

Financing & Exit Strategies

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Definitions

fi· nance n.

1. The science of the management of money and other assets
2. The management of money, banking, investments, and credit
3. finances Monetary resources; funds, especially those of a government or corporate body
4. The supplying of funds or capital

Middle English *finaunce* **settlement, money supply**

from Old French *finance* **payment**

from *finer* **to pay ransom**

from *fin* **end**

from Latin *fnis*



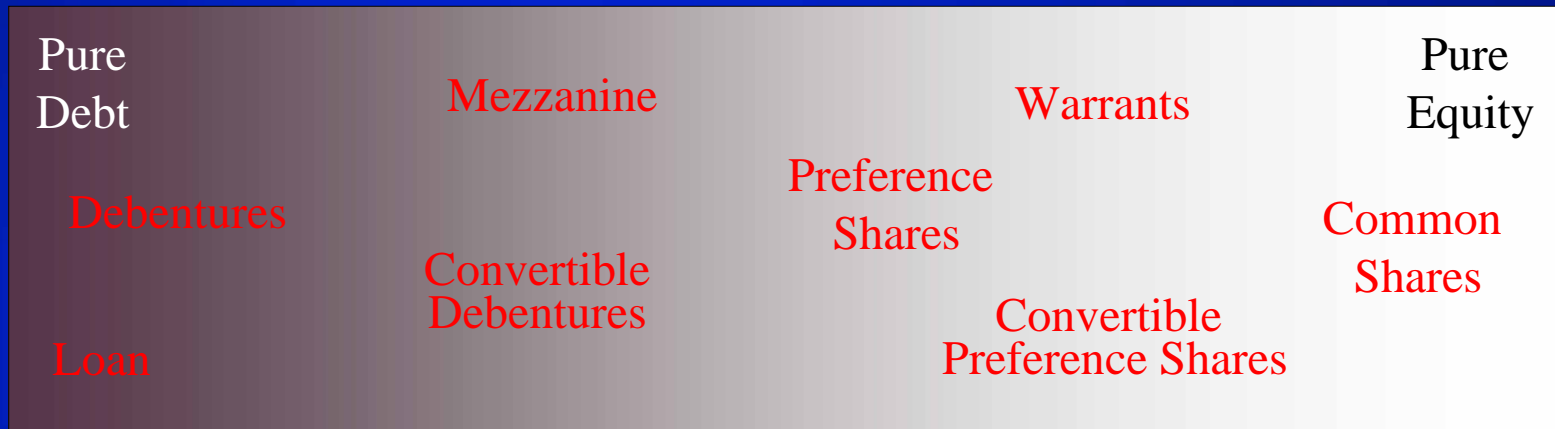
Financing Concerns

- Not making enough money (or any!)
- Don't want to give up equity
- Not big enough for financial institutions
- Don't understand financial markets
- Never got past the bank
- Don't know who to speak with / approach
- Legacy issues – bad experiences
- Fear of being ripped off
- Investors won't understand my business
- Too complicated



Difficult Financial Choices

“Shades of Gray”



Expensive
Reduces profit
Hurts the balance sheet

Dilutes shareholders
Low valuations
More complicated



Sources of Capital

- The Bank
- Friends & Family
- Angel Investors
- The Public Market
 - Capital pools
 - RTO (reserve take over)
 - IPO (initial public offering)
 - Income Trusts
- Private Equity



Key Consideration: Cost of Capital

- Not just a financial calculation (i.e. interest)
- Must include all other factors:
 - Shareholding dilution
 - Balance sheet implications
 - Any impact on future cash flows
 - Management / Board of Directors
 - Operations / strategic partnerships
 - Longer term issues / exit strategies

The Key Consideration:

What capital appreciation do you obtain on your stake in your company, after all costs, as a result of the infusion of capital



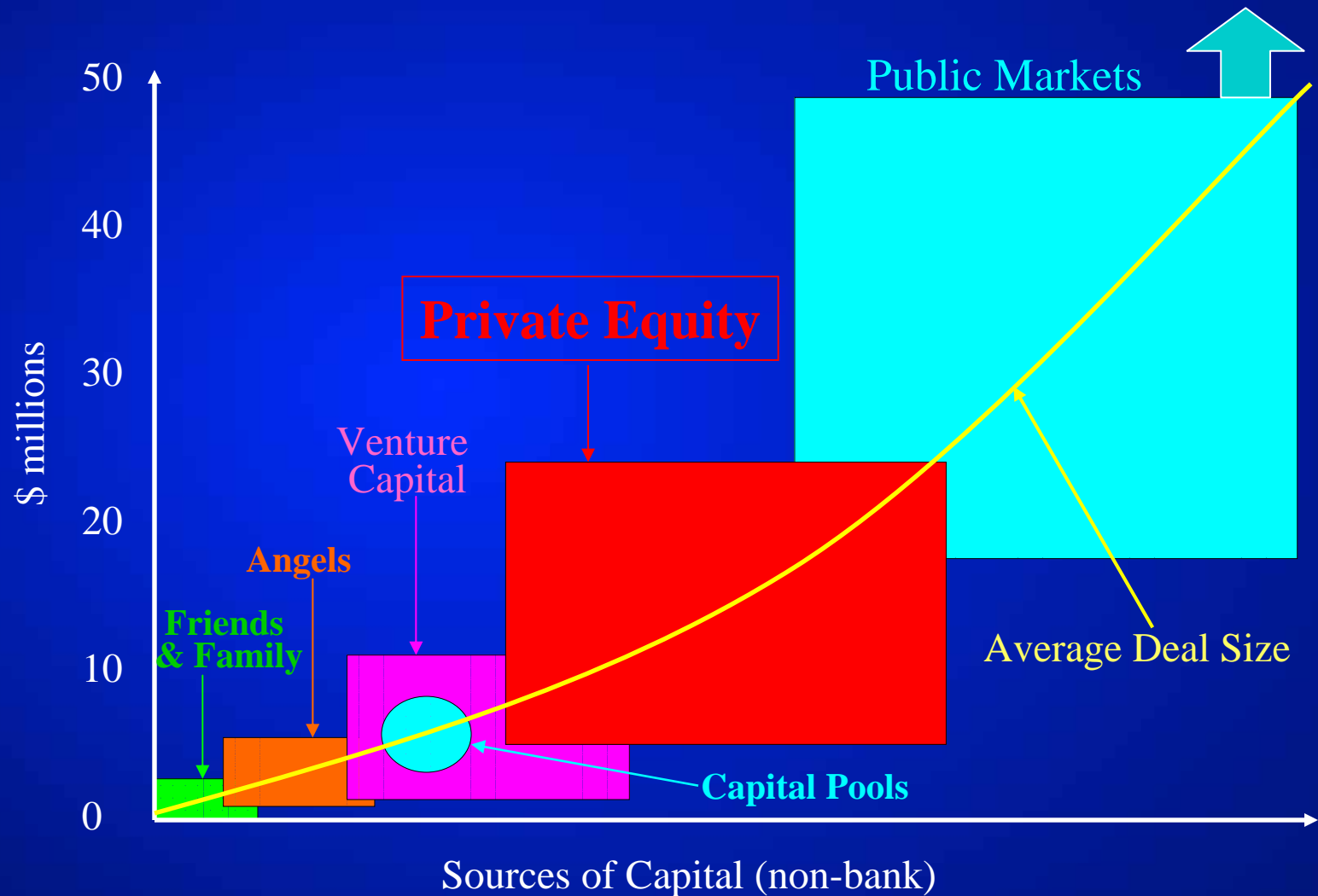
Your Friendly Banker

- Pros
 - No dilution
 - Relatively low rate of interest (hopefully!)
- Cons
 - Banks usually require security
 - Tough terms and conditions, which are likely to be enforced
 - If in default your loan will be called
 - Bankruptcy is tiresome and expensive
 - Debt weakens the balance sheet

*Bank financing is the way to go so long as
your business has little or no risk*



Financial Market Capital Sources



The Public Market

- **Advantages**

- Premium valuation (“*public multiple*”)
- Freely traded stock
- Access to capital

- **Disadvantages**

- High legal, accounting & professional fees
 - Annual listing fees
- Disclosure requirements onerous
- Need a free float and market following
- Non-alignment of interests (capital pools)

In the public marketplace, size definitely counts



Private Equity Financing

- Funds who invest in private companies
 - Full spectrum of financing approaches
 - Includes specialty funds & small cap funds
- Private Equity = flexibility
 - Common shares, pref shares, convertible prefs, mezzanine, convertible debentures & other variants
- Focus on mitigating risk for a high return
 - Usually want +20% IRR
- Management's ability to deliver a key criteria



Private Equity Requirements

- Due diligence
 - Full analysis of your company's business
 - Industry analysis
- Financial modeling and projections
 - Absolute must
- Business plan / report
- Identify exit strategies
- May want Board position



Private Equity Advantages

- Well suited to growth companies
- Cost of financing in effect paid by the supplier of capital
- Flexibility in capital structure
- Alignment of interests between investor and business owner
- Investor becomes “Business Partner”
- Immediate focus on growth requirements

Concerns:

- Financing process can be timely
- Valuation



Exit Strategies

- When should I think about exit strategies?
 - Now! Exit planning is ongoing process
 - Consider *Personal Issues*
- Burning Questions:
 - What are my Exit alternatives?
 - How will buyers value my business?
 - What makes my business attractive to a buyer?
 - What are my key value drivers



What Are Your Exit Alternatives?

- Bankruptcy!
- Initial Public Offering (IPO)
- Sale of Company (M &A)
 - **Strategic buyer:**
 - Competitors
 - Complementary firms
 - strategic partners, suppliers, customers
 - Outright sale vs. merger of equals
 - **Financial buyer – Private Equity firm**
 - Full sale
 - Recapitalization (partial sale)
- Buy-Out by business partners / employees
- Transition to your heirs



What Will Your Business Be Worth?

- Value is in the eye of the beholder
 - A business is worth what a buyer will pay
- Will depend on whom you ask
 - Strategic versus financial valuations
- Mix of art and science
 - Different buyers use different valuation methods
- Importance of Timing
 - Values are cyclical – catch the peaks



“Financial” versus “Strategic” Value

Valuation driven by 2 simple concepts:

1. Financial valuation

- Expected profitability \Rightarrow future earnings

2. Strategic valuation

- Strategic buyers pay premiums for synergies
- Greater “fit” = bigger premium



Financial Valuation - Methodologies

- Many approaches
- Different industries have differing methods

Adjusted Book Value

Capitalization of Income

Cash Flow Method

Discounted Cash Flow

Industry Comparable

Multiple of EBITDA

Multiplier or Market Value

Tangible Assets

Asset Valuation

Capitalized Earnings

Replacement Cost

Excess Earnings Method

Multiple of Earnings

Multiple of Cash Flow

Rule of Thumb Methods

Value of Intangible Assets



Financial Valuation – The Basics

Key concept = growth in future earnings

- Discounted cash flow
- Multiples of:
 - Earnings (i.e. >10 x)
 - EBITDA (i.e. 3 - 6 x)
 - Cash Flow (i.e. 8 -10x current)
- Public company comparables
 - Current trading multiples
 - Precedent M&A multiples
- Industry specific benchmarks



Valuation – Premiums vs Discounts

Key concept = predictable future earnings

- Premium value for:
 - Smooth growth in sales and earnings
 - Proof of concept
 - Recurring revenues = predictability
- Discounted value for:
 - Spotty or erratic financial results
 - “Hiccups” that require explanation
 - Key business plan elements pending
 - Customers, new products, key personnel



Simple Approach to Valuation

1. Total Invested Capital
 - Equity + Debt + anything else
2. Replacement Value
 - Cost of re-creating what you have
 - Values the “sweat” component
3. EBITDA multiple
(earnings before interest, tax, depreciation & amortization)
 - Normally 3 - 6 times EBITDA



Financial Buyers – Private Equity

- Valuation Tools:
 - Primary focus on return on capital employed
 - Internal Rate of Return (IRR) = +20%
 - Multiples:
 - P/E, P/CF, EV/EBITDA
 - Discounted cash flow
- Key Requirements
 - Dedicated management
 - Sound business plan
- Risk adjust everything
 - Conservative approach to risk and valuation



Financial Buyers – Private Equity

- Advantages
 - Payment in cash
 - Ability to negotiate future role in company
 - Retain stake in upside (partial sale only)
- Disadvantages
 - Purely financial valuation
 - No premium for “fit”
 - No upside in full sale



Financial Buyers – IPO / Public Markets

- Valuation Tools:
 - Determined by public market trading
 - Multiples
 - P/E, P/CF, EV/EBITDA
- Key Requirements
 - Profit history
 - Minimum size / critical mass
 - Full disclosure
- Publicly traded firms enjoy premium value
 - 25 – 30% typically



Financial Buyers – IPO / Public Markets

- Advantages
 - High potential value
 - Liquid shares
 - Retain degree of control
 - Retain stake in upside
- Disadvantages
 - Feasibility – difficult and demanding process
 - Costly - IPO process, ongoing costs
 - Hassle – reporting, disclosure
 - Market risk - founder sale restrictions



Strategic Buyers

- Who are your strategic buyers?
 - Competitors
 - Suppliers / customers / strategic partners
- Strategic buyers pay premiums for “fit”
 - Product – filling out a business line
 - Geographic – adding a territory
 - Consolidation – acquiring competitors
- Greater “fit” = bigger premium
- “Fit” is difficult to value
 - Determined by the buyer’s specific need



Strategic Buyers

- Advantages
 - Better “fit” = higher value
 - Payment = cash or stock of acquirer
 - Ability to negotiate future role in company
- Disadvantages
 - Bad “fit” = low value
 - Loss of control and identity
 - Risk of employees being terminated
 - Cash payment = no upside
 - Stock payment = market risk / resale restrictions



Timing Is Everything

- Values are cyclical
- Anticipate the peaks
- Look 3 years ahead 
- Outlook for your sector
 - Customer demand, competition, disruptive technology, industry consolidation, regulatory environment
- Outlook for your business – growth, profitability
- Identify universe of strategic buyers
 - Competitors
 - Strategic partners / suppliers / customers
 - Dating vs. marriage – develop strategic partnerships

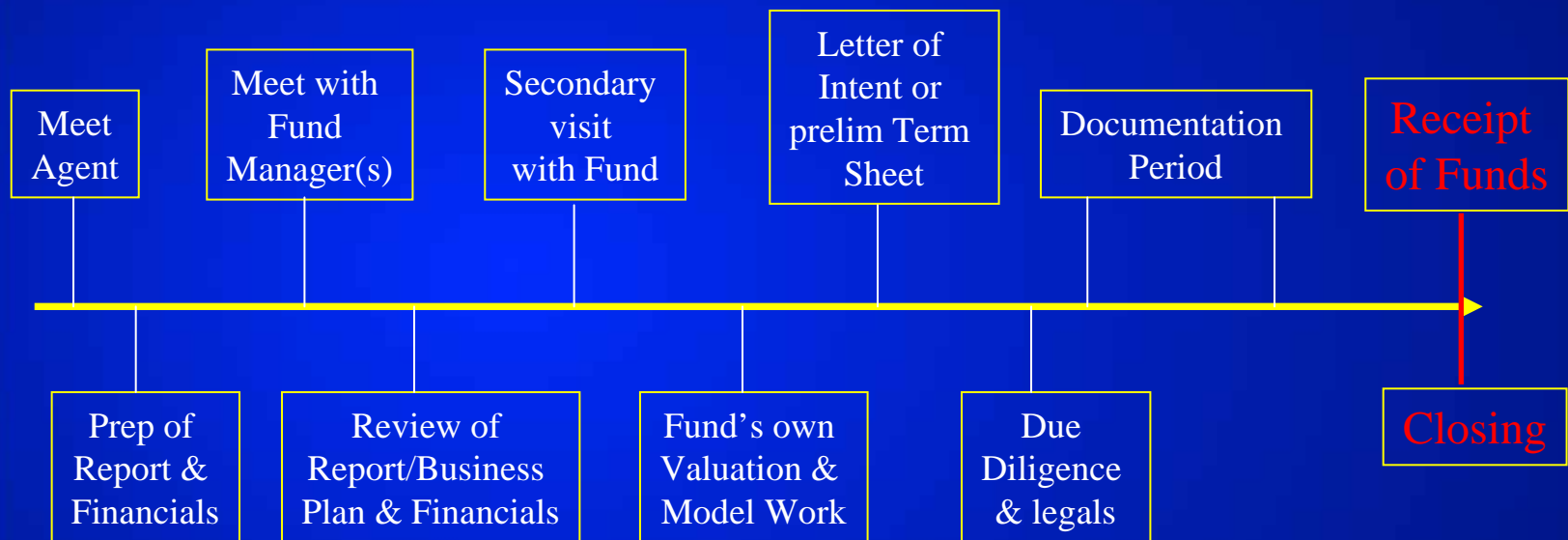


Preparing for Your Financing

- Internal house keeping in order
 - Business plan
 - Forward looking financial model
- Obtain professional advice early
 - Legal & accounting
 - OSC registered financial advisor
- Understand the “value gap”
 - Be informed and realistic in expectations



The Financing Cycle

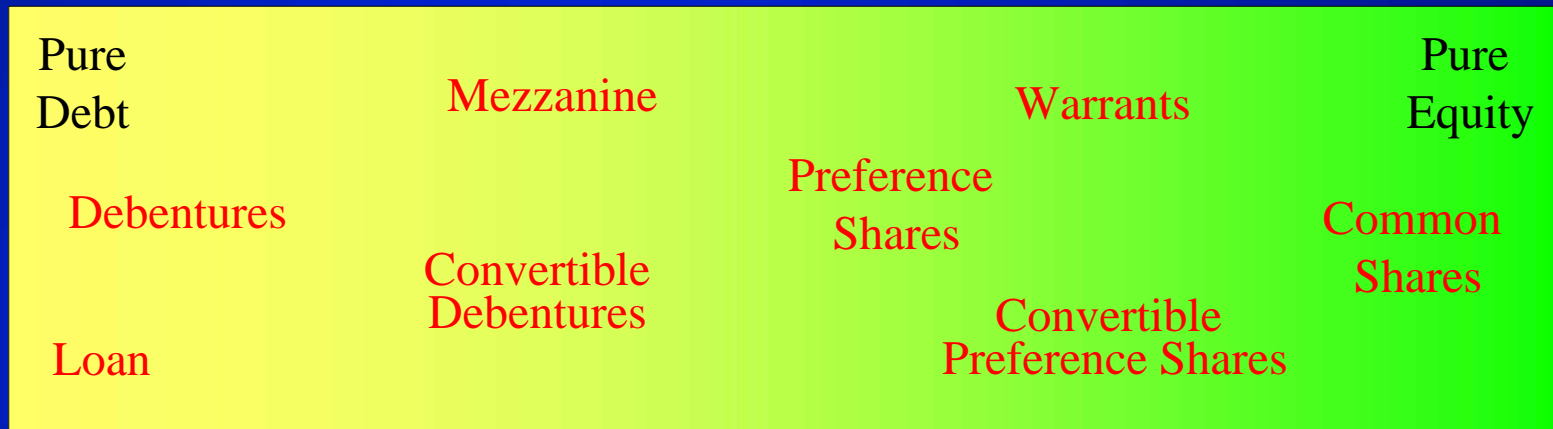


Normally some 4 months in duration



From Difficult Choices to Opportunity

"Financing Flexibility"



Retain full control

Balanced mix

Business Partner
For Growth



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Ask Yourself...

1. How much will you sell your business for?
2. When will you sell your business?
3. To whom will you sell your business?



Loewen & Partners

- Corporate finance advisory firm
 - OSC registered Limited Market Dealer
 - Family owned business
- Serving emerging growth companies
 - Dedicated to the private equity market
 - Matching clients with the right institutional investor
 - Private placements - \$5 million to \$30 million



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*Our reputation is built on
innovation, integrity and results*

Recent Deals

Over \$70 million of capital raised for clients



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