

Case Study in Connections:

How ACG Connections helped Bekins and its Business Partners deliver solutions.



Jim Vargo

When Jim Vargo joined The Bekins Company as Chief Financial Officer and SVP of M&A two years ago, he brought more than just experience and expertise to his new job – he also delivered the considerable relationships he had built for more than a decade through active membership in organizations like ACG Chicago.

Indeed, his ability to tap the resources of the leading authority on corporate growth and M&A has paid multiple dividends as Bekins continues its remarkable turnaround as a management and agent-owned enterprise. Vargo's story is really a case study in connections.

Establishing relationships

Vargo began his career in Chicago in 1981 after graduating from Northern Illinois University with a bachelor's degree in accounting and finance and later an MBA in finance. His first job was as an asset-based auditor with Northwest Acceptance Corporation. He subsequently worked for Congress Financial Corporation in credit and marketing roles, and later for CIT Group/Business Credit, leaving as Midwest Regional Manager to pursue a renewed life in consulting and corporate management.

In 1994, looking for networking opportunities as a marketing representative, Vargo joined the Association for Corporate Growth. At that time, in an effort to expand his contact relationships, Vargo asked then President Don Locke if he could become active on the board. The next year Vargo was elected as treasurer of ACG Chicago and served in this position for three years and as a director for the following six years.

"ACG was certainly one of the strongest local and national organizations for networking and building relationships in the finance and corporate growth arena," Vargo says. "And I've always believed that you have to be involved in a volunteer organization, working on committees and the board, to get the most out of it."

Connecting with Bekins

Vargo's connection with Bekins began in 2001 when he became Managing Director of Impact Capital Group in Chicago. In that capacity, he acted as financial advisor and key negotiator with the company's buy-out by key agents and management, helped arrange a \$20 million asset-based financing package from Textron Financial, and provided advice that helped Bekins turn a \$1.5 million profit over the prior year's \$13 million loss. Vargo joined The Bekins Company full-time as Chief Financial Officer at the end of 2003.

One of his immediate tasks was to conduct an appraisal of the business so the new owners would have a benchmark on what their original, partly distressed, investment was worth.

So, it was only natural that Vargo reached out to long-time ACG Chicago colleague Bill Golz of American Appraisal. Thanks to

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Save The Date!

2005 Midwest ACG Capital Connection

October 20, 2005

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South Building Ballroom

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Upcoming Events

May 17, 2005

Luncheon Meeting
Rick Kracum, Managing
Director, Wind Point Partners
The Metropolitan Club, Sears Tower
11:30 am – 1:15 pm

June 7, 2005

Annual Golf Outing
White Deer Run Golf Club
Vernon Hills, IL
11:00 am

June 21, 2005

Luncheon Meeting
Michael J. Soenen CEO, FTDI
The Metropolitan Club, Sears Tower
11:30 am – 1:15 pm

July 14, 2005

Joint Boat Cruise w/TMA &
MBBI
Navy Pier, Chicago

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We welcome submissions of content pieces of interest to our membership. Articles should be under 1000 words in length and must focus on a relevant issue, topic or situation; marketing materials will not be considered. We reserve the right to select and edit all submissions. Please send articles for consideration to ACG Chicago at chicagoacg@acg.org

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President's Column



Craig A. Miller
Oak Ridge Capital

The first word in ACG is Association. It is the reason we belong. With that in mind, I felt it was best to use this space to honor all those who actively volunteer to make each and every aspect of this organization function (and network a little more intensely). You have heard and seen many members of the Board of Directors, but they cannot be thanked enough for the time and effort they commit to you and me. It is also important to thank Terry Cobb our administrator and Elisa Hillock for their hard work and extra efforts. And finally, thank you to all those who have stepped up to work on committees and special projects to make ACG Chicago the leading authority on corporate growth. Please join us as we continue to build value for your membership and the ACG network.

Craig A. Miller

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Board members are shown in bold face

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Market Trends

Market Trends Favor Sellers in Today's Environment



Our Market Trends Panelists spoke to a full house on April 1st.

This is a great time to be a seller in the Mergers & Acquisition business, and it appears that the current trend will prevail for at least the balance of 2005.

That was the consensus of panelists for ACG Chicago's popular Market Trends panel discussion in April.

Daniel Sullivan, Vice President of the Federal Reserve Bank of Chicago says that the current economic expansion appears to be on very solid ground. "It's not super spectacular growth, but all the indicators are good, even if they appear to be boring," Sullivan says. He noted that there have been seven consecutive quarters of growth in GNP, with the past five at or above 4%. Forecasts for 2005 and 2006 are in the 3.5% to 3.75% area.

"Real consumer spending is solid, though not as high as in the late 1990s," Sullivan says. "Manufacturing and capital spending is improving, labor markets continue to firm, and productivity growth is robust. Inflation pressures are increasing, but the Fed is acting to take care of the little wiggles in order to avoid the big spikes like we saw in the 1970s."

Private equity

Stewart Kohl, Managing General

Partner of The Riverside Company in Cleveland, notes that 2005 started with a bang in large volume leveraged buyouts, and predicts that the full year will equal or exceed 2004's brisk pace of LBO deals.

Price multiples have increased, reaching 9.5 times for deals above \$100 million, 7.3 times for \$75 to \$100 million deals, 6.5 times for \$20-\$75 million deals, and 5.6 times for \$5-\$20 million deals.

"This is a great time to sell and a tough time to buy," Kohl says, "and there are rational reasons for that. Earnings are growing sharply, there are pervasive low interest rates, financing has eased, there is pent-up demand, strategic buyers are more active, and the quality of companies for sale has improved."

Mezzanine

Tom Turmell, a Principal of Golub Capital, says the mezzanine markets are very active, especially with the recent explosion of second lien activity in recent years. "Rising debt multiples reflect the very aggressive approach being taken today," he says. "It's a great time to be a borrower, and mid-market companies can get mezzanine lending right now."

Turmell warned that credit quality is slipping, with all deals in 2003 being rated B- and above and all deals so far in 2005 being rates B- and below.

"Times are good, but are they here to stay?" Turmell asked.

"There could be a later shock in the market."

Senior debt

Mark Gertzof, Director, Merrill Lynch Capital's Midwest Corporate Finance Team, says that today's extremely liquid

market is being fueled in part by historically low default rates in the 1% range, compared with 5-7% rates in the 2000-01 time period.

"The composition of leveraged lenders is changing dramatically," Gertzof says. He notes that hedge funds and high-yield funds make up 60% of the leveraged lending market, where banks previously did approximately 60% of the lending ten years ago.

"Interest rates should have had a cooling effect on the market, but lenders are moving out of fixed rate lending and into floating rates today, which exacerbates the situation," he says. Gertzof characterizes the current state of senior debt lending as "walking a tightrope and hoping we don't fall off."

Almost every deal has a weak point somewhere. But can every adviser find it in time?

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Developing a Genuine Anti-Fraud Environment

This article is one in a series of contributions by ACG Chicago's Platinum Sponsors. We appreciate their support.

by Carl W. Pergola and Peter C. Sprung, BDO Seidman, LLP

BDO Seidman opened our Chicago office in 1940. The Chicago practice is part of a national firm with over 30 offices and 250 alliance firm locations in the U.S. Providing services for over 90 years, BDO Seidman is the U.S. member firm of BDO International. The Chicago office leverages this global network of more than 600 offices in 105 countries to serve international clients.

BDO Seidman's Chicago practice has exceptional depth with over 200 assurance, tax, financial advisory, and consulting professionals. We serve diverse public and private industry clients through a team of experienced and knowledgeable partners and managers. These professionals focus on helping clients address financial reporting and business needs.

For more information on BDO Seidman's depth and breadth of services, please contact Steve Ferrara. Steve is the Central Region Managing Partner of Assurance Services for BDO Seidman, and previously served as Treasurer on the Board of ACG Chicago. He can be reached at (312) 616-4683 or via e-mail at sferrara@bdo.com.

The stream of corporate scandals and government investigations seems to continue without end. As the Enron, Global Crossing and WorldCom episodes graphically illustrate, such frauds, if left unaddressed, can have catastrophic results for a public company and create significant personal liability for individual directors and officers. Yet, despite the high stakes involved, board members and other corporate representatives have traditionally tended to view whistleblower complaints of fraud or government investigations as unexpected events, leaving them unprepared when a genuine crisis hits.

However, the risk of financial wrongdoing and the need for effective controls and an appropriate response can, like other business contingencies, be planned for and managed effectively. Risk managers can do much to help corporations develop the capacity to detect and prevent fraud before it gets out of control and help the corporation to develop a robust "anti-fraud environment." The following are some of the components of a proactive fraud detection and prevention program.

- ▶ An inventory should be prioritized by the fraud-related legal and ethical standards that govern the corporation's activities, and "risk activities" that could produce violations of those standards should be identified.

- ▶ The corporation should conduct regular risk assessments to gauge the nature and scope of fraud risks to the organization, and use the results of these assessments to inform the design and implementation of fraud detection and prevention programs. Constantly monitor, audit and evaluate the effectiveness of the programs.
- ▶ Support the establishment of whistleblower hotlines that provide an accurate, convenient and secure method for employees to report fraud concerns or any irregularities to an independent party without fear of retaliation.
- ▶ Promote education in fraud detection and prevention methods for board members, officers, managers and employees.

- ▶ Support employment and pre-employment screening, including background investigations and reference checks, based on the employee's level of responsibility and access to corporate assets.
- ▶ Promote rapid response fraud audits by establishing a standing relationship with a "SWAT team" of forensic accountants to focus on potential problem areas of the company's accounting treatments and business operations and to respond to indications of fraud or financial irregularities.

These are the minimum ingredients of the enlightened organization's anti-fraud efforts. While no one has invented a way to prevent fraud altogether, experience teaches that the ideology of "compliance"—simply meeting minimum legal standards—is not enough. Companies should seek to strike a reasonable balance by vigorously incorporating fraud risks into their broader enterprise risk management framework.

These measures are fully consistent with the new amendments to the Organizational Sentencing Guidelines, which encourage corporations to build into compliance programs regular risk assessments and other methods utilized in the fields of enterprise risk management and auditing. As a result, risk management professionals will likely assume a higher profile in matters of fraud detection and prevention. Risk managers should cooperate closely with compliance and internal audit staff and use independent experts as necessary to bolster the corporation's anti-fraud efforts.

...experience teaches that the ideology of "compliance"—simply meeting minimum legal standards—is not enough.

The value of integrity has never been higher. Courts, regulators and investors are

evaluating corporations using 20/20 hindsight. Therefore, corporations must aspire to 20/20 foresight. A proactive fraud detection and prevention program grounded in enterprise risk management is a way to attain that foresight.

Carl W. Pergola is the National Director of the FIRSTGlobal Investigations division of BDO Seidman, LLP.

Peter C. Sprung is also a director in FIRSTGlobal Investigations. Both authors are based in New York.

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Creative Financing Solutions Help Private Equity Firms Get the Deal Done

This article is one in a series of contributions by ACG Chicago's Platinum Sponsors. We appreciate their support.

By Tom Thompson, Vice President, PNC Business Credit, Chicago Office

PNC Business Credit is the asset-based lending business operated by PNC Bank, N.A., member of The PNC Financial Services Group, Inc.

Headquartered in New York with 25 offices nationwide, including Chicago and Milwaukee, PNC Business Credit works where our clients work.

PNC Business Credit specializes in providing secured financing from \$7.5 million to \$150 million for middle market companies in the manufacturing, wholesale, distribution, retailing and service industries. As a hybrid lender, PNC Business Credit can provide overadvance term loans without warrants at competitive prices.

Actual funded loan size is often the most important factor when selecting a senior lender to finance growth or an acquisition. Businesses need money to grow, and acquiring sponsors naturally want to maximize their returns.

For medium and small-sized equity firms in the Midwest, access to more capital at competitive rates and more advantageous terms and conditions is becoming increasingly important as the marketplace becomes more competitive. A stronger economy, low interest rates and a very liquid capital market is fueling an increase in merger and acquisition activity, particularly among middle market companies in the Midwest and across the country.

With more dollars chasing a finite pool of companies and more acquirers looking for companies with growth potential, merger and acquisition targets have more leverage to demand a higher price tag. In the last 12 months, transaction sizes have increased and sellers are now demanding, and obtaining, a larger multiple of their company's cash flow in the purchase price - up from three to five times earnings to at least six to nine times before interest, taxes, depreciation and amortization (EBITDA).

So how can companies maximize their financing options?

For private equity funds or companies looking to finance mergers, acquisitions or leveraged buyouts, asset-based financing with an overadvance term loan - also known as an airball - can be the best loan choice due to maxi-

mum proceeds, flexibility, cost-competitive debt structure and flexible covenant requirements.

Unlike cash flow financing, which relies on a company's ability to generate profit as the primary source of repayment, an asset-based structure consists of advances against account receivables, inventory, machinery and equipment and real estate. This structure is particularly helpful for asset-intensive acquisitions, such as manufacturers as well as wholesale distributors and retailers. Typically, these old economy companies, which have strong roots in the Midwest, are capital intensive, yet have lower gross profit margins.

An asset-based structure also is particularly helpful for companies that may be too small or have irregular or modest earnings and therefore do not qualify for cash flow financing, which typically is only available for larger companies with revenues in excess of \$25 million and a demonstrated pattern of stable profitability. As a result, asset-based lenders often advance funds when traditional commercial banking or cash flow sources are not available because the assets can serve as an additional cushion and source of repayment in a worst-case scenario.

In instances where the collateral values

provide insufficient cash flow liquidity, some lenders are increasingly willing to think outside the box and work with a client company to meet both parties' tolerance for risk.

For companies seeking maximum leverage, an asset-based loan with a cash flow component, also known as an overadvance, can serve as a hybrid solution. Companies get the borrowing base leverage of an asset-based structure with the flexibility of a cash flow solution. The overadvance is not covered by the availability of funds provided by the assets; rather a lender looks at the company's historical cash flow and ability to repay the debt.

Another similar loan structure is a seasonal overadvance, which is particularly helpful for highly seasonal businesses. By recognizing that working capital levels build in anticipation of peak selling seasons, higher advance rates for a specific period of time, such as three to four months, provide a company with greater working capital when it is most needed. The seasonal overadvance is repaid once the company completes its selling season.

A cash flow shortfall also can be remedied by combining a junior secured or a "term B" loan with the asset-based credit facility. While more expensive than traditional senior debt because it is secured by collateral in second place behind the senior lender, the pricing on this type of debt has come down in the last two years. Term B financing can be attractive because the need for working capital is often greatest immediately following an acquisition, restructuring or turnaround, and this type of financing provides companies with the increased liquidity needed to

meet both short and long-term goals.

To help companies decide which financing option best meets their needs it is important to work with a lender who is willing to take time to understand the business and find creative, flexible solutions for the company. The borrower should understand the lender's credit processes, its reputation for getting the deal done, and how the lender typically reacts if the business underperforms.

For example, last year a mid-sized equity group sought an asset-based loan structure to support the acquisition of a plastic injection molder that manufactures custom parts for appliances, computers, snowmobiles and all-terrain vehicles. In addition to lending on traditional collateral, the equity firm was able to leverage the company's strong track record of serving customers for more than 20 years.

Facing a tight deadline to close the transaction, PNC Business Credit provided a \$25 million financing solution that incorporated an overadvance, or cash flow component. Under the terms of the loan agreement, the overadvance facility will provide the company with the necessary flexibility to maintain its cash flow year-round.

In another instance, a Minneapolis-based private equity partnership was interested in investing in a specialty food distribution company that had a strong history of profitability and revenue growth, but the last two years had proved fiscally challenging. By recognizing the value of the compa-

ny's industry niche, PNC Business Credit engineered a senior financing solution that consisted of a creatively structured cash flow term loan, secured

term loan and an asset-based revolver. This bold financing solution, which closed in less than 60 days, met the sponsor's capitalization needs and positioned them for maximum long-term returns on their investment.

As these case studies illustrate, for companies and private equity firms looking for financing for increased working capital, mergers and acquisitions, turnarounds or buyouts, an asset-

based solution can help to unlock the value of the company's assets and provide the necessary working capital for growth. Clearly no longer the loan of last resort, asset-based lending has become the right choice for many middle market U.S. companies across the industry spectrum thanks to its flexibility and cost-competitive debt structure.

Indeed, in the last couple of years, the asset-based lending marketplace in North America has become increasingly competitive enabling borrowers to leverage higher levels of debt to finance the higher transaction costs. Today, companies looking to finance growth or an acquisition have greater borrowing power and asset-based lenders are more willing to find creative and flexible financing options to meet their clients' needs.

The borrower should understand the lender's credit processes, its reputation for getting the deal done, and how the lender typically reacts if the business underperforms.

Tom Thompson is Vice President for PNC Business Credit's Chicago office. He can be reached at (312) 338-5650 or Thomas.Thompson@pncbusinesscredit.com

Can You Rely On That Information?

Detailed representations and “non-reliance” provisions in acquisition agreements.

This article is one in a series of contributions by ACG Chicago’s Platinum Sponsors. We appreciate their support.

By Gary Levenstein and Andrew Levy, Ungaretti & Harris LLP

Leading up to and during the preparation and review of acquisition documents the buyer and seller may share a considerable amount of information. Acquisition agreements typically contain detailed representations and warranties. The intent of these representations and warranties is to allocate risks between the parties regarding the existence or absence of particular facts or circumstances.

Ungaretti & Harris LLP is a Chicago-based law firm with offices in Washington, DC and Springfield, Illinois. The transactional practice focuses on serving private equity funds and corporate clients in the areas of mergers and acquisitions, public and private debt and equity financings and joint ventures. The combination of skills and the coordinated efforts among practice groups provide the clients of Ungaretti & Harris with high quality and efficient legal services.

They are designed to specify the information upon which the parties are relying in deciding to proceed with the transaction. Typically also buried in the boilerplate at the end of such agreements is a “non-reliance” provision, which provides that the buyer (or seller) disclaims any reliance on any information other than that specified in the representations and warranties of the acquisition agreement. For example: “As between or among the parties, any oral or written representation, agreement or statement not expressly incorporated herein, whether given prior to or on the effective date, shall be of no force and effect unless and until made in writing and signed by the parties on or after the effective date.” The exclusion or inclusion of such language and the jurisdiction of the court applying it can have a substantive impact on the success (or failure) of your claims in the event of a dispute arising from the acquisition.

Why should you care?

This issue will typically arise under a claim from the buyer that the seller or its agent provided misleading information regarding the business’ operations or prospects either as part of a pre-sale auction, during due diligence or in the acquisition agreement itself. These will be part of contract or common law claims based on breach of warranty, fraud or negligent misrepresentation. In

a stock transaction, an unhappy buyer may also often try to bring securities fraud claims against the seller.

Specifically, federal anti-fraud provisions of the federal securities laws, including Rule 10b-5 of the Exchange Act, which can apply to a stock transaction even if it involves the sale of stock of a privately-held company. Rule 10b-5 requires plaintiffs to demonstrate that the defendant made an intentional misstatement or omission of material fact, upon which the plaintiff-buyer reasonably relied, causing the plaintiff’s injury. A Rule 10b-5 claim, if available, is often the weapon of choice for plaintiffs for two reasons. First, under federal securities law, the exclusive remedy provisions often agreed to in acquisition agreements do not apply to Rule 10b-5 claims. Second, the remedies available under Rule 10b-5 can include not only damages, but rescission of the agreement (including the return of the purchase price). For these reasons, a passable Rule 10b-5 claim can be a source of significant leverage in settlement negotiations.

Incorporation of a “non-reliance” provision is intended to undermine the reasonable reliance element of a plaintiff’s Rule 10b-5 or misrepresentation claim by limiting the scope of information that the plaintiff can rely on.

But does it work?

The Federal Circuit Courts are split on the effect of non-reliance provisions. The Second and Seventh Circuit Courts of Appeals, covering New York and Illinois, respectively, have gone in one direction, while the Third and First Circuit Courts of Appeals, covering Delaware and Massachusetts, respectively, have gone in another. The Supreme Court denied a petition for writ of certiorari on an appeal from the Third Circuit in December 2003.

In *Harsco Corp. v. Segui* (2nd Cir. 1996) and *Rissman v. Rissman* (7th Cir. 2000), the courts affirmed the effectiveness of

“non-reliance” provisions, holding that when combined with detailed representations and warranties, such provisions preclude fraud claims that are based on statements not specifically covered by the representations and warranties. The “non-reliance” provision is used to undermine the buyer’s argument of reasonable reliance on the seller’s extra-contractual statements, which is a required element of a claim for fraud or misrepresentation under state and federal securities laws. Under these cases, while a buyer is not entirely precluded from making a claim for fraud, the non-reliance provision limits the range of information on which the buyer can rely on making the decision to proceed with the acquisition.

In contrast, the courts in *AES Corp. v. The Dow Chemical Company* (3rd Cir. 2003) and *Rogen v. Illikon Corp.* (1st Cir. 1966) have held in suits brought under Rule 10b-5 of the Exchange Act, that enforcing non-reliance provisions as a bar to fraud claims would be inconsistent with other provisions of the Exchange Act. Specifically, the Act precludes contracting parties from defining the boundaries of their transaction in such a way that relieves a party from the duties imposed by the Exchange Act. These courts have found that even if a party promises not to claim reliance on any representation not set forth in the agreement, such a promise constitutes an impermissible anticipatory waiver of potential fraud claims under the Exchange Act. Instead, these provisions need to be considered in the totality of the circumstances.

The result is that identical claims arising from the same terms and conditions of an acquisition agreement could result in summary judgment for the defendant-seller if New York or Illinois law applies, but a lengthy and far riskier trial if Delaware or Massachusetts law applies.

So what should you do?

When representing a seller, advisors should consider the following:

- ▶ Weigh the impact of venue and jurisdiction provisions. If you want to be sure that the Harsco/Rissman rule applies (i.e. that non-reliance provisions preclude fraud claims for extra-contractual statements), consider incorporating New York or Illinois choice of law and venue.
- ▶ Consider specific provisions in the agreement designed to maximize the effect of any non-reliance clause:
 - Insist that the buyer affirmatively acknowledge that although they have received other information in connection with the transaction, that they are not relying upon that information, and they understand that their reliance will be limited solely to the information that is the subject of the express warranties contained in the agreement itself.
 - Include a clear integration clause in the agreement that specifically references representations and warranties (vs. the customary references only to “agreements and understandings”).

When representing the buyer, advisors should consider the following:

- ▶ Weigh the impact of venue and jurisdiction provisions. A Delaware or Massachusetts exclusive jurisdiction clause could limit the effect of a non-reliance clause by invoking the AES/Rogan decisions.
- ▶ Consider including a seller’s 10b-5 representation in the agreement to obtain the benefits of a securities fraud standard in the agreement (e.g. “representations and warranties do not contain any misstatement of a material fact or omit to state a material fact necessary to prevent the statements made therein from being misleading”).
- ▶ Do not agree to a non-reliance clause in the acquisition agreement, or seek to exclude fraud/negligent misrepresentation or specific items of concern from such a clause.
- ▶ Get comfortable with the results of your due diligence and the extent of representations provided by the seller.

Gary Levenstein is chairman of Ungaretti & Harris’ corporate, securities and finance group, he previously served as President of ACG Chicago, and currently serves as secretary for The Association of Corporate Growth. Andrew Levy is an associate in the firm’s corporate, securities and finance group.



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Exit Strategies

Forecast: A Perfect Storm for Liquidity Events



Left to Right
Panelists-
Michael Burr,
Brad Seaman,
and John
Underwood

If exit strategies in the world of growth mean getting out when the going is good, then today's market forces have converged to make it the best of all possible times to get going.

Mike Burr, Managing Director, JPMorgan Securities, having seen all aspects of the business cycle during his 18 years in the corporate and investment banking world, notes that the stars are in rare alignment to create a robust mergers and acquisitions climate.

Macro economic trends are good, corporate earnings are strong, the stock markets are slowly ebbing up, and many companies see the need to act on their globalization plans to sustain their growth rates. Most amazing, he says, access to capital is the best it has been in the past 10 years and yet the data shows that seller expectations are down.

"In short, we have a perfect storm for liquidity events today," Burr says. "We see these conditions prevailing

through 2005, with CEOs being more confident, dialogues with sellers increasing, financial markets remaining open, and pressure continuing on companies to sustain earnings growth." Given this environment, Burr moderated an ACG Chicago panel discussion on exit strategies to look at key factors to consider in capitalizing on today's opportunities.

Financial buyers can show you the money

John Underwood, Managing Director at Pfingsten Partners, said that the biggest advantage of exiting with financial sponsors is that they have a deep pool of capital and a consistent acquisition appetite.

"There are multiple buyers for every opportunity today," Underwood says. "This extends across all sectors and ranges from strong to distressed companies."

Underwood estimates there is some \$100 billion in unfunded private equity commitments existing today, in addition to another \$250 to \$300 billion in buy-

ing power available through debt.

"These figures will only go higher, because at least half of the private equity groups are in the market today to raise additional money for investment," Underwood says. "In addition, they typically have a four to six year window to get the money invested, so they are in a situation where they have to use it or lose it."

Non-economic advantages of selling to a financial buyer include the ability to continue a company's legacy as an independent enterprise, and the opportunity to continue participation in the business as a minority investor.

The economic disadvantages of financial buyers is that the deal can lose value because of the lack of synergy that a strategic buyer would provide, according to Underwood.

"In addition, the use of leverage in creating the capital structure for the deal means that you have more players, increased due diligence, and more complexity in negotiations," Underwood says. "The more parties that are involved adds time and risk to the deal."

He added that a company is typically more vulnerable after closing a financial deal because of the high levels of debt leverage that are involved.

Strategic buyers bring added value

Strategic buyers have re-emerged into the marketplace, according to Bradley Seaman, Managing Director, Tricor Pacific Capital, and they will typically pay the highest and best value because

of anticipated synergies.

“The S&P 500 companies reported some \$600 billion in cash on their books at the end of 2004,” Seaman says. “In addition, corporations have a one-year window to repatriate offshore cash under a new tax holiday law intended to spur job growth in the U.S., so there is a lot of new money becoming available for strategic purchases.”

That provision helped Johnson and Johnson raise \$12 billion to purchase Guidant. McDonald’s also recently announced it expects to repatriate some \$3.2 billion from its foreign operations.

In addition, Seaman says that there are many other backers available for strategic purchases thanks to a bubble in credit markets. “In 2004, for example, 20 percent of all high yield bonds were Triple C rated, with an expectation that half of them were expected to default,” he says. “Hedge funds and specialty lenders have helped push debt multiples up 25 percent, so the bubble is well into the process of inflation.”

In addition to being willing to pay top dollar for “ambiguous strategic reasons,” strategic buyers also don’t try to get the seller to issue paper for the deal, and they don’t need to keep existing management.

However, Seaman says that one disadvantage to a strategic buyout is social. “We work at creating partnerships with the management in the companies in our portfolio,” he says, “but that goes

away with a strategic exit. The legacy is not there for an entrepreneur who built the business.”

In addition, opening your books to potential strategic buyers means you risk giving your competitors information on your customers, margins, and strategies if the deal falls through, according to Seaman.

“If you’re looking to make a strategic deal, we recommend getting advice from an investment banker familiar

with your industry, deciding if price is the most important factor for you, and taking a targeted approach to rifle-shot strategic buyers,” Seaman says.

IPOs and dividend recaps

Initial Public Offerings came back to life in 2004, according to Burr, who says that many companies still have a vision of going public, even with the constraints of Sarbanes-Oxley regulations.

“We are often called in by companies who want to investigate an IPO, although after we explain everything that it entails, it’s often just one meeting,” Burr says.

“An IPO is not really an exit, it’s just a way to set third party valuations. Your world becomes an open book, your regulatory oversight increases, and you will be making more disclosures.”

On the other hand, Burr says that dividend recapitalizations are an excellent way for shareholders to get returns on their invested capital, take money off the table, de-risk their personal lives, yet still retain the legacy of their ownership.

“Typically, banks would back away from lending if the purpose was to fund a dividend recap, but today, one half of all the high yield deals have a dividend component,” Burr says. “However, I believe that when capital markets correct back, the discipline on the use of capital will return, but they are not correcting yet.”

Canadian Income Trusts an alternative

Seaman said that income trust companies are becoming increasingly popular in Canada, where there are 182 funds representing \$132 billion in market capitalization listed on the Toronto Stock Exchange.

“These companies operate like a Real Estate Investment Trust, with very little income tax as long as they pay out all their cash flow monthly,” Seaman says. “They typically pay seven to nine times EBITDA values for the companies they invest in.”

...access to capital is the best it has been in the past 10 years and yet the data shows that seller expectations are down.

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**Conference Chairman,
Mike Sklar**



**Keynote Speaker,
Renowned Economist
David Hale**

Chicago became the Midwest capital of global business on February 15 this year, as participants in ACG Chicago's International Conference took an intensive look at Business Without Borders.

This dynamic one-day look at the implications of globalization, and how local business leaders can participate in the booming growth of international trade and investment, represented a commitment to a new growth frontier for ACG, according to Michael Sklar, chapter executive VP and conference chair.

"We hope that this conference whets your appetite for more information on this vast and multifaceted subject of international trade and M&A," Sklar told participants.

The world at his fingertips

Keynote speaker David Hale, a Chicago-based economist whose clients include investment management firms, major hedge funds, and multinational companies, provided a fascinating and provocative look into the future of world economic trends.

Hale said that major changes were in the offing, probably not taking full effect until 2006 and beyond. However, they would prompt significant changes from the "calm and benign" conditions we are experiencing today.

"The past three years have been characterized by expansionist U.S. policies, including tax cuts each year, the lowest capital gains tax rate since the onset of World War I, the lowest interest rates in 50 years, and the largest housing infla-

tion of the 20th century," Hale said. "While I don't see major changes over the next 12 to 18 months, there are a variety of challenges that will inevitably change the current economic climate." Hale said that changing monetary policy, government fiscal policy, and the combined effects of the weakening U.S. dollar and trade deficits would alter the current expansion. "The goal is neutral policies that will not stop the expansion, but moderate it," he said. In the area of monetary policy, the Federal Reserve will continue its current increases in interest rates, probably hiking it from 2.5% today to 3% by June.

"Contrary to expectations, long term bond rates have stayed at 4% while short terms rates went up," Hale said. "At some point that will change, but it's been like a miracle the past 12 months."

Government fiscal policy will be affected by both tax reform and Social Security reform proposals, according to Hale. He said the Alternative Minimum Tax will be a major target for reform and replacement revenues will probably come from eliminating state income and sales tax allowances. "This will not hurt people in states with relatively low tax rates, like Illinois, but it will have a major impact in high tax states like California and New York, which happened to vote Democratic in the last election," Hale said.

Hale foresees just a 50/50 chance that Social Security reforms will pass, including the creation of private accounts and changing index rates from wages to prices, as measured by the Consumer Price Index. "Democrats are terrified that private accounts will



Julie Sell, Midwest Bureau Chief of *The Economist* magazine, speaks on *The Current Climate*

turn millions of poor people into wealth owners, because that will create a whole new generation of Republicans,” he said.

Finally, the current U.S. trade deficit of \$600 billion, or 6% of GNP, is the largest in the history of the world, according to Hale. It’s currently being funded through the intervention of the Japanese and Chinese central banks, and Hale expects that to continue through 2005.

“But at some point in the future, Japan and China will decide they can’t keep funding our deficit,” Hale said. “When that happens, U.S. bond yields will rise to 6 or 7% and mortgage rates will follow, leading to a consumer recession that will cause the current account deficit to fall.”

The other solution would be increased economic growth in other parts of the world than the U.S. and China, according to Hale, although Europe and Japan economies are still sluggish. In addition, an increase in the U.S. manufacturing utilization rate would create inflation, which would cause the Federal Reserve to rate interest rates to 6-7%, which would spur a housing crisis leading to a consumer recession.

Hale said a key decision that will help determine how this economic scenario



Siva Yam, an investment banker and president of the U.S. China Chamber of Commerce speaks on *The Current Climate*.

plays out will be who President Bush appoints to replace Alan Greenspan as chair of the Federal Reserve in January of 2006.

best companies were less likely to feel like victims because they were managing changing trends.” Sell said that the major trends in international business included globaliza-

The Current Climate

A panel of experts led off the conference with a look at the current climate in international trade and investment. Julie Sell, Midwest Bureau Chief of *The Economist* magazine, said that anticipating change is the key to business success.

“A recent survey showed that unsuccessful companies claimed to be beset by forces beyond their control,” Sell said, “while the

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The Growing World of Global Business

Continued from previous page



Conference attendees listen in to 1 of the 3 panel groups offered.



Brant Ahrens, LaSalle Bank N.A., speaks on Cross Border Financing.

tion, with technology speeding the pace of this long-standing movement; demographic changes, including the aging of developed countries; changing consumption patterns, with 80% of the middle class in ten years residing outside industrialized countries; and natural resources, with both oil and water representing looming crises 40 years from now.

Greg Anderson, director of foreign exchange strategy for ABN AMRO, noted that there is a massive imbalance in regional trade today.

"The U.S. trade deficit is large and growing, Europe is in surplus with us but in a deficit with Asia, and Asia has a massive trade surplus with everyone," Anderson said.

The traditional fixes are no longer correlating as they did in the past, according to Anderson – not the falling dollar, nor correcting the U.S. fiscal deficit.

"There's never been this big of a trade imbalance before in modern economic history," Anderson said. "I believe the dollar will continue its decline in 2005 and when foreign central banks get to risk levels that cause them to stop buying, that will prompt a crisis."

Siva Yam, an investment banker and president of the U.S. China Chamber of Commerce, noted that China and the

U.S. were each dependent upon each other, and together they accounted for half of all the global growth last year. "Without the U.S., China would have had a trade deficit," Yam said, adding that half of its exports actually originated in other countries, most notably Japan.

"China continues to be very much a developing country where the supply of raw materials constrains growth and there is a large pool of unskilled labor," he said.

U.S. companies are increasingly incorporating China into their strategies, according to Yam, but they continue to face challenges from poor communication, the lack of reliable information, and so-called "well-connected" China experts. "Many people have breakfast at the International House of Pancakes and call themselves international experts," he said.

Getting the Deal Done

A nuts and bolts panel on how U.S. middle-market companies can get international deals done was moderated by Andy Rice, of Jordan Industries, who said that many mistakes can be avoided by obtaining good advice from seasoned consultants and advisors. Panelists included:

- ▶ Brant Ahrens, LaSalle Bank N.A., on cross border financing.
- ▶ Allan Cheshire, Former Director of International Consulting with RSM McGladrey Inc., on Outsourcing.
- ▶ Philip Gawthorpe, AON Risk Services, on Insurance and Risk Assessment.
- ▶ Daniel McMann, BDO Seidman, on Taxation.
- ▶ Ted Lemberis, Diners Club International, on Legal Issues.

Financing

There are many challenges for mid-market companies seeking to get financing overseas, according to Ahrens, who noted that Europe has yet to pull together its banking systems beyond the traditional provincial approach.

"The European Union has no facility for subsidiaries to draw from, so a company needs to establish credit lines in each country where it operates, or establish a Global Treasury Management system based on cash pooling, with a master account in one country," Ahrens said. "For larger deals of \$100 million or more, the market is thriving in Europe and is evolving toward U.S.-style structures. Cross-border deals are not as difficult, though they are based more on enterprise



Attendees of the Business Without Borders Conference took advantage of the opportunity to talk one on one with participating Consulates and Trade Representatives.

value, rather than collateral of assets.” Ahrens noted that financing is still difficult in China, as it is outweighed by investment. “There are only five national Chinese banks, and there are not enough foreign banks to fill the need,” he said.

Outsourcing

Cheshire said that it’s become a Wal*Mart kind of world, like it or not, heightening the importance of outsourcing as a business issue because it results in restructuring markets. Japan set the pattern of a 30- to 40-year cycle, starting with low-price, low-quality exports and moving up in value and quality as the cycle continued. “China is beginning the cycle again, but it will only take them 10 to 15 years to hit the top of the spiral,” Cheshire said. “The Fortune 500 companies are already there, and their suppliers will have to be there too.” If you like capitalism, you’ll love outsourcing, according to Cheshire, because it all comes down to money. “Local mid-market companies are learning that they can increase sales, lower costs, and generate higher profits through out-sourcing,” he said. “It needs to be done right the first time, it takes planning and on-the-ground implementation, and it leads to faster than expected growth, new selling opportunities, and net jobs addition over time.”

Insurance and risk

Gawthorpe said that risk management

is becoming an increasingly high priority in international due diligence due to globalization and the high cost of risk transfers.

“When you see red flags in the process of investigating a potential acquisition, it means it’s time to re-think the deal,” he said.

Among the unique international issues for assessing risk, Gawthorpe cited the absolute need for on-site visitations, knowledge of in-country exposures and laws, the contrasting sense of urgency with U.S. standards, the challenging data review process, the lack of a risk management culture in many other countries, and the issue of insurer security.

“In many cases, you will find companies that rely excessively on insurance, rather than taking a broader risk management approach,” Gawthorpe said. “There is a growing global trend for joint ventures, especially in emerging markets, to help manage risk issues.”

Taxation

McMann said that incorporating tax planning strategies in advance of cross-border transactions can represent potential long-term opportunities. “It can be scary the first few times you do it, but it can really pay off to carefully determine the nature of the transaction, the consideration, the acquiring party, and the tax planning objectives,” McMann said.

Factors that come into play include determining the effective jurisdiction for

acquisition indebtedness, setting future repatriation plans, deciding how to best structure the closing, and evaluating the use of offshore holding companies. “The benefits you can achieve include reducing foreign taxes, facilitating tax-efficient cash deployment, allowing for cash repatriation strategies, and providing overall flexibility for future acquisitions,” McMann said.

Legal issues

Lemberis said that the general principles of a contract in international business agreements are basically the same as in the U.S. – terms agreed upon by two parties in written contracts supercede local laws.

“But you still need local counsel for advice,” Lemberis cautioned. “If any lawyer tells you he knows the law in another country, leave.”

The only fair and equitable way to resolve disputes in international business arrangements is arbitration, according to Lemberis. “In your contract, you need to determine the language to be used, although English is almost universal; what body will govern; what law will govern; and where to hold the hearings,” he said.

“The basic premise going into any deal is that an agreement has to be fair. Your objective has to be to keep the flow of commerce going, so you can’t try to sneak anything by.”

Finally, Lemberis advised the audience to always include the force majeure clause in any contract or agreement.



▼ Rich Jander, CapitalSource Finance, Joe Fobbe, PNC Business Credit along with Cliff Deremo, Stevenson & Company enjoy networking at the ACG Chicago reception at InterGrowth.

▲ George Stevenson, President of Stevenson & Company receives the Meritorious Service Award from Jim Tucker at the ACG InterGrowth Conference.



◀ Nicole Korczak, Oryx Capital International, Mary Lou Bartlett, LaSalle Bank, Dave Althoff, Duff & Phelps and Lee Vandermyde of Harris Nesbitt were just a few of the over 100 attendees at the ACG Chicago reception.



Emerging Growth Award.

Presented to Zebra Technologies on March 22. From left... Craig Miller, ACG Chicago President, Ray Daly, Awards Co-Chair, Randy Whitchurch, CFO and Treasurer, Zebra Technologies, and Mary Warmus, Awards Co-Chair.

Case Study in Connections:

...continued from cover page.

American Appraisal's work, Vargo was able to demonstrate to shareholders that their investment on paper had increased in value by some 50 percent in a down market due to the exceptional turnaround and projected growth of the company.

Headquarters building purchase

His next order of business was to buy Bekins' 110,000 square-foot corporate headquarters and warehouse facility in Hillside, Illinois, a complex it had been leasing since 1990.

And to do so, he turned to Mark Sander of LaSalle Bank, another long-standing ACG Chicago colleague, who brought in a lending team that included Mary Lou Bartlett and Sean Silver to underwrite the deal and Larry Richman to approve the transaction.

"LaSalle Bank stepped up to help an early turnaround deal with a financing package of more than \$4 million to purchase the building, a move that saved the company more than \$3 million in leasing costs over the ensuing three years, which put the company on a solid track back to profitability," Vargo says.

Once again, Vargo was able to meet his objectives with a little help from his professional friends.

Legal expertise

With Bekins back on its feet and looking to enhance its growth prospects, Vargo turned to Gary Levenstein, former president of ACG Chicago, who brought the resources of his Ungaretti & Harris law firm to bear on some buy-out opportunities for Bekins.

"One of the deals that Gary and his team were instrumental in helping us put together was the purchase of Gilbert's Home Delivery, a competitor in

the logistics space,” Vargo says. “That brought some \$6 million in new revenue into Bekins, a business we have since expanded to some \$20 million.”

In addition, Ungaretti & Harris has continued to supply legal services to Bekins, including looking at other acquisition targets and litigation work, again demonstrating the advantages of finding professional expertise all in the family.

Financing enhanced service

Last year, Vargo helped Bekins launch a project to enhance the companies fast-growing HomeDirect USA product line, which serves online and storefront retailers by delivering large items like sofas, big-screen TVs, and high-end appliances directly to consumers’ homes.

Bekins selected IBM Business Consulting Services to integrate hand-held computers and a route-optimization system for its more than 800 drivers across the U.S., a program called STARS (Service Tracking Automated and Routing System). An essential element of the program was financing that would accommodate multiple vendors and a variable, long-term timeline, a package provided by Ray Daly at IBM Global Financing (IGF).

“Having friends you can trust is a big factor, and Ray was able to expedite the complicated process,” Vargo says. “As a result, IGF came through with 100 percent financing and is now a long-term partner with Bekins.”

IGF’s innovative loan structure allowed Bekins to draw down partial advances and avoid making a large up-front capital investment, thereby enabling Bekins to better manage its cash flow at each stage of the project.

“The ability to match cash outlays with projected benefits was very important for us,” Vargo says. “That’s great flexibility, and it has enabled us to improve service levels dramatically and enhance transportation efficiencies by up to 20 percent – with minimal increase to incremental costs.”

Additional growth capital

Most recently, with its prior senior credit agreement about to expire, Bekins wanted to replace its old structure with one from a lender who could provide a flexible asset-based structure that would give them additional growth capital beyond the value of their assets. It’s little surprise that one of the first people Vargo turned to was yet another longtime ACG Chicago colleague, Karen Peters of Merrill Lynch Capital, who connected him with Mark Gertzof and his Midwest team at Merrill Lynch Capital’s Corporate Finance Group. Merrill Lynch Capital structured a \$26 million facility that includes a \$20 million revolver, a \$3 million capex line, and a \$3 million senior stretch revolving tranche predicated on Bekins’ stable and growing cash flow.

“This new credit facility ensures that we have the flexibility to continue our tradition of exceeding the expectations of our customers with a lender who was able to bring us the best structure in the market,” Vargo says.

Looking forward

The way that Vargo has been able to reach out and tap the connections within ACG Chicago is far from an isolated example. Indeed, members leverage the networking opportunities at ACG activities on a routine basis on behalf of their own companies and

clients.

But Bekins represents a powerful case study in the value of good connections in fostering corporate growth, and one that will continue in the future.

“In every aspect of our business where we want to improve our performance, it’s a tremendous benefit to be able to reach out and touch folks that we know and trust,” Vargo says.

“Strong relationships and added credibility makes transactions much easier to accomplish, so we will continue to mine those relationships in the future.”

Has your firm recently completed a deal involving a fellow ACG Member? If so let us hear about your success story. Contact Terry Cobb at Chicagoacg@acg.org

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