



## Getting Full Value for Your Brands

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*"...failure to protect your marks with registration can result in a lower price and/or a holdback of part of the price..."*

### What's the Difference?

**Trademark**

A trademark includes any word, name, symbol, or device, or any combination, used in commerce to identify and distinguish the goods of one maker or seller from goods of others, and to indicate the source of the goods. In short it's a brand name.

**Service Mark**

A service mark is any word, name, symbol, device, or any combination, used in commerce, to identify and distinguish the services of one provider from services of others, and to indicate the source of the services.

While they're building and managing the business most entrepreneurs don't give much thought to the intellectual property value that they're building. That could be a costly mistake.

You're building value in the brands of your products and services and in your company name and, if properly protected, these could add to the price an eventual acquirer would pay, in the form of "goodwill". There are two ways to claim protection.

The first and most secure way to protect your trademarks and service

marks (see side panel for the distinction) is by registering them with the U. S. Patent and Trademark Office, which entitles you to use an ® after them. The other method is to consistently provide notice of your claim in an unregistered trademark or service mark by using ™ or ℠ after them, respectively.

Registering your marks gives a higher level of assurance to a buyer and, given the modest cost, is usually worth the effort. It also protects you by:

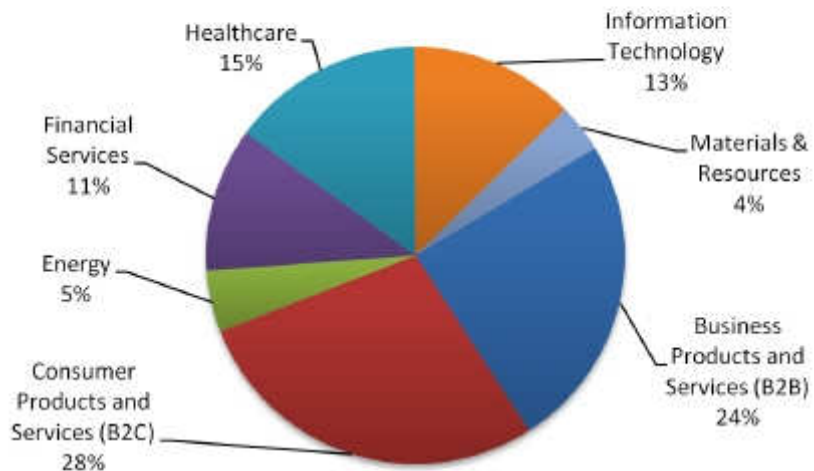
1. giving you notice, at the time you file, if the mark, is already registered by

someone else 2. precluding someone else from registering the same or similar marks.

You don't have to register your marks to claim property in them but when you sell your business failure to protect your marks with registration could result in a lower price and/or a holdback of part of the price while the buyer tries to register the marks.

If you are a licensor or licensee of any intellectual property make sure that your rights will be protected in a bankruptcy. Consult an IP or bankruptcy attorney.

The chart below shows where the M&A action was in Q1 of 2009. This chart focuses on transactions executed by Private Equity Groups but is a fair representation of the pattern of action as a whole. These represent 188 transactions (versus 590 in Q1 2008) of which 66% were buyouts. Median buyout value was \$39m. The remainder were injections of growth capital.



Source: PitchBook Platform

Consumer Products & Services (B2C) rose from 24% of deal flow in 2008 to 28% of deal flow in 1Q 2009, overtaking the Business Products & Services (B2B) sector as the most active sector in 1Q 2009. Business Products & Services (B2B) tumbled from 35% of deals in 2008 to 24% of deal flow in 1Q 2009.

“...do not rely on vague statements such as *Generally Accepted Accounting Principles (GAAP)*.”



“Leaks can often come from employees who are not told anything.”

## Seller's Due Diligence

“Due Diligence” is typically associated with the buyer carefully evaluating the seller's business. It should be a two way street, particularly if the seller is going to continue to work in the business and/or will receive contingent payments (such as an earnout).

### Is this a Viable Buyer?

Is the buyer financially qualified to do the deal? Your investment banker should have done an initial screening prior to presenting the business to the prospects. When it comes to evaluating Letters of Intent (LOIs) you and

your advisors should request financial details and/or references from the prospective buyer. If you accept one parties LOI discussions with others will be suspended so you will need to know who is capable of doing the deal.

### Is This a Good Fit?

If you're expecting to be working in the acquired business beyond a short transition period you must be comfortable with the “fit”. Typically you'll no longer be in charge so you need to assess if you can comfortably work with the new owners management team. Meet the team early

in the negotiation process.

### Will the Rules Change?

If you'll be paid an earnout or other contingent fee you must understand the rules upon which this will be based. The rules should be very explicit and not rely on vague statements such as *Generally Accepted Accounting Principles (GAAP)*.

### What's the Buyer's History?

If the buyer has made prior acquisitions discover how those worked out for the sellers? Were there any relevant points of contention after the sale?

## Loose Lips Shrink Values

A recent large scale study by the Cass Business School at City University London revealed that leaks about M&A transactions have several important effects including the following:

- Leaks decrease the likelihood that the deal will close.
- Leaked deals take 70% longer to close.
- Leaked deals close at a 14% lower price.

While the study focused on public companies the lessons are clear. Deal leaks also happen in private company transactions and also have an impact on price.

### How do private deals leak out?

The leaks about a pending sale or acquisition of a private company don't often come from the company's professional advisors (lawyers, investment

bankers and accountants) who build their business on confidential relationships.

Leaks don't often come from potential buyers because its against their own interests as it can lower the value of the business and increase the competition for it.

Most leaks come from employees of the seller. These can be employees that of necessity become aware that a sale is being mooted (such as a bookkeeper, a manager or a salesman). If they are informed and told of the necessity to keep it confidential they are less likely to talk.

Leaks can often come from the employees who are not told anything but observe that unusual things are happening without explanation. The

trigger could be a parade of “suits” or a sudden interest in precisely tracking inventory or requesting detailed reports.

Unexplained changes make employees nervous and when they're nervous they talk to one another and to customers and to suppliers and make them nervous too.

### What can you do?

- Prevent rumors. Give a *reason* for unusual events well before they happen. (e. g. The “suits” are advising on cost reduction).
- Understand who is likely to figure out what is happening and tell them yourself seeking a personal confidentiality promise.
- Be sure that all your employees have executed non-disclosure agreements as part of their employment contract.

## Long Term Capital Pain

Business owners considering a sale in the next 4 years should be aware that the federal long term capital gains tax rate (LTCG) is being revised. This tax applies to the net proceeds from the sale of a business. The current LTCG rate of 15% was scheduled to revert to 20% on December 31, 2010.

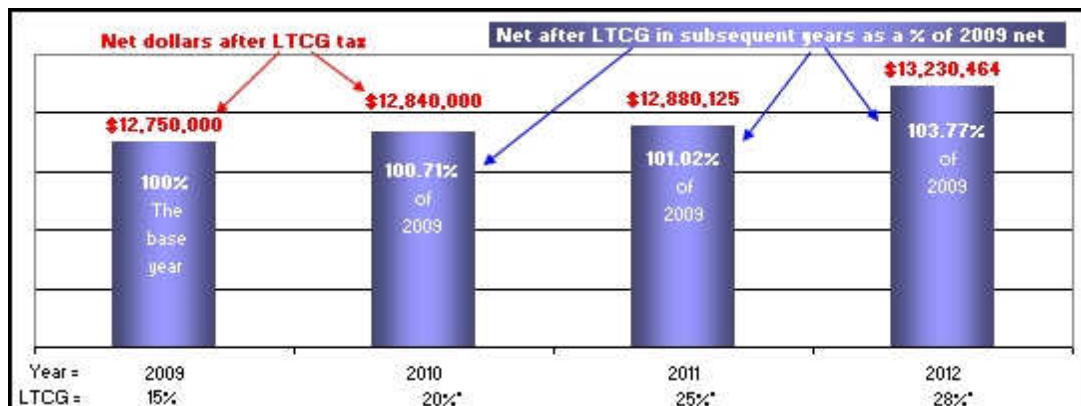
In 2008 Obama indicated that he wished to push the LTCG rate as high as 28%. The President's 2010 budget proposes a LTCG rate of 20% in 2010 for those earning \$200k or more. Based on Obama's stated target rate of 28% we project that the LTCG rate will rise to 25% in 2011 and then to 28% in 2012 as the economy recovers and the deficit is paid down.

The graph below uses the projected LTCG rates referred to above and these other assumptions for *Hypothetical Co.*:

1. 2009 revenue will be \$20 million.\*
2. Year to year revenue growth will average 7% through 2012.
3. EBITDA\*\* will be a steady 15% of revenue\*.
4. Seller's Basis is zero (the whole sale price is subject to LTCG).
5. Seller's taxable income is  $\geq$  \$200k.
6. The market price for the business is steady at 5X EBITDA\*.
7. No provision is made for the deductible costs of a sale.
8. No provision is made for the state LTCG tax (current range: 0% to 8.98%).



\*Changing the 2009 base revenue, the fixed EBITDA or the price multiple does not affect the net percentages.  
 \*\* EBITDA= Earnings Before Interest, Taxation, Depreciation and Amortization



*“...Year-on-year revenue growth through 2012 ... (22.5% cumulative growth) will result in just 3.77% more in net proceeds from a sale in 2012 than would a sale in 2009.”*

Year-on-year revenue growth through 2012 to \$25.5 million (22.5% cumulative growth) will result in just 3.77% more in net proceeds from a sale in 2012 than would a sale in 2009. Slower growth would net less than 2009. Other factors to consider:

1. Is your state LTCG tax likely to rise as the state attempts to balance its budget?
2. Will your business be able to exceed this 7% annual revenue growth rate?
3. Is your current EBITDA as a percentage of revenue sustainable through 2012?
4. Will your business sector become more or less attractive to buyers in the future?

5. Would selling now and reinvesting the proceeds elsewhere give you a better 3 year return than 3.77%?
6. The \$200k threshold for the higher LTCG rate could drop in future years.
7. The LTCG rate could plateau at 25%, increasing the 3 year net return to 8%.
8. Are the anticipated rewards of waiting commensurate with the risks?

Proceeds from a sale net of LTCG tax is not the only factor to consider but, as it can take 8-14 months or more to close a business sale, you must keep it in mind and plan well ahead to avoid surprises.

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## Where Did the Money Go?

Over 93% of Americans were as employed at the end of 2008 as they were at the end of 2007 but they didn't seem to be spending and that precipitated the consumer-led recession. Where did that unspent money go?

American individuals, in aggregate, turned from non-savers into good savers within 9 months. About \$20 billion was added to personal savings during Q1 2008 (about \$6.67 billion per month). During the ensuing 9 months \$323 billion more was added to savings (about \$36 billion per month).

At the end of 2007 personal savings represented about 13.6% of GDP. At the end of 2008 savings were up to about 16% of GDP. If this rate continues personal savings could represent nearly 19% of U.S. GDP by Q2 2009.

## Is This Pent Up Demand?

A perception of wealth (in unrealized retirement plans, property values, etc.) is said to have led the boom from 2003 through 2007. Change and confusion in 2008 created consumer fear, uncertainty and a loss of confidence. This in turn led to the closing of wallets. If this fear and caution ceases to grow there will come a point when those savings will flow out as consumer spending, thereby initiating a consumer-led recovery. When will that happen? Many estimates place the upturn Q3 or Q4 of 2009.

## Are We There Yet?

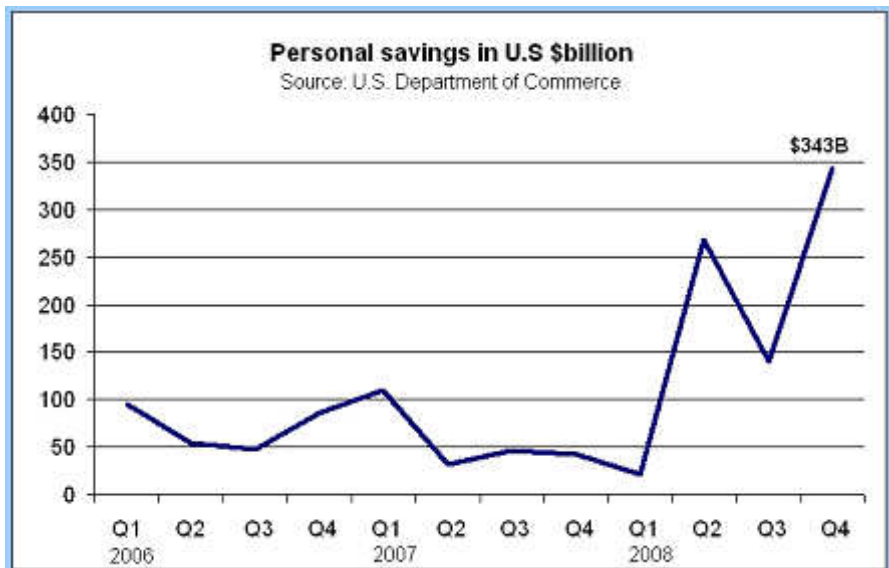
The decline in consumer confidence in the U.S., a leading indicator, flattened out in Q1 (per Nielsen).

Annualized GDP (output of goods and services) contracted by 6.1% in Q1.

Consumer spending, a leading indicator, increased by 2.2% in Q1 (the largest increase in 2 years).

Inventories of goods were drawn down in Q1 at the fastest rate since 2000.

Is this the end of the beginning?



## The Paradox of a Business Exit in a Recession

Many economists believe that we're at or near the economic nadir but that it's premature to believe that we're at the point of economic upswing. The bottom can only be recognized months after it happens because a "dead cat" will usually bounce several times (to borrow a stock market phrase) before a steady recovery is established. The most optimistic predict recovery during the summer but the consensus pick is Q4.

How does this affect the timing of a business exit? For profitable businesses (even with recent declines) exit values are very good for a variety of reasons. While there are bottom feeders around looking for bargains there are just as many potential strategic buyers with strong balance sheets looking to position themselves and their acquisitions for the upturn.

These strategic buyers are informed and cautious but they also know that buying cheap gets you what you paid for. They will take longer to negotiate the deal that is right for the combination of acquirer and target and not just for the lowest price today.

This creates an opportunity for owners of solid businesses to negotiate a staged exit that will provide the seller with significant liquidity now (at the lower LTCG tax rate) and a second bite at the apple when the economy recovers. Caution: This type of staged exit agreement needs to be carefully negotiated and tightly written with the help of experienced advisors.