

# Uncertainty And Expectation: The Joys Of Life

No one likes uncertainty. Most of the time, we feel relatively confident about the future. Over time, economies grow, asset values appreciate and our standard of living improves. We might worry about the failure of one of our customers or the success of a new product, but the world keeps turning.

However, today the world is awash in uncertainty. Several major financial institutions have failed while others fight for their lives. Almost every economy and industry is in recession. Real estate and stock prices were down by a third at the end of October. And in the U.S., a new administration is set to take office in January.

The breadth and depth of uncertainty raises myriad questions and provides few clear answers. How will the new administration address the unprecedented economic and financial crisis we face? Will it raise taxes, and if so, by how much? When will the credit markets thaw? Amid the chaos, you might be questioning all these things, as well as your strategic business alternatives and capital needs.

**Are buyers making acquisitions given the current environment?**

According to the Bureau of Economic Analysis, non-financial business cash balances as a percentage of total liabilities were about 10 percent at the end of the second quarter of 2008—an 18-year high. This historic amount of cash provides buyers much of the capital they need to make acquisitions. That being said, middle market deal activity slowed slightly in the third quarter of 2008, according to GF Data Resources. Although the full impact of the economic and credit market turmoil has yet to be seen, high performers in attractive industries will likely stand out more now than they did during the 2006-2007 boom. The result? Buyers are spending more time looking for acquisitions and performing due diligence. Leverage multiples are lower. Financing terms are tighter, but deals are getting done.

**Is it too late to sell my company before capital gains tax rates increase?**

U.S. President-elect Obama has promised to tax capital gains at 20 percent, an increase compared with the current rate of 15 percent. However, most

of his tax ideas were floated before the credit markets froze and the economy faltered. Pundits say this could force the president-elect to shelve his tax plans while he focuses on the economy. According to Robertson Williams, principal research associate with the nonpartisan Tax Policy Center, “Most of his tax proposals will be deferred because they don’t have a stimulus effect, and some of them will make the economy worse.” Regardless, the 15-percent rate on capital gains will revert to 20 percent after December 31, 2010, if no action is taken. Tax rates are only one of many factors to consider. If you are ready to explore a sale, 2009 and 2010 will likely be good years to sell from a tax perspective.

**My balance sheet is strong, but sales are flat. Is this a good time to consider growth through acquisition?**

Data compiled by the Administrative Office of the U.S. Courts reveal bankruptcy filings rose 28.9 percent to 967,831 during the 12 months ended June 30, 2008. It seems likely this trend will continue into 2009 and perhaps beyond. As sales and profits plummet and the ratio of assets to liabilities constricts, it becomes increasingly difficult to fund a business as a going concern.

Alternatives become limited. At some point, a distressed sale, reorganization or liquidation are the only options. Although they may not necessarily be in or headed for bankruptcy, some of your competitors are weak and present acquisition opportunities. Even if your markets are shrinking, the right acquisition can help you grow by grabbing more market share. If you have access to capital, one or more carefully structured acquisitions may be one of the best ways to restart growth.

**If most of my sales are to the auto industry, how do I grow or survive?**

CSM Worldwide predicts North American auto production will contract more than 11 percent to 11.3 million units in 2009 from 12.8 million units in 2008. By 2010, production is expected to bounce back more than 8 percent to 12.3 million units, reaching 16.0 million units in 2014. With auto production stuck in reverse for the next few years, acquiring one or more of your competitors can help. However, you need to

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diversify. So, an acquisition outside the automotive industry would be best. The experience gained and skills developed while serving auto customers should be transferable to other, attractive industries. It is hard to imagine a more demanding customer base than the auto OEMs or their suppliers. If you lack access to the capital required to make an acquisition, but your business model is sound, you might need to find a financial or strategic partner to help.

**My bank has asked some of my business friends to find another bank even though they have never missed**

**a payment. What can I do to avoid this situation?**

To banks, loan agreement covenants are more important than payments. That means you need to understand all financial and non-financial covenants, how to satisfy them and when to communicate with your bank. Consider a covenant checklist and forecasting model to monitor compliance. Make them part of your annual budget process and review them at least quarterly. And communicate potential problems with your lender(s) as they arise. Don't wait.

Banks are expecting record levels of covenant violations during the next few quarters, so it is a good time to reread your covenants and start being proactive. If your bank is one of the many looking to raise capital, one of its best sources is its customers who do not comply with their loan agreements.

Given the level of uncertainty, many business owners and managers are reconsidering their strategic alternatives and capital needs. The mergers and acquisitions window remains (cracked) open, especially for buyers with cash and sellers with exceptional businesses who want to sell at the 15-percent capital gains rate. Banks are lending, but only to outstanding companies that know and satisfy their covenants. ■

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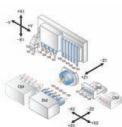
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