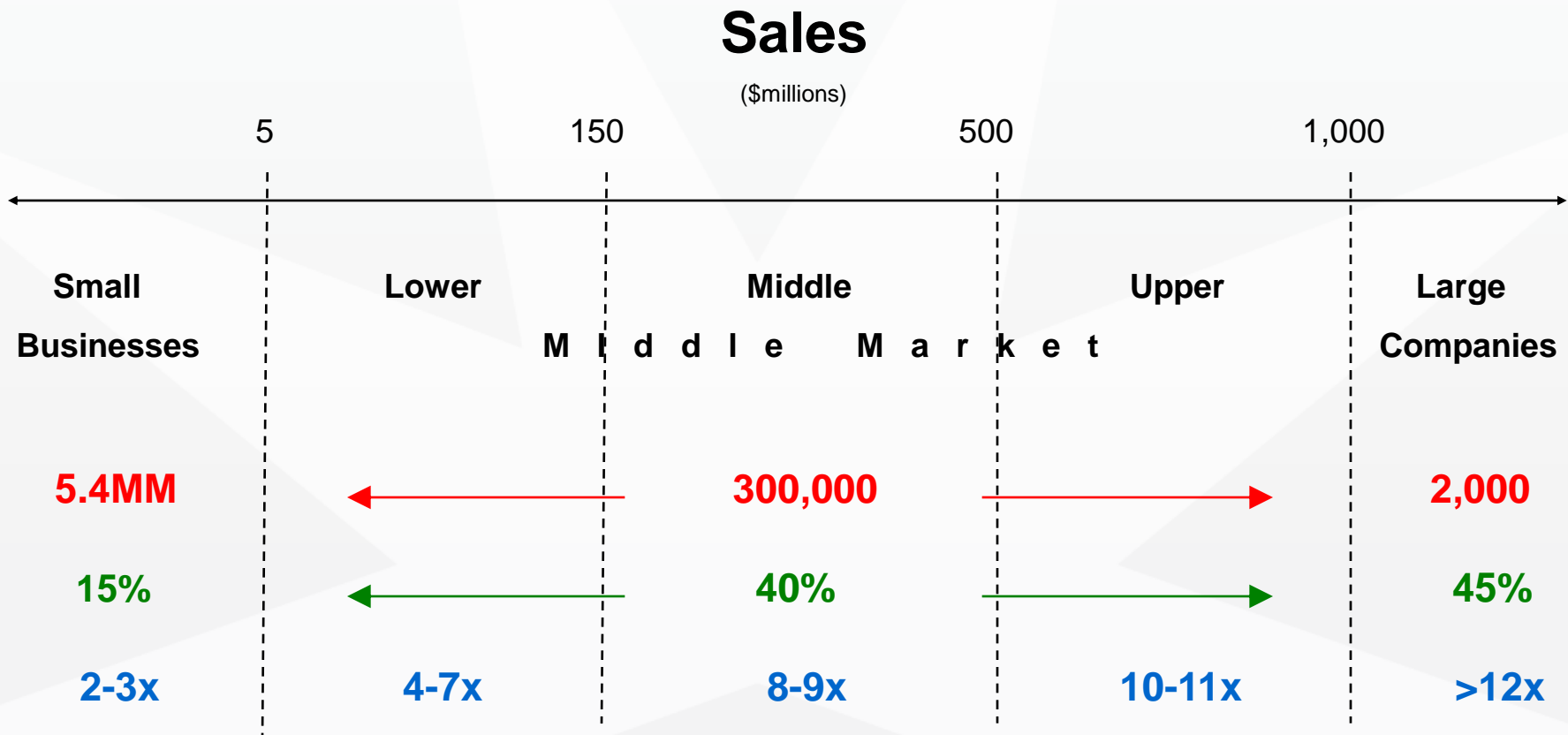


How to Build Value in Your Company

Presented by
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- Capital Markets Overview



- Creating a More Valuable View
 1. Focus on the business model
 2. Develop a recurring revenue/income stream
 3. Institutionalize the business (mgmt, systems, etc.)
 4. Create transparency on all fronts
 5. Rationalize the process chain

- End Result: Better/cheaper access to capital plus a higher acquisition multiple

- The Middle Market – What’s Happening?
 - The US middle market is one of the largest economies in the world
 - There are roughly 8,000 Private equity groups (PEGs) in the US – with several trillion dollars in spending power
 - PEGs own around 35,000 middle market companies (12%) – but this represents about 30% of the market equity...moving to more than 40% of equity by 2012
 - Hedge Funds are newer to private investments – but they have raised more than \$1 trillion in the past 2 years
 - Realized returns are dropping like a rock

- Intermediated Value Gap

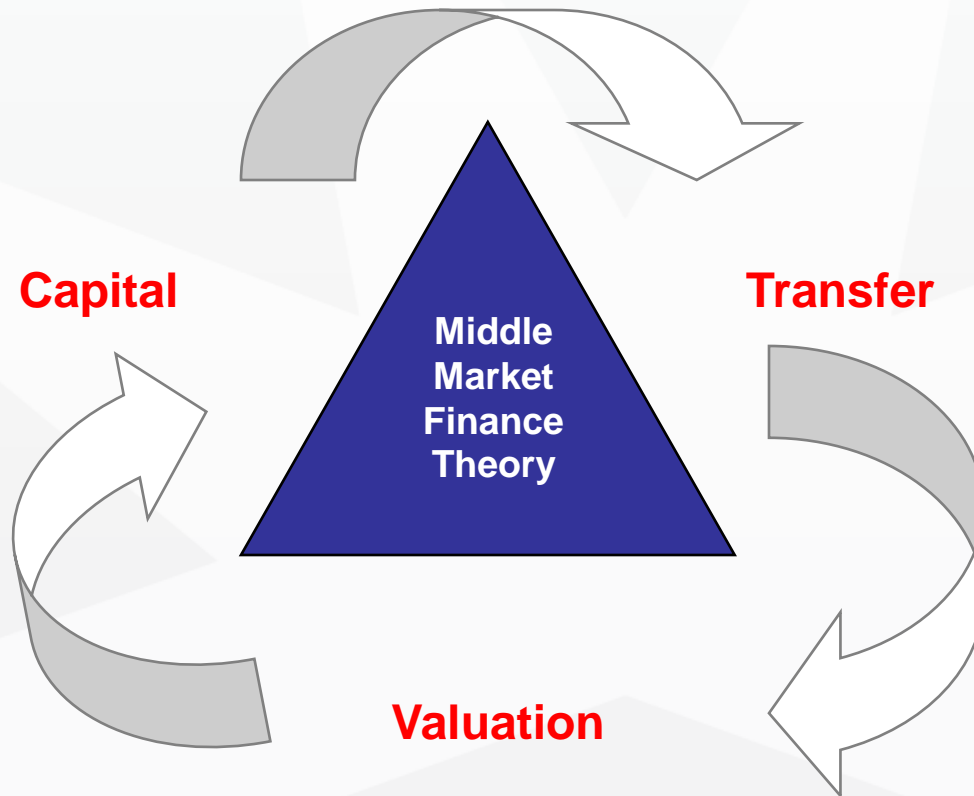
Middle Market Investments				
Expected versus Realized Returns*				
Investments	Expected Returns	Realized Returns**		
		5 Year	10 Year	20 Year
Venture capital	38%	4.6%	-1.5%	17.8%
Mezzanine capital	21%	2.7%	2.3%	6.7%
Private equity	30%	5.8%	2.8%	11.3%

*Thomson Reuters US Private Equity Performance Index (PEPI)

**Realized returns are net to investors after management fees and carried interest.

- Owner Value Gap
 - Most lower middle market companies have a cost of capital of 25-30%
 - Yet 80-90% of owners do not generate returns on investment to cover this cost of capital
 - This means that over time, a value gap occurs (the difference between what the owner wants/needs the value to be...versus what the market says it is worth)
 - The value gap shows-up in a number of negative ways (lack of job creation; diminished GDP; lower loan demand, etc.)

- Middle Market Finance Theory



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- Middle Market Finance
 - The study of how managers of private middle market companies make investment and financing decisions
 - Value Relativity: Value is relative to the reason for an appraisal
 - The Bizarre Bazaar: Private capital is allocated in a bazaar
 - Transfer Spectrum: Business transfer comprises a spectrum of alternatives
 - You are lost until you understand the integrated structure of private finance

- Value World Theory
 - Motive leads to a purpose (reason) for an appraisal
 - The purpose for an appraisal selects a value world
 - A private business value is relative to the value world in which it is viewed
 - Therefore every private company has dozens of correct values at one point in time
 - Why is there value relativity? Because I say so...NOT!

- A Few Value Worlds
 - Market Value – what the open market says the business is worth (Asset, Financial, and Synergy Subworlds)
 - Fair Market Value – what the IRS/Courts say it is worth
 - Owner Value – what the owner says it is worth
 - Investor Value – what an investor says it is worth
 - Collateral Value – what the bank says it is worth
 - Incremental Business Value – returns greater than investment
 - Others: Insurable; Early Equity; Public; Fair Value
 - The 30 second rule

- Value Worlds Planning

ACTION

CRTs
Acquisitions
MBOs
Go Public

ENTER

FMV
BRuptcy
Investment
FMV / MV

EXIT

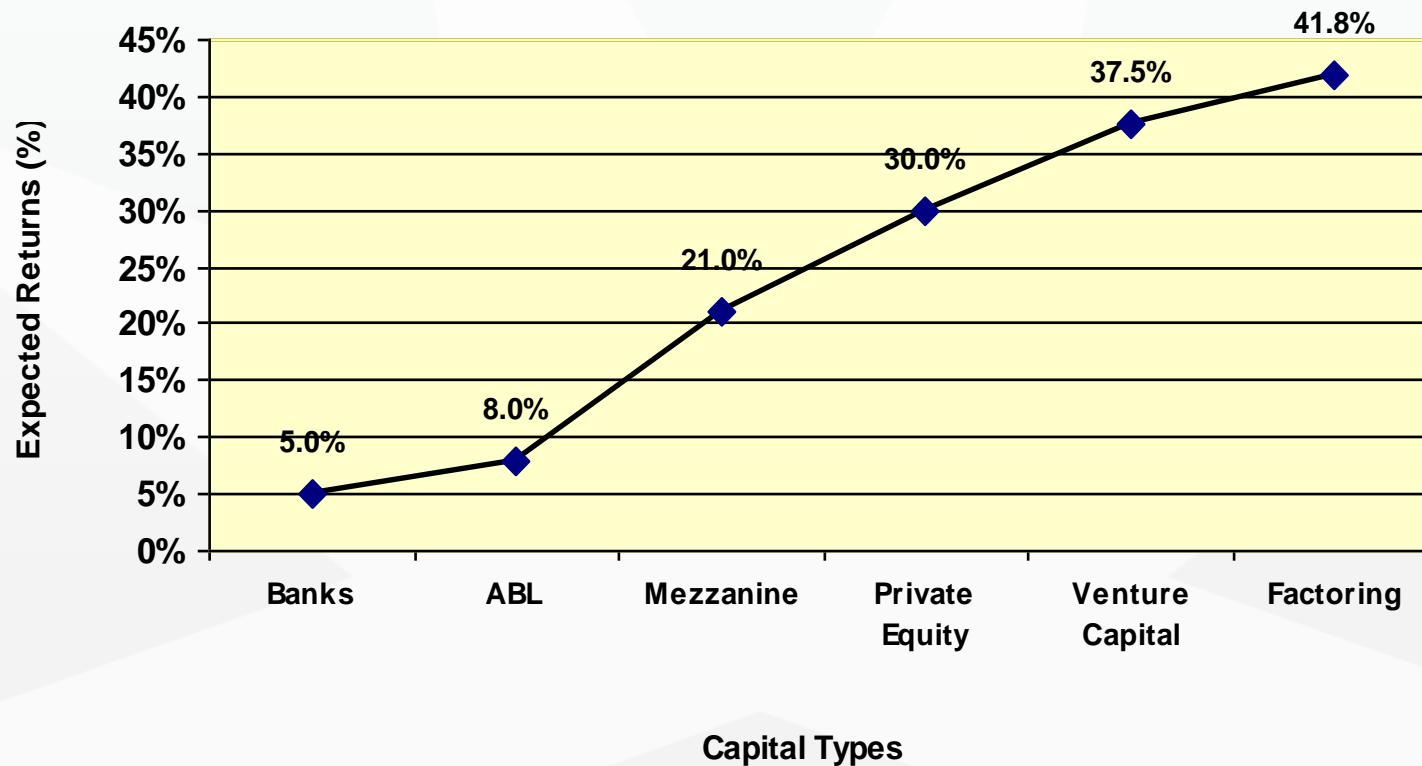
MV
Synergy MV
Owner
Public

- The Bizarre Bazaar of Private Capital
 - Why a bazaar and not a supermarket?
 - There is a structure and rules
 - Be prepared for financial hand-to-hand combat
 - Realize that capital providers constantly move their tents
 - Need to create capital solutions one deal at a time

- Structure of the Bazaar
 - Private capital owner motives include a desire: for few shareholders; to stretch equity; to eliminate personal guarantees; to manage business – not balance sheet
 - Capital is allocated based on the credit requirements of the providers (credit box)
 - Capital providers have unique return expectations
 - Return expectations are all-in rates (not just stated interest rates)
 - Return expectations can be graphed

Pepperdine Private Capital Market Line

Lower Middle Market Expected Returns (\$5-10M)



Private Auction Steps

Execute a Confidentiality Agreement



Distribute a Selling Memorandum



Step 1: Formal Expression of Interest



Buyer Visits - Data Room



Step 2: Call for Offers - Seller Supplied Format



Negotiate Synergy Sharing



Execute a Letter of Intent



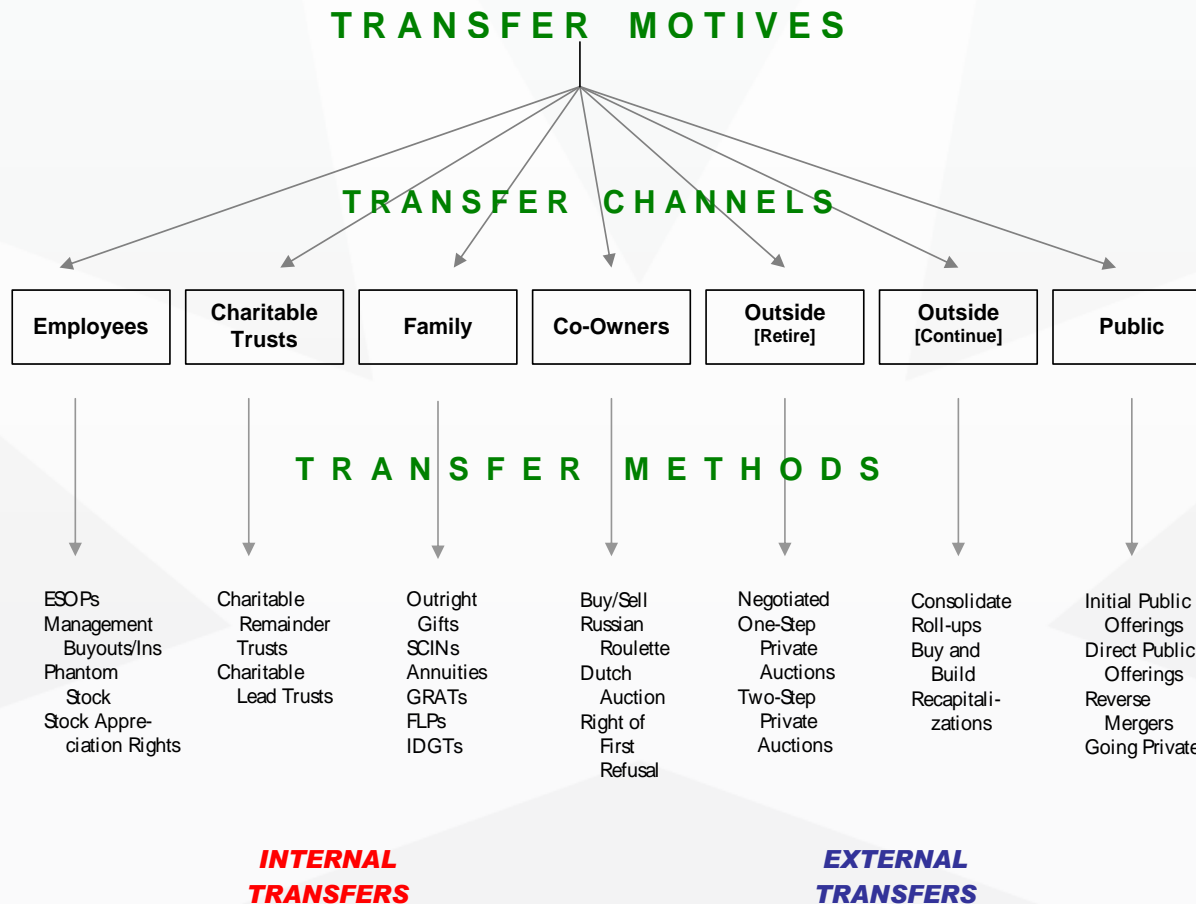
Buyer Due Diligence / Definitive Agreement



Closing

- Business Transfer
 - Business transfer reflects all possible ways or methods to transfer or exchange a private business interest
 - An owner's transfer motive selects a transfer channel (e.g., Employee channel)
 - Each channel contains numerous transfer methods (e.g., ESOP or MBO)
 - Transfer methods select value worlds!

■ Business Transfer Spectrum



- Owner Motives Matter – PrivateCo's Values

<u>Method</u>	<u>Value World</u>	<u>Value</u>
Buy/Sell	Asset Market Value	\$ 2.4 MM
MBO	Investment Value	7.5 MM
ESOP	Fair Market Value	9.2 MM
Equity Recap	Financial Market Value	12.0 MM
Negotiated	Owner Value	15.8 MM
Auction	Synergy Market Value	16.6 MM
Public	Public Value	18.2 MM

Business Owners Choose a Transfer Value!

- Private Market Timing

U.S. Ten Year Transfer Cycle



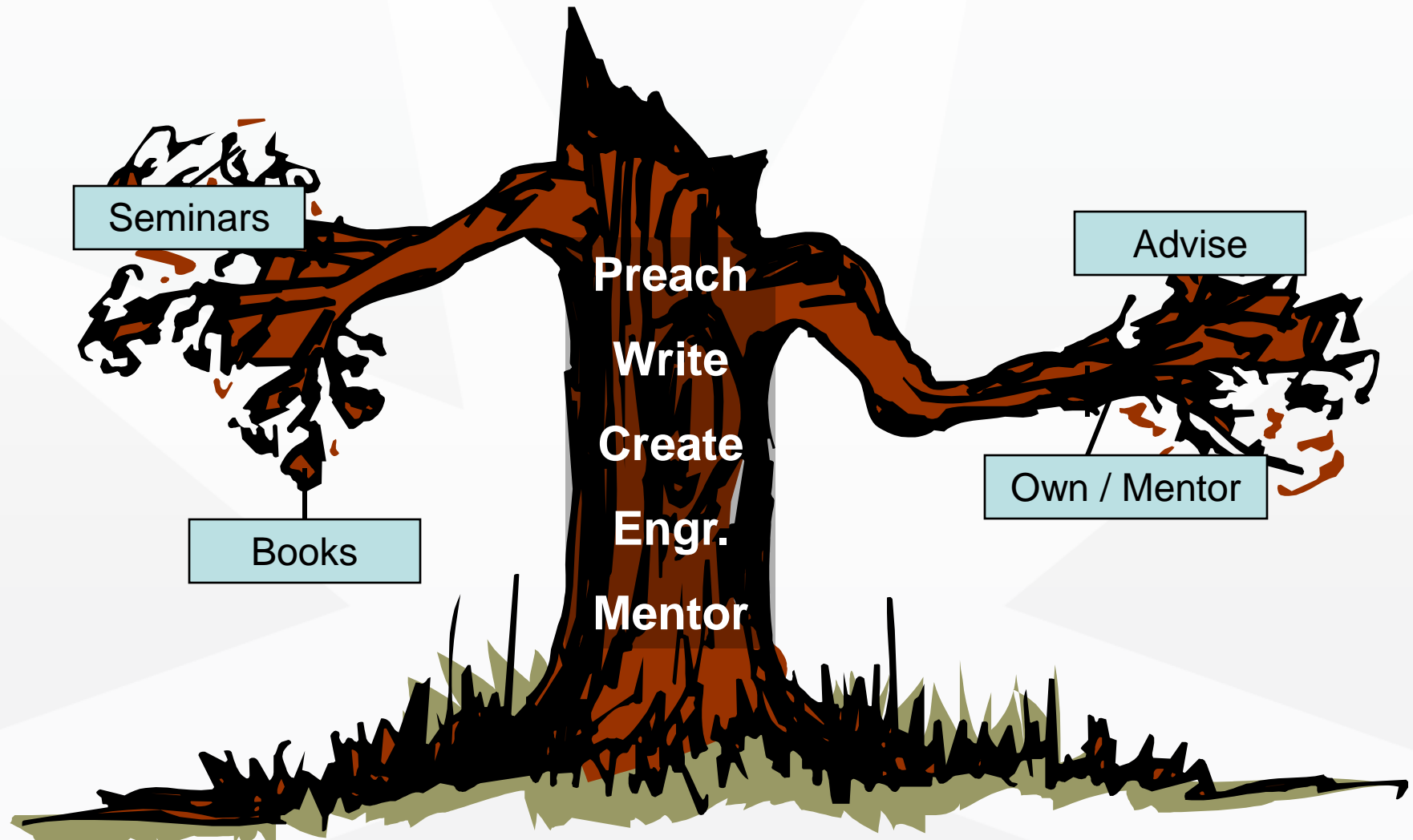
- How to play this cycle?

■ Value Architecture

- Tradespeople - mechanics; fingerprints on everything; low leverage (less than 2:1); earning a living; probably small businessperson for life
- General Contractor - still fingerprinting; some leverage (less than 5:1); earning a lifestyle; may or may not realize financial independence
- Value Architect - fingers on pulse; substantial leverage (more than 10:1); creating value/wealth; is or has realized financial independence

- **Becoming a Niche-aholic in Your Business**
 - Incrementalism versus departurism...do the math
 - Steps:
 1. Complete a physical inventory of your intellectual capital
 2. Describe the needs/wants/behavior of your current markets
 3. Determine several niches that you can exploit
 4. Use an Aggregation Model
 5. Rinse, lather, repeat
 - Create a niche conglomerate?

- Niche Conglomerate



- Where Do We Go From Here?
 - Clarify your goals ... how important is financial independence to you?
 - Do you want to become a Value Architect?
 - Join MidasNation.com
 - What else can you do?

- Thank You

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