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— ATTORNEYS —

VEBER  PARTNERS

# Business Exit Strategies

June 1, 2016

# Private Company Wealth

“The greatest part of America’s wealth lies with family-owned businesses. Family firms comprise 80% to 90% of all business enterprises in North America.” (J.H. Astrachan and M.C. Shanker, "Family Businesses' Contribution to the U.S. Economy: A Closer Look," Family Business Review, September 2003)

“... households with entrepreneurial equity invest on average more than 70 percent of their private holdings in a single private company in which they have an active management interest.” (Returns to Entrepreneurial Investment research paper, Tobias J. Moskowitz & Annette Vissing-Jorgensen)

# Readiness and Succession Planning

Top ten challenges for family owned businesses:

1. Succession
2. Labor costs
3. Health care costs
4. Finding qualified employees
5. Foreign competition
6. Labor union demands
7. Domestic competition
8. Oil prices
9. Availability of credit from lenders
10. Estate taxes

# Readiness and Succession Planning

“40% agreed that formalizing and modernizing the business is a key challenge over the next five years.”

(PwC, Family Business Survey, 2014)

“Only 16% of family businesses have a discussed and documented succession plan in place.”

(PwC, Family Business Survey, 2014)

# A few questions to ask yourself

1. What will happen with your customers, your vendors, your employees, and your competitors if something happens to you?
2. How do you see your involvement in your business changing or evolving in the future?
3. What is your plan for your ownership interest in your business: do you plan to pass ownership along, or arrange for a sale some day?

# **Case Study**

## **Transition Readiness**

# Case Study – Transition Readiness

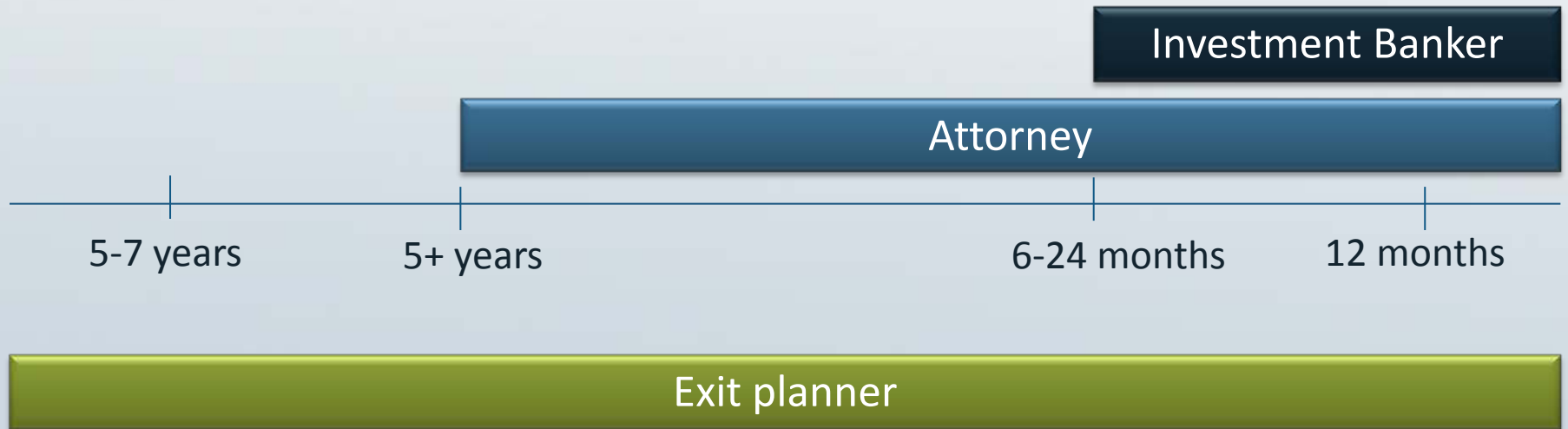
- › Local manufacturing company with EBITDA of \$5 million (adjusted)
- › Ownership: 50% father (58), 50% mother (56)
- › Retirement: Planning for age 63-65
- › Family: Daughter works in bus.; son does not
- › Key mgmt.:
  - Father, CEO
  - Non-family COO
- › Owner goal: Maximize value in sale to 3<sup>rd</sup> party

# Case Study – Transition Readiness

- › Issues:
  - 40% customer concentration
  - Key person
  - Inaccurate financial statements, not timely
  - Reliance on unprotected products/processes
  - C-Corporation
  - Environmental issues
  - Long-term warranty obligations
  - Union pushing for contract
  - Equalizing estate plan?



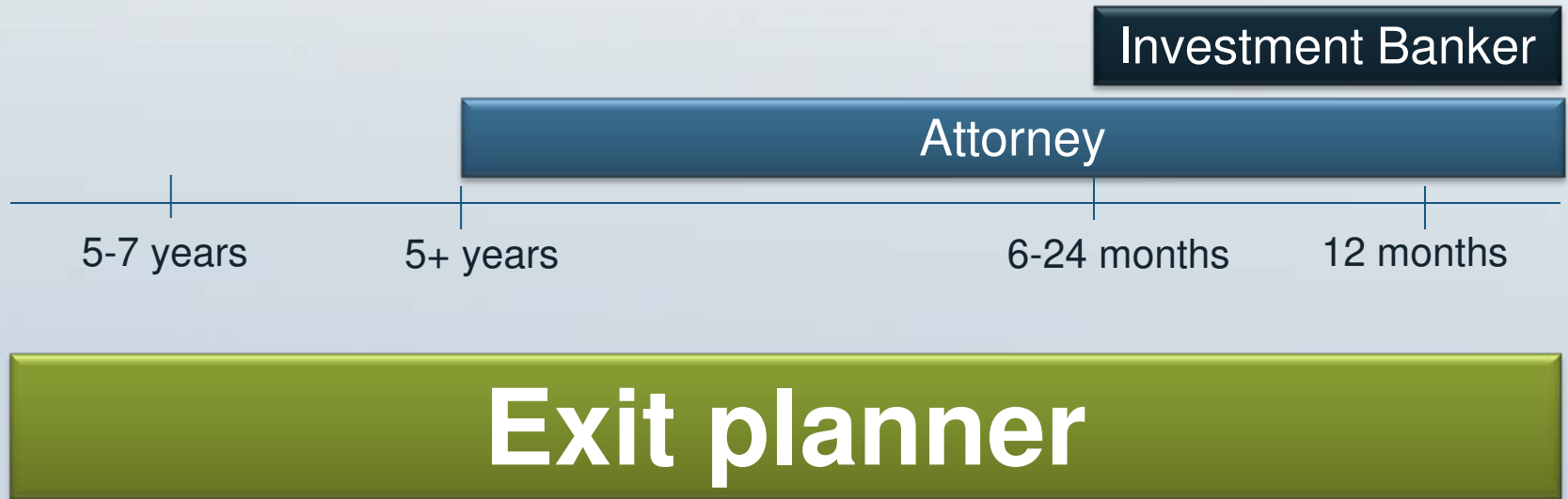
# Timing – Who do you call & when?



# Exit Planning Timeline

- › 5 years - S Corp Election
- › 3-5 years - Reducing customer/vendor concentration
- › 2-5 years - Environmental
- › 2-3 years - Tax planning vs. increase of EBITDA
- › 2-3 years - Distributing Excess Assets
- › 1-3 years - Intellectual Property  
(Patent/Trademark/Copyright)
- › 1-3 years - Obtaining Employment, Non-competition  
and Shareholder Agreements
- › 6 mos.-2 years - Filing registration in proper  
jurisdiction

# Timing - Who do you call & when?



What Do I Want?

**GAP**  
Closing The Gap

What Do I Have?

Exit Paths

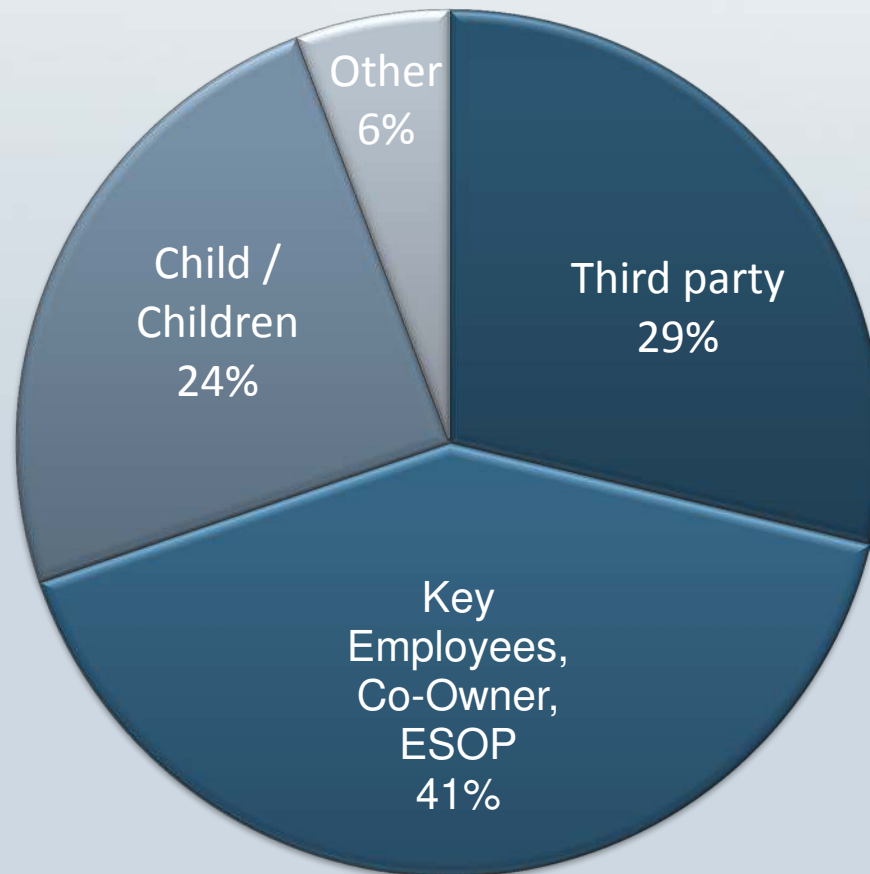
Third Party

Inside Sale

Death

# Owner Demographics: Exit Plan Paths

Business Owner Market: When owners do plan exit path choices



# Closing the Gap

# Closing the Gap

- › Business owners want/need to:
  - Protect Business Value (Minimize Risk)
  - Preserve Value (Minimize Taxes)
  - Promote Value (Build Value through Value Drivers and Incentive Planning)

# Minimize Risk to Business

- › Key employees leave & compete
- › Breach of confidential information
- › Uninsured casualty loss
- › Death of key person
- › Death of owner
- › Financials



# Minimizing Taxes

- › Tax planning
- › Estate planning
- › Retirement funding
- › Domicile

# What is "transferable value"?

"Ultimately, your success is measured not by how well you run the business, but by how well the business runs without you."

—John H. Brown,  
speaker and author of best-selling  
exit & succession planning books



# Growing Transferable Value

- › Transition owner's role to working on, not in business
- › Develop "Best of Class" management; stays after owner leaves. Motivate and keep key employees
- › Develop operating systems that improve sustainability of cash flow
- › Solidify and diversify customer base
- › Obtain valuation and understand drivers
  - Fair market value for estate planning & internal transfers
  - Strategic value for 3rd party sale “finding the market”

# Levels of Value

## Levels of Value

**Strategic Control Value**

Strategic  
Control  
Premium

**Financial Control Value**

Financial  
Control  
Premium

Lack of  
Control  
Discount

**Marketable Minority**

Marketability  
Discount

**Nonmarketable Minority – Voting**

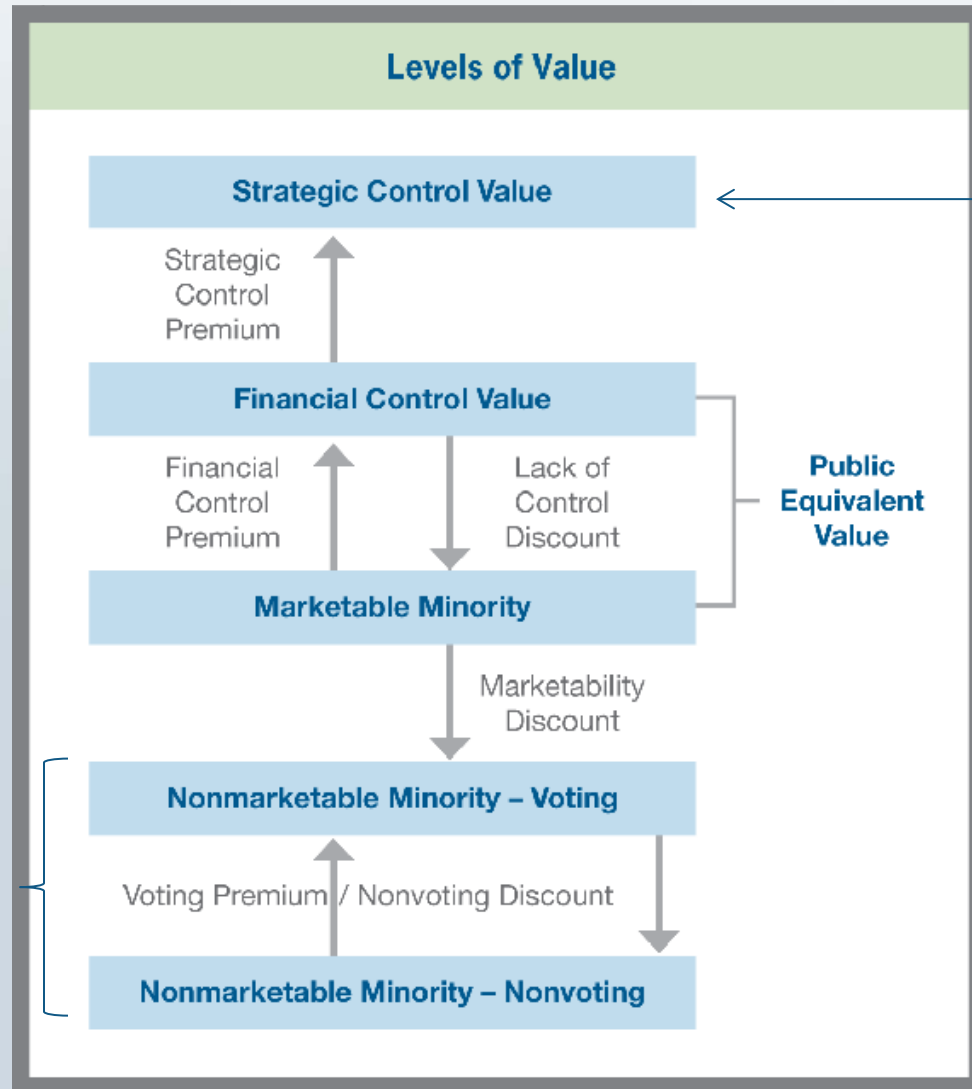
Voting Premium / Nonvoting Discount

**Nonmarketable Minority – Nonvoting**

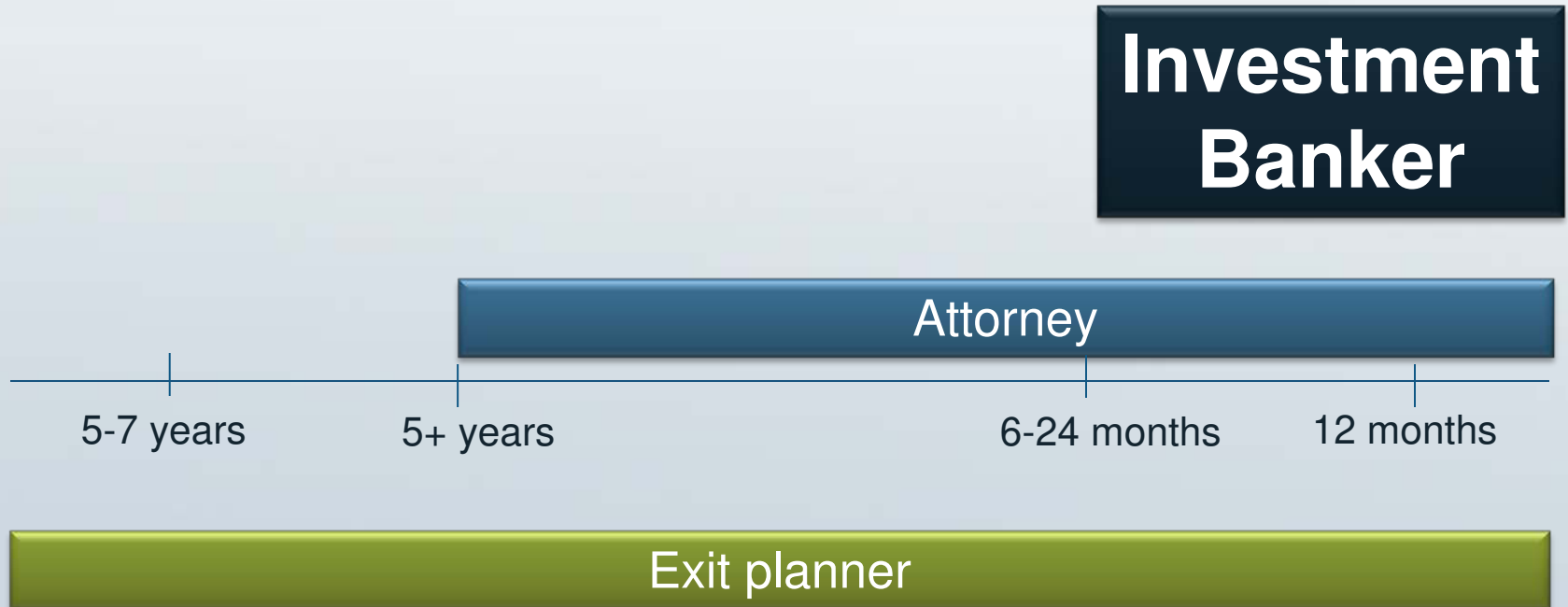
← Finding the market

**Public  
Equivalent  
Value**

Estate  
planning



# Timing - Who do you call & when?



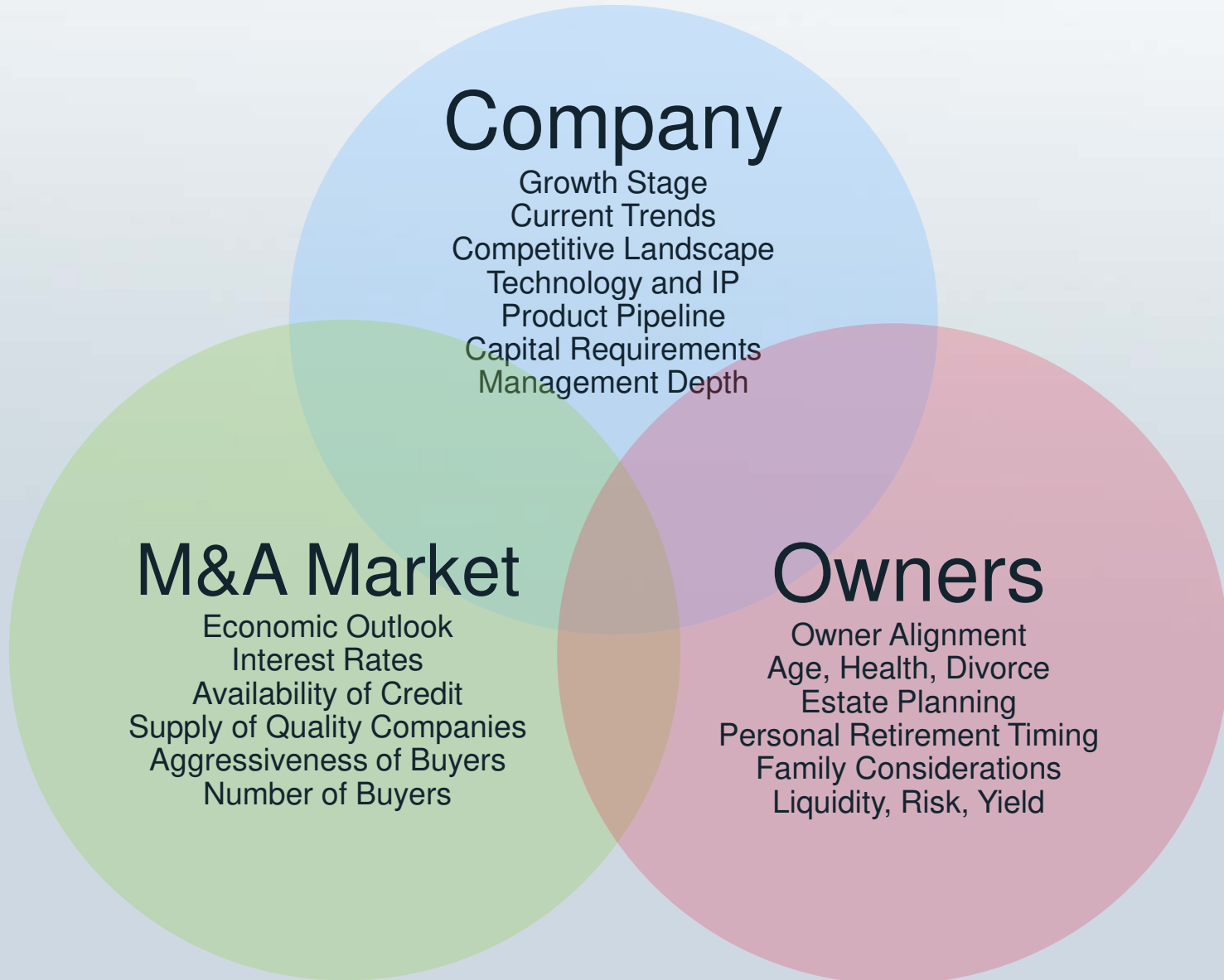
# Value Considerations

- › Company history, maturity
- › Revenue size, growth & quality
- › EBITDA, EBITDA growth, EBITDA margin
- › Capital requirements
- › Technology and Intellectual Property
- › Product line, product pipeline

# Value Considerations

- › Competitive position within the market
- › Performance of company in relation to performance of market
- › Quality and stability of management
- › Legislative and regulatory environment
- › Brand value
- › Barriers to entry
- › Growth prospects

# Three Realms to Consider





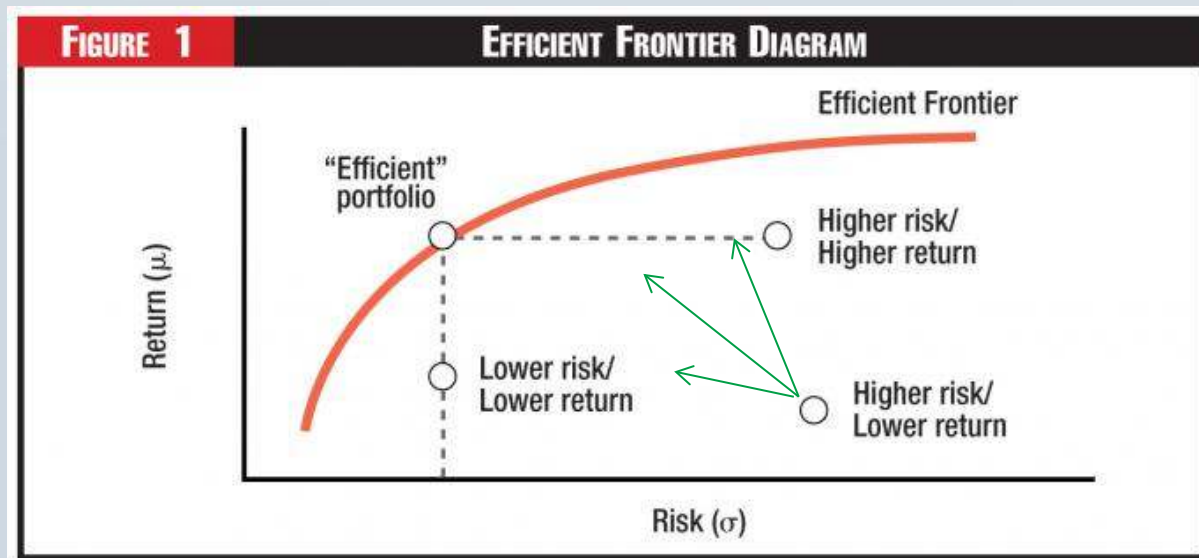
# Three Primary Motivations

- › Strategic business reasons
  - Competitive position of company within the marketplace
  - Company needs some combination of capital and talent
  - Industry trends, and increasing speed of evolution



# Three Primary Motivations

- › Investment reasons
  - Risk, Return, Liquidity, Yield
  - Efficient frontier, modern portfolio analysis
  - Is the return I'm receiving adequate for the risk I'm taking?

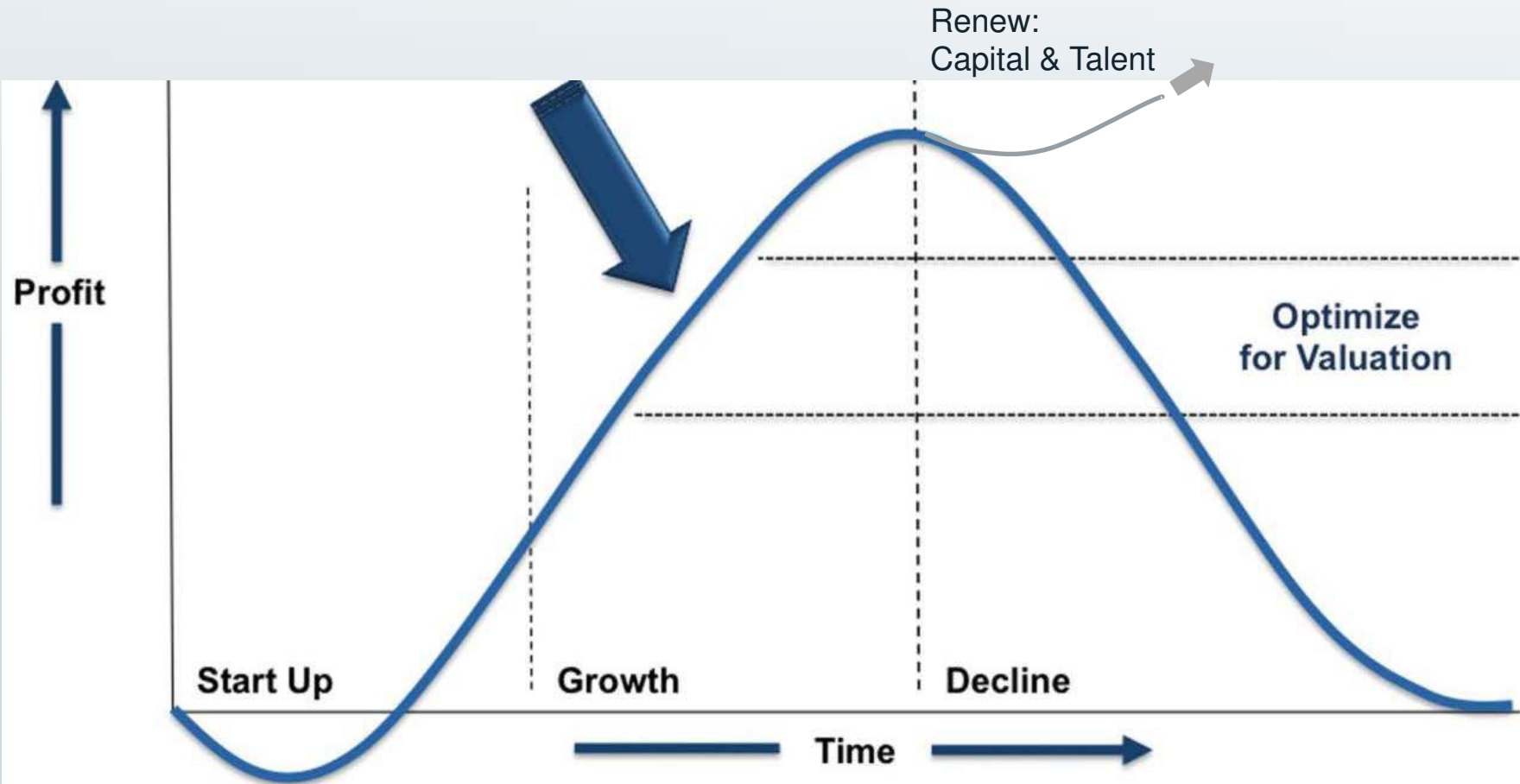


# Three Primary Motivations

- › Personal reasons
  - Health & Age
  - Allocation of time and resources
  - Appeal of an alternate investment/career
  - Family dynamics

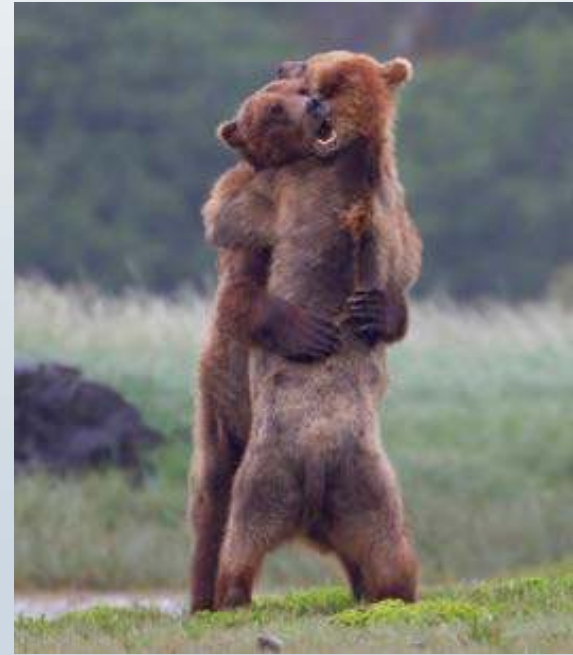


# Company cycle – don't wait too long



# Beware the Bear Hug

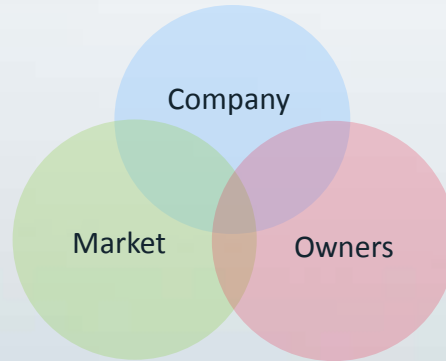
- › Don't get seduced by a single buyer
  - Easier process, until the negotiation begins
  - Shorter time, but more likely to fail
  - Typically less value, but the seller knows for sure
  - Impossible to negotiate effectively with only one buyer
  - Re-trading of initial offer is common
  - Walking away is expensive
    - Failed sale attempt history
    - Difficult on owners and management
- › Don't let someone else set your timing
- › If the time is right, engage in a process



# Transition is Inevitable

## Optimization requires planning

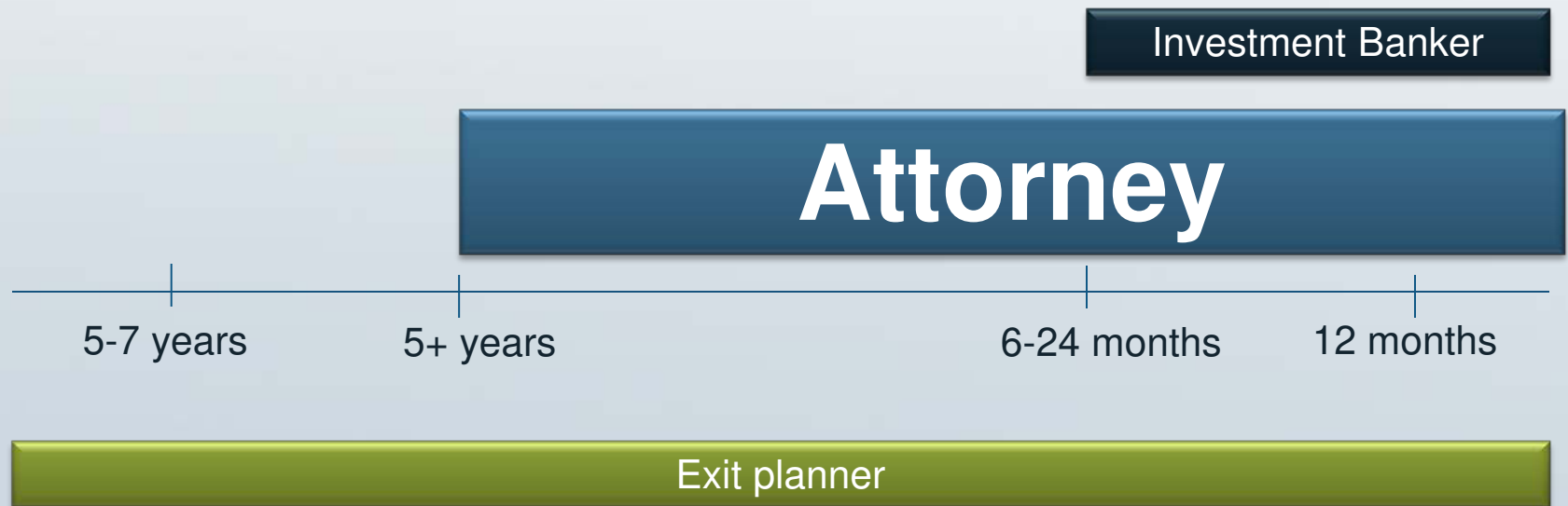
- › Be proactive



- › If not ready for a complete exit, consider a partial exit
- › Owners tend to underestimate the value of timing the M&A market
- › Asset traders are engaged in market timing - business owners should do the same
- › All else being equal - a strong market should trump conventional timing
- › Engineer a competitive environment



# Timing - Who do you call & when?



# Driver of Value/Deal Considerations

- › Structure of Sale
  - Asset Sale vs. Stock Sale vs. Franchise
- › Entity Issues
  - Type of Entity
  - Affects sale & taxes
  - “C” vs. “S” vs. LLC (Corp. Level vs. Pass Thru-Taxation)
  - Deemed Sale/Spinoff
  - Partnership liabilities
  - Drag Along/Tag Along
  - Additional entities needed



# Cash vs. Leveraged Sale vs. Merger

- › All Cash
- › Cash with Note and security
- › “Be Important” as creditor
- › Degradation of business after sale
- › Subordination to buyer’s lender, line of credit

# Values (Reduction in Values) to Purchaser

- › Free and clear assets
- › Patents, trademarks, copyrights (registration)
- › Trade secrets
- › Non-Compete/Non-Solicitation agreements
- › Confidentiality agreements

# Values (Reduction in Values) to Purchaser

- › Term Employment Agreements
- › Long Term Contracts with Customers (Good/Bad)
- › Lease Agreement (Good/Bad)
- › Franchise/Licensing obligations (Good/Bad)

# Transaction Concerns

- › If sale on contract - limitations on transfer (due on sales clause)
- › Third party consent requirements – lack of assignability
- › Concentration of clients
- › Below market contracts
- › Drag along / Tag along
- › Reliable Financials (or lack thereof)

# Transaction Concerns

- › IP not protected/no registrations of P/T/C/TN
- › Unpaid tax issues
- › Not registered in proper jurisdiction (federal, state, county, city, etc.)
- › Warranty liability (holdbacks)
- › Collection of A/R (hold backs / set off)
- › Maintenance of continuing business/revenue stream - (earn out/warranties/hold back)

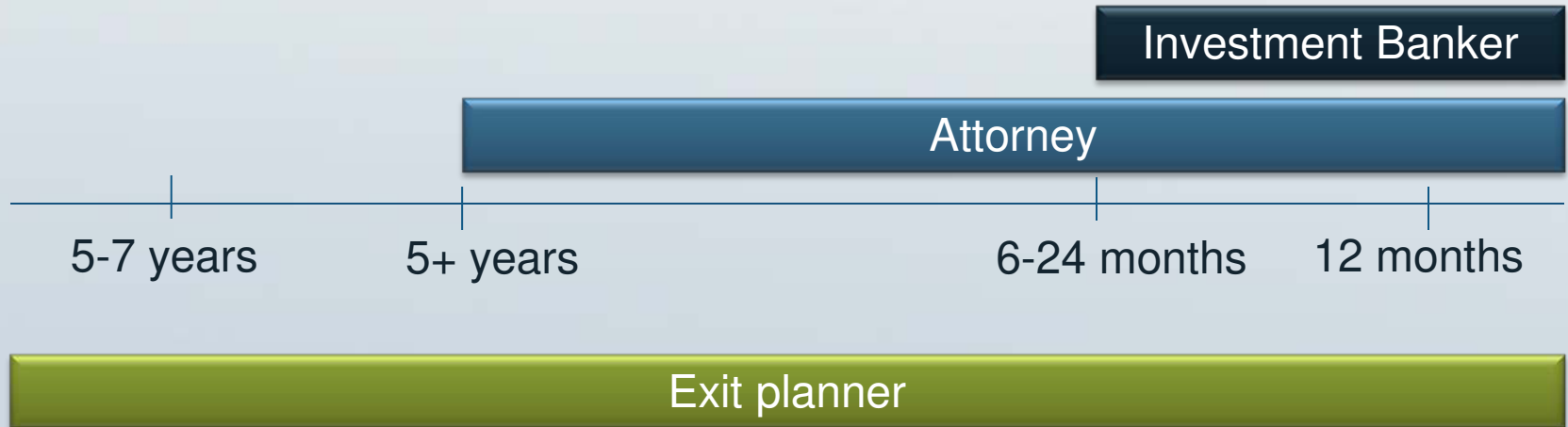
# Transaction Concerns

- › Continuity of workforce/management/non-compete
- › Owner's continued relationship to business
- › Changing technology, consumer needs, consumer wants - (buggy whips, palm pilots, flip phones)
- › Confidentiality

# Due Diligence

- › Buyers consider the following:
  - Cash flow
  - Environmental
  - Warranties
  - Vendors
  - Asset condition
  - Consumer tastes
  - Concentration
  - Workforce

# Timing - Who do you call & when?





# Take action!

- › Answer the exit planning Qs & discuss w/ advisors
- › Complete the business continuity checklist w/ advisors



The image shows the cover page of a 'Business Continuity Plan' form. The title 'Business Continuity Plan' is prominently displayed in white text on a green background. Below the title, the date 'JUNE 2016 | Rev. 1' is printed. The page is divided into sections for instructions and contact information. The instructions section explains the purpose of the form and provides guidance on how to use it. The contact information section lists three individuals: Paris Powell, Lisa Goecke, and Eric Hornel, along with their roles and contact details. The form is designed to be a guideline for business continuation or disposition in the event of the owner's death or incapacitation.

## Business Continuity Plan

JUNE 2016 | Rev. 1

**Instructions:**

This form is meant to serve as a guideline for the Continuation or Disposition of the Business in the event of the death or incapacitation of the Owner.

Complete this form to the fullest extent possible. Share it with your Spouse and Trusted Advisors. File a copy with your Will, Living Trust and Buy/Sell Agreement. Review and update it every year.

If you have Legal, Tax or Estate Planning questions, please consult with your Trusted Professional Advisors.

DATE OF COMPLETION: \_\_\_\_\_

NAME OF INDIVIDUAL COMPLETING FORM: \_\_\_\_\_

COMPANY: \_\_\_\_\_

**1. MANAGEMENT**

For any questions or additional clarification, please contact your Exit & Succession advisor or one of the Perkins & Co Exit & Succession planners:

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# Take action!

- › Accurate financial reporting
- › Fiscal year-end review
  - Review of business income tax status
  - Additional corporate considerations
  - Individual planning considerations
  - Review of owner-based goals

# Take action!

- › Legal audit/planning
  - Corporate structure/documents
  - Operating documents
    - Management contracts
    - Intellectual property
    - Leases
    - Franchise agreements
  - Ongoing practices and procedures

# Take action!

- › Balance 3 realms (including the M&A cycle) & 3 motivations
- › Work on customer/vendor concentration
- › Build management team
- › Get the best advisors available

# Questions?

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