

THE M&A ADVANTAGE

Summer 2009

Are you sure you're ready to sell?

Exit planning: Prepare for an out while you're still in

Navigating the new tax landscape

No "I" in merger
Building a successful deal team



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Financial Group, LLC

*A Merger and Acquisition Firm
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Serving Middle Market Companies*

*Seller/Buyer Representation - M&A Appraisals –
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Are you *sure* you're ready to sell?

You may have decided it's time to sell, but before you begin the M&A process, you need to take a good, hard look at what you plan to put on the block. Just because you're ready doesn't mean buyers will be interested — particularly if this is the first time you've thought about preparing your business for sale. Prospective buyers won't just scrutinize your business, but they'll also compare it to other opportunities in the marketplace.

ASKING TOUGH QUESTIONS

With the help of your M&A advisors, go over your company with a fine-tooth comb, just as a buyer will during the due diligence stage. Evaluate everything from debt levels to personnel to customer relationships and address any issues that are likely to give potential buyers pause, such as too much business concentration in only a few customers.

As an owner, you probably value your business and its sale prospects highly. But to understand its actual market value, you need to think like a buyer and ask the kinds of questions buyers will. These include:

Is it financially sound? Is your balance sheet strong relative to those of your competitors, particularly when it comes to debt? Do you have good growth prospects or has your company's growth plateaued? If buyers sense financial distress or little growth opportunity, they'll undervalue your business or, more likely, move on.

Is it unique? Identify what gives you a leg up on the competition. Do you make a niche product essential to the business of other manufacturers? Do you own a valuable patent, trademark or brand? Do you have an exclusive client or

customer list? Such assets can increase your company's value in the eyes of the right buyer.

Is it an easy fit? Buyers look for businesses with strong leaders, similar corporate cultures and the prospect of smooth integration. Do you have an experienced management team capable of easing the company through a merger transition? Have you provided incentives for good employees to stay?

HOUSECLEANING MANDATORY

Before entering the market, streamline your company's operations so that buyers can focus on your essential offerings and not be distracted by peripheral issues. Begin at the office level, ensuring your facilities are clean, modern and professional-looking. Next, make sure key business documents



are well organized and easily accessible, including financial statements, which need to be accurate, up-to-date and easy to review.

Streamline at the organizational level as well. Try to resolve or minimize potential snags such as:

- Ongoing or pending lawsuits,
- HR issues,
- Major outstanding insurance claims, and
- Ownership of intellectual property.

You may also need to separate your real estate holdings from your business. Some buyers prefer to buy real estate separately from the rest of the business so they have the option of easily selling it when the transaction closes.

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BE YOUR OWN HARSHTEST CRITIC

As you evaluate your own company, be as critical as possible. If sales have slowed, a key executive is halfway out the door or your vendor relationships are shaky, don't try to sweep these problems under the rug. Prospective buyers and their financial advisors will notice.

So if you can't easily remedy a problem, honesty is the best policy. In some cases, what challenges you could be a simple fix for a buyer. If, for example, you've had trouble getting favorable pricing on relatively small supplies orders, a larger company placing bigger orders may be able to get preferential rates that enable it to lower production costs.

BRACE YOURSELF

With fewer companies capable of financing an acquisition, those that have the money to buy can afford to be choosy. Before you put out the "for sale" sign, conduct a rigorous self-assessment.

If you know your strengths and shortcomings and understand what likely buyers in your industry are seeking, you're in a better position to find a buyer. □

Get real about price

With scant credit available — particularly for larger deals — many buyers simply can't afford their desired targets. If you're determined to sell your business and have been unable to find a buyer, you may be overvaluing your company relative to the current market. Now's the time to reconsider your asking price.

Sellers, particularly founding owners, often believe that years of dedication and hard work should translate into a substantial dollar amount. But you must remove sentiment from the equation. Your company's value lies in its numbers — including its customer base, revenues, market share and debt load.

EBITDA (earnings before interest, taxes, depreciation and amortization) is a critical figure in determining sale price. Typically, the higher a company's EBITDA, the higher the selling price it can expect. However, many smaller businesses reduce EBITDA to cut tax exposure and, therefore, need to "normalize" these numbers if they hope to realize a fair price.

Also, consider offering some form of seller financing. If a buyer can't get adequate bank credit and you really want to complete the transaction, you may need to finance part of it yourself. Seller financing also assures other potential lenders that you believe in the buyer and your company.



Exit planning: Prepare for an out while you're still in

Running a successful business is time-consuming, leaving you little time to plan what may seem like distant succession issues. It's important, however, to outline an exit plan and make succession decisions as early as possible. Evaluating and grooming possible successors or preparing for an outside sale can take years. And it's never too early to make retirement and estate plans.

TAKE STOCK

Before determining where you want to be when you're ready to retire, assess where you and your business are financially today. Prepare a detailed financial analysis of your business with the help of a valuation professional. This expert will review historical data to determine its current value.

Also examine all contracts and agreements to make sure your business is transferable. Transfer restrictions, such as professional license restrictions, government contracts, franchise agreements, lending agreements, shareholder agreements or other types of contracts, can slow down the process significantly.

TRANSFER OR SELL?

Next, develop a succession plan that outlines how your business will be sold or transferred. If you have business partners, they will most likely be able to buy your ownership interests according to the terms of your company's shareholder or other agreements.

You might choose to groom a family member to eventually take the helm. Or consider selling the business to a key employee or group of employees. Employee buyers may have several financing options, including private



equity partners, bank loans and Employee Stock Ownership Plans (ESOPs).

If none of these succession options seem viable — or attractive — you'll likely want to sell your business to an outside party. Competitors or those in related industries might view your business as a good expansion vehicle. To protect confidentiality, you should consider working with an M&A advisor to identify potential strategic buyers.

At the same time, consider whether the company would likely generate more proceeds if sold intact or broken down by segments. Liquidating or divesting your assets might be your best option if you have equipment or real estate, or particularly valuable profit centers, and it seems unlikely you'll be able to sell the business outright because of weak financials or a changing marketplace.

LIVING THE GOOD LIFE

Although the value of your business won't be determined by your retirement needs, it's important to conduct a personal financial assessment.

To determine income needs after you step down from your business, consider your health, lifestyle and financial obligations. Then, with the help of financial advisors, determine what you have. This might include Social Security benefits, retirement accounts such as IRAs, or 401(k), Keogh, or Simplified Employee Pension (SEP) plans. When tapping these accounts, be sure to avoid actions, such as early withdrawals, that could have negative tax consequences.

Also consider that certain corporate entity formations may provide options for additional distributions and more favorable tax treatments. Think about changing your corporate structure and placing assets where they facilitate the most cost-efficient succession.

You might also want to consider staying with your company after the sale — perhaps as a paid consultant or salaried employee. Doing so may provide extra income, and you'll be able to continue contributing to tax-advantaged retirement plans. But working part-time also has

tax consequences, so be sure to discuss any such plans with your advisors.

PROTECTING YOUR HEIRS

Just as important as succession and retirement plans is an estate plan. If you haven't already, write a will and appoint an executor to oversee the distribution of your assets when you die.

Trusts can help you avoid the costs and inconvenience of probate. Trusts may also protect assets from creditors and provide privacy. Your circumstances — including your assets' estimated value, their allocation and your beneficiaries — will help determine the structure and tax implications of your ideal trust.

CRITICAL ISSUES

Succession planning isn't just about who will run the company when you step down. The process also enables you to secure your own future income and provide for your heirs. Critical issues such as these can't be put off. □

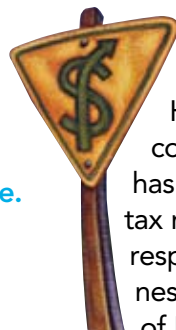
Navigating the new tax landscape

If you're considering buying or selling a business, the precarious state of the economy shouldn't be your only concern. You also need to think about the potential for major tax law changes that could affect business owners and a few that could affect M&A transactions. You should be prepared to work with your advisors to navigate the new tax landscape.

CHANGE WILL COME

Tax changes are far from definite, and new policies will likely take time to pass through Congress and go into effect. Still, many tax

experts believe that the current administration will be able to enact into law an increase in long-term capital gains tax, from the current 15% rate to 20%.



Higher taxes for some individuals and many companies are also likely. The White House has proposed to increase the top two income tax rates to 36% and 39.6%, from 33% and 35%, respectively. This could affect many small businesses because, as a 2007 National Federation of Independent Business survey found, about 15% of small-business owners and half of those with at least 20 employees claimed household

incomes of more than \$200,000 and likely fall into the top brackets.

Also, estate tax law changes could affect many business owners. Currently, the estate tax is scheduled to disappear in 2010 but resume in 2011 with a top estate tax exemption of \$1 million and top estate tax rate of 55%. Many believe that lawmakers won't allow the estate tax to expire and instead will make permanent the 2009 estate tax law, which provides a \$3.5 million estate tax exemption and a top estate tax rate of 45%.

DEFER NO MORE

A policy that enables U.S.-based companies to defer paying taxes on overseas subsidiary income is also expected to change, and could affect some business buyers. Currently, tax laws allow U.S. companies to defer taxes on this income until the subsidiary transfers the money to the parent company.

Going forward, however, companies will likely have to pay these taxes immediately. If your company buys a business with overseas operations, you'll need to report all overseas income, which could be a major tax burden and reduce corporate income significantly.

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A FEW POSITIVES

Although some tax policy changes may make certain transactions less advantageous and more complicated, others can benefit M&A participants. For example, the Stimulus act passed in February extends the maximum net operating loss (NOL) carryback period to five years for qualified small



"So why didn't someone mention we haven't filed our tax returns for the last three years?"

businesses with gross receipts of \$15 million or less. Generally, an NOL may be carried back only two years. The extended carryback period applies to 2008 (not 2009) NOLs and could help fundamentally sound but temporarily troubled companies with what is essentially a tax refund — boosting their bottom line and enhancing their sale prospects.

The Stimulus act also includes a provision for businesses, in certain situations, to defer cancellation-of-debt income (CODI) generated from repurchasing business debt after Dec. 31, 2008, and before Jan. 1, 2011, until calendar year 2014. This could be an incentive for a business seller to buy back debt and reduce its debt load.

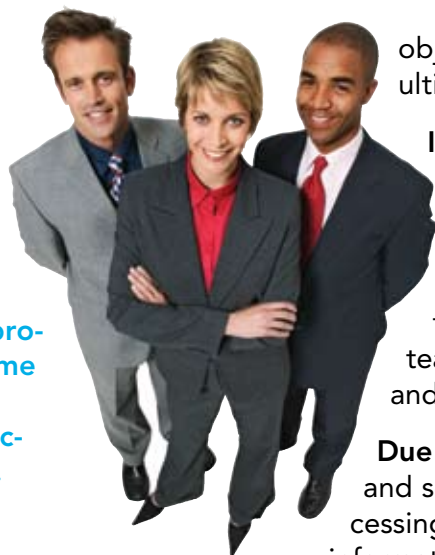
KNOWLEDGE IS POWER

If you're considering selling your business or making an acquisition in the near future, a potentially higher tax bill or more-complex deal process could give you the incentive to speed up your deal. Before you act, however, discuss your plans with an experienced tax advisor. Tax and M&A professionals can work with you to mitigate the tax consequences of the new laws on your sale or purchase. □

No “I” in merger

Building a successful deal team

Selling or buying a company is time-consuming — even full-time — work. Owners and executives who expect to run their company as usual during the M&A process generally find that they can’t do both jobs well. By assembling a deal team made up of key employees and professional advisors, you relieve some of the pressure on yourself. Your company is also more likely to successfully complete a deal quickly.



COACHING THE DEAL

Deal teams range in size from less than a handful of people to a dozen or more, depending on the size of the company and complexity of the proposed transaction. Teams are responsible for moving a deal through every stage of a merger — from initial inquiries and analysis to due diligence, negotiations and, in some cases, integration.

Although it’s usually led by a professional advisor or the company’s owner, CEO or CFO, an effective deal team should include representatives from all major areas of a company, including accounting, legal, IT, personnel, public relations, and, if the company has significant holdings, real estate. M&A, financial and legal professionals work with the team to draft a deal plan and timeline and help the members stay on course.

FOLLOWING THE GAME PLAN

Typically, a deal team starts by setting rules to protect confidentiality and establishing a line of command. The team’s leader should encourage open communication from all participants during every stage of the merger and give members clearly defined tasks that contribute both to the

objectives of each stage and the ultimate goal. These might include:

Initial stage. A seller’s deal team needs to prepare the company for sale, prepare nondisclosure statements and a confidential business review, and put out feelers for potential buyers. A buyer’s deal team should size up potential sellers and select a target.

Due diligence. At this stage, both buyer and seller teams are responsible for processing and organizing large amounts of information — including financial, legal and operational. Sellers should ensure that documents are available and easy to review and that procedures are in place to protect proprietary information. Buyers should strive to be as thorough as possible, given the usually limited timeframe.

Negotiations. Buyer and seller teams often work together to draft and edit the details of the purchase agreement. Financial advisors play a particularly important role if the parties encounter roadblocks on price and deal structure.

The team’s job isn’t necessarily over when the paperwork is signed. Companies often rely on their deal teams to handle employee and public communications and last-minute issues such as regulatory compliance. And buyer teams often conduct the integration process.

BEST OUTCOME

Mergers can be stressful for everyone, particularly company leaders. But if you distribute deal responsibilities among the members of a focused and well-organized team, your company can enjoy a much smoother process — and a better outcome. □



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SUMMA Financial Group, LLC

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SUMMA Financial Group, LLC is a merger & acquisition firm dealing in the representation of sellers and buyers in business-to-business services, manufacturing, and distribution companies. The size of middle market companies which are represented by SUMMA are \$2.0 million to \$50 million plus in value.

SUMMA, through its highly skilled associates and staff with over 75 years of collective experience, is dedicated to providing the client with the highest professional services possible in the field of mergers and acquisitions. Since 1985 SUMMA has strived to continuously upgrade its system to deliver services with the utmost of confidentiality, while attaining the highest and best exposure to potential acquirers. You can feel confident in SUMMA acting as your M&A Intermediary.