

Maximizing Opportunities in Today's M&A Market



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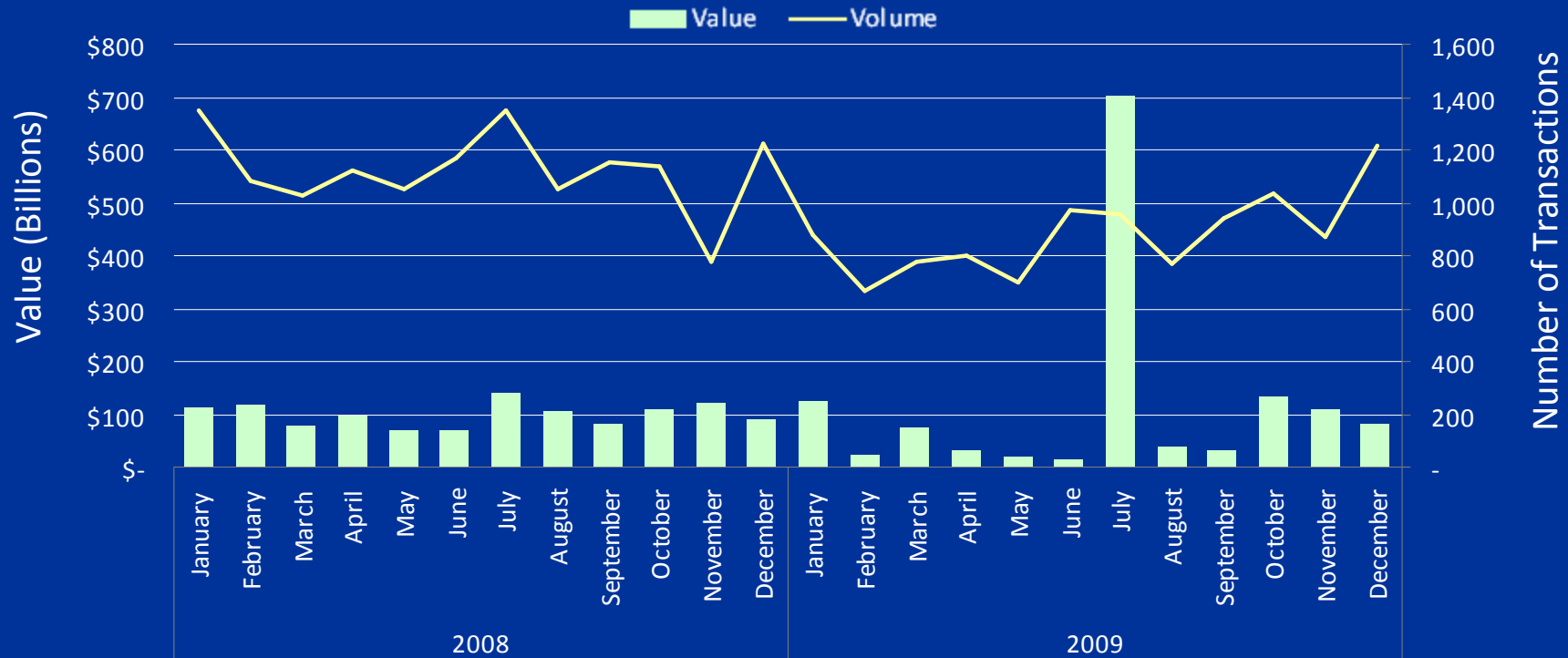
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Agenda

- 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 – 2009

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

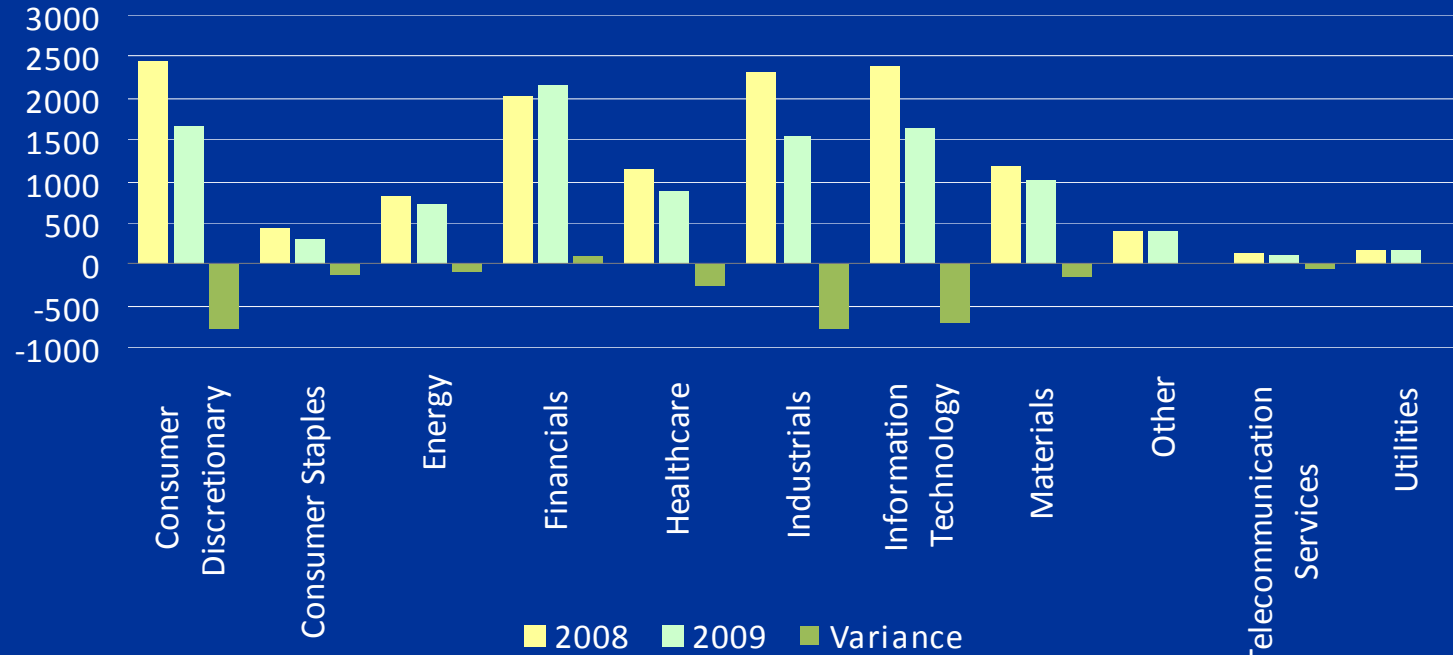


Number of Transactions in 2009 was down by 21.5% from 2008
Value was up by 15% for the same period

Source: Capital IQ

2008-2009 M&A Activity by Industry

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



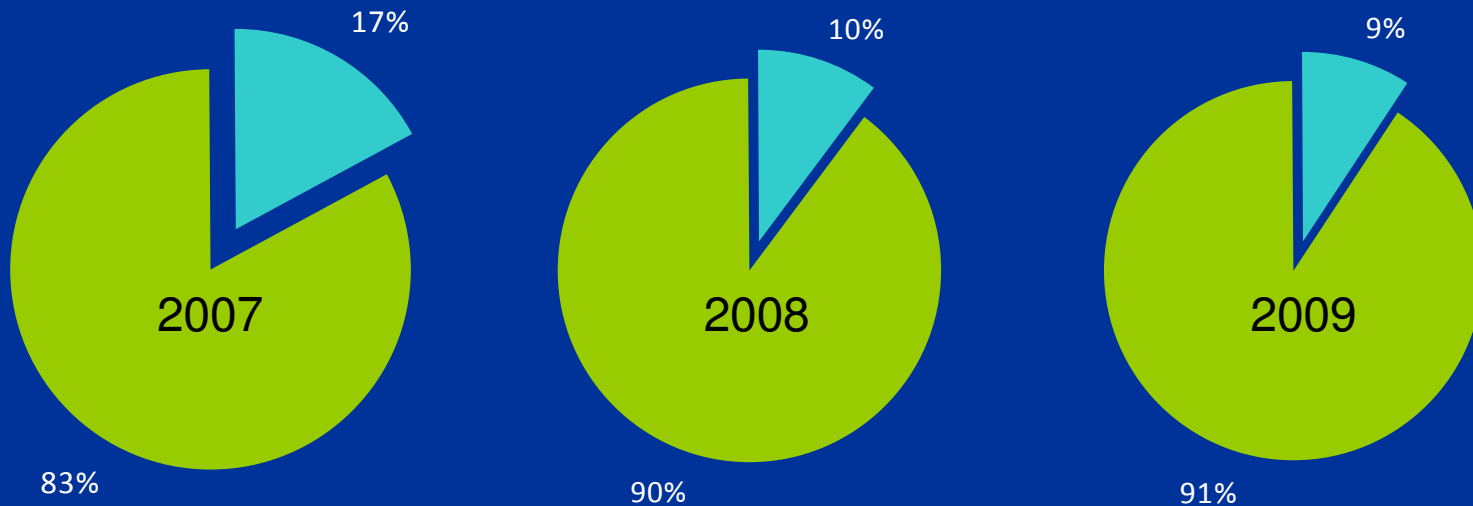
Most major industry sectors saw deal activity decline with the notable exception of financial companies where bank mergers and other such combinations picked up.

Source: Capital IQ

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

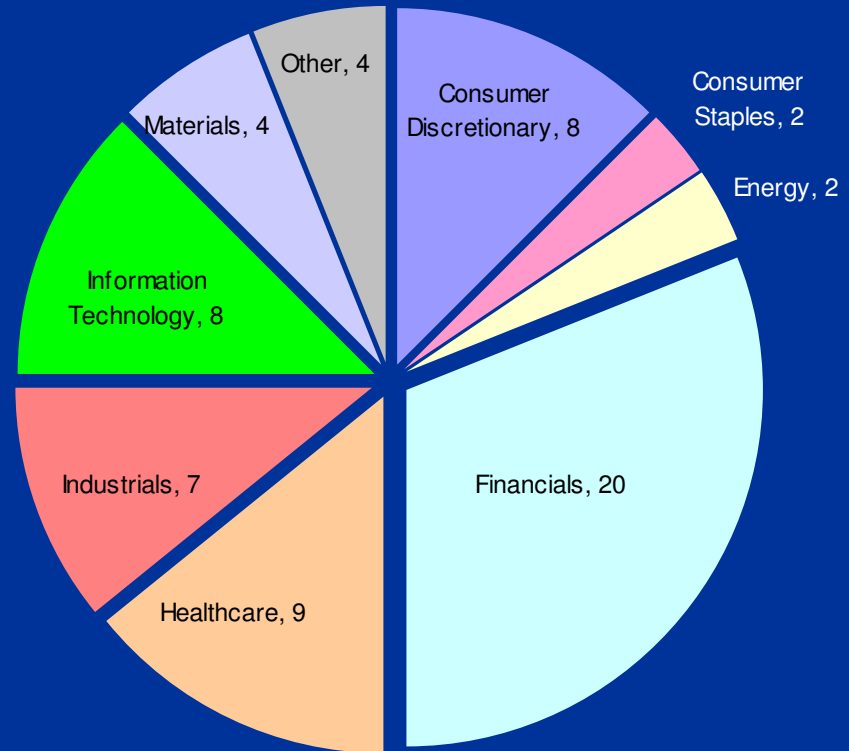
IPO Market 2009

The IPO market surprisingly came back to life in mid-2009, with a total of 64 new public offerings by year-end.

The last week of September 2009 was the busiest week for IPOs in more than 2 years.

The pipeline for IPOs grew substantially in Q3 fueled by improving capital markets.

Financials were most active, with Verisk and Banco Santander Brasil, each valued over \$1 billion, going public in Q4



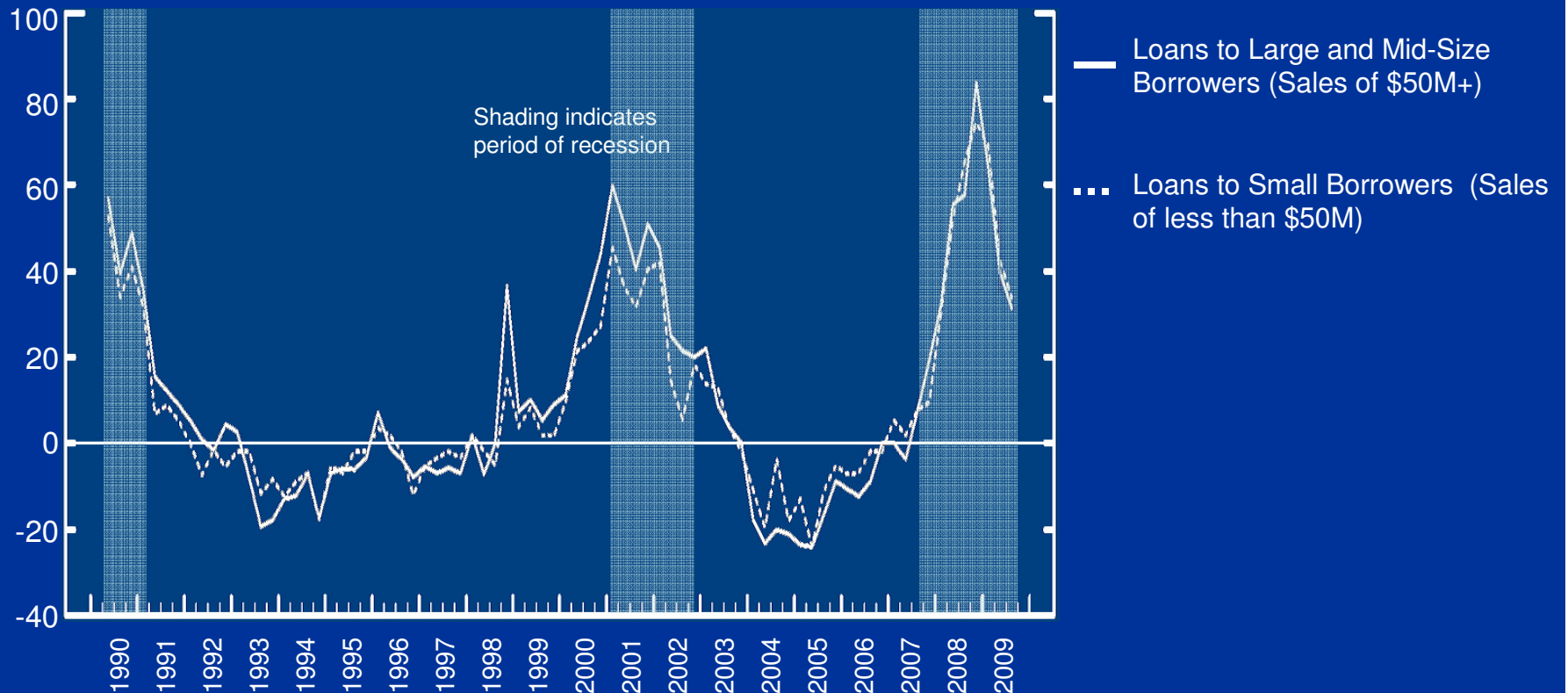
Sources: Dealogic, Hoovers

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Credit Market: How Tight Is It?

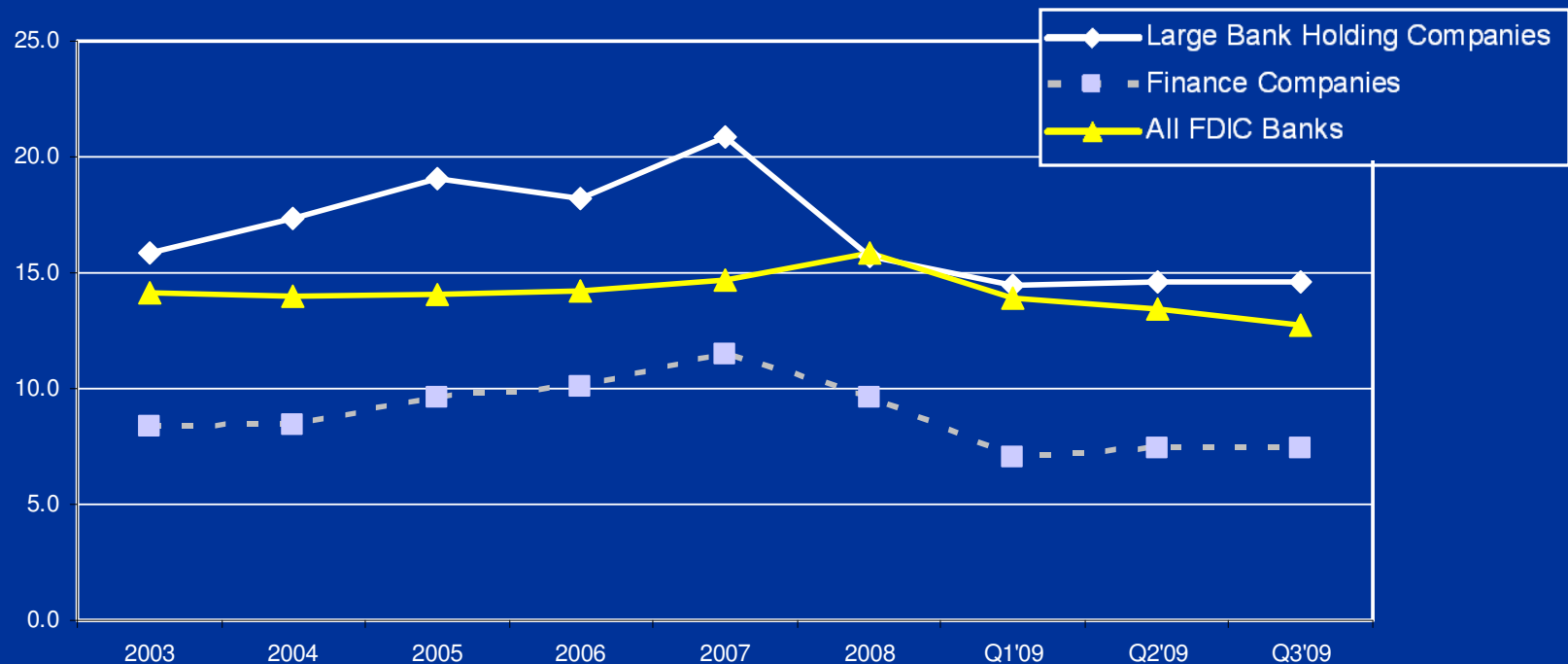
Net percentage of U.S. banks that indicate tightening credit standards on corporate loans



Source: Federal Reserve (July 2009 Senior Loan Officer Opinion Survey)

Is the De-Leveraging Over?

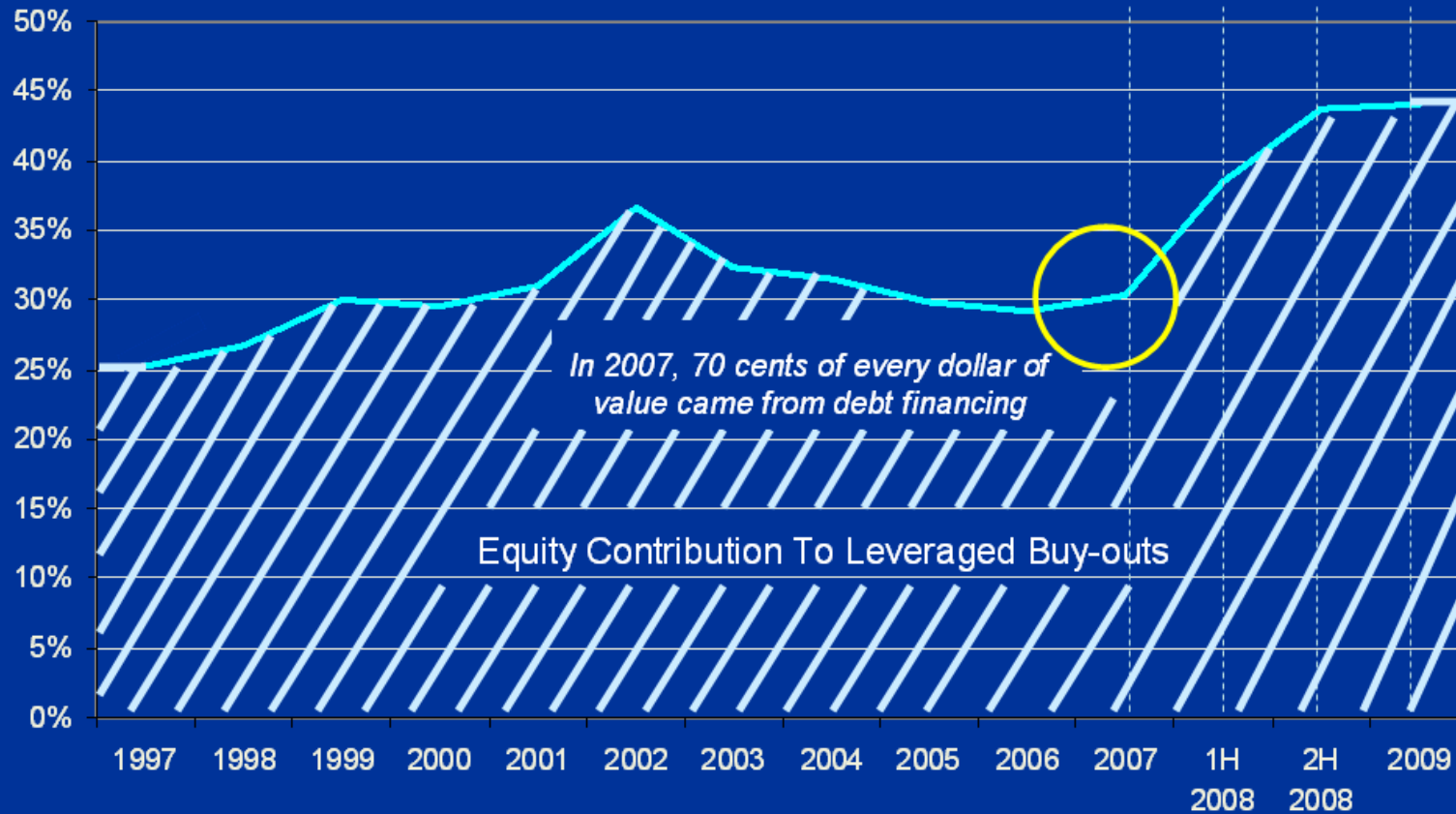
Lenders began the de-leveraging process following the Bear Stearns collapse in Q1 '08. Leverage on "Tier 1 Assets" for all FDIC lenders was at 12.8x at the end of Q3 '09 (most recent data) – lower than Q3 '02, which is when the market began to expand.



Sources: FDIC Quarterly Banking Profile, Capital IQ, Thomson Reuters

Impact of Credit on Business Valuation

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



Source: Standard & Poors LCD

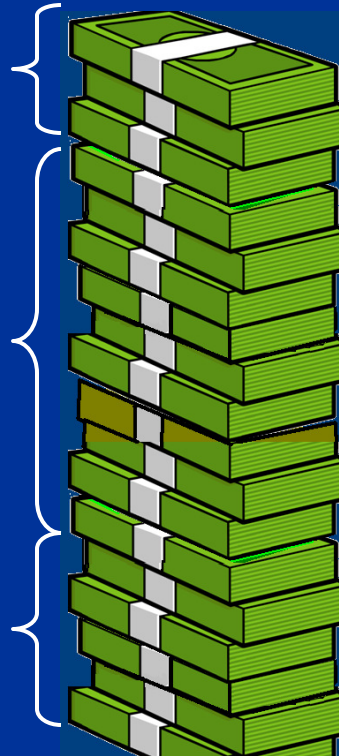
Impact of Credit on Business Valuation

2007 = 6.9x EBITDA

Subordinated Debt =
0.8x EBITDA

Bank Debt = 4.1x
EBITDA

Equity = 2x EBITDA
(30%)

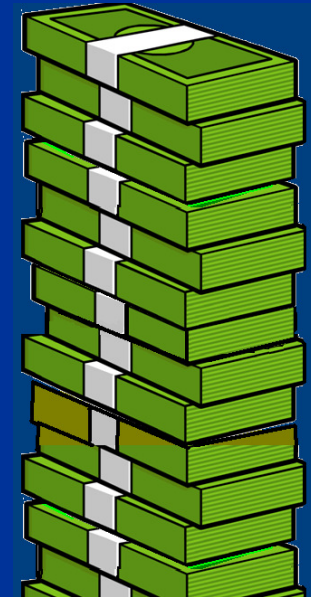


2009 = 5.5x EBITDA

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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2010 Transfer Tax Rules

- Federal estate tax “repeal” – temporary
- Gift tax in effect at a rate of 35%
- Federal lifetime gift tax exemption of \$1,000,000

2010

- Unless Congress changes the rules, as is widely expected
- Possibilities
 1. Estate tax re-imposed for 2010 at 2009 rates
 - \$3.5 million exemption
 - 45% estate tax bracket
 - Gift tax back to 45%
 - Either retroactively or not

2010 (cont.)

2. Congress does nothing

- No estate tax this year
- Estate tax returns in 2011 at much higher rate and with lower exemption

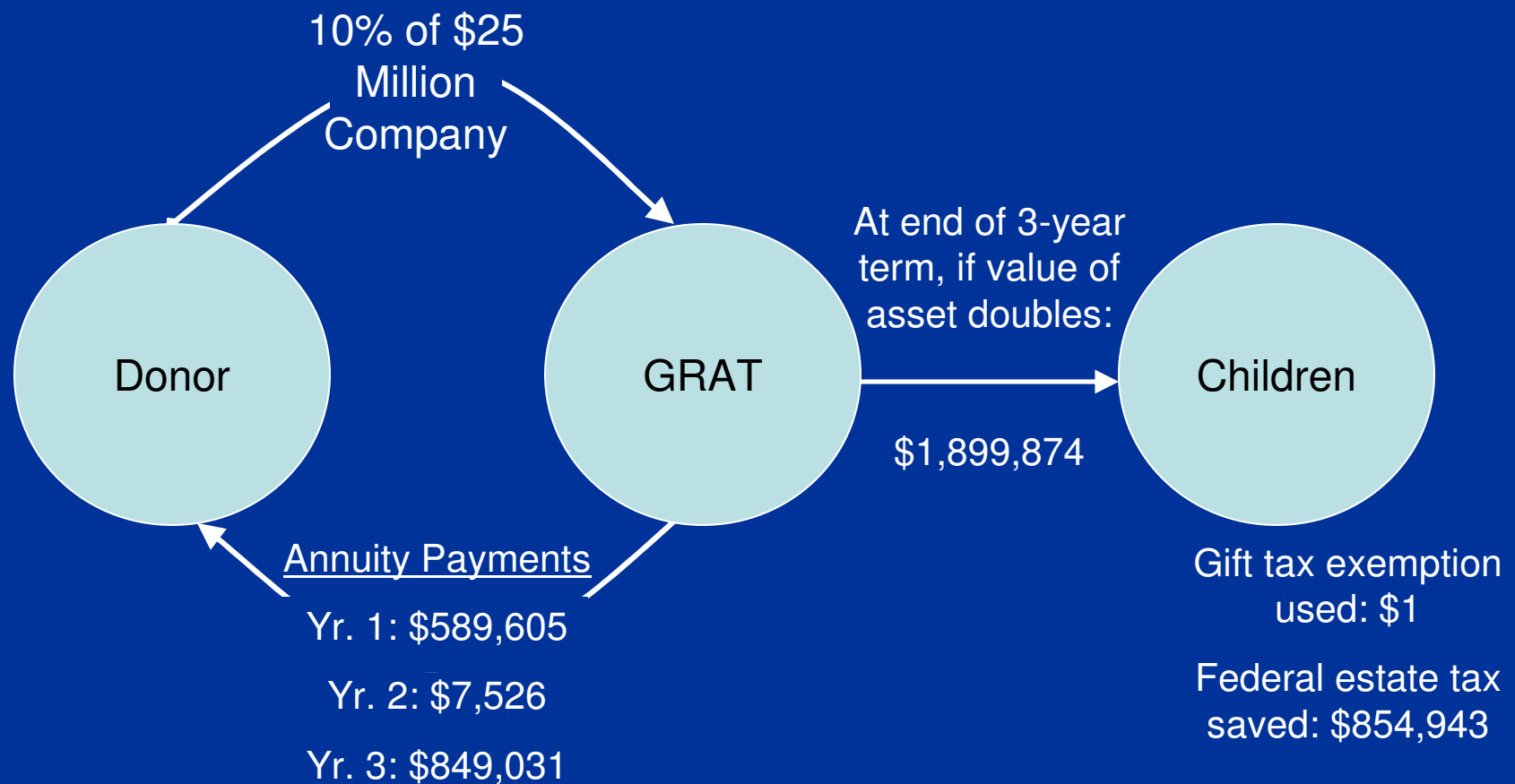
3. Congress does something completely different

Failing to Plan is Expensive

- Married couple has \$25 million in company stock and no other assets. Federal estate tax: \$5.8 million.
- Company doubles in size. Federal estate tax: \$14.8 million.

(assuming 20% discount on business assets, properly structured trusts, and that the federal estate tax is reinstated at 2009 rates)

Grantor Retained Annuity Trust (GRAT)



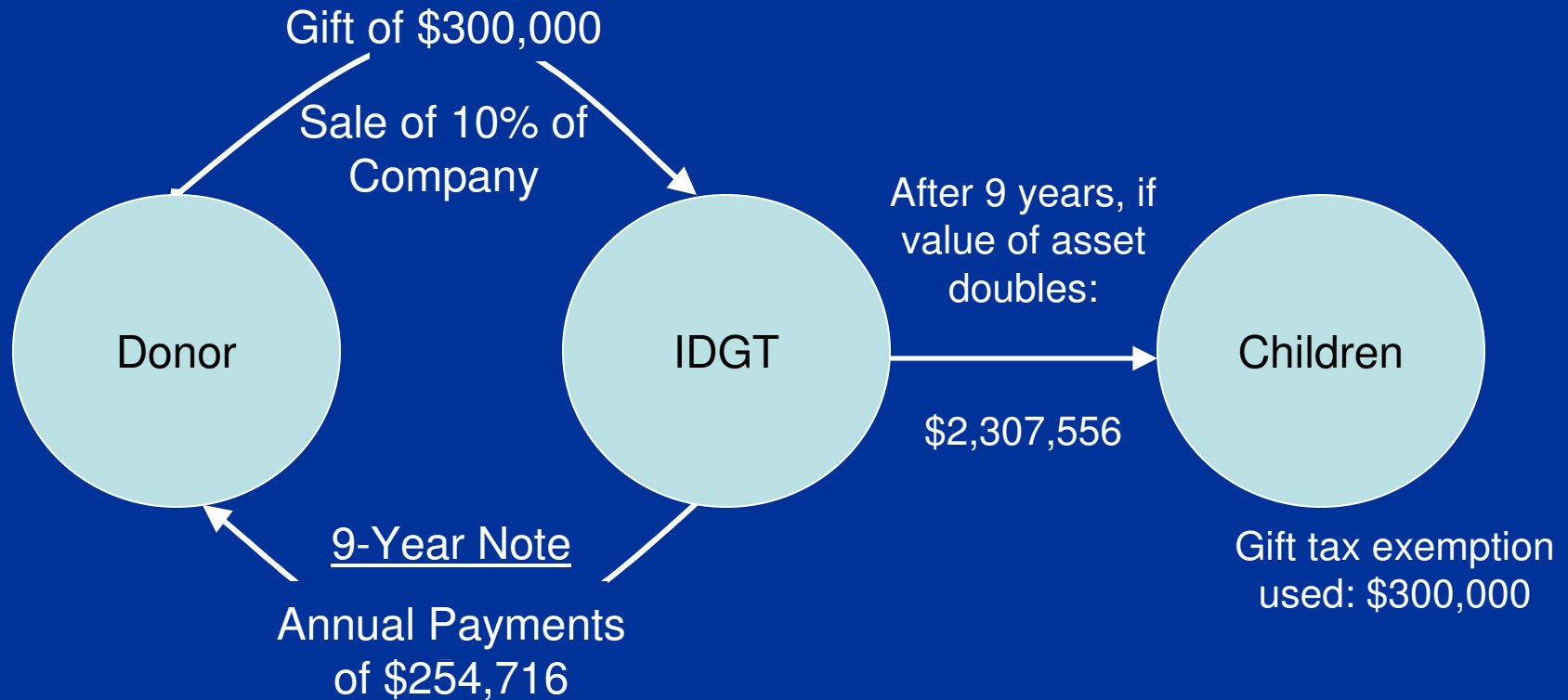
Advantages of GRAT

- Almost no gift tax exemption used.
- Blessed by statute. Low audit risk.
- No real penalty for failure.

Disadvantages of GRAT

- If you die within the term, it fails.
- If the asset doesn't outperform the IRS's §7520 rate, you fail.
- You only move the growth
- Not an efficient vehicle for gifts to grandchildren

Installment Sale to Trust



Advantages of Sale to Intentionally Defective Grantor Trust

- Transfer the entire interest, not just the appreciation.
- You can take advantage of a lower interest rate.
- Can be used to leverage Generation Skipping Transfer Tax exemption
- No capital gain on sale. Income tax on ordinary income is payable by donor, thus reducing estate tax in donor's estate.

Disadvantages of Sale to Intentionally Defective Grantor Trust

- Not blessed by statute. Increased audit risk.
- Must use some or all of gift tax exemption.

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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