What is the Value of Having a Well-Diversified Customer Base?

Private equity buyers can't live with the risk that you could be shut down or severely crippled by the loss of a dominant customer.

In recent years, the retail distribution of consumer goods has been increasingly dominated by a few behemoth retailers. We call them "big box" retailers – the Wal-Marts, Home Depots, and Staples of the world. Companies whose buying power is so great that they exert enormous control over the entire supply chain.

It's a story we hear a lot these days – from small manufacturers who have found themselves seduced by the apparent security, stability, and high growth potential from doing business with a big box retailer.

Win-Win Lure – or Bait and Switch?

At first, it feels like a windfall. You get a big order, with the potential for a national roll-out, and the profit margins are decent. You can predict your production, improve your own raw material buying power, and ensure stable employment for your workers. Then, perhaps a year or two into the relationship, after the big box retailer represents more than 30% of your sales, the other shoe drops. The customer puts the squeeze on your margins, asks you to deliver more value and services for less, and wants you to agree not to sell to their competition. Before you know it, you're little more than a captive outsourcing arm – and a modestly compensated one at that.

By the time an owner in this predicament asks us about the prospects for capturing his enterprise value, it's often too late. We have the unhappy task of explaining why selling the business is not a promising option.

Having too many eggs in one customer's basket makes you much less attractive to both strategic and financial buyers.

Private equity firms acquire companies that they believe have a strong potential for predictable future profit. They can't live with the risk that you could be shut down or severely crippled by the loss of a dominant customer.

For strategic buyers, the issue is much more complex. Acquiring your company and its behemoth customer will, by definition, upset the status quo for all involved. How will the buyer's existing customers perceive the addition of your big customer? Will it threaten their

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relationship and existing source of supply? How will your big customer react to the new owner's supplier relationships? Will the synergy be positive?

If you do find a buyer who's interested in your enterprise, despite your dependence on one customer, the purchase price offer will be hugely discounted from what it could have been if you had a broader customer base.

This "Lesson Learned for Building and Capturing Value" reflects knowledge and insights we've gained working with privately held companies throughout North America.

For more information about The Bigelow Company, visit www.bigelowco.com or call us at 603-433-6000 for a confidential discussion of your unique situation.

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Flaming Florals Candle Company isn't Waiting for a Big Liquidity Event

These true stories feature three Bigelow clients who emerged victorious from their encounter with the big box seduction. Each one pursued a different strategy, but all have successfully captured the value of their enterprises.

Rose Devens started out making holiday gifts for her friends – never imagining that she would soon be caught up in the hot new market for scented candles. After several years of steady growth, selling to specialty gift stores, she landed a major retail client that transformed her sleepy business.

Rose approached The Bigelow Company with the hope of finding a buyer for Flaming Florals. She assumed that her $20 million in revenue and $5 million in EBITDA would make her an attractive target for a major candle manufacturer.

However, with one customer representing 75% of her revenue, selling Flaming Florals was not an option. Fortunately, there was another way for Rose to capture her value. Instead of reinvesting her annual profits, we advised Rose to distribute them out each year. Today, she has over $10 million in the bank and her big box customer keeps calling, ordering enough to keep her employees happy and her profits accumulating. The day Flaming Florals candles stop burning, Rose Devens can retire with a fittingly rosy financial future. In effect, she is realizing her capital gain over time.

When the Big Box Retailer Called, Brightworks Just Said "No"

The design and craftsmanship of Brightworks lighting fixtures has earned them an enviable leadership position in the home lighting industry. Customers are happy to pay a premium for the fixtures' quality and artistry, and they value the ability to have their orders customized to their specifications.

Brightworks' owners immediately recognized the danger inherent in a big box retailer's highly lucrative offer to carry the Brightworks line. They knew that selling through a mass retailer could tarnish the Brightworks brand and compromise their relationship with their loyal lighting showroom retailers. Resisting the lure of an immediate jump in revenues and profits, they turned down the big box offer and continued to focus on the profitable and growing lighting showroom segment.

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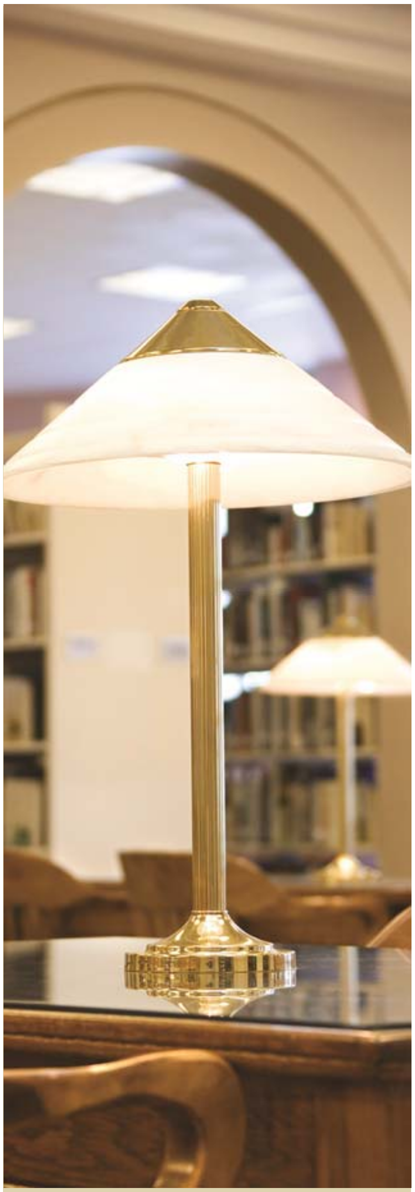

Fourteen years after near incineration by a single hot customer, Sonny sold his enterprise for 7x EBITDA.

This decision paid off handsomely when it came time to capture the value of the Brightworks enterprise. Impressed with their industry-leading profit margins, the breadth of their customer base of 2,000 retailers, and the cache of the Brightworks name, a private equity firm recapitalized the company, providing the owners with partial liquidity at a premium valuation, and the promise of another future capital gain as the company grows.

Icarus Press Got Burned, But Survived to Change Strategy

Sonny, the owner of Icarus Press, thought he had it made. After years of struggling to make a living printing short-run 2-color pamphlets, he had found a happy partnership with a promising young catalog company. The two companies flourished together, with Icarus investing in expanded facilities and expensive new printing presses to keep pace with the catalog company's exploding growth.

Overnight, Icarus Press' business melted away, and the company crashed into red ink. The catalog company, newly acquired by outside investors, dropped Icarus for another low-price printer, taking 75% of Sonny's revenues with them. Desperate to avoid liquidation, the bank that had financed Icarus' ambitious growth called in The Bigelow Company for advice.

Over the next decade, we worked with Sonny to develop a diversified customer base. Never again did he allow any one customer to represent more than 10% of his revenues. The strategy did more than restore Icarus to profitability. Recently, 14 years after near incineration by a single hot customer, Sonny sold his enterprise to a strategic buyer willing to pay 7x his EBITDA – a healthy multiple in today's marketplace.

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