

Committee on Middle Market and Small Business

Don't Rush for the Emergency Exit: Planning an Exit Strategy to Maximize Shareholder Value.

Panel Discussion at the 2012 American Bar Association Annual Meeting in Chicago, August 2 – 7

Moderator: Michel Gélinas - Stikeman Elliott LLP (Montreal, Canada)

Panelists: Yvette R. Austin-Smith - Stout Risius Ross (New York, NY)

Robert Boncosky – Former business owner (Chicago, IL)

Jared Kaplan - McDermott Will & Emery LLP (Chicago, IL)

Michael Radin - Tarlow, Breed, Hart & Rodgers, P.C. (Boston, MA)

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Fact Pattern

The following facts are assumed as background for the Program:

- A. The Company and its Shareholders.** Great Lakes Inc. (the "**Company**") is a Delaware S corporation with three shareholders. The shareholders consist of Albert, one of the founders of the business, his daughter Betty, who is 55 years old, and the former CEO, Donald. The outstanding common stock of the Company is held as follows: Albert holds 50%, Betty holds 45% and Donald holds 5%. The only shareholder actively involved in the business is Betty. When Chris, the other founder, retired, he sold his common stock to Betty with some stock repurchased by the Company. Part of the consideration for Chris' common stock was convertible notes in the Company and an amount of \$3M remains outstanding.

The Company has a stock option plan in which ten senior employees participate. The senior employees are entitled to an aggregate of 5% of the common stock and their options vest upon the earlier of January 1st, 2017 or the occurrence of a change of control. The Company has a shareholders' agreement but it predates the grant of the stock options. The Company's shareholders' agreement has a provision requiring unanimous shareholder approval for either a sale of the stock or the sale of substantially all of the assets of the Company.

- B. The Company's Board and its Management.** The Board consists of the three shareholders and Chris. The other children of Albert and Chris as well as Betty's children are not interested in the business. Betty's uncle, Zack, is vice president, corporate development (although the Company has grown organically and has never done an acquisition) but spends most of his time playing golf with his buddies and contributes little to the Company.
- C. Nature of the Business.** The Company is based near Chicago and designs, manufactures and distributes educational toys and related products and has experienced significant growth in recent years given its innovative products.

The Company has two divisions: retail and educational institutions. Historically, the educational institutions division has comprised the largest percentage of revenue, but future growth is likely to be slow as purchases are impacted by lower municipal budgets and lower institutional enrollment. Historically, retail products have been sold through specialty stores and online. However, the Company just signed its first "big box" store contract. This contract is likely to produce lower gross margins but higher volume.

The business is highly cyclical and the Company's working capital needs vary greatly and peak in the 3rd quarter of its fiscal year. The Company does not regularly prepare projections but prepares annual budgets that are modified as the year progresses.

Betty's sailboat, including maintenance costs, is recorded on the books of the Company as she regularly entertains clients on the sailboat.

- D. Nature of the Company's Assets and Liabilities.** The Company owns a manufacturing and distribution facility near Chicago and also leases a warehouse and distribution center near L.A. The Company has 188 non-unionized employees.

The Company has some of its products manufactured in China, but all of the products are designed in the USA. The Company distributes its products through a third party. The Company owns most of the intellectual property used in the Business. The current head of the R&D department, who had been hired 15 years ago as a junior engineer and signed a non-compete when he started, recently asked for a salary increase because he is being courted by a competitor.

The Company has no long term debt. However, it must pay 8% interest annually on Chris' convertible notes.

The Company's contracts with educational institutions are typically not assignable without their consent.

- E. Betty's Dilemma.** As a result of the "big box" retailer contract the Company just signed, the Company needs to make significant capital expenditures to upgrade its fulfillment capabilities. This will require additional financing and a significant amount of time and effort on the part of Betty to bring the Company to the next level.

After 30 years of hard work, Betty does not feel that she is ready for this new challenge and would like to monetize her holding and do something different. She would like to sail around the world with her husband over the next couple of years in the sailboat she considers hers, but which is really owned by the Company. As a result, her goal is to sail away as soon as the Company is sold.

During the recent contract negotiations, the "big box" retailer indicated to Betty that it would be interested in buying the Company, but that if Betty wished to sell she would have to act quickly because the retailer was also interested in buying one of the Company's competitors, and could only afford one acquisition.

The sale of the Company is a delicate subject for her father and it is unclear what would happen to uncle Zack should the Company be sold. While Betty has been thinking about a potential sale, she has not yet discussed it with her father, Chris, or Donald. Betty decides to seek guidance from her advisors.

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CHECKLIST

I. Planning Stage

A. Framing the Sellers' Objectives

1. Are sellers ready to sell? – importance of understanding the goals of the owners and reasons for selling the business (estate planning, no succession plan/retirement, monetize investment, ensure long-term growth and viability of the business). Is a sale of the business necessary or would a recap be sufficient to achieve the goals of those who want to sell?
2. Do the other family members/shareholders share the same view? Identify and manage any potential holdouts.
3. Do the sellers plan/are they willing to stay with the business after closing; (if not, consider alternate employment; explain to the sellers that buyer will require a non-competition clause).
4. Timing issues:
 - When is the best time to sell? (cyclical business, new developments in the industry, succession plan issues, etc.)
 - How long does it take to sell a business? Manage the sellers' expectations and confirm that a potential delay would not negatively impact the sellers' key objective(s).
 - At what point does the board need to be notified about a possible deal?
5. Financial objectives: Maximizing overall consideration vs cash consideration at closing – will the sellers accept the uncertainty and payment delay associated with earn outs, accept buyer's equity, etc.?

6. Risk allocation among the sellers: Who gives R&W on the business, indemnity rights, etc.? It is useful to have a discussion on this issue at a preliminary stage to manage sellers' expectations and prepare them for negotiations at the execution stage.
7. Who has to approve the deal? Are there formalities (right of first refusal, notice, approval rights) under a shareholders agreement? Who is going to negotiate the deal? Establish protocol to keep other sellers of progress.
8. If expanded family or many shareholders involved, consider establishing a voting trust, providing for drag-along provision in stockholders agreement and/or having a specific agreement regarding the sale of the business.

B. Estate and Tax Planning Considerations

1. Form of organization (S corporation, C corporation, LLC, partnership): should the form be changed in anticipation of a sale?
2. Form of sale:
 - Tax-free: A, B or C reorganization;
 - Taxable: assets or stock? (Section 338(h)(10) election);
 - Covenant not to compete;
 - Installment sale;
 - Partial sale (leveraged recapitalization; ESOP);
 - Pre-transaction removal or addition of assets (Section 351, Section 355);
 - Estate and succession planning considerations (transfers to grantor retained annuity trusts (GRATs), family limited partnerships (FLPs), charitable remainder trusts (CRTs), etc.).
3. Ensure that sellers have an updated will, trusts and power of attorney – to deal with situations where someone dies or becomes incapacitated during the sale process which could complicate, delay or even prevent the business from being sold.

C. Choosing Professional Advisors

1. Explaining to the sellers the value brought by the various advisors (and justify the costs involved).
2. Retaining advisors: Attorney, accountant, valuator and business broker/investment banker, how to select them, when to retain them and how to work with them.

3. Conflicts issues in representing the target company and multiple sellers. Is there only one seller or many? Should each seller have separate legal counsel?

II. Preparation Stage

A. Valuating the business

1. How much is the business worth?
2. Maximizing the value of the business:
 - Are there underperforming divisions or assets that should be spun-out?
 - Enhance financial reporting, GAAP reporting issues (changing accounting methods if favorable to sellers, etc.).
 - Focus on working capital: Dispose of obsolete inventory, settle delinquent accounts receivable and payable.
 - Tidy up facilities: Sell or remove redundant or obsolete equipment, machinery and parts, ensure equipment is well maintained (scheduled maintenance made, etc.).
 - Operational issues, documenting key processes, procedures and methodologies.
 - Have a clear succession plan for the business.
 - Who are the key managers? Consider both financial incentives and legal commitments/limitations (such as noncompetes). If there is an earn-out, there should be a commitment relating to the key individuals and proper incentive for them to stay and achieve the earn out.
 - Employee ownership (do employees hold stock or have stock options?; ensure that 100% of stock can be delivered to buyer, if not, buyer will seek an asset deal which may be less tax favorable to the sellers).
 - Third party relationships (formalize verbal agreements, consider assignment clauses). Review termination clauses in any key contracts. Develop standardized contract terms regarding customer payment, warranties, service levels.

B. Conduct "reverse due diligence"

1. Minute book: Sloppy minute book could transform a share deal into an asset deal (chain of title, fix incomplete/sloppy records, remove anything from minutes that is confidential (note special issues involving attorney-client privilege that could be involved in a stock sale) or family related if not relevant; ensure minutes of meetings are properly documented).

2. Intellectual property (ensure that IP is registered; settle any IP claims). Who owns the IP (ensure that all IP has been assigned or waived by employees/consultants and others). Look for any hidden IP (e.g., software development work, key websites, know-how).
3. Employees (confidentiality and non-compete clauses for key employees); ensure that appropriate HR policies are in place.
4. Contracts and permits review (all IP licenses fully paid, required consents identified, any permits or other regulatory issues that could affect timing?).
5. Searches: Discharge UCC and other liens that are no longer relevant; ensure that searches do not reveal unexpected liens, litigation or other issues.
6. Ensure tax and regulatory compliance (consider environmental Phase I report being available) to reassure buyers.
7. Identify any significant litigation and potential contingent liabilities and be ready to answer the buyer's questions.

III. **Execution Stage**

1. Consider preparing an offering memorandum (cost/benefits analysis).
2. Sale process (approach likely buyer(s) on a confidential basis vs. auction).
3. Understanding the buyer's objectives (timing (transaction desirable for upcoming IPO or roll up), synergies, prevent a competitor from scooping the deal, etc.) may have an impact on price, timing and risk allocation.
4. Organizing dataroom/organize contracts and records to ensure they are easily accessible – will also be useful to prepare disclosure schedules. How can a virtual dataroom be a useful tool?
5. Disclosure schedules – Ensure that the sellers understand the importance of the disclosure schedules and the amount of work involved.
6. Discuss seller indemnification issues (R+W, joint and several liability, caps and deductibles, escrows and holdbacks), contribution rights, and approach purchase agreement on various deal points. Is there any risk that can be offloaded into an insurance policy?
7. Agree on the negotiation process (who is negotiating, role of financial adviser, avoiding too many family members being involved, etc.).

IV. **Post Closing**

1. Advise client of matters that might have to be dealt with post closing (closing balance sheet, transitional issues, indemnification claims).

2. Identify tax returns and other filings that need to be done (if the client is a director of the target company and has been replaced, ensure that the public records are updated).
3. If the client receives significant proceeds from the sale, does the client need any private wealth management and financial planning advice?

* * *



Michel Gélinas

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Law Practice

Michel Gélinas is a partner in the Montréal office of Stikeman Elliott, a member of the firm's Corporate Group, a member of the Business Development Committee and a member of the Professional and Ethics Committee. He is recognized by *The Canadian Legal Lexpert Directory* 2011 as a leading practitioner in the mergers & acquisitions sector.

Mr. Gélinas has extensive experience advising public and private companies, private equity firms, investment and merchant banks, venture capitalists, entrepreneurs and other private investors in connection with structuring and negotiating mergers and acquisitions, divestitures, leveraged buy-outs and related financing, private placements and other investments (including preferred equity and debt), joint ventures and outsourcing, recapitalizations, workouts and restructurings, reorganizations and other complex transactions. Mr. Gélinas has advised clients from across Canada, the United States and abroad in a wide range of industries and sectors, including energy, food processing and distribution, manufacturing and distribution, pharmaceutical, healthcare and related sectors, publishing, real estate, retail, software and technology, media and telecommunications. From 1997 to 1999, Mr. Gélinas worked in the firm's New York office.

Mr. Gélinas also regularly advises U.S. and other international companies doing business in Canada as well as Canadian privately-held companies where he serves as *de facto* general counsel providing general business law advice on various matters such as raising capital and financing, negotiating commercial agreements, executive employment law, licensing and distribution, and intellectual property.

Professional Activities

Mr. Gélinas is a member of the Quebec Bar, a member of the Canadian Bar Association and a member of the American Bar Association where he is active in the Mergers & Acquisitions as well as the Private Equity and Venture Capital Committees of the Business Law Section. In addition, he is a member of the MBA Association of Quebec, of the Montreal Chamber of Commerce and of Réseau Capital, Quebec's private equity and venture capital association.

Speaking Engagements

Mr. Gélinas has been a speaker or panelist in his areas of expertise at several conferences, including conferences from the North American Securities Administrators Association, The Canadian Corporate Counsel Association, The Canadian Institute and Réseau Capital, and he was quoted or featured in a variety of media, including American Bar Association publications, the Financial Post and the Journal Les Affaires.

Education

McGill University (M.B.A., Finance and International Business, 1994), University of Montréal (LL.B., 1991), Canadian Securities Course (with mention of excellence, 1988) and University of Ottawa (B.Comm., Finance, *cum laude*, on the Dean's List, 1988).



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Education

M.B.A.
Columbia University
Finance

A.B.
Harvard College
*Government and
Philosophy*

Yvette R. Austin Smith is a Managing Director in the Valuation & Financial Opinions Group. Ms. Austin Smith specializes in fundamental valuation and credit and solvency analysis for capital markets transactions and related litigation. For more than 15 years, she has advised boards of directors, investors, lenders, and judicial entities on equity and fixed income transactions. Situations in which she has advised include mergers & acquisitions, recapitalizations, going private transactions, dissenting shareholder actions and adversary proceedings in bankruptcy. For transactions and litigation, Ms. Austin Smith has issued fairness, solvency and other financial opinions. She is based in the firm's New York office.

Representative client engagements include:

- Advised special committee of Barnes & Noble on retrospective valuation of acquisition target
- Advised MDVIP in connection with preferred stock issuance and acquisition by P&G
- Advised Magellan Health Services on two private-company acquisitions
- Testifying expert in Delaware appraisal litigation involving merger of two broker-dealers
- Testifying expert in New York shareholder litigation involving earn-out mechanism

Ms. Austin Smith is an associate member of the American Bar Association where she serves as Co-Chair of the Financial Advisor Task Force. She is also a contributor to the ABA's forthcoming Dictionary of M&A Terms. Ms. Austin Smith is a past faculty member for the Association's annual National Institute on Negotiating Business Acquisitions.

Ms. Austin Smith is on the board of Midori & Friends, a non-profit organization dedicated to music education for underserved children in New York City.

Prior to joining SRR, Ms. Austin Smith was a Managing Director with Charles River Associates where she led the firm's Corporate Finance Advisory services. Previously, Ms. Austin Smith had been a director in the Transaction Opinion and Investment Banking practice of Duff & Phelps.

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Selected Publications:

"Recent M&A Litigation Provides Updated Guidance for Fairness Opinions," The SRR Journal, Spring 2012

Contributing editor to: The Dictionary of M&A Terms; by The American Bar Association, Publication expected 2012. Primary responsibility for debt and credit market terms.

"Why Do Solvency Opinions Fail?" The SRR Journal, Spring 2011

Contributing author to: The Standard & Poor's Guide to Fairness Opinions: A User's Guide for Fiduciaries; by Phillip J. Clements and Philip Wisler; New York: McGraw Hill, 2005

Contributing author to: Model Public Company Acquisition Agreement with Commentary; by The Mergers & Acquisitions Committee of the American Bar Association; Chicago: American Bar Association, August 2011. Authored chapter on determining stock exchange ratios in mergers and acquisition transactions.

Speeches and Seminars:

"M&A Valuation: Troubleshooting the Standard Techniques and Understanding the Alternatives," Mergers & Acquisitions Committee of the American Bar Association, February 2012

"Defending the Pill: Lesson from Airgas," Mergers & Acquisitions Committee of the American Bar Association, August 2011

"Valuation Opinions for Private and Small Cap Companies," Middle Market & Small Business Committee of the American Bar Association, April 2011

"Post-Crisis Solvency Opinions," Mergers & Acquisitions Committee of the American Bar Association, January 2011

"Retrospective Solvency Opinions for Fraudulent Conveyance and Preference Litigation," a continuing legal education (CLE) approved curriculum

"Special Issues in Asset Acquisitions," American Bar Association's National Institute on Negotiating M&A Transactions (annual), panelist 2006 – 2009

"Structuring Biotech M&A Transactions," MichBio Expo & Conference, October 2007

"Beyond 'Plain Vanilla, Fairness Opinions," Negotiated Acquisitions Committee of the American Bar Association, October 2006

ROBERT BONCOSKY

When Bob Boncosky took over his father's chemical transport trucking company, revenues stood at \$2MM. When he sold it decades later, at age 62, revenues had grown to \$32MM. Two of Bob's three sons were active in the business and wanted to remain employed by the new owner. Bob's wife was not so sure he should retire. During this session Bob will share with us his experience that includes how he prepared for a sale, what it was like after the sale and to what he attributes his very successful business exit.



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Practice Areas & Industries

- Employee Benefits & Pensions
- ESOPs
- Mergers & Acquisitions

Education

- Harvard Law School, LL.B., 1963
- University of California-Los Angeles, A.B., 1960

Jared Kaplan is Senior Counsel in McDermott Will & Emery LLP and is based in the Firm's Chicago office. He focuses his practice on federal tax matters, corporate finance and employee stock ownership plans (ESOPs).

A frequent author and lecturer on ESOPs, Jerry currently serves on the ESOP Association's Valuation Advisory Committee. He is the former chairman of the State of Illinois Advisory Task Force on Ownership Succession, and has served on the state's Employee-Owned Enterprise Advisory Council. He served as chairman of the Legislative and Regulatory Advisory Committee of the ESOP Association from 1985 to 1990. He is the co-author of *Tax Portfolio on Employee Stock Ownership Plans (ESOPs)*, and *Corporate Portfolio on ESOPs in Corporate Transactions*, both published by the Bureau of National Affairs, and is editor of *The Best of Law*, published by The Family Firm Institute.

Jerry also is a past chairman of the Administrative Practice Committee of the American Bar Association's Tax Section. He is a member of the American, Illinois State and Chicago Bar Associations, and the Lawyers' Club of Chicago. He is also a member of the editorial advisory board of *Shannon Pratt's Business Valuation Update*, and has served on the board of advisors of the *Corporate Taxation Journal* and on the board of editors of the *Journal of Employee Ownership Law and Finance*, published by the National Center for Employee Ownership. In 1999, Jerry completed a three-year term on the board of directors of The Family Firm Institute, and in 2003 he was named its General Counsel. He is a Fellow of The Family Firm Institute, and holds its Certificate in Family Business Advising. In 2004, Jerry was elected a Fellow of the American College of Employee Benefit Counsel, and in 2005 he was named a Fellow of the American Bar Foundation. He is listed in *Who's Who Legal: Illinois*, *Who's Who in America*, *Who's Who in American Law*, *Leading American Attorneys*, *Global Counsel 3000*, *Chambers USA*, *The Best Lawyers in America* and *The Legal 500 United States*. Jerry was ranked as "recommended counsel" in Chicago for employee stock and incentive plans in the 2006-2007 *Cross-border Tax on Corporate Transactions Handbook*. He has also been named an Illinois Super Lawyer by *Law & Politics*.



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Michael is a member of the firm's Corporate and Real Estate groups who works extensively with clients in connection with their corporate, real estate, finance and intellectual property and distribution matters.

In the area of corporate and finance, Michael's expertise includes debt and equity financings, mergers and acquisitions, entity governance, buy-sell arrangements, incentive programs and joint ventures. In the distribution arena, Michael represents suppliers, manufacturers, distributors, franchisors and franchisees on a full range of business matters. Michael also helps clients manage and monetize their intellectual property, including trademarks, copyrights, patents and trade secrets, through licensing, outsourcing and sale/acquisition. Additionally, Michael counsels extensively on matters involving covenants not to compete. All of Michael's work is driven by a keen appreciation of the financial and operational impacts that every transaction brings to his clients' businesses.

In connection with real estate, Michael works extensively with the acquisition, financing, leasing, and dispositions of real estate. His clients are active in retail, hospitality, office and industrial projects.

Representative Experience

- Representation of the acquirer in an acquisition of an outdoor advertising media company. Also counseled this client in connection with the later sale and spin of a product distribution business that was excluded from the acquisition of the parent media company.
- Assisted a software developer/services company in retaining the servicing of a large medical practice group in connection with the hospital implementation of a highly controlled database.
- Assisted in the closing and packaging of multiple asset type commercial mortgages for CMBS syndications and sales of multiple tranches of securities from pools.

continued...

- Representation of a developer with obtaining \$22,000,000 of debt financing and hedge for a historical tax-credit assisted re-development of an apartment complex, including the modifications made to the related party credit lines.
- Structured and managed a long-term ground lease and option (through multiple rounds of financing) to permit redevelopment of a highly visible, mixed-use property, including representation through the structural risks presented by credit challenges of owner/landlord.
- Representation of a plastics manufacturer in a long-term, exclusive supply arrangement with associated university research project and with the intellectual property management involving a proprietary supply chain technology. Also included managing appropriate response in the face of customer break-out, and proper handling for off-shoring of retired tooling.
- Recapitalization of a service firm to compartmentalize the growth assets in anticipation of the future sale of a portion of the underlying business.
- Advised client regarding compliance and structure of both brand management and lead generation arrangements for differing goods and services in multiple channels.

Memberships

- American Bar Association - Business, Real Property, Intellectual Property and Franchising sections
- Massachusetts Bar Association - Business, High Technology and Real Estate Committees
- California Bar Association - Business, Intellectual Property and Franchise Committees
- Boston Bar Association
- Associated Industries of Massachusetts
- Smaller Business Association of New England (SBANE) - Member, Board of Directors and Executive Committee, Advanced Manufacturing Committee

Bar Admissions

Massachusetts Bar

California Bar

Rhode Island Bar

Education

B.A., Amherst College, *magna cum laude*, 1984

J.D., Boston University School of Law, *cum laude*, 1987