

Q1 Analysis: A Tale of Two Markets

Mergers & Acquisitions in 2008

A tale of two markets—that is how ASG Partners would characterize the story on mergers & acquisitions (M&A) last quarter.

The pace of mega-transactions has slowed in response to a tightened credit market, but demand for most privately held companies has flourished. In fact, larger numbers of these transactions are getting done as financial and strategic acquirers shift their attention to the middle and lower-middle markets, which lenders are still actively seeking.

For the last several years, deal volume in the U.S. and around the world has grown, with each year beating the record set in the prior year. In August 2007, the breakneck pace began to slow as the risk of losses on sub-prime mortgages caused uncertainty in the debt markets. As a result, the mega-transactions that dominate M&A statistics were more difficult to fund—and that dynamic continued through the first quarter of 2008. It took 107 days for global M&A volume to reach \$1 trillion in 2008, compared with 85 days in 2007. In the U.S., first quarter deal volume fell to \$204 billion from approximately \$340 billion a year earlier.

That's the bad news. Here is the good news: First, keep in mind that 2005, 2006 and 2007 were extraordinary years for mergers & acquisitions, fueled by a strong economy and readily

available capital. Although 2008 is not going to best the records of the last several years, it is still likely to be among the top ten or maybe the top 5 years in history. Second, the total number of deals announced in the first 107 days of 2008 was the highest year-to-date figure on record according to Dealogic.

A record number of transactions generating a lower dollar volume can only mean one thing: smaller transactions are still getting done. Lots of them.

ASG represents companies with revenues from \$3 million to \$100 million and we found very strong response for companies we took to market last quarter. In fact, the companies we marketed received 4 offers on average. Since the credit markets are hindering larger transactions, more capital appears to be chasing the smaller transactions. Private Equity fundraising reached a record \$4.7 trillion in 2007, and investors are looking to place capital with strong companies. Additionally, debt is still widely available for transactions in our market and acquisitions are



still a great growth strategy for many corporations. All of which is to say: the market conditions are still very strong for private company owners looking to transition into the next phase of their lives—despite the somewhat gloomy M&A picture that gets reported in the business press.

Market conditions come and go, but there is always demand for strong companies. Perhaps most importantly, maximizing the value of a private company has a lot more to do with proper planning than it does with attempting to “time” the market. For more advice on planning, visit the News & Articles page at www.asgpartners.com, or call us at 425-450-4800.

Lynwood Capital Partners, Inc.
Denver, CO
has acquired
 Universal Property & Flood
Spokane, WA

Hertz®
has acquired
 SECO Construction
 Equipment, Inc.
Kennewick, WA

System Controls & Integration
Bellevue, WA
has acquired
 Computer, Power &
 Service, Inc.
Bellevue, WA

Guest Expert: Private Equity

ASG Partners' interview with David Hanson, Managing Director, Lynwood Capital Partners

Each Quarter, ASG Partners brings you an interview with an expert professional. In this newsletter, we interview David Hanson, Managing Director of Lynwood Capital Partners, Inc.—a private equity firm that acquires and invests in middle-market businesses with revenues of \$5—\$75 million. With a track record of buying and growing companies, David is extremely well positioned to share valuable insights with our network of business owners and professional partners.

In this interview, David explains what Lynwood looks for in businesses, what sorts of issues can cause a deal to unwind, and why good companies continue to be highly valued even in the wake of the “credit crunch.”

What are the characteristics that Lynwood Capital looks for in businesses they acquire?

It is hard to lay out any hard and fast parameters. We really are generalist investors, and we sometimes surprise ourselves in what we aggressively go after.

We like fundamentally strong businesses with good people. We like simple and niche.

We've been doing this long enough that we have various sentiments and biases, and we judge companies and situations against these. We



don't waste anyone's time pursuing a company if, after talking to the broker and learning some very rudimentary info about a business, we know it wouldn't be a fit for us.

It surely helps if a Seller has audited financial statements, although it costs a little more. It also helps if a Seller can articulate, and provide evidence, if possible, that the Buyer can grow the business. Very few professional investors want to acquire a business that can't be grown. And for the record, we don't mind if a company doesn't show perfectly. We try to be good listeners and tailor our proposal to situation at hand and meet the various financial and intangible objectives of the Seller.

How many opportunities does Lynwood review in a typical year?

We look at over a thousand companies a year, easily. We probably actually visit with about one per month, and we typically make offers on the same number. If we visit, we're serious and probably have had at least one call with the Seller.

Of those, how many letters of intent (LOIs) do you submit? How many do you close on?

Unlike some of the folks we compete with, we only provide an LOI if we are confident we can finance and close. We don't view a LOI as the place to start the negotiation. Consequently, we do a fair amount of homework upfront and do our best to really get to know a company, and the people situation. We compete with folks who brag about how many LOIs they submit and execute with sellers and try to make a case that they exercise discipline by only closing a percentage of the LOIs they execute, but this is usually because they try to re-trade the deal even if there aren't material findings during the diligence phase—which sometimes there are.

Is the current economy impacting the number of opportunities, LOIs and closings?

If the Buyer is experienced and has a track record and strong relationships with financing partners, the present economy and financing environment shouldn't make any difference.

What is Lynwood's typical financing structure, and what types of partners are involved?

Most buyouts or recaps are going to have three flavors of capital on the balance sheet: 1) Some sort of Senior Loan and Revolver (probably from a bank or a non-bank funding source), 2) Subordinated Debt, Mezzanine Debt and/or Seller Note(s), and 3) Equity. Obviously, these three flavors can be sliced and diced into 31 flavors, but those are the three main categories.

An experienced Buyer will do all they can to make their own financing process transparent to the Seller, but the Seller will need to participate in a couple of meetings. The joke we always tell a Seller is that once they've answered the very same question about 15 times, the deal is probably close to closing.

At Lynwood we spend a fair amount of time cultivating and deepening the relationships we have with existing financing partners in portfolio companies. We also identify with whom we'd like to partner with because as generalists, we're never quite sure what kind of deal is around the corner, and we really strive to bring the best financing partners to each new investment. All firms have biases and size parameters and various redlined industries.

What kind of an impact—if any—has the “credit crunch” had on Lynwood's acquisition practices or criteria or partners?

We're steady as she goes. We've been investing since 1990, so we've seen high levels of activity and excesses and lows. We rely on our long-standing financing partner relationships and track record to get deals done in unsettled financing environments. I might also add that in this cycle, the big deals are the ones most impacted by changing or more limited financing alternatives, not the so-called middle-market—at least in our opinion and from what we see from our vantage.

What are some of the potential issues that can come up and unwind a deal in progress?

There are a few “syndromes”: There is the inexperienced broker syndrome. There is the inexperienced attorney syndrome, sometimes exhibited in the form of the buddy-attorney syndrome.

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Guest Expert: Private Equity *(continued from page 2)*

There is the misunderstanding syndrome.
There is the usual and customary syndrome.
There is the underachieving financial performance syndrome.

We would much prefer to negotiate and deal with a Seller who has both an experienced broker and corporate deal attorney, who both have done lots of deals and do that to make their living.

These two professionals help ensure a deal that should get closed will get closed. Otherwise, both Buyer and Seller waste a great deal of time, the proverbial wheel is re-invented over and over again with regard to routine issues (escrow, holdback, indemnities and various technical and important points in a 30–50 page purchase agreement). This basically defines what I had earlier termed the usual and customary syndrome. What really is normal course in the deal

world would be totally new to an estate attorney or a slip and fall attorney who has earned the trust of the Seller over time, but doesn't do corporate transactions for a living.

On another topic, the Seller should be sure they deliver the financial performance they say they will because the Buyer has based their structure, their valuation and their financing on the Seller's forecast of the future. Lastly, realistic expectations allow Buyer and Seller to achieve their objectives.

Each company is a different organism and professional advisors really help add perspective on what is likely the most important financial transaction in the Seller's business life, and one that they likely will only do once. A professional investor Buyer is just that, and typically has a measure of objectivity, and is probably a lot more dispassionate about issues. This asymmetry should be kept in mind by all.

In your opinion, is the current market a buyer's or seller's market and why?

With professionals representing both Buyer and Seller, I think that any market, including

the current one, represents a level playing field. There are so many professional buyers and investors in the marketplace that valuations are still high by any historical measure. We know that financing is available for us and others who have been in the business of acquiring companies for a while and have a track record.

For more information about Lynwood Capital Partners, visit Lynwood Capital's web site at www.lynwoodcapital.com.

News and Events: ASG Seminars

Seminars for Business Owners

Once a year, ASG Partners presents a highly informative one-day seminar to business owners planning the eventual sale of their companies. ASG Principals and our professional partners provide a wealth of information at this annual event designed to help business owners maximize the value of an eventual sale. Topics include maintaining confidentiality, valuing businesses, minimizing taxes, packaging a company for sale, what to do with an unsolicited offer, and handling negotiations. Upcoming dates include:

November 11: Seattle, WA

November 13: Spokane, WA

November 18: Portland, OR

For more info or to reserve your place at one of the seminars, please email info@asgpartners.com or call 425-450-4800.

Seminars for Professional Partners

ASG Partners regularly presents to lawyers, bankers, CPAs, financial advisors and other professionals on "Planning the Successful Sale of a Privately-Held Business." The one-hour course is designed to give professional partners valuable insights they can share with their business clients.

We typically present to a group of 10 or more professionals during a luncheon or monthly firm meeting. We bring 35–40 minutes of prepared material and leave plenty of time for questions.

To learn more or schedule a seminar, please email us at info@asgpartners.com.

Planning Ahead For Your Eventual Sale

The four most important questions to consider in the years before a transition

Every year, thousands of privately-held companies in the Northwest are sold to individual entrepreneurs, acquired by strategic buyers, or bought out by private equity firms. For some business owners, a sale comes quickly on the heels of the decision to cash in and move on. In the ideal scenario, the owners of these businesses begin thinking about an eventual sale many years in advance.

Principals at ASG Partners often speak to potential clients once or twice a year for several years before they begin the selling process in earnest. Whether you are planning to sell in three months or three years, reflecting on these four fundamental questions bring important issues to the fore, and addressing them will increase the value of any company.

What is my company's long-term vision?

When the time comes to sell, interested buyers will examine a company's operation not just for proof of a profitable history, but also for compelling evidence of a promising future. Because business owners wear so many hats each day, they sometimes forget to allocate time to strategic planning and budgeting exercises. Successful would-be sellers should formulate a vision of what their business might look like in three to five years. Consider your company's unique strengths, what differentiates its products or services from competitors' offerings, and where new competition might come from in the future.

Well-defined and focused companies identify and stay on the path to long-term success.

What would happen if I didn't come to work for a month?

Owners who have built their companies from the ground up are often deeply involved in day-to-day operations. While that may be the most efficient approach in the short term, it can reduce value in a sale, since buyers need to be convinced that the company's success can continue when the founder/owner departs.

So when you start planning a company sale, it's time to begin planning your own eventual departure as well. Assembling a team that will be capable of successfully running the company after the transaction is essential. A complete team of tenured employees will boost the value of a company, and owners who steadily reduce their involvement in day-to-day activities are better prepared personally for the day they finally step aside.

What will my operating metrics tell buyers?

Analyzing finances and other important operating metrics will yield crucial insights about any business. Owners who are not already maintaining accurate books based on accrual accounting should make the effort to get their houses in order, spend some time perusing their sales figures and operating expenses, and consider engaging a CPA to prepare year-end financial statements.

Gross and net profits are top priorities for buyers, but digging deeper into the numbers may reveal strengths and risks that can affect the selling price of a company. For example, predictable, recurring revenue streams show stability, while single products or large customers that contribute disproportionately to sales or profits may imply risk.

Sellers who adopt a buyer's perspective will identify issues that may prove challenging for their successors. Addressing these issues prior to a sale can add significant value.

What kind of help will I need when I'm ready to sell?

Most company owners assemble a team of trusted professionals when the time comes to sell. Accountants and attorneys play key roles, and their expertise is invaluable in reducing risks and consummating successful transactions.

Sellers may also benefit from the assistance of an experienced intermediary or merger and acquisition firm. Such advisers can significantly increase a company's value by confidentially engaging multiple prospective buyers in a carefully coordinated process that allows the owner to remain focused on running the company.

It is never too early to start planning the sale of your business. Addressing these questions now will help make your company more profitable and stable in the short term, and will also ensure that you get the maximum value out of your life's work when you cash in and move on to your next adventure.

If you are considering selling your business in the future, we invite you to call an ASG Principal for a confidential, no-obligation discussion about the steps you can take to increase the value of your company. Email info@asgpartners.com or call us at 425-450-4800.



ASG Partners is a locally-owned merger & acquisition firm that specializes in the sale of manufacturing, distribution and service companies. ASG focuses on representing owners/sellers of companies with annual revenues of \$3-100 million.

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