

August 3, 2005

This is the August 2005 monthly Wealth Management newsletter from Hoffman, White & Kaelber Financial Services, LLC. If you do not wish to be included in our circulation, please reply indicating your desire to be removed and we will be happy to oblige. Alternatively, any of your friends or colleagues may receive this on a regular monthly basis by sending their name and email address to info@hwkfs.com. Feel free to forward this to any of your friends who may find it useful. Thanks for your interest and I hope you enjoy the letter.

Attention All Business Owners! How Do You Plan to Retire?

Sooner or later, everyone wants to retire. But if you own a family business, retirement isn't just a matter of deciding not to go into the office any more. If you were able to save and make sure you've got enough money to retire on, that's great! If not, the whole question of what happens to the business when you're no longer running it becomes very important.

Who's going to manage the business when you're no longer there? How will ownership be transferred? Will your business even carry on or will you sell it?

The good news about preparing for retirement when you're a business owner: You call the shots. And, the bad news: You call the shots.

The issue of succession planning isn't limited to multi-national corporations that must publicly create, communicate and implement plans to satisfy shareholders, management and other financial community stakeholders. It is also absolutely vital for closely held business owners.

Why is succession planning often ignored? The reasons are endless, but typically focus on issues of control, issues about aging, lack of non-work interests and an inability to let go.

More often than not, people start businesses for reasons of the "here and now"! Like finding your purpose, being your own boss, pursuing financial stability or changing your commute.

However, business owners who create successful enterprises will often find that they have also created substantial wealth that can fund their retirement – the value of the business as an asset. Finding the means to transition from business to retirement is critical, and planning for this transition well ahead of time – "planning with the end in mind" – is a fundamental tenet of our concept of wealth management.

As readers of my newsletters well know, wealth management is the ultimate goal of all that we do at Hoffman, White and Kaelber. Yes, we promote our services; yet, you will find that we always seek to present thought provoking topics that are relevant to our wide audience.

In this edition of our newsletter, I've asked Rod Nasbe to outline and discuss how business owners might think about planning to maximize what might become their most valuable asset. Rod helps owners rethink business strategies to better achieve their long-term goals and works with Hoffman White and Kaelber clients on resolving management issues, including crafting strategies to prepare their businesses for when they ultimately exit.

Lastly, we will finish with a review of the economic and investing climate for the month past, the current market outlook and our investment performance.

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Thinking about retirement

It would be a rare owner, indeed, who has grown a business over the course of many years and not dreamed about the day – somewhere off in the future – when they might step away from it all. Dare they even say the word – retire.

For some, the dream is a bit of a fairy tale, since not much concrete thought has gone into preparing for such an event. “Perhaps a son or daughter could take over the business? What if they aren’t even interested? Have I prepared them to run the place? Maybe someone will knock on the door with an offer to purchase the business? Wonder what its worth?”

For others, however, retirement seems more certain, since having an exit strategy has long been part of – in fact, the starting point for – the business plan. Furthermore, executing those actions required to grow the business to the point of exit has been part of day-to-day operations. And, that includes knowing who will replace the owners, and when, and how.

If you’re a business owner and have a notion of retiring some day, there are several important actions you can take – starting now – to make it all more likely to happen the way you desire. In this article, we outline three important steps in planning your business exit strategy.

Step 1. Begin with the end – your business exit – in mind.

When would you like to retire? Regardless of how long you’ve been in business, you probably have some idea of when an eventual exit would be possible, or desirable. For some, it’s when they reach a specific age – like 55, 62 or 67. This might coincide with commonly held notions about when one should retire, or when other financial plans kick in that make it possible to retire. If so, then you have an end point in mind. If not, you should pick an age, an early age, to feed into (or provoke) your planning.

What options are there for exiting from the business? As owner, depending on the industry you are in, you may have a broad range of options for exit or harvest, including sale to, or merger with, an outside buyer; management buyout; employee buyout; licensing; IPO; or closure and liquidation of assets.

What actions can you take between now and then to make the business more attractive to the eventual acquirer? Regardless of how many years there are between now and the time you’ve targeted for retirement, there are actions you can take that will help move your business in the direction of successful exit. The first is to understand how your business is valued.

Step 2. Understand business valuation.

What is the business worth today? If you don’t know what your business is worth today – what you could get for it on the open marketplace – you need to find out. Current fair market

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value should be an interesting number, whether it's high, low, or somewhere in between. Whatever the number, current value provides a baseline for your thinking and planning.

What do you want the business to be worth when you retire? If the business is worth "x" now, and you want it to be worth "10x" when you are ready to exit, your business plan should be focused on actions that will increase the value of the business between now and then.

Perhaps even more important than specific value, however, is the set of factors that influence the value of your business. Such value drivers certainly vary by industry, and may vary by market served. These might include long-term sales growth, recurring revenue as a portion of overall sales, quality of relationships with key customers, and the value of your brand. If you know and understand the value drivers for your industry, you can take actions to increase the value of your business over time.

Step 3. Develop and execute a plan that will increase the value of the business.

Craft a business plan. This is your opportunity to rethink strategy, to question whether the strategy that has gotten you to this point will continue to take you through the future to successful exit. A good plan will tell a story about the business, a story that can be used to motivate management and staff, prospective recruits to your team, customers, suppliers, lenders and investors. While there are many "standard" outlines of business plans you might follow, we'd like to suggest a set of topics that should be addressed in any plan you develop:

1. **Pain.** What pain, problems, or unmet needs in the marketplace are you addressing?
2. **Customers.** What evidence do you have that customers are willing to pay money to buy your product or service?
3. **Solution.** To what extent does your product or service address customer pain?
4. **Market.** What evidence do you have that the target market will grow large enough, fast enough, and profitably enough to meet your goals?
5. **Competition.** How well is your business positioned against the competition to dominate your market segment?
6. **Strategy.** To what extent have you developed a focused, viable strategic direction (or approach) for achieving success?
7. **Marketing & Selling.** How effective are you in taking your product or service to market?
8. **Operations.** How efficiently can you make and deliver products or services to customers?
9. **Management.** How experienced and capable is your management team in being able to execute the plan? Do you have a well thought out succession plan that would take effect in the event of retirement, disability, or death of any of the senior leadership team?
10. **Financials.** Do you have a solid business model, including revenue model and profitability model?
11. **Funding.** How well do you understand your need for future funding (debt or equity)?
12. **Exit.** Have you identified a clear exit strategy and a rationale to support it?

One easy and effective way to prepare a business plan that tells a story is to address each of these topics on one sheet of paper (or slide). We prefer a landscape orientation that includes a headline at the top and supporting evidence and graphics below.

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Execute the plan. Given a well-crafted plan that communicates the owners' vision of the business, management and staff are challenged to make it happen. Key issues for implementation, of course, include keeping everyone on plan, constant communication, and continuing development of the management team, small groups within the business, and the organizational as a whole. One technique we've found particularly useful is breaking the strategic plan down into a set of specific, relevant metrics in each major area of the business; establishing monthly milestones for each measure; and reporting progress on those measures at the end of each month.

Follow through. Here we're talking about the management team and board of directors holding regular, periodic business performance reviews – monitoring actual performance against plan (ideally, on a monthly basis), along with some mechanism for making adjustments to either performance or plan, based on changing conditions in the business and in the marketplace.

A note about transitioning from growth to exit strategies

The above discussion assumes that the owner is several years from retirement and, thus, the business continues to pursue growth. During this growth stage, financial goals are focused on tax savings and working capital maximization to fund growth.

As retirement nears, the business needs to enter a new phase in preparation for exit. During this grooming period, financial goals should change to focus on revenue and profit, to maximize pre-tax valuation.

This might be a good topic for your next regular discussion with your principal advisor at Hoffman White and Kaelber.

Concluding Thoughts

Hat's off to Rod for doing such a great job at stretching your thinking about business succession planning!

Succession planning should form an integral part of any medium- or long-term business strategy, yet entrepreneurs frequently ignore it in favor of day-to-day financial and operational issues or sales and marketing activity. Instead of thinking about succession planning as the unfortunate end of a happy career, it should be perceived as the pinnacle of achievement: the time when a business owner unlocks the value of the business s/he has created, is publicly rewarded for his or her efforts and triumphantly moves on to the next phase of his or her life.

Hoffman White and Kaelber can arrange an introductory meeting with Rod to discuss your particular situation and explore ways he could help. Or, contact him directly at rnasbe@businessbrainpower.com or 703.980.9110.

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Hoffman, White & Kaelber Financial Services Investment Performance Update

While the optimism in financial markets looks pretty lofty at the moment, one might tend to think that there is little risk to consider. Yet, if we look back over the top economic stories this past month and prior, one can believe that the biggest risks to growth in the world markets over the near term could be oil prices and the so called housing bubbles.

So far, record oil prices (in nominal terms) can be blamed for half to two-thirds of the deceleration in world growth from 4.1% last year to 3.2% this year. Yet, some parts of the world economy have prospered, including the energy-producing regions of the US (such as Texas, Alaska, Wyoming, Louisiana, and Oklahoma) and other oil-exporting countries. Some analysts think that oil prices could reach \$80/barrel over the near term which is believed could push Japan and some western European economies into a recession.

Housing bubbles are probably the next biggest threat to the sustainability of the current economic recovery. With few exceptions (Germany and Japan), house prices have risen sharply in most industrialized economies since the mid-1990s. If the bubbles can slowly deflate, we may be OK; but if they burst, we're in for an ugly time.

The US certainly seems very prone to a rise in inflation and long-term interest rates than most other industrialized nations. Whereas, the Euro-zone is more likely to suffer sluggish growth because of overly restrictive macro-economic policies. Both are vulnerable to future terrorist attacks. Asia will probably be hurt the most if China suffers a hard landing. And, almost all the emerging regions will doubtless suffer damage if commodity prices plummet.

The "up-shot" is that current growth momentum suggests that the world economy will most likely be able to withstand any one of these shocks, without going into recession. However, if two or more hit at the same time, all bets are off.

For the month ended July 31, 2005, our one-month performance is up 1.52%, our year-to-date return is up 2.76%, and our average annualized return since inception is up 8.71%. While volatility has become exceedingly vigorous in the equity markets, our risk profile continues further downward to +/- 5.75%. This conservatively low risk level remains consistent with our strategy. With our expectation that this statistic gains increasing importance, our Sharpe Ratio is more than respectable at 1.23.

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