



Dissident Shareholders on the Warpath

by François M. de Visscher

How to handle dissension in the business without wrecking the family.

When a competitor submitted a takeover bid five years ago for Taubman Centers, the huge Michigan-based shopping mall developer, the Taubman family did what controlling families usually do in such cases: They reorganized the company's ownership structure, increasing the family's stake from 19% to 30% of the voting shares—enough to block any future hostile takeover bids.

Sure enough, five years later, a dissident group of non-family minority shareholders, Simon Property Group of Indianapolis, offered \$1.74 billion for the company, which the Taubman family and the company's independent directors rebuffed. Simon countered by challenging the legality of the 1998 reorganization—claiming, among other things, that the Taubman family pushed through the reorganization without proper disclosure and without a shareholder vote.

The legality of that 1998 Taubman restructuring is still being appeared back and forth as of this writing. But suppose the dissident shareholders had been related to the Taubmans? Instead of protecting the company's management, such a reorganization might have devastated the controlling family.

That's just what happened to another family business I know. This food company, owned by 30 members of the third generation, was paralyzed by 15 dissenting inactive family shareholders who kept voting down family managers' attempts to reinvest capital in improvements and expansion opportunities. The dissidents wanted the company to pay higher dividends—a common demand among inactive shareholders.

The ten active managers created a voting trust, into which they placed all of their shares plus those of five other inactives who supported them. Two trustees—family managers, of course—vote this entire bloc. This arrangement enables them to make decisions quickly and take advantage of business opportunities as they arise.

Voting Trusts may fail to address shareholders' liquidity needs.

“The company is making more money, but the dissidents are angrier than ever.”

In the seven years since the third generation created this voting trust, the company has become much more profitable as it maneuvers in its market more freely. And that has created more value for all shareholders. But the family has paid a steep price: The 15 inactives are angrier than ever, thanks to the highhanded way they were deprived of their voice in company decisions. The family factions are now entangled in lawsuits that may jeopardize the long-term survival of the family company.

Voting trusts have been much more common in Europe than in the U.S. However, such trusts are beginning to get a toehold in U.S. family companies. Voting trusts do a great job of addressing one side of the family business triangle (see diagram on next page)—capital to grow and create value. But in many cases, voting trusts fail to address, and may even exacerbate, issues related to the other two sides of the triangle: the liquidity and control needs of shareholders.

Are there any solutions to a family squabble besides this “radical dissident-bypass surgery?” In today's capital-market environment, here are some alternatives to voting trusts that may address some or all of these needs:

- **Recapitalize the business by creating another class of stock, such as non-voting preferred stock.** The tradeoff: The preferred shares would pay a higher dividend, which addresses liquidity concerns of inactive shareholders but obviously costs the company money and leaves less capital for growth or maintenance.

- **Convert to a limited liability corporation (LLC).** This structure allows the company to have different classes of members with different powers and dividend yields on their classes of stock. Tradeoffs: As with granting preferred stock, the management class gets more control over day-to-day and strategic operations, but the company must shell out higher cash returns to shareholders.

- **Spin off or split the business.** Tradeoffs: While this tactic would allow each of the shareholder groups to control their own destiny and future liquidity events, it does raise a question about the ability of the individual units to raise capital to grow. The valuation of each of the units would be an issue as well.

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2003 Tax Act: A boon for family firms?

By reducing capital gains tax rate and dividends tax rate to the same 15%, President Bush's Tax Act of 2003 substantially affects the value creation opportunities in family businesses and changes the way family companies resolve the conflict between filling the shareholders' liquidity needs and the company's growth capital needs.

- By making the capital gain tax equal to the dividends tax rate, the Bush tax plan reduces the urge to sell stock to gain liquidity.
- The Bush Tax Plan enhances the benefits of Annual Stock Redemption Plans by allowing selling shareholders to sell shares each year under the redemption plan and accept dividend tax treatment at the same rate as the capital gain tax rate. (Previously, family attribution rules would most often prevent them from using the lower capital gains tax rates).

Highlights of the 2003 Tax Act

David R. Nave, Tax Director of Pitcairn Trust explains the major provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003. To view this article in its entirety, please visit www.pitcairn.com.

Signed by President Bush on May 28, 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 is considered the third largest tax cut package in US history. Highlights of the Tax Act include:

Capital Gains Tax Reduction

Under the new law, the maximum net capital gains tax rate reduces the 10% and 20% rates on net capital gains to 5% (zero, in 2008) and 15%, respectively. These new rates are effective for sales and exchanges (and payments received) on or after May 6, 2003 and through December 31, 2007 (with the 15% rate continuing unchanged in 2008). An important point is that the lower rates apply to both regular tax and alternative minimum tax (AMT).

Dividends Tax Rate Reduction

The Tax Act also reduces the maximum individual income tax rates on dividends to 15% through 2008. As in the case of the capital gains rate reductions, taxpayers in low income tax brackets will generally have a maximum rate of 5% (zero, in 2008) on such dividends. The reduction in rates on dividends applies retroactively to dividends received on or after January 1, 2003. The reduced dividend rate applies to dividends received by individual taxpayers from domestic corporations (with certain limited exceptions) and from qualified foreign corporations. Dividends are eligible for the reduced rate whether paid out of current or accumulated earnings and profits of a corporation.

Acceleration In Individual Income Tax Rate Cuts

Under the new law, the 25%, 28%, 33% and 35% tax rates, which were scheduled to take effect in 2006, are set to apply to tax years beginning in 2003 through 2010.

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- The Bush Tax Plan makes Family Holding Companies and other control structures less onerous by reducing the impact of double taxation of intercompany transfers.

- It encourages companies to design "true" dividend policies, which could declare extraordinary dividends for extraordinary events, such as sales of assets.

- It makes "preferred recapitalizations" more attractive as a succession vehicle, since dividends on preferred stocks no longer carry a large penalty.

- Because shareholders' after-tax liquidity increases, the Bush plan allows a larger amount of capital to remain in the company for re-investment if the shareholders didn't desire more immediate liquidity.

By François M. de Visscher
(Adapted from *Family Business Magazine*, Spring 2003)

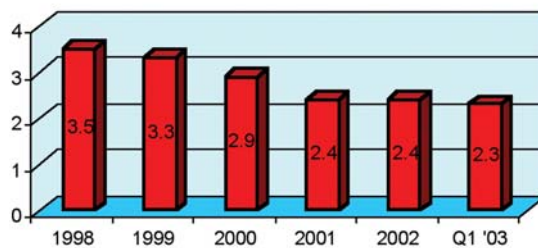
Accessing Capital in Today's Market

by John C. Willert

Current environment

The current lending environment is the product of an enduring cycle. You may remember that in the late 1990's raising capital was comparatively easy, given the backdrop of fast IPOs and strong public interest in equity investment. It was also comparatively easy for family businesses to borrow from banks because many were focused on increasing their market share and their portfolios were healthy. This has all changed. The Federal Reserve Bank tightened credit and lending standards through 2001 in an effort to keep the economy from overheating and, while the Fed eased rates throughout 2001 as the U.S. economy stalled, banks have been working through troubled loans and have experienced increased defaults in their portfolios. These credit problems, and a broader climate of investor conservatism, has resulted in lenders becoming increasingly risk averse. Subsequently they have raised their underwriting standards, particularly with regard to "cash-flow" loans to companies with less than \$50 million in annual revenues. Unfortunately, this adversely affects many family businesses. The ratio of senior debt to operating cash flow (EBITDA), that lenders are, willing to provide more than 2.5x cash flow.

Leveraged Senior Loans/EBITDA



Source: S&P and Portfolio Management Data

Another source of frustration is the ongoing consolidation in the lending community and the perennial staffing shuffles at major institutions. How many lending relationship officers have you had in the past five years? If your answer is one, you're in the minority. Moreover, many family companies are in mature and cyclical industries that have been impacted by the current economic environment. Changes in credit profile often lead lenders, who may not carry a well-developed personal knowledge of the business due to staffing changes, to classify borrowers as "Troubled" or "Workouts" even though there is nothing fundamentally wrong with the family business. The result of this classification on the otherwise healthy family business can range broadly, from: a soured relationship, the inability to access needed credit for growth or capital expenditures, increased fees, to the expression by the lender of its desire to be repaid in full, often after announcing that it has already sold the loan to a third party.

In the midst of these market trends, the credit needs of family businesses persist. Many family companies are profitable and in need

of increased funding to seize growth opportunities and fund shareholder liquidity programs. Family business owners seek a secure long-term lending relationship that provides their businesses with stable access to low-cost funding.

Sources of debt today

Luckily for family businesses, there are alternative capital sources available. Selected regional banks are financially sound and expanding. Many have avoided the pitfalls that plagued the larger banks stemming from the aggressive lending into the frothy telecommunications industry, and financing internet businesses. Non-bank finance companies particularly those focused toward lending primarily against the collateral value of tangible corporate assets and secondarily against cash flow or business value, are aggressively providing funding to middle market companies.

Equipment leasing is becoming increasingly popular because it often allows family businesses to leave existing credit lines intact and finance 100% of equipment costs - including "soft" costs such as shipping, software, training, and installation, with no cash outlay.

Subordinated debt or Funding Sources

"Mezzanine" debt providers (so called because they provide a bridge between bank debt and equity capital) are an excellent source of incremental debt funding. Mezzanine lenders provide flexible interest only loans that are subordinated in payment to the senior debt (paid only after satisfying the senior lender's claims), and feature longer amortization - at a price of an increased interest rate and often a small right to participate in the company's equity appreciation.

Non controlling, or minority, position equity investors, such as Family Capital Growth Partners, and other private equity funds and family offices known to favor investment in family controlled companies, may be appropriate for your business. Along with capital, investors of this sort can bring experienced board members, strategic planning, and access to future capital.

Financing advice for family business

Know when its over. If your bank has transferred your loan to the Workout Department, recognize that this is a one-way trip - you need to find a new lender.

Create a competitive process. Profitable family businesses with a good "franchise" have many funding options - even at this point in the lending cycle. The best way to find out which option is best is through an organized process of presenting the right information to the right prospective lenders and negotiating the best overall package for the company among multiple parties. You should highlight:

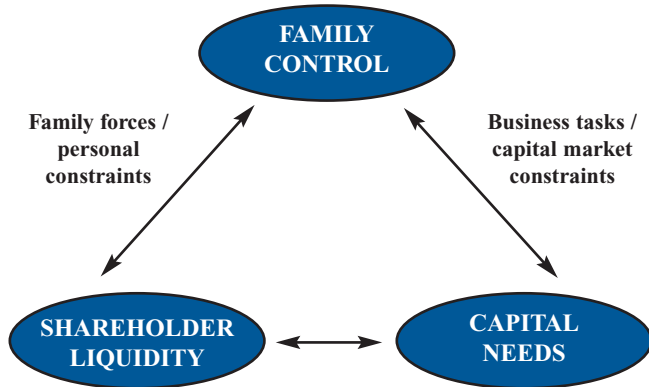
- A clear strategic plan for the company's future direction
- The adequacy of the management team to achieve this plan

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• **Have the pro-growth family managers buy out the inactive family shareholders.** Tradeoffs: Finding a fair and reasonable price that responds to the liquidity needs of active and inactive shareholders may be difficult. Financing a buyout might hamper future business growth or unduly erode the company's debt-equity ratio. Therefore, a buyout often requires an outside private equity investor or strategic partner, whose arrival can create a whole new group of relationship issues.

Family Business Triangle™



• **Sell the entire business and distribute the proceeds according to ownership.** Tradeoffs: This is a drastic solution that addresses liquidity needs of shareholders and control (because they now have their money). It may also be difficult to find a buyer that all family members find acceptable.

Dissension among family shareholders is almost unavoidable, especially as the company expands and the family moves into the third and fourth generations. But the value of a family's "patient capital" in today's uncertain world has an even greater impact on the ability of the business to take a long-term, strategic approach to decision-making.

In other words, it's shortsighted for active shareholders to view inactive shareholders' needs as bothersome constraints. Those who take a positive view—who nurture their family's and company's patient capital, by addressing all shareholders' liquidity and control needs—give their company the best chance to grow and prosper in the future.

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- A review of the company's product or service and revenue model
- An explanation of the business' historic financial results
- A financial model of the business incorporating the prospective financing structure, illustrating how the loan will be repaid
- All available collateral – including asset appraisals as appropriate

In many cases lenders also want to know the family business' management and ownership succession plan.

Draw upon an experienced advisor

Sourcing and securing a new funding relationship is a time consuming task that requires well established relationships with lenders, knowledge of the current lending landscape and an ability to analyze and present the company. A professional advisor should be used for this process in order to provide a negotiating buffer and allow the family business management team to keep focused on the business, while determining and accessing the most appropriate financing options.

News This Fall



Employee News

 We would like to welcome Francis Kim who has joined us in August as an analyst. Previously he served as our summer 2002 intern. He holds a Bachelor of Science degree in industrial and labor relations from Cornell University.

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Save the Date... 

We will be speaking or participating at the following conferences:

Family Firm Institute Conference
October 1-4, 2003 - Toronto
For more information contact FFI at www.ffi.org

European Family Office Conference
November 18-19, 2003 - London
For more information contact Campden Publishing at www.campdenconferences.com



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. Family Capital Growth Partners, a private equity fund affiliated with de Visscher & Co. also provides equity and subordinated debt capital to growth-oriented closely held and family-owned businesses.

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Family Capital Growth Partners L.P.

July 2003



Family Capital Growth Partners L.P.

is pleased to announce its investment in

MedScan

a medical diagnostic imaging company
based in Florida

\$2,000,000
Redeemable Preferred Stock
with Warrants

This announcement appears as a matter of record only.

MedScan, Inc. is an operator of medical diagnostic imaging centers focused toward developing market leadership on a regional basis, with initial emphasis on the State of Florida. FCGP partnered with Saugatuck Capital Company in acquiring MedScan, Inc. and establishing a platform for growth.

Family Capital Growth Partners L.P. is a uniquely focused private equity firm providing both growth capital and shareholder liquidity capital to family owned and closely held businesses.

Family Capital Growth Partners ("FCGP") is actively seeking investment opportunities. FCGP has a flexible investment charter that provides a particularly attractive financing alternative for family business owners and their advisors.

To its investment partners Family Capital Growth Partners brings:

- ◆ **Family Business Focus** FCGP is a committed private equity fund raised predominantly from families and wealthy individuals to invest in family businesses, hence the concept of *Families Investing in FamiliesSM*.
- ◆ **Flexibility** FCGP is a flexible source of capital that can invest in growth and/or liquidity situations, minority or majority positions and equity or subordinated debt securities.
- ◆ **Patient Capital** FCGP's typical investment horizon is 5 to 7 years and we have been innovators in structuring a range of creative exit alternatives.
- ◆ **Partnership Philosophy** FCGP adds value to its portfolio companies in the areas of: strategy formulation, business development and acquisitions and financing expertise. FCGP provides meaningful equity ownership incentives to its portfolio company managers.

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August 2003

This announcement appears as a matter of record only.



Strategic Minerals Corporation

has obtained a

\$17,000,000

credit facility provided by

General Electric Business Credit

The undersigned served as financial advisor to Strategic Minerals Corporation in this financing



de Visscher & Co.

de Visscher is pleased to announce that Strategic Minerals Corporation ("Stratcor"), has completed a senior debt refinancing and obtained a \$17,000,000 loan facility from General Electric Business Credit. Stratcor is the world's leading producer and marketer of "high-purity" and proprietary vanadium products used in the steel, titanium and specialty chemicals industries. The GE facility includes long-amortization term loans and provides Stratcor with the financial flexibility to pursue its growth initiatives and maintain leadership within the global vanadium industry.

August 2003

This announcement appears as a matter of record only.



has sold its assets to a subsidiary of:

Taylor Corporation

The undersigned served as exclusive financial advisor to Union Pen Company in this transaction



de Visscher & Co.

de Visscher is pleased to announce the sale of Union Pen Company to Taylor Corporation, a strategic acquirer. Union Pen was a closely held direct marketer of imprinted advertising specialties sold to a broad spectrum of customers. After a targeted search process, Taylor Corporation was selected because of its unique ability to maximize the potential of Union Pen's brand name and substantial franchise.