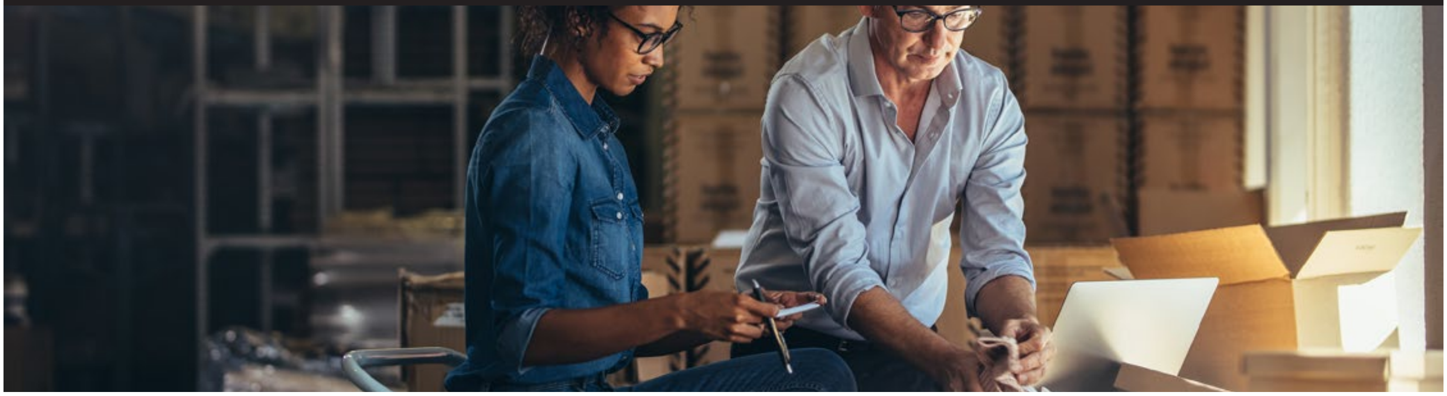

Considerations for Diversifying Ownership in Your Company

There are many reasons an owner of a company might consider diversifying ownership. The timing for a change in equity ownership can be driven by a number of factors. Often it's the natural progression of a majority owner seeking to diversify a portion of his/her net worth. For many business owners, private company equity ownership often represents their single largest asset. Therefore, this diversification can be an important step in de-risking the majority owner's financial world.

Most business owners are looking to (1) grow the value of their business, (2) monetize a portion (or all) of their business at some point in time and (3) diversify their financial holdings. The following three categories represent most company equity owner's mindset as well as their objectives.

They are:
1. Energized and want to continue to grow;
2. Stable and still engaged; or
3. Stale and focused on external matters (possibly including an exit from the business, starting their next endeavor, financial diversification, retirement, etc.)

For the owner in either the 2nd or 3rd category, evaluating a minority shareholder buy-in may make sense. By definition, a minority shareholder owns less than 50% of the company. Frequently, that means the subject shareholder doesn't have voting control.

Executing a minority shareholder buy-in often starts with understanding the goals and objectives for the (current or proposed) minority and majority shareholder(s). Recognizing where each shareholder is regarding his/her priorities in this progression of business ownership will help in drafting or amending the buy/sell agreement or negotiating a minority shareholder share purchase. This step can be an effective vehicle for rewarding and retaining a strong employee or member of management.

Many businesses are in industries that require periodic capital investment. Not all shareholders have similar personal situations or equal/proportionate capacity for capital investments in his/her business.

Different partners may very well have different priorities as influenced by his/her own circumstances (including age, family, finances, differing personalities amongst management or ownership, health, etc.).

Provided that a majority shareholder is not looking to take on more risk, this circumstance is an opportunity for the minority shareholder looking to grow his/her holdings in the company. Recognizing these priorities and their drivers can provide clarity and direction to a minority shareholder buy-in.

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Diversify Ownership in Your Company

Other factors to consider include: (1) agreement on business valuation methodology; and (2) bank financing for a minority equity purchase. A bank's willingness to lend on a minority share purchase is directly correlated with a stable earnings history of the company in question. The primary underwriting factor is the debt capacity/personal cash flow of the minority stockholder. This analysis must include the expected increase in the minority stockholder's personal cash flow via the increased post-tax distributions from the company. This adjustment typically drives the minority stockholder's ability to service the proposed debt. Most banks will not consider the stock being purchased as acceptable collateral and may require the seller to guarantee all or a portion of the debt. Typically the repayment period for loans of this type range from 3 to 5 years.

Any minority shareholder needs to feel very comfortable in his/her relationship with the majority owner because they are making an investment in a minority position of an illiquid asset. The minority shareholder needs to understand what else might accompany his/her investment, or increased level of investment, in a privately owned business. Some of the changes could or should include:

- a seat on the Board of Directors
- additional authority
- increased distributions via a formalized distribution policy
- a put option to the company for his/her stock in the event he/she leaves the company voluntarily or involuntarily.

Diversification for a business owner via a minority shareholder buy-in is a meaningful step for both the majority and minority shareholders. Often a majority shareholder is seeking to diversify and de-risk. At the same time, a younger minority shareholder may want to position himself/herself for a bigger subsequent event such as acquiring up to, and including, 100% ownership of the company. That progression may then lead to further opportunities for the (current minority shareholder) including an outright sale at some point in the future to a strategic or financial buyer.

There are many factors to evaluate when considering diversification of your company's ownership such as: performing a valuation of your business, establishing what financing may be needed; and understanding the goals and objectives of all shareholders (existing and proposed). All of these decisions are further influenced by the financial, emotional and timing considerations involved. If you have been considering transferring a portion of your business equity for diversification purposes, Florida Capital Bank can help you establish a plan for success.