

THE

M&A

ADVANTAGE

Summer 2008

Weathering the current credit crunch

Will your business retire when you do?
Plan now for succession and possible sale

Reverse mergers offer a
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The HR department
Your deal's nerve center



SCA

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Weathering the current credit crunch

If you're considering a merger or acquisition this year, you face a far more difficult environment than that of one year ago. The collapse of the mortgage securities market and downturn in stocks have reduced liquidity across the financial markets, resulting in fewer buyers, less capital and potentially greater expenses. Today, getting a deal off the ground requires expertise, skill, tenacity — and luck.

HARD FINANCIAL TIMES

Results from the first quarter of 2008 show what many in the M&A market had already assumed: The number of completed transactions has fallen substantially. According to Piper Jaffray, there were \$29 billion in M&A deals (212 deals) in the first quarter, compared with \$219 billion (1,147 deals) over the same period the year before.

Greater difficulty in finding financing is a major reason for the slowdown. Issuance and trading are down in markets such as bank loans, mortgage-related financing, auction-rate securities and other formerly liquid sectors. What's more, many major Wall Street institutions are trying to avoid becoming a casualty of unwise decisions and economic weakness like the now-defunct financial giant Bear Stearns. As a result, access to capital is more limited, especially for smaller, less-capitalized companies.

*Remain as flexible as possible:
Be prepared to act quickly should
a good opportunity or offer come
your way.*

CHANGING BUYERS

The credit crunch is changing conditions for buyers and sellers. For years, private equity firms represented a large segment of business buyers. Only a few tended to be strategic buyers — those that bought companies for their specific qualities,



such as lucrative markets or valuable patents, and intended to hold onto them. The majority were financial buyers that looked for undervalued targets they could turn around and sell in a few years at a profit.

Active private-equity investment was generally favorable for sellers, as it produced a large pool of competitive bidders. This environment meant many companies were snapped up quickly. No longer. If you're planning to sell, expect fewer and more focused buyers. Most of the private-equity buyers left are strategic and likely to consider your company only if it fits their larger investment strategy.

Don't forget your MAC

If your proposed target's financial standing is deteriorating, your company may need to consider a material adverse change (MAC) provision. A MAC is typically defined as a relatively rapid change that could negatively affect a business's performance. MACs might include, for example, the target experiencing a sudden, severe decline in profitability due to the loss of a major customer.

MAC clauses generally cover the period between the dates of the seller's most recent audited financial statements and the deal closing. They allow buyers to terminate or renegotiate a deal without having to pay a reverse breakup fee. Recently, private equity firm Lone Star negotiated a 22% reduction in its purchase price for Accredited Home Lenders after alleging its target had experienced a MAC.

MAC clauses also contain a list of carve-outs — exceptions and qualifications that can't be considered when determining if a seller has experienced a MAC. These include:

- Changes in the general economy that affect the target's industry,
- Changes in securities law affecting the target,
- Changes in Generally Accepted Accounting Principles (GAAP), and
- Unpredictable events such as terrorism, war or natural disasters.

Claiming a MAC isn't something a buyer should undertake lightly. But if the alternative is paying a breakup fee or merging with a suddenly ailing company, you may want to consider it.



SURVIVAL STRATEGIES

The M&A market isn't hopeless, of course. If you plan to buy or sell, consider doing the following to improve your chances of a successful transaction:

Wait for the bottom. You might want to postpone your potential acquisition or sale, if at all possible. The market may not have reached its bottom, and more dislocation is likely. Putting off an M&A for even a few months could help you avoid selling your business at a rock-bottom price or a deal whose value is dramatically reduced by the expensive debt required to finance it.

Update valuations. Because of reduced liquidity throughout the credit markets, buyers now need to finance acquisitions with a greater percentage of equity, which puts pressure on both buyers and sellers to present the best, most accurate current value of their companies. A business's value could

change by the week, so appraisals by knowledgeable professionals should be performed more often.

Be flexible. If you plan to make an acquisition or sell your business despite weak credit conditions, remain as flexible as possible. Be prepared to act quickly should a good opportunity or offer come your way. This doesn't, of course, mean you should give short shrift to due diligence. Experienced advisors can assist you in evaluating a potential deal and help you include escape clauses in your purchase agreement (see "Don't forget your MAC" above) to provide an exit.

TURBULENCE PREDICTED

Although it's impossible to predict the credit or M&A market's future, it's safe to say that you should be prepared for even more turbulence. Remember to keep focused on your core business strategy and you'll be less likely to become a casualty of these chaotic economic times. □

Will your business retire when you do?

Plan now for succession and possible sale

Research by the University of North Carolina–Asheville’s Family Business Forum found that, over the next five years, 30% of family-owned companies will experience a change in leadership due to retirement. Unfortunately, many owners put off planning for this event. According to the Family Firm Institute (FFI), more than half of family-owned business CEOs nearing retirement age (61 years or older) haven’t yet chosen their replacements.

If your business is left without a successor, it could lead to organizational chaos and disputes. And if your heirs need to come up with the money to pay estate taxes, they may jump at any acquisition offer, even one that severely undervalues the company you’ve worked hard to build.



SOONER THAN YOU THINK

The majority of companies are family-owned — 80% to 90% of all business enterprises in North America, according to the FFI. Even when they differ by industry and size, they tend to face similar issues when it comes to succession planning.

Many experience lack of good communication among founding-generation owners and second- and third-generation owners. For example, company founders may believe that their children want to take over the company, only to find that, when they seriously discuss succession, their children turn out to have other ideas.

If you’re considering a generational change in management, sit down with your heirs and all your business’s owners to discuss your — and their — plans and expectations. Do this as early as possible because, if it turns out the succeeding generation doesn’t want to assume the mantle, you’ll need time, generally years, to prepare your company for sale to an outside party.

You’ll also require plenty of lead time if an employee or group of employees have expressed interest in buying the company. If they intend to finance the purchase with bank loans or a private-equity partnership, they’ll need solid financial statements to show to potential lenders or investors.

EXPECT THE UNEXPECTED

Even if you’ve decided who will succeed you, your plans may not go as smoothly as you’ve anticipated. Premature death or disability can disrupt even the most carefully thought out succession plans, throwing a business into turmoil for some time.

Try to keep a lid on those factors you can control, by, for example, putting in place a buy/

sell agreement that dictates the terms under which potential successors can value and buy your business. And plan for estate taxes, which can wreak havoc on transition plans if you haven't anticipated their effect. Estate taxes typically are calculated based on the fair market value of a company upon the date of the owner's death. The IRS will value your company according to its own formulas — which may overvalue or undervalue your business.

Enlisting the help of financial and legal experts knowledgeable about retirement and estate planning is, therefore, essential. Your advisors can help design a plan that will enable your heirs to pay taxes associated with a business transfer. The plan could include trusts and life insurance policies.

SELLING ISN'T A SURE THING ...

Even if you've decided to sell your business when you retire, your plans can be disrupted by factors outside

your control. Poorly performing capital markets, for example, could reduce the number of prospective buyers, making it difficult to sell or get what you consider a fair price for your business.

Investment bankers and brokers who specialize in small and middle-market companies can help you minimize this type of risk. They can guide you through the often-complicated process of coordinating your retirement with the company's sale, and address your retirement income, wealth management and estate planning needs.

... BUT RETIREMENT IS INEVITABLE

Failing to plan for succession can put your company's future — and even your financial security — at risk. Although you can't anticipate every eventuality, planning your retirement now will provide your heirs and successors with a roadmap to navigate the rocky terrain of an ownership transition. □

Reverse mergers offer a strategic alternative to IPOs

Thinking about going public, but concerned about the state of the securities markets? If so, consider a reverse merger. Regarded as an easier and less expensive alternative to an initial public offering (IPO), reverse mergers have never been more popular.

ACTIVATING A DORMANT COMPANY

A reverse merger occurs when a privately owned business merges with a public — typically dormant — company that serves as the deal's "shell." The shell company officially buys the private company by issuing new publicly traded stock. Then, the private company acquires a majority stake (as much as 90%), contributing all of its privately traded shares to the shell company.

At the end of the deal, the private company owners have majority control of the newly merged companies. They now can issue publicly traded shares without having to go through the IPO process.

ILLUSTRIOUS HISTORY

Reverse mergers have a long history. Ted Turner's Turner Broadcasting System is the result of a 1970 reverse merger with Rice Broadcasting. And a host of major companies, including RadioShack Corp., Occidental Petroleum Corp. and Blockbuster Inc., all have their origins in reverse mergers. More recently, hedge fund Halcyon Asset Management and Web-based publisher Fund.com have successfully completed the process.

Reduced cost and increased speed are among the top reasons to consider a reverse merger.

Reverse mergers enjoy broad popularity among companies of various sizes and industries. In 2007, 222 reverse merger transactions were completed, with an average deal size of \$55 million. Compare

that to the 234 IPOs completed last year, with an average deal size of \$229 million.

SPEED AND ECONOMY

One reason for the rapid growth of reverse mergers is that they're generally faster and cheaper than IPOs. A reverse merger's base costs can be as low as \$75,000, compared with an average \$200,000 tab for a similar-size IPO. Of course, you'll also need to factor in fees and the cost of purchasing a shell company, for a total bill in the \$200,000 to \$900,000 range.

And reverse mergers sometimes can be completed in as little as a few weeks, compared with the six-to-12-month IPO process. Much of the grunt work, such as finding an investment bank underwriter and registering with the Securities and Exchange Commission (SEC), was already done by the shell company when it went public.

PICKING UP THE PERFECT SHELL

If you think your company should go the reverse merger route, it's critical that you find the right public shell corporation. The company should have no assets or liabilities on its balance sheet and no pending lawsuits, liens or other legal claims against it. Yet it should remain a legitimate, SEC-registered entity. Once you've found an appropriate shell, you'll need to raise additional capital. Companies might offer private placements, place new bond issues or make secondary stock offerings.

You'll also need to get up to speed on SEC reporting requirements, tax regulations and legal documents required for a deal with a public company. For example, you'll need to file at least two years of audited financial statements a few days after merging with an SEC-compliant shell. If your current advisors don't have much experience with public compa-

nies or reverse mergers, enlist the help of financial and legal professionals who do.

Once you've completed the deal and traded shares with the shell, your business will officially become a wholly owned subsidiary of the former shell company. But you'll control the new entity, and will likely want to change the name of the shell to your own company's.

WHY DO IT?

Reduced cost and increased speed are among the top reasons to consider going public via a reverse merger. But there are other strategic reasons as well:

Stock options. If your company wants to compensate employees with stock options without initiating a public offering, a reverse merger can provide you with a ready supply of public stock.

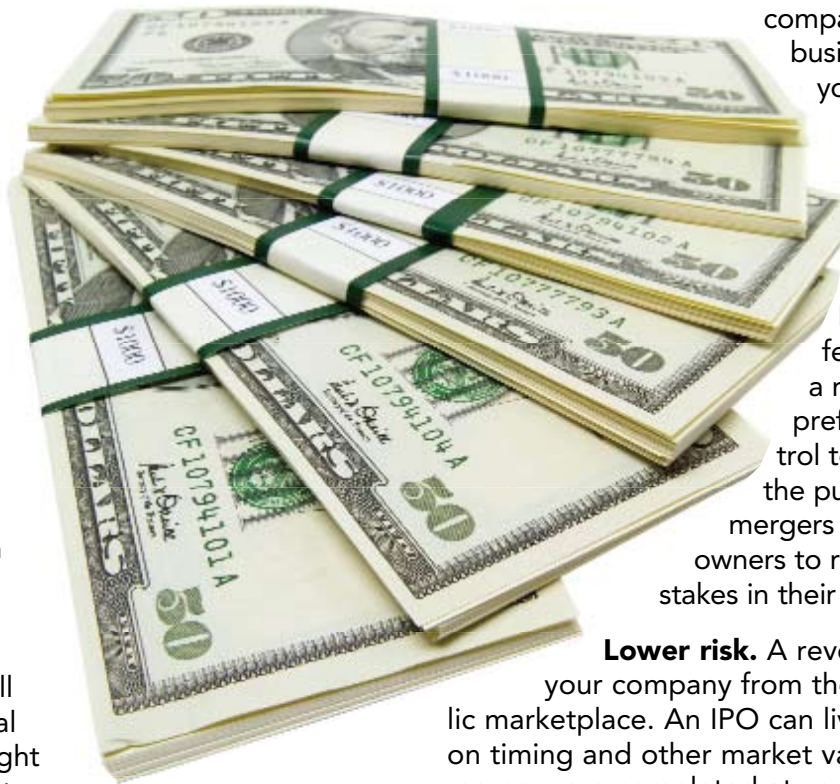
Acquisition financing. If your company intends to make business acquisitions, you could use a reverse merger to access publicly traded stock that can then be used to finance deals.

Retaining a majority. If your private company fears ownership dilution, a reverse merger may be preferable to losing control to outside investors in the public market. Reverse mergers allow private company owners to retain large majority stakes in their companies.

Lower risk. A reverse merger protects your company from the whims of the public marketplace. An IPO can live or die depending on timing and other market variables, but reverse mergers are completed at your pace and are under your control.

FUNDING FOR GROWTH

If you need to be able to offer public shares to pursue your growth plans, but would prefer to avoid the risk and expense of an IPO, a reverse merger may just be the ticket. Selling off your company — at least on paper — can make you the owner of a company with the possibility of much greater potential. □



The HR department

Your deal's nerve center



When you merge two companies, your human resources department is the deal's nerve center. HR has the potential to ensure a merger runs smoothly and efficiently — from the planning stages through integration.

COMMUNICATING CHANGE

HR professionals are best positioned to communicate an impending deal and its ramifications to employees. Rank-and-file employees, in particular, are likely to be nervous about potential layoffs, wage cuts or changes in benefits. Without adequate information, staff members spread rumors, which can reduce productivity and even threaten your deal.

Your HR department can help prevent organizational instability by taking these steps:

- Provide detailed information about upcoming changes, such as workforce reductions and facility closings, as soon as it's safe to publicly reveal it.
- Give laid-off employees assistance, which may include severance packages and help finding new jobs. If your company bungles any terminations, it's likely to alienate those employees you hope to retain and it sends a negative message to staff you may be acquiring as part of the merger.
- Work to strengthen your company's bonds between employees and management by making sure both parties are in regular contact with each other and that management's plans are adequately explained to — and understood by — employees.

Don't let your HR officials devote all their time to benefits restructuring and payroll charts. Instead, they must become the face of your company to internal stakeholders. Employees need to feel comfortable approaching them with questions and concerns, and not worry that HR only represents the interests of upper management. Encourage HR staff to have "open-door hours," during which employees can stop in and talk.

INVESTIGATIVE MISSIONS

HR personnel are well qualified to evaluate merging corporate cultures and ascertain the quality of employees being acquired. While your accounting personnel are going over the target company's financial assets, your HR staff should be doing the same for the company's human assets: examining prospective employees; ranking them according to longevity, expertise levels, productivity and performance; and then determining which employees are the most critical to retain.

HR staff should meet with every prospective employee, not only to get to know them, but to obtain a sense of cultural differences. Are employees dressed more formally or informally than your current employees? Are they accustomed to a centralized or unstructured environment? Have they been unhappy with any of their company's policies or decisions? These questions are likely to elicit valuable insight into how best to combine the two companies.

RECEPTIVE TO NEW IDEAS

Your HR department must also be open to changing its own practices. The staff should meet with their counterparts at the target company to learn what has worked for it — ranging from work schedules to health care plans to incentive programs — and determine which policies to implement in the combined organization.

To make the many tasks involved in a merger manageable, HR officials need to set clear, short-term goals, such as dates when specific departments will be integrated. And they should publicize the achievement of these goals so that employees feel the process is going according to plan and will be free of surprises going forward.

THE PUBLIC FACE

For employees experiencing an M&A, there's no such thing as too much information. Let your HR professionals manage expectations and help integrate cultures. □

COMPLETE SOLUTIONS

Sunbelt Corporate Advisors expertly facilitates the transaction from start to finish. We represent the seller, source the buyer, and negotiate the deal.

Our most recent success stories include:

- Industrial Equipment Manufacturing business sold to a Public Company Strategic Buyer
- HVAC business sold to a Public Company Strategic Buyer
- Engineering services firm sold to a private investor
- Specialty Manufacturing Business sold to a Private Equity Group
- Financial Staffing Firm sold to a private investor

PROFESSIONAL ASSOCIATIONS

SCA Advisors is a member of the Association for Corporate Growth, Alliance of Mergers & Acquisitions Advisors, and M&A Source

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SCA Advisors manages transactions using the proprietary ClearView process, which is designed to maintain deal integrity and assure positive outcomes for all parties.

EXECUTIVE BIOGRAPHY

Managing Director: Dan Elliott has over 15 years experience representing owners of privately held businesses. Mr. Elliott has successfully negotiated the sale of businesses to Private Equity Groups and Strategic buyers. Focused on representing business owners located in Texas and New Mexico, Mr. Elliott has identified and completed transactions with buyers from throughout the U.S. and internationally. Mr. Elliott can be contacted at 832.476.9560.

