Focusing on the Balance Sheet

A New Approach to Family Wealth Management

The Panel

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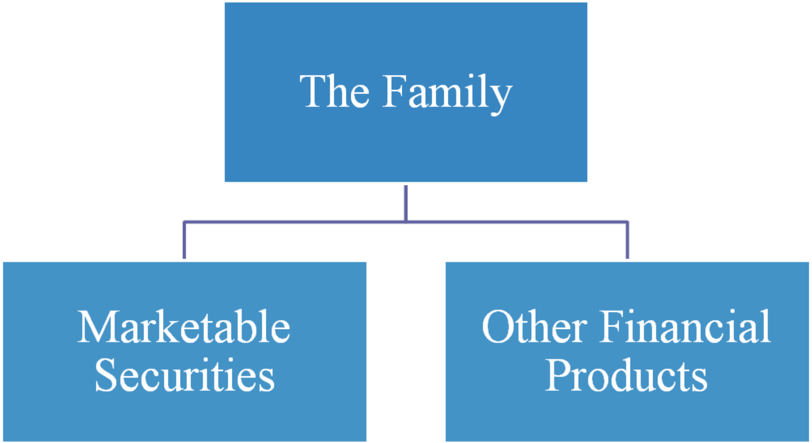
Thesis

- Current “de facto” definitions of “wealth management” do both the industry and the truly wealthy family a disservice by focusing on investable assets and products to the exclusion of a more holistic and economic view.
- The time has come for a new paradigm whereby such families are viewed as they truly are: multi-generational economic **“Family Enterprise”** with complex balance sheets and cash flows. As such, they are ongoing streams of economic activity which not only require the highest application of intellectual and real capital but which can also produce economic returns for the savvy “investor”.

The Family: Traditional WM View



Implications of New Paradigm

The "Family Enterprise" view:

- Holistic view of client provides better data for asset allocation.
- Broad asset base provides variety of collateral and sources of cash flow for financing at franchise level.
- Analysis of cash flow streams at franchise and subsidiary levels.
- Risk analysis yields to risk/return analysis.

Case Study: Smith Family Enterprise

Hiram Smith is the Chairman and CEO of Smith Widgets, a company he founded in 1979. Due to a proprietary widget making technology, Smith's company has grown exponentially since its founding and now controls more than 60% of the market. Smith stock has also had a dramatic run. Hiram has borrowed against its ever increasing value, using stock margin loans, to purchase a variety of other assets .

By October 2008, the widget market has gone into a tailspin and so will Smith stock. Unfortunately, the bulk of the Smith stock decline comes in one week after Smith announces disappointing quarterly earnings. In the three trading days following the announcement, Smith stock drops 30% and then another 70% the following week.

The private banks, who had continued to hold Smith stock as collateral for the margin loans, sell it out entirely for $150 million, leaving them with an $412 million in aggregate unsecured debt resulting from the deficiency of stock sale proceeds.

Case Study: Smith Family Enterprise

Smith "Family Enterprise" Balance Sheet as of 9/1/08

- $750 million company stock; leveraged 75% ($562 Million)
- $250 million book value in Private Equity funds; $75 MM of future commitments
- $100 million direct investment in private companies.
- $50 million Hedge Fund portfolio
- Operating agricultural property: Maine (50,000 acres)
- 5% ownership: Sports franchise
- Primary residence: Manhattan
- Secondary residences: Mount Desert, Palm Beach, Telluride
- Significant collection of American Impressionist Art

Case Study: Smith Family Enterprise

Smith "Family Enterprise" Balance Sheet issues as of 12/1/08

- Stock devalued by 80% to $150 million then sold and applied to reduce debt
- $412 million of stock loan "deficiency" remains outstanding and in Default
- Private Equity future commitment remains, portfolio value unclear
- Direct investment in private companies stable
- 25% of Hedge Funds gated
- Annual debt service: $16.8 million
- Annual cost of living excluding debt service: $20 million
- 2007 total comp: $48 Million; 2008: TBD

Case Study: Smith Family Enterprise

Smith "Family Enterprise" Issues:

- Unsecured stock deficiency loans are in Default and immediately payable.
- Minimal liquid assets available for repayment or collateral.
- Lending banks are threatening bankruptcy if not paid back.
- Bankruptcy would trigger a SarBox event leading to employment termination.
- Value of Private Equity portfolio is unclear.
- Redemption possibilities from Hedge Funds is limited.
- Cash flow is restricted.
- Client is experiencing a "Structural Debt Squeeze".

Case Study: Smith Family Enterprise

Private Banks' Issues:

- Loss of liquid collateral on loans; $412 million now "unsecured" and in Default.
- Available collateral from client is outside banks' lending policies.
- Fear client's ability to pay debt service is significantly impaired.
- Internal auditors applying pressure to reclassify loan.
- Need to move loans to "workout" group due to change in situation.
- Need an immediate workable solution to avoid "write down".
- Client's viability as economic entity in doubt.

Case Study: Smith Family Enterprise

What happens to
Hiram Smith
Now?

Case Study: Smith Family Enterprise

Hiram’s Alternatives:

- Traditional Wealth Management Approach:
  - Sell assets and pay off debt

- New Paradigm Approach:
  - **Restructure Hiram Smith using “Family Enterprises” view**

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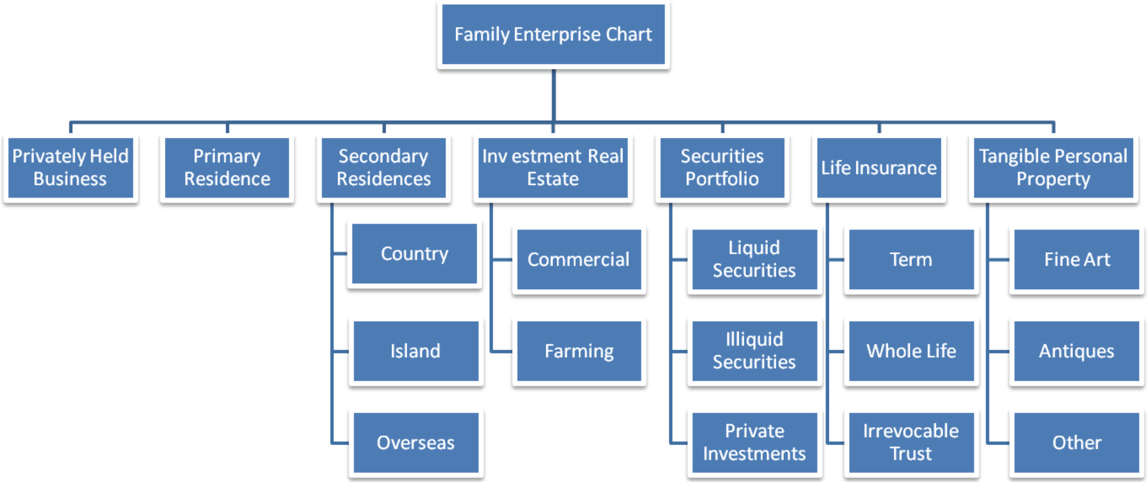
Case Study: Smith Family Enterprise



Case Study: Smith Family Enterprise

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Restructuring Alternatives

- Work to secure existing lending group.
  - (collateral issues; relationship fatigue; unwillingness to extend terms)
- Find a new lender to refinance in whole or in part.
  - (removes relationship fatigue but not other issues)
- Find an investor.
  - (introduces concept of “return” on an individual)

Case Study: Smith Family Enterprise

Hypothetical Investor Proposal: Debt with Equity Kicker

- Smith “Family Enterprises” issues investor $500 million of five year debt.
- Smith “Family Enterprises” uses proceeds to pay off banks. Covenants to invest balance in liquid fixed income portfolio to defray cost of debt.
- Investor receives cash interest of LIBOR plus 4.5% and additional payments equal to 20% of upside in private equity portfolio and direct investments.
- Investor to obtain first lien at agreed upon value on negotiated combination of Private Equity, Hedge Funds, direct investments, secondary residences and operating agricultural property.
- “DIP” financing alternative available.

Case Study: Smith Family Enterprise

One Remaining Issue:

Today: **No such investor exists**

Question: **Can such an investor be created?**

Answer: **Yes.**

Conclusions

- By their unwillingness to assume collateral other than marketable securities and primary residences, the money center private banks have disintermediated themselves from financing entrepreneurial wealth.
- A void exists that can only be filled by private investment not subject to the strictures now imposed on these banks by their management.
- Absent the creation of a private investment capability that recognizes the innate value of an ongoing economic enterprise like Hiram Smith and his family, Smith “Enterprises” may not be able to “live to fight another day.”