

BUSINESS DISPOSITION PLANNING FOR THE BABY BOOMER GENERATION COUNTERING DEPRESSED VALUATIONS WITH CREATIVE STRATEGIES

Abstract

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Maximizing the emotional and financial return to the exiting owner, president or CEO of a business that was either created or acquired and expanded over a significant period of time, where succession (sale to family members), or an ESOP (sale to employees) is not an option. A breath of fresh air to the pre-retiring business owner in a turbulent current and future environment comes from the application of proven, but little known techniques applied 3 to 15 years prior to the owner's complete exit.

The Problem

The 'third party' option for a sale of a business as an exit strategy, in the year 2010, and moving forward for the next 5 to 10 years presents two significant problems:



*19 million businesses
will be put up for sale in
the next 5 to 10 years,
creating unprecedented
supply in the
marketplace and
depressing valuations,
regardless of the
economic environment.*

1. According to multiple reports, one of which was published in INC Magazine in 2008, the number of 'baby boomer' business owners that plan to retire and put their businesses up for sale in the next 5 to 10 years is estimated to be close to **19 million**. As a result, regardless of the future state of the economy, the sheer unprecedented supply of available inventory will depress prices.

2. The state of the current economy means that should a 'boomer' business owner decide to retire early and search for a buyer now, though supply is balanced with demand, prices are depressed and financing is difficult as a result of the current economic environment.

The Solutions

Certain companies which appeal to institutional investors can benefit from JV and/or Bundling strategies, creating a new route to exit for the shareholders.

A strategy used successfully for decades by industry consolidators, hidden to many non-industry practitioners, creates an ideal solution to these problems for many businesses with the potential to double or triple in size over 3 to 15 years. The author of this report, BizHarmony, specializes in structuring a transaction in a manner which removes the business owner, president or CEO and the asset (the company) from the current state of existence. This strategy does not apply to all types of businesses, but there are many to which this does apply, such as: Manufacturers and / or Distributors of products that are under-developed, such as those not serving the national or global marketplace, as well as companies in the service sector, which are highly profitable, but too small to appeal to institutional investors. Job shops that do not have a proprietary product can also benefit from this approach.

Two distinct solutions to solving the problem as outlined above exist:

- The Joint Venture / Deferred Exit approach.
- Bundling / Pre – Rollup for consolidation.

- **Joint Venture – Deferred Exit :**

A JV Partnership is ideal for shareholders planning an exit in 3, 5, 10, or 15 years as it locks up a higher multiple to the shareholders based upon future growth.

A Joint Venture is broadly defined as a legal entity formed between two or more parties to undertake an economic activity together. JV partners agree to terms outlined in the agreement for a finite period of time and create a new entity, each contributing assets and/or equity to the new entity. These partnerships are created when one party seeks the resources of another, whether financial, managerial, patents, technology or a combination. This strategy is ideal for the business owner planning an exit in 3, 5, 10 or 15 years, that lacks the financial resources to take the company to its full potential in that time frame, thereby missing the opportunity to benefit from the potential growth that a new capital, management or other infusion would provide. Such a partnership is ideal in that it can act to lock up a higher multiple to the shareholders contingent upon the future growth of the company.

BizHarmony implements a JV based strategy through its network of investor / buyers who focus on a broad range of industries including Medical, Food, Energy, Education, Internet, Software, Homeland Security and others, with the following in common:

- Contain unique characteristics such as a competitive advantage over other players in the industry, are part of a highly fragmented industry sector with no dominant player or hold the dominant position themselves, or have intellectual property attributes creating barriers to entry. Any of these qualities appeal to an investor / buyer, as these companies have huge undeveloped potential.

In order to realize the potential, expansion or growth capital may be required and, if so, becomes part of a strategy that is planned extensively by experienced advisors alongside the business owner. The growth plan may require the acquisition of similar businesses to capture market share, acquisitions to diversify product line and customer base, or a combination of both.

Such a strategy could provide a return to the current owner of two to three times that of the open market, simply by planning ahead.

The JV counterparty typically brings more than capital, as many such growth opportunities require new talent to support current operating executives as a cornerstone of bringing a growth strategy together and to ensure that goals are reached.

A joint venture, then, is not a third party sale, but a creative solution to growth of an underdeveloped entity, requiring a vested interest and aligned objectives of both parties, while providing liquidity up front to the owner, and again when goals are reached, at which point the final exit plan can be implemented.

In a transaction as described, typically the new JV Partner acquires a majority share of the business and commits the necessary capital to support the growth objectives as determined by the current owner. The partner expects the current owner to maintain the role of operating the company under an employment contract for 3, 5, 10 or 15 years as agreed upon and the owner retains meaningful equity in the business.

The owner's equity position is pre-formulated for sale at the time of agreement, and applied to the new ebitda growth objective when the time frame and target is reached and a capable successor is groomed. The advantage of such a strategy in the current environment in part is that it removes the current owner from the competition with others who have decided to wait 3, 5, 10 or 15 years to seek a third party traditional buyer. Such a strategy could provide a return to the current owner of two to three times that of the open market would, simply by planning ahead.

- **Bundling – Pre Roll Up :**

Large, fragmented industries where high demand exist, have enormously profitable companies, but sometimes lack companies of the scale that most institutional buyers require. Bundling is a solution to such a problem.

Business bundles are formed in industries where the minimum threshold of company size required for institutional investors does not exist. Simply, it is a method of creating an entity in the absence of one, through the integration of multiple. This strategy is ideal for a company involved a 'high demand - highly fragmented' industry.

Some industries are populated with literally hundreds, if not thousands of small businesses, that when combined, have total annual revenues in the billions of dollars. As stand alone companies, they survive because of exceptionally high profit margins, but because of their minimal size, do not appeal to Institutional Investor / Buyers that have the resources to take them to the next level, since in most cases, the desired minimum for a 'platform' company, is \$10.0 million ebitda.

The problem is solved creatively through BizHarmony, which aids in applying a qualified, licensed M&A Broker to work with the 'bundling' leader in identifying other targets which the broker would contact to add to the platform.

Each interested player, would enter into a 'letter of participation', and this process would continue until the combined ebitda target was reached, and packaged as a single stand alone company, even though, in reality, they are all individual companies.

BizHarmony, then takes the packaged group of companies, and locates the Investor / Buyer that would acquire each entity individually, with the

intention of integrating them post sale in order to create the new platform, which in sum is large enough for the investor / buyer to engage.

The platform then follows an organic and acquisition oriented growth strategy, consolidating the market space and creating a dominant player, with the original platform participants growing their respective interests similar to the JV – Deferred Exit as outlined in the beginning of this paper.

The return to the platform participants can be 10 to 15 times greater than would be realized for a standalone sale, because of the potential created by establishing the platform and capturing market share.

- ***The Job Shop***

Job shops that have no patents or proprietary products can often be integrated through JV's or bundles in order to create an appealing opportunity for an investor / buyer. Doing so involves locating one or more products that the job shop could produce, thereby converting the job shop to a manufacturer which has significantly higher value to a third party purchaser. This strategy represents a combination of bundling as well as joint venturing, increasing value to all involved shareholders through creative solutions.

Conclusion

For those companies that align with the scenarios mentioned above, the astute retiring business owner, president or CEO has many options in light of the current and future exit obstacles. The solution involves starting the planning process today, setting goals and designing a structure to deliver emotional and financial expectations, packaging a deal, locating the investor / buyer now, and putting a plan into action. With a pre – determined exit date and a formulated financial package, the business can literally be extricated from the competitive environment, providing the highest possible return on the owner's lifetime of hard work.

BizHarmony provides all of the services mentioned in this white paper. Please contact us for a tailored solution.