RESOURCE MATERIAL

Pathways to Liquidity: Advising Your Clients in Monetizing Their Illiquid Wealth

Thursday Luncheon Presentation
October 23, 2014

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Matt is president of Mercer Capital and provides corporate valuation services related to corporate planning and reorganization, transactions, employee stock ownership plans, and tax issues. In addition, Matt is a senior member of Mercer Capital's Financial Reporting Valuation Group. He is experienced in the valuation of intangible assets, options, and assets subject to specific contractual restrictions.

He is also active in valuations related to asset management firms and has broad industry experience in insurance, real estate investment ventures, and technology companies. Along with Brooks K. Hamner, CFA, Matt publishes research related to the asset management industry.

He serves as a course developer for the American Society of Appraisers BV302 course on Advanced Topics in the Valuation of Intangible Assets, and actively participates in the Appraisal Issues Task Force, a group that interacts with the SEC to address new and developing fair value issues.

Matt holds the Accredited Senior Appraiser (ASA) designation from the American Society of Appraisers and is member of the Business Valuation Committee. He also holds the Chartered Financial Analyst (CFA) designation from The CFA Institute.

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Nick leads Mercer Capital's Valuation Services Group. He has extensive experience in providing valuation and corporate advisory services for purposes including mergers and acquisitions, fairness opinions, solvency opinions, employee stock ownership plans, buy-sell agreements, estate and gift tax planning and compliance matters, and corporate planning and reorganizations.

Over his career, Nick has provided transaction-related consulting services to numerous clients on both the sell-side and buy-side of transactions. Such consulting has included the delivery of transaction opinions, such as fairness opinions and solvency opinions, and strategic advisory related to transaction pricing and execution.

Nick holds the Accredited Senior Appraiser (ASA) designation from the American Society of Appraisers. He is also an active member of several professional organizations including the ESOP Association, the National Center for Employee Ownership, and the American Society of Appraisers. He serves as an officer in the New South Chapter of the ESOP Association.

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Mercer Capital is known for uncommon professionalism, intellectual rigor, technical expertise, and superior client service. We provide business valuation and financial advisory services to public and private companies and financial institutions throughout the world.

Mercer Capital is one of the largest independent business valuation and financial advisory firms in the nation.

We offer a broad range of services, including corporate valuation, financial institution valuation, financial reporting valuation, gift and estate tax valuation, M&A advisory, fairness opinions, ESOP and ERISA valuation services, and litigation and expert testimony consulting.

Since 1982, we have provided thousands of valuation opinions for corporations of all sizes in a wide variety of industries.

Our valuation opinions are well-reasoned and thoroughly documented, and provide critical support for any potential transaction.

Our work has been reviewed and accepted by the major agencies of the federal government charged with regulating business transactions, as well as the largest accounting and law firms in the nation in connection with engagements involving their clients.

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10 Insights

1. Generational Issues
2. Good Time to Sell
3. Ownership Always Matters
4. Valuation
5. EBITDA
6. Wealth Management
7. The One Percent Solution
8. Liquidity
9. Selling In
10. Selling Out

1

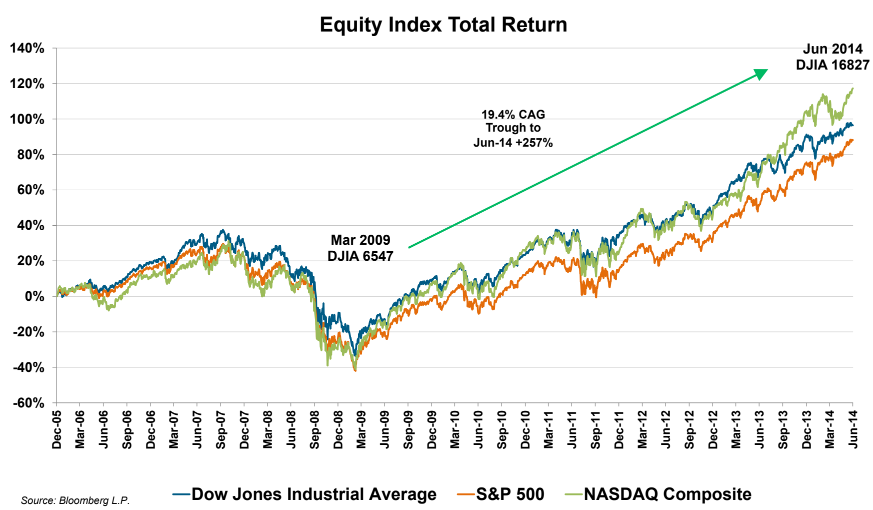
Generational Issues

Baby boomers and their businesses

- There are 76 million baby boomers in the US or approximately 25% of the US population
- 66% of all businesses with employees, or nearly 4 million companies, are owned by baby boomers
- The oldest of the baby boomer generation started turning 65 on January 1, 2011, at a rate of 10,000 people a day — a trend that will last for the next 19 years

Good Time to Sell

Stock Market Indices



Source: Bloomberg L.P.

5

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Broad market M&A activity

Deal Size			TRANSACTION VOLUME | Excluding Financials									
			Annual			Six Months as of				Last 12 Months		
From		To	2012	2013	% Chg	Jun-12	Jun-13	Jun-14	% Chg	Jun-13	Jun-14	% Chg
> $1 Billion			155	134	*-13.5%*	65	62	103	*66.1%*	152	175	*15.1%*
$500M	to	$999.9M	125	124	*-0.8%*	53	48	59	*22.9%*	120	135	*12.5%*
$250M	to	$499.9M	220	194	*-11.8%*	106	82	122	*48.8%*	196	234	*19.4%*
$100M	to	$249.9M	380	346	*-8.9%*	182	155	175	*12.9%*	353	366	*3.7%*
$50M	to	$99.9M	391	356	*-9.0%*	178	144	177	*22.9%*	357	389	*9.0%*
$25M	to	$49.9M	448	399	*-10.9%*	191	188	199	*5.9%*	445	410	*-7.9%*
$15M	to	$24.9M	384	410	*6.8%*	172	186	164	*-11.8%*	398	388	*-2.5%*
$5M	to	$14.9M	808	749	*-7.3%*	369	361	312	*-13.6%*	800	700	*-12.5%*
$0	to	$4.9M	1,316	1,286	*-2.3%*	654	633	525	*-17.1%*	1,295	1,178	*-9.0%*
Not Disclosed			8,242	7,684	*-6.8%*	3,960	3,780	4,434	*17.3%*	8,062	8,338	*3.4%*
$0	**to**	**> $1B**	**12,469**	**11,682**	***-6.3%***	**5,930**	**5,639**	**6,270**	***11.2%***	**12,178**	**12,313**	***1.1%***

6

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Private equity M&A activity

	2012	2013					'12 & '13	2014	
All Transactions (1)	Ttl '12 (2)	Q1	Q2	Q3	Q4	Ttl '13 (2)	(2)	Q1	Q2
Deal Volume	232	24	24	37	60	145	377	34	41
Total Enterprise Value ÷ EBITDA	6.2x	6.1x	6.4x	6.5x	6.7x	6.5x	6.3x	6.3x	**6.4x**
Senior Debt ÷ EBITDA	2.4x	2.6x	2.9x	2.6x	2.5x	2.6x	2.5x	2.4x	2.9x
Sub/Mez Debt ÷ EBITDA (3)	1.0x	0.5x	0.5x	1.2x	0.8x	0.8x	0.9x	1.2x	1.0x
Total Debt ÷ EBITDA	3.4x	3.1x	3.4x	3.8x	3.3x	3.4x	3.4x	3.6x	**3.9x**
Implied Equity ÷ EBITDA (3)	2.8x	3.0x	3.0x	2.7x	3.4x	3.1x	2.9x	2.7x	2.5x
Implied Equity as a % of Capital (3)	44.5%	49.2%	46.9%	41.5%	50.7%	47.5%	45.7%	42.9%	39.1%
Implied Ttl Debt as a % of Capital (3)	55.5%	50.8%	53.1%	58.5%	49.3%	52.5%	54.3%	57.1%	60.9%

Notes

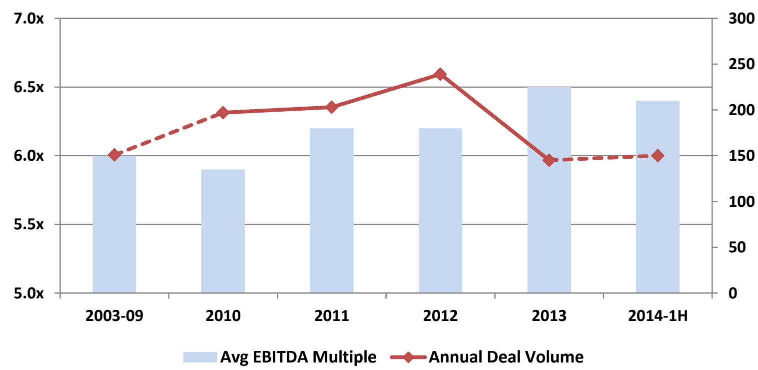
(1) Information provided by GF Data®. This report may not be used in work product or republished in any format without the written permission of GF Data® and Mercer Capital. GF Data® data summary: Deals from 191 of 223 contributing P/E firms; Deal valuations ranging from 3x to 12x; Deal values $10-250mm

(2) Calculated by Mercer Capital as the deal-weighted multiples of all quarters for each respective year. 2012 data per GF Data Aug 2014 report.

(3) Derived by Mercer Capital

7

Private equity M&A activity



Note: 2003-09 Annual Average of 7 Yrs
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8

Ownership Always Matters

Value is always a question for your clients to consider

- Where are your clients in the ownership timeline?
- Where is their business?
- What if they had to sell tomorrow?
- Is their business working for them?
- Are they planning the ownership of their future?
- What could affect their ownership – and are they ready?

10

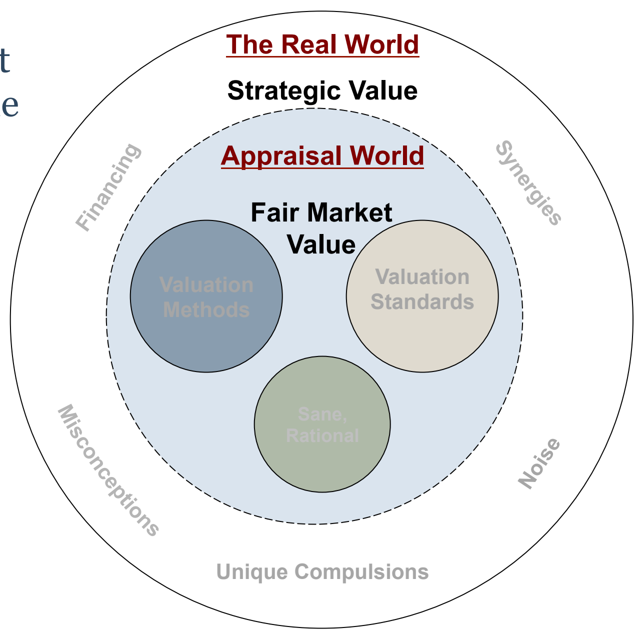
Ownership is not a static concept...

	Partial Sale / Transfer	Total Sale / Transfer
Active Events	ESOP / Management Outside Investor(s) Sales to Insiders / Relatives Combination Merger / Cash Out Going Public Gifting Programs Buy-Sell Agreements	Sale of Business Stock Exchange w/ Public Co. Stock Cash Sale to Public Co. Installment Sale ESOP / Management Buyout Liquidation Buy-Sell Agreements
Passive Events	Death Divorce Forced Restructuring Shareholder Disputes Buy-Sell Agreements	Death Divorce Forced Restructuring Bankruptcy Shareholder Disputes Buy-Sell Agreements

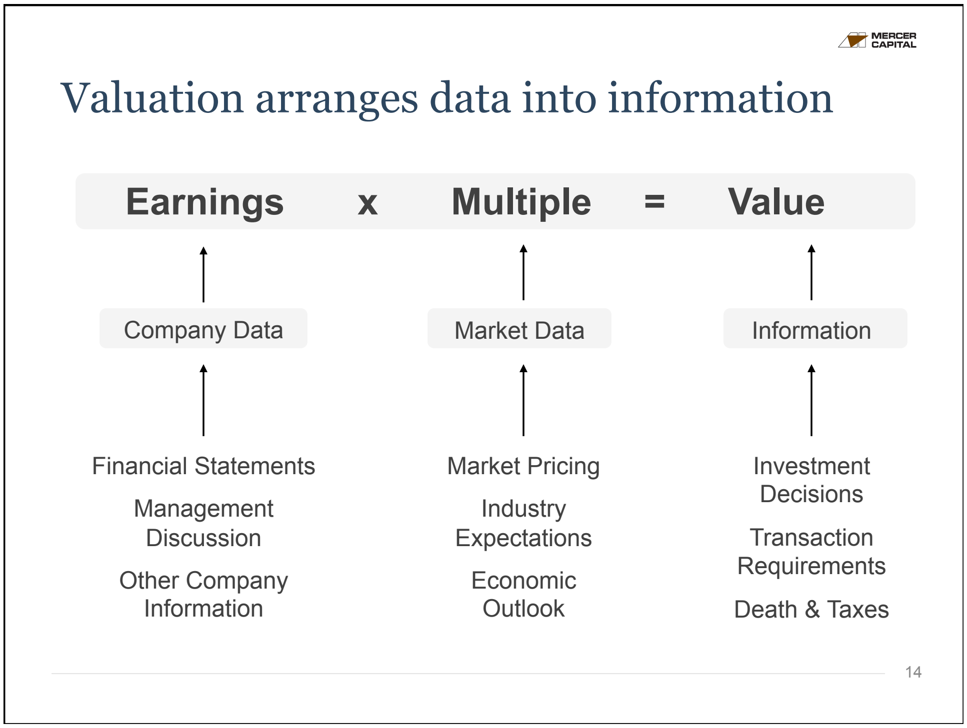
11

Valuation

Fair market value vs. the real world



13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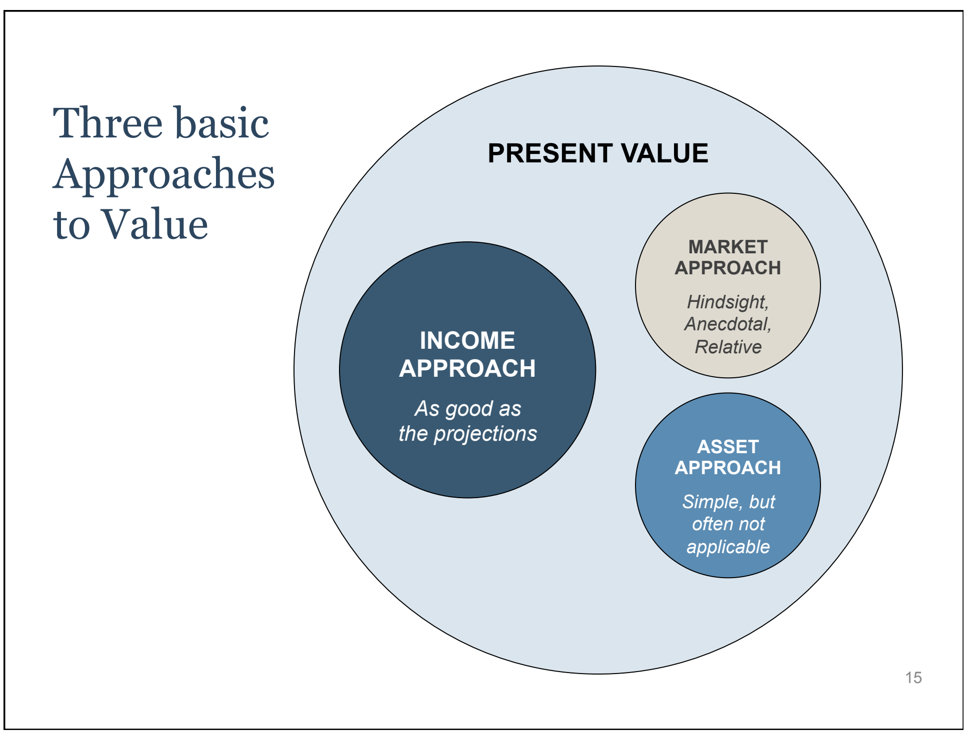
Valuation arranges data into information
Earnings x Multiple = Value
Company Data
Market Data
Information
Financial Statements
Management Discussion
Other Company Information
Market Pricing
Industry Expectations
Economic Outlook
Investment Decisions
Transaction Requirements
Death & Taxes
14

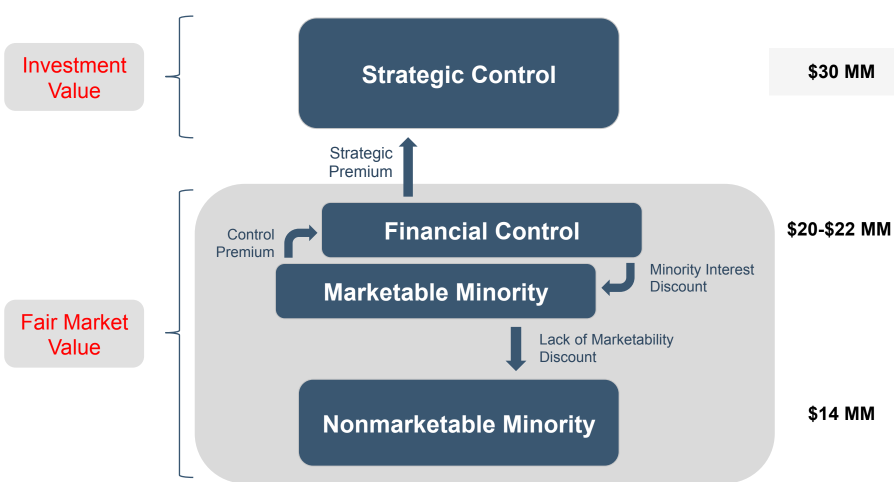

Three basic Approaches to Value
PRESENT VALUE
MARKET APPROACH
Hindsight, Anecdotal, Relative
INCOME APPROACH
As good as the projections
ASSET APPROACH
Simple, but often not applicable
15

When you hear about someone selling for 2x sales…

- They probably meant **Enterprise Value** (industry experts' focus)…
  - The value of your total "assets"
  - Conceptually familiar to many owners
    + Rules of thumb
    + Representative of virtually all transactions
- …But the seller got **Equity Value** (valuation experts' focus)
  - Equity value + debt = enterprise value
  - Obscure to most business owners
  - Requires more disciplined modeling and considerations to develop

16

How and what you sell can have a big impact



17

EBITDA

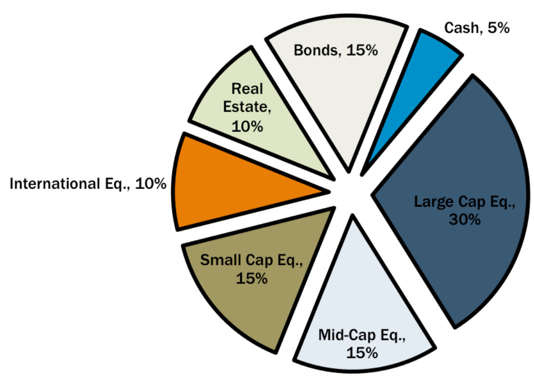
Why is EBITDA the most commonly cited performance metric?

- Gross cash flow of an enterprise providing for six critical things
  1. Reinvest in capital expenditures or other investments
  2. Working capital needs from growth
  3. Interest payments on debt
  4. Principal payments on debt
  5. Taxes
  6. Returns to shareholders

19

Wealth Management

Asset allocation of a business owner with $5 million of liquid assets



21

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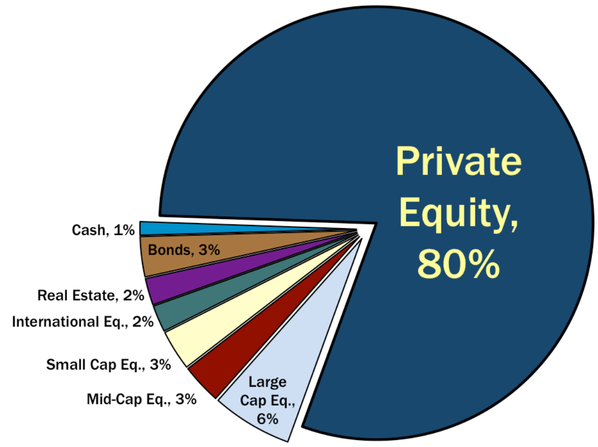
The reality if that business owner has a $20 million closely held business



22

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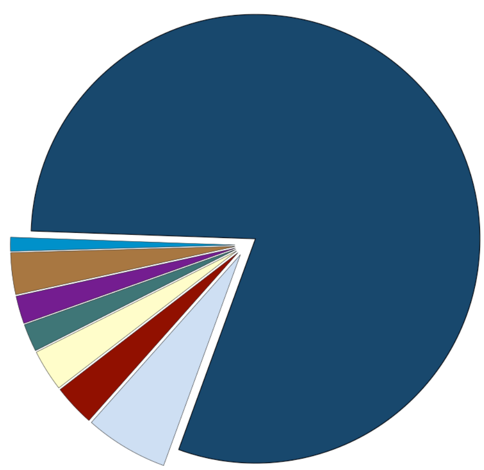
Why should you care?

Baby boomers are transitioning their wealth and seeking to begin the next phase of their lives



Are your clients working to manage ALL their wealth, both liquid and pre-liquid?

23

Wealth Management Principles

24

The One Percent Solution

The One Percent Solution

- Allocate a percentage of value for the illiquid assets under management to provide the budget necessary to manage wealth
- Liquid Assets
  - 1% of assets under management, +/-, depending on asset category
- Pre-Liquid Assets
  - 0.5% to 2% of value (AUM) for businesses depending on value

26

One Percent Solution Activities

- **Attest services**
- **Life insurance funding**
- **Wealth manager compensation**
- **Annual valuations and monitoring value growth**
- **Buy-sell agreement pricing (per annual valuations)**
- Annual legal reviews
- Estate planning
- Financial planning
- “Make ready” consulting projects

27

Liquidity Options: Holding On

Regular dividends

Benefits

- Current returns to shareholders
- Initial step toward diversification
- Enhance capital structure and maintain return on equity

Risks

- Little downside risk if attractive reinvestment opportunities are not available
- Focuses management attention on maintaining regular dividend
- Enhances attractiveness of minority ownership interests

29

Special dividend

Benefits	Risks
▪ Liquidity to shareholders from excess assets	▪ Paid to shareholders pro rata
▪ Potential diversification opportunity	▪ Does not change or facilitate ownership transition
▪ Enhance capital structure and return on equity	

30

Share redemptions

Benefits	Risks
▪ Generally small transactions	▪ Easy to Accomplish
▪ Use excess assets, seller financing or external financing	▪ Must establish/agree on pricing
▪ Liquidity opportunity for selling shareholder(s)	▪ Favorable dividend treatment for selling owner(s)
▪ Enhanced returns/relative ownership % for remaining owners	▪ Makes a partial market in shares and enhances attractiveness of minority ownership
	▪ Reasonable transaction costs

31

Leveraged dividend recap

Benefits

- Potentially significant diversification opportunity
- Enhance capital structure and return on equity
- Perhaps good in conjunction with "status quo" strategy
- Shift risk from equity owners to lenders

Risks

- Little downside if leverage is not excessive
- External lenders will require certain restrictive financial covenants
- Tax on dividends at dividend rate

32

Leveraged stock recap (buy-back)

Benefits

- Creates liquidity and diversification opportunities
- Capital gains treatment for selling shareholder(s)
- Enhanced ROE for remaining owners
- Optimize capital structure
- Dividend pick-up if company pays and maintains a dividend
- Enhanced ownership percentages for remaining owners
- Can facilitate ownership transition

Risks

- Reasonable risk of leverage is not excessive
- External lenders will require certain restrictive financial covenants
- Potential for change of control depending on ownership structure
- Price will be a financial price (rather than strategic)
- Reasonable transaction costs

33

Liquidity Options: Selling In

Management buy-in

Benefits	Risks
▪ Helps to align interests of key managers with company	▪ Pricing and terms should be reasonable so that purchases can be reasonably paid for
▪ Installment sale can facilitate transition	▪ Creeping sales, and often not possible in large amounts (% of company)
▪ Effect with treasury stock and dilute other owners	▪ Can facilitate both ownership and management transitions
▪ Effect with sales by other owners (liquidity for them)	

35

Employee stock ownership plan

Benefits	Risks
▪ Creates liquidity and diversification opportunities ▪ Selling shareholder (controller) defines process ▪ Ownership incentive for employees ▪ Can be part of ownership and management transition ▪ Potentially favorable tax treatment on rollover investments	▪ ESOP legal and regulatory complexities ▪ Potential to increase risk for employee retirement if replace profit sharing or other plan(s) ▪ Potential fairness issues to be addressed ▪ Price will be financial (not strategic) ▪ Company will have ongoing repurchase obligation (manageable in most cases) ▪ Expectation of significant management consistency ▪ Reasonable transaction costs ▪ ESOP transactions are usually 100% ▪ Personal guaranties will likely be required by lenders from selling owners

36

Employee stock ownership plan
(51% or more)

Benefits	Risks
▪ Creates liquidity and diversification opportunities ▪ Selling shareholder (controller) defines process ▪ Ownership incentive for employees ▪ Can be part of ownership and management transition	▪ ESOP legal and regulatory has complexities ▪ Potential to increase risk for employee retirement if replace profit sharing or other plan(s) ▪ Potential fairness issues to be addressed ▪ Price will be financial (not strategic) ▪ Company will have ongoing repurchase obligation (manageable in most cases) ▪ Expectation of significant management consistency ▪ Reasonable transaction costs ▪ ESOP is fully leveraged ▪ Personal guaranties be required by lenders from selling owners

37

Liquidity Options:
Selling Out

Private equity
(Majority investment)

Benefits	Risks
▪ Creates liquidity and diversification opportunities ▪ Facilitates ownership transition ▪ Management transition may be part of process ▪ Selling owners may be required to retain equity in business ▪ Equity retention provides upside but risk, as well	▪ Private equity (P/E) may change ownership/ management dynamics ▪ Growth capital (leverage) may be part of deal ▪ P/E investors will have control ▪ External lenders will require certain restrictive financial covenants

39

Third-party sale
(Financial buyer)

Benefits	Risks
▪ Total liquidity for owners and diversification opportunities ▪ Completes ownership transition ▪ May retain management positions for key managers	▪ Price is financial (not strategic) ▪ Choice re timing of transaction if performance is good ▪ Should be conscious, long-term plan ▪ All planned gift/estate tax planning should be completed in advance ▪ Watch out for requested owner financing ▪ Some choice over potential purchasers to approach ▪ Transaction costs include transaction adviser, counsel, etc.

40

Third-party sale
(Strategic buyer)

Benefits	Risks
▪ Total liquidity for owners and diversification opportunities ▪ Completes ownership transition	▪ Only option where strategic price is available (if there is competition) ▪ How is the economy, the stock market, and industry performing? ▪ What is the company's unique brand or competitive position? ▪ Don't bet on long-term employment with new buyer ▪ Social costs of integration and financial costs of potential loss of jobs ▪ Potential for partial consideration in stock of public or private acquirer

41

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Concluding Thoughts

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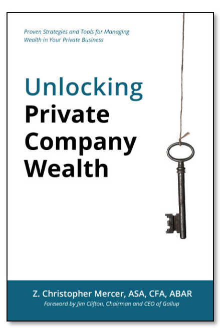
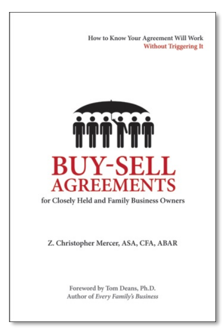
Resources





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43

Proven Strategies and Tools for Managing Wealth in Your Private Business

Unlocking Private Company Wealth

Z. Christopher Mercer, ASA, CFA, ABAR

Foreword by Jim Clifton, Chairman and CEO of Gallup

Praise for Unlocking Private Company Wealth

Chris' latest book, *Unlocking Private Company Wealth,* is an absolute "must read" for all business owners. It digs deep into the "illiquid" wealth locked up in most successful businesses and provides great strategies on how to ultimately unlock that wealth. Chris' 25 questions on managing private wealth will not only get you thinking, it should cause you to take action!

Allan D. Koltin
Chief Executive Officer, Koltin Consulting Group
Chicago, Illinois

Prescient, practical, down to earth tools for privately held companies. I've witnessed Chris in action in the boardroom using these very ideas. The concepts matter in *Unlocking Private Company Wealth,* and Chris can build value for you with them. Read the book.

Dennis Allen
Chief Executive Officer, Jones Stephens
Birmingham, Alabama

Decades of my own experience with private business owners tell me this book will be an eye-opener for many. *Unlocking Private Company Wealth* will be valuable for both those owners who expect to sell the entire business at some point down the road and for those who have no intention of ever selling. Mercer demonstrates the need for managing not only the business but the ownership of it – as an asset that dominates the financial well-being of the owners and their families. Then he explains in clear language how the tools of financial management can be used to respond to that need.

Don Kozusko
Managing Partner, Kozusko Harris Duncan
Washington, D.C.

Unlocking Private Company Wealth reviews many of the issues we have been dealing with in succession planning for our company. It lays out much of what we have discussed with professionals. This work is a call to action on developing and executing a plan and lays out the options to move forward.

Russ Stigge
Chief Executive Officer, Plains Equipment Group
Lincoln, Nebraska

Unlocking Private Company Wealth is a practical guide to managing and unlocking private company wealth. Mercer's insights challenge the reader to re-think how you view ownership in a privately held company. The book is a must read for business owners and their advisors!

Martin Willoughby
Principal, Butler Snow Advisory Services
Memphis, Tennessee
Author, Zoom Entrepreneur

If you're a sophisticated business owner or advisor to business owners, you need to read and implement suggestions in *Unlocking Private Company Wealth*. Think about this book as a survey course on how to manage the investment known as your business. If you gave half the attention to learning Mercer's strategies and techniques as you do with your liquid investments, you would have a much happier financial outcome when it's time to leave your business. Here are some questions for you to ponder that are answered in the book:

1. Do you pay regular dividends and do you have a strategy for managing them?

2. Do you have a method for understanding what the value of your company is?

3. How are you managing risk within your business?

4. Do you think about your business as one that is an investment as well as one that provides income?

5. If you were an outside investor, would you want to own your business?

Unlocking Private Company Wealth will help you answer these questions. It will force you to look at your business as a wealth creation tool. You get to understand what drives private company wealth, as well as great methods of managing that wealth. Advisors need to understand the principles presented in this book. You'll find that you'll have more intelligent conversations with your clients and you'll be able to help your clients make wise decisions. I hope you take the time to read and understand Mercer's message. Business owners and advisors will benefit from the effort.

Josh Patrick
Founding Principal, Stage 2 Planning Partners
South Burlington, Vermont
New York Times Blogger

In an environment where blogs and blasts partially describe a lot – and thoroughly detail nothing – Chris Mercer stands out as an exception. *Unlocking Private Company Wealth* captures the essence of unlocking the wealth and capital inside a privately held business. From valuation and liquidity issues to the arcane world of legal structures, Chris provides a flexible road map for business owners and advisors – a road map that helps successfully manage wealth.

The challenge to providing ideas for unlocking wealth in a privately held business is the topic's breadth and complexity. Chris Mercer's book cuts through the clutter and provides a clear and cogent view of how to create, monetize, manage and transfer capital.

When a business owner seeks to unlock the wealth of a business, the challenge is the army of advisors that must be deployed. Chris Mercer's book consolidates the information on two issues, challenges and opportunities in monetizing business wealth, and serves it up in a clear and readable fashion.

Steve Parrish, JD, CLU, ChFC, RHU
National Advanced Solutions Director, Principal Financial Group
Des Moines, Iowa
Contributor, Forbes.com

It's best to take action when the circumstances are favorable and the timing is right. *Unlocking Private Company Wealth* examines strategies you can implement now that will increase the future value of your closely held business.

Bill Rankin, CPA
Chief Financial Officer, Blue Bell Creameries, LP
Brenham, Texas

I used to think it was odd how business owners would closely monitor the performance of a few hundred thousand dollars in a retirement account, but have no idea how many millions their business was worth. Stranger still was the fact that their financial advisors didn't seem to recognize this as a problem. *Unlocking Private Company Wealth* illuminates this lopsided view of wealth management and offers a number of smart solutions to fit any business/owner situation. This book is a must-read for business owners and their advisors. Not reading it – or taking Chris Mercer's wisdom to heart – is leaving money on the table. *Unlocking Private Company Wealth* brings clear perspective and concrete solutions to one of the missing pieces of business ownership – how to turn a lifetime of work into a legacy of wealth.

Barbara Taylor, MBA
Co-Founder, Allan Taylor & Company
Rogers, Arkansas
New York Times Blogger

I have been in and around privately held family businesses for over 40 years. I believe every family member owner, especially those who don't work in their family's business, needs to read Chris' book. It is an excellent framework for understanding the importance of their investment and provides essential concepts to assist them in understanding and measuring for themselves the value of what is, for most, the largest asset in their investment portfolio. I plan on sharing it with our Family Council as a great educational tool for our family owners.

Daniel B. Hatzenbuehler
Chairman of the Board, E. Ritter & Company
Marked Tree, Arkansas

Unlocking Private Company Wealth is packed full of outstanding information and valuable advice for anyone who owns or is considering purchasing or investing in a privately held company. Not only does this book share key ways to preserve existing wealth, but also ideas for how to grow that value. Chris Mercer has a way of simplifying very complex transactions. Thank you for sharing your insights, Chris, and making all private companies better.

Emily Nielsen
Corporate Treasurer, Gallup
Omaha, Nebraska

True to form, Chris has delivered an erudite action plan for any stakeholder in the value of a private company. If you have before resolved to change the status quo and finally – focus on what you need to do to drive growth, Unlocking Private Company Wealth will motivate you to get serious about enhancing and monitoring financial performance. Chris clearly and cogently outlines various options and concrete strategies. His tactical approaches like *The One Percent Solution,* the implementation of a dividend policy, consideration of minority interest private equity investment and the READY (Risks, Earnings, Attitudes/Aptitudes/Actions, Driving Growth, Year to Year Comparisons) framework will form the basis of the business plan you won't want to put off any longer. Readers of this book will be lucky indeed to count Chris in their circle of outside advisors whose counsel is essential for taking a business to the next level.

Lucretia Lyons
President, Business Valuation Resources, LLC
Portland, Oregon

As the fourth-generation CEO of a family business, I can assure you that the concepts Chris introduces with his *One Percent Solution* idea – making deliberate investments in such things as estate planning, outside board members, and annual stock valuations – are critical to success if you wish to perpetuate your business to future generations. One percent may not be the right number for everyone, but we would not still be here today as a family business if our previous generations of owners had not made those important investments.

David J. Duda
President & Chief Executive Officer, A. Duda & Sons, Inc.
Oviedo, Florida

Too many business owners go to work every day and manage their people, their tasks, even their cash flow, but not enough of them are giving thought to wisely managing their business as an asset. Chris Mercer has no peer when it comes to valuing a business, and offering perspective on managing that asset. Read his new book and you will be inspired by creative possibilities and informed on multiple fronts for managing all opportunities afforded you through your enterprise.

Don Hutson
Chief Executive Officer, U. S. Learning
Memphis, Tennessee
#1 New York Times and Wall Street Journal Best-Selling co-author of
The One Minute Negotiator and Selling Value

Chris has provided a well-organized discussion of the wealth management responsibilities and techniques that owners, executives and managers of private businesses should appreciate. In an easy-to-read style, with real world examples, he covers a variety of topics around the fundamental theme that wealth, separate and apart from the business itself, must be actively managed and stewarded by and for the ownership. Critical to perpetuating businesses for multiple generations is recognition of this fact.

Barton Weeks
Executive Vice President and Chief Operating Officer, A. Duda & Sons, Inc.
Oviedo, Florida

Great book! Two thoughts reverberated in my mind as I was reading it. First, I would have made such better decisions with my own business had I read this book sooner! (And I wish I had) And second, every Financial Advisor who has business owners clients must read this book and help their clients make better decisions about managing their company wealth.

Bill Bachrach
CEO and author of Values-Based Financial Planning
San Diego, California

After owning my business for 25 years, I have always thought of myself as a good, smart business person. Your book, *Unlocking Private Company Wealth* helped me think through so many critical issues relating to the wealth of both my company and my family that I have never addressed or considered creating a plan. This book is a must read for every business owner.

Peter Stark
President, Peter Barron Stark Companies
San Diego, California

I live and work in the world of privately owned (usually family owned) businesses. Chris Mercer's *Unlocking Private Company Wealth* is a breath of fresh air, a systematic and thoughtful way to look at the "wealth" locked in a privately held business with the same dispassion and analytic calm that most owners insist on in the management of their investment portfolios. The emotional ties to and personal relationships within privately held companies frequently result in something akin to "management by intuition", an inherited or habit-formed set of "strategies" that can go unchallenged for decades.

The chapter on "Tools for Private Company Wealth" provides, by itself, a matrix for any business to periodically look at itself not as its insiders see it, but as outsiders would. Armed with that discipline the owners can then make decisions that explicitly acknowledge current market thinking. If the decision is to opt out of "maximizing value" for tactical or personal reasons, then it is done with intentionality. A deliberate decision to forego maximizing short or mid-term " "realizable" value for the owners may be grounded in very real and defensible values or strategy, but that grounding is stronger when it recognizes the trade-offs it entails.

At its heart, *Unlocking Private Company Wealth* is a proposal for the opposite of "Management by Intuition." In no way does analysis commit the business to management denuded of values or longer term strategy. Rather it is the Best Practice for a company and its owners to make knowing decisions and allocations of resources.

Stephen G. Salley, JD
Partner, Banyan Family Business Advisors
Orlando, Florida

After decades of advising entrepreneurs on liquid assets, I found this book to be a great tool to help entrepreneurs evaluate their business in the context of all their assets. Chris highlights questions and concepts that help entrepreneurs frame up opportunities and risk holistically.

Steven Sansom
Co-Founder, Green Square Capital
Memphis, Tennessee
YPO-WPO International Board

Unlocking
Private Company Wealth

Proven Strategies and Tools for Managing Wealth in Your Private Business

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Table of Contents

Section 2
Tools for Managing Private Company Wealth

CHAPTER 3

Managing Private Company Wealth Is A Big Deal

Wealth management for illiquid assets like in your closely held or family business is a big deal that is ignored by too many business owners. We use the term, "pre-liquid," to describe this wealth because that's how you think about it.

Your company is with you today. Someday, perhaps a long time from now, you are going to sell it. Right? Then, you will have liquid wealth. So, today, your wealth is pre-liquid. But there are many things you can do in the interim, between now and an eventual sale, to manage your pre-liquid wealth.

Wealth management principles are well established for liquid assets as we have seen. The picture is quite different when the typical wealth manager encounters pre-liquid assets. Wealth managers simply do not know how to address such illiquid assets. They do not fit into any of the typical investment classes.

Regardless, the management of the illiquid wealth locked into your closely held or family business is a big deal for you, your family, your fellow owners, your employees and, indeed, all of your stakeholders.

Pre-liquid assets either become liquid or facilitate the creation of liquid assets when they are sold (entire businesses or partial sales).

Pre-liquid assets generate potentially liquid assets when economic distributions (i.e., distributions net of associated taxes) are made to their owners.

Pre-Liquid Wealth Represents Real Money

We are talking about real money when we discuss pre-liquid assets. Professors Moskowitz and Vissing Jorgensen, writing in the prestigious *American Economic Review* (September, 2002), suggest that the magnitude of private equity and public equity held by households were similar in magnitude, at least through the 1990s, the period of their study. The article is titled "The Returns to Entrepreneurial Investment: A Private Equity Premium Puzzle?"

The professors found it puzzling that households routinely invest substantial amounts in a single privately held firm with a seemingly far worse risk-return trade-off than investing in liquid wealth. We will incorporate some of the professors' observations into our discussion of managing private wealth.

As of 1998, the professors estimated the value of private equity held by households in the United States was $5.7 trillion. Inflation adjusted, the number would exceed $8 trillion today. In the book, *The $10 Trillion Opportunity,* published in 2005, authors Richard Jackim and Peter Christman estimated that private businesses worth some $10 trillion would be sold in the next decade. Similar predictions continue to be made today.

We know two things. First, there is a huge amount of wealth locked into private businesses in America. We also know that the tsunami of business sales predicted by Jackim and Christman has not yet occurred. We had a financial crisis in 2007-2009 that severely reduced transactions involving private companies. We have not yet returned to pre-recession transaction volumes.

An interesting study, "Baby Boomer Business Owners: Will There Be a Mass Sell-Off?," makes important observations about the age distribution of business ownership (Carey McMann, SME Research, September 2002):

- Well more than half of all businesses in America are owned by baby boomers (currently aged 50 – 67) and the still older silent generation.

- Baby boomers are still starting businesses, with 21% of all start-ups during 2011 having owners 55-64 years of age.

- 37% of businesses have owners with ages of 55 years or older.

The study concludes that perhaps 20% to 25% of all businesses in America will be sold or otherwise change hands over the next five-to-ten years.

Any way you care to cut it, there is a large and growing number of business owners in the United States who are in their 50s, 60s, 70s, and even older, who will sell their businesses in the coming years, or die in the saddle and burden their families, who will have to deal with their messes.

A True Story and the Ownership Transfer Matrix

Henry was in his mid-80s when age caught up with him. After selling below control a few years prior in a leveraged stock redemption, Henry caused the company to continue purchasing shares from departing employees and other shareholders. As a result of these repurchases, Henry's ownership crept up above 50%.

After his death, Henry's estate was valued on a controlling interest basis, rather than on an illiquid minority basis. The good news is that his wife was somewhat younger and in good health. Hopefully some good planning will take place so that the control block, which passed to her through the estate, will be reduced to a minority interest.

The point is that Henry didn't pay attention during the interim between his leveraged stock redemption and his death and created potentially expensive problems as a result.

Most business owners think of their ownership as binary. "I own it now and someday, I won't." Henry never sold his company. And today, he doesn't own it any longer. Examine the Ownership Transfer Matrix in Figure 3. Itmakes this critical point:

> *There's no way outside the boxes, so it is best to plan what for happens inside them.*

The Ownership Transfer Matrix

	Partial Sale/Transfer	Total Sale/Transfer
Voluntary Transfer	ESOP Outside Investor(s) Sales to Insiders/Relatives Combination Merger/Cash Out Going Public Gifting Programs Buy-Sell Agreements	Sale of Business Stock-for-Stock Exchange with Public Company Stock Cash Sale to Public Company Installment Sale to Relatives/Insiders ESOP/Management Buyout Liquidation Buy-Sell Agreements
Involuntary Transfer	Death Divorce Forced Restructuring Shareholder Disputes Buy-Sell Agreements	Death Divorce Forced Restructuring Bankruptcy Shareholder Disputes Liquidation Buy-Sell Agreements

Figure 3

Simply put, there is a lot of wealth tied up in closely held and family businesses, and a lot of that wealth is owned by Baby Boomers and their parents. All of these business owners will engage in one or more of the transfers outlined above. You will transfer your business ownership interest. The transfers may be partial or total. And they may be voluntary or involuntary. Have any of the transfer items in the boxes above happened to you?

Private Company Wealth is Concentrated

Was the example of Mr. Jones' portfolio in the prior chapter realistic? Listen to the professors:

> *"We find investment in private equity to be extremely concentrated.* ***About 75% of all private equity is owned by households for whom it constitutes at least half of their total net worth.*** *Furthermore, households with entrepreneurial equity invest on average more than 70% of their private holdings in a single private company in which they have an active management interest. Despite this dramatic lack of diversification, the average annual return to all equity in privately held companies is rather unimpressive. Private equity returns are on average no higher than the market return on all publicly traded equity." (emphasis added)*

We will talk about the returns we realize from closely held and family businesses in the next section of the book. But think about the implications of this study.

Look at the typical wealth manager's considerations of liquid and preliquid assets for the same clients.

Very few wealth managers are involved in setting investment objectives *for the substantial pre-liquid assets held by some of their clients.* If they do not help set objectives, it is difficult to be involved in establishing strategies.

Worse, in many cases, the wealth manager is attempting to help his or her client without specific knowledge of what is likely the largest single asset in the client's portfolio.

> On a risk adjusted basis, many private companies achieve lower returns than those available in the public securities markets. Not good.

Worse still from an adviser's viewpoint, when clients obtain liquidity from their closely held and family businesses in a sale transaction, they may seek larger, better known wealth managers for this newly obtained liquidity – especially if the existing wealth managers were not involved in the owner's decision-making process beforehand.

We recently spoke to Samantha, a successful wealth planner who works primarily with private businesses in the middle market. She observed that it is extremely rare for business owners to hold meetings with their key advisers at the same time, and that virtually none of the advisors has any unified concept of what the owner's financial planning should entail.

Samantha said:

> *In fact, each of the advisers has his or her own agenda for working with business owner clients, and there is never, well, almost never, any concept of a coordinated program for the businesses, the owners' estates, or for ownership or management transition planning.*

That's what we are talking about.

Do owners of closely held and family businesses typically think about their pre-liquid assets as investments? Not if our experience is representative.

The bottom line is that liquid wealth tends to be very closely managed, while pre-liquid wealth is not usually managed very closely at all.

As a business owner, you may be thinking: "Why, of course, my pre-liquid wealth is managed. I run the business every day."

The business should be run everyday. However, that's not the point at all. In fact, the comment helps make the point.

- **Every company, public or private, is managed (to greater or lesser degree).** What we are talking about is managing the pre-liquid wealth in private companies and creating strategies for converting that wealth from pre-liquid to liquid form over time through enhanced performance, distributions, partial sales, or ultimately, the sale of the businesses.

- **The business owner who manages a business every day tends not to think longer-term about when and how the wealth in the business will be realized.** That business owner is seldom thinking about how to use the business to create liquid assets to facilitate diversification away from the primary asset, which is, of course, the business.

The professors quoted previously explain the need to manage pre-liquid assets:

> *What we hope to convince the reader is that a complete theory of household portfolio choice should emphasize both public and private equity.*

The fact is that pre-liquid wealth is often not managed at all, and is seldom managed to the degree typically found with liquid wealth.

Disparity Between Management of Pre-Liquid and Liquid Wealth

What are some of the implications of the disparity of management of pre-liquid wealth and liquid wealth?

1. **Substantial management fees paid to wealth managers for managing liquid assets.** As I am writing, I received the quarterly statement from our profit sharing and 401-k plan. A quick calculation shows that we are paying management fees of about 70 basis points for the management of those tax-deferred funds in our plans.

2. **Little use of investment principles by wealth managers as applied to pre-liquid assets.** Few businesses actually calculate a rate of return for their closely held investments each year. Many business owners have never paid a distribution.

3. **Virtually no "management fees" paid for managing pre-liquid assets.** We are not aware of any financial consultants or wealth managers who work with business owners to manage pre-liquid wealth and charge fees based on a percentage of assets under management.

4. **Inadequate attention paid to the management aspects of pre-liquid wealth.** Too few business owners have a coordinated plan to diversify their wealth over time and to plan for their need for ultimate liquidity – when they either cannot or will not want to work in the future.

5. **Inadequate attention to basic corporate finance techniques designed to enhance value.** We will talk about a number of these tools later in the book, but for now, we are focusing on things like dividend policy, balance sheet management, share repurchase plans, and recapitalizations to take funds out of the business while still maintaining ownership.

6. **Almost no attention paid by business owners to the critical monitoring and enhancing investment principles, and to the reallocation of pre-liquid wealth into liquid form.** The professors point out that returns to private company equity are not adequate, on average, from a risk-adjusted point of view. It is

easy to get comfortable with our businesses and to let important planning and investment principles wait. It is easy to let excess assets accumulate inside your business where they dampen your investment returns and mess up your balance sheet. It is easy to avoid paying dividends because you think, in your infinite wisdom, that it is inappropriate for your shareholders (your kids?) to have this source of return. What would you say if the public companies you invest in, directly or indirectly, did the same thing? It is easy to let things slide during the interim between your current status quo and your ultimate disposition of your business.

Just to be clear, let's ask this question directly:

What do many, if not most, closely held and family business owners do to manage the wealth tied up in their closely held business?

For many, the answer to the question is "not much." It is time to focus on managing your private wealth.

Liquid wealth management is serious business. Pre-liquid wealth management should receive the same degree of attention and respect as that of liquid wealth management. The costs of not doing so are simply too high. There is much to be done in the interim between your current status quo and the ultimate sale or other disposition of your business.

Business/Finance $25.00

Unlocking Private Company Wealth

Are you managing the wealth represented by your ownership of a private business with the same care and respect as you manage your liquid asset portfolio and retirement funds? Most business owners don't. If you think you are different, then you are a statistical outlier. This book can help you turn your business into the liquidity creating vehicle it needs to be for you to become independent of the business and truly free to sell it, stay with it, or transition it to others of your choice.

Who should read this book and why?

BUSINESS OWNERS

- If you are the owner or part-owner of a successful closely held or family business
- If you are a baby boomer business owner
- If you have your wealth highly concentrated in your business ownership position
- If you don't know what you need to do to begin managing the wealth in your business like you have your liquid portfolio managed
- If you are uneasy about what you haven't done to initiate either ownership or management transition plans

BUSINESS ADVISERS

- If you want to understand how to talk to business owners about managing their private company wealth
- If you want to work with your private company clients as part of the team that manages private company wealth
- If you want to become more knowledgeable about concerns of business owners regarding wealth management and ownership and management transitions
- If you want a diagnostic tool to help you understand your private company owners' needs regarding wealth management

See Praise for Unlocking Private Company Wealth Inside.

Chris Mercer is a businessman and a valuation guy. He has been working with business owners and their advisers for over 30 years and is now focused on helping his fellow baby boomer business owners.

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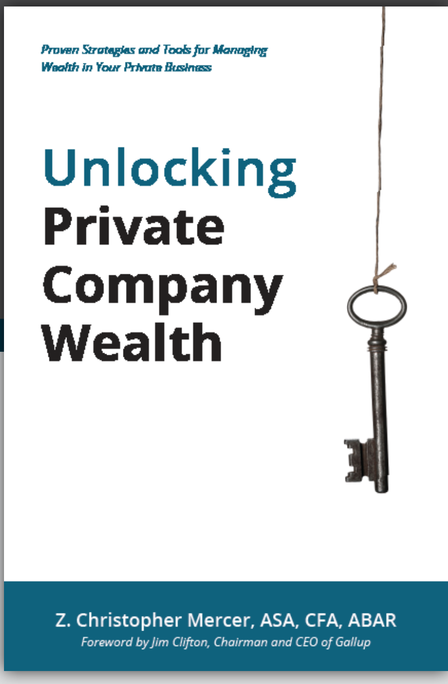

Unlocking Private Company Wealth

Proven Strategies and Tools for Managing Wealth in Your Private Business

by Z. Christopher Mercer, ASA, CFA, ABAR

I used to think it was odd how business owners would closely monitor the performance of a few hundred thousand dollars in a retirement account, but have no idea how many millions their business was worth. Stranger still was the fact that their financial advisors didn't seem to recognize this as a problem. *Unlocking Private Company Wealth* brings clear perspective and concrete solutions to one of the missing pieces of business ownership – how to turn a lifetime of work into a legacy of wealth.

Barbara Taylor, MBA
Allan Taylor & Company
New York Times Blogger

It's best to take action when the circumstances are favorable and the timing is right. *Unlocking Private Company Wealth* examines strategies you can implement now that will increase the future value of your closely held business.

Bill Rankin, CPA
Chief Financial Officer
Blue Bell Creameries, LP

He just wanted to buy a bass boat...

Norm, the controlling owner of a substantial and valuable private company was not a poor man by any stretch of the imagination. He just didn't pay attention to gaining liquidity from his business. He left funds in the company, many of which were reinvested in low-yielding cash assets.

One weekend he went to buy a new $25,000 bass boat and found, to his dismay, that he had to take out a loan to buy the boat.

We know about this story because we knew Norm. He was a client. His situation was not unlike the situation of too many other business owners. His wealth was locked inside his business.

The ideas and advice found in this book can help you help your clients turn their business into a liquidity-creating vehicle so that they can become independent of the business and truly free to sell it, stay with it, or transition it to others of their choice. Norm used several of these ideas and then truly enjoyed fishing until his dying day.

Benefits to Business Advisors

You must read *Unlocking Private Company Wealth* if you…

- Want to become more knowledgeable about concerns of business owners regarding wealth management and ownership and management transitions
- Want to understand how to talk to business owners about managing their private company wealth
- Want to work with your private company clients as part of the team that manages private company wealth
- Want a diagnostic tool to help you understand your private company owners' needs regarding wealth management