

Safe Business Journeys...

Successful Strategies for Entrepreneurs to Enter & Exit Business Ownership

Bankers Advocate Group

January, 2005 Newsletter

www.BankersAdvocate.com

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6 Steps to Ready a Business for Sale...

By Chris Curtin, Bankers Advocate Group

Whether you are ready to sell your business now or in the future, steps should be implemented now to make your business more sellable. Potential buyers will weigh purchasing your business against other investment opportunities. Taking these six steps will help your business stand out from the others. We still advise using Professionals Advisors (see the article in this issue by Juanita Schwartzkopf), but we hope these six steps get you headed in the right direction.

1. Clean up Your Books. Are your monthly financials completed by the 15th of the following month? Are you comfortable that the P&L, Balance Sheet, AR and AP are correct and truly represent the status of your business? Do NOT run your business by *only* eyeballing the checkbook.

2. Understand your Books. One reason step one is not followed is that many times financial numbers are not that meaningful to business owners. Financials are only



a useful tool if understood and used correctly. If you don't fully understand your books, get some help. Also, make sure data is presented to you in a useful format. Many businesses have too many general ledger accounts to be meaningful. Use sub-accounts to clean up the clutter. Expense items should be reviewed as a percent of sales. Track the change in percentage of key expense accounts and

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Maximizing YOUR Return: Increasing the Value of Your Company Before the Sale...By Juanita Schwartzkopf, Focus Management

As a business owner, your financial future is directly related to the success of your company. In turn, the success of your company is most often measured in terms of profitability, specifically the "EBITDA" (Earnings Before Interest, Tax, Depreciation and Amortization), which drives the potential sale value of the Company. The sale value of a Company is frequently measured, as the multiple of EBITDA the buyer is willing to pay. Companies are constantly being sold with the purchaser subsequently improving the EBITDA performance, reselling the Company, and then reaping another financial

reward. It is exactly this second financial reward that you, as the current business owner, should be focused on when considering the timing of the sale of your Company.

3rd party Financial Advisory firms are typically brought into companies that are experiencing problems with their lending relationship, their equity owners, or both. However, the experience, which Financial Advisory professionals hold in quickly reviewing a company's performance, can also be used to maximize the value of a successful business for the current owner.

A potential purchaser of a

business reviews the historic financial performance, estimates what financial improvements can be made, buys the company based on historic performance, makes the improvements, and then sells the Company thereby realizing a quick profit. We recommend you, the business owner, implement the middle step in this timeline and reap that additional reward.

The approach a savvy owner, interested in maximizing their return, would be to bring in a 3rd party with financial and

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“The 1996 statute provides that a covenant not to compete must be in writing and signed by the person against whom enforcement is sought”

FLORIDA NON-COMPETE AGREEMENTS...

By Diane J. Geller, Esq. Ruden McClosky

The Florida Legislature in 1996 passed a new version of the Florida Statutory Authorization of Non-Compete Agreements. This Florida Statute, §542.335 made a number of changes with respect to agreements executed or effective on or after July 1, 1996.

The 1996 statute provides that a covenant not to compete must be in writing and signed by the person against whom enforcement is sought and codifies earlier case law with respect to what constitutes a “legitimate business interest” that is protectable under the law. The statute also provides for presumptions as to the reasonableness of the duration of the non-compete in certain specific contexts.

Recognizing that there would likely be confusion as to which statute would apply in determining the enforceability of a non-compete covenant, the 1996 statute expressly provides that it does not apply to agreements executed or effective prior

to its effective date. Therefore, in order for a non-compete covenant to be enforced under the new statute, the covenant must have been signed “post July 1, 1996.” Covenants signed pre-July 1996 will be enforced in accordance with the statute in effect at the time they were signed.

Employers must engage counsel in drafting the non-compete agreement and in enforcing the non-compete agreement.

Those employers who find that they have agreements executed prior to the July 1, 1996 may be well advised to insist that a new agreement be executed. Employers attempting to modify a preexisting agreement may find that the 1996 statute will narrow the enforceability of the modified non-complete provisions. Therefore, where an employer intends to modify rather than replace an existing pre-1996 covenant, the amendment must clearly and expressly state that the amendment is solely intended to supplement rather than

replace the prior covenant¹.

When drafting non-compete covenant, the company needs to consider the legitimate business interest that it seeking to protect. The 1996 statute establishes some parameters for what constitutes a legitimate business interest² and provides that a court is only to enforce a non-compete agreement to the extent necessary to protect the legitimate business interests at issue³. While in Florida, we are fortunate that the statute provides for “blue penciling” of an over broad covenant⁴. Companies often fail to understand that the purpose behind the statute is not to avoid competition, but to protect the company from an employee pirating its proprietary assets.

Aside from considering the purpose and following the statute’s parameters as to the length of time that is presumptively reasonable

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Business Values and M&A Activities are Up... By George Abraham, Business Evaluation Systems

As a Business Appraisal company, it is hard to determine, with any degree of accuracy exactly how much the overall values are up. Since there are many different industries, any overall conclusion would be totally misleading. However, from our own data, many industries did rise in value and the amount of companies we valued for contemplation of sale rose dramatically in 2004. This alone indicates that there was an increase in the Mergers and Acquisitions (M&A) activities, since more owners were having their companies valued. From our own research, we feel that the lowest level was 2002 and the activity, in our company, started in September of 2003 and has been building steadily since then. We noticed healthier balance sheets, increasing inventory levels and revenues in most industries increased and are still growing. Owners seemed to be more optimistic about the future than we have

seen in a long time. We talked to Shannon Pratt of Business Valuation Update, the most prominent author of Business Appraisal books and research in the industry, and he felt that 2002 was the bottom and the multiples were rising. Shannon Pratt’s December, 2004 Business Valuation Update newsletter shows some excellent research on multiples for several industries from 1998 through the third quarter of 2004.

Chris Mercer of Mercer Capital, a leading business valuation author who’s company is one of the largest independent valuation firms in the nation and the only such firm that has an expertise in financial institutions, stated in his December 2004 newsletter “Without question, 2004 witnessed substantial M&A activity, as the aggregate transaction value rose to a level not

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WORKING CAPITAL: Selling to retailers? Are you about to take a hit?

By Lunelle Siegel, Alliance Financial Capital

Working capital is the life's blood of business. Cash in the bank to pay bills when they come due...payroll, suppliers, taxes, insurance, rent, etc.

Since 9-11, many wholesale & distribution companies have seen erosion in working capital as their retail customers have slowed payable disbursements to vendors. As their cash turns back around from customers slower, they find their bank balances falling lower and lower, and ability to keep up tighter and tighter. Only companies that take proactive steps to address these working capital shortfalls are surviving.

Tightening cash flow is one thing...but what if a customer NEVER pays? Many retailers have fallen on tough times. K-mart filed for bankruptcy protection then merged with Sears in a real estate play, but will the new entity survive as a retailer? Toys-R-Us and Mars Music filed for bankruptcy and many of their vendors took a hit. Vendors are likely to be stuck with tens of thousands

of unpaid balances as unsecured creditors - if they don't pay attention!

Checking and monitoring customer credit is a thankless, but necessary job. How can you protect yourself?

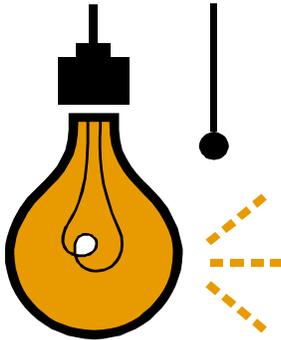
1. **Become informed** – take an educated risk. When you grant terms you are 'investing' in your customers. Find out if it's a good investment. Look up your

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Other Uses for a Business Appraisal...

By Chris Curtin, Bankers Advocate Group



The majority of the time Bankers Advocate employs a certified business appraisal, it is for use when our Client is Entering or Exiting Business Ownership.

However, recently we utilized a certified business appraisal, where the shareholders were not happy with the results their long time president provided. The owners had called in a top turnaround consultant to review the company's performance. The turnaround consultant reported to the ownership group "the good news is the business is being run for the benefit of the family, the bad news is that it is not your family!"

Ownership replaced the existing president with the consultant and profitability and cash flow were improved tremendously.

The one problem left over from the old regime is that the company had loaned the ex-president the money to buy a small equity stake in the business. Now that he was gone, they needed to negotiate with him to buy those shares back. We were called in to value the business for a stock sale factoring in the minority discount and the fact the appraisal had to be to litigation standards (i.e. The appraiser would be ready to testify in defense of the appraisal, if necessary).

We gathered the data and our appraiser completed his work. The client was happy to see that the appraiser's work valued the minority shares at a 75% discount to what they had planned to offer the ex-president.

Six months later, an update of the original appraisal was requested. The update confirmed that the consultant had created over \$1.2 million in enterprise value under his

stewardship. The ownership group is much happier and is looking for more investment opportunities in their industry.

This real life example describes uses 1-3 of the following list of possible Business Appraisal usages.

- Ownership Disputes
- Buy/Sell Agreements
- Investment "Yardstick"
- Fund Life Insurance
- Marriage Dissolution
- ESOP Valuation
- IRS & Tax Planning
- Estate Planning
- Joint Venture
- Equity Infusion
- Borrowing Justification

These are just a few of the examples where a certified business appraisal can be a valuable tool.

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The Three Components of Business

“Value” ...By Chris Curtin, Bankers Advocate Group

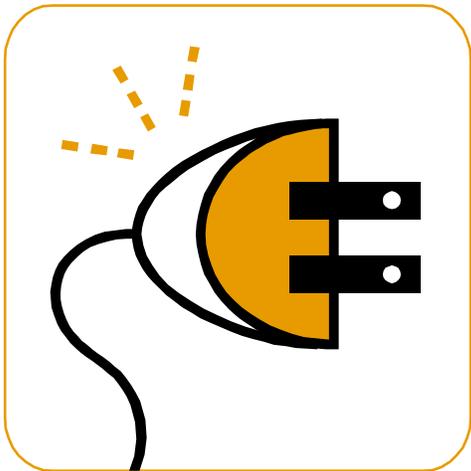
What makes up the value of any business? Most good appraisals will include several methods of value determination, but typically, the three components of the total value are as follows:

1. **Hard Assets.** Land, equipment, vehicles and buildings are usually valued at Fair Market value. In a business appraisal, you will also see a percentage of the inventory in this number since it takes a certain level of inventory to generate A/R and cash.
2. **Goodwill or Enterprise Value.** This number is a multiple of the businesses ability to generate cash for the owner. Many variables can adjust the multiplier up or down. For

example: complexity of the business, profit consistency or ease of entry by competition. If the cash flow generated by a business barely covers the current owner's total compensation, the enterprise value can be zero.

3. **Adjustment for the Balance Sheet.** If a business is sold as a stock sale versus an asset sale, an adjustment must be made for the adjusted values of assets and liabilities in the balance sheet. This adjustment can be a negative or positive number depending on the values of A/R, inventory, fixed asset replacement

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FOCUS ON: INTERNAL AUDIT FRAUD ALERT...

By John Capizzi, Internal Audit Services

It is *highly* recommend that when Company checks are prepared for executive review and signature, that an identifier recognizable only to the executive signee signifying that the check is an authentic company check, be placed on the document. For example: a control code, account number, watermark, etc. (anything recognizable only to the signee.)

Case Example:

In a recent internal audit case, a company had vehicles financed through GMAC and company credit cards issued by Capital One. The employee responsible for the production of monthly checks also had her personal vehicle and credit card through the same issuing companies as her employing company. Company checks would be processed and brought to executive management for signature. All checks were

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Maximizing YOUR Return: Increasing the Value of Your Company Before the Sale... (Continued from Page 1)

operating experience to review the operational & financial performance of the Company. Based on that review, the business owner and the 3rd party Advisor would develop a joint plan. The changes to enhance the operational and financial performance of the Company would then be implemented. Once those improvements were visible in the financial records, i.e. the income statement and balance sheet, then the Company would be marketed for sale at an increased price.

An obstacle that typically preclude the business

owner from taking steps to earn an additional financial premium center around the current owner's belief that his or her business is operating at optimal performance. That is exactly why a 3rd party review by an experienced Advisor can provide value. If the company were operating at optimal performance, the Advisor would ratify that performance standard and would be able to provide additional strength and support to value estimates during the sale negotiations. If performance can be enhanced, then the

Advisor would work with management to develop or implement the improvement plan.

The financial investment the current owner makes in the Advisor would be returned in improved negotiating strength and sale value, or in improved financial performance and sale value. Either way, you enjoy the future buyer's hope for gain; the reward associated with improved performance is yours for the taking.

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6 Steps to Ready a Business for Sale... (Continued from Page 1)

manage them accordingly.

3. A/R Issues. Many businesses have liquidity issues. One of the easiest ways to find the "low hanging fruit" is to take a hard look at your accounts receivable (A/R). What percent of your A/R is over 60 days old? 90 days old? Recently, a client at our urging reduced their largest customer's 60+ days A/R by \$100,000 even though sales had increased. This cash increase reduced their yearly factoring fees over \$35,000.

4. Inventory Issues. Inventory is another area where much cash is wasted. Check your turnover on stocked items. Items that you hold for more than 90 days need

evaluated for different re-order or manufacturing levels. Any inventory that is older than 180 days needs special attention. I have heard many arguments about this "great deal" clients made buying goods. However, inventory is described as a "wasting" asset. Besides consuming precious working capital, it also generates additional storage, insurance and handling costs. Unless inventory turns and solid profits are realized-liquidate!

5. Surplus Equipment. Entrepreneurs are great accumulators of "stuff". I am not a psychologist, but I think that it gives them some measure of comfort to see all the bulldozers, trailers, forklifts and tanks

that they own. Bottom line is that if an asset does not earn your business profits compensatory to its value, it is a drain on cash flow. Again, liquidate!

6. Analyze Sales Sources. I believe much money is wasted on fixed cost advertising (yellow pages, newspapers, radio, etc.). I understand it is important to have a presence and a clear message in the marketplace, but when was the last time you researched the source of your new clients. You might be better served by cultivating more referral sources. Know your true sources and costs to secure and keep clients.

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"Obstacles that typically preclude the business owner from taking this step and earning this additional financial premium center around the current owner's belief that his or her business is operating at optimal performance"



“Should the company learn that an employee is violating the non-compete, prior to rushing to the courthouse, the company needs to consider the fees and costs of litigation when deciding if litigation is an appropriate route to pursue.”

FLORIDA NON-COMPETE AGREEMENTS...(continued from Page 2)

for the duration of a covenant,⁵ the company management needs to seek the advice of their counsel pre-litigation and preferably pre-termination of the employee. If consulted prior to the employee's termination, counsel may be able to improve the chances that a court will enforce the agreement if litigation arises.

While Florida courts have traditionally held that non-compete agreements provide for their effectiveness under circumstances of termination with or without cause, that enforcement can no longer automatically be assumed.⁶ Therefore, in instances where the company believes that the employee will voluntarily resign if conditions allow, the appropriate advice may be to choose to wait for the employee to quit rather than to discharge him. This approach may increase the chances that the non-compete agreement will be enforced. Regardless, the most important advice that counsel can give to company management concerning the termination process is to strictly adhere to the employment agreement and to its policies and practices regarding employee termination. The employer's failure to follow the employment agreement or company policy could provide the employee with a defense in any subsequent litigation over the enforcement of the

non-compete.⁷

As part of the substantiation of the legitimacy of the business interest that the company is trying to protect, it is imperative that the information is actually treated as proprietary and confidential. By way of example, it is critical that a company claiming its client list to be proprietary does not post a list of its representative clients on its website. The company should establish policies and procedures as to the treatment of its proprietary materials and follow those policies. Further, at the time of the termination of employment, the company should require the departing employee to return all documents and materials belonging to the company and should inventory the materials being returned. The company should also remind the employee in writing of his or her obligations under the non-compete agreement and provide a copy of the signed agreement to the employee.

Should the company learn that an employee is violating the non-compete, prior to rushing to the courthouse, the company needs to consider the fees and costs of litigation when deciding if litigation is an appropriate route to pursue. Non-compete cases are often won or lost at the temporary injunction stage, and therefore result in intense legal activity and

large legal fees are incurred virtually immediately after filing suit. The company can also consider an action strictly for damages and not injunctive relief. This course of action is slower and does not prevent the immediate harm from the continued use of its proprietary materials, but it does provide compensation after the fact, and as compared to an injunction, the immediate large outlay of legal fees is generally not required, as the case proceeds at a slower pace.

Prior to engaging in litigation, the company must carefully review the costs and its goals to determine whether or not this particular instance is the appropriate one in which to file suit.

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Footnotes:

1 North American Products Corp. v. Moore, 196 F. Supp. 2d 1217 (M.D. Fla. 2002); Infinity Radio, Inc. v. Whitby, 780 So. 2d 248 (Fla. 4th DCA 2001)

2 Florida Statute § 542.335(1)(b)

3 Florida Statute § 542.335(1)(c)

4 Florida Statute § 542.335(1)(c)

5 Florida Statute § 542.335(1)(d)

6 § 542.335(1)(g) permits consideration of all “legal and equitable defenses” except “individualized economic or other hardship” and discontinuance of business caused by violation of non-compete. So, may consider principle breach by employer as basis to preclude enforcement.

7 Ibid.

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WORKING CAPITAL: Selling to retailers? Are you about to take a hit? ... (Continued from Page 3)

customers on hoovers.com. If they are public companies, look at their financial statements. Are they losing money? Are they making a profit? Do they have more cash than accounts payable? If they are not public, find out what you can. Order a Dun & Bradstreet report. Are they making a profit or losing money? Are they paying vendors more slowly? What are the trends? Ask for financials and tax returns. If they are not willing to share financial data with a vendor, that is answer to many questions right there.

2. **Protect Yourself-** consider insuring your receivables against credit losses. Several reputable insurance companies will assume the credit risk on your customers, assuming

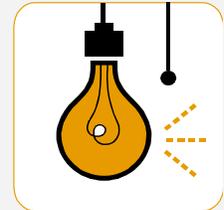
they are manageable credit risks. Most insurers won't allow you to pick and choose accounts; they want to mix the both the safe and risky accounts. If you can't get credit insurance on a client, should you sell to them on an open account?

3. **Diversify-** don't allow one uninsured customer to be indebted to you to the extent that if they never paid, your company could not meet its obligations. For example, if budgeted profit to be retained in the business (after your salary and term loan payments) is \$50,000 ...it would not make sense for one customer to owe you \$100,000, if they are not a safe credit risk. If they did not pay, you would have to pull out previous year's profits, i.e. permanent

working capital either in cash or in liquidating other assets, or borrowing, to cover the loss. This could be a catastrophic cash flow event for the company.

A prudent strategy includes all three steps: become informed, insure AND diversify. But not doing at least one is like sitting in the middle of the interstate hoping you won't get run over. It might not happen in the next ten minutes, but eventually, it will happen.

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"Don't allow one uninsured customer to be indebted to you to the extent that if they never paid, your company could not meet its obligations."

INTERNAL AUDIT FRAUD ALERT... (Continued from Page 4)

signed (including those checks not related to company business.)

Result:

\$140,000+ embezzled from the company over a 2 ½ year period from a "trusted", long term, very well liked employee.

Embezzlement was verified in her written and signed confession, in addition to office supply, postage loss and payroll fraud through falsification of vacation time and pay reports.

Conclusion:

The wrongdoer is presently

being processed through the judicial system for prosecution and restitution back to the company. All Unemployment issues were avoided since a resignation was obtained from the employee.

For further information on this or any other Business Fraud issues, please contact:

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Are there any specific questions or topics you would like addressed in the April Newsletter?

Please contact us with any article subject requests.

**We're on the Web!**

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Websites of Interest...

Here are websites of interest to our clients and author's sites.

www.tmaflorida.org www.alliancefinancialcap.com
www.focusmg.com www.sba.gov www.besappraisals.com
www.internalauditservices.com www.ruden.com www.nceo.org

About Bankers Advocate Group...

Bankers Advocate Group is a Boutique Sales, Mergers and Acquisitions firm specializing in companies with enterprise values of \$1-20 million dollars. We design and help implement both Entering and Exiting Business Ownership

strategies for Entrepreneurs.

We have a very talented group of professionals that can help improve your businesses profitability and cash flow. This can lead to an improved lifestyle and a more successful exit from

business ownership.

We use the **E⁴** symbol to represent how we help entrepreneurs throughout the complete cycle of business - Evaluating, Entering, Enhancing & Exiting Business Ownership...

The Three Components of Business "Value" ... (Continued from Page 4)

cost versus their book value, and liabilities and debts that stay with the business.

Under the Federal Accounting Standards Board's (FASB) Statements Number 141 & 142, each portion of Goodwill that is separated out by your accountant for depreciation purposes MUST be valued separately for IRS purposes. For Instance, non-compete agreements would need to be valued by third party appraiser.

The cover letter of an appraisal will address

these three areas, giving the subtotals of each area and a grand total. The balance of the appraisal will then contain the appraiser's justification and the different methodologies he used to create the appraisal.

Contact us for an example appraisal cover letter or any other general appraisal questions.

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Business Values and M&A Activities are Up... (Continued from Page 2)

experienced since 1998."

A phone interview with Jack Sanders, creator of BizComps, one of the leading data bases for comparable sales, indicated the same problems we had in trying to determine a meaningful growth percentage in that there were so many different types of industries and any overall growth percentage would be misleading. However, he did say that the ratios throughout the years have kept fairly consistent. This is not surprising, but realize when profits are down or up, even using the same ratios will have a significant impact on value.

Consistent with our in-house research, the February 2005 INC Magazine article "Small and Mid Market M&A Activity Rose in 04" stated "Both the volume of deals and their value rose sharply, according to Mergerstat, an M&A research firm based in Santa Monica, California. Through the first three quarters of 2004, Mergerstat reported the closing of 3,394 small or mid Market deals (those worth up to \$500 million each). That's

a 40 percent jump over 2003. Equity valuations surged ahead by 68 percent." The article goes on to say that the latest figures mark a return to the level of activity seen prior to the dot-com meltdown.

Business Week Online on December 27, 2004 in its article "Mergers: A Bit of Mania for 2005" stated, "Conditions are shaping up to favor more deal making next year. Though still not a boom, the action should be plentiful". Later on in the article it speaks of a calmer environment and that several of the problems that made CEOs wary of M&A in 2004 were the electoral and regulatory uncertainty, rising oil prices, disappointing job growth, and a stock market that often resisted merger plans. According to the article, these have abated.

As balance sheets get healthier, revenues keep growing and increasing levels of inventory are rising, we feel the near future is going to be bright for business values and M&A activity.

George Abraham, Business Evaluation Systems, gabraham@besappraisals.com