



Ongoing liquidity programs can keep relatives on board

Offering family shareholders a chance to redeem some of their shares can enhance your relationship as business partners.

IN ONE FAMILY BUSINESS I know, the family managers wanted to buy out a group of family board members who were not involved in management. The managers, however, feared that recapitalizing the business to raise debt capital would impede future growth. Instead of a buyout, they created an ongoing redemption program that allowed shareholders to sell some of their stock each year at a preset valuation and within certain redemption guidelines. The share price would be determined by an annual valuation.

They instituted this program five years ago, yet to this day no shares have been sold. By offering liquidity to the shareholders on an annual basis, they alleviated a feeling of forced illiquidity and united the family. There are two types of redemption programs. One involves buying out family members; the other, commonly called an ongoing liquidity program, offers regularly scheduled opportunities for shareholders to redeem some of their shares.

Many family business leaders considering setting up an ongoing liquidity program are concerned that family redemptions might drain the company's financial resources and create splits in the family. However, as occurred at the company above, what may start as a family buyout actually can evolve into a more friendly shareholder redemption program.

Pricing the shares is more art than science and may depend on how the family defines fairness.

Preventing future conflicts

In the case of a buyout, the value of the shares being repurchased is often determined either by contractual arrangement, as may be the case in a buy-sell agreement, or through negotiation between the company (the buyer) and the selling shareholders. In the latter case, the valuation will be influenced by the friendliness—or the hostility—of the negotiations.

A buyout terminates the relationship with the selling shareholders. As in an M&A transaction, each party wants to get the best price. But in family companies, the parties will continue their family connections after their business relationship is dissolved, so it's important that the negotiations be friendly. Including buyout provisions in the shareholder agreement will help prevent future family conflicts.

In an ongoing redemption program, the purpose is not to terminate the business relationship but to enhance it by providing some or all of the shareholders an opportunity to cash in on appreciation in their holdings. Therefore, such programs must take into account the objectives of the company as well as those of the shareholders who wish to redeem some of their shares.

Pricing complications

Three variables determine the effectiveness of an ongoing redemption program: how it's structured, how it's funded and the valuation method used to price the shares. The thorniest variable is how the shares are valued. One reason is that pricing is subjective and depends on the purpose of the valuation. It is more art than science and may depend on how the family defines fairness. Some redemption programs are set at a very low value to discourage family shareholders from selling and to establish a low company value for estate tax purposes. Other redemption programs are set at a high value to encourage minority shareholders to sell and eventually reduce the number of shareholders.

Another pricing complication concerns the amount of liquidity available. The more liquidity the company has, the greater the extent to which it can fund the program. But ample liquidity will increase the value of the shares by reducing the amount of the discount. If the family is large, with many buyers and sellers, the value of the company will also be affected.

The valuation must be fair to the sellers as well as to those who stay in. Because most valuation programs involve a partial, rather than full, shareholder buyout, the company must be able to defend its valuation to both sides of the family. Even if there is a set of "obvious" sellers at the outset, that might change over time.

A liquidity program should not be designed as a one time event. When shareholders have an ongoing ability to sell, the company will have an easier time coming up with a valuation that's interpreted as fair—because in any year any shareholder may be a buyer or seller. Thus there's less trouble finding a middle-ground valuation that's fair for both buyers and sellers with ongoing liquidity programs.

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Because the valuation used in a redemption program will have some tax and accounting consequences, it's wise to settle any unresolved estate issues before creating a liquidity program. In most countries, estate tax value will depend not on whether there's a program in place, but whether the program has been used.

Valuation methodologies

Three different valuation methodologies can be used in ongoing redemption programs. Each method has advantages and disadvantages.

1. Valuation formula. The family has agreed on a predetermined formula, such as a book value, a percent of book value or cash flow multiples.

Advantages: This method is very predictable and stable year after year and is not subject to outside market conditions. It is also very transparent to potential selling shareholders in the ongoing liquidity program, and easy to communicate to them. Another advantage lies in the method's simplicity; annual computations are unnecessary.

Disadvantages: The formula may be out of sync with the actual market value. When the industry is hot and the market is trading at twice book value, shareholders are not likely to want to sell at book value.

2. Market valuation. A trusted family advisor performs a valuation of the stock every year based on up-to-date valuation multiples and parameters. Discounts to public-market values for lack of liquidity and marketability may be applied.

Advantages: Because the price will be close to the market, it should be easier to agree on a fair price. Participation in the redemption program may be higher than it would be if a valuation formula were used.

Disadvantages: Because the price is likely to fluctuate year to year, it is difficult for shareholders to do long-term planning. If they decide to sell stock today vs. two years from now, they must take into account what they think the market will do. Shareholders who use a fixed value need worry only about how well the company will do in terms of book value. Determining whether this is the right time to sell requires a greater level of shareholder sophistication—how educated they are, and how well the company's governance structure has informed them about the opportunities.

Another disadvantage is that this form of valuation is often subject to interpretation of the "right" amount of discount to the market. Discussions of this topic can be contentious, so we recommend that shareholders agree to use a fixed discount of market value when they set up the program.

3. Dutch auction. This method named after the Dutch tulip auctions involves no valuation and no predetermined formula. Each selling shareholder establishes his or her own valuation within parameters set by the company.

The company first determines how many shares it will be purchasing or how many dollars it will allocate for the Dutch auction. Within set price parameters, each selling shareholder informs the company how many shares he or she is willing to sell at specific price levels. The company then fills sell orders, starting with the lowest price, until its set number of shares or dollar amount has been fulfilled.

For example, if shareholder A is willing to sell for \$50 a share, Shareholder B will sell for \$75 and Shareholder C will sell for \$100, the company will use its available cash to purchase A's stock first. (Shareholders could set different prices for different stock quantities.)

Advantage: The major advantage of a Dutch auction is that it avoids any discussions regarding the amount of discount for liquidity and marketability used in the valuation.

Disadvantages: This method puts the valuation burden on the selling shareholders, therefore requiring even more shareholder education than market and fixed valuation methods. Shareholders must be aware of what the valuation is under current market conditions and what it might be under possible future conditions.

There's also a little bit of a poker factor in Dutch auctions. As a seller, you must predict how the rest of the shareholders will react. If you feel you're the only seller (that is, if other shareholders don't seem to want to sell), you can set your value pretty high. But if you really need your liquidity this year and a lot of other shareholders are seeking to sell, you should set your price low.

by François de Visscher

We will be speaking or participating at the following conferences:

Master Class in Family Offices and Private Equity

April 10th, 2008, New York, NY

Business Growth Alliance Northeast Conference for Family and Closely Held Businesses

April 30th, 2008, Greenwich, CT

For more information please visit www.businessgrowthalliance.net

The Estate Planning Council of New York City The Princeton Club of New York

May 1st, 2008, New York, NY

University of Toledo

May 6th, 2008, Toledo, OH

Family Firm Institute Conference

Oct. 29th – Nov. 1st, 2008, London, England

For more information please visit www.ffi.org

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Ahola Payroll Services Overview

The Pursuit Group, a member of the Business Growth Alliance which was co-founded by de Visscher & Co., helps closely-held companies identify and execute strategies to make business development efforts more effective and efficient. Their capacity to integrate branding, marketing communications, and lead generation with sales and customer retention processes has helped dozens of business-to-business companies truly optimize the complex sales cycle.

One such company is Ahola Payroll Services, a second-generation, family business based outside Cleveland, Ohio. Thanks to their investments in software and product development, the Ahola family believes they are well-positioned for growth in their niche market: the special payroll processing and related HR needs of family-owned businesses in the U.S. They were not as convinced, however, that their marketing and sales approach could lead them to their growth goals.

Following an introduction by de Visscher & Co., Ahola asked The Pursuit Group to conduct an assessment of the company's efforts. The Pursuit Group met with Ahola managers, interviewed sales and marketing staff, and reviewed corporate processes, communication materials, technology tools and customer data.

The outcome was eye-opening. "Our assessment yielded very clear strategies necessary for Ahola to grow in their marketplace," says Barry Rosen, President of The Pursuit Group. "They have a solid foundation, but were missing key opportunities to more effectively reach their target audience and more efficiently allocate their sales resources."

With support from The Pursuit Group, Ahola is now working on implementing those strategies, and company leaders are decidedly optimistic. "We finally have the right plan and team in place to get to that next level," says Jeff Ahola, CEO. "The Pursuit Group will play an instrumental role in helping us get there."

The following services provided by The Pursuit Group are of particular interest to family businesses:

- Marketing and sales assessments
- Lead generation and qualification
- Branding, collateral, audio and video production
- Sales tool identification and implementation, including
 - CRM
 - Two-way communication tools
 - Proposal and presentation development technology
- Large account process development
- Specific account pursuit

For more information on The Pursuit Group, visit www.thepursuitgroup.com or call 866-4-PURSUE.

For more information on Ahola Payroll Services, visit www.ahola.com or call 800-727-2849.

Weathering the Current Credit Market Storm

As the cold weather of winter settles in, there is also a distinct chill in the formally friendly credit markets. With the sub-prime loan problems sending ripples through the credit markets, mid-market companies are increasingly finding it harder to get the money they need to run their businesses, particularly those with anything but a pristine credit history. Sure, the Fed is doing what it can by dropping the federal funds rate at a pace not seen in decades, but businesses are experiencing a much less favorable lending environment as lenders have tightened loan underwriting standards, decreased spreads, instituted less-relaxed covenant terms and increased the equity component required for transactions. In addition, many suppliers have implemented tighter credit terms, so companies no longer have the same flexibility managing their accounts payables. Taken together, and in contrast to the past couple years, the dynamics have shifted and companies should now give stronger consideration to other alternatives and financing options.

One option to consider in a tightening credit market is turning to Private Equity. Despite the economic slump, the Private Equity industry remains awash in cash. In fact, according to the January 2008 edition of the Dow Jones Private Equity Analyst, U.S. Private Equity firms raised \$302 billion in 2007, a 19% increase over the \$255 billion raised in 2006. In an effort to put this money to work, Private Equity firms may consider shorter-term investments to help address a void that businesses may have looked to traditional lending options to fill. In addition, Private Equity firms are likely to move "down market" a bit to focus on mid-market businesses that are more plentiful and less dependent on Wall Street driven financing syndicates.

Another alternative to the credit markets is Hedge Funds. The difference between Hedge Funds and Private Equity capital has become less discernible as hedge funds broaden their investing activities. Although previously characterized by short-term investments, Hedge Funds have shown a willingness to invest in longer-term positions in privately held and family owned companies. Hedge Funds also continue to raise record amounts of cash and could use the tightening of the credit markets as an opportunity to provide debt or hybrid financings, to help businesses refinance existing debt.

A third alternative is foreign investment capital. Driven by a weak U.S. dollar and domestic economies that have largely been unaffected by the credit issues in the U.S., foreign investment has been increasingly more prominent in today's transaction environment. From mature economies in Europe, to developing countries looking to move beyond their borders, to sovereign funds of the Middle East, foreign investors have become more prominent players in the U.S. for mid to large-sized companies. Although the foreign investment alternative may not be as good a fit for debt refinancing, it should be considered if a business seeks to recapitalize or strengthen its balance sheet with equity.

These alternative types of funding have helped keep capital markets buoyant despite the credit market turmoil and have been a key reason transaction multiples remain at attractive levels. So, if as a middle market business you are unhappy with the lending options offered by your traditional lending alternative, consider the various other funding resources that remain vibrant despite the current market turbulence.

by Ross Sealfon

Strategic Valuation for a Family-Owned Premier Branded Product

de Visscher acted as exclusive financial advisor to Teddy and Arthur Edelman, Limited ("Edelman Leather"), the world's premier branded luxury leather provider in four major niche markets – high-end residential interiors, corporate interiors, hospitality and private executive aviation.

Teddy and Arthur Edelman had founded and developed an international business providing exceptional product quality and service to its luxury markets and well-recognized customer base. Primary ownership of the business had been transferred to the second generation under the leadership of their son John as President. Given its strong continued growth, the company had received expressions of interest from potential strategic as well as financial purchasers and the shareholders decided to obtain professional investment banking advice. de Visscher was selected from several firms, given its experience in maximizing shareholder value for family-owned businesses, as well as its domestic and international contact network.

We conducted a carefully focused sale assignment on a tight timeline, contacting a select number of potentially interested parties. The ultimate purchaser provided a very strategic fit with clear synergistic benefits and an ongoing key role for the management team and employees. As a result of the process and the company's growth record with continuing strong financial results, the shareholders received the appropriate premium level of valuation for their business. In addition, the family felt that they had passed the quality reputation of their business into good hands.

"de Visscher & Co. took time to learn the company's business and potential and to understand the shareholders' objectives. As a result, we worked smoothly together throughout the process, driving the transaction forward while the management team continued to produce strong operating results."

John Edelman, President
Teddy and Arthur Edelman, Limited

October 2007

Knoll

through a wholly-owned subsidiary has
acquired the assets of

Teddy & Arthur Edelman, Limited
EDELMAN[®]

The undersigned served as exclusive financial
advisor to Teddy & Arthur Edelman, Limited



de Visscher & Co.

This announcement appears as a matter of record only.



Employee News

We would like to welcome **Ross Sealfon** who joined us as an Associate in July 2007. Prior to joining the firm, Mr. Sealfon was an Associate in Ernst & Young's Transaction Advisory Services Group. Mr. Sealfon earned a BA in Psychology from Middlebury College and an MBA in Finance and Accounting from Boston College's Carroll School of Management.



de Visscher & Co.

is an independent financial advisor to business owning families and closely held businesses worldwide. Through a unique combination of financial advisory, capital raising and investment banking services the team at de Visscher & Co. creates high value-added solutions to the liquidity needs of shareholders and the capital needs of their businesses.

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A National Affiliate Network of seasoned, professional services firms dedicated to providing growth advisory and investment banking services to middle market and family-owned companies and their principals.

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