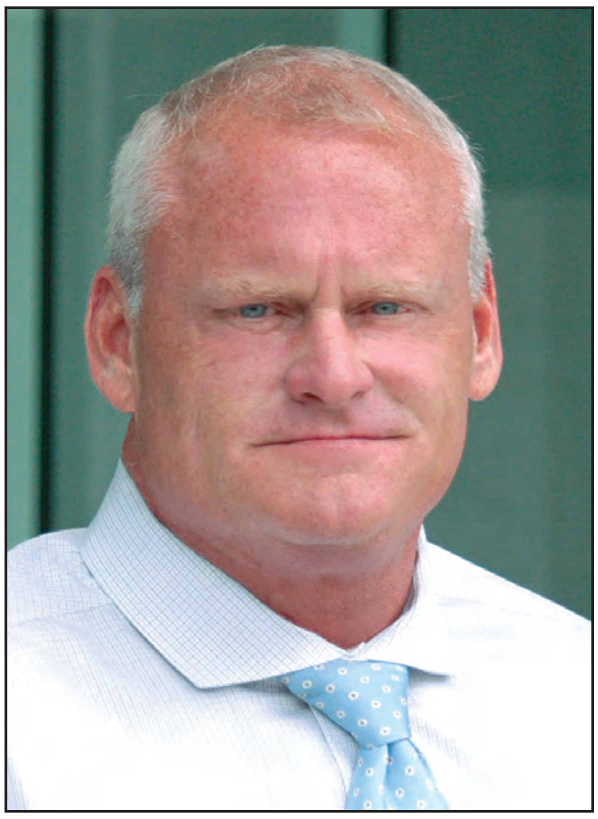
KEYS TO ENTREPRENEURIAL SUCCESS ROUNDTABLE



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The Orange County Business Journal has asked some of the community's top experts to share their insights on the keys to growing a successful business. These leaders have touched upon topics essential to any entrepreneur, such as locating financing, growth through acquisitions, succession planning and exit strategies. ➡

KEYS TO ENTREPRENEURIAL SUCCESS ROUNDTABLE PARTICIPANTS

Jeffrey M. Verdon Law Group LLP
At the Jeffrey M. Verdon Law Group LLP, the country's leading asset protection law firm, we believe in helping our clients protect their assets from unforeseen lawsuits, and to make sense out of the complex tax code and wealth transfer opportunities available to the well-informed. Our boutique Trust & Estates law firm located in Newport Beach, Calif., with satellite offices in Los Angeles and Redwood City, Calif., serves affluent families, technology entrepreneurs and successful business owners with estates of $10M to $500M. Through our Comprehensive Estate Planning platform, we optimize income and estate tax deferral opportunities found in the Tax Code and approved by the IRS in its private and public rulings, while placing effective "firewalls" around the assets to protect against future unforeseen lawsuits. With more than 30 years of experience and providing extraordinary levels of client service, we serve the needs of the discriminating client looking for the latest and most effective strategies for protecting and preserving wealth through advanced planning. For more information, email jeff@jmvlaw.com, visit www.jmvlaw.com or call 949.333.8150.

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Pacific Mercantile Bank
Pacific Mercantile Bank is one of the largest banks headquartered in Orange County. We serve small- and middle-market businesses with a full range of loan, deposit, and cash management products and services. We are proud that our clients look to us for business banking beyond the obvious. Our clients choose Pacific Mercantile Bank for experienced perspective and wise counsel on enterprise issues critical to their business success, including company growth strategy, optimizing capital structure, and creative and flexible financing solutions. Our clients seek to master unique challenges and leverage rare opportunities not addressed by "one size fits all" banking. They aspire to achieve their business vision, and they want experienced, empowered bankers to assist along the way. We finance visions, not just receivables or real estate. We strive to be an integral part of our clients' success, now and into the future.

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SingerLewak
SingerLewak is a leading accounting, consulting and tax services firm headquartered in California. Serving the western region since 1959, with offices throughout California and Denver, SingerLewak has developed a reputation for excellence as professionals with unparalleled expertise in the accounting and management consulting industry. Our professionals pride themselves in guiding and helping entrepreneurs and family-owned businesses succeed by providing the services of a large firm with a personal approach to individual needs. **Business growth takes the right partner**.

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KEYS TO ENTREPRENEURIAL SUCCESS ROUNDTABLE

"For an owner who is serious about growing their business, a board of advisors (BOA) is a must ... You do not want your banker, accountant, attorney or investment advisor on your BOA. They should already be providing advice to you (if not, change advisors).

– David Krajanowski
Partner
SingerLewak"

Taxes in California are some of the highest in the nation, should entrepreneurs consider moving their businesses to a more tax-friendly state?

Jeffrey Verdon, Esq., Jeffrey M. Verdon Law Group LLP: Moving a business to another state is complex and expensive. Before considering moving the business to another state, consideration should be given to whether the business would qualify for many of the tax mitigation opportunities found in the tax code. These would include, but would not be limited to: IRC Sec 831(b) Small Captive; NING Trust; qualifying companies are taking advantage of Puerto Rico's Acts 20 and selling one or more divisions of their company to a Puerto Rico company where the income can be sourced in Puerto Rico, reducing the corporate tax rate from 35% to 4%. Puerto Rico is a U.S. Territory, and its tax code overlays on the Internal Revenue Code, and can be used advantageously where the circumstances dictate.

How does a business owner create an effective board of advisors that will give sound advice for long-term success?

David Krajanowski, SingerLewak: For an owner who is serious about growing their business, a board of advisors (BOA) is a must. Unlike a statutory board where control of your company can be given up, BOAs are consultative only. However, to be effective, ownership must be willing to hear, consider and act on the advice; otherwise, the process is a waste of time. BOAs are growth agents for a company. There are many types of BOAs, but they can typically be categorized into three types: operational, value creation and succession. Do you need help in operations in order to get your company to the next level? Will advisors with proven backgrounds in new products or technological (scientific) innovation be your best option for continued growth? Is your industry stagnant, and your best choice will be members who can open new markets or introduce new customers? Do you need help dealing with family issues inside a business or an exit strategy? What your most pressing need is will determine who your members should be. You do not want your banker, accountant, attorney or investment advisor on your BOA. They should already be providing advice to you (if not, change advisors). The major challenge for an owner who implements a BOA is truly being receptive to change and a willingness to be held accountable.

What is the key thing to know or the most effective method to secure the capital necessary to grow a business? What are other common recommendations you have made to your clients to help them grow their business?

Tom Wagner, Pacific Mercantile Bank: Investors want a return and it is up to you to prove they will get it. Be prepared to be challenged on every assumption you present. Many new companies fail. Often that failure is the result of underestimating the investment necessary to gain critical mass. Sales growth projections in excess of the market growth rate are not sustainable for long. If you forecast growing faster than the market, you must adjust your pricing and margin assumptions down over time. When you are big enough for your competitors to target you, they will, often with a price cut that could rattle the thesis of your company. Bankers are the least expensive source of capital, but they also take the least risk. Private equity is scarce, but can be found for the right opportunity. The number one source of funding for most new businesses is re-investment of cash flow generated. To maximize growth, do not distribute more earnings than absolutely necessary.

How do we prepare the next generation for succession and what traits should you look for from an outsider or a family member?

David Krajanowski, SingerLewak: Preparation for succession by a family member, or a specifically skilled individual from outside the company, is a process that needs to start early (preferably 5-10 years out). It begins with an assessment of strengths and weakness of the candidate, as well as how the successor will fit into the organization. A written development program with timelines can be drawn up to both maximize strengths and minimize weaknesses. The program usually entails both education and on-the-job training. Frequent, honest evaluations must be conducted as the process unfolds. Changes can also be made as the situation changes or more/different responsibilities are assigned/assumed. Traits to look for are a passion for the business, people skills, leadership potential, vision and an ability to make decisions.

How can business owners structure their organization and/or residency to reduce their tax bill?

Jeffrey Verdon, Esq., Jeffrey M. Verdon Law Group LLP: The tax code is replete with many opportunities to reduce their tax liabilities, using such tools as qualified retirement plans, 831(b) Small Captives for risk management, Puerto Rico Act 20 companies and Puerto Rico Act 22 residents where the tax rate on capital gains is eliminated until 2034.

How can acquisitions help to increase the value of a business faster?

Tom Wagner, Pacific Mercantile Bank: Acquisitions can accomplish many things faster. They can be used to increase market share, add product depth and diversification, accelerate research and development, add distribution channels, expand markets and add critical talent. Generally, the redundant functions that existed prior to acquisition can be eliminated and the profitability of the combined entities will exceed the

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"Debt is a fixed cost requiring cash flow servicing. Its impact is no different than any other fixed expense the company may have. It provides leverage. Leverage works in both directions, with small changes in the top line creating greater volatility in the bottom line, both positively and negatively."

– Tom Wagner
Executive Vice President and Chief Strategy Officer
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profitability of the two companies operating independently. However, none of this is lost on the seller, and the better the performance and resources of the target, the more expensive the acquisition price. A successful acquisition needs to deliver combined efficiencies that exceed the cost of the acquisition. To the extent leverage is involved in the acquisition, the efficiencies must be realized quickly to ensure compliance with the debt service and performance covenants of the new lender. Get professional help and take your time in due diligence. Most acquisitions fail because of undisclosed issues or overly optimistic expectation of synergies.

How can the small business owner protect the business assets from future lawsuits?

Jeffrey Verdon, Esq., Jeffrey M. Verdon Law Group LLP: Presently, wage and hour claims and tort liability place business assets at great risk. Once liability insurance is exhausted, if there is any coverage at all, the insurance policy will require the business to cover the first dollar of liability claims. Separating the riskier assets from the less risky assets is basic 101 planning. For example, real estate and vehicles, equipment, etc. could be held in separate LLCs and leased to the company. The ownership of the assets is outside the company and not subject to the company's future lawsuits. A Private Retirement Plan, under CCP 704.115, is an excellent and effective way to plan for retirement and protect assets from lawsuits for both the company and the company's owners.

What are some keys to selecting the right lending partner?

Tom Wagner, Pacific Mercantile Bank: If cost is your only requirement, then the lowest rate may be the best decision. However, if you are looking for someone who understands your market, your business and your objectives, then you are seeking a true partner. You will be able to tell fairly quickly who meets your criteria. The banker who invests the time to hear your story is a great place to start. You also need someone who can bring the full resources of their organization to bear for your company and can identify your challenges, opportunities and solutions before you ask. To find out if your banker is a partner, request the memorandum the banker writes up on your behalf when pursuing internal approval of your loan. That memorandum is the banker's synthesis of your company, including its strengths and weaknesses. Don't you want to know if your partner has it right?

How much leverage should I take on?

Tom Wagner, Pacific Mercantile Bank: The answer is not: "as much as I can." Debt is a fixed cost requiring cash flow servicing. Its impact is no different than any other fixed expense the company may have. It provides leverage. Leverage works in both directions, with small changes in the top line creating greater volatility in the bottom line, both positively and negatively. For starters, you need to identify the volatility of your industry and your company specifically. The more volatility, the lower the leverage. You also need to consider where you are in the life cycle of the company. If you are young, growing and investing new capital, re-directing cash flows for debt maintenance makes less sense. If you are mature, and cash flows exceed investment opportunities, debt makes more sense. Notice I use the terms more or less. More or less than what? The industry average for your company. It is never advisable to take on significantly more leverage than the industry. When selling against your competitors, the last thing you want questioned is your survivability. You may not bring it up, but your competitors will.

What are the benefits of using a professional service firm that specializes in entrepreneurial firms?

Jeffrey Verdon, Esq., Jeffrey M. Verdon Law Group LLP: Selling a company is a complicated business and not to be undertaken without the experience of a qualified investment banker and his team, an M&A lawyer, and the company's CPA. Never attempt to do this on your own just to save professional fees. Selling a company is not the time to be penny wise and pound foolish.

As a professional advisor to many family-owned and entrepreneurial companies, what is the best advice you can give a business to increase their rates of success? Is it all in the planning? The talent? The operation?

David Krajanowski, SingerLewak: A combination of vision, planning and execution is my advice. Vision to see or create the future. Planning, so you are not just a boat on the ocean subject to the currents or wind direction. Document the vision, mission, strategic objectives, and then communicate it throughout the organization. Invest in planning (budgets, cash forecast, sales plans, etc.) and in building talent. Lastly, and most important, is execution. Why do professional teams train and practice the little details, running plays to perfection? Too many owners spend too much time and money looking for consultants to provide the magical fix. We all know what needs to be done (or 85% of it). Spend the time perfecting execution. To execute, you need accountability from the top (yes, you) throughout the organization. Family is not an excuse.

I'm getting ready to sell my business and am hearing a lot of, "What's your number?" How do I determine it? If there is a differential between the current and desired number, what steps do I take build to that?

Tom Wagner, Pacific Mercantile Bank: I think having "your number" is critically important. Build a five-year forecast. At the end of five years, assume

Keys to Entrepreneurial Success Roundtable

"Every seller should take all or most of the proceeds from the sale that will not be needed for daily living expenses and place them in an asset protection trust (APT) as soon as the escrow closes."

– Jeffrey Verdon, Esq.
Managing Partner
Jeffrey M. Verdon Law Group LLP

a perpetual growth rate of 2-3% and value the annuity of free cash flow (cash that could be distributed after required reinvestment) in year five. Then discount it, and all the other free cash flow generated over the forecast period. That is "your number." It is the value you can create if the company is managed by you. Any number in excess of "your number" means someone else believes that the future is brighter, or the operation can be squeezed to generate more cash. In other words, the resources are worth more to them than to you. If the bid is less than "your number," the company is more valuable in your hands. If there is a disagreement, wait and continue to execute; they will be back.

How does a business owner prepare a company for an exit? What advice can you give someone looking to exit their business in the next three years? How about five years?

David Krajanowski, SingerLewak: All successful business owners I know run their businesses as if they were going to sell tomorrow. They are driven by three factors: operating profitability; always delivering quality products/services to their markets (knowing who your customer is and the market you are in); and developing good people, including having a succession plan or plans (whether it be owning your company for 20 years, but always being prepared for life's unexpected twists or selling in five years). Managing these three factors alone almost guarantees success. Key factors for any company to pay close attention to when contemplating a sale include: consistently high margins for your industry, diversifying your customer base, continuous flow of improved or new products, and employing a proven management team who work through ingrained processes and procedures. The business should not be dependent on you to operate. No one knows when they want to sell. The market provides a key opportunity to do so. Always be prepared.

When a business is sold, what post-sale risks is the seller exposed to?

Jeffrey Verdon, Esq., Jeffrey M. Verdon Law Group LLP: Buyer's remorse can lead to a lawsuit. Buyer's remorse is one of the biggest risks. The buyer may not perform as well as the seller and may run the business into the ground. Trying to cover his bases, he may allege the seller cooked the books and then threaten to sue the seller for fraud and misrepresentation. Every seller should take all or most of the proceeds from the sale that will not be needed for daily living expenses and place them in an asset protection trust (APT) as soon as the escrow closes. If later the buyer tries to unwind the sale, the proceeds, safely held inside the APT, will likely discourage the buyer from pursuing a lawsuit against the seller, and the claim may be settled for a minimal or nuisance value to encourage the buyer to walk away.