M&A TODAY

Vol. 13 July 2004 No. 7

Newsletter for the Professional Intermediary

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STANDARD & POOR'S Corporate Value Consulting Responds To Changing Markets

*Editor's Comments: Constant change in the M&A market results in new opportunities for some of the constituents in the industry and, unfortunately, a sense of malaise for others. Some of the constituents affected by M&A activity include transaction attorneys, investment banks and valuation services firms. Most of these businesses have been negatively impacted in recent years by the reduced level of M&A activity. Notwithstanding the changing M&A market, Standard & Poor's Corporate Value Consulting (CVC) has been able to successfully refocus and address new business opportunities to drive its valuation practice. Such new opportunities include stock option valuation, fairness opinions and providing services to law firms related to valuation disputes. In this article, **M&A Today** interviewed Dave Spieler, Managing Director and City Leader for CVC's Boston office to understand how CVC is serving its clients in the current business environment.*

BACKGROUND

In September of 2001, Standard & Poor's acquired the U.S. Corporate Value Consulting business from PricewaterhouseCoopers as the latter was faced with new SEC rules that restricted the provision of valuation and other consulting services to its audit clients. In 2002, the Sarbanes-Oxley Act formally outlawed most of the consulting services relationships between companies and their auditors. The CVC acquisition was ideally suited for Standard & Poor's in its quest to meet the growing need for objective, independent analysis for its burgeoning list of clients.

David Spieler

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CVC has advised clients on valuation and corporate finance issues for over thirty years, earning a reputation as the leading provider of insightful, independent and objective valuation advice.

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Marty Mannion's Views

At a Boston ACG meeting recently, Marty Mannion, Managing Partner of Summit Partners, discussed his views of the M&A market. Summit has a capital base of more than $5.5 billion and focuses on growing, profitable, privately held companies. Since Marty joined the firm in 1985, Summit has grown from less than 10 employees in one office to more than 100 employees in three offices, and the private equity group (PEG) has grown from a cottage industry to a significant segment of the financial services sector.

Specifically, since 1985 when the PEGs had $10 billion of dry-powder (available capital to invest) the amount of capital for PEGs to invest is now $330 billion. Marty warned other investors that they better have a strategy for managing their portfolio or as Yogi Bera says: "If you don't' know where you are going, you will end up somewhere else."

The recent phenomenon in the M&A marketplace is that historically strategic buyers were usually willing to take *operational* risks but not *financial* risks. Conversely, PEGs were usually willing to take financial risks but not operational risks. Now, Marty says, he is seeing PEGs taking both financial and operational risks. While it is easier nowadays for PEGs to engage good management teams for their new acquisitions, it doesn't assure them of overcoming operational problems. With purchase price multiples moving-up in the last year, there is enormous pressure for PEGs to: 1) put their excess capital to work or return it to their limited partners; 2) carefully analyze the financial and operational risks; and 3) not overpay for acquisitions despite the investment banks reliance on the use of auctions for their sales process.

Marty said the good news for PEGs is that the "banks are back" willing to be more accommodating for acquisition loans. He continued: "Low interest rates don't drive deals as much as banks loosening up their loan criteria. Furthermore, the portfolio companies are healthier as PEGs have influenced them to clean-up their balance sheets over the last few years by paying down debt. In an effort to diversify their holdings, PEGs have been swapping some of their portfolio companies with each other, but not flipping them in less than two years.

Certain trends are noteworthy:

(1) With the advent of Sarbanes-Oxley and rule #404 documentation requirements, a company can cost upwards of $800k in one IPO and then an additional $500k annually once public. These hardships will convince certain companies to sell-out for a liquidity event rather than consider an IPO… all of which is good news for buyers seeking growing companies to acquire.

(2) For some situations, the buyer's concern is not only being outbid by a strategic acquirer, but the seller deciding to do a "recap" and taking money off the table now and delaying the eventual sale for a number of years.

(3) While strategic buyers are anxious to grow through acquisitions, they are continually reluctant to do deals unless the target company is a "close-fit".

(4) When some PEGs lose-out in an auction for an attractive company in an interesting industry, they might call around for companies in the same industry to see what is available for sale… especially since the PEGs have become "up to speed" with the industry dynamics. Such action causes an increase of purchase multiples in that industry.

With the floor open for questions, Marty's response to how Summit Partners creates their deal flow was most revealing. Using college graduates for a direct marketing campaign to targeted industries, these marketers make 1,200 telephone calls per month, which equates to approximately 14,000 calls per year. Additionally, these marketers make 1,000 calls annually to investment bankers. Over the years, Summit has accumulated about 100,000 companies in their database for target companies. Their marketing efforts results in Summit sourcing 75% of their 20 deals per year. For the balance of the deals, if Summit is involved in an auction, it tries to only "play" when the buyers have been narrowed to less than six highly qualified acquirers instead of some mass marketed auctions of up to 100 bidders.

Marty's views of the M&A marketplace is only one man's opinion… however, over the years his opinion has been consistently respected by his peers in the M&A industry.

The Critical Line Between DEALMAKERS *and* DEAL BREAKERS

by Gabor Garai and Susan Pravda
Courtesy of
Mergers & Acquisitions Publication

As the world of buying and selling companies grows ever more complex, deal negotiations become more complicated. There are more strategic alliances and more cases of small companies buying larger companies. More deals are being financed by the seller and fewer by banks. And we are seeing staged acquisitions, with the buyer gradually taking ownership over an extended period of time.

As a result, the participants negotiating skills are playing a much larger role in determining the success or failure of these complex transactions. Negotiating skills become especially important during potential "melt-down" points when the whole deal is most likely to go sour.

The key to being a successful negotiator lies in being able to recognize these critical points – five of which we have identified as key – and overcome the hurdles they present. How one handles these critical junctures reveals whether one is a "dealmaker" or a "deal breaker".

One of the most important lessons we have learned in bringing more than 200 negotiations to a successful conclusion is that the barriers to a successful deal are as often emotional, political, or psychological as they are economic. Dealmakers are able to surmount the many obstacles that rise during a negotiation and keep all parties focused on bringing the transaction to a mutually satisfactory conclusion. Deal breakers focus so heavily on economic issues that hey lose sight of the many other matters that have critical importance.

> A dealmaker keeps focused on completing the deal during negotiations. A deal breaker allows small points to get in the way.

We have identified five critical stages in the negotiation process when deals can be sabotaged by the deal-breaker mentality. We also have developed some strategies to overcome this mentality and strike deals that proved satisfactory to both buyer and seller.

CRITICAL STAGE #1:
AN INITIAL NEGOTIATION TARGET

Every negotiation must be driven by a strategy that can bring the proceedings to a successful conclusion between a seller who wants to sell and a buyer who wants to buy. In sports, it's called keeping your eye on the ball. In negotiating a merger or acquisition it involves the ability to keep negotiations on point, on schedule, and moving forward.

Negotiations should begin in earnest immediately after the potential buyer and seller have agreed to move toward a deal. This is the first critical stage of negotiations. Moving forward at this stage requires giving the parties to the negotiation an initial target – preferably a letter of intent. In addition to giving the negotiations a focus – or a ball, to continue the sporting metaphor – the letter of intent also serves special purposes. It:

- Puts the deal into words.
- Eliminates unnecessary expense for both sides, if there reality is no deal.
- Helps resolve significant omissions and ambiguities to avoid misunderstandings.
- Acts as a psychological instrument for the buyer and makes the deal real to a hesitant seller.
- Gives the deal a sense of finality, making it harder to change things at the purchase-and-sale stage.

It is important to establish a realistic deadline to conclude the negotiations for a letter of intent. This deadline must allow time for the buyer to investigate the company and for the seller to get affairs in order. The point of a deadline is *not* to hurry the deal through.

> It is important to establish a realistic deadline to conclude the negotiations for a letter of intent.

The longer it takes to negotiate a letter of intent, the better the chances are that both sides will take their eye off the ball and become bogged down in relatively minor details. The timetable forces all parties to focus on the big issues. Nagging details can be left for the purchase-and-sale agreement.

CRITICAL STAGE #2:
NEGOTIATING PRICE GAPS

The economic issue most likely to threaten the deal obviously is price. It can surface in numerous ways and at diverse times, even if a price has been

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Structuring Boards of Advisors to Make a Difference

by Dr. Laurence J. Stybel

Editor's Comments: Recently Larry Stybel spoke to the Boston Association for Corporate Growth regarding the use of Board of Advisors in conjunction with the CEO and the Board of Directors. He discussed not only the attributes and short-comings of a Board of Advisors but how to structure and compensate them. This article includes the highlights of Larry Stybel's presentation.

OVERVIEW

With the advent of Sarbannes-Oxley, there is pressure on Boards of Directors to assure that companies are in compliance and adhering to proper corporate governance. There is equal pressure on CEOs to obtain the best advice at a time when many qualified people are reluctant to become directors because of the increased responsibility and liability. One approach is for companies to keep their Board of Directors to a minimum and establish a Board of Advisors as a way to improve the over-all team of advisors.

Boards of Advisors occupy a position midway between consultants and Boards of Directors. Consultants can often have a project/short-term perspective to their client relationships. Boards of Directors have a long-term interest in the company's success. Boards of Advisors have some of the positive aspects of both structures.

Board of Advisors do make a difference whether it is to improve company performance, or to build shareholder value or dress-up the company for sale.

WHY ESTABLISH A BOARD OF ADVISORS

In a private company, a Board or two different Boards of Advisors might be an alternative to a Board of Directors. In a public company, a Board of Advisors would be in addition to a Board of Directors. The value for Boards of Advisors are:

Credibility — many companies involved in the sciences and advanced technology are as understandable as black magic. Advisors with the proper credentials from well known institutions, even if their names are unknown, add credibility to the company.

Recognition — Let's suppose Smith Medical Company produces heart valve machines. With an advisor with a recognizable name like Dr. Paul Dudley White, the company gains recognition by association.

Leveragability — Experienced advisors can open doors for important sales calls at a higher management level and/or help implement alliances with larger companies such as Johnson & Johnson and IBM.

Shareholder Value — A survey in the United Kingdom of 700 companies showed that Board of Advisors for small-cap companies contributed to the increase of shareholder value while Directors who by and large had trophy names serving on multiple boards did *not* increase shareholder value.

Eye on Technology — Advisors "in the know" can perceptively guide companies forward through their knowledge of leading edge technologies and break-through discoveries.

Further along in the article the responsibilities of Board of Advisors will be discussed. Aside from the above attributes which advisors should be able to fulfill, they should provide complimentary industry skills and an ability to help the CEO solve difficult problems that arise from time to time.

PROS & CONS OF BOARD OF ADVISORS

While the attributes should definitely outweigh the shortcomings of a Board of Advisors one should be aware of the downside. The Board of Advisors does add some complexity in that there is a mandatory Board of Directors and then an additional group of councilors which

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TRENDS IN CORPORATE DEVELOPMENT

1. Going public is far less attractive for middle market companies than prior to 2000. According to *Business Week*: "Armed with plenty of financing options, some smaller private companies are resisting the lure of raising quick and cheap money by going public. As a result, the average size of an IPO is mushrooming. And over the last two years the median annual sales of a company going public have reached $164 million, up from $15 million in 1999 and 2000." As many of these companies still need an exit strategy to pay out their investors such as venture capitalist, private equity groups, mezzanine players, etc., the opportunity exists for small regional investment banks to be retained to sell these smaller companies.

2. As Sarbanes-Oxley has sharply raised the cost of being a public company,*Business Week* states: "Bankers expect a record number of U.S. companies to go private this year, topping last year's 86. Three years ago only 53 did. More than two-thirds of the deals involving companies going private since mid-2002 were management buyouts, generally funded by private-equity firms. Again, opportunistic investment banks should seek out small public companies that are heavily burdened by the recently increased costs of being public.

3. Some diversification, assuming it is a logic extension of the core business, makes eminent sense. A number of industries are hugely dependent on issues such as interest rates and energy prices which are beyond their control. Acquisitions to achieve some diversification is appropriate. As *Business Week* reports: "Many financial institutions are now insulated against higher interest rates. Diversification explains a big part of why the impact of higher rates could be less dramatic than before. The 50 largest U.S. banks now get 40% of their revenues from fees generated by the likes of investment banking, asset management and insurance, up from 26% in 1990. Changes in interest rates don't have any direct influence on fee earning businesses."

4. The new paradigm in manufacturing is to offer complimentary services along with the product itself. GE, for example, produces aircraft engines, diesel locomotive engines, MRI diagnostic machines, etc., but GE also has ancillary businesses which finance services and maintain the equipment they manufacture. Forty years ago, IBM principally produced computers and practically gave the software away to go along with the hardware. Now, approximately 50% of IBM's business is service and growing … especially with their acquisition of the PricewaterhouseCooper's consulting practice. And Sun Microsystems is in the midst of a turnaround which is largely dependent on the success of its recurring revenue business model. Sun is shifting its focus from selling hardware and software… to servicing and licensing that generates recurring revenues.

5. The merger mania in the USA is driven in part by CEO's ego and desire to rapidly grow the business. Some of our most successful companies concentrate on organic growth such as Wal-Mart, Walgreen and Southwest Airlines. While two of the most successful automobile producers, Toyota and Honda, have succeeded without acquisitions; other automobile producers have had disasters with their investments, e.g, BMW (Rover), Daimler (Chrysler and Mitsubishi), Ford (Jaguar, Mazda and Volvo) and GM (Fiat, Saab and Daewoo). For the more patient and modest companies, acquisitions are less likely to be part of their growth strategy.

6. Corporate development is concerned with the company's growthÖ..but also with positioning the company for long term survival. Most companies do not survive a century. In 1897, the Dow Jones averages were created with 12 of the most prominent companies at that time. All but General Electric have been acquired or gone out business today. Before John Akers, CEO of IBM, retired about a dozen years ago, there was serious discussion of splitting up the corporation into numerous separate companies. As shocking as it may seem, Micheline Maynard in her recent book, *The End of Detroit*, predicts that GM, Ford and Chrysler will either: 1) shrink further; 2) GM and Ford might merge (assuming the federal regulators would allow it) and; 3) GM or Ford might seek a foreign partner. The point of this analysis is that more companies will be spending more time not just on growth issues but how best to position itself for long term survival. Under Jack Welch, G.E. abandoned their least attractive companies and added or entered into more attractive companies, thus making bold decisions for future prosperity.

7. Corporate development does not always imply growth through acquisitions. Corporate development also means refocusing and concentrating on a company's core business. In this fast paced world, entire industries are changing through specific dynamics such as airlines (deregulation), book retailers (Internet), banks (ATMs), credit cards (outsourcing), photography (digital), etc. Frequently, companies in these changing industries are faced with staying the course and hopefully improving shareholder value through acquisitions. Alternatively, the companies could sell out to those companies that can make better use

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The Critical Line Between DEALMAKERS *and* DEAL BREAKERS

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agreed to in a letter of intent. The seller may hear war stories from friends who claim to have sold comparable businesses at much higher prices. Or it may turn out that the buyer shook hands on a pre-emptive bid that was tailored to excite the seller's greed but failed to spell out some of the details that might cause the price to drop before closing.

Whatever the cause, a price gap often develops between the buyer and seller. In these cases, a number of vehicles that go beyond simply compromising on a price are available for bridging the gap. The old horse trade approach of "I'll come up a million if you come down a million" rarely solves the problem. The more practical solutions to price impasses transcend the issue of price and delve into the personal, emotional, and psychological realms.

One solution is to suggest that the buyer enter into an employment or consulting agreement with the controlling owner of the selling company. The arrangement has tax benefits for both sides. The buyer gets a lower selling price, and subsequently lower financing costs.

The consulting fees paid to the seller help spread the cost of the purchase over a longer period of time and they are generally tax-deductible, whereas the purchase price is not. The seller winds up getting the desired price, albeit belatedly, and may be able to avoid or defer some tax liability.

For the buyer, keeping the seller involved has its benefits. It gives the seller a vested interested in the continued success of the business which could help keep customers and employees happy and maintain vendor confidence. It also may minimize the risk that the seller will bad-mouth the business or begin a competitive one – noncompete clauses notwithstanding.

If the buyer doesn't want the old boss hanging around, the "noncompete" agreement is a useful gapbridging tool. It avoids some of the downside risks posed for the buyer by employment and consulting agreements, e.g., the meddling syndrome by the outgoing owner.

CRITICAL STAGE #3:
OVERCOMING SELLER'S REMORSE

Frequently, we discern during the course of a negotiation that the seller is simply so attached to the company – having started it, grown it, and lived with it for many years – that the thought of selling it is downright painful. "Seller's remorse" tends to grow worse as negotiations drag on. It can emerge at any point in the talks and is a serious potential problem that must be constantly anticipated.

Gabor Garai

Often closing a deal requires attention to noneconomic factors that may be responsible for the seller's reluctance to sell. The buyer can provide a panoply of incentives to the seller at little or no cost. They include such simple perquisites as letting the outgoing owner retain a company car, continuing to pay for his or her country club memberships, or letting the seller retain a title with the company, such as chairman. Or the seller may want to continue to book travel arrangements through the corporate travel office or continue to have the services of a personal secretary.

While these perquisites may seem petty in the larger scheme of things, their importance should not be underestimated. A few years ago, one of our buyout clients was ready to sign the purchase-and-sale agreement for a manufacturing business in Cincinnati. Everyone was waiting for the seller to arrive and put pen to paper. When the seller showed up, he had only one announcement: he had changed his mind about selling.

> Seller's remorse" tends to grow worse as negotiations drag on.

Having confronted seller's remorse before, our client was not surprised, although he acted that way in front of the group. Over drinks and dinner with the seller that evening, our client discovered the problem: The seller simply could not imagine what he would do the morning after the sale, without an office to go to, a secretary to take care of his personal matters, and a telephone to use to "schmooze" with his industry buddies. Our clients immediately offered to retain him as a consultant for special projects for the company, providing him with an office, secretary, and telephone, and even adding a small monthly fee for his services. Rather than letting the seller use his former office, however, our client rented an office lease suite in a nearby building. In the client's view, the extra rent was worth keeping the owner away from his former business and minimizing his ability to meddle.

The next day, the deal was closed. Subsequently, the former owner "repaid" the extra costs by helping out in difficult situations involving his industry colleagues.

The mistake that we see most often is that buyers treat seller's remorse as an economic problem rather than an emotional one. Throwing money at this problem will not solve it. More likely,

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Susan Pravda

it will simply drive up the price to the point where the seller's worst fears – that his or her child will flounder in the hands of a buyer that overpaid – are ultimately realized.

CRITICAL STAGE #4:
Effective Due Diligence

Let's say we've bridged all the gaps, cleared all the hurdles, massaged all the egos, calmed all the emotions, signed the letter of intent, and are nearing the closing. Now the fun begins. Or at least that's what some lawyers think, because this is where they get into the action of negotiating the purchase-and-sale agreement. It is interesting to see lawyers' eyes light up when the purchase-and-sale agreement comes up. That's the sexy stuff, where the art of negotiation can be best displayed. Mention due diligence and the eyes glaze over. That's the boring stuff for the young associates.

Both areas are crucial. In point of fact, it is often through due diligence – properly done and carefully reviewed by the business people and attorney in charge – that the key risks and issues are identified and then resolved through skillful negotiation.

There is a real difference between negotiating issues raised by due diligence and those raised by the purchase-and-sale agreement. Due diligence issues are always new, different, and business-specific. They require negotiating approaches that are original and creative. They demand that negotiators fully familiarize themselves with the problems and come up with a constructive, pragmatic, and mutually satisfactory solution.

We recently closed a transaction involving the sale of the assets of a technology company. We discovered during due diligence that the patients covering certain elements of this technology were invalid. The same technology was covered by an earlier patent issued to a giant company.

> Practical solutions to price impasses transcend that issue and delve into personal, emotional, and psychological realms.

The transaction was restructured so that the technology was purchased for one dollar, and a license agreement was negotiated with the other company. We knew that this company was willing in these situation to grant a license of its technology for a standard 2% royalty.

It was agreed that if we were able to get such a license for the standard royalty, we would make an additional payment to the seller in an amount equal to the originally assigned value of that technology, less the license fees. If we were not able to get such a license, we agree to return the technology to the seller for one dollar.

CRITICAL STAGE #5:
The Purchase/Sale Agreement

In contrast to due diligence, negotiations concerning the purchase-and-sale agreement are much more formulaic. While there are always new combinations and compromises, the parameters are much more defined. Purchase-and-sale negotiations are generally "win-lose", "zero-sum deals" – what one party gets, the other party must give up. Due diligence negotiations more often are "win-win" approaches. The best compromises leave both sides better off.

Negotiations over purchase-and-sale agreements are true lawyers' negotiations, in which knowledge of the particular business is less important but a command of the panoply of legal solutions available to resolve controversies is of utmost importance.

The best way to stifle the deal breaker at the purchase-and-sale stage is to concentrate on major issues curing the letter-of-intent and due-diligence stages. If the major issues were fully negotiated during the letter-of-intent stage, purchase-and-sale negotiations can be dramatically streamlined. The chances for the deal breaker to grandstand and employ brinkmanship tactics are greatly decreased.

BEING A DEALMAKER

The key lesson we have learned from due-diligence issues also applies to the negotiations at large. Spend the time and effort to understand the business, discover its warts, and find the skeletons in the closet. Be ready to accept creative suggestions that make the deal happen in spite of those warts and skeletons.

To be a dealmaker one has to assiduously avoid getting caught up in the conventional negotiating game. The art of negotiation lies in listening to and addressing the needs of both the buyer and the seller – not by scoring debating points, grandstanding, or dwelling on every small point. Those are the characteristics of a deal breaker.

The object is to make a deal. We firmly believe that, given the right terms, practically every transaction is doable. The job of the consultant is to negotiate an agreement that ultimately benefits both the buyer and the seller.

For more information, contact either Gabor Garai or Susan Pravda who specialize in mergers and acquisitions in the Boston office of the law firm of Epstein, Becker & Green at 617-342-4000 or ggarai@ebglaw.com *and* spravda@ebglaw.com.

STANDARD
&POOR'S
Corporate Value Consulting
Responds To Changing Markets

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THE DYNAMICS OF THE BOSTON OFFICE

CVC has a total of about 320 professionals located in twelve offices throughout the U.S. (New York, New Jersey, Philadelphia, Atlanta, Houston, Dallas, Los Angeles, Palo Alto, San Francisco, Chicago, Detroit and Boston) and two international offices (London and Amsterdam). Each office has industry experts who focus on those industries that are germane to their geographic region, e.g., automotive in Detroit, energy in Dallas, healthcare in New Jersey, entertainment in Los Angeles, technology and info comm in Boston.

Dave Spieler, who is in charge of the Boston office, was previously a management consultant at Arthur D. Little and a Partner in PricewaterhouseCoopers' Financial Advisory Services practice. His areas of expertise include business and intangible asset valuations, as well as providing expert testimony. Asked to describe the business climate for valuations in the Boston office, Mr. Spieler responded: "There will always be a base demand for valuation services by Boston area companies for their financial and tax reporting. While we sometimes compete with the Big Four accounting firms, other than PwC, we often receive referrals for valuation assignments from these firms. Due to SEC and Sarbanes Oxley requirements, companies must find independent firms who can provide valuation services. Having such independence is an important strategic advantage for CVC."

In the Boston marketplace, valuation services are also provided by some of the regional investment banks. However, such services are not always viewed as being totally independent, especially if such investment bankers are receiving contingent fees related to a sales mandate or an IPO underwriting. Mr. Spieler noted that "CVC will sometimes be retained to provide a 'second opinion' on the value of a significant asset or business unit before a company's Board of Directors takes action based solely on the advice of its investment banker."

Alan Cody

M&A Today asked Mr. Spieler about the flow of new business opportunities. He explained that "We are always proactively seeking new business and new client relationships, so we focus on being highly visible in the marketplace. The senior members of our practice regularly participate in external events sponsored by industry trade groups and professional organizations. In my City Leader role for the Boston office, I spend about a third of my time marketing, another third overseeing on-going engagements and the final third managing the practice. An important aspect of this management function is recruiting and training. In general, we like to hire professionals who have technology or science backgrounds, who have had significant work experience, and who have aspirations of completing the Chartered Financial Analyst (CFA) program."

CHALLENGES GOING FORWARD

CVC offers a full complement of valuation and consulting services including the following:

- business valuations
- purchase price allocations
- intangible and fixed asset valuations
- real estate valuations and consulting
- goodwill impairment analyses
- fairness opinions
- corporate finance consulting
- revenue forecasting/market modeling
- tax related valuations
- law firm services (including expert testimony)

Historically, many of the above services in the Boston office were M&A driven. As most people realize, the M&A business has been by and large in the doldrums for the past three years… but is now showing signs of a comeback. Not only had acquisition prices risen too high, but CEOs lost confidence for acquisitions as the economy weakened. Companies have, therefore, been focusing on productivity, profitability and credibility…not willing to risk dilutive acquisitions during this period of keen investor scrutiny. According to Mr. Spieler, the challenge has been to identify new business opportunities that fit the scope of CVC's expertise and refocus accordingly. The following are examples of these business opportunities:

1. Law Firm Services: There is little indication that the business community is less litigious, so there is a continuous need for both the plaintiff and the defendant to

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prove the value of businesses and/or assets in dispute. This is an area where CVC has recently made significant investment in resources to address complex cases that involve issues such as fraudulent conveyance, Rule 144 stock transfers and intellectual property disputes. CVC professionals have provided expert testimony in Delaware Chancery Court, U.S. District Court and State Superior Court.

2. Stock Options: There has been much discussion about proposed rules to require expensing stock options beginning in January 2005. Already marquee companies like Microsoft and Coca Cola are expensing stock options. The accounting rulemakers are leaning towards recommending the use of lattice models to estimate stock option fair values, rather than the traditional Black Scholes model. CVC expects to assist most of its larger clients with the adoption of any such new rules and the application of stock option valuation models.
3. Fairness Opinions: Given the heightened scrutiny on Boards of Directors brought on by Sarbanes-Oxley, the demand for independent fairness opinions should increase significantly as the M&A market improves. Given the industry expertise as well as deep financial and analytical skills of its professionals, CVC is well-positioned to meet this surge in demand.
4. Operating Unit Valuations: Companies that are restructuring their balance sheets for internal re-organization will need the services of CVC. Examples would include recapitalization for companies raising cash for investment or acquisition purposes, or merely for the stockholders to take some money off the table. Also, companies might decide to sell their non-core assets or operations and implement a sale/lease back arrangement.
5. Transfer Pricing: Known as Section 482 of the Internal Revenue Code, this relates to the value of assets and chargeback arrangements among the operating units of large companies. From an IRS perspective, such pricing arrangements must be at arm's-length and related to the fair values of the shared assets. Estimating such asset fair values, especially for complex intellectual property (eg. patents and related know-how) is an area of deep expertise for CVC.

Delivering services in these specialized areas also strengthens the skills of CVC's professionals to provide broad-based M&A advisory services. For example, the insights gained from advising a law firm on a dispute can be used to assist a client in drafting a purchase and sale agreement for a business acquisition.

DEPTH OF SERVICES

While ***M&A Today*** has discussed the breadth of CVC services, it is important to note the extent of their rigorous procedures for valuation assignments. Many valuation firms develop the majority of their findings by "crunching the numbers." However, Dave Spieler and his team also place emphasis on the non-financial aspects of the business. For most business valuation assignments, CVC's professionals spend a significant amount of time interviewing the company's senior management. "It is very difficult to prepare a credible valuation without fully understanding the company's strategy and future prospects. Our role is to test management's value driver assumptions and overall business plan against industry norms," notes Mr. Spieler. CVC always has professionals on its engagement teams with specific industry knowledge. If not, the client will quickly recognize this void.

Additionally, when CVC undertakes a Fairness Opinion it recognizes that its report is typically subjected to scrutiny by many third parties, including regulators.

Marguerite Piret

Therefore, CVC increases the number of steps in the engagement process with added documentation, industry research and exhibits of supporting material. A critical aspect in preparing Fairness Opinions is the review process by CVC's internal committee of up to five Managing Directors. They render experienced judgments based on the facts presented, industry knowledge and prior relevant transactions.

The depth of CVC's Boston office expertise is exemplified by its Managing Directors, who work as a team with Dave Spieler:

Alan M. Cody, CFA – Specializes in Technology and Info Comm companies, and has over 25 years of experience in valuing patents, trademarks and other intangibles.

Nathan I. Levin, CFA, AM – Leads the Consumer and Industrial Product Industry group, and has over 15 years of experience in business and asset valuations.

Timothy A. Luehrman, PhD – Is Chairman of CVC's National Technical Committee and a standing member of all Fairness Opinion review committees. Recently, he served as an advisor to the Financial Accounting Standards Board on stock option valuation methodologies. He previously spent 15 years as a finance professor at some of the world's leading business schools, including Harvard Business School.

Robert L. Paglia, CPA – Has extensive experience with technology, consumer and industrial products companies. He is an Executive Managing Director for CVC and has overall responsibility for managing the practices in 12 U.S. cities as well as two in Europe.

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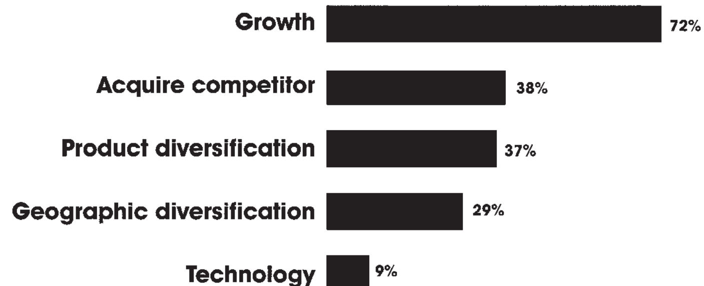
M&A Update

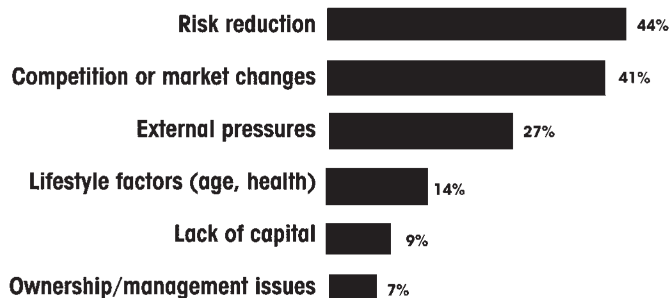
New Study Favors M&A

by Tom West and Russ Robb

Over the years, study after study indicates that a majority of M&A deals that do not meet investors' expectations as measured by earnings that exceed the cost of capital, accretive earnings vs. dilutive earnings, or some other measure of performance. Recently the Boston Consulting Group analyzed long-term market performance of 705 public U.S. firms from 1993 to 2002. the study divides the sample into three groups on the basis of their level of merger-and-acquisition activity. For the 10-year period, the highly acquisitive companies had the highest median total shareholder return – 29% higher than other firms. The study was designed to determine whether the stock market rewards acquisition-driven growth strategies. BCG says its research differed from other merger studies in that it examined long-term rather than short-term performance.

As expended by *Investors Business Daily*: "Companies that systematically pursue growth through acquisitions outperform those that make few or no acquisitions. That's despite research showing that most mergers fail to create value for the acquirer's shareholders."





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STRUCTURING BOARDS OF ADVISORS TO MAKE A DIFFERENCE

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will require extra time for the CEO to manage. Additionally, in order to attract an effective Board of Advisors, it will be necessary for the company to make a financial commitment to them.

On the upside, the advisors should be able to improve the decision making process of the CEO by imparting their wisdom and experience. In selecting the advisors carefully, they will contribute their time and energy for the challenge of being an impact player without the necessity to receive generous compensation. Further, the advisors do not require onerous D&O insurance enabling the company to utilize their services without the costs associated with directors.

COMPENSATION

Board of Advisors, maybe consisting of two or three per company, generally meet only three or four times a year. While they are paid an annual retainer of $3 to $5,000 for small middle market companies and up to $7,500 for larger companies, the compensation is not tied to the number of meetings. Advisors are expected to provide continual in-put and accessible by telephone anytime for advice to the CEO. The advisors can also work for the company on outside consulting projects while such projects are generally unacceptable for outside directors. Additional compensation might be shares of the company's stock such as Ω of 1% of the shares outstanding particularly if the advisor serves for two 3 year terms. It is customary to offer an advisor one three year term with another renewable three year term if both parties agree.

RESPONSIBILITIES

Aside from the industry expertise and the various capacities mentioned earlier, the advisors should be responsible for the following:

- forming and advising on company strategy
- reviewing performance for ethical standards and legal compliance
- review fiscal controls, reporting and risk management systems
- advise on business succession

FINDING ADVISORS

Recognizing the need for a Board of Advisors is one thing, but just as important is selecting the right advisors. A potential mistake is the CEO who selects a business friend from his Rolodex. The advisor who is so much like the CEO will probably not challenge the way the company does business nor bring a fresh perspective. It is best to engage a retained search firm or contract industry talent banks such as the National Association of Corporate Directors (NACD). Interest groups like the Financial Executives International (www.fei.org) and the Boston Club (www.thebostonclub.com) provide Board Talent Banks for members. The Board of Directors Talent Bank at Boardoptions.com provides an "introduction service" for Board members.

CONCLUSION

Although it was not discussed in this article, a Board of Advisors can be extraordinarily helpful if the CEO is either interested in buying other companies or selling his company. The right advice in M&A transactions can be worth its weight in gold. For those companies which do not have a Board of Advisors… this may be the year to consider one.

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The website is www.boardoptions.com.

STANDARD &POOR'S Corporate Value Consulting Responds To Changing Markets

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SUMMARY

Despite the tough, local M&A market during the past few years, the CVC Boston practice has managed to thrive. As Mr. Spieler explains, " By staying close to our clients and maintaining awareness of their business issues, we have been able to adapt our expertise to meet a variety of marketplace needs. We have found this ability to innovate constantly and redirect our analytical skills toward such changing needs is the key to a successful practice."

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M&A Today is a newsletter for the professional intermediary—and all those involved in the buying and selling of mid-sized companies.

Subscription rates:
$210.00 for 12 issues
Payment may be made by check or credit card. (Mastercard and Visa only)

Mail or fax to:
M&A Today
P.O. Box 247
Concord, MA 01742

Telephone:
978.692.0323
Fax:
501.638.6803
www.businessbrokeragepress.com

Publisher
Thomas L. West

Editor-in-Chief
Russell Robb

Design
Pamela Trush
Delaney Designs
603.332.0993

Published by Business Brokerage Press
Concord, MA 01742
© 2004 Business Brokerage Press

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