



**Florida Institute on Federal
Taxation Conference**

**Succession Planning for the
Family Owned Business**

Overview / Capital Market Trends/ Liquidity Options

November 2011



The Lenox Group, LLC - Overview

- Full-Service Corporate Finance Advisory Firm
- Premier Advisory Firm for Lower Middle Market Transactions
- Expertise in Assisting Management Teams & Entrepreneurs to:
 - Achieve Liquidity
 - Sale of the company, leveraged recapitalization or leveraged ESOP
 - Raise capital (debt and equity) to execute management buyouts
- Comprehensive Corporate Finance Services for Middle-Market Companies and Entrepreneurs

Since 1995, Lenox Professionals have achieved a high closure rate, completing transactions representing well over \$1 billion in transaction value.



Broad Corporate Finance Experience

Capital Raising

Private Equity and Debt Placements

Senior Debt Refinancings & Restructurings

Acquisition Financing

Going Private Transactions

GENERAL PROCESS*

- Analyze pricing, underwriting criteria, and structural issues
- Evaluate alternative capital sources
- Prepare descriptive memorandum
- Identify and contact prospective investors/lenders
- Price, structure, and negotiate the transaction
- Facilitate due diligence and closing

Mergers & Acquisitions

Sell and Buy-side Advisory:

- Divestitures
- Recapitalizations
- Management and Leveraged Buyouts

GENERAL PROCESS*

- Evaluate strategic and financial alternatives
- Perform valuation analysis and establish expectations
- Prepare descriptive memorandum
- Identify and contact strategic and/or financial buyers/investors
- Price, structure, and negotiate the transaction
- Facilitate due diligence and closing

Financial Advisory

Business Valuations (BV)

Fairness Opinions (FO)

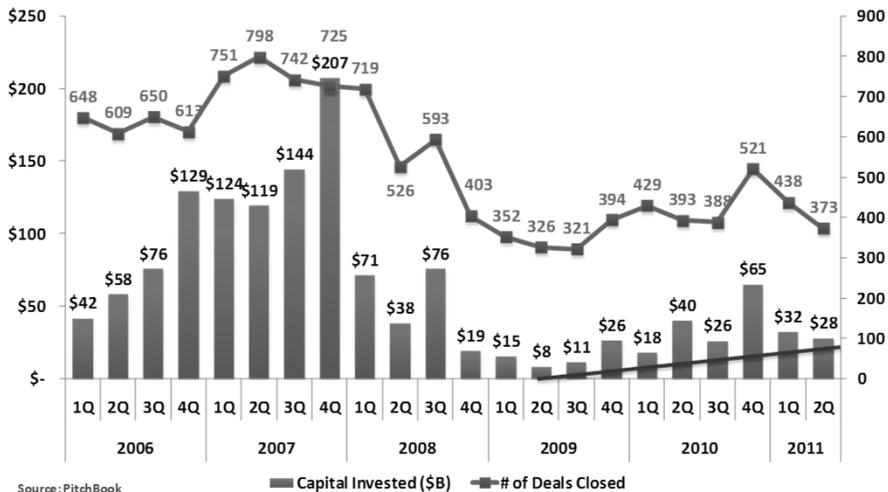
Strategic Advisory (SA):

Shareholder Value Maximization Studies

GENERAL PROCESS*

- BV:** Analyze historical and projected financials and current market information to establish a range of values for the business
- FO:** Advise Special Committee to the Board by opining on fairness of transaction from a financial point of view
- SA:** Evaluate strategic alternatives for the company and recommend and implement a strategy to maximize shareholder value

U.S. Private Equity Deal Flow

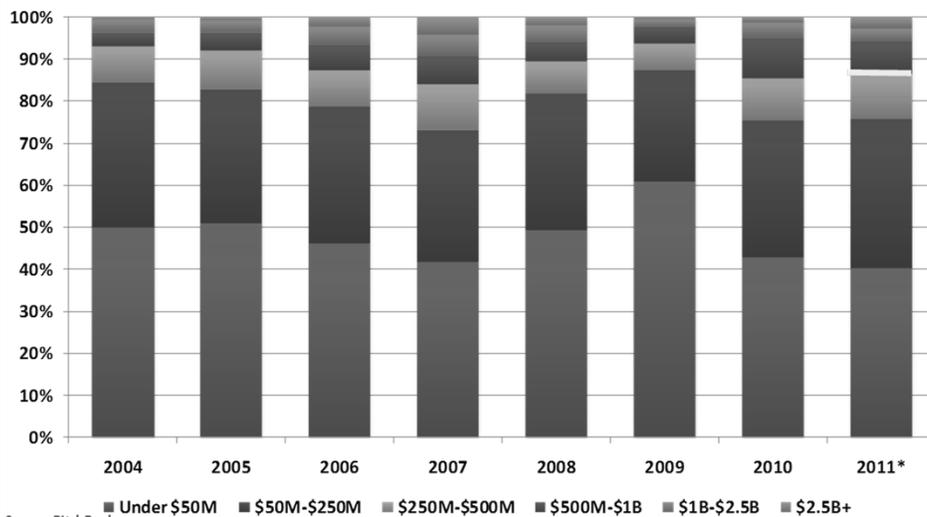


M&A Drivers

- Factors driving Financial Sponsor M&A higher include:
 - Low interest rates
 - Significant capital on sidelines
 - Improving leverage market

- Factors driving Corporate M&A:
 - Excess cash on the balance sheet
 - Weak consumer demand and high unemployment reducing organic growth
 - Fewer cost savings initiatives
 - Growth driven by acquisition

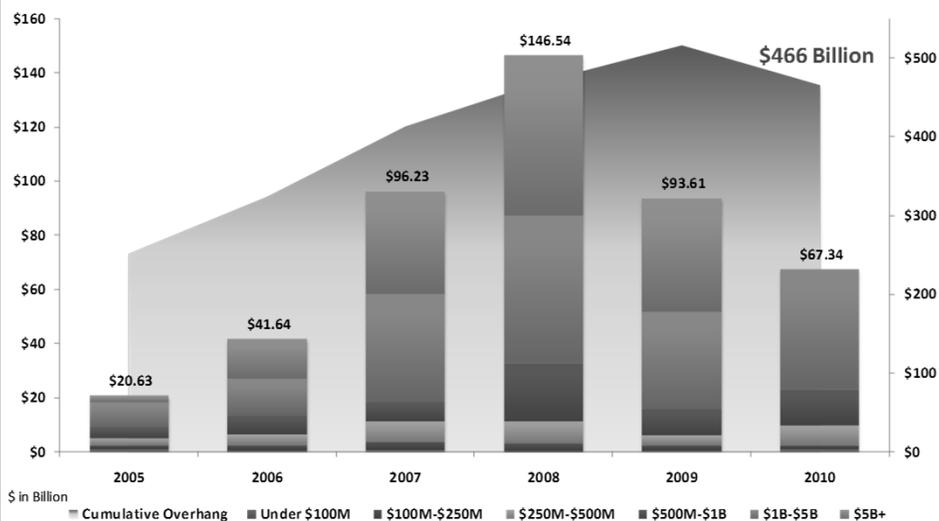
Middle Market Deal Activity Significant



Capital Availability

- Private equity “dry powder” reached approximately \$500 Billion in 2010 representing about six years of capital at current deployment rates.
- While fundraising for buyout funds is down versus prior years, the amounts are still quite high on a historical basis.
- Amount of mezzanine capital increased in 2009 and 2010 reflecting a challenging senior debt market.
- U.S. companies are sitting on nearly \$1 trillion of cash and short-term investments. According to a recent Moody’s report, tech, pharma and energy sectors are the top “cash-heavy” industries.
- Conclusion: There is ample capital to facilitate growth and change of control transactions.

Capital Overhang – U.S. Private Equity



Purchase Price Multiples Increasing

Multiple factors impacting higher multiples:

- Record amounts of available capital
- Limited universe of solid performing companies
- Good insight into management teams and how they managed through recession
- Organic growth limited for strategics resulting in growth through acquisition to appease Wall Street

Liquidity Options

- A. Sale to Strategic Buyer
 - 1. Cash and/or stock sale
 - 2. With or without earn out component
- B. Sale to Financial Buyer (Private Equity Group)
 - 1. Asset or stock sale
 - 2. Partial Sale (Recapitalization)
- C. Sale to Existing Management Team
 - 1. Use Private Equity Group to back Management Team
 - 2. Use Seller Note for portion of Transaction
- D. Sale to a newly created Employee Stock Ownership Plan (ESOP)
 - 1. 100% Sale with Cash and Seller Note
 - 2. 50% Sale with Cash and Seller Note
 - 3. 30% Sale with Cash

What is an ESOP?

- An employee stock ownership plan ("ESOP") is a qualified, defined contribution, employee benefit plan.
- ESOPs are "qualified" in the sense that the ESOP's sponsoring company, the selling shareholder and participants receive various tax benefits.
- An ESOP is very similar to other qualified retirement plans, like a 401(k) plan, except that the ESOP is designed to invest primarily in the stock of the sponsoring company.
- The first ESOP was created in 1957, the tax benefits which make the ESOP so popular were introduced in 1975, and there are in excess of 11,000 companies with ESOPs (excluding subs and affiliates) in the U.S. today.
- A leveraged ESOP ("LESOP") is simply an ESOP that has obtained financing to purchase shares of the company.

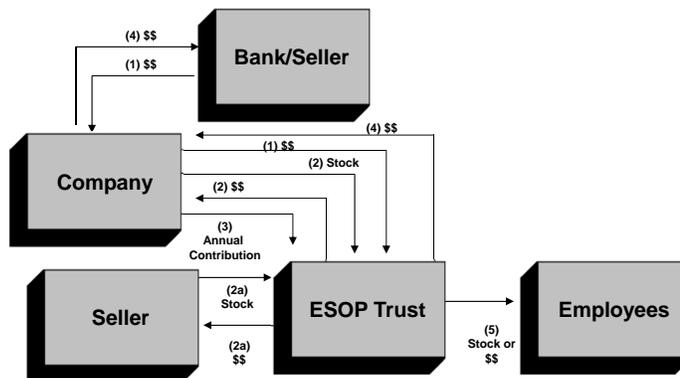
Dual Track Process

- Proceeds Comparison – Implied Equivalent Value

	Strategic	ESOP	Equivalent for Strategic
Purchase	\$50.0	\$50.0	\$63.3
Tax Rate*	21%	0%	21%
Taxes	\$10.5	\$0.0	\$13.3
Proceeds	\$39.5	\$50.0	\$50.0

*Capital Gains Rate is 15% and Georgia State Tax Rate is 6%. / Basis in stock assumed to be zero.

Typical Financing Structure



1. If fully leveraged, lender(s) lend the purchase price to Company which, in turn, lends same to ESOP Trust.
2. The ESOP trust uses the loaned funds to buy the stock from Company or (2a) from the shareholders.
3. Company makes annual tax deductible contributions and dividend payments to ESOP Trust.
4. ESOP Trust repays Company which, in turn, repays Bank (and shareholders with respect to any seller financing).
5. Employees collect stock or cash when they retire or leave Company.

Advantages of an ESOP Sale

- A. Always a Stock (vs. Asset) structured transaction
- B. Tax free or partially tax-free
- C. Owner can defer taxes until death using a Section 1042 election
- D. Incentivizes Employees to work harder and rewards management
- E. Keeps business out of competitors hands (as Sale alternative)
- F. Long Time Horizon- No Full Exit Required
- G. Keeps Company out of Competition's hands

Disadvantages of an ESOP sale

- A. Levers up business: can hinder growth
- B. Can cause cash-flow issues
- C. Third party (trustee) at the table; requires annual valuation, admin
- D. Unfunded liability concerns- depending on age of employee base
- E. Can hinder future sale attractiveness
- F. Typically no outside “fresh” management is brought in for new ideas (as in traditional sale to 3rd party)
- F. Potential loan/margin calls may result from fluctuations in the market price of Qualified Replacement Securities (QRPs)



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