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# Mind Your Own Business

## SPECIAL ISSUE: The Capital Crises

**Blackbridge**  
PARTNERS LLC  
Investment Bankers

### Inside:

- Alternative Sources of Capital
- Information Asymmetry
- Distressed Situations
- Retirement Accounts
- Can I Sell My Business in This Environment?
- Improving Inventory Efficiency

*“I didn't drop the ball – the ball fell from me.”*

### What's the Difference?

#### Wall Street Investment Bank

These investment banks act as underwriters or agents and serve as intermediaries between an issuer of securities and the investing public. They also deal in derivatives (unregulated contracts such as “swaps” and “CMOs”) with other financial institutions and institutional clients. They may also advise larger public and private companies (sales >\$500 million) on mergers and acquisitions.

#### Middle Market Investment Bank

These investment banks do not underwrite securities nor sell the same to the public, although they are typically affiliated with a FINRA licensed entity. They focus on advising private companies with sales of <\$150 million on mergers, acquisitions and private recapitalizations.

### What Just Hit the Fan?

Wall Street exists in a parallel universe where bankers and brokers benefit from the profits (like the 8-figure bonuses Wall Street executives paid themselves in Q1) but shift the losses of their bad decisions and Ponzi schemes to the rest of us by coming to the government dressed as beggars and disclaiming any responsibility for the consequences of their own behavior. “I didn't drop the ball – the ball fell from me.”

What happens on Wall Street usually has little to do with what happens in small business but their high crimes and misdemeanors are bleeding into the rest of

the economy where access to capital will remain tough despite the various government loan guarantees and bailout schemes.

The other universe, our universe, is the one consisting of 22.9 million small businesses, which account for over 50% of private sector jobs and create 75% of all new jobs in the U.S. every year. That's the one where we all live and work and build our businesses.

We shouldn't let our feelings of anger and betrayal keep us from acting to protect our own

small businesses and, consequently, the economy and our pension funds which are invested in that same Wall Street. We've all been through recessions before. Almost 98% of small businesses survived each of the last 10 recessions and the most active companies during those slow times see the most rapid growth when the recession ends. As an entrepreneur you're already a focused, motivated and pragmatic problem-solver, risk-taker, optimist, Jack of all trades and networker. We hope some of this information from the experts that we consulted will be of help.

### Passivity is Not a Viable Option

We all know that passivity is not a winning strategy in a recession. Here are a few suggestions from the experts whom we consulted:

**Get the Whole Team Involved** You may feel that you're in it alone but you're not. Your employees and their families are also affected so keep them informed and involved. This will help you to keep key employees and to avoid the distrust and panic that comes from being kept in the dark.

**Sales and Marketing** Now is not the time to lose your visibility with customers and prospects. They'll need to make some hard choices and you need to be

amongst the options they consider.

- Increase your advertising budget if you can, but only use advertising vehicles that have worked for you in the past. This will ensure that you will receive an adequate return on your advertising investment.
- Use guerilla marketing. That is, get yourself and your business exposed to customers and prospects in ways that cost you little or nothing by, for example, offering yourself as speaker or to be interviewed by a trade magazine, etc.
- Spend more time on sales and deliver the best service possible.
- Offer discounts for early payment (e.g. 5% net 30)

which will benefit both you and your customers.

- Offer bonus goods or services to customers in order to encourage loyalty without significantly cutting into your margins.

#### Conserve Cash

- Review expenses on a weekly basis (or even daily) and trim any excess.
- Brainstorm with the entire team (not just management) on ways to reduce expenses and costs. Creative ideas can come from anyone and lots of small savings add up to big ones.
- You can also hire “cost reduction” experts to look for savings. Their fee is usually a percentage of what they save you on

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*“Work with employees to create a deferred remuneration plan...”*

### **...Passivity...** *Continued from page 1*

materials, shipping, utilities, stationery, rent, etc.

- Increase your own work hours so that you can get more done with fewer people (and you don't have to pay yourself overtime).
- Try to avoid hiring replacements for departing staff. Work with employees to create a deferred remuneration plan and they may be willing to take up the slack at no current cost and wait to be repaid when things improve (consult your attorney).

**Access to Capital** Even long-standing banking relationships can be under strain in the current

environment. Our research has found that most commercial lenders did not get hit by the housing bubble and have plenty of money available to lend to businesses but a few things have changed.

- Expect to pay a higher interest rate as most commercial loans are tied to the LIBOR rate which has gone up sharply. Try to find a lender that uses U.S. Treasury rates rather than LIBOR and they may offer lower interest rate.

- Collateral requirements may be higher and some banks may want to factor your receivables (that is, collect them for you and

pay themselves first before turning over the remainder to you). Try to avoid factoring as it may send the wrong message to customers.

- The loan covenants (or trip wires) and reporting requirements for loans may be more restrictive. That is, you may need to provide your lender with P&Ls and Balance Sheets more often and they will read those documents more carefully to look for any signs of weakness.

- Look for alternative sources of capital (more on this below).

### **Alternative Sources of Capital**

As odd as it may seem, the current economy has actually widened the overall capital base that is accessible to businesses in the “lower middle market” (businesses with revenues of \$5-\$150 million).

#### **Private Equity Groups**

There are hundreds of billions of dollars controlled by the 1800+ Private Equity Groups (PEGs) in the U.S. They've turned to the lower middle market for the simple reason that PEGs are also having difficulty borrowing money on attractive terms for larger deals. They're now looking to participate in smaller deals where they will not have to borrow.

PEGs often like to take a controlling interest in a business but they're also interested in backing existing management by taking minority stakes and by providing loan capital at

attractive rates. (Note: PEGs usually won't lend without taking at least a minority interest in the business).

Of course each PEG has its own sectors of interest and its own investment criteria. They are looking for “platforms” (first investments in a sector) and for add-ons to existing platforms. Platform investments are typically in businesses with sales of over \$20 million but add-ons can be as small as \$3m in sales.

A PEG investment can have the added advantage of supporting a strategy to grow your business by providing easier access to further capital.

#### **Strategic Investors**

Bigger businesses that had been making larger acquisitions in their sectors had been borrowing a big piece of the price they paid

for those acquisitions. Now large scale loan capital is not available to them on acceptable terms from the usual sources. Some of these companies have plenty of cash to make smaller investments and acquisitions without borrowing and they're actively looking to do so during the recession.

Our research has found that some of these strategic investors will look at quite small businesses if those businesses can bring a specific piece of value to the table such as a key customer, a new product or service to bring to existing customers, some new customers for existing products, access to new geography, etc.

It should be noted that because of the above synergies strategic investors will often offer better terms than PEGs do.



*“The current economy has actually widened the capital base accessible to businesses..”*

## Information Asymmetry

"Information Asymmetry" is characterized by a situation in which one party to a transaction has more or superior information compared to another. This could be a harmful situation because one party can take advantage of the other party's lack of relevant knowledge.

In the present context both strategic investors and PEGs will probably know more about recent business values, investment and acquisition terms, covenants, earnouts, convertible

debentures, preferred shares, puts, calls, etc. than you do and they will use that to their advantage in a negotiation. The advantage inherent in this imbalance can be magnified by the pressures on you to act promptly in an uncertain business environment.

You can eliminate this imbalance and even gain an advantage by engaging investment bankers who are familiar with this type of investment environment to advocate and negotiate on

your behalf. You can gain a further advantage when they create an auction style competition for your business.

Of course, it's essential to have attorneys on your side to validate that the documents match the deal and to protect your interests but first you need to find an investment bank (not the Wall Street type) to advocate for you and you will get a much better net price from the deal despite the stressful environment.

*"You can eliminate this imbalance and even gain an advantage...."*

## Distressed Situations

Businesses that are facing possible bankruptcy or dissolution are said to be in a "distressed situation". As upsetting as that can be passivity is still not the best option if disappearance of the business is not the goal.

Consider a business that had been in operation for more than 50 years, had a strong customer base and sales of

\$20 million. It overextended itself by acquiring modern capital equipment to remain competitive just as it lost a key customer. In the current credit squeeze, it could not raise loan capital from its bank in order to restructure its debt and clear operational payables. Other banks were not responsive and the company was put into involuntary dissolution by a

creditor/supplier that was owed a mere \$500k. The business was dissolved and the owners received little.

There are investors that specialize in distressed situations. It's better to explore options with them before a dissolution petition is filed as the business may be kept alive, even in a new and smaller form.



## Retirement Accounts\*

If you have a retirement account or mutual fund that is invested in the public equity markets then the recent shrinkage of share value on Wall Street has probably got your attention. Is it something that you should worry about?

The experts say that what we're seeing is panic selling that has nothing to do with the underlying fundamentals of the businesses (excepting the collapsed financial institutions). Much of the volatility is caused by "technical traders" who care nothing about the longer term viability of the

businesses but who only gamble on the short term price fluctuations. Many of these technical traders are at the same institutions that precipitated the current financial crises.

While the market seesaws Warren Buffet and other wealthy investors are snapping up bargains and listed companies are starting to buy back their own shares because they are now at or below book value.

Most people are more concerned about where the prices will be when they retire than where they are

during a period of high price volatility like this. However, these events begin to merge if you're looking at short time lines to retirement.

The experts say that it's now a bad time to pull money out of a 401k and that you should wait if you can. If you need cash to top up a 401k or for current personal or business use you might want to consider seeking an investor in your business. Also consider that the money that you take out of your business now will qualify for long term capital gains tax at the rate of 15% but this is scheduled to rise to 25% after 2010.

\* This is for informational purposes only and must not be construed as tax or investment advice. Always consult a professional tax advisor when considering the tax consequences of any transaction.



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

As a leader in mid-market sales, mergers and acquisitions, investment banking services, and corporate recapitalizations we deliver professional client services to a global audience with first class results.

**Specializing in the Middle Market – Businesses with sales of \$5 – \$150 million.**

## Can I Sell My Business In This Environment?

We're constantly in discussion with Private Equity Groups, Angel Investors, Venture Capitalists, and Strategic and Corporate Buyers. They're all telling us the same thing. They have money and they are still looking for good quality opportunities. Yes, they are being more cautious and yes they will take a little longer on due diligence than they might have prior to the downturn. They may also require more tripwires and covenants in the Purchase and Sale documents but they're still anxious to do deals.

Those who invest with these Private Equity firms do so because they expect to get a good return from the PEGs investment in and purchase of good quality businesses. They don't want the

Private Equity firms to sit on the sidelines collecting management fees. This can work to your advantage.

While you may feel that this is a lousy time to consider selling your firm, we suggest you seriously explore it now if you've given any thought to a transition sometime in the next 3-5 years. The process of a business sale can take a year or longer and most acquiring firms will want you and your senior management team to stay on for a transition period of 1 to 2 years after closing and they will provide financial incentives for you to do so (an "earnout"). This earnout gives you, as the seller, a "second bite at the apple". That is, if you grow the business after the sale, even with the

PEG's financial support, you can actually get an even higher final price.

No one knows when the present recession will ease but, based on recent history, it's likely that your final exit will be enhanced as the economy begins to expand again in 18 to 24 months.

If you would like to discuss your liquidity options further, please feel free to contact us. There is, of course, no charge and no obligation to continue our discussion or to work together. Our experienced investment bankers are happy to help you to consider and evaluate your options in this trying environment.

