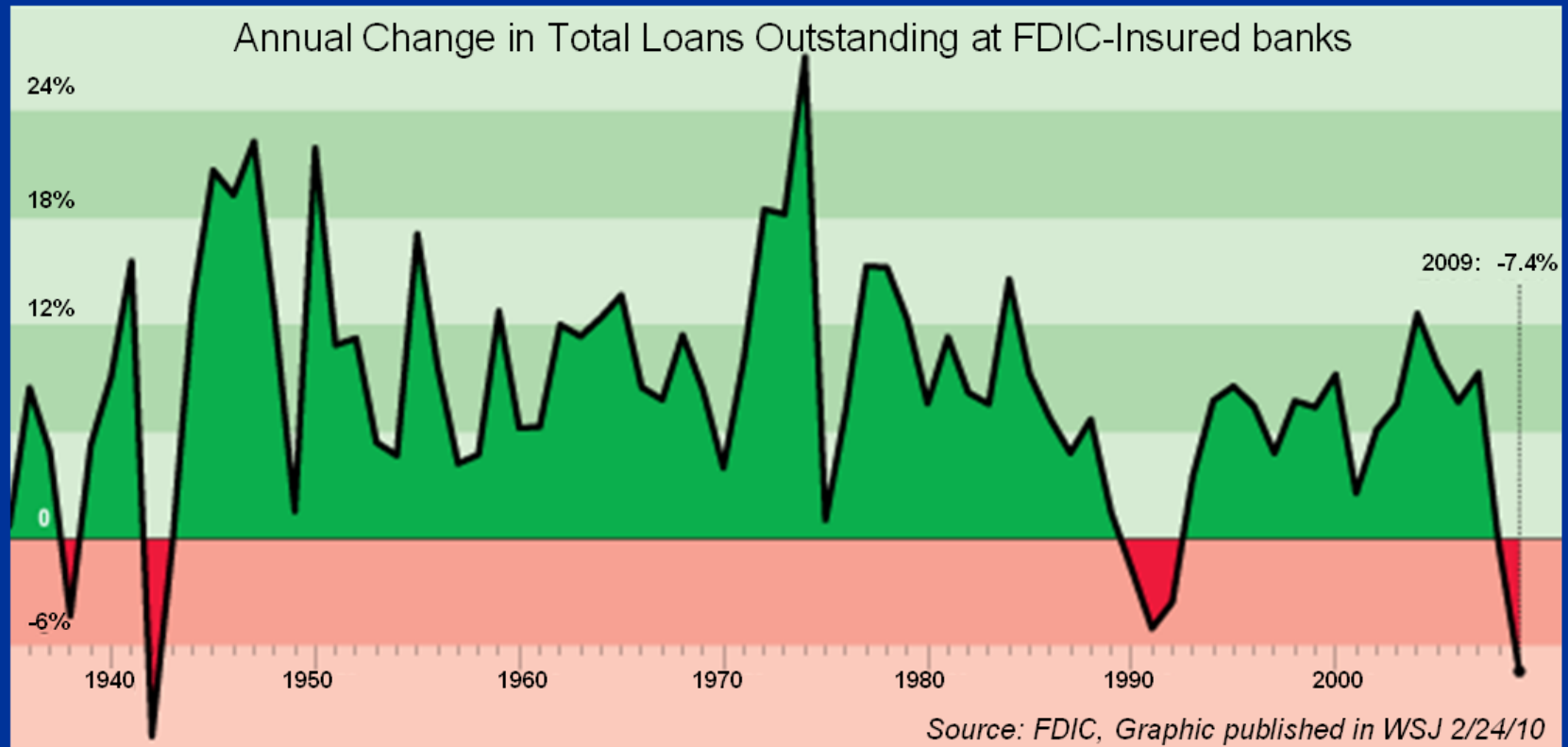
Banks, Savings Banks, and Thrifts that have failed since the beginning of 2008:

211



Source: WSJ April 19, 2010

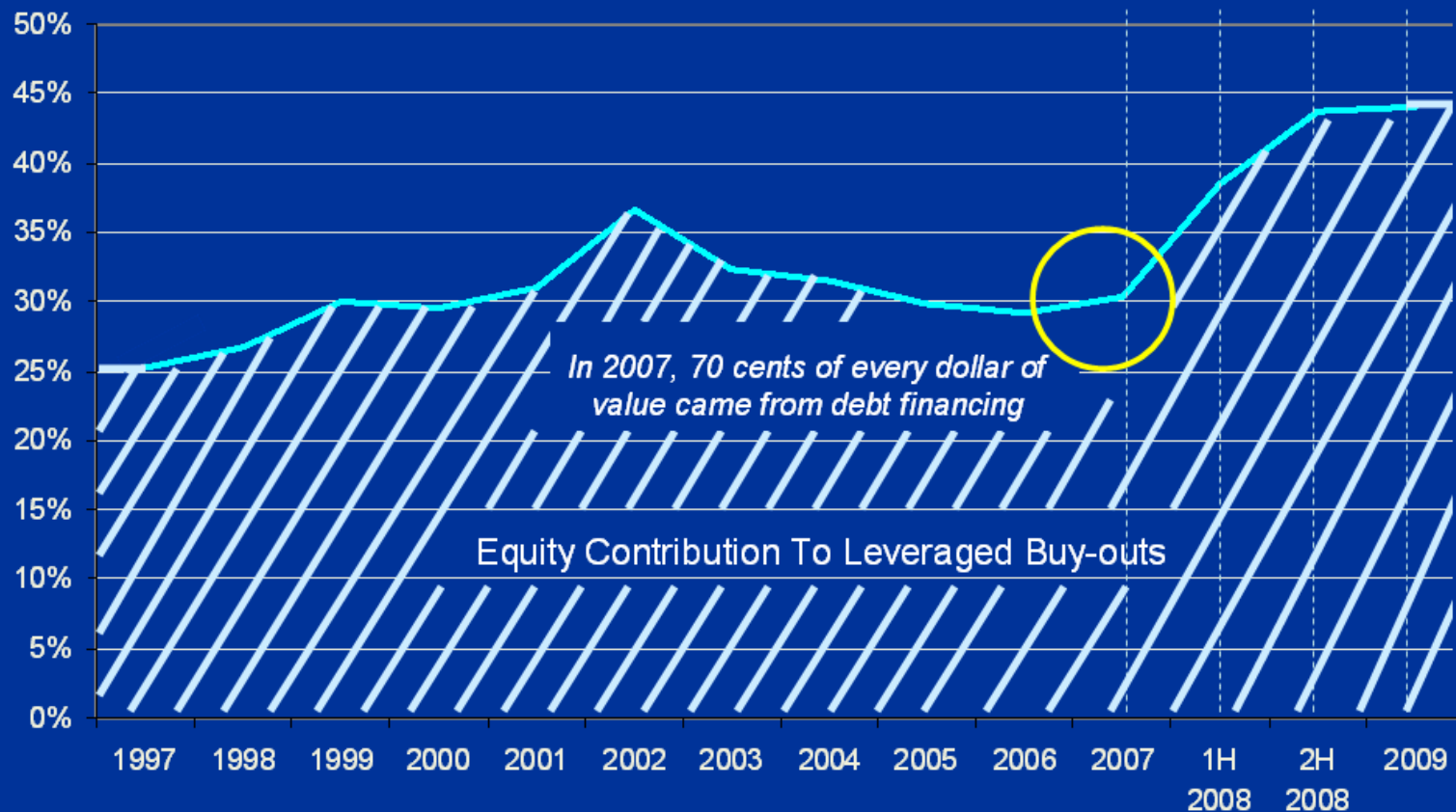
Credit Market: How Tight Is It?



Bank failures, de-leveraging, and the economy have all contributed to an overall decline in total loans outstanding

Impact of Credit on Business Valuation

As the Credit Markets tightened, buyers relied less on debt to finance transactions



Source: Standard & Poors LCD

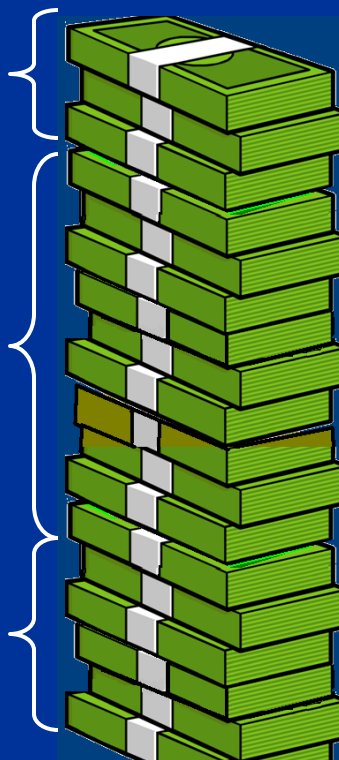
Impact of Credit on Business Valuation

2007 = 6.9x EBITDA

Subordinated Debt =
0.8x EBITDA

Bank Debt = 4.1x
EBITDA

Equity = 2x EBITDA
(30%)

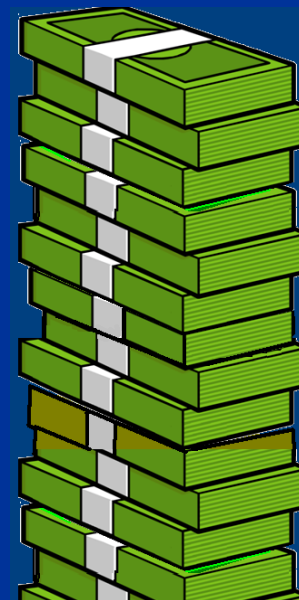


2009 = 5.5x EBITDA

Subordinated Debt =
0.8x EBITDA

Bank Debt =
2.4x EBITDA

Equity = 2.3x EBITDA
(44.1%)



Impact of Credit on Business Valuation

	<u>2007</u>	<u>2009</u>	<u>Δ</u>
EBITDA	\$3,000,000	\$3,000,000	\$0
MULTIPLE	6.9x	5.5x	(1.4x)
Enterprise Value	\$20,700,000	\$16,500,000	(4,200,000)
Seller's Debt to be retired at Closing	\$3,000,000	\$3,000,000	0
Cash in the Business at Closing	\$1,000,000	\$1,000,000	0
Equity Value	\$18,700,000	\$14,500,000	(4,200,000)
Tax Basis	\$1,500,000	\$1,500,000	0
Gross Capital Gain	\$17,200,000	\$13,000,000	(4,200,000)
Tax Bill for Capital Gains	\$3,440,000	\$2,600,000	(840,000)
Legal, Accounting, Investment Banker Fees	\$564,000	\$480,000	(84,000)
After-Tax Proceeds	\$14,696,000	\$11,420,000	(3,276,000)

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Moderated Business Valuations and Relevance to Estate Planning

- LOWER BUSINESS VALUATIONS = EXCELLENT ESTATE AND GIFT TAX PLANNING OPPORTUNITIES
- Current low interest rates and related IRS tables enhance positive planning environment
- Unique opportunity to transfer assets at depreciated values and low interest rates
- As economy improves, gift and estate tax benefits will decrease
- Advance planning (pre-transaction) and highly specialized expertise is essential to reap positive benefits

Example #1: No Planning

- Mom and Dad own stock in a closely-held business with a current appraised value of \$10,000,000 in 2010
- In five years, Mom and Dad sell their business for \$20,000,000
- In 2015, Mom and Dad give $\frac{1}{2}$ of their post-sale business assets to their adult children
- Gift tax cost to Mom and Dad is \$3,600,000*
- Estate tax cost at death for Mom and Dad's retained \$10,000,000 will be another \$4,500,000 before considering appreciation or state estate taxes*
- Total: Children receive \$11,900,000 and U. S. Government receives \$8,100,000

*Assumes estate and gift tax rate will resume at 45% in 2010 with \$1,000,000 lifetime exemption

Example No. 2: Pre-Transaction Planning

- Mom and Dad's closely-held business has a current appraised value of \$10,000,000 in 2010
- In 2010, Mom and Dad give $\frac{1}{2}$ of their stock to their adult children
- Gift tax cost is \$1,500,000
- In 2015, business is sold for \$20,000,000
- Estate tax cost upon Mom and Dad's death is \$4,500,000
- Total: Children receive \$14,000,000 and U. S. Government receives \$6,000,000
- Tax Savings: \$2,100,000

Example No. 3: Pre-Transaction with GRAT

- Mom and Dad's closely-held business has a current appraised value of \$10,000,000 in 2010
- In 2010, Mom and Dad transfer their closely-held stock to a ten year "zero gift" Grantor Retained Annuity Trust
- Gift tax cost is zero
- In 2015, business is sold for \$20,000,000
- In 2020, children receive \$10,000,000 (\$10,000,000 plus IRS set interest (3.1%) goes back to Mom and Dad over the ten year term)
- Estate tax cost upon Mom and Dad's death is \$3,600,000
- Total: Children receive \$16,400,000 and U. S. Government receives \$3,600,000
- Tax savings: \$4,500,000

Estate Planning Basics for Closely-Held Assets

- Planning Vehicles are Complex:
 - Alphabet soup of planning vehicles
 - GRAT, IDGT, SCIN CRT, NIMCRT, and others
 - All planning vehicles are subject to specific and intricate IRS rules and guidance
 - Sophisticated estate planning advice is essential
- Benefits are well worth the cost

Key Takeaways

- Estate planning is always a good idea. Estate planning **BEFORE** you start the process of marketing and selling your business can save millions in estate taxes.
- Planning with tax and estate professionals well in advance of a transaction is the most essential aspect of achieving the best results.

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“What do you mean I will pay more taxes if I sell assets instead of stock?”

- Decisions that you make when forming your business can influence deal structure and pricing of your sale
- Good advice is critical
- Asset sale vs. stock sale
- LLC's can't do a “tax free reorganization”

“Why is one business worth 7x and mine’s only worth 5x?”

- Reduce the buyer’s business risk
 - Improve financial visibility
 - Reduce customer concentration
 - Maintain strong, documented sales pipeline
 - Exhibit operational excellence
 - Develop strong second-level management

“You’re doing such a great job, I’ll give you 10% of the company when I sell”

- Adopt and adhere to best practices
- Properly document agreements/promises
- Keep and organize documents and corporate records (meeting minutes and stock issuances should be documented)
- Deal momentum is important
 - Lack of organization and records can result in costly delays
 - Consider a pre-deal legal audit

“I’ve run my business conservatively, can’t the buyer figure out how they’ll grow the business?”

- To maximize value, demonstrate a strong growth strategy
 - Can you double in size over the next 5 years?
 - What resources have you put in place; what do you need to add?
 - What are the market characteristics?
 - Do you have a scalable business model?

“Why do I have to go through all this aggravation they call *due diligence*?”

A buyer's due diligence serves two purposes:

1. Investigative Due Diligence: Uncovering operational, financial or legal problems
2. Confirmatory Diligence: Understanding and evaluating the financial projections and assumptions

Common problems:

- Improper revenue recognition
- Lack of written agreements with customers, suppliers, employees
- Other employee issues

“That’s not what the LOI says”

- Talk to legal counsel and other advisors before you sign the LOI
- Deal terms will be set
- Exclusivity period
- Non-binding

“What do you mean, they want to reduce the purchase price?”

- Risks identified during due diligence give buyers the opportunity to ask for reductions
 - Current financial performance lagging budgets/projections
 - Undisclosed liabilities
 - Taxes
 - Environmental
 - Employee-related
 - Intellectual Property

“My licensor/supplier won’t consent to assignment of this contract. Can we still close?”

- Think about how a contract entered into today might impact the value of the business to a buyer
- “No assignment without consent” provisions
- Exclusivity can be dangerous
- Right of first refusal or “first offer”
- Can your stockholders block the sale?

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“Why do I want to grow by acquisition anyway. Aren’t I just buying someone else’s problems?”

- Reach critical mass faster
- Acquire certain customers or customer segments
- Broaden your product line
- Increase profits by spreading overhead across a larger revenue base

“Why should I consider buying a business in this market?”

- Valuations are down
- Good companies/products are in some cases available because of balance sheet problems, not business problems
- In a contracting market, the only way to grow is by taking (*or buying*) market share

“What do I need to know about due diligence?”

- There are problems with every business
- A good deal team is important
- Be prepared to negotiate a lower price

“How do I know how much I can afford to pay?”

- Cash in the bank
- Assets being acquired that are financeable
- Your own ability to borrow

“How important is the founder?”

- It depends on the type of business and the roles the founder plays
 - Many founders wear multiple hats (president, CFO, head of sales, etc.)
 - Make sure you understand all the roles the founder plays in order to make sure they are covered
- If the founder is important, keep him or her engaged through
 - Earn-outs
 - Employment agreements

“What should I be worrying about?”

- Falling in love with the deal (“*breaking up is hard to do*”)
 - Be prepared to walk away
 - Problems uncovered during due diligence
 - Unreasonable contract terms
- Integration
 - Studies show that the biggest cause of failed acquisitions is a failure to quickly and completely integrate the business

“Is there anything about the LOI that I need to keep in mind as a buyer?”

- Binding/non-binding provisions
- Exclusivity
- List assumptions
- Non-disclosure agreement