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Recharger

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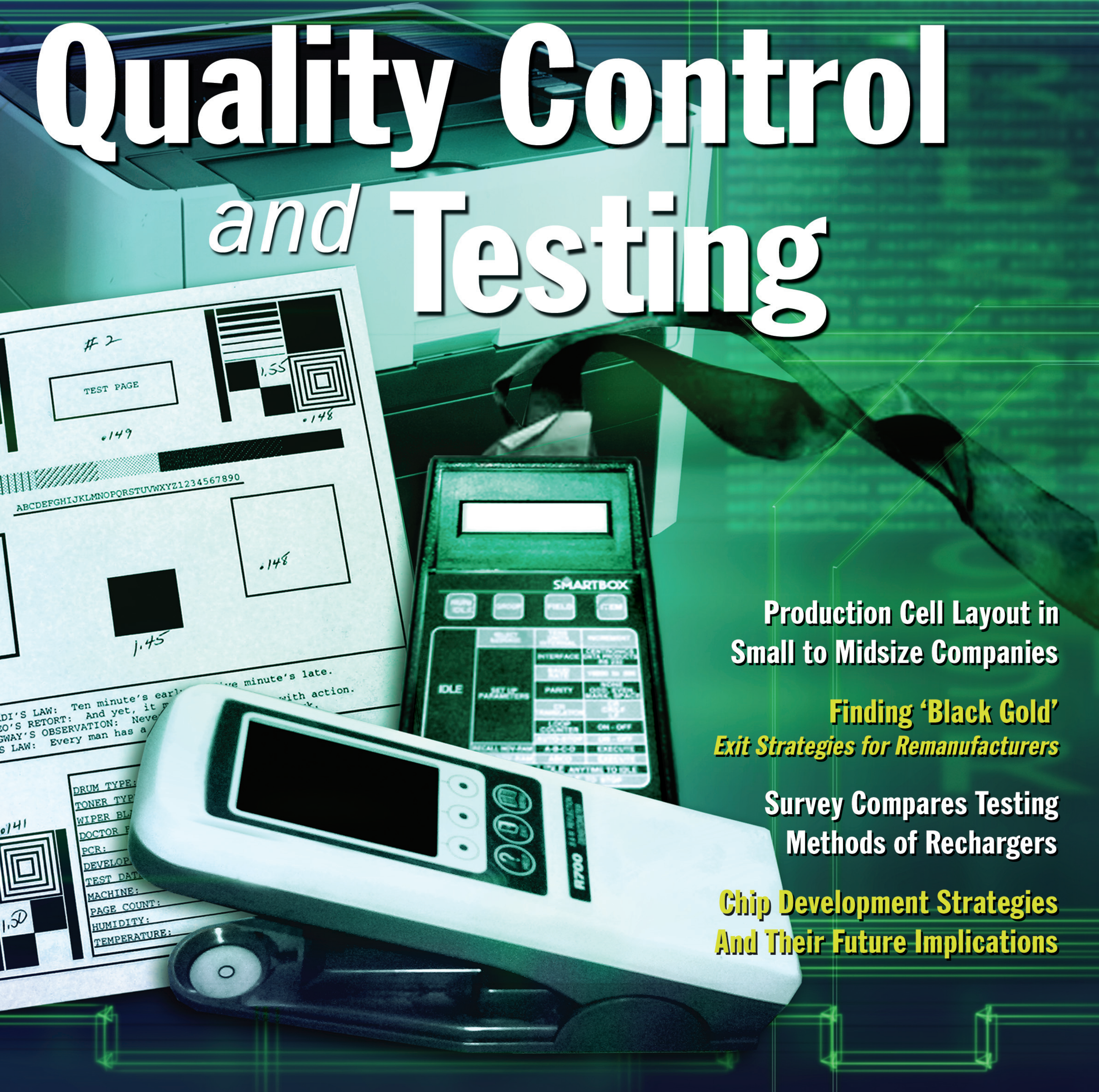

Production Cell Layout in Small to Midsize Companies

Finding 'Black Gold'

Exit Strategies for Remanufacturers

Survey Compares Testing Methods of Rechargers

Chip Development Strategies And Their Future Implications

by **Joy James** | The Joy James Group

Finding 'Black Gold': Exit Strategies for Remanufacturers

Editor's Note: This article is the first in a three-part series.

A lot has changed since our industry's beginnings in the late 1980s and early 1990s. Word began to spread that there was "black gold" to be found in remanufacturing toner cartridges, and fledgling entrepreneurs sought out the training necessary to start their own cartridge recharging businesses. Many rechargers first learned about the industry as the result of a small, black-and-white "business opportunity" ad in the back pages of *Entrepreneur* magazine. The ad featured the caption: "Refill toner cartridges at your kitchen table." And thousands of entrepreneurs did just that.

Remanufacturing cartridges was relatively easy given the limited number of toner cartridge SKUs. Until 1992, the narrow product line was mainly comprised of two cartridges, the SX and the EX. No refilling equipment, overhead or inventory was necessary to get started. These extremely low barriers to entry attracted a wide range of individuals seeking home-based business opportunities.

Today, according to Lyra Research Inc., the aftermarket represents a $4 to $6 billion industry and has captured about 32 percent of the total laser (monochrome) printer supplies market share. The product line has mushroomed and now comprises some 300 toner cartridge models and 125 inkjet cartridge models. The top 75 percent of the installed base for toner cartridges is comprised of 41 SKUs.

As the industry has matured, the business environment has become increasingly complex. Barriers in the form of Prebate, chips and other lockout devices have challenged the industry; legal battles have played out and price erosion has set in. The aftermarket has met each challenge head-on and has proven to be a strong and resilient force within the imaging supplies industry.

To grow their businesses, owners have invested their own capital, along with significant amounts of their time and energy. And there are hundreds of highly successful companies within the industry. In many instances, the company itself represents the owner's single largest asset. For a host of reasons ranging from asset diversification to competitive threats to capturing a return on their hard work, or simply to pursue other interests, many aftermarket business owners are contemplating exactly what their exit options are.

This article series will explore aftermarket exit strategies for business owners and provide three detailed case studies of real companies that have addressed this issue by using three different mechanisms. In addition, the series will offer business owners advice on what to consider when planning an exit strategy, as well as detailed analysis of the pros and cons associated with each option. Figure 1 shows the pros and cons associated with choosing an IPO as an exit strategy.

This first installment covers the process of going public. Since Teckn-O-Laser's announcement that it was going public through a reverse merger with Adsero, several aftermarket companies have expressed an interest in following suit within the next 24-36

Pros	Cons	Typical Size
High financial rewards. Immediate access to liquid capital.	Average price of being a public firm reported to be almost $2.5 million. Rigorous ongoing reporting requirements made mandatory under the 2002 Sarbanes-Oxley Act essentially doubled the accounting, audit and legal fees of publicly traded companies.	Companies with annual revenues more than $100 million.
Stock can be used as partial financing for acquisitions of other companies.	IPOs generally take about a year and approximately 50 percent of the owner's time to complete. Substantial amount of management time must be dedicated to ongoing reporting requirements.	**Why Choose This Option?**
Stock options can highly motivate employees to execute.	Loss of freedom and autonomy to act without board approval.	Owners who initiate IPOs seek to raise capital for aggressive growth plans. High risk, high reward.
Increased visibility and prestige. Increased press coverage, ability to attract and retain top talent.	A public company is required to reveal sensitive information including detailed financials, business strategies and executive salaries.	**Aftermarket Examples**
	Pressure to grow the stock price, revenues, profits and dividends can change company culture, and lead to an emphasis on short-term strategies rather that long-term initiatives.	Nu-Kote Holding (1995), Teckn-O-Laser (2004)

Figure 1: Choosing an IPO as an exit strategy.

months. Although this strategy is truly viable for only a select few aftermarket companies, the information presented in this article will serve as a foundation for Part 2, where we will cover exit options such as selling to a strategic buyer (which has been particularly effective in the aftermarket), employee stock ownership programs (ESOPs) and private equity group (PEG) funding, an aftermarket strategy that is becoming increasingly popular. Finally, the third installment will explore selling your business to individual investors, including innovative options for smaller, locally based operations with less than $1 million in annual revenue.

	Company X ($5 million)	Company Y ($50 million)	Company Z ($500 million)
EBITDA (10% of revenue)	$500,000	$5,000,000	$50,000,000
Initial Public Offering Cost	$1,500,000	$2,000,000	$2,500,000
% of sales	30%	4%	1%
% of earnings	300%	40%	5%
Annual Cost (audit cost, filings, PR – estimate)	$300,000	$500,000	$1,000,000
% of sales	6%	1%	0.2%
% of earnings	60%	10%	2%

Figure 2: The cost of going public — three scenarios.

Want to Go Public?

"Becoming a publicly traded company is not for the faint of heart," explained Tony Pallante, managing director of Manchester Consolidated Corp., a strategic partner and major shareholder of Adsero Corp. "It's much more difficult and expensive today than it was, say, five years ago because of (post-Enron) regulations such as the Sarbanes-Oxley Act of 2002." Pallante, along with a number of other sources, stated that Sarbanes effectively doubles the accounting and reporting costs for small companies.

Indeed, completing a public offering is expensive and time consuming. The cost to complete an initial public offering (IPO) normally amounts to millions of dollars ($1 to $2 million minimum), not including the ongoing costs of auditing and filing SEC statements (estimated at $150,000 per year), and retaining a public relations firm to make your business identifiable to the investment community (estimated from $150,000 to $1 million per year).

As Figure 2 shows, the cost structure associated with being public does favor large companies. For example, a company with $50 million in annual sales and a 10 percent net profit could easily spend 40 percent of its annual earnings to initiate an IPO (assuming a $2 million offering cost) and at least 10 percent of its annual earnings to maintain its public status (assuming a $500,000 annual cost).

According to Chris Schenkenberg, senior manager in the federal tax practice of Grant Thornton LLP's Chicago office, the costs associated with going public are prohibitive for even the largest aftermarket competitor. "It simply doesn't make sense for companies with less than $200 million (in annual revenues) to go public," he said.

Another source indicated that a company should earn a minimum of $10 million in annual operating profit (usually more than $100 million in sales) before considering going public.

Success Comes in All Sizes

There are, however, many examples of relatively small companies, even startups, that have reached phenomenal success by using a public mechanism.

One success story is Eltron International Inc. (Nasdaq: ELTN), a bar-code printer manufacturer, which did $17 million in annual revenue when it went public in February 1994. The company netted $5 million from the sale, which was only the beginning of the windfall; as Figure 3 shows, Eltron's stock commenced trading at $6 a share, and within 20 months reached a high of $38.75 a share.

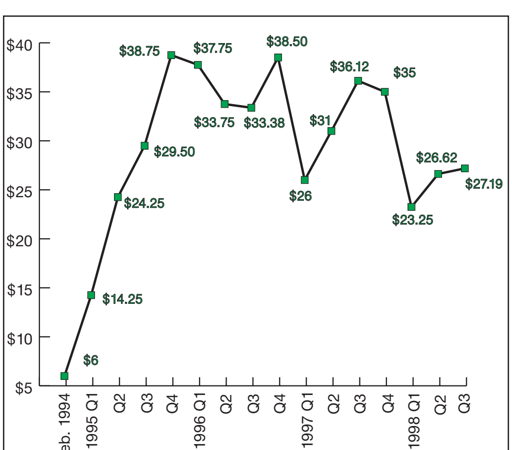

Figure 3: Eltron International Inc. stock price from IPO (Feb. 1994) through sale to Zebra (Oct. 1998).

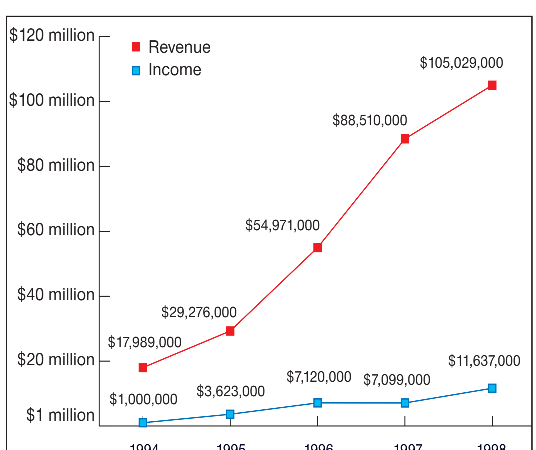

Figure 4: Eltron International Inc. income and revenue by year, from IPO (Feb. 1994) through sale to Zebra (Oct. 1998).

Donald Skinner, president and chief executive of Eltron, has been quoted as saying that the best thing about going public was, "Having the cash. There's not anything better than that."

Eltron was purchased by Zebra Technologies (Nasdaq: ZBRA) in October 1998, when Eltron stock was trading at $26.62 and total revenues were $105 million.

Eltron's success can be attributed to its ability to execute consistently. As Figure 4 shows, Eltron successfully grew both revenues and profits in a highly competitive environment.

Eltron took advantage of a key benefit of going public — gaining an acquisition currency. Rather than having to pay all cash, or get cash through debt or equity sources, Eltron was able to use its shares as a currency to purchase other companies. This allowed the company to grow through acquisition and add shareholder value.

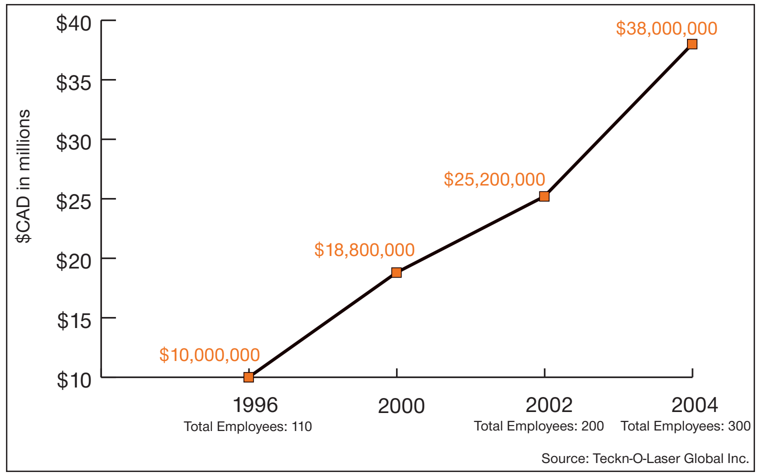

Figure 5: Teckn-O-Laser total revenue and number of employees by year.

The Teckn-O-Laser 'Fit'

With annual revenues of approximately $32 million (CAD$38 million), Teckn-O-Laser may not seem to be an ideal candidate to become a publicly traded company because of its size. But the Adsero/Teckn-O-Laser team viewed this deal as the perfect opportunity at exactly the right time in the market's evolution.

Both Pallante and Teckn-O-Laser founder Yvon Léveillé concede that companies with revenues less than $50 million are considered small in the public's eye, but they maintain that there's no easy answer to the size question. "You have to have a vision for where you are going to take the business down the road. To take a $30 million, $50 million or even an $80 million business public and stay there simply isn't big enough," explained Pallante.

Léveillé has a highly focused vision to grow Teckn-O-Laser into a $500 million conglomerate specializing in "e-waste" solutions in the areas of printers, print cartridges, computers, cell phones and other related electronic devices.

Like Eltron, Teckn-O-Laser will have the opportunity to use its stock as a currency to buy other companies through acquisition or merger. According to Pallante, the Adsero team "will be looking to acquire well-run, profitable companies with the right business model."

In fact, Teckn-O-Laser is considered the ideal partner for Adsero because of Teckn-O-Laser's strong leadership, solid management team and long track record of success. Pallante says Adsero only seeks out companies where the owner/leader is a "top-notch individual who is going to stay in the company and drive the vision."

Teckn-O-Laser Background

Like many aftermarket success stories, Léveillé started Teckn-O-Laser in the basement of his home in 1988. "I originally started Teckn-O-Laser to create a job for my wife, Céline," he said. At that time, Léveillé was running a software development company named Micro Tempus that he founded in 1982 and took public in 1986.

Micro Tempus developed software that linked IBM personal computers to IBM mainframes. Although the company had success, over time, as communication software became embedded into computer hardware itself, the market evaporated. The company was eventually taken off the public market and sold to a German software company. The code that Léveillé developed is still being used today in various applications such as credit card transactions.

Léveillé enjoyed the public market, but remained dissatisfied with the outcome of his investment, which totaled about $1 million, and took almost 50 percent of his time.

"I watched Teckn-O-Laser grow like crazy while I was running the software company, which wasn't growing nearly as fast," Léveillé explained. "At some point, I had to make a decision about which unit to track. I decided to focus on Teckn-O-Laser and I haven't looked back since."

Léveillé clearly made the right choice. As Figure 5 shows, Teckn-O-Laser has experienced tremendous growth in terms of revenue and employees. Along the way the company has made some sizeable investments that have created a platform for future growth, such as adding an ERP system and becoming ISO 9001:2000 compliant. Along the way, Léveillé sold some shares in Teckn-O-Laser, but remains the majority owner of the company.

Today, Teckn-O-Laser produces between 40,000 and 60,000 toner cartridges, and between 5,000 and 10,000 inkjet cartridges per month. The 60,000-square-foot facility outside of Montréal employs 300 employees.

Exit Planning

"I haven't been able to stop aging yet," Léveillé joked. "And so, as I get older, I've had to think about how I will eventually leave Teckn-O-Laser and what I need to put in place over the next decade for this to happen properly. You can either pass a business on to your children, your employees or to another owner. This needs to be figured out first."

Explaining his decision to become a publicly traded company as a catalyst for reinvention and growth, Léveillé continued, "There are challenges in our industry today like never before. The market has now reached a point of consolidation. The challenges we face today will change how things are done and will ultimately reshape the industry as a whole. However, every challenge presents an opportunity, particularly for companies like Teckn-O-Laser that are well-positioned in the market and have a demonstrable plan for growth."

Léveillé's past experience of going public caused him to favor this exit option. Although Léveillé was certain that he wanted to go public, he wasn't willing to follow the same path that he took in 1986. "I was overly submerged with additional functions. It took my focus away from running the (software) business." So, when Léveillé began discussions with the Adsero team, he saw the advantages of becoming public through a reverse merger.

Because Adsero is already a publicly traded company on the Nasdaq OTC Bulletin Board (Nasdaq: ADSO), Teckn-O-Laser will become public at the time the transaction closes. This type of transaction is known as a "reverse merger" or "reverse acquisition," where a private company merges into the shell of a publicly traded company and usually acquires a majority of the stock.

The benefit of this type of merger is that it will save Teckn-O-Laser the time and some of the cost necessary to go public through an IPO. However, the annual costs to maintain a public company remain.

In this case, Adsero Corp. has no active operations or revenue stream, and Teckn-O-Laser's operation will initially represent 100 percent of Adsero's sales. Upon the deal's close, Léveillé will become the CEO of Adsero, join the board and be the company's largest shareholder. Léveillé and his management team will continue to run Teckn-O-Laser and execute the company's growth strategy. Léveillé expects to eventually exit the business in about 10 years.

Adsero Background

Prior to March 2004, Adsero was known as Reink Corp. (Nasdaq: RINC). Reink Corp. was the parent company of operating subsidiary Reink USA Ltd., an aftermarket remanufacturer and distributor of inkjet and laser cartridges, bulk ink and refill kits. At its peak in 2002, revenues totaled slightly more than $8 million (with a net loss of $1.8 million).

After becoming public in May 2000, Reink was unable to remain profitable on an annual basis (although the company did show some profits during the first three quarters of 2002). By July 2003, Reink Imaging USA Ltd. filed for Chapter 7 bankruptcy. The parent holding company was then restructured, renamed Adsero Corp. and sought out the strategic acquisition of an industry leader.

According to SEC public filings dated Sept. 30, 2004, the operating subsidiary Reink Imaging USA Ltd. was forced to cease its operations on Jan. 1, 2004, after the management team of this subsidiary resigned their positions and dismissed all employees, allegedly without authority. Litigation against former

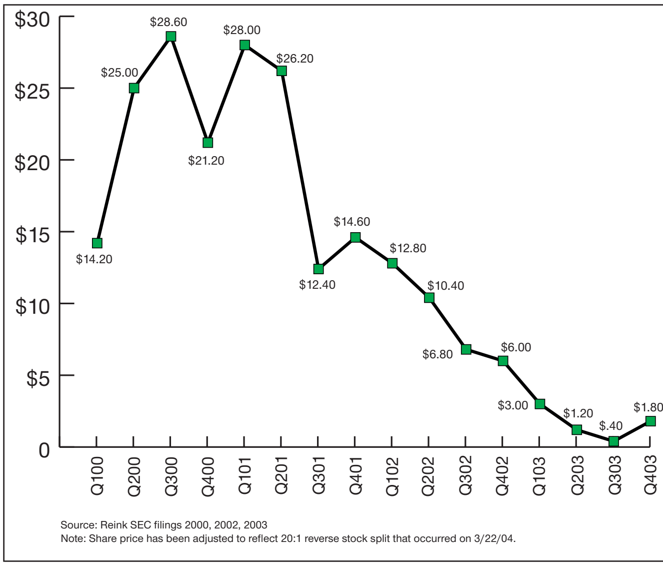

Figure 6: Reink stock price, March 2000 through December 2003.

company officers was initiated by Adsero in May 2003 for actions related to this situation. A countersuit was filed.

Figure 6 shows the company's common stock (RINC) trading price over time. Adsero's stock (ADSO) was trading at $1.57 on Nov. 26, 2004.

The Adsero team is quick to explain that their team was not running the Reink Imaging USA business, and in hindsight they would have done things very differently. "In the end, it was a very good learning experience for us," Pallante explained. "These things happen in business sometimes. We've learned through the trenches where the opportunities and pitfalls of the imaging business are. Experience allows you to make better decisions in the future."

An outside industry analyst speculated that taking Reink public might have been a little premature. Pallante does not argue this point, saying the company might have held off going public with Reink until they were better "groomed" and some efficiencies were gained.

The Adsero team pointed out that success ultimately comes down to having the right people and management team in place. This sentiment was reiterated by several investment bankers, which made an observation that Wall Street wants to see seasoned management teams with a good knowledge of the industry.

The Adsero team is 100 percent confident they have the right partner in Teckn-O-Laser. "Teckn-O-Laser has a seasoned and visionary leader, a stellar reputation and proven track record of success," Pallante said. "There's going to be some exciting stuff coming out of Adsero in the next couple of years."

The Deal

On May 3, 2004, Adsero Corp. signed a letter of intent to purchase all of the stock of Teckn-O-Laser for an estimated

US$16.6 million. As Figure 7 details, the consideration includes CAD$8.38 million (US$7 million) in cash, 35 percent of which will be paid out over time and is subject to profitability; 6 million shares of Adsero common stock, which is valued at US$9.4 million (based on Adsero's closing stock price of US$1.57 on Nov. 26, 2004); and 300,000 stock options at a price of not more than US$1 per share (valued at US$171,000 on Nov. 26, 2004). As part of the transaction, Léveillé and another key manager signed three-year management contracts.

Generally speaking, Léveillé stated the purchase price for Teckn-O-Laser was fair, and noted that eventually both sides must agree on a number to close the transaction.

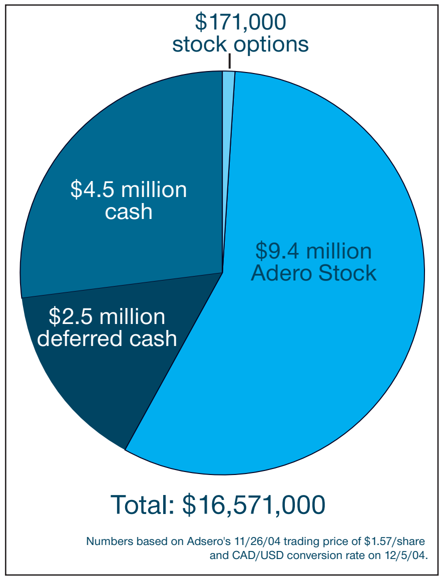

Figure 7: The purchase price of Teckn-O-Laser, in U.S. dollars.

The purchase price of Teckn-O-Laser was valued based on its earnings (profits) before interest, taxes, depreciation and amortization (EBITDA). EBITDA is used to analyze the profitability between companies because it eliminates the effects of financing and other accounting decisions. It is not always a good indicator of cash flow, however.

"We value the business based on a multiple of EBITDA," Pallante explained. "The multiple that we use is affected by several factors, including the value-add evident in the business." Generally, multiples range from four to six times EBITDA.

As Figure 8 shows, the multiple used in valuing a business makes an enormous difference. For example, a $10 million company with a $1 million EBITDA and a valuation multiple of three is worth $3 million dollars (or three years of goodwill); whereas a $15 million company with a $3 million EBITDA and a multiple of six would be worth $18 million dollars.

Calculating EBITDA — 3X		Calculating EBITDA — 6X	
Total Sales	$10,000,000	Total Sales	$15,000,000
Cost of Goods Sold	$5,000,000	Cost of Goods Sold	$7,000,000
Gross Profit	$5,000,000	Gross Profit	$8,000,000
Less:		Less:	
Sales, General & Administrative Expense	$4,000,000	Sales, General & Administrative Expense	$5,000,000
EBITDA	$1,000,000	EBITDA	$3,000,000
Less:		Less:	
Interest, taxes, depreciation and amortization	$600,000	Interest, taxes, depreciation and amortization	$1,100,000
Net Profit	$400,000	Net Profit	$1,900,000
3X EBITDA- Value	$3,000,000	6X EBITDA- Value	$18,000,000

Figure 8: Two valuation scenarios based on EBITDA.

The valuation multiple, according to Pallante, can be positively affected when a company has a good business model, a strong and stable management team, a proprietary base of business with contracts in place and a diversified base of customers. In Teckn-O-Laser's case, value was added because Léveillé offers strong leadership, the company has maintained audited statements from the beginning, and Teckn-O-Laser has made investments in the infrastructure, which should reap substantial rewards in the future.

Figure 9 on the next page offers business owners a rough guideline to help estimate an appropriate multiple for their businesses. This chart is the work of Hank James from Corporate Finance Associates and serves as a very rough approximation of the factors that buyers often consider when valuing a business. In most circumstances, buyers will have their own criteria, but it typically includes some portion of the elements listed in Figure 8. To calculate a multiple, simply select a response that most nearly applies in each category. Subtotal the values and add a base multiple of three to determine the multiple to be used.

Past Lessons Learned

Reink is not the only public aftermarket company that's fallen into bankruptcy; perhaps the best known example is Nu-Kote Holding Inc. (a former incarnation of today's privately owned Nu-Kote International).

Nu-Kote Holding was originally spun off from Unisys after the Burroughs-Sperry merger and sold to a N.Y.-based buyout firm, Clayton, Dublier and Rice, for $55.8 million. After acquiring ICMI, a toner manufacturer worth between $18 and $20 million, Nu-Kote Holding completed an initial public offering (Nasdaq: NKOT). The opening trade price was $18 a share; that price peaked at $42. Clayton sold out within six months after the IPO and realized a profit of about $41 million on the deal.

Rob Leonard, a former executive at ICMI/Nu-Kote, remembers that time fondly. "Nu-Kote had a very unique opportunity. We had a proven track record of being the largest and best ribbon company in the industry with a 55 percent market share in the impact side of the business. It was a sellable story on Wall Street that Nu-Kote could achieve the type of market share in the non-impact side of the business that we had been able to achieve in the impact business."

After a series of acquisitions including ICMI (1992), Future Graphics (1993), Pelikan (1995) and Jarfalla R&D (1995), Nu-Kote experienced significant growth, nearly tripling its revenues between 1994 ($150.7 million) and 1996 ($424.1 million). At the same time, Nu-Kote was busy defending itself against various OEM lawsuits.

"Nu-Kote should have been a category killer," Leonard said. "We had the best of the best in toner, ribbons, inkjet and remanufactured cartridges, and we were virtually 100 percent vertically integrated in every aspect of the business. During that time of accelerated growth, Nu-Kote became engaged in various OEM lawsuits, and as a result, managing that vision and executing the plan became quite challenging. Eventually, we slipped into Chapter 11 reorganization bankruptcy."

As Figure 10 shows, Nu-Kote's total revenues slid from a high of $424 million in 1996 to $240 million in 1999, and that drop was reflected in the net profits, which were -$55,000,000 by 1999. Figure 11 on the next page shows the company's stock prices.

"When we became public, the tail started wagging the dog," Leonard said. "So often in these cases companies start doing things the way the analysts want them to instead of what they know is the right thing for their business."

In 2000, Nu-Kote submitted a reorganization plan that included taking the company private and extinguishing the outstanding (public) shares.

Today, Nu-Kote International is a profitable, well-respected privately owned and operated company. In the end, staying private appears to have been a better strategy for Nu-Kote.

"I have a tremendous amount of respect for the current management of Nu-Kote," said Leonard. "Their ability to stay in the game and find success in spite of all the challenges is really a testament to their top-notch management team."

"The dynamics of this industry today are very different than when Nu-Kote was public. They jumped in when it was the wild,

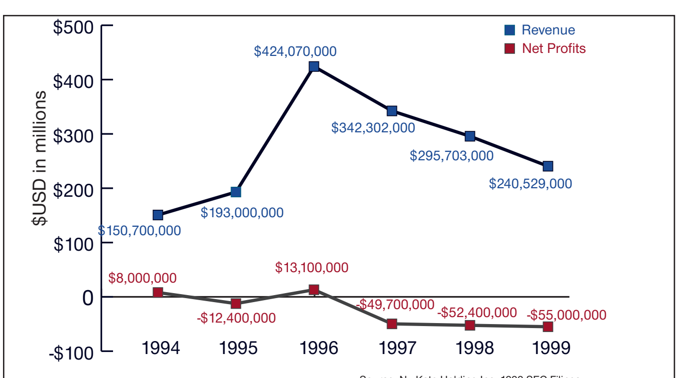

Figure 10: Nu-Kote Holding's revenue versus net profits.

	Attribute	Status	Value
1	Market	Expanding	0.2
		Flat	0
		Declining	-0.2
2	Age of Industry	More Than 5 Years	0.3
		2-5 Years	-0.2
		New	-0.4
3	Competition	None	0.5
		Average	0.1
		Cutthroat	-0.9
4	Local Economy	Dynamic	0.2
		Average	0
		Declining	-0.2
5	National Economy	Dynamic	0.1
		Average	0
		Declining	-0.1
6	Employee Turnover (average employee tenure)	Less than 1 Year	-0.2
		1-3 Years	0
		Over 3 Years	0.2
7	Local Labor Market	Strong Competition	-0.1
		Normal	0
		High Unemployment	0.1
8	Labor Unions	None	0
		Weak	-0.4
		Strong	-0.9
9	Number of Emloyees	0-20	0.1
		Over 20	0
10	Management Continuity	Long Experienced Staying	0.4
		Short (0-3 Years) Staying	0.2
		No Manager Staying	-0.2
11	Years in Business	More Than 5 Years	0.4
		2-5 Years	0.2
		Less Than 2 Years	0
12	Net Profit Before Tax (annual)	Over $200,000	0.5
		$100,000 to $200,000	0.4
		$50,000 to $100,000	0.3
		Under $50,000	0
13	Experience Skills Required	Average Skills	0.3
		Industry Knowledge Required	-0.1
		Very Technical	-0.3
14	Owner Support Post-Sale	More Than 1 Month	0.2
		Up to 1 Month	0.1
15	Location	Average	0
		Difficult	-0.2

Source: Hank James (www.cfaw.com)

Figure 9: Determining a valuation multiple.

wild West," explained Pallante, who firmly believes Teckn-O-Laser has a business model just right for today's times.

Pros and Cons of a Public Mechanism

Clearly, there are pros and cons associated with a public strategy. The liquid access to capital is amongst the largest benefit, along with the ability to use the company's stock as a currency to acquire other companies.

Another main benefit is the notoriety and perks associated with being a large, publicly traded company. Increased press coverage and visibility create opportunities for the company, as well as for the founders. Would as many people be aware of Google founders Sergey Brin and Larry Page if they hadn't gone public?

From an employee perspective, stock options can be bittersweet. Robert Goldstein, founder of Future Graphics, explained, "When I sold my company to Nu-Kote in 1993, the employees loved the compensation packages and stock options. But over a period of time, their 401ks were tied up in Nu-Kote stock that became worthless."

Stock options as part of a compensation plan can serve to highly motivate key employees with organizational directives. Scott Benson, former director of operations at IKON, said, "We would do anything and everything to meet shareholder expectations, which was our main goal every quarter. We lived and died by the analysts' expectations."

"Growing the company and pushing the stock price up can become addictive," Leonard added. "It's a deal that you can't walk away from."

But this pressure, day in and out, can change the company culture and lead to an emphasis on short-term strategies rather than long-term initiatives. For example, Benson explained, "We would have mandatory travel freezes at the end of IKON's quarter that precluded us from attending the *Recharger* World Expo trade show. It didn't make much sense."

From Léveillé's perspective, there are some disadvantages associated with being a public company, such as the disclosure requirements, which require companies to report major strategies and acquisition plans. "There's some information that you'd like to keep to yourself and not release to competitors. I don't like that part. But overall, I like the ability to raise money to accelerate growth and invest in R&D," he said.

Teckn-O-Laser's Future and Vision

Adsero, Léveillé and the Teckn-O-Laser management team all share the vision that Teckn-O-Laser has the potential to become a multi-hundred million dollar company through a series of strategic moves, using Teckn-O-Laser as a platform company for a well-thought-out growth strategy.

"We will continue to grow smart," Léveillé said. "Nobody can be successful building a company from 300 to 3,000 employees overnight. It will take some time. If you take on more than you can handle, it can become detrimental.

"We have succeeded in building a base that is well structured, with the right backbone (MIS system), a proper investment in R&D, a focus on quality and quality stems and the right human capital; this is a solid base from which to grow."

In addition, Léveillé is committed to retaining his company culture, which includes a lot of open communication, empowering employees and continuous improvement. "There may be an evolution in our culture because of the size we will become, but certainly not at the expense of working on solid values, team spirit and growing smart."

Indeed, Teckn-O-Laser, which has been named one of Canada's Best Managed Private Companies for three consecutive years, appears to have in place many of the elements to make its IPO a success. Pallante and Léveillé are firmly committed to the belief that Teckn-O-Laser's public offering will go the way of Eltron rather than Reink or Nu-Kote.

Post-Closing

The Teckn-O-Laser/Adsero deal, at the time of this writing, is in its final stages. The closing date has been pushed back several times, as Adsero is waiting on final bank approvals. The Adsero team stresses that the deal will get done.

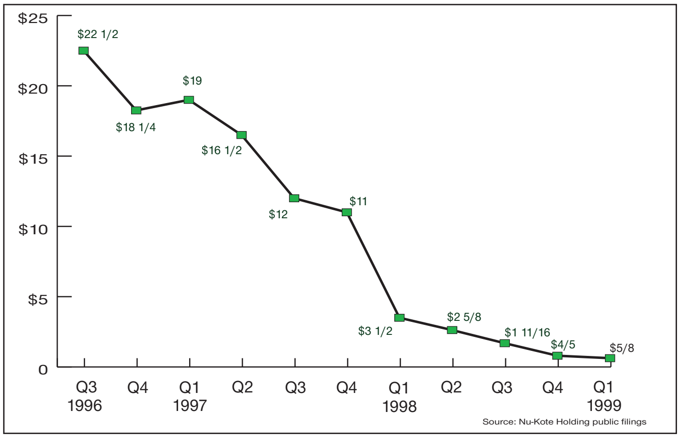

Figure 11: Trading price for Nu-Kote Holding's common stock, 1996-1999.

After the transaction is finalized, Léveillé is expecting to hit the streets, spending approximately 15 to 25 percent of his time lobbying the investment community about his company and its vision of the future.

"We are ready to execute," Léveillé said.

Meanwhile, Adsero will surround Léveillé with a high-level advisory board to help him execute the team's ambitious plan over the next decade.

For other business owners considering going public, the Adsero/Teckn-O-Laser team has several words of advice:

"Do your homework, and seek professional advice," Pallante said.

"Never underestimate the amount of effort and cost of the process," added Léveillé, who jokes that 30 to 50 percent should be added to the initial numbers you hear.

In addition, Léveillé suggests that a company going public must be of a sufficient size, have good growth capability, have a strong management team in place, and exhibit clear objectives. "Going public is not a destination. It's really just the beginning."

Conclusions

Going public in any industry, particularly in the aftermarket, is a high-risk, high-reward venture. It involves the intersection of preparation and opportunity, which must meet at the perfect time under exactly the right conditions.

Although the aftermarket has not been an industry actively "in play" on Wall Street, times have changed. Today, the aftermarket is recognized as a legitimate industry that is growing in terms of employment base, revenue, profits and market share.

Only time will tell the results of the Adsero/Teckn-O-Laser deal. Success will bring forth a series of industry consolidations, and perhaps, some interesting mergers and acquisitions in the future. R

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by **Joy James** | The Joy James Group

Finding 'Black Gold' Part 2:

Exit Strategies for Large-Scale Remanufacturers

Editor's Note: This article is the second in a three-part series.

The first article in this series explored the pros and cons of a public mechanism, and looked inside one the biggest transactions to hit the aftermarket — Teckn-O-Laser's decision to become public by participating in a reverse acquisition with Adsero Corp. (Nasdaq: ADSO).

Becoming a publicly owned company is a high-risk, high-reward strategy. Success often stems from the management team's ability to execute the business plan and to grow the company's revenues and profits. Going public as a long-term exit strategy favors very large businesses because of the high cost structure associated with being public.

This second installment provides options for large-scale remanufacturers interested in selling into the private equity market, strategic buyers, or to employees through employee stock ownership plans (ESOPs). We will discuss the pros and cons of each option shown in Figure 1. In the final installment next month, we will explore selling your business to individual buyers, including some innovative options for smaller operations with less than $1 million in annual revenue.

Exit Options for Sellers by Business Size

	Private Equity Group (PEG)	ESOP	Strategic Buyer
Typical Size	Annual sales more than $20 million	Annual sales more than $20 million	Annual sales more than $5 million
Pros	Offers immediate liquidity and access to capital.	Tax advantages.	Liquidity.
	Access to experienced, strategic thinkers.	Acquisitions can potentially be made using tax deductible dollars.	Business model 'fit' creates value which often equates to a higher sales price.
	Relatively quick transaction.	Can retain organizatonal control.	Deal terms are often controlled by the seller.
	Existing management team can participate.	Aligns employee focus with organizational objectives.	Access to experienced managers & other resources.
Cons	3-7 year window before a secondary exit strategy.	Very complicated. Difficult to administer.	Loss of control.
	High performance level required.	Must have a significant payroll.	Strategic growth opportunities.
	New outside directors.	Can be a hard sell to unsophisticated employees.	Cultures may clash between organizations.
	High debt load.	Ongoing maintanence cost.	Fate of existing employees is unknown.
Why choose this option?	Owners choose a PEG as an interim exit strategy to create value through growth, operating performance and leverage.	Owners choose ESOP for an exit strategy that favors employees.	Owners seek a strategic buyer to create synergistic opportunities and maximize value.
Aftermarket Example	Clarity Imaging Technologies (2003), Quality Imaging Products (2001)	GRC (1995)	Summit Laser and Graphic Technologies (2004), Golden Imaging/Turbon Group (1999), Future Graphics/Nu-Kote (1993)

Figure 1: Exit options for sellers by business size.

Shhh ... It's Private

Due to the very nature of PEGs being private, they generally try to maintain a low profile, especially in attractive industries. Several PEGs agreed to be interviewed for this article under the condition of anonymity. For purposes of a case study we will use the information collected to construct a typical deal using a hypothetical company.

Selling Today

Business owners are selling. As the industry continues to mature, owners are exiting for both personal and strategic reasons. Some owners have reached a point in their lives where they're seeking less responsibility. Other owners are cognizant of the resources it will take to bring the company to the next level and are not able or willing to provide these resources. Finally, some business owners are selling to capture the value of the company that they've built.

Market environments also affect ownership transitions. Chris Schenkenberg, a senior manager in the federal tax practice of Grant Thornton LLP's Chicago office, believes the market is opening up for sellers today.

"There is more private equity capital looking for deals, more senior debt and more high-yield debt. This makes it an attractive market for a seller because premiums will be higher," Schenkenberg said.

This combination of an attractive market environment and motivated ownership has sparked increased aftermarket transactions. Because of more available capital and easier debt financing, private equity group funding (PEG) has become increasingly popular today.

PEGs

PEGs provide equity capital to established companies in connection with a change in ownership or growth capital transaction. These third-party investment groups often have long-term relationships with banks and other investors, as well as the ability to provide professional management that can step in to take over or help manage the business. About 17 percent of the companies that comprise *Inc.* magazine's "Inc. 500" list use PEGs as a source of capital for continued growth.

Figure 2 illustrates the basic private equity formula for value creation: make investments in the right company and in the right industry. The correct execution is essential in order to create long-term value. PEGs invest in private markets to create value and achieve a superior return on their investments.

Right Industry + Right Company + Right Execution = Value Creation

Figure 2: Basic private equity formula for value creation.

In addition, the management team is a critical part of the deal, and most PEGs prefer to see the owner stay on to run the company. Generally speaking, an owner increases the business' stability and reduces overall risk. "We wouldn't be making this investment unless we were happy with the management team," said a member of a PEG who is currently in the process of closing a growth equity investment in the aftermarket.

PEG investments can be broadly categorized into three types, as detailed in Figure 3. These options are based on 1) the owner's needs, 2) the PEG investment philosophy and 3) the dynamics of the business.

PEGs prefer to handle established companies with more than $20 million in annual revenue, and about $2 million in earnings before interest, taxes, depreciation and amortization (EBITDA). (For more information on EBITDA refer to Part One of this series in last month's *Recharger*.) This size preference is due mainly to the high transaction cost associated with a PEG investment.

Because private markets are inherently riskier than other investments, the average PEG return is quite attractive, as illustrated in Figure 4.

	1 Year	3 Year	5 Year	10 Year
All Venture Funds	9.6%	32.2%	26.7%	16.8%
Buyout $0-$250MM	9.0%	18.5%	19.7%	19.7%
All Buyout Funds	16.4%	18.1%	19.1%	17.0%
All Private Equity	14.3%	22.4%	21.7%	16.9%

Source: Buyout Magazine, *1999*

Figure 4: Average Private Equity Returns, 1989–1999.

A Typical Leveraged Buyout (LBO)

Private equity groups have been able to achieve solid returns over the past two decades; hence the popularity of LBO funds in mature capital markets. Therefore, a value-creating LBO will effectively: 1) identify industries with opportunities, 2) screen companies within this industry for suitable investment targets, and, following the investment/acquisition, 3) execute effectively.

Execution involves both the determination of a proper strategy and a disciplined approach to following through on that strategy. Typically, PEGs will look for both sales growth and improvements in operations. Oddly enough, manufacturing companies with low operating margins present a good opportunity for PEGs. The characteristic of low margins presents both risks and opportunities. The potential risk is that failure to rapidly respond to a downturn in volume, with appropriate reductions in fixed costs, can quickly lead to cash flow shortfalls. The attractive opportunity, however, is the potential to dramatically improve earnings. A highly simplified hypothetical income statement (as a percentage of revenue) of a company

Types of Investments PEGs Make

	Growth Equity Investment	Recapitalization	Owner Exit
Characteristics	Limited liquidity to owner. Investment sticks mostly to the business to accelerate growth.	Shareholders receive cash through a combination of new debt and new equity into the business.	PEG must have an executive looking to get into the industry or has experience in the industry.
	New directors added.	Control of the company may go to investors.	After a transition period the owner will exit the business completely.
	Management team is supplemented with PEG managers.	The business becomes leveraged with debt.	May get a lower multiple. The risk is higher because the owner is leaving.
Why choose this option?	This option is right for an owner who wants to stay in his business and take it to the next level by bringing in equity.	Owners choose this option when they want to receive cash in exchange for a portion of the business.	Owners choose this option when they seek to fully exit their businesses and do not have a strategic buyer opportunity.
Aftermarket Example	Clarity Imaging Technologies Inc. (2003)	N/A	Quality Imaging Products (2001)

Figure 3: Three different PEG investments.

with Unfocused Operations is contrasted against a company with Focused Operations, as shown in Figure 5.

In these two scenarios, there exists only a 5 percent difference in costs, yet the resulting impact on EBITDA is almost 50 percent. Since manufacturing companies tend to trade at valuations based on a multiple of EBITDA, this improvement in earnings will translate to an equivalent increase in the value of the company. A similar analysis shows that an 11 percent reduction in costs would double the value of the company.

Figure 6 illustrates sample scenarios for increasing the value of the business. In the first scenario, the revenues in the first year are $10 million and costs of goods sold (COGS) are $8 million, which results in a gross margin of $2 million. Selling, general and administrative expenses (SGA) costs are $1 million, so the EBITDA (cash flow) is roughly $1 million. The scenario assumes a value multiple of 5X, so the value of the business is $5 million.

Unfocused Operations	
Revenue	100.0%
Cost of Goods	65.0%
Gross Margin	35.0%
SGA	25.0%
EBITDA	10.0%

Focused Operations	
Revenue	100.0%
Cost of Goods	61.7%
Gross Margin	38.3%
SGA	23.8%
EBITDA	14.5%

Figure 5: The financial significance of low operating margins.

Each year, the business is assumed to grow at 30 percent, so revenues in year two are $13 million, $16.9 million in year three and $28.56 million in the fifth year. Costs and SGA expenses are assumed to remain constant, and the purchase multiple is also assumed to remain constant at 5X. At the end of five years, the business is now valued at $14.28 million (5 x $2.86 million EBITDA). The equity appreciation per year is 23 percent.

In the second scenario, the business grows at the same rate, but the management team also improves the margins each year both on cost of goods sold and SGA. As a result, the EBITDA increases at a faster pace.

So, in year one, just like in the earlier example, revenues are $10 million, costs of goods sold are $8 million, which results in a gross margin of $2 million. SGA costs are $1 million, so the EBITDA (cash flow) is roughly $1 million. The scenario assumes a value multiple of 5X, so the value of the business in year one is $5 million.

Again, like the first scenario, each year the business is assumed to grow at 30 percent, so revenues in year two are $13 million, $16.9 million in year three and $28.56 million in year five. As mentioned, costs and SGA expenses are assumed to decrease by 1 percent of revenues per year, so by year five the EBITDA is $5.14 million. Assuming a 5X EBITDA value, the company is now valued at $25.70 million. In this scenario, the equity appreciation is 39 percent.

The third scenario assumes, like the second scenario, strong revenue growth and increased margins. In addition, the third scenario assumes the company is purchased at a low value and sold at a high value and that debt is also used to finance the purchase. In

Scenario 1 — Strong Revenue Growth, Constant Margins

	Year 1	Year 2	Year 3	Year 4	Year 5	Assumptions
Revenues	$10.00	$13.00	$16.90	$21.97	$28.56	30% yearly growth
COGS	$8.00	$10.40	$13.52	$17.58	$22.85	Constant
Gross Profit	$2.00	$2.60	$3.38	$4.39	$5.71	
SGA	$1.00	$1.30	$1.69	$2.20	$2.86	Constant
EBITDA	$1.00	$1.30	$1.69	$2.20	$2.86	
Multiple	5	5	5	5	5	
Value	$5.00	$6.50	$8.45	$10.99	$14.28	23% ← Return

Scenario 2 — 30 Percent Revenue Growth, Increased Margins

	Year 1	Year 2	Year 3	Year 4	Year 5	Assumptions
Revenues	$10.00	$13.00	$16.90	$21.97	$28.56	30% yearly growth
COGS	$8.00	$10.27	$13.18	$16.92	$21.71	1% of sales per year
Gross Profit	$2.00	$2.73	$3.72	$5.05	$6.85	
SGA	$1.00	$1.17	$1.35	$1.54	$1.71	1% of sales decrease per year
EBITDA	$1.00	$1.56	$2.37	$3.52	$5.14	
Multiple	5	5	5	5	5	
Value	$5.00	$7.80	$11.83	$17.58	$25.70	39%

Scenario 3 — Strong Revenue Growth, Increased Margins, Buy Low, Sell High, Reduce Leverage

	Year 1	Year 2	Year 3	Year 4	Year 5	Assumptions
Revenues	$10.00	$13.00	$16.90	$21.97	$28.56	30% yearly growth
COGS	$8.00	$10.27	$13.18	$16.92	$21.71	Constant
Gross Profit	$2.00	$2.73	$3.72	$5.05	$6.85	
SGA	$1.00	$1.17	$1.35	$1.54	$1.71	Constant
EBITDA	$1.00	$1.56	$2.37	$3.52	$5.14	
Multiple	4	5	5	5	7	
Value	$4.00	$7.80	$11.83	$17.58	$35.99	55% appreciation in value
Equity	$1.00	$5.40	$10.03	$16.38	$35.39	104% ← return
Value	$3.00	$2.40	$1.80	$1.20	$0.60	

Figure 6: Three sample scenarios for increasing the value of a business.

this scenario, the returns increase substantially.

So, in year one, just like in the first two examples, revenues are $10 million and costs of goods sold are $8 million, which results in a gross margin of $2 million. SGA costs are $1 million, so the EBITDA (cash flow) is roughly $1 million. In this example, the scenario assumes a value multiple of 4X, so the value of the business in year one is $4 million.

Of this $4 million, it is assumed the business is purchased with only $1 million in equity and $3 million in debt. (It is rare in today's environment to purchase a business with so little equity. Typically, deals require 40 percent plus equity in the transaction.)

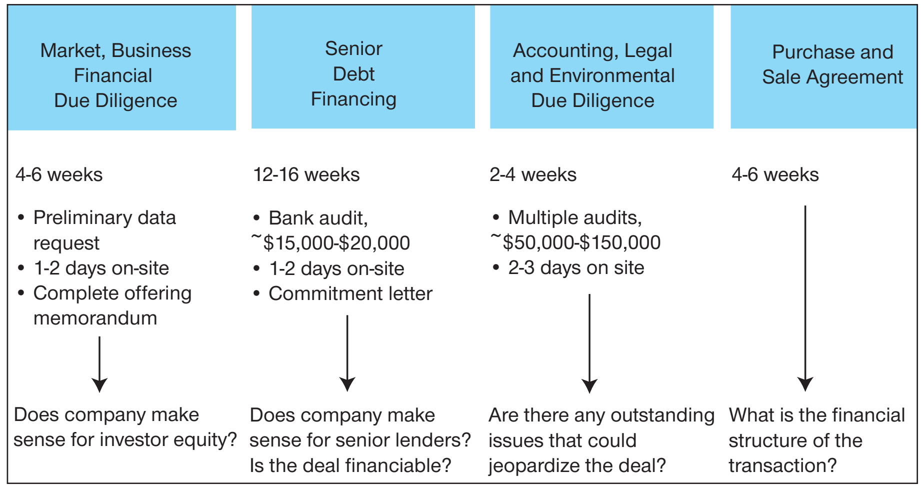

Figure 7: PEG due diligence process map.

Again, like both earlier scenarios, each year, the business is assumed to grow at 30 percent, so revenues in year two are $13 million, $16.9 million in year three and $28.56 million in year five. As mentioned, costs and SGA expenses are assumed to decrease by 1 percent of revenues per year, so by year five the EBITDA is $5.14 million.

In this third scenario, the business is assumed to be sold at a 7X multiple, so the total sales value is $35.99 million. The debt is assumed to be amortized over five years, so $600,000 is paid down per year. In year five (depending at what point in year five the business is sold), the debt level could be as high as $600,000. So, the debt is subtracted from the total sale price and the remaining $35.39 million is equity. In this scenario, the equity has grown from $1 million to $35.39 million over five years, which is a 104 percent return.

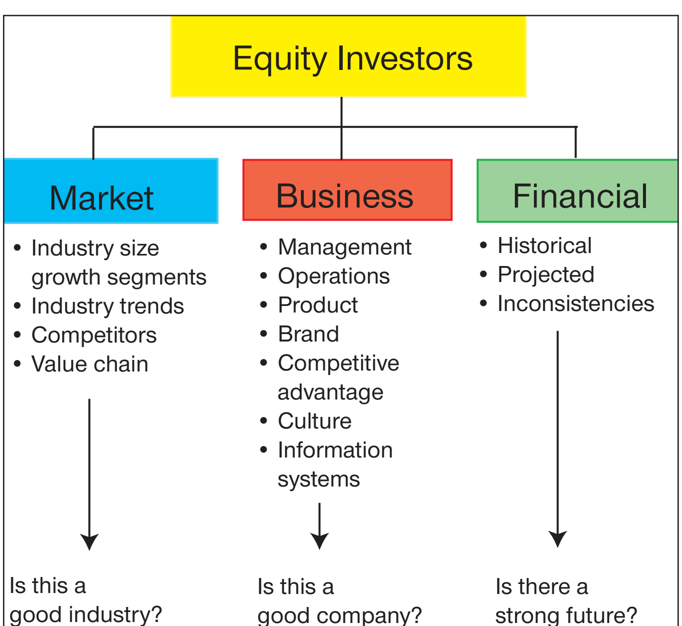

Figure 8: Market, business and financial due diligence.

This scenario has a host of optimistic assumptions. It is very rare to have such high returns on an investment, but the scenario is intended to highlight some of the methods PEGs use to create a return on their investments.

Due Diligence Process

As Figure 7 illustrates, the PEG due diligence process typically involves several steps. Each of these aspects are critical to the deal proceeding, and negative conclusions will often end a PEG negotiation. In terms of timeframe, the process generally takes between six and eight months to complete.

The threshold due diligence (Figure 8) analyzes the industry, the business and the financial aspects of the deal. The completion of this first step will determine whether the deal makes sense and will conclude in an offering memorandum.

The PEG due diligence process culminates in a purchase and sales agreement that details the financial and legal structure of the transaction. Several professionals are involved in the process including attorneys and accountants. Typically, the process costs about $200,000.

PEGs' Interest in Aftermarket Industry

"The aftermarket industry has a lot of pros going for it," explained a PEG associate. "It is growing rapidly, and it will continue to grow rapidly. Also, the profit margins on the laser side specifically are quite favorable. When you combine these two attributes, guys like me are going to take notice of the industry."

Indeed, several PEGs have entered the aftermarket during the past few years, including Champlain Capital Partners LP, which raised a reported $4.7 million for Clarity Imaging in 2003, and Blackford Capital LLC, which purchased Quality Imaging Products from founder

Jim Steiner in 2001. Also, at the time of this writing, several deals are pending for PEGs to enter the industry.

Martin Stein, president of QIP and former managing director of Blackford Capital, said, "We found the aftermarket industry attractive in 2000 and 2001 because it was large, growing, profitable, highly fragmented and operational excellence was a competitive differentiator. We believed that in the industry, the correct business model combined with successful execution would yield strong returns."

PEG Concerns in the Aftermarket Industry

Interestingly, there have been at least two PEGs that have reportedly backed out of an aftermarket investment close to the transaction closing date. Sources say that investors got cold feet and couldn't get comfortable with the deal.

One area of the aftermarket that provokes investor discomfort is the intellectual property (IP) issue. According to an unnamed PEG associate, the risk of being sued by an OEM weighs heavily on their minds. "As an investor managing money, you do not want to put money somewhere when you know there's a risk out there that you can't control," he said. "We could make an investment today, and then get sued by an OEM tomorrow, forcing us to pay over a million dollars to defend the company in court."

According to antitrust/intellectual property litigation attorney Ron Katz of Manatt, Phelps and Phillips, this is a reasonable fear. "The nuisance of IP lawsuits is high, at least mid-six figures," he said. However, Katz suggests that PEGs should ultimately be able to get comfortable with this issue. "With appropriate due diligence, the risks are no larger in the remanufacturing industry than elsewhere," Katz said.

QIP's Stein also stated, "In addition to the IP concerns, some of the other drawbacks to the aftermarket industry are: a) limited accounting infrastructure and financial controls, b) inordinately complex cost structures and inventory valuations on cores, c) highly variable raw material inputs, and d) inconsistent price structures across the industry. Each of these factors, individually, is not a deal breaker, but, collectively, they present significant odds to closing a deal. For example, an aftermarket entrepreneur can alter the bill of materials and revalue inventory levels based on aggressive and optimistic replacement assumptions for components. These changes can have a large impact on margins and, ultimately, affect the value of the company by substantial amounts. A PEG unfamiliar with the industry can be blindsided when they learn about these tactics, and it can shut down a deal."

Clarity Imaging

After a 2003 investment by PEG Champlain Capital Partners, Clarity Imaging Technologies was on track for growth. The company stood out as one of the largest regional players and continues to sell through both direct and distribution channels. Clarity made a name for itself with its PageMax program and was one of the early entrants into the cost-per-page model.

Warren Feldberg is CEO of Champlain Capital and was formerly the CEO and president of U.S. Office Products, which was sold to Corporate Express in 2001. In its first fund, Champlain raised a reported \$4.7 million for Clarity, and Feldberg became chairman of both companies. Not coincidentally, Clarity soon became a vendor for Corporate Express (the largest distributor of remanufactured toner cartridges in the world) as well as other large end-user accounts such as Citigroup (the largest company in the world according to *Fortune*'s Global 100). Most likely, Clarity's business doubled in size shortly after Champlain's investment. This is the benefit of a PEG strategy. Clarity was on track until it was sued as a co-defendant in a 2004 lawsuit initiated by Lexmark International. According to the complaint filed by Lexmark on Oct. 8, 2004, Clarity is being sued on several counts, including violating Lexmark's Prebate program, patent infringement and violations of the Digital Millennium Copyright Act (DMCA).

Clarity now must defend itself against these claims, which should play out over the next year or two.

PEG Pros and Cons

"Private equity groups have a number of advantages," explained Grant Thornton's Schenkenberg. "First, they provide access to professional management. Second, they are good at long-term strategic thinking. Third, they have ready access to capital. Most importantly, they have high expectations for organizations, which can sometimes be a negative for a management team that does not perform." Most PEGs expect to see a past history and future plans for aggressive growth.

In terms of downsides, a PEG transaction can become expensive. Attorney, accounting and consultant professional fees often total six figures, up to \$200,000.

Also, you must be prepared for organizational change. PEGs will often insert new directors and management into the company. In some cases, existing staff may be replaced. "There will be members of your existing team that can't keep up," cautioned one PEG. "They might be the person who's been with you since the beginning. You will have to replace them, and if you don't, we will replace you."

Finally, be aware that most PEGs seek to deploy and recoup their capital within a three- to seven-year window, meaning that a secondary exit strategy must be planned. Options include going public or selling to another buyer for a profit. For example, an equity firm may buy a remanufacturer for three or four times earnings, improve its market share and performance, and resell the company for five or six times earnings.

"It's important to know who you're getting in bed with," stated a PEG associate. "Just as the PEG is going to do an extensive due diligence process on the entrepreneur and his business, that entrepreneur should be just as diligent in checking out the firm he's considering partnering with. Unfortunately, there's a lot of sharp-toothed guys in the private equity world who give people like me a bad name. There's also a lot of good guys who are focused on growing and building businesses. You have to learn the difference."

Strategic Buyers, Mergers and Acquisitions

Many relatively large-scale remanufacturers have chosen the option to sell to a strategic buyer. A strategic buyer is a company that has a presence in the industry, whereby the selling company adds value to the buyer's existing business.

The added value can take many forms, including increased market share, product line expansion, geographic expansion or vertical integration. The additional synergy or added value is expected to allow the buyer to pay more for the business because they can appreciate more of the value.

"People buy businesses for strategic reasons. There is a market out there," said Robert Goldstein who founded, sold and later repurchased Future Graphics from Nu-Kote Holding.

Examples of large-scale strategic buyer transactions include Golden Imaging/Turbon Group (2000), Graphic Technologies/Summit Laser (2004), and Nu-Kote acquisitions ICMI (1992), Future Graphics (1993) and Pelikan (1995).

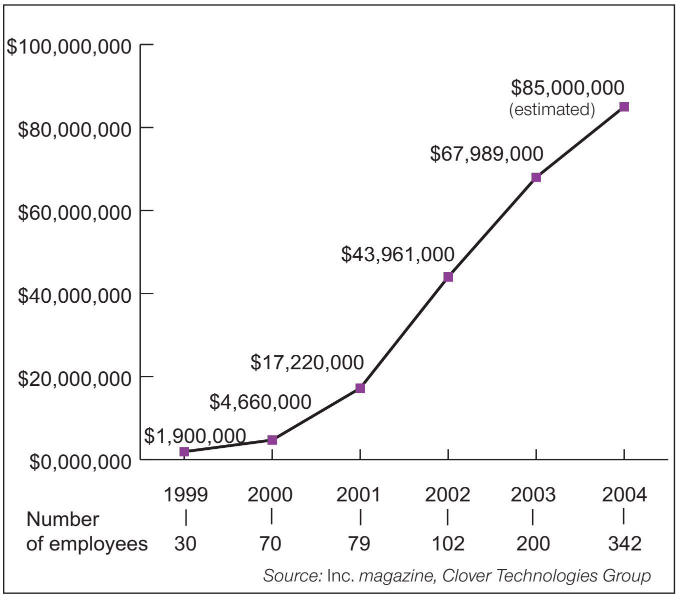

Figure 9: Clover Technologies Group total revenue and employees by year, 1999-2004.

Strategic Acquirers

Strategic acquirers usually have several key characteristics, including: 1) being large enough to acquire a business, 2) having a solid infrastructure that can support the business integration and 3) the need to acquire something that cannot be developed in-house.

For example, when ribbon manufacturer Nu-Kote purchased ICMI and Future Graphics in the early 1990s, it did so to meet the product needs of its distribution customer Office Depot. At the time, Office Depot wanted to carry remanufactured/compatible toner cartridges and Nu-Kote did not have the ability or knowledge to develop toner cartridges in-house.

Aftermarket Example: Clover Technologies

Illinois-based remanufacturer Clover Technologies Group is currently in the process of negotiating two strategic acquisitions. Clover President Jim Cerkleski adds that Clover's target is to "acquire four or five companies over time."

Cerkleski, who has a background in strategic acquisitions and was formerly division president of U.S. Office Products, has no plans to slow down Clover's growth or to exit the business anytime soon. As Figure 9 shows, Clover has experienced very impressive organic growth since 1999 when Cerkleski purchased the company.

"Bigger is only better if you can manage the business and remain profitable," explained Cerkleski, who seems to have a keen sense of what it takes to be successful in today's market. "I think the only way to remain successful in this business is to reinvest to stay in line with the OEMs."

Attributes that Clover seeks in a potential acquisition candidate include geographic location, existing customer base and profitability. If the company is not profitable, Clover can quickly determine whether the business can be turned around during the due diligence period.

Cerkleski envisions 2005 being Clover's best year ever. Given Clover's strong track record of growth and ambitious nature, Clover is on track to become one of the industry's big players.

Strategic Seller Profile: Golden Imaging

Golden Imaging started as Golden Ribbon Corp. in 1981. "We were guys right out of college," explained co-founder Bill Patterson. "We did quite well in the ribbon manufacturing business. We grew and grew." Golden Ribbon Corp. was named one of *Inc.* magazine's fastest growing privately held companies in 1987.

Golden Imaging financed its growth with personal and bank financing until the late 1980s. "We finally outgrew our capital and had reached our limit on bank debt," Patterson said. "We opted to get some private money from an angel investor to continue our growth." Over the next several years, Golden nearly quadrupled the size of its manufacturing plant and aggressively pursued new business.

By the early 1990s, Golden entered the toner cartridge business by acquiring remanufacturer LaserTek in Las Vegas. In 1997, Golden acquired a second laser cartridge business from PM Company and became one of the bigger remanufacturers in the aftermarket at that time. Total annual revenue was reportedly about $10 million.

Although Golden had a good quality product and an impressive operation, it was never able to fill the additional capacity.

"It was unbelievable how many times we came in second place to Nu-Kote, Turbon or Dataproducts on large (superstore/contract stationer/co-manufacturing) deals," recalled Patterson. "We just didn't quite have the capability to get the big customers on those deals. They liked us. They liked the plant. They just ultimately picked a bigger player."

In the end, Golden wound up with excess capacity and a high overhead structure. "We ended up with a huge overhead," confessed Patterson. "In retrospect, we should have stayed in the smaller space and just put on another shift."

The partners decided that it was the right time to sell the company. "We'd talked with Turbon on and off for a couple of years about selling," Patterson said. "We talked about the synergies of coming together, and there was mutual interest."

The Turbon Group, owner of such companies as Curtis Young and Jetfill, was a logical candidate. There was a long-term relationship between the companies, and Turbon was actively acquiring at the time. Once the decision was made, it took only about four to five months to complete the transaction.

In the end, Golden's customer base was secured and its operations were discontinued and merged into Turbon over a short period of time in a professional manner. According to Patterson, the company downsized from around 90 employees in 1999 to about 12 employees in 2001.

"Letting go of the bricks and mortar isn't as hard as the people," Patterson said. "Some of the employees had been with us since the early 1990s, and we'd grown fond of each other. We had a good crew."

On the Decision to Sell

From time to time, Patterson and his three business partners sat down and discussed exit strategies. "By 1999, we'd been in business 18 years. A couple of the partners were ready to go or needed to go do something different.

"It was time, and the deal made sense," said Patterson, who did express some regret for selling, but added that not all the partners wanted to continue running the business. As part of the deal, Patterson signed a three-year management contract with Turbon to oversee the transition.

By contrast, in 1993 Robert Goldstein sold Future Graphics on a Friday and never stepped foot back in his office again.

According to Goldstein, he originally sold the business to Nu-Kote for personal objectives. "I had worked five years, 24/7 building Future Graphics into the largest cartridge remanufacturer in the industry. We went from three employees to more than 250 employees in a very short period of time."

"Selling the business to Nu-Kote offered me an opportunity to recharge my batteries and go spend time with my family."

Option to Merge

Graphic Technologies founder Ira Seaver is doing things his own way. Seaver opted not to exit the company that he started in 1985, choosing instead to merge the business and simultaneously take a step back from his presidential responsibilities.

"I don't want to work a 60-hour week at this point in my life," explained Seaver, who is in his late 50s and has three children ranging in age from 12 to 16. "My children are not old enough to take over the business, and I was not looking for an abrupt exit. Merging with Summit Laser was the perfect fit," said Seaver, who seems genuinely at peace with his decision.

In his new role, Seaver will focus his efforts into areas of the company that he enjoys most. "I prefer to spend my time working in the product development side of the business," he explained, adding that he finds R&D "captivating." Seaver, who has a degree in journalism, is known as a highly proficient technical expert who enjoys overcoming difficult challenges.

Steven Hecht has taken over the reigns as president of the new organization, renamed Summit Technologies (a merging of the two company names), which is headquartered in New York. Seaver remains a minority shareholder and employee of the organization.

According to Seaver, the most difficult part of the transaction was negotiating the contract, which went through more than a dozen versions before being finalized. "Bringing together these two large companies was very complex," he said.

Pros and Cons

Often, the deal terms are controlled by the seller in a strategic acquisition or merger. This is a main benefit, but also puts the responsibility on the seller to articulate exactly what they want and what they are willing to give up. Deals usually take three to six months to complete.

Selling all or part of your shares to a strategic acquirer for cash is probably the best way to gain liquidity and maximize value. The owner may completely exit, or not, after a transition period typically between 12-24 months.

Because many aftermarket business owners are young — many are less than 40 years old when they sell — they use the experience as a springboard to pursue other opportunities. Bill Patterson completed his management contract and started a new business called B2B Direct. Robert Goldstein repurchased Future Graphics in an asset sale four years after the original sale to Nu-Kote and rebuilt the company to where it is today.

Additional pros for the business are growth opportunities and access to resources not otherwise available. Sometimes, being a part of a larger company can offer strategic advantages.

One major con is losing control of the organization. Often, strategic acquirers have a different vision for the company and pursue it. One industry observer says it comes down to a simple question: "Do you want to be rich, or do you want to be the king?" Most often, you are no longer king when you sell the majority of your shares to a strategic acquirer.

ESOP Facts (U.S.)	
Number of…	
Total ESOP companies	12,000
ESOP companies that are majority-owned by the ESOP	3,000
ESOP companies that are 100 percent owned by the ESOP	1,200
Employees participating in an ESOP	8 million
Percentage of ESOP companies in manufacturing sector	25 percent

Source: ESOP Association (www.esopassociation.org)

Figure 10: ESOP fact table.

"If you stay on, be prepared for lots of change," Patterson cautioned.

"You've got to get beyond your personal control issues or you are destined for failure," Seaver added.

Another downside is that company cultures may clash between organizations. Seaver offers his advice: "It simply comes down to how things are done. Sometimes you have to let go of the way you always did it before."

Finally, a disadvantage of strategic acquirers is that the fate of the existing employees is unknown. Although key management will often sign a management contract, the employees may be released depending on the buyer's objectives.

Words of Wisdom

"My biggest piece of advice for sellers is to hire a professional adviser to assist with the transaction," Schenkenberg said. "The adviser does not need to be a high-priced Wall Street investment banker, but should be someone who has experience with transactions. Advisers play an important role for a seller, who might not have sold a company before."

Employee Stock Ownership Plan (ESOP)

An ESOP is an employee stock ownership plan that makes the employees of a company the stockowners in that company over time. The ideal candidate for an ESOP is a profitable midsize company that pays corporate taxes and expects to continue doing so. The business must be a C or S corporation (partnerships or sole proprietorships cannot have ESOPs).

As Figure 10 shows, there are approximately 12,000 total ESOP companies in the United States, and 25 percent of them are in the manufacturing sector. Generally speaking, the number of ESOPs in the United States has remained flat since 1990.

How Does it Work?

A company sets up an ESOP by first creating a trust to which the company makes an annual contribution. Figure 11 shows a typical transaction for a leveraged ESOP where the trust obtains bank financing to pay for the company stock that the owner sells into it. Then, the company (not its employees) pays off the bank loan, making both the principal and interest tax deductible.

Stock is typically allocated to each employee based on compensation, years of service or some combination thereof. The

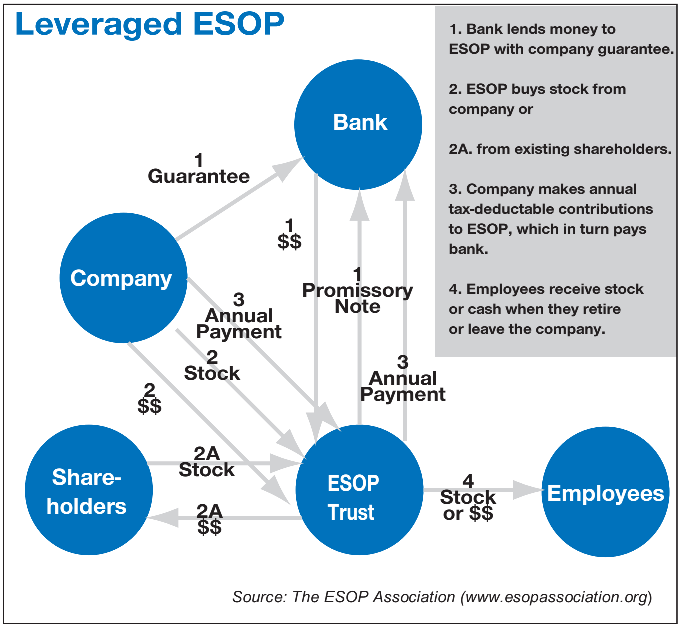

Figure 11: Typical transaction for a leveraged ESOP.

stock must vest for a period of time before employees are eligible to receive the asset. Employees receive the vested portion of their asset in the event of termination, disability, death or retirement.

"An ESOP is not a workplace democracy," said Michael Keeling, president of The ESOP Association, who added that an ESOP does not give employees any implied or express decision-making authority. However, Keeling warns that there is a psychological effect that occurs post-ESOP. "If you cannot get comfortable psychologically with selling to the employees, you shouldn't proceed because it does have an impact on the company both short and long term."

Common ESOP Valuation Approaches and Methods			
	Asset-Based Approach	**Market Approach**	**Income Approach**
Definition	A valuation process for the business whose primary source of income is its assets.	Valuation of a business by comparing a similar business that has been sold.	A valuation based on the income generated by the business.
Methods	Adjusted Book Value Method	Evaluating publicly traded companies	Capitalization of Earnings Method
	Liquidation Value Method	Sales of similar companies	Discounted Cash Flow Method

Figure 12: Common ESOP valuation approaches.

Aftermarket Example

Aftermarket leader Bob Daggs chose this option when he sold a majority of his GRC stock to the company's more than 450 employees through an ESOP in 1995. Although Daggs prefers to keep the details of the transaction quiet, he did disclose that he willingly stepped down as president and became chairman of the board after the sale. His sons Jim and Bill continue to work for the company today, and Daggs remains active in both the company and the aftermarket industry.

Valuation

The valuation of an ESOP must meet requirements that are set forth by the Internal Revenue Service and the U.S. Department of Labor. Under IRS Code Section 401(a)(28)(C), a company must conduct an independent appraisal of its shares each time the plan acquires stock and at the end of each plan year.

As Figure 12 shows, there are three common valuation approaches in an ESOP, including the asset-based approach, the market approach and the income approach.

Common ESOP Valuation Approaches

According to IRS Revenue Ruling 59-60, all aspects of the business must be considered in the evaluation, including the nature of the business, its economic outlook, the outlook of the industry as a whole, the financial condition of the business, the book value of the stock, the company's earnings potential, the company's dividend paying capacity, and perhaps most importantly, the market price of interests or stocks issued by companies in a similar line of business.

Pros and Cons

According to Schenkenberg, a main advantage of an ESOP is the tax advantages for shareholders. "Companies owned by ESOPs tend to have a lower effective tax rate than companies with other ownership structures," he said.

Two other advantages of an ESOP are retaining organizational control and the terms of sale. In essence, the owner is negotiating with himself. Post transaction, the company may choose to continue to run the organization in the same manner as before the ESOP.

In theory, an ESOP should align employee goals and serve to motivate and empower employees. However, this is not always the case. Employees receive a yearly statement that tells them the value of the stock. Inevitably, the stock value will stagnate or go down and employees may blame management for conditions outside of their control.

Another disadvantage is transaction complexity and ongoing maintenance cost. Each year, an ESOP company must complete an independent valuation of the shares. ESOP Association's Keeler explains that "ESOPs are an animal of federal statute. They have tons of tax law and ERISA law, which combines both tax and labor laws." The result is ongoing professional fees.

Finally, a company with an ESOP becomes more difficult to sell. According to a PEG member, "ESOPs limit the strategic opportunities available to a company from a mergers and acquisitions standpoint."

Conclusion

The growth and success of the aftermarket has opened up new opportunities for exiting owners. Private equity investments and strategic mergers and acquisitions seem to be on the rise. As the industry continues to consolidate, large-scale remanufacturers are positioning themselves for the future. It appears the big are getting bigger. This may serve as a cue for smaller companies to consider their top level and exit strategies.

In the next installment, we will consider options for smaller sellers, including strategic mergers and individual buyers. R

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by **Joy James** | The Joy James Group

Finding 'Black Gold' Part 3:

Exit Strategies for Smaller Remanufacturers

Editors Note: This is the final part of a three-part series.

Business owners seeking liquidity have several options available depending on their company's size, profitability and upside potential. As previously explored in the first two articles of this series, large aftermarket companies may consider 1) going public through an IPO or reverse merger (e.g., Teckn-O-Laser), 2) selling all or part of the company to a private equity firm or PEG (e.g., QIP), 3) creating an Employee Stock Option Plan or ESOP (e.g., GRC) and 4) selling to a strategic buyer (e.g., Golden Imaging).

Generally speaking, it is difficult for smaller companies to attract private equity funding because of the high transaction costs associated with the deal. For this reason, PEGs typically prefer to handle companies with more than $20 million in annual revenue or about $2 million in earnings before interest, taxes, depreciation and amortization (EBITDA). (For more information, refer to Part One of this series in the January 2005 issue of *Recharger*.)

Selling to a strategic or synergistic buyer for cash is probably the best way for a business owner to gain liquidity and maximize value. However, this option is typically reserved for businesses that fulfill a specific need that the acquiring company cannot develop themselves, such as serving a new market, increasing market share or gaining a new technology. For example, in 1993 ribbon manufacturer Nu-Kote Holding purchased Future Graphics and ICMI primarily to fulfill its distribution channel's requirement to supply remanufactured toner cartridges.

If a strategic acquirer is not knocking at your door, there are several other alternatives to consider. In this final installment of the series, we will explore the option to sell your business to an individual buyer or industry consolidator. In addition, we will cover the pros and cons listed in Figure 1. Although selling to friends and family does remain an option for some sellers, it usually provides for very limited liquidity and is therefore not included in this article.

Exit Options for Sellers by Business Size

	Individual Buyer
Typical Size	Annual sales less than $10 million
Pros	
	Flexible deal structure creates strong personal fit.
	Some cash up front, balance over time.
	Buyer may provide skills or contacts not previously available to the company.
Cons	
	Lower value multiple than larger company transactions.
	Seller financing required.
	Can be time consuming with many setbacks. Inexperienced buyers can waste seller's time.
	Fate of existing employees and corporate culture is uncertain.
Why choose this option?	Owners seek this strategy to add/change company management. These companies are generally too small for other options.
Aftermarket example	Paul Hawker/Laser Saver (1992) Glenn Hetzel/Prime Laser (2003)

Figure 1: Exit options for sellers by business size.

Anything Goes

In general, individual buyers purchase smaller companies that require less cash down and offer more flexibility in payment terms. In almost all cases, some amount of seller financing is required as part of the deal.

Unlike PEG transactions or strategic acquisitions, the individual buyer can sometimes be less sophisticated — perhaps even irrational — and may lack professional guidance. As a result, these transactions can take a long time to complete and a high percentage of deals fall through. In fact, 25 percent of all businesses listed never actually sell. These odds can be improved with proper planning, good books and a competent adviser.

Individual Buyers

Most individual buyers seek to purchase a financially healthy business that they can own and operate post-sale. Typically, these buyers have some expertise and/or practical experience in a related industry, giving them the ability to manage and grow the business.

This type of transaction is usually coordinated through a business broker, who discreetly "shops" your business to qualified buyers both in and outside of the industry. In addition, the broker facilitates the transaction in exchange for a fee, which is typically between 10 percent and 13 percent of the selling price.

"Buyers buy value — what's in it for them," explained Deborah Alagna, a business broker in Newport Beach, Calif. "The more turnkey the business is, the better." Alagna added that there is a "right" buyer for every business based on qualifications and the business' needs. "If the company lacks marketing acumen, for example, someone with special skills in that area would be a good candidate as a buyer."

Valuation

Valuing a business, particularly a small business, is more of an art than a science. In the end, it is the market that determines what someone is willing to pay for your business. Generally speaking, individual buyers will not pay as much as PEGs or strategic acquirers.

The most common business valuation method is based on the company's earnings, or EBITDA. EBITDA is used to analyze the profitability between companies because it eliminates the effects of financing and other accounting decisions. It is not, however, always a good indicator of cash flow.

A business' value is usually determined by calculating a multiple of EBITDA. This multiple is based on a number of factors unique to the business such as location, years in business, customer composition, number of employees, level of competition and the business' overall dependency on the owner.

Currently, individual buyers are reportedly buying businesses from a 1.5X to 3X multiple of EBITDA. Two examples of valuation scenarios are listed in Figure 2. In this example, a $1-million company is valued at $150,000 using a 1.5X multiple, and a $1.5 million company is worth $900,000 using a 3X multiple.

Buying a Job?

According to Alagna of VR Brokers, there's been a recent surge of former corporate executives seeking to be their own bosses. "(More than) 90 percent of the deals I do are individual buyers looking to purchase a job and/or lifestyle," she said.

Aftermarket Profile: Paul Hawker

While working for Johnson & Johnson in 1991, Paul Hawker sought to purchase a company to become his own boss and avoid relocating from sunny Southern California to a colder climate. In addition, the travel associated with his marketing and sales position at J&J had taken a toll on Hawker, who eventually purchased San Diego-based Laser Saver in 1992. Laser Saver produces, sells and delivers remanufactured printer cartridges, and provides on-site service and equipment direct to the end user.

Calculating EBITDA — 1.5X		
Total Sales	$	1,000,000
Cost of Goods Sold	$	500,000
Gross Profit	$	500,000
Less:		
Sales, General and Administrative Expenses	$	400,000
EBITDA	**$**	**100,000**
Less:		
Interest, Taxes, Depreciation, and Amortization	$	60,000
Net Profit	$	40,000
1.5X EBITDA — Value	**$**	**150,000**

Calculating EBITDA — 6X		
Total Sales	$	1,500,000
Cost of Goods Sold	$	700,000
Gross Profit	$	800,000
Less:		
Sales, General and Administrative Expenses	$	500,000
EBITDA	**$**	**300,000**
Less:		
Interest, Taxes, Depreciation, and Amortization	$	110,000
Net Profit	$	190,000
3X EBITDA — Value	**$**	**900,000**

Figure 2: Two valuation scenarios.

Hawker purchased the unprofitable business with a plan to turn the company around within the first year. At that time, Laser Saver's annual revenue totaled $627,000.

"At J&J we knew that we could buy an unprofitable business and then use our marketing and sales abilities to make the business profitable. I followed the same model," said Hawker, who added that "coming out of the medical industry I was shocked at the high failure rates of (toner) cartridges. I knew that I could add some value to the business by establishing some standardized procedures and quality-control initiatives."

Hawker gave the former owner some cash down (based on what he could afford) and set up seller financing to pay off the balance of the loan over a four- to five-year period. According to Hawker, "If certain results were met, I would accelerate the payment terms and pay more for the business."

Hawker executed his plan and made the company profitable within the first year. "Necessity is a mother," explained Hawker. "We didn't have a choice but to make it profitable." As Figure 3 shows, Laser Saver's annual revenue grew to more than $3.3 million in 2004.

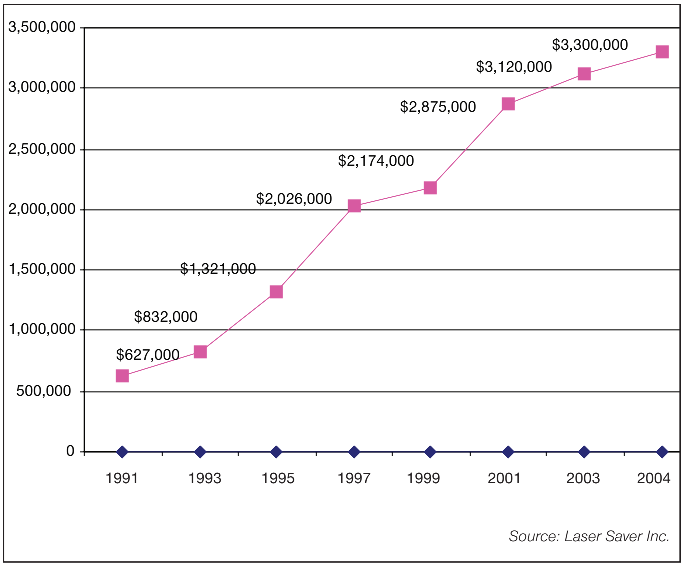

Figure 3: Laser Saver total revenue over time.

Calling All Competitors — Industry Consolidator

Since paying off the original business loan, Hawker has acquired four other local competitors. Most of these transactions resulted from long-term relationships with other business owners, many of whom Hawker, who is currently president of the West Coast chapter of the ITC, met at local association meetings.

"I remember shooting pool at an ITC chapter meeting where I met up with a local competitor," recalled Hawker. "He was a good competitor who made a high-quality product. We talked. I told him that I'd be interested in buying his business if he ever wanted to retire. Years later he called and we did the deal."

As with most industry consolidator transactions, Hawker created value by consolidating manufacturing facilities and operational overhead. Typically, these transactions were asset sales that did not pay for any goodwill or consulting agreements to the seller. In most cases, Hawker did not acquire the business' existing employees or any long-term debt. Very little (if any) of the inventory was purchased.

Hawker describes these deals as a win-win opportunity. "Most of the deals weren't profitable enough for someone else to buy the company on a stand-alone basis. It wouldn't support a livelihood," he explained. "It worked well for Laser Saver because all of the fixed expenses went away post-sale. I simply tied the customer base directly into my existing business."

Hawker expects to continue Laser Saver's impressive growth pattern through a combination of organic growth and future acquisitions. "We currently have capacity for a $5-million operation," Hawker said. "We will get there."

Profit and Loss — Existing Ownership

	Amount		%
Sales	$	600,000	100%
CGS	$	408,000	68%
Gross Profit	$	192,000	32%
SGA	$	290,000	48%
EBITDA	**$**	**(98,000)**	**-16%**

Profit and Loss — Post-Consolidation Sale

	Amount		%
Sales	$	600,000	100%
CGS	$	390,000	65%
Gross Profit	$	210,000	35%
SGA	$	27,000	5%
EBITDA	**$**	**183,000**	**31%**

Figure 4: Company XYZ's profit and loss with existing ownership and post-consolidation sale.

Example of a Small Company Consolidation Deal

In a consolidation play, the buyer attempts to gain market share and economies of scale by purchasing the assets of another business that may or may not be profitable. Most often, the seller can eliminate the majority of the fixed expenses associated with running the seller's business by folding the operation into the buyer's existing company.

The main benefit of this option is the ability to extract higher profits than what is possible under the current ownership structure — a real 1+1=3. Figure 4 on the previous page illustrates this point. The selling company — Company XYZ — is a local remanufacturer and service provider that is currently not profitable given its existing overhead structure. However, when the company is successfully folded into the buyer's existing company, a profit of $183,000 per year can be realized. Ideally, sellers could receive a 1X to 3X multiple of the post-consolidation EBITDA. (Note: Valuations vary widely. This may or may not be typical.)

Business Segment Analysis			
	Total Sales	Gross Profit Margin	Percent of Total Business
Remanufactured/Compatible Toner	210,000	50%	35%
New Cartridges	150,000	12%	25%
Printer Service and Repair	180,000	36%	30%
Equipment Sales	60,000	8%	10%

Figure 5: Company XYZ business segment analysis.

EBITDA With Discount for Low-Margin Segments		
	Amount	%
Sales	$ 390,000	100%
CGS	$ 220,000	56%
Gross Profit	$ 170,000	44%
SGA	$ 27,000	7%
EBITDA	**$ 143,000**	**37%**

Figure 6: Company XYZ discounted EBITDA.

The product mix of the business is one of the variables that will change the value of the transaction. As Figure 5 shows, 35 percent of the company's sales are comprised of low-margin products. Sellers will typically discount the value of the business and exclude the low-margin segments, as shown in Figure 6. In this case, the business' valuation is based on the lower EBITDA figure of $143,000.

Seller Example: Prime Laser

When Glenn Hetzel founded Prime Laser in 1983, he already had an exit strategy in mind. "From day one my plan was to build the company into a viable operating business that someone could step into and run. The whole point of starting the business was to eventually sell it."

Hetzel's first love has always been accounting. Prior to starting Prime Laser in his garage, Hetzel worked as the chief financial officer for a publicly traded international conglomerate. "I enjoyed the travel and working with foreign banking systems," explained Hetzel.

Although for the past 20 years Hetzel was able to maintain an independent accounting practice on the side, he was never able to develop the accounting business into an international practice as he'd first dreamed. "At times, it became very difficult to manage both Prime Laser and the accounting practice. Tax season was nuts because both the toner business and accounting practice were at a high. I remember not sleeping for days at a stretch in mid-April. It took its toll on me physically and mentally."

Prime Laser continued to grow by selling service and supplies direct to the end user. At its peak, the company employed nine people and did more than $600,000 in annual sales.

Hetzel noticed things starting to change in late 2002 and early 2003 when HP released the 4200/4300 line. Revenues and profits were down. Sales per customer were also declining.

Hetzel recalled, "The OEM technology became more difficult and required more R&D time to decode. As a result, my customers were forced to buy (lower-margin) OEM product until the technology obstacles were overcome. This effectively reduced the opportunity to sell (higher-margin) remanufactured products to my customer base." Hetzel also observed that the OEMs were adding more toner to increase their page yields. As a result, the annual number of cartridges sold per end user was declining.

During this time Hetzel noticed direct costs trending upward. "Replacing components was no longer an option — you had to do it. This naturally increased costs and declined margins."

Along the way, Hetzel was forced to tap into several lines of credit to expand the facility and to carry more OEM inventory. In addition, Prime Laser invested in some marketing campaigns that failed to deliver a return on investment.

Hetzel made the decision to sell Prime Laser in 2003 and completed the deal 13 months later. Prime Laser was purchased by Irvine, Calif.-based Triumph Business

Single-party transactions offer significant flexibility in terms of the deal structure. Effective communication and full disclosure create the best possible "fit" for both sides.

Systems. "I felt that the opportunity with Triumph gave me the greatest potential for the company to succeed," Hetzel said.

Hetzel and Triumph's owner, Pam Feld, had worked together for many years as executive board members of the Association of California Cartridge Remanufacturers (ACCR). "The comfort level between Pam and I helped. The fact that we know each other and have worked together in the past made the deal a lot easier to do," Hetzel said.

Interestingly, Hetzel was not interested in selling the business to an individual buyer. "I question whether someone without industry experience could effectively protect the asset," he said. "This is an important aspect because you don't get all of your cash up front when you sell a business."

Since selling Prime Laser six months ago, Hetzel has focused on his accounting practice and is slowly building an international clientele.

"It's a great time for me right now. My accounting business is growing, and I'm also fitting in more travel time." In fact, since selling the business Hetzel has traveled to three countries and was headed for New Zealand right after being interviewed for this article.

As for regrets, Hetzel doesn't have any about selling. "Your business is just something that you do," he said. "If you're not where you want to be, then simply take the steps necessary to do something different."

Pros and Cons

Selling to an individual buyer can be a good source of liquidity for businesses with less than $10 million in annual sales. Unlike a PEG or ESOP transaction, there is no minimum size requirement to attract an individual buyer.

Another main advantage is that these single-party transactions offer significant flexibility in terms of the deal structure. Effective communication and full disclosure create the best possible "fit" for both sides. Also, individual buyers may offer relevant skills and opportunities that will help the company grow faster and more profitably.

Some of the cons associated with an individual buyer include owner financing requirements, complete seller exit and a lower probability of closing.

Typically, the buyer will pay some cash up front and require the seller to carry a note with interest for the balance of the loan. Although the note is almost always personally guaranteed, the seller is not always the first in line to be paid. For example, it's not uncommon for a buyer to borrow the down payment from a bank that demands priority within the capital structure. In some cases, the seller financing payments are not made and the only option is to go to court, which can be expensive and time consuming.

In addition, the note payment schedule is often dependent on the business' performance level. Since most sellers exit the business completely and have no control over the post-sale operation, this aspect of the agreement can prove challenging.

Also, sellers may find the process consuming, with many setbacks. According to Chris Schenkenberg, senior manager in the federal tax practice of Grant Thornton LLP, "Caution should be exercised as sellers compare potential buyers, as sometimes individual buyers, when compared to institutional buyers including financial or strategic buyers, may have limited access to capital. This may impact the ability to close the deal. As a seller, you don't want to waste valuable time with the wrong buyer."

Finally, there can be culture-integration issues. Paul Hawker noted that he has never been successful in acquiring the employees of a business that he's purchased. "It just doesn't work," he said. As a result, the fate of your existing employees is an unknown.

Conclusions

Selling a small remanufacturing business to an individual buyer or industry consolidator requires foresight and patience. Because of the nature of the marketplace, there is no "typical" deal structure or valuation process. In the end, it is up to the two parties to carve out an agreement that both sides can live with. R

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