Vol.1 No. 2

# Acquisition MarketPlace Review™

"Successfully acquiring a business is not an event, it's a *process*. The process begins with the formulation of your goals and criteria and does not end until you have closed the transaction and obtained the anticipated benefits."

– Bob Machiz
President
MoneySoft, Inc.

*As long as capital is plentiful, interest rates remain low, and stock values "relatively high," the cost of capital should generally favor acquisition activity.*

## M&A Activity Update: Dollar value of deals skyrockets

The M&A statistics for the first half of 1998 are available. The mega-dealmakers have been very busy. According to Mergerstat (a division of Houlihan Lokey Howard & Zukin), the value of deals announced in the first six months of 1998 broke all previous records. With six months remaining in FY98, dealmakers have already chalked up a staggering $773 billion in transactions. That shatters the previous record of $657 billion set in FY 97—and there are still six more months to go. In addition to breaking the all-time record for transaction values, 8 of the 10 largest deals in US history were announced during the second quarter of 1998! (At the time of this writing, British Petroleum and Amoco have announced a proposed merger that will have a market capitalization of $110 billion and GTE and Bell Atlantic have announced a proposed merger valued at $52 billion. The second half of 1998 is off to a strong start.)

Two industries lead the way: Banking/Finance and Communications. There's no doubt that deregulation in both banking and telecommunication is fueling the market. In addition, it seems that one deal begets another. As one billion-dollar firm buys or merges with another, a new giant is created. This sends competitors scrambling for a deal, a case of "keeping up with the giants." Deal activity is also spurred by classical motivations such as adding customer base, scope of available services, strategic resources, and global infrastructure. All things considered, technology may be playing the leading role in stimulating deal activity in the Banking/Finance as well as Communications sectors due to the expense of network technologies and need for a customer/subscriber base.

Will mega-merger mania continue? For a while, but eventually most of the large targets in the Banking/Finance and Communications sectors will have been acquired or merged. Perhaps regulatory changes, new technologies, or shifting markets will drive other sectors into the urge to merge, but they may not have the vast assets of the Banking/Finance and Communications behemoths.

Despite the tidal wave of mega-deals, the number of announced deals as reported by Mergerstat has grown at a modest rate of 6%, from 3,650 during the first six months of 1997 to 3,890 for the first half of 1998. Middle-market players take note: Mergerstat's statistics show a decrease in the number of announced transactions valued at $500 million or less. Such activity is down by 20.3%, from 911 during the first half of 1997 to 726 for the same period in 1998. These stats do not include private and unannounced transactions.

Does this indicate a slow down in M&A activity? Maybe, but as long as capital is plentiful, interest rates remain low, and stock values "relatively high," the cost of capital should generally favor acquisition activity.

## DEAL FLOW: A veteran dealmaker's perspective

Thomas H. Lee, one of the acknowledged masters of the LBO, was recently interviewed on CNBC. To the credit of the program host, the interview went beyond the usual atmospherics and preoccupation with transaction size, and delved into some of the arcane aspects of doing deals. During the interview, Mr. Lee indicated that his buy-out fund looks at 1,200 deals a year. These are all friendly candidates (as opposed to hostile takeovers). From the 1,200, they might find 300 deals to review. Based upon their evaluation, they would bid on 50—less than 5% of the deals that are brought to them. Out of the 50 deals they bid on, 5 may actually close. Now, that's looking for the proverbial needle in the haystack!

Mr. Lee is indicative of many of the buy-out mavens. They all know that one of the critical elements of an acquisition program (for both financial and corporate buyers) is developing and maintaining a steady flow of deals and being able to sift through those deals to find the ones that most closely match their criteria and are worth pursuing.

# Finding Deals and Managing Deal Flow with Help From MoneySoft

If you are interested in increasing your deal flow and effectively screening potential acquisitions, MoneySoft has three software solutions that will make your life easier and allow you to use your time more effectively:

**Lightning Deal Reviewer®** Helps you clarify your vision, strategy and goals and quickly sift through acquisition candidates with preliminary information about the target. Perfect for that "first pass" analysis of a prospective acquisition. Allows you to react quickly and stay ahead of competition.

**M&A Opportunity DataBank™** The most extensive and deal-rich database available that is dedicated to the middle market. The current issue contains over 1,400 companies that are actively seeking to be acquired. The database is searchable according to your industry, sales revenues, and geographic preferences. (Updated every quarter.)

**M&A Advisors DataBank™** A searchable database of investment bankers, merger and acquisition specialists, business brokers and advisors who specialize in middle-market deals. These intermediaries are an excellent source of deal flow and most provide value-added services such as valuations, due-diligence, and acquisition planning.

Please call the MoneySoft product information desk at 800-966-7797 for additional information about how to increase your deal flow. Be sure to ask about <u>*special pricing and competitive upgrade offers.*</u>

## MoneySoft Programs Are Year 2000 Compliant!

Much has been written and said about the Year 2000 Bug, an amazingly big problem caused by such a little programming practice: the 2-digit dating convention. The 2-digit dating convention dates back to the 1960s when processor and storage memory was very limited. To reduce the size of programs, programmers started the practice of dropping the first two digits of the year. So, "1900" became "00." Unless modified in advance, programs using the 2-digit convention do not distinguish between 1900 and 2000 because both read "00." If programs and microprocessors are not corrected or replaced prior to the year 2000, systems may crash and data may become corrupt.

An article in Business Week (March 2, 1998) estimates that two-thirds of all large companies have not resolved the Y2K problem. The number of unprepared smaller firms is believed to be significantly higher. If you are concerned about the Y2K problem, you might want to obtain a copy of McAfee's "2000 ToolBox." This find-it-and-fix-it tool automatically performs a complete audit of your Windows 95/98 hardware, software, and data files.

You can reach McAfee at (800)-338-8754 or visit the website at http://www.mcafeemall.com/mall/mcafee/2000tboxemail/.

With respect to MoneySoft's products, we are pleased to report that they are Year 2000 Compliant. All of our Windows programs use a 4-digit dating convention.

## NEW! Just released...

# Prepare Professional Valuations and Presentations with Corporate Valuation™ Software from MoneySoft

MoneySoft announces the immediate availability of Corporate Valuation™, the newest program in the Acquisition MarketPlace™ family of products and information resources. The Acquisition MarketPlace is a suite of software and information resources designed to make each critical step in the acquisition process as efficient and profitable as possible.

Corporate Valuation is a powerful and flexible solution for professionally analyzing and valuing closely held corporations. Business buyers, sellers, and their advisors can use Corporate Valuation to quickly evaluate a business or prepare a professional appraisal. As compared to Buy-Out Plan, which is very narrow in its focus of preparing acquisition-related analysis, pricing, deal structuring and financing plans, Corporate Valuation can be used for a wider range of valuation assignments in the areas of corporate finance, personal financial planning, taxation, and litigation support. Please review Figure 1 on the following page, which lists the various types of assignments that Corporate Valuation can be used to successfully complete.

## A Knowledge-Based System

In developing Corporate Valuation, the members of our development team drew from their extensive experience in M&A, valuation, and developing valuation software. Some of our team members have consulted with the Internal Revenue Service in order to review the appropriateness of valuations and business appraisals submitted to the IRS. In our experience, we found that any problem with a valuation is likely to show up in one or more of the following areas:

1. The analysis of the present position of the company and it's true economic earnings.
2. The outlook for the company and assumptions regarding future performance/earnings, and how well these assumption link with the historic performance of the company.
3. The adequacy of working capital or credit capacity to meet the future assumptions.
4. The selection of appropriate risk rates, capitalization rates, and discounts/premiums.
5. The selection and application of the valuation method(s).

> *Corporate Valuation is a powerful and flexible solution for professionally analyzing and valuing closely held corporations.*

Some business valuations are prepared using "home grown" spreadsheets or limited, inflexible valuation software programs. The time spent writing and managing spreadsheets can become an "activity trap" that distracts the analyst from the important and critical elements of a sound valuation. Unfortunately, the majority of third-party programs, despite their promises, lack the power and flexibility to prepare an effective valuation. While, these programs typically automate the calculation, they tend to be difficult to use and understand, have rigid data entry procedures, limited forecasting capabilities, and nominal reporting facilities. They just don't have the horsepower to prepare a solid valuation.

MoneySoft's Corporate Valuation system is a breakthrough technology with unequaled power and flexibility to value a closely held company. Corporate Valuation picks up where other programs end and offers a number of value-added innovations such as:

- Easy and intuitive navigation—you are no more than two mouse clicks away from any screen, so you won't be buried in layer upon layer of "pop-up windows"
- Easy to learn and use, so you can focus on the quality of your analysis instead of figuring out how to work with the program.
- Open and flexible chart of accounts allows you to mirror the financial statements of the company.
- Complete control over every line item allows you to prepare more accurate projections of future earnings for a more accurate valuation.
- Built-in logic helps you address easily overlooked items such as required fixed asset expenditures and the adequacy of the company's working capital to make certain that growth assumptions are supportable.

Continued next page...

Continued: Valuation Software...

- Fully linked, detailed income statements, balance sheets, statement of cash flows, statements of retained earnings, and sources and uses of funds are automatically calculated for you.
- Ability to value multiple earnings streams including Free Cash Flow gives you the ability to match the appropriate earnings base with the appropriate discount or capitalization rate.
- Built-in "reality check" tests hypothetical value against discretionary cash flow and the cost of capital to verify that the selected value makes economic sense.
- Print options allow you to control scale, layout, page numbering and add headers or footers as desired to create professional looking and organized supporting schedules.
- Smart Report builder merges conditional text with your analysis to create a preformatted presentation that you can edit in Microsoft Word—no more exporting or messing with clunky generic word processors.

From now until the end of the year, Corporate Valuation is available at the special introductory price of $495. List price is $695. If you are a Buy-Out Plan for Windows customer, please call our product information desk at 800-966-7797 for special upgrade pricing. If you are using another valuation system, call for <u>*special competitive upgrade prices*</u>.

| Description of User | Specific purpose(s) for a valuation |
|---|---|
| **Shareholders and Owners** | To support decisions in the areas of personal financial planning, asset protection, and the disposition business interest (e.g., selling shares to a third party or ESOP; purchasing shares; structuring a buy-sell agreement; obtaining life insurance; prepare personal financial statements; satisfying the desire to know the value of their business; determining the value of a charitable contribution; estate and gift tax matters; and as part of a legal or administrative controversy). |
| **Corporate and Financial Management** | To support corporate financial decisions and protect the interests of the company (e.g., sale, merger, acquisition or divestiture; tracking the value of the company; taking the company public (IPO); obtaining business financing; recapitalizing the company; creating an ESOP; dissolving a corporation; reorganizing under the bankruptcy laws; as part of a legal or administrative action). |
| **CPAs and Business Valuation Professionals** | To render an "opinion of value" to a client for just about any purpose. |
| **Turnaround Consultants** | To support corporate finance decisions (e.g., the possible sale of the company; divestiture of a business unit; obtain financing; recapitalize the company; or reorganize the company in bankruptcy). |
| **Tax and Estate Planners** | All purposes with emphasis on estate planning, inheritance tax, feasibility or installation of an ESOP, buy-sell agreements (with or without life insurance,) property taxes, and charitable contributions. |
| **Attorneys** | All purposes with emphasis on establishing damages and matters before a court, administrative body or regulatory agency (business and personal). |
| **Business Brokers and M&A Specialists** | To advise clients on matters of value, obtain qualified listings and engagements, analyze a buyer's offer, and close deals. |
| **Life Insurance Agents** | As a business development tool and a service to help determine if a business owner's life insurance is adequate. |

*Figure 1*

# New and Available Now:

## *Buy-Out Plan™ Professional Advisor*

Buy-Out Plan Professional Advisor is a new and more powerful version of Buy-Out Plan that was created for financial decision-makers and management advisors who want to perform a more powerful analysis, projection and valuation of a company for either acquisition or valuation purposes. Professional Advisor includes all of the capabilities of Buy-Out Plan, plus a number of added features that offer greater insight into the target company, more control over financial projections and financing, and all of the valuation methods included in MoneySoft's newly released Corporate Valuation program. Here is a list of the added capabilities that the Professional Advisor gives you:

- **Z-Score Model:** Measures the probability that the target company will become insolvent within the next 12 months. Developed by Edward I. Altman, Ph.D., the popular Z-Score model helps assess the target company's viability – both before and after the acquisition.

- **Sustainable Growth Model:** Measures the maximum rate of growth in sales that can be sustained without depleting financial resources. Another popular model, Sustainable Growth, helps determine whether or not revenue growth assumptions are in line with profit margins, dividend payout, asset turnover, and financial leverage assumptions – both before and after the transaction.

- **Build-Up Method** (of Discount Rates): The Build-Up Method, enhanced in this version, is the most commonly used method in business valuations for developing a Discount Rate. It is generally used for small "mom and pop" valuations or when no comparable companies can be identified.

**CREATED FOR FINANCIAL DECISION-MAKERS AND MANAGEMENT ADVISORS WHO WANT TO PERFORM A MORE POWERFUL ANALYSIS, PROJECTION AND VALUATION OF A COMPANY**

- **Capital Asset Pricing Model** (CAPM): New to this version is the Capital Asset Pricing Model (CAPM) method of determining a Discount Rate. The Capital Asset Pricing Model is generally preferred over the Build-Up Method, because CAPM utilizes Beta Factors from companies that are assumed to be comparable to the subject company. Like the Build-Up Method, CAPM is based on a combination of risk factors including a Risk-Free Rate, a Comparable Company Equity Risk Premium, a Size Premium, and other identifiable risk factors that are specific to the subject company.

- **Debt-Free Discount Rates & Capitalization Rates Based on WACC:** The Debt-Free Discount Rate is a special calculation that adds the Weighted Average Cost of Debt and the Weighted Average Cost of Equity. The rate is then used in the earnings valuation method to discount or capitalize projected EBIT, EBITDA, or Free Cash Flows.

- **EBIT, EBITDA & Free Cash Flow Earnings Bases Now Available in All Earnings Valuation Methods:** The EBIT, EBITDA and Free Cash Flow earnings bases are used to value Total Invested Capital (i.e., both debt and equity capital). These earnings, when capitalized or discounted, provide an indication of value as if the company had no interest-bearing debt, and therefore result in a "Debt-Free Value."

- **"Free Cash Flow" Earnings Base:** The Free Cash Flow earnings base is now available in all earnings based valuation methods. Free Cash Flow can sometimes provide a more meaningful measurement than Net Cash Flow, Net Income, EBT, EBIT, or EBITDA if these "accounting" earnings bases include adjustments such as restructuring charges, inventory write-offs, and/or one-time realignment charges.

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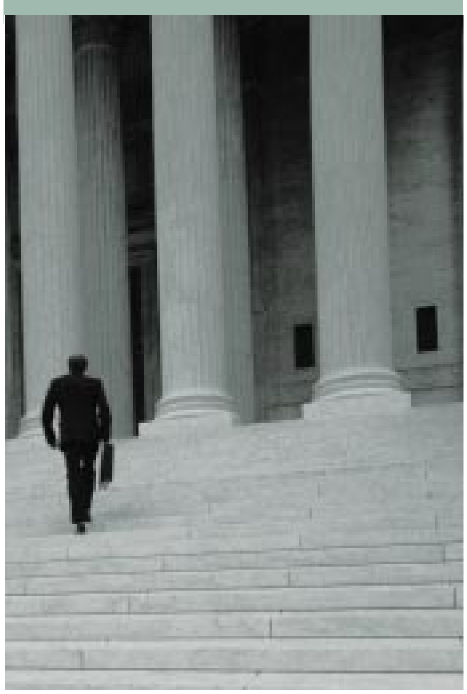
The Noncompete Covenant provides the Buyer with much needed protection and offers both parties a potential tax benefit.

***Buyer and Seller need to review the value and terms of the Noncompete along with the facts and circumstances with their respective legal and tax professionals. The parties want to be certain that any desired tax savings/deductions are, in fact, likely to withstand scrutiny from the IRS and that contractual terms provide for the appropriate protections.***



# The Deductibility of Noncompete Covenants

## What is Reasonable?

Buyer and Seller frequently allocate a portion of the purchase price to a Covenant-Not-To-Compete. The Noncompete Covenant provides the Buyer with much needed protection and offers both parties a potential tax benefit.

This is very desirable to the Seller when the transaction is structured as an asset sale and the selling company is a C-Corporation. Allocating a portion of the purchase price to a Noncompete and making payments to the individual Seller(s) is a common tax reduction strategy. Consideration paid directly to the Seller(s) for a Noncompete eliminates taxation at the corporate level.

Prior to 1993, buyers in an asset transaction had an incentive to allocate as much of the purchase price as possible to assets that could be depreciated (tangible assets) or amortized (intangible assets). The amount allocated toward a Noncompete could be written off over the term of the Noncompete – usually five years or less. Since Goodwill could not be written off, the strategy was to minimize any allocation toward Goodwill. With passage of the Omnibus Budget Reconciliation Act of 1993, that all changed. The 1993 Act provided that the capitalized costs of certain intangibles, including Goodwill and Noncompete Covenants can be amortized over 15 years. The good news was that Goodwill could now be deducted. The bad news was the term over which Noncompete Covenants could be amortized: rigidly set at fifteen years.

If the transaction is structured as a stock purchase, the Buyer may desire to allocate a portion of the purchase price toward a Noncompete. A Noncompete can be amortized and provide a tax savings, but the Buyer's "basis" in the stock cannot be amortized.

One of the unique features of Buy-Out Plan is the built-in DealSense™ that logically guides the user through the steps of determining purchase price, structure, and allocation. Buy-Out Plan allows the user to allocate a portion of the purchase price toward a Noncompete Covenant. The user can select an amount to be paid for the Noncompete, cash down, and payment terms; and the program automatically flows the expense and tax savings into fully linked financial statements.

### What is a Reasonable Amount to Allocate to a Noncompete?

When considering a Noncompete, the potential tax advantages might tempt the parties to "load up" on the amount allocated toward the Noncompete. The problem is that the allocation toward the Noncompete may be reviewed by the Internal Revenue Service and will likely be subjected to an economic reality test.

**Here are 11 questions to consider regarding the deductibility of a Noncompete allocation:**

1. Does the Seller have expertise necessary to compete?
2. Does the Seller intend to compete?
3. What are the Seller's financial resources?
4. What is the potential damage posed by the Seller's competition?
5. Does the Seller have contacts and relationships with the company's customers, suppliers, and other business relationships?
6. What is the duration and geographic scope of the Noncompete?
7. How enforceable is the Noncompete under state law?
8. What is the age and health of the Seller?
9. Are payments being made to all of the Sellers or just the ones capable of competing?
10. Will the payments to the Seller cease upon breach of the Noncompete or upon the Seller's death?
11. Were the terms and value of the Noncompete actively negotiated between the parties?

# MoneySoft's Acquisition MarketPlace Order Form

*A complete line of software solutions to make more profitable acquisitions!*

| | Quantity | Price |
|---|---|---|
| **Buy-Out Plan™**<br>The professional system to analyze, value, price, structure, and finance successful acquisitions.<br>$595 (Retail $795) | | |
| **Financial Report Builder**<br>Makes it easy to create compelling and credible presentations based upon your Buy-Out Plan analysis!<br>$195 (requires Buy-Out Plan) | | |
| NEW! **Buy-Out Plan Professional Advisor™**<br>All the power of Buy-Out Plan plus enhanced analysis, valuation and forecasting capabilities.<br>$790 (List Price $985) Current Users: Call for special upgrade pricing. | | |
| **Buy-Out Plan Professional Advisor and Financial Report Builder Bundle**<br>$985 (List Price $1,180) Current Users: Call for special upgrade pricing. | | |
| NEW! **Corporate Valuation™**<br>Quickly analyze and value closely held corporations.<br>$495 (List Price $695) | | |
| **Lightning Deal Reviewer®**<br>Define your acquisition goals and screen opportunities in a flash!<br>$245 (List Price $295) | | |
| **M&A Opportunity DataBank™** (Annual Subscription)<br>The leading source of middle-market acquisition opportunities—over 1,400 deals!<br>Updated every quarter. $395 (List Price $445) | | |
| **M&A Advisor DataBank™** (Annual Subscription)<br>Locate middle-market advisors and increase your deal flow network.<br>Contains over 700 deal sources! $195 (List Price $245) | | |
| **Subtotal** | | |
| **Tax** | CA: 7.25%<br>AZ: 6.8% | |
| **Shipping** | $10.00 Standard<br>$20.00 Overnight | |
| **Total** | | |

SHIPPING: PLEASE ADD $10.00 FOR SHIPPING AND HANDLING. FOR OVERNIGHT DELIVERY PLEASE ADD $20

MoneySoft™

*One East Camelback Road, Suite 550, Phoenix, AZ 85012*
*For faster service call 800-966-7797 or FAX to 602-266-7713*

NAME TITLE

COMPANY

MAILING ADDRESS

CITY STATE ZIP

AREA CODE/PHONE FAX E-MAIL

**Payment:**

My check for ____________________ is enclosed. This includes sale tax (if any) and shipping charges. Sale tax: CA 7.25%; AZ 6.8% . Please make checks payable to MoneySoft, Inc.

Bill my: ______Visa ______MC ______AMEX

Credit Card number Exp. Date Signature

***Please send completed order form to:***

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- **Cash Maintenance Revolver Routine:** A new optional function for maintaining a target cash level in the projected balance sheets. With this function enabled, you can eliminate wildly fluctuating projected cash balances by borrowing from short-term financing instruments only when required, paying them down with any excess cash, and by placing further cash reserves into interest-bearing cash equivalents.
- **Preferred Stock Valuation Analysis:** The new preferred stock valuation feature is used to value any preferred stock based on the market yield of the preferred stock of comparable companies.
- **Account Linking & Formula Editing:** A new facility for creating formula links to accounts in the projected financial statements. Now you can easily create formulas that link a selected account to another account or to multiple accounts. After creating formulas with the Link Account feature, you can manually "fine tune" them as required for your specific analysis.
- **Minority Interest Valuation:** This new feature allows you to value and also structure the acquisition of a minority ownership interest in a company.
- **Valuation and Appraisal Reports:** (Requires the Financial Report Builder.) A context-sensitive valuation and appraisal report has been added. The valuation and appraisal report (as well as the acquisition proposal) is preformatted and can be edited in Microsoft Word to easily create a very effective presentation.
- **Import from Buy-Out Plan:** You can import your existing files from Buy-Out Plan into the Professional Advisor so that you don't have to enter your numbers again.

***Free training is also available!*** A training session will be held via conference call every two weeks. During the conference call, a member of our development staff will guide the attendees through each section of Buy-Out Plan and answer any questions about the operation and application of the program.

Professional Advisor includes all of the capabilities of Buy-Out Plan, plus a number of added features that offer greater insight into the target company, more control over financial projections and financing, and all of the valuation methods included in MoneySoft's newly released Corporate Valuation program.

***Network Enabled:*** This enhanced version of Buy-Out Plan is now network-enabled for both client/server and peer-to-peer configurations on Windows NT, other Microsoft networks, and Novell NetWare.

### *Special Upgrade Offer:*

Special upgrade pricing (single user) is available for existing Buy-Out Plan for Windows customers: $390 (includes the Professional Advisor version plus the Financial Report Builder) or $195 for the Professional Advisor without the Financial Report Builder. For new users, the Professional Advisor version of Buy-Out Plan is currently available for $985 and includes the Financial Report Builder that is necessary to prepare the context-sensitive acquisition funding and valuation reports. The Professional Advisor is available to new users without the Financial Report Builder for $790.

Please call the MoneySoft information desk at(800) 966-7797 for network pricing.

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Established in 1991, MoneySoft publishes and distributes financial software and information products that help organizations create value through mergers, acquisitions, ESOPs, corporate finance and strategic planning.



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