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| LIQUIDITY |

Optimizing a Liquidity Event

The Dimensions of Value Maximization

The ultimate goal of most owners of private companies is to sell their business in order to convert the wealth inherent in the stock of their companies to cash, thus enabling the achievement of family security and a new lifestyle. Such owners have worked very hard over many years of expending "blood, sweat, and tears" building their business.

Accordingly, the crescendo represented by a sale transaction is an extremely monumental event. There are few, if any, inflection points that are more significant for a business owner. As a result, maximizing the value, or outcome, for a usually once-in-a-lifetime event could not be more important.

There are three dimensions associated with a liquidity event's value maximization: 1) selecting the optimum time and form of an event, 2) creating new value before a transaction is executed if preparatory time is afforded, and 3) perfecting certain elements within, or during, the transaction execution process.

1) TIMING & FORM

A critical item most business owners do not benefit from is a clinical and dispassionate analysis dedicated to answering two key questions. The first is simply "**What should I do?**" in regard to when to consider a sale event. Most owners have a "feeling" about the answer, and the feeling tends to be driven more by personal sentiments than a business-case proof. The second question pertains to "**What is the optimal alternative?**" in regard to a minority, majority, or outright sale. The answers have significant value maximization consequences since some alternatives afford risk-sharing and a second wealth generating event. A "one-size-fits-all" answer does not exist.

The Approach

The best-practice methodology to answer these key questions and eliminate the "feeling fog" is as follows:

1. Obtain a valuation of your company using a comparative purchase price multiple approach thereby producing a key metric with pragmatic execution integrity.
2. Identify the opportunities to create new value, and these may entail propositions that do, and not require the injection of capital.
3. Prioritize the propositions by their perceived risk/reward relationship and create a value creation hierarchy.
4. Select the best propositions related to building the company's core and an adjacency (a universal best practice: refer to the article "Proactive Acquisitions" from Vol. 6, No. 1), and create a projection.
5. Derive the company's future value based on the projection (the multiple should increase), and assess the differential between the current and future value.
6. Assess the company's existing capacities, endowments, etc., related to the ability to execute the propositions in order to realize the valuation differential.

The Outcome

If the best build, or value creation propositions encompass material pressures, risk, outside resources, and/or is simply not be aligned with the owner's interests (e.g., the valuation differential is not large enough), then a liquidity event at the current time, vs. continuing to build, is appropriate. The optimal form of the event should be based on calibrating the relative risk/reward composition of the value creation agenda. Should the agenda encompass:

1. Relatively "low hanging fruit," selling a minority interest to diversify some wealth, benefiting from a financial partner, and being afforded a second bite at the wealth apple in the future might be best
2. Propositions requiring significant outside resources and/or a moderate to high level of risk, selling a majority interest to transfer most of the risk/reward relationship while retaining some upside might be best
3. Opportunities requiring a substantial transformation with a high level of risk given scalability, market dynamic, penetration, etc., issues, selling outright might be best

Remember, each owner's assessment of risk and reward is relative, and there will always be buyers that will assess the same risk/reward differently for a variety of reasons and embrace the opportunity. Also remember valuation is maximized when BOTH earnings of the proper quality and the growth agenda are robust, so achieving an earnings highpoint at the expense of future growth, e.g., exhausting a backlog, will not produce an optimal outcome.

2) CREATING NEW VALUE

If an owner does not want to sell immediately, there are two sets of opportunities to create new value before an event. One set pertains to strategic development opportunities, and the other pertains to progressing all of the key operating and financial elements that move the valuation needle, i.e., the "Universal Drivers."

Strategic Development

While all companies should be engaging strategic development at all times, the successful pursuit of such opportunities provides the most dramatic valuation impact, however, these take time to realize and will likely require capital formation, whether engaged organically or through acquisition. Propositions such as: 1) building the core via expanding the same offering to the same customer group, 2) creating an adjacency via modifying the offering to the same customer group, or 3) creating a new offering to a related customer group, are the architectures to achieve next-level development. Keep in mind the most robust alternative is creating an adjacency. The good news is the value creation agenda required within the Timing & Form methodology is the de facto the strategic development agenda. Moreover, it is a key element within the transaction processes maximization (described below).

Universal Drivers

A holistic diagnostic of a company's operating and financial dimensions will produce a variety of opportunities to achieve meaningful value enhancement. The top centers of attention include: ensuring the owner has made himself/herself redundant via succession, strengthening the middle management team, minimizing the customer concentration, vendor concentration and offering concentration, enhancing and protecting intellectual property, enriching the branding, transitioning from discrete purchase orders to multi-year contractualized revenue streams, transitioning from purely customized systems to more commercialized systems, ensuring the financial reporting is well-validated by a third-party, enhancing the cost accounting system, segmenting the data related to profitability as much as possible, and ensuring the company is in good-standing in regard to all regulatory and legal matters.

3) EXECUTION ELEMENTS

The third source of value maximization pertains to perfecting key elements within the liquidity event transaction process. Typically these elements reside in the domain of, and are effectuated by, an investment banker retained to both, provide important advisement to the owner about the prospective outcomes and other key matters, and represent and support the best interests of the owner with the counterparties. Since a "buyer's dream" is to engage an owner directly for a variety of reasons, the first execution-related value maximization initiative is for an owner to hire a high-quality investment banker. The set of value-enhancing imperatives assumed by the investment banker include the following:

1. Create a comprehensive and compelling Information memorandum describing the operating, financial, and strategic profiles (the value creation agenda) to reduce due diligence uncertainty and validate quality.
2. Construct the proper buyer/investor group based on the nature of the company, and in particular, its prospective synergistic symmetry with certain types of buyers.
3. Manage a tight and formalized auction process, inclusive of definitive timelines, with the buyer group to enhance the benefit of the competitive dynamic.
4. Negotiate to achieve the best outcomes by first understanding the owner's priorities, asking for more, and then trading victories with the buyer.
5. Pursue the highest valuation based on earnings quality and growth profile arguments, while capturing some future value based on achieving an indifference between selling today, or building and selling tomorrow.
6. Obtain the most attractive tax-friendly transaction form, and consideration exchange arrangement if an all-cash transaction is not provided.
7. Support the owner's specialized legal counsel's positions in regard to representations & warranties, and the indemnity (post-transaction contingent liabilities) arrangements.

SUMMARY STATEMENT

The importance of a liquidity event for an owner compels the achievement of value maximization in accordance with each of the three outlined dimensions. The best-case outcome is always realized when an owner provides the time to properly prepare for an event based on the timing and form, and the new value creation dimensions. So if you are an owner, begin to prepare for tomorrow today.