Lyons Solutions, LLC
Profit from our experience

15R Hartford Avenue
P.O. Box 809
Granby, CT 06035

Tel: (860) 653-4777
Fax: (860) 653-4263
www.lyonssolutions.com

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M&A 2006: Who's Buying, What's Selling and Why?

By Jack Lyons

Opening Remarks . . .

I'd like to thank all the attendees, all you business leaders for coming to this session. I'm in good company and feel very privileged to be on this M&A panel with Al, Chad and Bret. Together I'm hopeful that we can give you information and advise that will be pertinent to your needs.

Much of my experience has been within the computer industry. I was with RCA's computer division in the early 1970's and from 1973 to 1983 I was with Digital Equipment Corporation. In 1980 and 1981 I was part of a team that studied the industry, projected where it was going and sought to position Digital for future business opportunities that would arise from coupling personal computers and application software. Digital chose another path than the one I thought it should have chosen.

In 1984 I founded what is now Lyons Solutions. We provide financial advisory and transactional services on an exclusive basis to business owners and private equity firms who retain us.

Our seller clients typically have revenue of $5M to $100M. Bill Quish and I are the only deal makers in the company. Together Bill and I have over 40 years of M&A experience and have completed over 100 middle market transactions with about 45 of them being in the IT, Staffing and Consulting industries.

Bill and I are personally involved in every transaction. There are no juniors in our firm.

I believe that if I'm going to sell a company I have to know my client and their business thoroughly and find the best buyers available in the market at the time of a sale to get a seller-favorable deal. I'm not just looking to find a buyer. That's the easy part. Making the right deal is another matter altogether.

Today's M&A market for IT Services firms is more vibrant than I've seen it since 1999. In a recent IT deal we had offers from 8 buyers. In another deal we had 6 buyers. Both were attractive companies for different reasons. One was growing quickly; the other was in a great location. In both cases we received offers from public companies and private companies. In one of the cases, private equity groups were interested. There are also foreign buyers in the market, but foreign buyers were not interested in either of these companies probably because they weren't large enough.

Employment and non-compete agreements for the staff is more important today than it has ever been before. Deals are getting held up until the non-compete's are signed and if the staff won't sign a non-compete agreement, the deal won't get done.

Financial due diligence is more stringent today than it was in the past. Sarbanes-Oxley is partially responsible for this. Also because there are more financial buyers today than ever before, financial due diligence has become more stringent. One of your major assets is your financial credibility and you should be prepared for a very close review of your financial statements.

In the past, many buyers got burned by acquisitions that didn't work out because of reasons they should have known about before doing the deal. In this day of narrowing vendor lists, customer due diligence has taken on new meaning. There has always been operational due diligence performed for most acquisitions, but operational due diligence is now more intense, meaning there won't be many stones unturned unless the buyer has a very strong agenda for the company following its acquisition or is doing a rock bottomed price deal that needs to be done by a certain date to keep the seller afloat. I hope none of you are in the staying afloat situation.

Bigger is generally better than smaller from a buyer's viewpoint as it costs about the same to get a smaller deal done as it takes to get a larger deal done. We see more demand for larger deals than we see for smaller deals and they're easier to get done because they're generally cleaner deals with fewer obstacles.

High gross margin businesses are bringing better pricing and more demand than low gross margin businesses. Some buyers won't look at a low gross margin business. Buyers also look at the gross margin trend to see whether it is going up or down and the reason behind the trend.

When it comes to valuation, there are no rules for what it should be from a multiple of EBIT or % of revenue viewpoint. One buyer may offer a 4 multiple of EBIT, another may offer a 6 multiple of EBIT.

There's a lot of valuation by rumor that goes on in the market. People hear that a company sold for 50% of revenue and believe that's the #. That couldn't be further from the truth.

Supply, demand, interest rates, economic circumstances, buyer, structure, size, location, and business trends are some of the variables that come in to play around valuation which varies by deal and buyer.

Some people try to time when they sell based on when they think their company will reach a certain value. I call that trying to time the top and at this time in the acquisition cycle I think that's a dangerous thing to do. Many people were thinking about timing the top back in 1999, 2000 and 2001 and look what's happened since then. I'm hearing similar sounds from potential sellers now as I heard back then.

Why am I concerned? I'll try to make this simple. In the last 2 years the Federal Reserve has raised interest rates a total of 16 times. Eventually the Federal Reserve will go too far and throw the economy into a recession.

So………., **"If you're close to being ready to sell, I think there is a lot of downside risk in waiting because your company could be worth a lot less tomorrow than it is today for a number of reasons, none of which are in your control!"**

I'll leave you with the following question - **How are you going to feel if you conclude at some later date that you've waited too long before selling?**

Thank you.