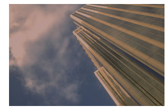
BRERETON AND COMPANY, INCORPORATED
Private Investment Banking




Private Company Crossroads: Should you Keep or Sell Your Business?

Who Should Read this Guide?

This quick guide is intended for owners and their families, company advisors, and executives of private companies who wrestle with issues about the future of their business. This guide is intended to stimulate discussions about succession plans, corporate strategy, and developing leadership to meet today's challenges.

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I. Introduction

The challenges of succession planning in private companies are immense, with issues both emotional and financial. A transition becomes the focal point where power and authority, business value, legal and tax issues, family dynamics, and trust (or lack of it) all come together at one point in time.

For some, selling the business is the right way to go. When the company has no energy or capital for growth, owners are burned out and financially dependent on the business, and there are no successors, the decision to sell is easy. For those who have sold, some are quite happy in their new activities, and some are ambivalent or still second-guessing the decision to sell.

Opportunities to sell a private company will continue to be a fact of life. This makes the decision to keep or sell, however tough and complex, a constant responsibility.

II. The Environment

There is a fundamental shift occurring in the ownership of private companies. Record numbers of private businesses are merging and consolidating. These sales are due to financial and market opportunities undreamed of before, immediate wealth for entrepreneurs running young, dynamic companies and opportunities to monetize illiquid assets for aging owners facing retirement. We have all heard the internet tales of instant mega-millionaires. Less public, but more profound, is the sale of thousands of private companies each year – established, mature brick and mortar, boring businesses that command significant premiums and create new liquidity for their owners.

More buyers are in the marketplace today then there have been at any other time in history. Companies that have never seen suitors are receiving attention from a variety of buyers. According to *Mergerstat* (a service that tracks deals in excess of $1 million), there have been 8,000 or more deals in each of the last six years, representing the exchange of trillions of dollars. Very few of these deals get national attention, with over

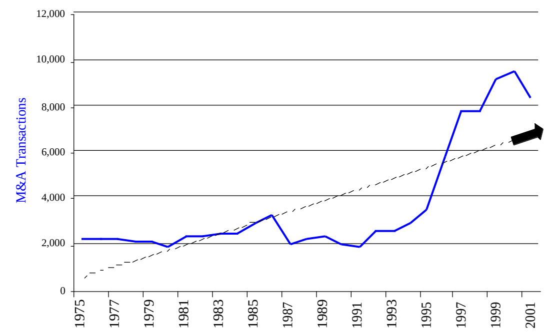
80% of the deals valued under $100 million. Furthermore, a study by the Arthur Andersen Center for Family Business indicates that buyers are paying more for companies today than ever before.

Where do these buyers come from? Some may be well known consolidators active in specific industries. They may be public companies or private firms that want to go public. They may be investment groups.

You know you will have to take some calculated risks in the future, and the business will have to change, just to survive. Maybe you're better off letting someone else take those risks, with their money. Or perhaps you should keep the company, let current management run it, turn it over to family or bring in professional management to carry it on, and create or preserve your family's legacy. The business has probably been a good corporate citizen for years, employing people from the community, and making or distributing a product or service that you, and your family, are proud of. Selling the company could mean relocation, a consolidation, layoffs, and a different way of doing business.

If you decide to keep the business, it means a commitment to the succession process. If you decide to sell the company, it means a commitment to a new type of life without ownership of the business. At the beginning of these paths is an often confusing crossroads, where you explore your options. Each path has risks and rewards. The following pages hopefully will assist you in exploring these issues, from a strategic, financial and emotional perspective.

Historical M&A Activity



Source: MergerStat.

III. How do I know if I should sell my business?

Casual budgeting, lax policies, unexplored opportunities, and under-utilized human, financial, and physical resources can undermine a company's value. ***Assessing your business' current strengths and weaknesses, and then fixing those weak spots will not only help you realize maximum value should you eventually decide to sell, but also poises the business for unimagined success should you ultimately keep the business.*** Before considering the decision to keep or sell, you'll first need to tackle a number of issues so you can clearly evaluate and maximize your choices.

You need to asses the current state of your company, its strengths and weaknesses, before you can determine whether the best strategy for realizing its potential is by continuing to own/run it or choosing to sell. You may need to challenge basic assumptions about your business and its future. Don't assume that the future will be a continuation of the past. The assessment and "future thinking" should include critical "others" such as key management, advisors, and perhaps potential successors. Explore different scenarios, and understand the trends that are occurring in your industry, so you can create a plan to address the various possibilities that may occur.

If you eventually decide to sell, having a plan will help you maximize the value of your business since it will help support your financial projections for future earnings. If you keep the business, the strategic plan, including alternative scenarios, will provide a roadmap for addressing future opportunities and threats.

Aversion to Change

One of the key benefits to undertaking a critical assessment is to find out where you are versus your expectations and your perception of other companies like you. One additional part of this assessment involves how open you and your company are to change. While you may be able to identify key problems and obstacles in growing the business, one factor that is more difficult to spot, but will influence the decision to keep or sell, is whether change is difficult to implement in your business. For example, some entrepreneurs do not have a clear understanding of what has made them successful – they are afraid that changing any aspect of how the business operates will threaten the company's success. The business often gets bogged down in the policies and procedures that ensure the company does not veer from its original path. Sometimes deviating from the original path is healthy for the company. Ward and Aronoff describe seven inhibitors to change in private companies:

1. Institutionalizing operating details and certain behaviors
2. Deeply entrenched values
3. Long tenures by each generation of leaders
4. Long-term loyalty to managers and advisors
5. Autocratic/paternalistic management style
6. Insulation from changing conditions outside the business
7. Tendency to be risk-averse and debt-adverse

These traits have advantages, but they can also inhibit change. Entrepreneurs who have invested everything in their company may be reluctant to change once they experience success. Instinct makes owners want to cling to their winning strategy and structure. But what brought the business its early success may not ensure its future.

Personal Assessment

A critical analysis of the business can reveal where the business needs attention. Another set of important questions to ask is about the emotional readiness of you, the business owner, in preparing for change.

Too often, owners are still holding too tightly to their company – afraid to let go, afraid not to. How do you know when it is time? Often there are internal signals. Perhaps you have plateaued, or taken a "psychological retirement" while still going through the motions. Maybe you're just not there – unplugged emotionally. Perhaps your relationship with your work or your partners has changed or you simply want to spend more time with your family or "on the beach." Indeed, we had one client who was determine to scuba dive around the world, and exactly three months after closing he had set sail.

If you recognize any of these issues, it may be time for a change. The question is whether the malaise can be cured by selling the company. Also, there may be a time gap between intellectually knowing you should sell the company and emotionally being ready to do so.

Comparison of Keeping or Selling the Business

The benefits of private company ownership range from freedom to set one's own compensation and other deductible perks, including employing family members, to rapid decision making, risk-taking, and enjoying the fruits of hard work. For some, it is the ability to realize one's dream, to create a successful business, and to see it grow and evolve. For those who inherited or continued a business from an earlier generation, it is the opportunity to take a company to the next level, to grow a business from an existing foundation, or to put one's own stamp on the company. For others, it is the ability to keep family assets in one operating business as a way to protect future generations or to create a family legacy.

In the past, entrepreneurs started out with the challenge of building the business and didn't think much about the future transition of ownership until a buyer came along, or children entered the business. Now, with increased competition and more efficient M&A markets, the question of transition can't be ignored. Regardless of what path is chosen, ownership of a successful private business provides a comfortable lifestyle and family wealth. Which route is best for you? The decision hinges on how well your company's internal resources are poised to handle new economic realities and your personal goals.

The following table, while not comprehensive, summarizes some of the current reasons to keep as well as sell the business. You should ask yourself the importance and relevance of each item.

Trusting Relationships
Privacy - not having to release information
Pride of ownership/build a legacy
Long-term perspective
Control your compensation and perks, employ family members
Keep family wealth consolidated in one entity for multiple generations
Rapid decision making, no committees, no bureaucracy
Wealth building potential of keeping the business versus selling

Opportunity with qualified buyers
Waning personal interest in the business
Strategic decision, competitive pressures, consoldiation in the industry
Reduced capital gains tax
Fear that the window to sell may close
Fianancial reasons - insufficient retirement assets, diversification, and reduce risk
No successors or unsure of successor's competencies and leadership skills
Wealth building potential of keeping the business versus selling

Asides from current business realities, there are many potential future influences that should be anticipated.

Future Considerations

Capital Considerations

- Is additional capital going to be needed to support growth initiatives? Are there sources to increase the company's capital?

External Forces

- Have future owners and managers assessed industry forces (consolidations, globalization, etc.) and their effects on future profitability?

Cohesiveness of Owners

- Do owners collaborate on finding solutions to mission critical problems?
- Is new leadership consciously cultivated?

Wealth Management

- Are there entities formed and functioning to hold family assets?
- Were the adult members of the next generation involved in the decisions about those entities?

Liquidity

- Is there a way to provide liquidity to shareholders who wish to sell a few shares?
- Is there regular reporting on the value of the business?
- Is the business performance regularly compared to peer companies?

Here are some additional signals that may indicate it is time to consider selling the business.

Signals to Sell

Risk Aversion

- Have you have developed an aversion to risk, perhaps in part to protect your personal next?
- Would others say you're becoming more inflexible?
- Have you developed a narrow perspective and do you avoid new ideas?

Opportunity

- Is your industry in favor, rapidly consolidating or experiences major technological changes, could interest be waning?

Strategic Decision

- Are there economies of scale and revenue synergies to be achieved through a sale?

- Will you be “left behind” and unable to compete independently?

Reduced Capital Gains Tax

- Can creative business combination structures put more after-tax dollars in your pocket?

For families that own an interest in a closely held company, there often comes a time when it is in the best interest of the owners to sell the business. If the next generation has no involvement in the company professionally, emotionally, or financially, or doesn’t have the skills to run or own the business, then selling the company may be the smartest move.

Finally, the decision to keep or sell cannot be made unilaterally. Others are affected and should be involved in the decision because it will have a profound impact on family members and key people in the future.

And then, even if all the objective factors indicate you would be better off selling the business, you still may want to go with you’re your “gut feeling” and keep it. And that’s okay. Hopefully, however, after your analysis you will now know where some the weaknesses are in your business, and you can begin to address them

IV. If I am considering selling my business, or just want to keep the option available, what should I do now?

As you contemplated the questions presented above you may have realized that you owe it to yourself and your business to explore the possibilities of a merger or sale. Maybe you just want to get a few chips off the table. You could become financially independent, give the kids some money to pursue their own dreams and do something different with your life.

If you are like most business owners, selling your business will be one of the most monumental events of your life, both financially and personally. Done right, it can create great satisfaction and financial security from many years of effort. Done poorly, it can cause frustration, financial risks, and a disappointing return on your investment. What are the options? What does a seller need to know? How can you prepare? This section should provide you with a general guideline to put yourself a position to maximize your options.

Selling Your Business? Then Plan Two Years in Advance

Selling your business is a once in a lifetime opportunity, that can bring a host of financial and emotional issues. We agree with Merrill Lynch's synopsis and their suggested countdown plan.

Countdown

24 months prior to the sale – Commence having your financial statements audited by a reputable and well-known independent accounting firm in order to insure credibility and respectability from your potential buyers.

18 Months Prior to the Sale – Establish a strong management team that can successfully run the business when you are absent and encourage customers and supplier to less and less on dealing with you.

12 Months Prior to the Sale – Broaden your business so you are not overly dependent on a few customers or a few suppliers as buyers become very concerned about "too many eggs in one basket."

8 Months Prior to the Sale – Flush out all problem areas that may become apprehensive, i.e., unsettled law suits, EPA problems, outstanding warranties, uncooperative minority shareholders, unsettled lease arrangements, etc.

6 Months Prior to the Sale – Line up advisors to assist you such as a professional appraiser, experienced intermediary, transaction oriented lawyers and accountants, etc. Your intermediary will help you develop a plan to market your business effectively and identify logical buyers.

Then – Choose the optimum time to sell your business when the trends are up or strategic buyers are in an acquisitive mode.

Valuation

Obviously, you should always be trying to enhance the value of your firm. However, when it comes to a potential sale, there are additional considerations you must take to ensure that your present and future value is maximized. Before you pursue a buyer, you should have a reasonable idea of how a third party will value your business. Many owners know the "rules of thumb" common in their industries. But these only provide a rough approximation of value, and can be misleading for a business whose financial parameters do not line up with those of its competitors. Perhaps you should hire an expert to determine the company's value. A business valuation will be based on a set of assumptions about future events. In other words, the valuation is a starting point, not the endpoint. It can help you define company goals and strategies.

Controlling Your Value

Value is a dynamic concept, and as a seller you have great control over it. There are several ways in which you can increase it:

Cash Flow is King – Private companies usually sell on a multiple of EBIT (Earnings before interest expense and taxes). Therefore, the most fundamental method for adding value to a company is to clean up the income statement towards the purpose of maximizing EBIT.

Asset Quality – If you want to beef up the cash at closing in the sale of your company, beef up its assets. Reinvest earnings into assets that directly relate to producing cash flow. Sell or divest assets that are unrelated to your cash flows, such as raw land, redundant warehousing capacity, or headquarters art collections.

Avoid Surprises – Buyers and banks hate surprises. It may surprise to learn that the more information you disclose, the better it is for you. Uncertainty in the mind of a buyer in a private deal results in hold-back escrow accounts and less cash at the closing.

Get Audited Financial Statements – Because audited (or reviewed) financial statements reduce uncertainty and risk on the part of the buyers, having your statements audited can actually impact the purchase price and terms you can command.

Address Off-Balance Sheet Assets – Off-balance sheet assets can include intellectual property, licenses or proprietary techniques, patents in process, research and development innovations, undervalued assets, or just plain good people. If you don't tell the buyer about these off-balance sheet assets, who will?

Focus on Strengths – Eliminating weak product lines should increase your overall profit margins and improve your return on assets. Buyers typically don't want diversified businesses; they want resources concentrated in your strongest activity.

Management Depth and Employee Teamwork – A business that is excessively dependent on the owner is risky for a prospective buyer. Appointing a second-in-command and department managers enhances a company's value by alleviating that risk.

There are, of course, many other factors that influence your value. Some of which have very little to do with your operations, but you should been keenly aware of nonetheless. Examples of these are your strategic value to a particular buyer and the level of competition between motivated buyers.

V. If I am going to sell my business, what should I expect in terms of buyers and process?

No two deals are the same, so advice planning, creativity and flexibility are critical is all parties are to fulfill their objectives. With that said, however, there are a series of steps that greatly lubricates the sales process. The next section should provide a general outline of the buyers and a typical sales process.

Selling the business can provide instant liquidity – especially if your financial "eggs" are mostly in the company. If you are thinking about spending less time in the business, or retiring altogether, and have no clear successor, selling the company can help you meet this goal. Perhaps the business has become too large and too complex to manage personally, or you may be unable to provide the capital you need to expand. By selling to a larger company, you may gain greater management depth, more sophisticated operating systems, or better financing than you could on your own.

There are, however, several alternatives to selling the entire company, you can:

- Sell off a subsidiary, division or product line
- Recapitalize (Sell a portion of the firms ownership)
- Form a joint venture
- Go public

The right path is dependent upon your current strategic positioning and, more importantly, general market conditions.

The Buyers

There are essentially four types of buyers: consolidators, financial buyers, strategic buyers and management. Each has different goals and objectives for buying a private company. The type of buyer your advisors negotiate with will determine the types of strategies and deal structures you and they will pursue.

Consolidators – This type of buyer is already active in the industry in which your company operates – they typically are strong industry leaders busy buying weaker rivals.

Roll-Ups – This is a type of consolidator, specifically created to consolidate a fragmented industry. A roll-up is created when entrepreneurs set out to create one big company by rolling up dozens of little firms into one large enough to create efficiencies, wield marketing muscle, and create a national brand.

Financial Buyers – This group is made up of investors or other entrepreneurs interested in the return they can achieve by buying your business. They are generally interested in cash flow and exit opportunity. Their goals may include increasing cash flow by reducing expenses, increasing sales, and creating economies of scale by acquiring other similar companies. Their exit plans may include reselling your company or taking it public at a much higher multiple of earnings than originally paid.

Strategic Buyers – This type of buyer creates synergy by matching marketing and distribution channels, and complementing product lines, using existing manufacturing processes, etc. These may be private or public companies, competitors, or friends in the industry. Strategic buyers are interested in growing both companies through a combination.

Management Buyouts – Existing management may also be a potential buyer of your business. Few management teams have the financial resources to pay all cash. Most management acquisitions involve seller financing or support from and acquisition fund or other institutional sources of financing. It should also be noted that this consideration should come late in your selling process, because a manager involved in the auction process has a clear conflict of interests.

It is important for you and your advisor to evaluate all potential buyers. Not all buyers will fit your company's culture. Sometimes the buyer with they highest price is not the one you will be most comfortable selling to. We were once representing a large organic farm that received a much higher offer from a financial group, but decided to sell to another local farm. This decision was far more comfortable for them and put the business into the hands of people they can relate to and trust. It is important to do some research, known as *due diligence* on your potential buyers and learn about how they have treated other acquired companies after the deal closed. Your advisor's due diligence should encompass the following areas:

- Financial
- Operational
- Acquisition History
- Potential Synergies
- Financial Condition
- Eagerness to Buy

The Courting Process

As in most business transactions, competition, or at least the appearance of competition, can make a difference in maximizing the price you receive for your business.

Your advisors should create a limited auction where you narrow the acceptable buyer to two or three and then enter into parallel negotiations with those parties. You should first identify a group of likely buyers, be they consolidators, financial buyers, strategic buyers, or management. Then your advisors contact those parties to determine their interest, have them sign a confidentiality agreement and then forward the selling memo (described below) to those who want to review it. The potential buyers submit preliminary acquisition proposals or expressions of interest to you or your advisors. You and your advisors assess each proposal, identify the potential buyer who submits the acquisition proposal that is most attractive, and then begin to negotiate the financial terms of the sale.

There are some situations where this may not be practical. For example, when an acquisition proposal has already been received from a serious buyer, or the board of directors prefers to negotiate with only one or two potential buyers. But, before you rush into a deal, keep in mind it may be smart to create competitive bidding, or the appearance of competition, between at least two interested parties. You may also want to do some research to get information about comparable historical transactions that may be helpful in negotiating your price.

Your approach to the acquisition process will depend on whether you are interested in selling all of the stock or other equity in your business or only a majority or minority interest in it. Your advisor should help you be creative if you want. After all, it's your business, and buyers can be flexible up to a point in getting the deal done.

When to Use an Investment Banker

Of course there are pros and cons of using an intermediary versus doing it yourself. You will probably know who the strategic buyers and consolidators are in your industry. But, just because you know who the buyers are doesn't mean you should try to sell your business yourself. Use an experienced team to help you negotiate with sophisticated buyers. The fees you may spend are well worth the added value that a savvy group of advisors can bring to the table during this project. You only get one shot at a successful transaction; you want to make sure you nail it.

What's more, selling your business is such a major undertaking that it is virtually impossible to do while still providing adequate attention to your day to day operations.

Some of the advantages of using an investment banking firm are:

- They are involved with the capital markets on day-to-day basis
- They are involved in high level negotiations with potential buyers on a day-to-day basis
- They can organize and manage a competitive process and bring a certain discipline to the process so the buyers come forth with the best price and terms
- They can provide value-added services. They are familiar with creative deal structures and aware of critical deal points.
- They provide a third party validation to your claims.
- The investment banker can think outside the box and identify potential buyers that the seller hasn't thought of.
- They are well connected and have access to information otherwise inaccessible.

Preparing Your Selling Memorandum

One of the first steps in preparing a company for sale is to develop a selling memorandum that provides a prospective buyer with enough information about your company to decide whether he or she is interested. This process is almost always done through Investment Bankers because they have extensive experience in preparing a book that exactly caters to what buyers want to see. The quality of your descriptive memorandum can have a significant impact on where your negotiations begin.

A selling memo includes information about the company's history, the markets in which it operates, the company's competitors, information about the company's products and services, its operations, management and the company's strengths. Also, the memo should include information about why the owners are considering a sale of the company at this time.

One by-product of completing the selling memorandum is that it provides you, the seller, with the necessary information to develop a realistic valuation range for your company.

The buyer you choose may not be the one with the highest price. He or she should have the best overall deal, which could include important other terms: legal, tax, management, and emotional. In the organic farm deal mentioned earlier, one of these key terms was the seller's ability to sign a shorter employment contract and retire. Getting the best possible deal will require some savvy negotiation skills. Remember, price is negotiated; value is perceived. If the seller can help the buyer perceive greater value, price will increase.

After negotiations and deal structuring is complete, the firms enter the closing process.

With that said, selling your company should be more than just a transaction. It should be a partnering of intent. That intent should be in the combined commitment to continue the process of adding value to the company. Only through this commitment can the seller, the buyer, and ultimately all the people who benefit from the company, come away from the deal feeling that they gained from the transaction.

What's Next?

For most business owners who have sold their company, there are new challenges. The most immediate change is learning to manage newly liquid assets for retirement and for the next generation, but there are many options to explore. Some of our entrepreneurs have started new companies, devoted time to philanthropic endeavors or continued their education.

We hope this brief guide can in some way help you anticipate the many decisions and challenges that may lay in your future. Good Luck!

Brereton and Company, Incorporated
Private Investment Banking

BRERETON AND COMPANY, INCORPORATED
Private Investment Banking

Brereton and Company is a boutique investment bank dedicated to maximizing the value and liquidity of closely held businesses.

If you are:

- *Undercapitalized and experiencing explosive demand for your product*
- *Facing a difficult transition after many years at the helm*
- *Unsure about how to best maximize the value of your business for your heirs*
- *Ready to harvest your business investment to diversify your net worth*

Please give us a call. Our initial discussions and analysis are strictly confidential and complimentary.

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