

Financial Advisory

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de Visscher & Co.

Proactive Steps in 2012!

By Jim Murphy

What are other family businesses doing now and what can our business do now to survive and prosper in this market? This is a common inquiry from business owners seeking advice from their trusted advisors, business consultants and financial advisors in the face of negative economic news stories and a lingering recessionary environment. Beset with a whirlwind of global financial crises, and an unsettling sense of uncertainty about the future, one can understand a business owner's sense of hesitancy and caution. The tendency to draw inward and not pursue growth and shareholder value creation strategies, however, can cause more harm than good, particularly when a downturn can create opportunities and be a catalyst for clarifying objectives and creating positive change. Some family owned and closely held business owners have been using the downdraft to rethink their strategies and priorities and take proactive steps to capitalize on some of the value creation opportunities that these unique circumstances provide.

Refinancing with Lower Cost Bank Debt

Interest rates are at historically low levels and lending institutions are now reopening their checkbooks. If a company hasn't refinanced its bank debt in the past two years, or taken advantage of available corporate borrowing capacity, the chances are good that it is missing out on one of the best, low risk, opportunities to increase shareholder value. Business owners are not shy in seizing low rate, home mortgage, refinancing opportunities to enhance personal wealth but are often hesitant to achieve a similar cost savings and value enhancement in the corporate setting. Low rate interest environments offer not only lower carrying cost opportunities but the chance to access more capital, lengthen loan amortization periods and, in some cases, remove longstanding personal guarantees.

Go on "Offense"

Many businesses have already hunkered down in a defensive mindset. Well positioned and self-secure management teams are now going on the offensive to take advantage of once-in-a-lifetime acquisition and hiring opportunities. Strategic acquisitions, where the business fit makes sense, can always attract the necessary financing. In addition, key sales professionals and top producers may be more amenable to making a change to join forces with growth-minded enterprises. If full shareholder liquidity seems to be a less viable alternative today, then the corollary, that growing through acquisition has to be a timely strategy, has never been truer. It is likely that we will look back and say that business owners should have taken advantage of the buying and hiring opportunities that were available in 2012.

Take Advantage of the Opportunity to Plan

If there is a silver lining hidden in periods of slower economic growth, it is that challenging markets bring focus and attention to what is truly important. They also bring the opportunity to look inward and self-examine some of the strategies and ways of doing things that might be altered for the better. Over time, certain policies, marketing methods and strategies can lose their importance or relevance and

should be sunset. Family business surveys repeatedly indicate the less than 30% of business owners have a detailed, five-year, strategic plan to guide the company and demonstrate that management has thought out where it wants to focus and why. A detailed strategic plan is one of the most underappreciated and underutilized, but highly effective, weapons a business owner can employ. If it is not deemed a priority to have a strategic plan when the market is tough and margins are under pressure, then when will it be appropriate?

Update Technology and Capabilities

Many closely held companies are behind the pace of fast changing technology and have not integrated new communications methods and strategies into their enterprise. E-mail marketing, webinars, social media tools, blogs and Twitter have all contributed to a new frontier in business marketing and communications. Cloud computing, better data collection and industry-specific, business performance metrics are all projects that are often recognized as "important but not urgent" and therefore have typically been given less attention than necessary.

Access Longer Term, More "Patient Capital"

Business owners seeking longer term, more flexible sources of capital can be encouraged by a new breed of capital source emerging to challenge the traditional sources of private equity and mezzanine debt funding. Family offices and certain hedge funds, having become further dissatisfied with the high pricing and volatility in the public markets, are allocating more capital to longstanding and more stable private company enterprises. In addition to offering longer investment horizons, of seven to ten years or more (patient capital), they tend to offer more "family friendly" capital from the stand point of investing in minority ownership positions (keeping control) and more variety in the capital structure and governance provisions (flexibility) by offering common stock, preferred stock, or subordinated debt alternatives and, in many cases, investing in the same securities as the owners (alignment of interests). In short, patient capital investors allow a business owner to access capital to achieve more objectives for the business and family without having to give up control.

Taking Action

There is an old coaching adage that says: "you are either getting better, or getting worse, you're not staying the same." Despite the past year's volatility and uncertainty, this is no time to merely hold on. There are many ways to create shareholder value currently and to position a company to maximize its potential to gain from the forthcoming recovery. We are optimistic for 2012 because of the growing number and variety of specialty capital sources and niche lending programs, many of which are inclined to support companies with less than perfect credit histories. Proactive steps and a bias toward action are what define entrepreneurs and have driven them to seek control of their own destinies. We believe we will see more of that "can do" mindset in the next twelve months.

Is Now the “Best” Time to Sell?

We can never be certain of that, but it's certainly a good time to think about it.

By Terence Hannafin and Anthony Macaluso

You've weathered the storm. It wasn't easy but an unwavering dedication to the business and ability to make many tough decisions has paid off. As a result, revenues and earnings have rebounded and the balance sheet is healthy again. With the business again on solid footing, your family has made yet one more very difficult decision - to explore a liquidity event. But, is now the “best” time to explore a sale of the Company? We can never be certain of that, but it's certainly an excellent time to think about it.

To say we've witnessed a lot over the past several years would be more than a mild understatement. Since then, we've experienced a near collapse of our banking system, a freezing of our credit markets, substantial volatility in our equity markets, battered consumer confidence, uncertainty with respect to tax legislation (i.e. capital gains, estate tax), and the list goes on. Needless to say, it wasn't an environment supportive of a robust M&A market.

Fast forward to today. According to FactSet Research, the number of transactions completed during the twelve months ending November 2011 is up 5.9% over the twelve months ending November 2010, proving that deal activity stayed consistent during 2011, despite the economic uncertainties – the U.S credit rating downgrade, the Eurozone debt crisis, volatile equity markets and macroeconomic concerns – that have persisted recently. Interestingly, although deal activity has remained somewhat flat in 2011, the overall value of all U.S. deals for the year is projected to be \$894 BN, an 18% increase over 2010, per Ernst & Young LLP's transaction advisory services group. So what's fueling the increase in M&A valuations? On one hand, it's the improvement in operations that many middle market businesses have been able to achieve in the past year, as a result of increased focus on business fundamentals (“internal factors”). On the other hand, it's the confluence of many outside factors (“external factors”) which together create a receptive market place. A few of the external factors that maybe driving today's increased M&A valuations are below:

- **Record levels of cash on corporate balance sheets** resulting from restored profitability post-recession and a generally conservative, “cash is king” approach to capital spending over the past several years. As a result of this conservatism, many large corporations put off necessary capital expenditures during the downturn. A renewed focus on growth (versus the defensive mentality of the past few years), may encourage an acquisitive environment versus a buy and build strategy and stimulate strategic M&A activity;
- **Credit is available** for high quality companies as lending institutions have funds to invest, yet they are reserving that capital for the most attractive opportunities. However, there is a lot of capital chasing

good opportunities, so pricing is very competitive, thus benefiting borrowers;

- **Interest from foreign buyers** remains keen as foreign companies seek to access the U.S. market (and its management talent, proprietary IP, brands, etc) and capitalize on favorable currency imbalances;
- **Capital gains tax rate extended...** for the time being. A topic of much ambiguity in 2010 (along with Estate Transfer taxes), the government agreed to extend the Bush era tax cuts through 2012. While tax codes should not be the driving factor in your decision to explore liquidity, they should be considered as they can be impactful;
- **Private equity firms are hungry to “put money to work”** as they collectively sit on nearly \$1 trillion of “dry powder” (along with a mandate to invest – or give the funds back to their investors). The stabilizing credit markets are helping sponsors fund prospective deals.

In the backdrop of today's environment, the current M&A market has created opportunities for business owners to attract capital, form strategic alliances or obtain liquidity at attractive valuations. We believe that window of opportunity will continue, at least for the near future.

A Word of Caution

Business owners who have made the decision to sell their companies too often attempt to “time the market” perfectly – that is to sell at the peak of its value – or may have unrealistic expectations about the price they may receive in a sale process. Like their publicly traded counterparts, the value of privately held companies will fluctuate based on a variety of “internal” (revenue, profitability, leverage, IP, management team, key customers, etc.) and “external” factors (a few are discussed above). While some may be fortunate enough to time it just right (in hind-sight), this tends to be the exception more so than the rule. If you are resolute in your objective to seek liquidity, don't worry about “leaving something on the table”. Keep in mind, a company on solid footing, with strong growth prospects, will elicit the attention of eager buyers.

To answer the question we posed at the beginning of this article - **The best time to sell is ultimately when you're ready and when the external factors dictate market receptivity.** In our opinion, the external market factors are aligning in such a way that the upcoming year may prove to be the right time to explore liquidity options.

At the very least, even if you decide not to go through with a potential sale, exploring the opportunity will make you more educated about your business, your industry and the financial options available to you – making you a much more informed business owner.

WEALTH MANAGEMENT

In assessing risk, consider financial and operating assets

A total wealth management approach measures risks and rewards separately for the two types of assets -- and considers the emotional components.

By François de Visscher

Most family businesses and single family offices around the world are still dealing with the aftermath of the financial crisis. Many of them are confronting an interesting problem: a significant shift in the allocation of the family's total wealth between operating assets (the family business or other mostly illiquid investments) and financial assets (the family's liquid investment portfolio).

Most likely, both the operating assets and the financial assets suffered a significant devaluation during the crisis. However, the speed and magnitude of the devaluation of the two asset categories were not equal. A portfolio that was perfectly balanced before 2008 may now look very imbalanced, with an over-concentration of wealth in illiquid operating assets.

During down cycles, operating assets tend to hold more value than other investments. The value of financial assets – such as investments in hedge funds, private equity, bonds or other types of securities – is defined by short-term market factors and parameters. In contrast, the value of operating assets is determined by long-term external and internal factors (such as the “family effect”).

It may seem wise to try to rebalance such a portfolio. But when deciding what to hold and what to relinquish, few family business stakeholders consider the different risks and rewards involved for the two types of assets.

The return on financial assets is primarily tangible, and their risk is measured by volatility. The rewards that come with operating assets, on the other hand, are not just tangible or financial; they include the emotional connection that many owners feel to their company, their control over management and their desire to perpetuate family values. Operating assets are long-term in nature; they are measured by discounting the present value of long-term future earnings.

Risks associated with operating assets include fluctuations in value as well as business risks, such as product or market obsolescence, availability of working capital to meet cash flow needs and access to funding for future growth. For example, an operating company faces the risk that banks might cut off credit, especially if the company's customers and suppliers are also under stress.

Patient capital vs. modern portfolio theory

A family business owner whom I'll call Daniel recently told me, “I plan to sell all my toys – my cars, my boat, everything – and pour the money into my company to keep it afloat.” His company has lost about 20% of its value since the financial crisis began. Although it continues to return about 3% a year, he's feeling a cash-flow squeeze; his customers have been taking longer to pay and his bank has refused to extend his lines of credit.

Looking through the lens of financial assets' risks and rewards, it seems as though Daniel is just throwing good money after bad. But Daniel views his company as a family legacy asset. In his decision making, he factors in his emotional connection to the company and his previous track record as a capable entrepreneur who has navigated the business through previous economic storms.

Owners of family businesses that have plummeted in value during the past couple of years generally respond in one of two ways:

- **The patient capital perspective.** Like Daniel, people who are emotionally attached to their company want to keep it in the family at almost any cost. Because Daniel's family business has retained more value than liquid assets during the downturn, he can rationalize his decision to invest heavily in the company.
- **The modern portfolio theory perspective.** At the opposite pole are those who assess asset allocation and the family company's risk-and-reward equation as they would calculate risks related to financial assets to which they have no emotional tie (such as real estate or a hedge fund). Business owners who take this approach might consider the company's return too low in relation to the risk involved. They would argue that this is a great time to sell some stake in the company to reduce their exposure and to return their portfolio to previous allocations.

Is Daniel so focused on preserving the legacy company for future generations that he's ignoring the short-term threats that may jeopardize the future of his ailing company? Are portfolio managers who recommend against over-concentration in any one asset – even if that asset is a family business – being shortsighted?

Often, family business owners are well served by their patient capital – their willingness to forgo short-term personal financial rewards to nurture a company. For instance, they may opt to reinvest capital in the company rather than pay out dividends to shareholders. While investors in public companies put pressure on CEOs to produce ever-increasing returns, a family's patient capital allows family business managers to pursue long-range strategic goals and produce sustainable, long-term returns.

Sometimes, though, patient capital can be a liability. Emotional attachment may overshadow short-term external market risks, such as access to capital, or more fundamental risks, like product obsolescence.

No single perspective fits all situations. The decision to keep or sell an asset depends on family members' needs for immediate liquidity and their attitude toward long-term

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stewardship of the business. As the economy improves and the world enters a renewed era of growth, there will be new opportunities to create wealth. In order for the family to capitalize on these opportunities, they must agree on why they own a particular asset, where future capital should be invested and how family liquidity will be generated.

The total wealth management approach

In assessing a business owner's portfolio, many wealth managers ignore the largest portion of the client's assets – the family business – because the tools used to evaluate a financial portfolio do not apply to most operating assets.

A total wealth management (TWM) approach, by contrast, measures the risks and rewards of operating and financial assets separately. Along with the financial attributes of those assets, it evaluates the emotional components.

Traditionally, family business owners think of themselves

as stewards of the family business. In a TWM approach, they would regard themselves as stewards of all the assets: financial, operating and emotional.

Daniel's patient capital has turned into a desperate attempt to save his depreciating asset (the company) by selling other assets that are also devalued in today's market. TWM principles might help him uncover other opportunities, such as ways to diversify his financial securities as well as his company's concentration of customers (geographically and by sector).

A sound family governance system that separates management of the family business from management of the family wealth can help implement TWM. While the board of the operating company focuses on business risks and opportunities, a family office or other family governance structure can evaluate the risks and rewards related to the family wealth, and how best to transmit family assets and family values to future generations.

de Visscher & Co.'s Upcoming Speaking Engagements and Conferences

Family Business Wiki "Master Class" Series for 2011-12
Family Business Capital Teleconference
February 7, 2012
www.familybusinesswiki.org

Family Office Association Spring Global Summit
Greenwich, CT
March 29, 2012
www.familyofficeassociation.org

**Family Business Magazine Conference:
Transitions East 2012**
Orlando, FL
April 25 - 27, 2012
www.familybusinessmagazine.com

Family Firm Institute Conference
Brussels, Belgium
October 17 - 20, 2012
www.ffi.org



To celebrate our 20th year as a company devoted to advising family enterprises, de Visscher & Co. established an annual scholarship for next generation consultants and advisors in the family business field. Starting in 2011, this scholarship will provide \$5,000 annually for enrollment in the FFI

Certificate Program in Family Business Advising and the related courses and conferences. The winner of the first de Visscher & Co. Annual Scholarship for Next Generation Consultants and Advisors to Family Enterprise is Jacek Lipiec, Ph.D. from the Warsaw School of Economics, Warsaw, Poland. Congratulations Jacek!

Employee News

- Congratulations to Anthony Macaluso who has been awarded the FFI Certificate in Family Business Advising and Family Wealth Advising by the Family Firm Institute. The Family Firm Institute (FFI) Certificate in Family Business Advising and Wealth Advising is designed to increase awareness and exposure to concepts, skills and knowledge necessary to optimize effectiveness as family business advisors and consultants.
- In other news, Anthony announced his engagement to childhood sweetheart Laura Hrunka. They will tie the knot this summer!

Congratulations to Anthony and Laura!



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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