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Mind Your Own Business

In this issue: ***Magic Multiples***

Blackbridge PARTNERS LLC
Investment Bankers

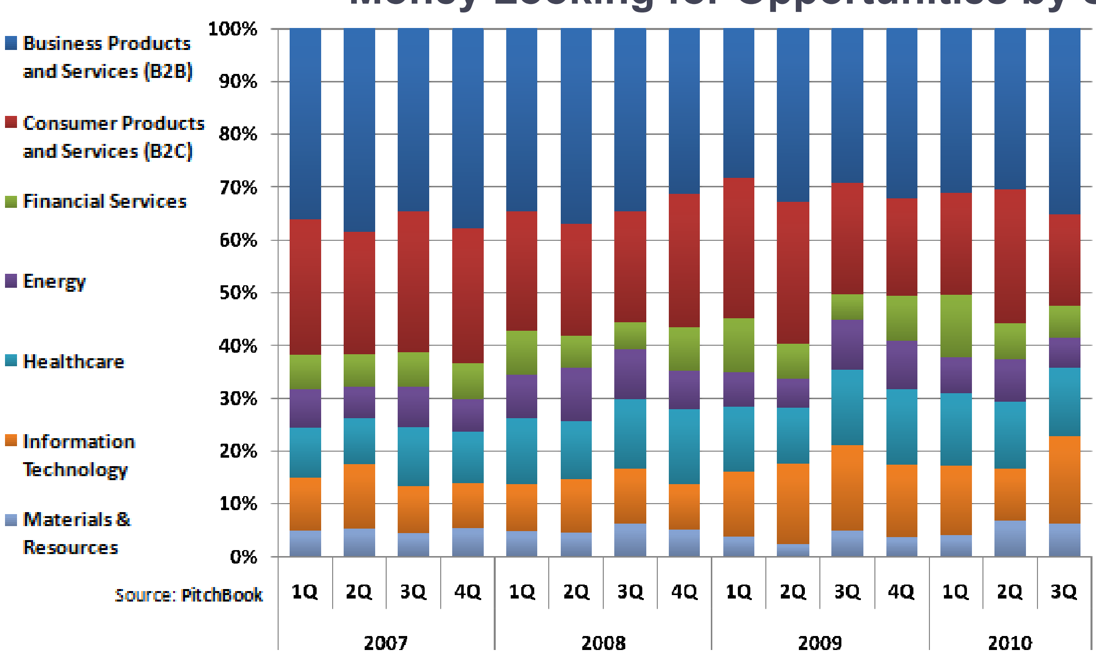
Inside:

Small Business Owner Exit Plans

Family Business Legacy

- 30% of family businesses successfully transition to the second generation (per a study the University of Southern Maine)
- 15% of businesses survive beyond the second generation (per a study by U.S. Trust)

Money Looking for Opportunities by Sector



The graphic at the left gives an indication of where the M&A activity had been in 2010. This chart is only for reported private equity deals because private strategic deals are harder to track. Nonetheless this table provides a useful high altitude view of where some of the action is.

There is about $650 billion dollars in U.S. private equity money and about $975 billion in investment capital sitting in U.S. corporations looking for deals This situation can favor sellers in well-managed auction.

Fibonacci Retracement

Even very experienced technical stock market traders understand they can't recognize a peak or trough when its happening. To make decision-making easier they use models. A popular one is based on the Fibonacci number sequence (identified by the eponymous 13th century mathematician).

In technical analysis a "Fibonacci Retracement" is created by looking at past markets and using the ratios between Fibonacci numbers to estimate when the current market is within a certain percentage of its estimated peak (e.g. 23.6%) . This is seen as a trigger point at which to exit rather than to wait longer as the peak could occur sooner and you could miss it badly (e.g. at 20% less than the current trigger point).

The lesson is that you must have the discipline to lower your risk by realizing your gains ahead of the hoped for peak price and by hedging when possible.

You Can Only Measure It By Looking Out the Rear Window

It's Over!
On September 21st, 2010 it was announced by the National Bureau of Economic Research that the recession had ended in June of 2009. That was15 months before!

Why did it take so long to discover that nadir had passed long ago? Measurements rely on hard quantitative data (as opposed to guesses or forecasts). "Hard data" results from measurements of things that have already happened, not on guesses about what may happen. Therefore, you can only measure an economic event in context by looking at the past.

Business Retrospective
What is true of the economy is also true of every sector within the economy. You don't know when a business sector has peaked or when it has troughed until you have enough objective historical data.

In the present context this has important implications for deciding when it is time to exit your business. You will never know the right time until you see it in the rear view mirror

Seller's remorse vs. Non-Seller's Remorse
Accepting that you can never buy or sell a business (or a stock) at the ideal time is the important first step to avoiding remorse about the timing decision. You will be late or early. Which is best?

Hedging the Bet
If you're later to market than competitors there's little you can do to hedge your bet. If you're earlier to the market than competitors it may be possible to hedge your bet.

In this context the "hedge" is created with a deal structure that allows you to exit yet share in the benefit of the business's post-sale momentum. This is done through performance based deal components in an "earnout". An earnout is not right in every case and requires careful drafting but it can take the edge off the exit timing decision.

Bargain Hunters and Bottom Feeders

Challenging economic times and the cusp of a recovery tend to bring out the bargain hunters and bottom feeders. They trawl for weakened businesses that they can acquire for depressed values from disheartened owners. How do you recognize them and how do you deal with them?

This class of buyer can initially look just like any other interested party but they usually begin by making a direct and unsolicited approach to a target business rather than responding to an offer for sale (this is not to say that all such approaches are by this type of buyer). They get attention by floating a possible price that falls within a reasonable range.

Thereafter the bottom feeder will quickly try to lock in a no-shop period (an exclusive negotiation period) that is relatively short (30-60 days).

Having gotten some level of commitment from the seller the bottom feeder will begin to slow down the pace of the process. They believe that the longer they draw out the process the more opportunity they will have to drag the seller down on price and terms.

Amongst their tactics:

- repeatedly bringing up minor issues to justify lower offers
- submitting written offers that are inconsistent with verbally agreed terms
- inserting undefined "material adverse change" contingencies allowing them to justify a price reduction later on

If a bottom feeder is interested in your business then it's likely that full value buyers will also be interested. The best way to screen out bottom feeders and to get full value is to have several offers to consider at once.

To attract multiple competing offers (while protecting your business) you'll need to conduct a confidential "auction". In the context of that auction the bottom feeders will be easy to weed out.

If the business is in decline and/or in a challenging market a lower price might be justified but competition for the business provides the context for informed decision-making. It also give you the leverage to negotiate favorable deal terms and structures.

The Magic Multiples

The most common rule of thumb for measuring the relative prices paid for businesses is X times EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) but what does it tell you?

This rule of thumb is most useful when looking at large volumes of sale transactions to get a general feel for trends in the market, per the table at the right. The table uses "Total Enterprise Value" rather than price because not all investments were total buyouts. In cases where less than 100% was purchased TEV shows the pro rata value of the whole business.

The most obvious pattern is that the larger the TEV the larger the multiple of TEV. So large deals and small deals have different rules.

TOTAL ENTERPRISE VALUE (TEV)/EBITDA—ALL INDUSTRIES

TEV	2003–2005	2006	2007	2008	2009	1H 2010	Total	N =
10-25	5.5	5.7	5.4	5.3	5.1	4.8	5.4	392
25-50	6.0	6.0	6.2	5.9	6.1	6.3	6.0	295
50-100	6.1	6.5	6.6	6.4	6.1	6.2	6.3	186
100-250	6.9	6.8	7.5	6.6	6.5	6.9	7.0	69
Total	5.9	6.0	6.0	5.8	5.7	5.5	5.9	
N =	337	171	189	131	72	42	942	

Please note that N for 2003-05 encompasses three years of activity.

SOURCE: GF DATA RESOURCES LLC

Aside from TEV what is hiding inside this data that you would need to know to make sense of it? Here are a few:

- Is the price paid in a single payment based solely on historical EBITDA or are their future contingencies that can change the multiple?
- Is it a business with a high or low future Capex requirement?
- Which sector is it in?
- The average is shown but what is the EBITDA range?

The lesson is to be cautious with rules of thumb.

New Window for a Tax Efficient Exit

The Bush era reductions in long term capital gains taxes to 15% were given close scrutiny by the Obama administration. When campaigning for office Obama had considered a number of LTCG alternatives include one rate as high as 27%. The most probable target rate was 25%.

In the horse trading that took place at the end of the last legislative session in 2010 all the Bush era tax cuts were extended for another 2 years. In the State of the Union address delivered on January 25, 2011 Obama made it clear that he would fight much harder against extensions beyond that date.

Why should you care? We don't yet know what the 2013 rate will be but given the expressed prior intent, and the need to reduce the deficit, it would likely step up to 25%.

If it is 25% then a business owner closing on the sale of their business on or before December 31, 2012 could retain an additional $100,000 after tax per $1m of priced paid than they will after that date. If it only goes to 20% the post tax savings with be $50,000 per $1m. It's significant.

In practical terms (and assuming a 25% rate after 2012) the owner of a business would be no worse selling for $10m today that he would be selling for $11.3 in 2013 (see table below).

Year	Price	LTCG rate	tax	net after tax
2011/12	$ 10,000,000	15%	$ 1,500,000	$ 8,500,000
2013	$ 11,345,000	25%	$ 2,836,250	$ 8,508,750

Hiring M&A Counsel

It will save you time, money and aggravation if you hire an experienced M&A attorney to help with the sale of your business. Don't rely on a generalist even if you've been with them for years.

How do you evaluate them? It's your money so don't be shy about asking them questions including:

1. How many M&A deals involving privately-owned businesses have they worked on in the last 3 years?
2. Have they worked with a seller represented by an investment bank?
3. What do they see their role as (correct answer: "getting the deal closed").
4. Will you or junior counsel be active on my deal?
5. What is your fee structure and do you work on a "not to exceed" basis?
6. What is my work likely to cost, stage by stage?
7. How will you keep me and my advisors informed?

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Blackbridge Partners LLC is a Boston-headquartered investment bank. We specialize in merger and acquisition and capital raising advisory services for owners of privately-held lower middle market companies seeking to harvest maximum value upon exit and companies seeking to acquire the same.

We are a boutique firm delivering a level of professional service not usually available to the lower middle market.

Our experience ranges from medical services to manufacturing, software, IT services, technology and professional services.

Specializing in the Middle Market – Businesses with revenue of $5 - $150 million.

What's the Business Sale Process Like?

Harvesting the maximum value from your business takes time and requires a considered process. Even before seeking outside advice there are some things that you should do:

Preparation

1. The initial step is to consider what your personal timelines and goals are and to begin tax planning (see tax Efficient Exit on page 3).
2. The second step is to make sure that all of your records (leases, employment, financial, corporate, etc.) are accurate and up to date.
3. Next look at outside factors such as the economic environment and the prospects in your business sector (see also Looking Out The Rear Window on page 2), assess their impact and document how they may present opportunities to an acquirer.
4. Consider what you can do to enhance the value of your business (reducing customer concentration, clearing up regulatory issues, turning verbal agreements in to written contracts).
5. Consider all your liquidity options including selling to employees, selling to an ESOP, sale to another business, an asset sale, transfer to family, a staged exit through sale to a financial buyer, etc.
6. Once you begin to consider the sale options you should also establish a relationship with an M&A attorney. They can help you with the legal aspects of getting ready and will be vital once you go to market. You need an experienced M&A specialist.

Valuation & Evaluation

But what is the business worth and how do you find that out? Many business owners consult with accountants or talk to a valuation firm to get a feel for what their business might be worth. That can be valuable for estate, tax and divorce purposes but this doesn't necessarily advance the sale process. They will give you a Fair Market Value but this doesn't always correlate with the Real Market Value in an actual sale.

The best step is to consult with an experienced investment bank. They will have access to statistical data (see Magic Multiples on page 3) but will also be able to weigh your specific variables to give you a range of value. They should do this evaluation at no charge because its part of their own evaluation process. If they want to charge you to determine if they want to represent you then they're more interested in this fee than in selling your business. Find someone else.

For example, Blackbridge can only decide if we would want to represent a business if we to do our own analysis at our own cost. We need to fully understand the business's operations, the financial details (P&L and Balance Sheet), the competitive context, the customer network, the growth potential, reasons for sale, corporate structure, capex requirements, IP assets and many other factors. This process can take up to 60 days.

Only when we've completed this process, supplemented by some Q&A, can we present the owners with a useful indication of a value range for the business and what can be done to enhance it as well as possible deal structures and target buyers.

This report and value range is only for the seller's internal use in evaluating their options. We never go to market with an advertised price because:

- This sets a ceiling price and all offers will come in below the advertised price.
- The value in buyers' hands can vary greatly from one buyer to the next depending on their needs, strategies, synergies, etc. Wait for buyers to make an offer and negotiate from there.

All of this is done confidentially and with no obligation between the parties. If the sellers and Blackbridge decide that we wish to work together then Blackbridge will submit a detailed proposal.

Fees

Blackbridge aligns its interests with those of the seller. We do not charge open-ended monthly retainers, which can encourage delay. Blackbridge charges a fixed fee at engagement and charges no other fees until the sale is successfully completed and the seller is paid. If the sale never happens the fixed engagement fee is all we'll ever get for all the work we've done. In other words, we always have skin in the game.

Length of Time

We typically get a business to market within 60 days. Thereafter we are not in total control and a sale could take as little as 90 days or as long as 18 months or more.