A FASTER AND BETTER WAY FOR BUSINESS OWNERS TO CONNECT WITH BUYERS

Maxi-AUCTION℠ WHITE PAPER

By: Huxley Nixon

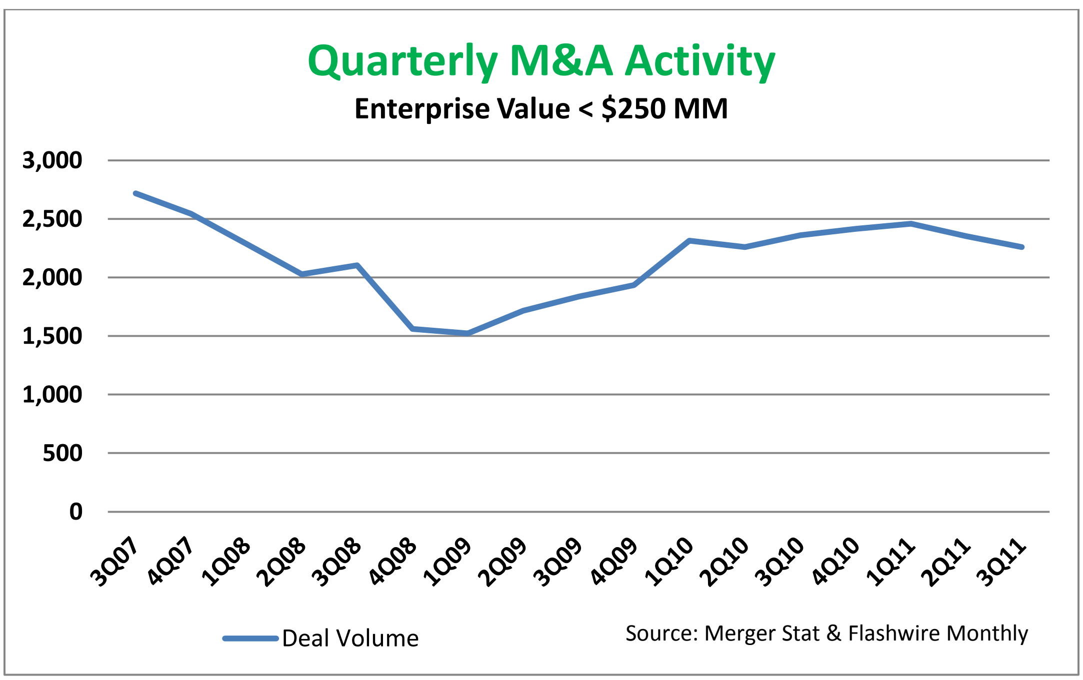
The M&A MARKETPLACE by CHC℠'s goal is to create a more level playing field for the closely held family business owner and provide financial buyers and investors with an additional deal flow channel of attractive Middle Market companies they otherwise would not see.

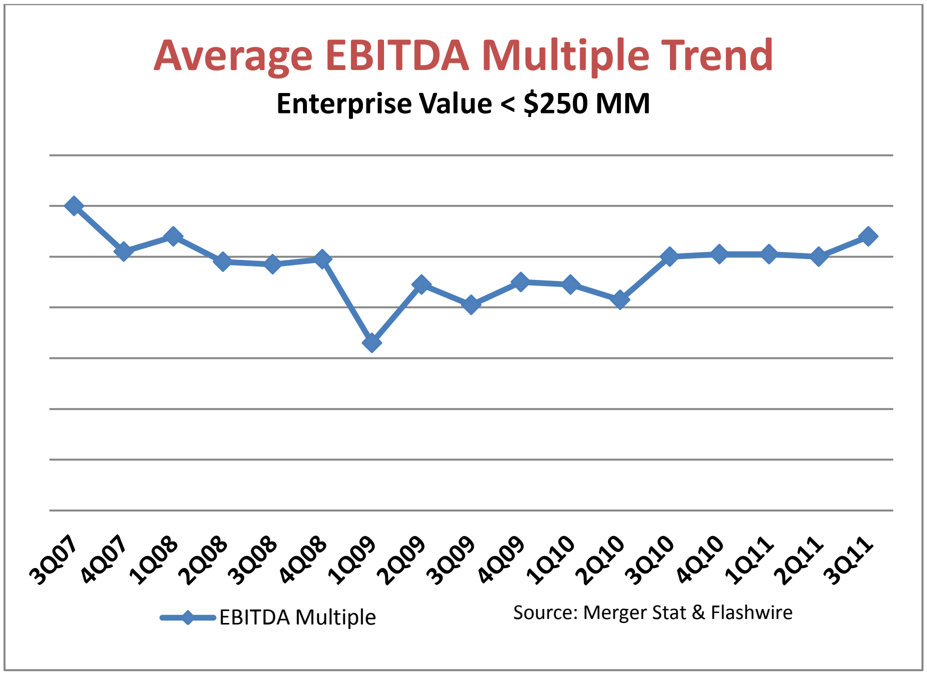
CURRENT ENVIRONMENT

Economy:

The author has not seen a more uncertain economic environment in his lifetime than the period between September 2008 and today. While credit markets are no longer frozen, there has been a flight to quality, transaction terms are more restrictive and will remain so for the near future. With less money available from commercial banks, mezzanine funds have come back to bridge the funding gap between equity and senior debt, seller paper is more common and valuation multiples have dropped but demand for top tier companies in growth markets remains very strong and still demand premium pricing.

Is it foolish to think about M&A transactions in a capital-constrained environment? Q1 2009 appears to be the bottom for M&A activity both in number of transactions, deal size and valuations.





Strategic investors dominated the M&A landscape in 2009 and most of 2010 but private equity funds are sitting on over $500 BN in cash and are starting to more aggressively get back into the market by being willing to accept much lower initial leverage. The average equity invested by financial buyers increased from 28% in 2007 to 51% in 2009. In a recent survey of 137 private equity funds, approximately 5% invested 90% to 100% of the total invested capital in transactions closed in 2009[1]. Private "Middle Market" companies below $500 million in transaction value with stable earnings will be where the action is according to a consensus of numerous experts. For the above-mentioned reasons plus the uncertainty about future capital gains tax and interest rate increases, they see a continuation of the upward trend in M&A activity through 2012.

Owners sell for a variety of reasons unrelated to general market conditions (i.e. death or illness of a founder, divorce, burnout, diversification of net worth risk by the owner(s), changing industry environment, etc.). Strong willed entrepreneurs built these companies and typically are more conservative when it comes to using debt, thus creating stronger balance sheets and more stable earnings in economic downturns. 2010 through 2012 should be an excellent time to sell for the privately owned company that has stable earnings, strong management and growth opportunities. For the rest it is an excellent time to get their personal and business house in

[1] Pepperdine University Graziado School of Business and Management, Private Capital Markets Project, Survey Report II – Winter/Spring 2010.

order, pick up strong management talent, buy weaker competitors, diversify product offering(s), and improve internal management and financial systems. (Take the Maxi-QUIZ℠ TO SEE IF YOU ARE READY- link: http://mamarketplace3.businesscatalyst.com/html/maxiquiz.html)

Middle Market M&A Landscape:

The U.S. is about to witness the largest transfer of family owned businesses in history. There are 10.8 million private companies run by the founder/descendants. They represent 58% of the workforce, and 59% of the Gross Domestic Product[2] in the U.S. Only one third of all family businesses survive as such to the second generation and only 12% make it to the third generation[3].

The leading edge of the Baby Boomer wave in this community is now reaching retirement age and since January 1, 2011 there are approximately 14,000 turning 65 daily. This will continue through 2025. Two million of these businesses have revenue of between $10 million and $50 million[4]. Over the next 15 years a very large number of businesses will transition to a new owner though a sale to a third party or middle management.

The advent of Sarbanes-Oxley and the expense of compliance coupled with separation of the research function and sales/origination functions of brokerage houses have all but killed The IPO Market as an exit option, except for very large companies in better times. The average amount of equity raised in an IPO in 1999 was $10 million; in 2006, this average was $246 million[5]. Even in good economic times, an IPO is no longer an option for the vast majority of these companies. As a result, the most likely exit for these business owners is a private sale transaction or a recapitalization of the company (which today is much harder to do with just debt).

Potential buyers can be broken into two camps, **strategic** and **financial**. Typically, both are larger and more knowledgeable about the M&A process than is the seller and have usually has greater resources. The legal negotiation process can be very confusing and appear adversarial and less sophisticated participants of a transaction are at a severe disadvantage. The buyers are very familiar with the current M&A process whereas the sellers ***only sell their company one time.*** This unfamiliar process can be viewed by them as lengthy (six to twelve months or more), intrusive and expensive. Historically, a large percentage of these sellers do NOT hire a professional investment banker, with knowledge and experience in these types of transactions,

[2] Family Business Review, vol. XVI, no. 3, September 2003 © Family Firm Institute, Inc.
[3] *Family Firm Institute, Inc.*
[4] Prospect Partners.com
[5] Source: Capital IQ

thinking they are saving money on transaction fees but failing to understand the true cost to them in lost value and emotional angst.

Buyers:

In 2006, financial buyers represented approximately 30% of the total US M&A market activity in dollar volume and they were sitting on an estimated $150 billion in dry powder[6]. By the end of 2007, there were over 8,000 financial buyers and they owned 25,000+ private companies[7]. After dropping to 15% of all M&A transactions in 2009 financial buyers represented 18% in the 1st half of 2011 and they are sitting on approximately $500 billion in cash[8]. Thus, these financial buyers are becoming more like the strategic buyer and can respond more rapidly and should be very active through 2012.

The M&A MARKETPLACE by CHC℠ is targeting financial buyers. In the current market environment, only firms that are willing to do transactions with very conservative amounts of debt will be successful. Financial buyers are comfortable in paying fees, which are factored into the ultimate price they are willing to pay the seller. Most importantly, they usually need the management, employees and facilities of the seller versus the strategic buyer, who is interested primarily in the seller's customers, revenues and any proprietary IP, processes, or technology it might possess.

In a perfect world, the buyer prefers to avoid a competitive process that can drive the price higher and potentially increase the chances of losing the deal. In the case of a less sophisticated seller, this thinking is flawed. Their unfamiliarity with the process and current market metrics will cause them to be more likely to "walk" on what might be a very fair deal for them where a competitive environment adds legitimacy to the result and confidence to the seller. The exception to this is where the buyer has gained the "trust" of the seller, but getting to know the individual business owner and gaining his trust can be a very difficult and long process, which is not very efficient.

Therefore, most financial buyers have some sort of business development function to help create deal flow by trying to develop relationships with a variety of intermediaries/professional advisors that identify potential sellers. However, most do not know their TRUE "development" costs!

[6] Source: Thomson Research
[7] Source: Private Equity Info.com
[8] Pepperdine University Graziado School of Business and Management, Private Capital Markets Project, Survey Report II – Winter/Spring 2010.

If the financial buyer is successful in getting the investment banker to include them on the target list, it is usually through a "broad auction" process where one hundred or more potential buyers are contacted. These odds are horrible for the buyer and for the seller the opportunity can get "shop worn". Based on conversations with a cross-section of private equity groups revealed that in the 2007 – 2008 timeframe, the success rate as percentage of deals/opportunities presented versus transactions actually closed ranged from a low of less than one half (1/2) of 1% to 3%. Annual development costs (review and closing costs) for a very large private equity fund was approximately $12 million (not counting any fees to intermediaries). Clearly, this is not an efficient way to source new business.

Since every buyer's money is "green", it is very difficult to differentiate competitors when literally thousands of buyers have identical investment profiles. While there may be some differences based on industry focus, size of transaction and risk profile all have the same approach to reach sellers – professional intermediaries, direct marketing, professionals such as CPA's and attorneys and conferences.

However, in the last few years a handful of financial buyers have adopted cash flow acquisition models. These firms are typically private funds that have a long-term investment horizon and put very little debt on the company. They manage it with the goal of maximizing cash flow and they dividend out a good portion on the profit annually. During this time of great economic uncertainty, these buyers are well positioned compared to the private equity firms that are seeking to maximize its IRR with high debt levels.

Many private equity funds are Limited Liability Partnerships ("LLP") to provide some level of liability protection to the passive investors, which are large pension funds, insurance companies and endowment funds. These partnerships usually have a ten-year "sunset" provision that shortens their holding period and reduces their flexibility. These funds will have to adapt to the de-leveraged environment by investing more equity, get the seller to accept subordinated notes for part of the purchase price or they will not be able to conduct business.

MOST private equity firms that raised new funds in the last "boom" cycle were closed in 2007 and like to allow 3 – 5 years to acquire, grow and exit an investment. The lifecycle midpoint of these firms representing $500 MM of idle cash (earning virtually zero percent) is the end of 2012. This also coincides with the ever increasing supply of businesses entering the M&A market and the expiration of the Bush era tax cuts (LT Capital Gains rate increases 33%, from 15% to 20%). We have not discussed the huge deficits, gasoline prices or pressure to increase taxes and raise interest rates in the future - but they will not help the market. For the quality company ready to sell it will be a seller's market through the end of 2011. Even though many firms are still waiting to get back the previous high-water mark of the last growth cycle, now through the end of 2012 may be the good-old-days for the next decade. At least owners not ready to completely exit should be considering hedging their bets by taking some chips off the table.

The M&A MARKETPLACE by CHC℠ has created a buyer pool of 30 financial buyers based upon a diverse set of criteria. From this universe, never more than ten (10) firms familiar with the seller's industry will review the opportunity. This streamlined process will not waste the buyer's resources in reviewing opportunities that do not meet their criteria, thus helping create a more efficient market for all.

Sellers:

Most sellers do not plan for the sale of their companies.
Often it is thrust upon them due to personal issues or when an unsolicited offer is presented to them. A large percentage of these sellers will not hire professional Investment Bankers to assist them in this once-in-a-lifetime event.

Some sellers try to negotiate directly with a buyer without the assistance of experienced advisors on their team. Frequently this leads to failed transactions because they have unrealistic expectations (price, terms, etc.). Many times their "trusted" advisor is a long time friend or business peer who means well but is frequently not knowledgeable when it comes to understanding current market dynamics, processes and best practices. Thus, when an impasse occurs during negotiations, the seller is at a severe disadvantage in an unfamiliar arena and frequently results in them walking away feeling frustrated about the process even though they might have been offered a fair proposal. Thus, both buyer and seller lose.

If a large percentage of these sellers do not hire investment bankers to assist them, where do they turn?

Many turn to a devil they know versus one that they do not - the "friendly" competitor. The seller rationalizes this decision because he knows this buyer is highly motivated to maintain confidentiality, understands the seller's business (thus making the diligence much less painful), and he typically knows the buyer personally from years of competing against each other. This translates into a "*higher trust"* and awareness factor, the seller feels the buyer will treat his employees fairly, but frequently must accept a lower price than he might have received had he gone through a competitive process. Clearly, this is not a way to optimize value for sellers.

However, the BIGGEST downside occurs if the transaction does NOT close. The seller has just disclosed his most sensitive information to a competitor that can severely hurt him in the marketplace and lessen his attractiveness to other potential suitors.

Advisers:

Investment Bankers ("IB") are the most likely to feel threatened by this market approach but should not be. The author has been in the financial world for the past thirty years and has bought and sold companies as a principal and he has served as an intermediary to assist scores of middle market companies to raise capital, buy and sell companies. He understands the frustrations of all parties involved in this process.

A good IB can definitely add value for the seller but if they are not able to establish the necessary "trust" with the seller, they seldom will be hired.

Thus, in a situation where they were not going to receive anything for their marketing efforts the M&A MARKETPLACE by CHC℠ can be an alternative for the IB where they can receive a referral fee or serve as a consultant to advise the seller about the process and market.

Attorneys and accountants that represent these sellers now have an alternative to suggest to their clients that is a safe way for them to navigate these fearful waters and still involve them in the process.

Any group that directly or indirectly provides services or products that target the buyer or seller will have a *forum to help inform and educate as to "best practices" in their specific arenas when it comes to the need for PLANNING for this MOST important event in the seller's business/personal life.*

CHALLENGE

How can the playing field be leveled and the process made fairer for both sellers and buyers?

SOLUTION

Technology and Transparency

By using the power of the Internet to help reach the business owner and/or their "trusted adviser", the M&A MARKETPLACE by CHC℠ has created the *"Maxi-AUCTION℠"* to provide a powerful go-to-market alternative at virtually no financial risk to the business owner serious about a transaction. Having access to the best databases to identify key opinion leaders, advisers and the best buyers (on a global basis) to participate in the master buyer pool, the M&A MARKETPLACE by CHC℠ will eventually create an interactive portal open to all those involved in this community. Initially, it will inform and educate sellers through its website and use of social media (LinkedIn) and will provide access to leading experts in a variety of disciplines (e.g. attorneys, accountants, psychologists, investment bankers, lenders, buyers, educators, sellers, wealth managers, top financial consultants, valuation experts, etc.).

Our proprietary auction process (the "Maxi-AUCTION℠") provides a unique tool that allows for a very confidential, efficient and fair alternative for the seller who is unwilling to hire a professional investment banker to represent him.

Buyers, through this very efficient process can identify those pre-vetted quality private companies for sale with between $10 million and $500 million in revenues. The Maxi-AUCTION℠ provides a win/win solution for both the buyer and seller and will provide cash flow to the M&A MARKETPLACE by CHC℠ to help propel its growth and awareness to the community.

Maxi-AUCTION℠ Options:

Maxi-AUCTION℠ RECAP

For the owner who is not ready to give up CONTROL but wants to take some chips off the table to diversify his asset holdings or do some estate planning, the equity re-cap Maxi-AUCTION℠ is an excellent solution. This pool of proven institutional investors focuses on the long-term and understands that to build TRUST with the owner they must demonstrate their willingness to be a partner first by buying a minority stake in the company.

Maxi-AUCTION℠ SALE

When the owner has decided to sell but does not feel comfortable with hiring an Investment Banker, the proprietary Maxi-AUCTION℠ SALE establishes a fair, swift, uncomplicated, competitive and VERY confidential sales process for qualified sellers. It provides the pool of financial buyers an semi-exclusive "first-look" at an opportunity to pursue a transaction with a motivated seller that meets the buyer's investment criteria.

In both of the above Maxi-AUCTION℠'s, all auction-closing fees are borne by the investor/buyer.

Key Features

- VERY CONFIDENTIAL - maximum of ten (10) qualified buyers would be in the buyer pool for a given auction, the seller is not identified until a Confidentiality Agreement is in place and the buyer is made aware of the "essential" deal requirements of the seller.
- QUICK -
    - at least one Letter of Intent ("LOI") meeting the "essential" seller requirements must be issued within 30 days from the time the pool participants receive the “teaser” or the seller is released from the "exclusivity period" obligations and can terminate the process; otherwise,
    - Closing must occur within 90 days* from signing of an LOI.
- COMPETITIVE – Limited number pre-qualified buyers, knowledgeable about the seller's industry and have a proven record of accomplishment of prior acquisitions with the ability to CLOSE in the current market.
- NO RETAINERS or SUCCESS FEES due by seller - if you are a "serious" seller, there is virtually NO financial risk to you! Buyer/investor pays all Maxi-AUCTION℠ closing-fees.

*This time line is subject only to delays for regulatory approval or other events beyond the control of the buyer and seller.

CONCLUSION

Regardless of our current economic environment, huge numbers of owners of private, family owned companies still will want to take some or all of their chips off the table over the next fifteen years. In addition, there are more buyers today than ever in our history with trillions to invest. The rules have changed but for those who adapt, they will reap huge rewards. The Maxi-AUCTION℠ provides the buyer/investor participating in the pool a “first call” on quality, pre-vetted deals they typically would never see. It will also provide the owner a competitive price and remove much of the “angst” out of this very unsettling process by adding transparency and fairness.

December 3, 2011

Background

The founder of the M&A MARKETPLACE by CHC℠, Huxley Nixon, comes from a family of entrepreneurs and he has co-founded or founded three businesses and has been in the financial services arena for the past 30+ years. Through Concord Hill Capital, Inc., which he started in 1989 as a merchant banking firm, he has served as a principal and intermediary to middle market private companies. He has completed more than thirty-five transactions in the corporate finance, venture capital and M&A arenas and has raised $1 billion in capital for his clients.

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For discussions on topics of interest to business owners considering a transition in the next five to ten years go to for HUXLEY'S Blog: WWW.SELLYOURCOMPANY.ORG

Some of the posts are:

"President Signs Debt Bill – What NOW?"
"When is the BEST Time to SELL?"
"How valuable is a COMPETITIVE process"
"Want to SELL Your Company in 120 days?"