

**SOURCE: Business Week SmallBiz
August / September, 2007**

AUGUST/SEPTEMBER, 2007
BW SMALLBIZ -- BUYBACKS

How To Beat Seller's Remorse

They realized they'd made a mistake. Then these entrepreneurs buckled down and bought their businesses back

Thomas Karren founded WingateWeb in 1998, thinking it would be a side venture for vacation money. But to his delight, the Lindon (Utah) maker of Web-based event-planning software landed a big contract almost immediately, and he and his two co-founders quit their day jobs. By 2004 they'd taken the venture as far as they could on their own, so they sold it to MediaLive International, an established player in the event industry. The founders agreed to work for MediaLive in a so-called earn-out, in which an entrepreneur is paid for his company over a few years and gets full payment only if it does well as a unit within the larger one. Still, Karren prepared to retire at 37. "We thought we'd set something up that would take care of us," he recalls.

But a funny thing happened on the way to Shangri-la. In 2006, a year before the earn-outs were scheduled to end, MediaLive received an offer for all of its other properties. Once that deal was completed, WingateWeb would be MediaLive's only holding, and the founders knew it was only a matter of time before MediaLive sold it. "We didn't think a spin-out to yet another buyer would be a positive thing for our employees or customers," Karren says.

So he and his partners sat down to talk about whether they wanted to recommit their cash-outs and say goodbye to their longed-for lives of leisure. Since the sale, WingateWeb had been supporting MediaLive's other ventures, such as trade publications and marketing, and Karren felt the software had taken a backseat. "We were doing things like helping event people line up speakers," Karren says. Meanwhile, demand for Web-based event planning software was growing quickly. The founders thought that being a dedicated software company would let them take better advantage of a growing market, even without a big company's resources and legitimacy.

So two years after selling WingateWeb, they bought it back, in a deal that combined cash and the forgiveness of money still owed to WingateWeb's founders from the original deal. After that, says Karren, "we went from 25 to 50 customers in six months." Revenues, which were less than \$3 million at the time of the 2004 acquisition, will approach \$10 million this year. Nevertheless, says Karren, "there is a little bit of that *Groundhog Day* feeling where you get up every day and wonder how you wound up here again."

ENTREPRENEURS ARE QUITE FAMILIAR WITH seller's remorse. For one reason or another—because they still have the bug, because they hate what the new guys are doing, because they sold high and can buy back low, or simply because they can't quite cut the cord—it's not unusual for entrepreneurs to buy back their companies just a few years after selling them.

It can be a perilous undertaking, especially if impelled less by business acumen than by sentimental attachments. Repurchased companies often have to deal with new, corporate-size costs, bigger staffs, and atrophied product lines and customer bases. The company's credibility may need to be rebuilt. These difficulties are exacerbated when founders try to rehire all their old staff, are reluctant to cut costs, or ignore important changes in the industry, the customers, or the business itself.

This is not to say that buybacks can't work—just that a clear eye and careful planning are essential to a happy result. The first thing to realize is that your company is probably available only because the original

deal fell short of expectations—maybe calamitously so. Disappointing profitability is the most familiar culprit in deals gone wrong. "As many as 70% of acquisitions don't throw off the return the buyer expects," says **Robert Fesnak**, a managing partner in **Fesnak & Associates**, a Blue Bell (Pa.) accounting firm with clients on both sides of buybacks. It's up to you to determine whether the failure is the result of an inherent problem with the enterprise, weakness in the market, a screw-up by the new owners, or your own unreasonable behavior and expectations.

If you decide it makes sense to consider diving back in, your first step will be to try to figure out what your company might be worth in its current state. The balance sheet and cash flow statements may look a lot different from the last time you were in charge of them. Then you'll have to work with the owners to come up with a deal that won't leave you with too much debt or dangerously strain your cash flow. You'll also have to decide what the company needs to thrive as an independent entity. There may be urgently needed investments, and you might not have the proper staff or even the proper business model to move forward.

The first step, as when you sold the company, is research. "You seriously have to do your due diligence because it's not the same company you sold," says Christine Comaford-Lynch, a serial entrepreneur and former venture investor. "Did the acquirer let the product molder on the shelf, and are you going to be investing a lot in bringing it up to speed?" In addition to figuring out how much debt you'll need to finance the acquisition itself, you'll need to include some amount for product development and accept that costs might rise and revenues might slip as you attempt to manage the transition. You'll also need to compare the company's revenues, costs, profit margins, cash flow, debt, and goodwill with their previous levels and your estimate of where they should be.

At Boston's *Weekly Dig*, a small alternative newspaper that founder Jeff Lawrence sold in 2004 to New York publisher Metrocorp Marketing, costs had skyrocketed once it became part of a larger entity. "Everything got much more expensive," Lawrence says. "Printers wouldn't bargain with me. Writers wanted market rates. Everyone stuck their hand out." Lawrence bought back the company earlier this year.

Repurchasing your company might take less cash than you expect. The parent will certainly want to be compensated for the future earnings it's giving up. You can offset some of the cash by forgiving debt, forfeiting parent company stock, or leaving part of the business behind. Before selling Ebbets Field Flannels, a Seattle company that makes reproductions of old-fashioned baseball caps and jerseys, Jerry Cohen had acquired Stall & Dean, a Carlstadt (N.J.) maker of athletic apparel. This was the asset his investors wanted the most, so when Cohen was negotiating to get his Ebbets Field line back, he agreed to let the investors keep Stall & Dean.

You also should consider where you are in your earn-out and how much stock you have in the parent company. "By the time this happens, the earn-outs usually aren't significant, so they're sometimes forgotten or treated as a forgiven debt," says Dennis Ceru, an adjunct professor of entrepreneurship at Babson College in Wellesley, Mass. If the parent company is public, the entrepreneurs usually sell their stock on the public market to raise the cash. If it's private, things get more complicated. "Both sides have to agree to a valuation, and that can be crazy," says Ceru.

The financial health of the parent company and your potential spin-off will affect how things play out, too. When Jeff Lawrence repurchased the *Weekly Dig*, both the *Dig* and Metrocorp were financially viable. Not surprisingly, the deal was pretty straightforward. When he sold the *Dig*, Lawrence kept a minority stake. When Lawrence wanted the company back, he simply used cash and a short-term note to buy out Metrocorp's stake.

Things were more complicated for Felicia Palmer, who sold 4Control Media, a Jersey City operator of hip-hop news and community Web site SOHH.com, to Urban Box Office in 2000. UBO bought some 20 properties and went from roughly 30 to 300 employees in a matter of months, then failed to get much-anticipated financing. Barely 10 months after Palmer went on the UBO payroll, the company filed for bankruptcy. Palmer refers to her buyback as "more of a settlement than a sale," albeit one that ran her \$35,000 in attorney's fees. She and her partner forfeited money they were owed, and UBO forfeited its right to the 4Control assets.

Often, the repurchase price isn't of paramount importance to the parent. "Out of six deals I've been involved with in the past few years, four were bought for less than the value of their assets," says **Fesnak**, the buyback adviser. "A \$3 million business out of a billion-dollar company is not a big deal. They don't want to take a big hit, but once they decide to get rid of the business, they want to move it along. They don't need to hold out for the best price."

EVEN MORE IMPORTANT THAN NEGOTIATING the deal is knowing what to do once you're on your own again. In repurchasing the *Weekly Dig*, Lawrence knew he had to make changes well before he was free. Metrocorp management "knew for several months that we wanted to buy the paper back and gave us time to position it," he says. Metrocorp had put the *Dig* on a five-year growth plan that would have let it operate at a loss for three years. But to run an independent paper, says Lawrence, "I had to get my costs in line with my revenues." In the runup to the deal, he cut employment from 28 to 20 people, cut the freelance budget, and reduced circulation from 65,000 to 50,000. Lawrence expects revenues to be about \$2 million in 2007, up from about \$750,000 when he sold the paper, and he says the paper is headed toward its first profitable year.

Palmer wasn't prepared for such straitened circumstances once she regained 4Control. Since UBO went bust so soon after purchasing her company, it didn't have time to line up the sponsors and strategic partnerships it had promised. Palmer's business model was built on advertising, and the ad market crashed just as she was negotiating her buyback. She had no revenue stream and no plan for carrying the business. Yet she felt responsible for her 14 staffers and tried to keep them on. "We had a little money left over from the sale and I blew it all on HR," she says. "I had to let them all go after six months anyway because we ran out of money." Over the next two years, she moved the business into her house, which she refinanced, and borrowed from her mother so she could pay basic operating expenses like leasing servers.

Early in 2003, things started to turn around. Business had been dead, and she decided to pack it in and look for a job. She even sent a letter to her customers saying she would be shutting down. Then she received a request for a proposal from Coca-Cola for a \$20,000 ad campaign. "When you have no revenue, \$20,000 is a lot," she says. "I thought we'd do this one deal and that would be it." At least she could pay her debts. But more advertisers sought her out, and she saw a chance to rebuild, this time with a real business plan. Today she sets a budget based on projected ad revenue and doesn't invest in new people or technology until the cash is in the till. The company is profitable, with projected revenues of \$2.5 to \$3 million this year.

Besides facing up to the hard necessity of laying off staff, you'll need to shed any attachments to the old way of doing business, as Cohen of Ebbets Field Flannels learned the hard way. When Cohen started his company in 1988, he painstakingly researched original designs and fabrics for uniforms from old Major, Minor, and Negro League baseball teams and sold them by catalog to a small but loyal group of customers. After he reacquired the business in 2005, he set out to rebuild his neglected customer base.

Unfortunately, he headed full speed into the past instead of the future. He still thought of his company as the catalog business he'd started in the 1980s, but the mail-order industry had changed radically. Mailing and printing prices had soared, and response rates to Cohen's mailings were not bouncing back enough to justify those costs. He hired back all of his old employees. "It was a nice idea," says Cohen, "but not practical." By the end of his first year he was borrowing from the bank just to meet overhead.

Midway through last year, he began laying off staff and streamlining overhead. He cut back on mailings and replaced a Seattle store that didn't draw enough foot traffic with a small factory outlet within his offices. That saved money and helped Cohen focus on where the mail-order business was going: online. He reduced the number of baseball caps pictured in his catalogs by more than two-thirds, inviting people to the Web site to see more. He also started using the Web to track customer behavior and better tailor e-mails and mailings, sending one mailing to customers who buy jerseys and another to impulse buyers who order T-shirts during the holiday season. "Once we started experimenting, we found things that worked, and we got some momentum," explains Cohen. He says the company moved into the black in 2006, and he expects revenues of around \$1 million this year, about where they were before he sold. Next up: high-end tour merchandise for rock bands and premium giveaways for corporations. That will let Cohen do custom work on a bigger but still manageable scale.

ONCE YOU'VE GOT YOUR COMPANY BACK IN the fold and healthy, your next step might sound surprising: If the stories of our entrepreneurs are any guide, you will seek another buyout. Three of the four—Palmer, Karren, and Cohen—are looking for investors again. They say they'll choose their partners more carefully this time and bring greater savvy to negotiations. Palmer is looking for a large, established media company with solid finances. Karren and Cohen would each prefer to find a venture capital investor who is interested in their companies solely for what they are.

All three will do what they can to get paid up front, relinquish control, and move on as soon as possible. "When you have an earn-out, you have handcuffs on. You have to meet objectives, but you don't have control," says Karren. "And no matter what goes down on paper, after the smiles and handshakes are done, everyone will do what's in their best interest." Now, happily, he's free to concentrate on his own best interest.