

# INTERCAP M&A, LLC

## NEWSLETTER

SUMMER 2006 NEWSLETTER

EXPERTS IN THE SALE OF PRIVATELY-HELD COMPANIES

### The Top 10 Costliest Mistakes Owners Make When Selling Their Company

*Each issue of our newsletter will present one of "The Top 10 Costliest Mistakes." The entire list may be viewed on our website at [www.intercap.us](http://www.intercap.us).*

## MISTAKE #6:

### Improper or Incomplete Documentation

You don't get a second chance to make a first impression, and the stakes are high.

Quality documentation is essential to attracting the attention of premium buyers — and capturing their interest. Documentation prepared from the perspective of potential buyers can turn a company's past into a valuable, saleable future. Complete and well-prepared documentation will present a realistic, defensible foundation for the company's value and substantiate buyer expectations of future earnings.

Without quality and professional documentation, premium buyers may not dedicate their valuable time and resources to pursue the potential acquisition, or at least will view the opportunity as a potential bargain for them.

## CHOOSING A CORPORATE STRUCTURE: PLANNING IS ESSENTIAL

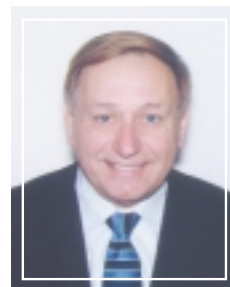
INTERCAP'S WINTER NEWSLETTER INSPIRED SEVERAL QUESTIONS AS A result of Attorney Martin Milita's article on Corporations and LLCs. It will be recalled that Marty is a businessperson who happens to also be an attorney. He is the Managing Partner of Holman Group and Holman Exit Strategies. Marty is actively involved in the M&A Market.

By way of quick review, the choice of entity decision is not so much about choosing a permanent format for your business, but more about whether the potential tax benefits of starting as a limited liability company (LLC) or an S corporation outweigh the attendant documentation and income tax compliance burdens.

Remember that both LLCs and corporations will provide a liability shield to the founders for most business liabilities (there are certain liabilities like payroll tax withholding, securities, environmental, and other liabilities that can sometimes reach owners despite the corporate shield). Recall also that an LLC cannot issue incentive stock options, something that key team members often expect. Finally, for a variety of reasons we noted that venture capital funds typically do not like to invest in LLCs and will insist that you convert your company to a C corporation before they invest.

The C corporation tax regime imposes two layers of tax: the corporation is taxed (if any), and the stockholders also are taxed when they receive dividends or liquidation proceeds from the corporation. These two layers of income tax can result in a significant

combined income tax rate. Start-up losses incurred by a C corporation cannot be used on its owners' personal income tax returns.



MARTIN J. MILITA

In contrast, both LLCs and S corporations are "flow-through" (also known as "pass-through") entities, which means that generally there is no income tax imposed on the company itself. Instead, the company's owners must include their share of the company's income on their personal income tax returns and pay tax on it.

Avoiding two layers of taxation is even more beneficial if the corporation happens to sell all of its assets in what is commonly called an "asset sale."

Unlike an LLC, an S corporation can issue incentive stock options, the conversion from S corporation status to C corporation status will almost always be a tax-free event, and it is possible for an S corporation to be acquired by a public company in a tax-free merger.

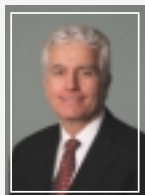
Unfortunately, S corporation status has strict eligibility requirements.

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## FREQUENTLY ASKED QUESTIONS

*Each issue of our newsletter will present one of several Frequently Asked Questions. The entire list may be viewed on our website at [www.intercap.us](http://www.intercap.us).*

### How long will a buyer expect a seller to remain with the Company?



If the buyer acquires 100% of the company, depending on the nature of the business and owner dependency issues, transition periods range from three months to one year. It is common for the former owner to start the transition period on a full-time basis and then phase into a part-time consulting role. Initial transition periods usually do not include any compensation whereas subsequent consulting will involve compensation. Transition periods, are in all cases, part of the deal negotiation.

If there is a partial sale of the business, the buyer and the former owner are each shareholders and the final exit of the owner may or may not be predetermined at the time of the partial sale. Partial sale of a company allows an owner to take some chips off the table and partner with an acquirer that brings something to the table that helps both parties grow the business.

■ *John Mullen*

### *Choosing a Corporate Structure, continued*

An S corporation may only have U.S. individuals as shareholders and an S corporation cannot have preferred stock outstanding (a popular method of financing for venture and other private equity investors).

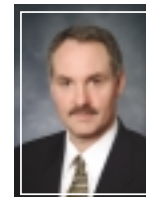
The bottom line is that the LLC structure is cumbersome in situations where employees or investors will have an equity stake in the business. An S corporation makes sense when it is possible to comply with the strict eligibility requirements, but this S status will be transitory — and may not be worth the effort — where venture funding or some other S status terminating event is imminent.

The C corporation, although the least tax beneficial choice at the early stages, is often the simplest from a documentation and income tax compliance standpoint, and many LLCs or S corporations will wind up a C corporation in the end anyway. A common approach is to start as an S corporation (if eligible), then switch to a C corporation if outside equity financing is imminent.

Planning is essential. Analyze your goals and assess the best options for ensuring smooth business succession, business sale, merger, acquisition, or recapitalization. The more you plan now, the more you earn later.

■ *Martin J. Militia*

### InterCap Announces Our New Website




In June of 2006, InterCap unveiled our new website. The new website has been designed to provide maximum information and functionality.

New sections include Briefs and Articles on topics relevant to company owners considering the M&A market, M&A Market News, with up to the minute news on macro trends in the M&A market, details on The InterCap M&A Process to better acquaint owners with what to expect prior to entering the process, and an entirely new area for Attorneys, CPAs and Financial Advisors to register in our database of other M&A professionals. ■ *Mike Ryan*

### Giorgio Foods Purchases Franklin Farms


InterCap is pleased to announce the sale of certain assets of Franklin Farms, Inc., (“Franklin”) located in Franklin, CT to Giorgio Foods, Inc., (“Giorgio”) of Reading, Pennsylvania. InterCap M&A LLC acted as exclusive M&A Advisor for Franklin.

Established in 1983, Franklin Farms has sprouted into a top grower and harvester of certified organic mushrooms in the US. The company's mushroom crop, grown completely without pesticides, includes agaricus (the popular white “button” mushroom), portabella, shiitake, crimini, oyster, enoki, beech, and miatake.



**GIORGIO FOODS, INC.**  
OF READING, PA

HAS ACQUIRED CERTAIN ASSETS OF



**FRANKLIN FARMS, INC.**  
OF FRANKLIN, CT

THE UNDERSIGNED ACTED AS AN EXCLUSIVE  
M&A FINANCIAL ADVISOR TO THE SELLER

**M&A INTERCAP**  
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