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# Challenges of Selling a Business in Today's Environment

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**North Atlanta Chapter, GSCPA's**

**July 17, 2008**

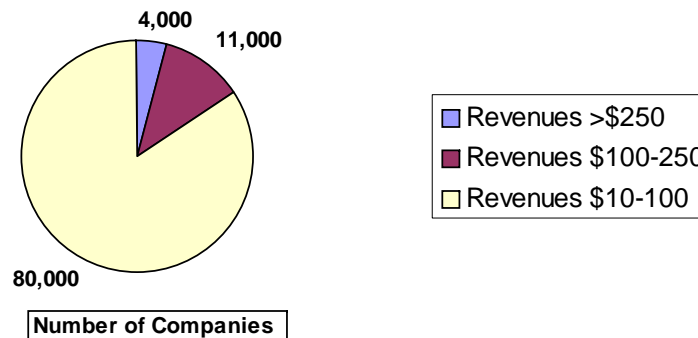


# *Market Overview*

# Overview of the Middle Market

- More than 90% of all businesses in the U.S. are family owned
- Estimated value of these firms is \$2.4 trillion
- 30% of family held businesses will change hands in the next five years
- Only 30% of family businesses survive into the 2<sup>nd</sup> generation, 12% to the 3<sup>rd</sup> generation, and 3% to the 4<sup>th</sup>
- Middle market companies (revenue \$10-\$100 million) represent 85% of U.S. private companies
- 25% of senior generation family business owners haven't completed any estate planning other than a will, 80% want the business to stay in the family, & 20% aren't confident of the next generation's commitment to the business

**Distribution of US Private Companies**

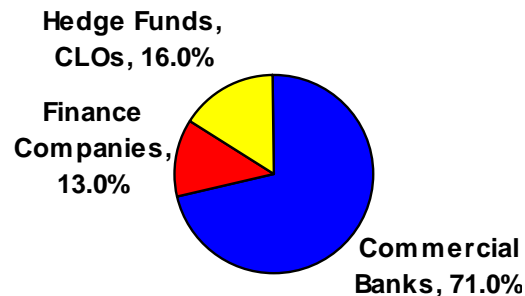


Source: UNC Asheville Family Business Forum

# Evolution of Leveraged Finance Market

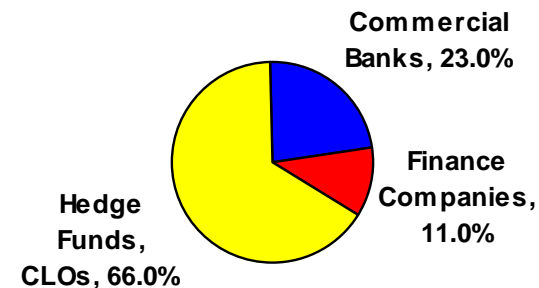
- Over the '95-'05 decade, there was a complete reversal in market share of the leverage market participants.
- Due to the sub-prime mortgage crisis, this trend is reversing once again towards more traditional financing.

Leverage Finance Market - 1995



<b>Banks</b>	<b>71%</b>
<b>Non-Banks</b>	<b>29%</b>

Leverage Finance Market - 2005



<b>Banks</b>	<b>23%</b>
<b>Non-Banks</b>	<b>77%</b>

Source: Merrill Lynch Capital

## Transactional Data: *Financial Buyers*

- Deal activity in Q1 of 2008 was markedly slower than in past years
- Valuations continued the slide from year end '07 with overall valuations dropping from 5.8x in the second half of '07 to 5.6x for Q1 2008:

TEV/EBITDA	1st half 07	2nd half 07	1st Q 08
\$10-25 million	5.7x	5.4x	4.8x
\$25-50 million	6.7x	6.0x	5.3x
\$50-100 million	7.0x	5.8x	7.4x
\$100-250 million	7.4x	7.4x	6.5x
Total	6.5x	5.8x	5.6x
N=	55	44	15

Source: GF Data Resources, June 2008 Report Summary, Thomson Reuters Q2 M&A Review

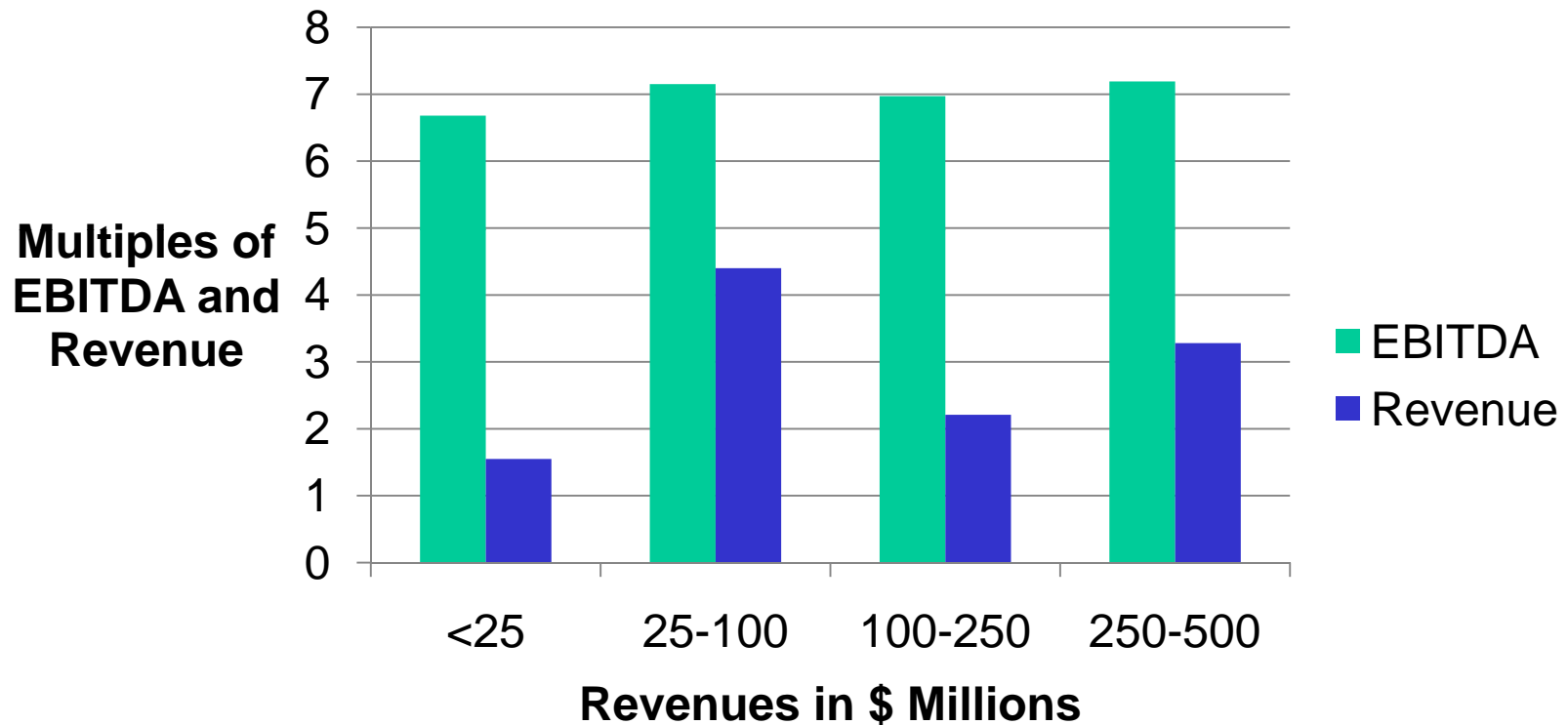
## *Transactional Data Highlights*

- The decline in valuation had the greatest impact on smaller transactions. Deals in the \$10-25 million and \$25-50 million value range declined by 0.6x-0.7x EBITDA from year end 2007. This continued a decline from valuations prevailing before the onset of the sub-prime mortgage industry crisis in July 2007.
- However in Q1 2008, many PE firms reported they were seeing an uptick in deals under letter of intent.
- Leverage did not bounce back to early 2007 levels, but debt multiples did not decline further, either. Total debt/EBITDA averaged 3.6x in the first quarter, compared to 4.1x in the first half of 2007 and 3.5x in the second half.

Source: GF Data Resources, June 2008 Report Summary

# Transactional Data: *All Buyers*

➤ Strategic buyers pull these multiples upwards:



Note: Data includes healthy company multiples between 3x and 25x excluding real estate and telecommunications transactions.

Source: Capital IQ, Data as of 7/14/08

# Leveraged Lending Multiples

## Total Debt/EBITDA—All Industries/By TEV

TEV	2003	2004	2005	2006	2007	2008	Total	N =
10-25	3.5	2.8	3.1	3.4	3.4	3.1	3.3	146
25-50	3.6	3.4	3.6	3.8	4.1	3.4	3.7	140
50-100	3.3	3.9	3.4	4.5	3.8	4.4	3.8	95
100-250	3.7	4.0	2.8	3.8	5.2	4.7	4.2	29
Totals	3.5	3.4	3.4	3.8	3.9	3.6	3.6	
N =	67	57	72	110	89	15		410

## Senior Debt/EBITDA—All Industries/By TEV

TEV	2003	2004	2005	2006	2007	2008	Total	N =
10-25	2.0	1.8	2.2	2.4	2.7	2.2	2.3	119
25-50	2.4	2.6	2.6	2.8	3.3	2.5	2.7	127
50-100	2.4	3.0	2.5	3.3	2.9	3.6	2.9	84
100-250	3.1	2.7	1.9	3.2	3.6	2.9	3.1	27
Totals	2.3	2.5	2.5	2.8	3.0	2.6	2.6	
N =	61	53	61	91	76	15		357

## Total Debt/EBITDA—2007 splits vs. 1Q 2008

TEV	1st half 2007	2nd half 2007	1Q 2008
10-25	3.7	2.7	3.1
25-50	4.2	3.9	3.4
50-100	4.1	3.5	4.4
100-250	5.2	5.2	4.7
Total	4.1	3.5	3.6
N =	53	36	15

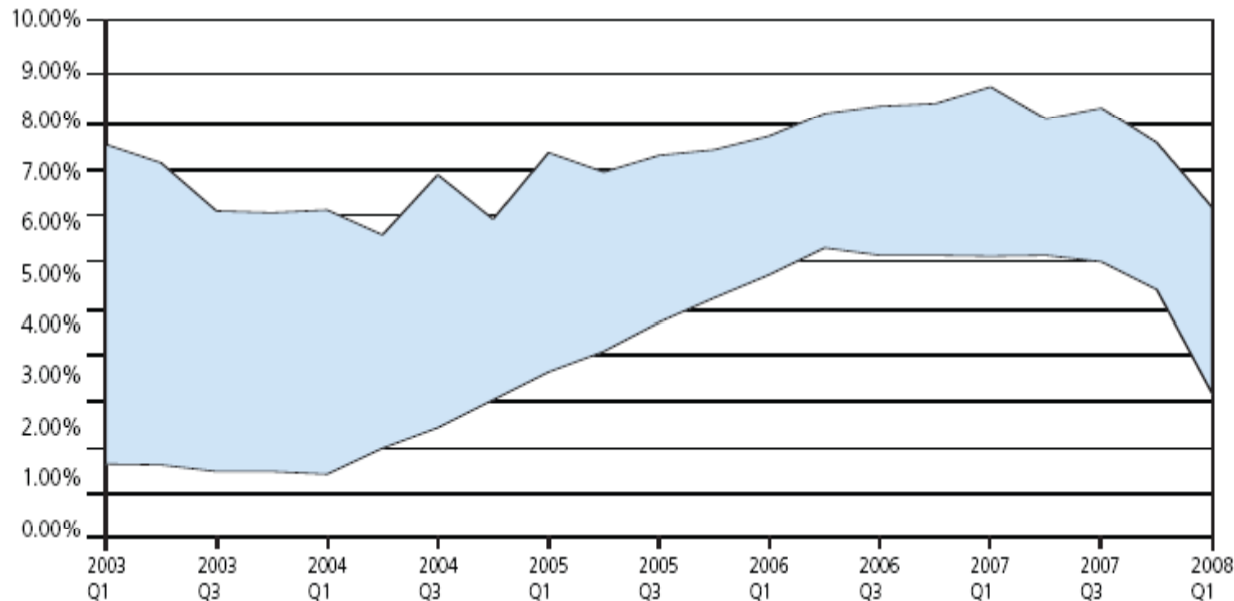
## Senior Debt/EBITDA—2007 splits vs. 1Q 2008

TEV	1st half 2007	2nd half 2007	1Q 2008
10-25	3.2	2.1	2.2
25-50	3.4	3.2	2.5
50-100	3.1	2.7	3.6
100-250	3.9	2.7	2.9
Total	3.3	2.7	2.6
N =	41	35	15

Source: GF Data Resources, June 2008 Report Summary

# Lending Spreads

## Senior Debt To LIBOR Spread



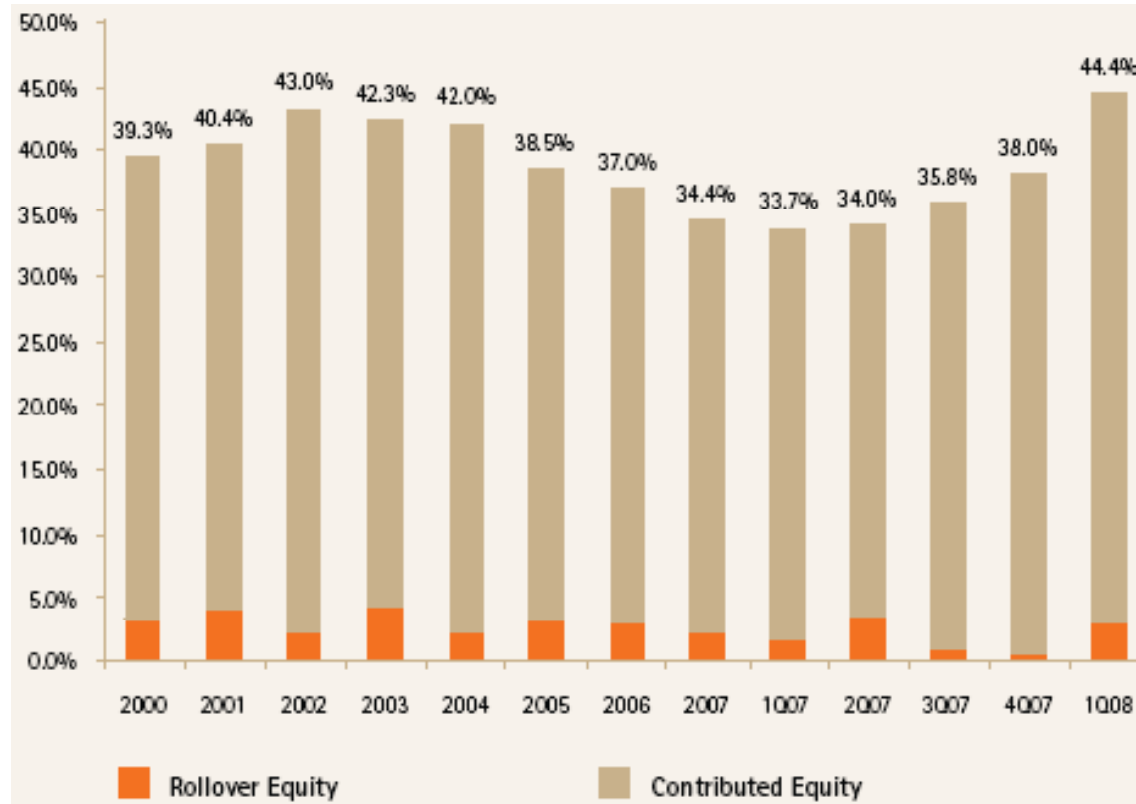
Senior Debt Pricing—2007 splits vs. 1Q 2008

TEV	1st half 2007	2nd half 2007	1Q 2008
10-25	8.5%	8.2%	7.1%
25-50	8.8%	7.6%	6.5%
50-100	8.4%	7.9%	NA
100-250	6.5%	9.4%	NA
Total	8.2%	8.0%	6.3%
N =	41	34	13

- While the first quarter featured dramatic cuts in interest rates, spreads against LIBOR expanded from 2.9% in Q4 2007 to 3.6% in Q1 2008.

Source: GF Data Resources, June 2008 Report

## Average Equity Contributions in LBOs



- Financial buyers must contribute more of their own equity, negatively impacting valuations. Strategic buyers with strong balance sheets are stepping up M&A activity.

Source: S&P LCD, Courtesy of Mirus Capital Advisors

## ***Market Conclusions***

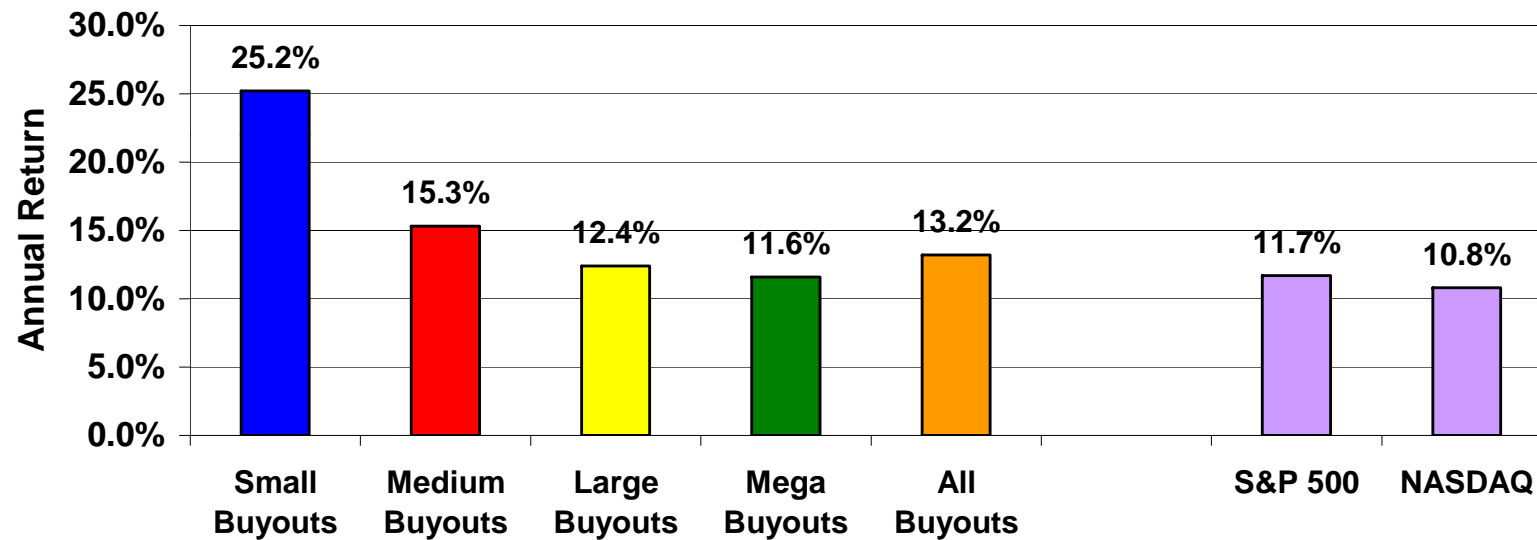
- The spotty level of transaction activity in Q1 reflected market **uncertainty** rather than market **weakness**.
- Lenders were more focused on capturing better pricing and deal terms than in continuing to tighten leverage.
- Despite some troubled sectors and conditions (e.g., oil prices), the market is generally reassured that the mortgage mess and related disturbances do not justify a sustained pullback in lower middle market deal activity.

Source: GF Data Resources, June 2008 Report Summary

# Private Equity Market

## ➤ Historical Performance of Private Equity

Buyout Returns for Last 20 Years versus Public Equities



Source: Thompson Financials' US Private Equity Performance Index

Definitions: Small Buyouts - \$0-\$250MM; Medium Buyouts - \$250-\$500MM; Large Buyouts - \$500-\$1,000MM

Mega Buyouts - \$1 Billion +

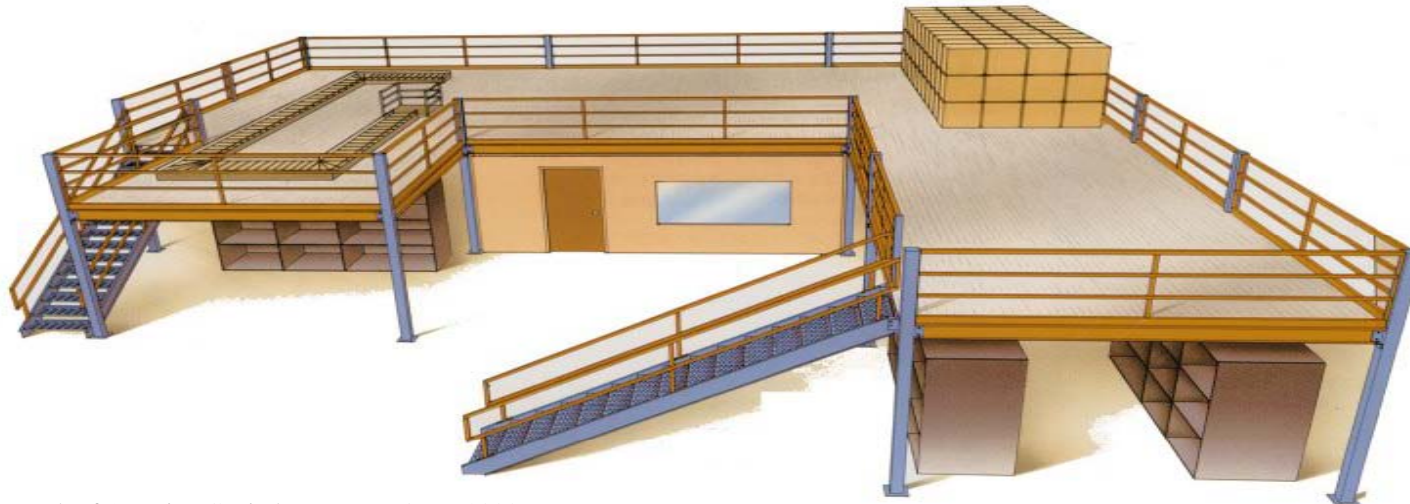
## *Private Equity Market*

- New private equity raised in Q1 08 increased 32% over Q1 07
- \$58.5BN in 81 Funds (Q1 08) vs. \$44.3BN raised in 68 Funds (Q1 07)
- \$132.7BN of PE raised in first half of '08, down 3%
- >\$362BN of Buyout and Mezzanine Funds were raised in 2007
- >\$25BN of Funds of Funds were raised in 2007
- First-half '08 VC fundraising increased 15% to \$11.5BN

Source: Dow Jones Private Equity Analyst, April, 2008, Buyoutsnews.com, July 8, 2008

## Resurgence of Mezz

- Mezzanine financing making a comeback due to recent constraints on senior and second lien lenders
- Mezz lenders now flush with capital
- Mezz lenders take a longer-term view
- New Mezz Funds (Goldman Sachs: \$20BN, TCW/Crescent: \$4.5BN, New York Life: \$800MM): equates to a first-half record
- Lenox Equity Partners has the ability to provide mezzanine capital



Source: Bank of America Capital Eyes, May/June 2008

# *Future Outlook in M&A*

## ***Key Trends Going Forward***

- Reasonable Deal Volume
- Moderating Valuations
- Foreign Buyer Interest
  - Driven by Weak Dollar
- Strong Corporate/Strategic Interest
- Flight to Quality
- Capital Gains Implications

## ***Additional Trends Going Forward***

- M&A professionals feel slightly more optimistic about the level of deal activity, although mega-deal activity is expected to decline.
- Total deal value is expected to fall 20% as private equity does not have access to low cost debt for large acquisitions.
- It's easier to stand out in a void than it is a crowd.
- More deals done for less attractive multiples for mundane businesses.
- Least attractive industries include: housing, retail, consumer and financial institutions.
- More optimism towards energy, healthcare and infrastructure.

Source: Bank of America Capital Eyes, Jan/Feb 2008

## ***Movement Towards Earn-outs***

- Two types: annual vs. single look-back
- Benchmarks should be clearly defined
- Try to include “catch-ups”
- Include mechanism for dispute resolution
- Include transparency clauses
  
- Lenox generally prefers not to use earn-outs

Source: Bank of America Capital Eyes, Jan/Feb 2008

# *Liquidity Options*

# Sale/Recapitalization Overview

- Option #1: Sale - Strategic or Financial Buyer/Investor (100% acquisition)
- Option #2: Recapitalization - Financial investor buys minority or majority ownership position

## Option 1:

### Fiscal Year 2008

(Amounts in \$000)

Revenue	\$ 37,000
EBITDA	3,700
Margin	10.0%

Acquisition Multiple (EBITDA) 7.00

Valuation of Company \$ 25,900

% of Company Sold Today 100.0%

**Liquidity Achieved \$ 25,900**

## Option 2:

### Fiscal Year 2008

(Amounts in \$000)

Revenue	\$ 37,000
EBITDA	3,700
Margin	10.0%

Acquisition Multiple (EBITDA) 7.00

Valuation of Company \$ 25,900

% of Company Sold in Recap 60.0%

**Liquidity Achieved \$ 15,540**

### Operational Changes Over 5 Years

Revenue Growth	10.0%	per annum
Margin Improvement	2.0%	
Exit Multiple	Increased by 0.5	

## Fiscal Year 2013

Revenue	\$ 60,000
EBITDA	7,200
Margin	12.0%

Acquisition Multiple (EBITDA) 7.50

Valuation of Company \$ 54,000

% of Company Sold in Exit 40.0%

**Liquidity Achieved \$ 21,600**

### Matrix of Returns in 2013

		EBITDA Margin		
		11.0%	12.0%	13.0%
Exit Multiple	6.50	17,160	18,720	20,280
	7.00	18,480	20,160	21,840
	7.50	19,800	21,600	23,400
	8.00	21,120	23,040	24,960

Note: Examples ignore outstanding debt and cash balances and are to be used for illustration only.

## *Proper Prior Planning*

- Reviewed or audited financial statements
- Strong financial and operating systems
- Correct any deficiencies on the management team
- Corporate books and records in order
- Have preliminary valuation completed to understand value of the Company

## *Execution of Plan*

- Hire experienced advisory team:
  - Transactional Legal counsel provides guidance on structure and documentation
  - Accountants provide valuable pre- and post- transaction tax advice
  - Investment Banker/Advisor brings value through experience and running a competitive process
    - Competitive process provides opportunity to find the right buyer
- Choosing the right **professionals** can make or break a deal

## *Key Take-Aways*

- Market conditions are still favorable for maximizing shareholder value through a sale or recapitalization
- There are active buyers with capital to put to work
- Value premium achieved through a competitive process
- Hire experienced advisory team

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# Challenges of Selling a Business in Today's Environment

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# *The Lenox Group, LLC*

## ***The Lenox Group, LLC - An Overview***

- **Full-Service Corporate Finance Advisory Firm**
- **Premier Advisory Firm for Transactions Below \$150 Million**
- **Expertise in Assisting Management Teams To:**
  - **Achieve liquidity - sale of the company, leveraged recapitalization or leveraged ESOP**
  - **Raise capital (debt and equity) to execute management buyouts**
- **Comprehensive Corporate Finance Services for Middle-Market Companies and Entrepreneurs**

***As a team over the past ten years, Lenox Professionals have completed over 90% of all assignments undertaken representing approximately 90 transactions and \$1 billion in transaction value***

# ***What Differentiates Lenox?***

- **Our Experience**
  - **Team of seasoned corporate finance advisors**
  - **Experts in both M&A and capital raising assignments**
- **Our Commitment**
  - **Creative solutions/results focused on client's objective**
  - **Hands on involvement throughout the process by senior team members**
- **Our Previous Track Record**
  - **>90% completion rate; 90 transactions and over \$1 billion in transaction value**
  - **Ability to execute challenging and complex transactions**

# Broad Corporate Finance Experience

## Capital Raising

**Private Equity and Debt Placements**

**Senior Debt Refinancings & Restructurings**

**Acquisition Financing**

**Going Private Transactions**

GENERAL PROCESS\*

- Analyze pricing, underwriting criteria, and structural issues
- Evaluate alternative capital sources
- Prepare descriptive memorandum
- Identify and contact prospective investors/lenders
- Price, structure, and negotiate the transaction
- Facilitate due diligence and closing

## Mergers & Acquisitions

**Sell and Buy-side Advisory:**

– Divestitures

– Recapitalizations

– Management and Leveraged Buyouts

GENERAL PROCESS\*

- Evaluate strategic and financial alternatives
- Perform valuation analysis and establish expectations
- Prepare descriptive memorandum
- Identify and contact strategic and/or financial buyers/investors
- Price, structure, and negotiate the transaction
- Facilitate due diligence and closing

## Financial Advisory

**Business Valuations (BV)**

**Fairness Opinions (FO)**

**Strategic Advisory (SA):**

– Shareholder Value Maximization Studies

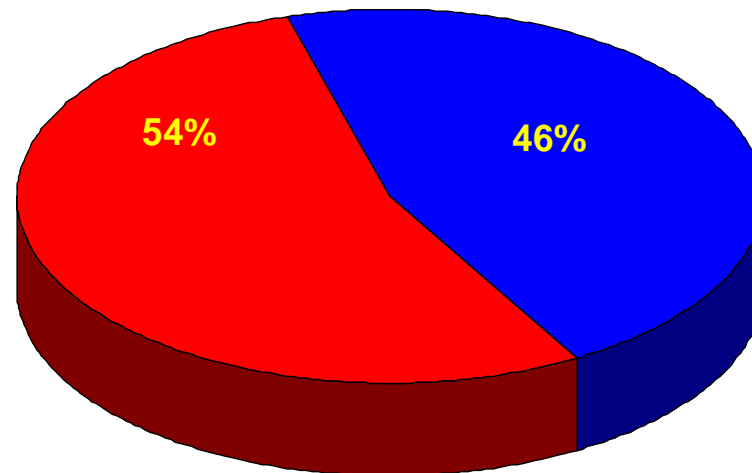
GENERAL PROCESS\*

- **BV:** Analyze historical and projected financials and current market information to establish a range of values for the business
- **FO:** Advise Special Committee to the Board by opining on fairness of transaction from a financial point of view
- **SA:** Evaluate strategic alternatives for the company and recommend and implement a strategy to maximize shareholder value

# Previous Engagements – Transaction Type\*

## Merger and Acquisitions / Financial Advisory

- Exclusive Sales
- Buy-side Acquisitions
- Mergers
- Leveraged Buyouts
- Management Buyouts
- Rollups
- Spin-offs
- Restructurings
- Divestitures
- Fairness Opinions
- Valuations
- Expert Witness

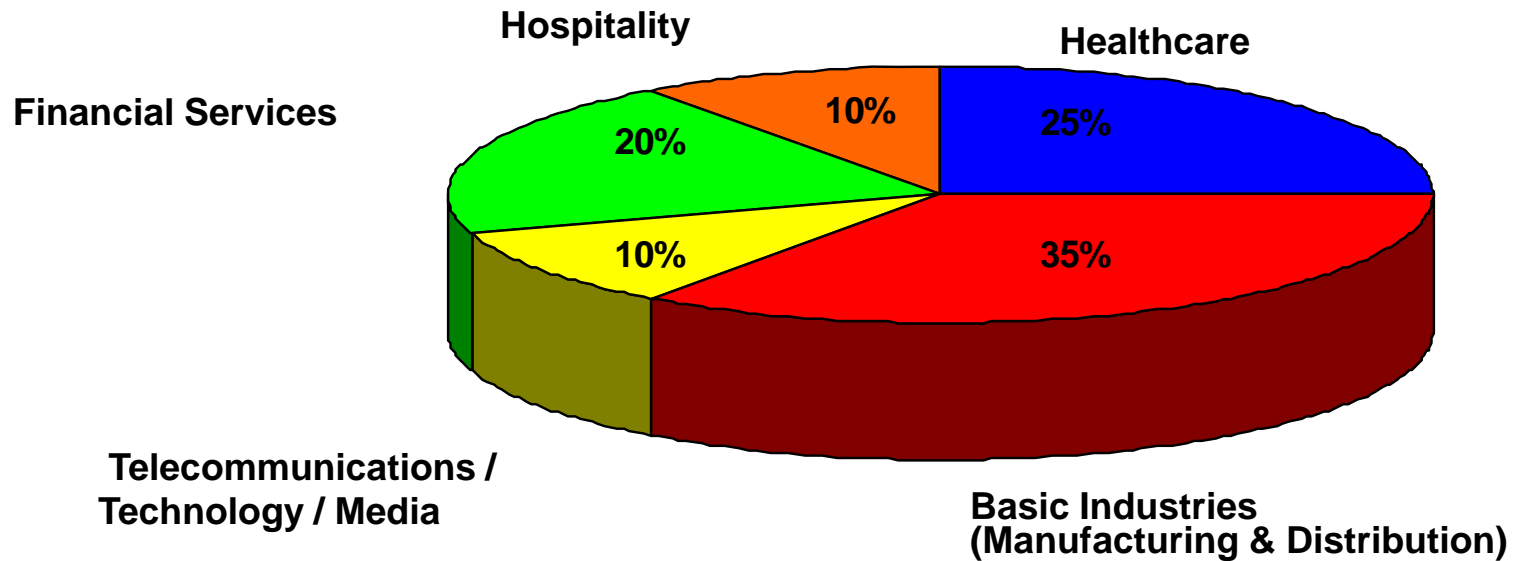


## Capital Raising

- Private Equity Placements
- Private Debt
- Public Equity Offerings
- Public Debt Offerings
- Acquisition Financing

\* Previous engagements by Lenox Advisors. Transaction type breakdown based on completed transactions

# Previous Engagements – Industry\*



\* Breakdown based on completed transactions

# Lenox's Exclusive Sale Process

**A strategically designed auction of an ongoing business, division or company to a universe of acquirers**

*We are responsible for managing the sale process and assisting in all aspects of the sale:*

- **Maintain a competitive environment**
- **Perform business due diligence**
- **Develop valuation framework**
- **Prepare Descriptive Memorandum**
- **Develop marketing strategy**
- **Formulate targeted investor list**
- **Contact prospective investors**
- **Solicit offers**
- **Evaluate offers**
- **Negotiate terms**
- **Assist in the investor due diligence**
- **Close transaction**

# Sale or Recapitalization Process

	<b>Strategic Analysis</b>	<b>Preparation/ Marketing</b>	<b>Negotiations/Due Diligence</b>	<b>Closing</b>
<b>Process</b>	<ul style="list-style-type: none"> <li>■ Evaluate current and projected financial performance</li> <li>■ Evaluate transaction alternatives</li> <li>■ Develop valuation framework</li> <li>■ Develop transaction strategy</li> </ul>	<ul style="list-style-type: none"> <li>■ Prepare Descriptive Memorandum/Management Presentation</li> <li>■ Identify/contact potential buyers/execute CA</li> <li>■ Hold Mgmt. Presentations</li> <li>■ Solicit letters of interest</li> </ul>	<ul style="list-style-type: none"> <li>■ Structure offer to value-maximize and risk-minimize</li> <li>■ Evaluate offers with respect to financial and operational implications</li> <li>■ Company/Buyer diligence</li> <li>■ Solicit final term sheets from interested buyers/investors</li> </ul>	<ul style="list-style-type: none"> <li>■ Finalize transaction terms</li> <li>■ Assist in completing definitive agreement documentation</li> <li>■ Draft all legal documents</li> <li>■ Close transaction</li> </ul>
<b>Key Points</b>	<ul style="list-style-type: none"> <li>■ Determine key value drivers</li> <li>■ Clarify owners' and management's goals</li> <li>■ Challenge projection assumptions to ensure credibility with strategic or financial buyers</li> </ul>	<ul style="list-style-type: none"> <li>■ Leverage industry knowledge and contacts to identify appropriate buyers</li> <li>■ Properly communicate key value drivers, synergies, and growth potential</li> <li>■ Create competitive process</li> </ul>	<ul style="list-style-type: none"> <li>■ Evaluate transaction structure and buyer's ability to execute transaction quickly</li> <li>■ Effectively manage due diligence process</li> <li>■ Determine net value to shareholders</li> </ul>	<ul style="list-style-type: none"> <li>■ Facilitate final documentation process among all professionals</li> <li>■ Ensure definitive agreement reflects deal terms</li> <li>■ Expedite closing</li> </ul>
	<b>2-4 weeks</b>	<b>4-8 weeks</b>	<b>6-8 weeks</b>	<b>4-8 weeks</b>

# Lenox Transaction Team

## **Thomas E. Ledford, Chairman**

Tom is a 25 year veteran in the investment banking industry. His career has been highlighted by significant capital raising experience for middle market companies. Prior to Lenox, Tom was a Managing Director for Legacy Securities Corp., where he was responsible for the firm's Basic Industries Group and a senior member of the healthcare and hospitality groups. He was actively involved in both capital raising and M&A engagements. Tom has also had significant experience in real estate and oil and gas ventures. Prior to joining Legacy, Tom was founder and served as President of Ledford Securities Corporation for 12 years which focused on capital raising for Southeastern companies. Tom was also Vice President with Equitable Securities Corporation directing corporate finance and real estate finance activities. From 1973 until 1979, Tom served as the Executive Director and Deputy Executive Director of the *Tennessee Housing Development Agency*.

*MPA, University of Tennessee.*

*BS in Business and Political Science, Middle Tennessee State University.*

## **James M. Fite, CFA, Managing Director**

Prior to joining Lenox, from 1998 to 2001, Jim was a Senior Vice President and co-head of the Basic Industries Group at Legacy Securities Corp. From 1995 to 1998, he was a Senior Consultant in Corporate Finance at Deloitte & Touche LLP where he completed over 20 merger and acquisition and capital raising transactions. From 1994 to 1995 he was Vice President of Eco-Pak Corporation where he assisted in the commercialization of a paperboard packaging concept in the beverage industry. From 1989 to 1994, Jim was Vice President of Mergers & Acquisitions at Westpac Banking Corporation where he initiated and executed merger and acquisition transactions for U.S. companies in the Pacific Rim. From 1987 to 1989, Jim was a Senior Financial Analyst at First American National Bank.

Jim is a member of the Board of Directors (Treasurer) of Pathways Community Network Inc., which provides internet based connectivity to Atlanta Social Service Agencies; President of Community Consulting Teams, an organization providing management and financial consulting to Atlanta area not-for-profits on a pro-bono basis.

*BS in Economics, Vanderbilt University. He is a CFA Charterholder.*

# Lenox Transaction Team

## **Richelle E. Terry, Vice President**

Richelle Terry joined the Lenox Group after completing her MBA at Emory University. Most recently, Richelle was a Manager in the Financial Services Division of Assurant Health, a provider of small group and individual medical insurance products, where she developed and implemented sales forecast tools and procedures to be used throughout the company's sophisticated multi-channel sales environment. She was also responsible for forecast analytics and reporting. Prior to Assurant Health, Richelle worked as an analyst in the Corporate Finance division of Imperial Capital, LLC ("Imperial"), a full-service institutional securities brokerage and investment banking firm specializing in the below investment grade market. At Imperial, Richelle assisted in the execution of a variety of merger and acquisition, debt financing and strategic advisory transactions. Prior to Imperial, Richelle was a consultant in the Business Recovery Services group of PricewaterhouseCoopers, LLP. There she worked in an advisory role in turnaround situations and participated in several challenging in- and out-of-court restructurings.

*MBA, Goizueta Business School, Emory University.*

*BS in Business Administration, Marshall School of Business, University of Southern California.*

## **Mark D. McKee, Vice President**

Prior to joining The Lenox Group, Mark worked as an Equity Research Associate at SunTrust Robinson Humphrey. There, he initially covered discount retailers and later moved to cover the financial institutions sector. In each role, he was responsible for monitoring macro-economic trends and publishing company-specific research reports. Previous to attending graduate school, Mark worked at Enterprise Capital Management, Inc. where he served as an analyst on growth, value, international, fixed income and sector mutual funds with combined assets under management of \$3 billion. He also spearheaded corporate strategy projects and conducted institutional investment manager research.

*MBA, Goizueta Business School, Emory University.*

*BS in Management, Purdue University.*

# ***Lenox Transaction Team***

## ***Todd K. Reich, Assistant Vice President***

Todd brings a unique combination of finance and marketing experience with over seven years in the investment banking industry. Prior to joining The Lenox Group, Todd was Director of Business Development for Applied Economics, LLC, an Atlanta based investment bank and valuation firm. Prior to Applied Economics, Todd held business development positions with Legacy Securities Corp., an Atlanta-based boutique investment bank, and DecisionPoint International, LLC, a boutique M&A shop focusing on technology clients. In these roles, he was responsible for originating M&A and private capital raising assignments, and developing numerous relationships with strategic and financial buyers. Todd also served as a Credit Risk Analyst for Bank of America's Financial Institutions Group, helping to maintain and underwrite a portfolio of more than \$4 billion. There, he also completed the Global Finance formal credit training program.

Todd is also an active member of several business networking groups and is a Cornerstone Mentor for the Sigma Chi Fraternity at Emory University.

*MBA, Goizueta Business School, Emory University.*

*BSBA, Kenan-Flagler Business School, University of North Carolina at Chapel Hill.*