Exit Strategies:
What Buyers are Looking For

John Loewen
Loewen & Partners

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Lessons From History

"Now this is not the end.
It is not even the beginning of the end.
But it is, perhaps, the end of the beginning"

Winston Churchill

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- Corporate finance advisory firm
  - Family owned business
- Serving emerging growth companies
  - Dedicated to the private equity market
  - Matching clients with the right institutional investor – financings and sales
  - Private placements - $5 million to $30 million

Our reputation is built on quality and integrity

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Exit Strategies

- When should I think about exit strategies?
  - Now! Exit planning is ongoing process
- 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

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What Are Your Exit Alternatives?

- 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

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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

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“Financial” versus “Strategic” Value

Valuation driven by 2 simple concepts:

1. Financial valuation
   - Expected profitability ⇨ future earnings
2. Strategic valuation
   - Strategic buyers pay premiums for synergies
   - Greater “fit” = bigger premium

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Financial Valuation - Methodologies

- Many approaches
- Different industries have differing methods

Adjusted Book Value	Asset Valuation
Capitalization of Income	Capitalized Earnings
Cash Flow Method	Replacement Cost
Discounted Cash Flow	Excess Earnings Method
Industry Comparable	Multiple of Earnings
Multiple of EBITDA	Multiple of Cash Flow
Multiplier or Market Value	Rule of Thumb Methods
Tangible Assets	Value of Intangible Assets

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Financial Valuation – The Basics

Key concept = **growth** in future earnings

- Discounted cash flow
- Multiples of:
  - Earnings (i.e. >10 x)
  - EBITDA (i.e. 3 - 5 x)
  - Cash Flow (i.e. 8 -10x current)
- Public company comparables
  - Current trading multiples
  - Precedent M&A multiples
- Industry specific benchmarks

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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

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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

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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

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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

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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

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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

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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

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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
- Be prepared !
  - Internal housekeeping
    - Accounting, legal etc.
  - Identify universe of strategic buyers
    - Competitors
    - Strategic partners / suppliers / customers
    - Dating vs. marriage – develop strategic partnerships

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Tips and Advice

- Understand the “value gap”
  - Be informed, be realistic
- Obtain good professional advice early
  - Quality law firms
  - Professional accounting firm
- Talk to your friendly corporate finance specialist…

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