

Exit Strategies For Business Owners Part 2:

Passing on Your Legacy to
Family or Employees



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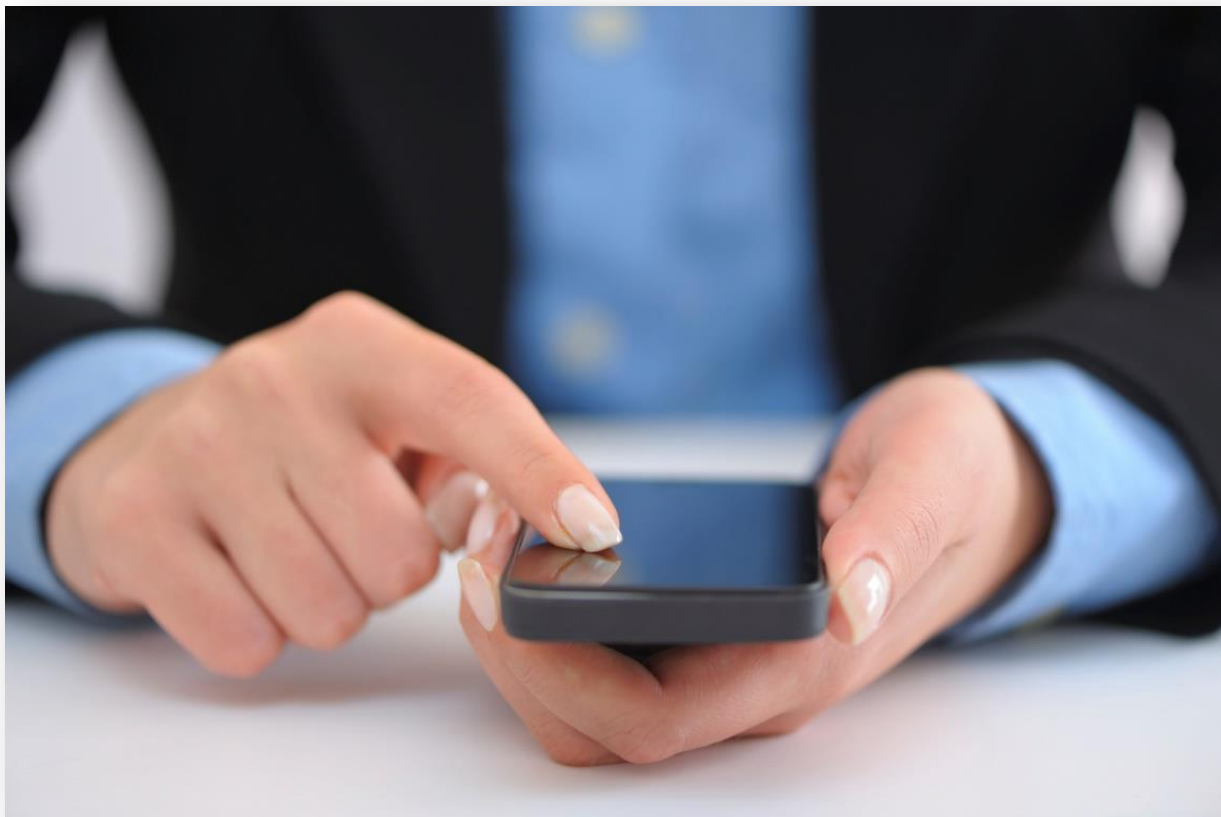
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Please provide your feedback at the end of today's presentation.

About the Speakers



Cathy McEwen, ABV

Senior Manager, Corporate Finance

Accredited in business valuation (ABV)

Managed her own firm for 14 years

Provides litigation support services

About the Speakers



Michael Shook, CM&AA

Vice President, Corporate Finance

Specializes in delivering strategic financial support to executives

Held a variety of senior and executive financial management roles during 20-year career in the private sector

Learning Objectives



Outline an ownership succession process



Evaluate structures and techniques



Learn key considerations for both sides to succession



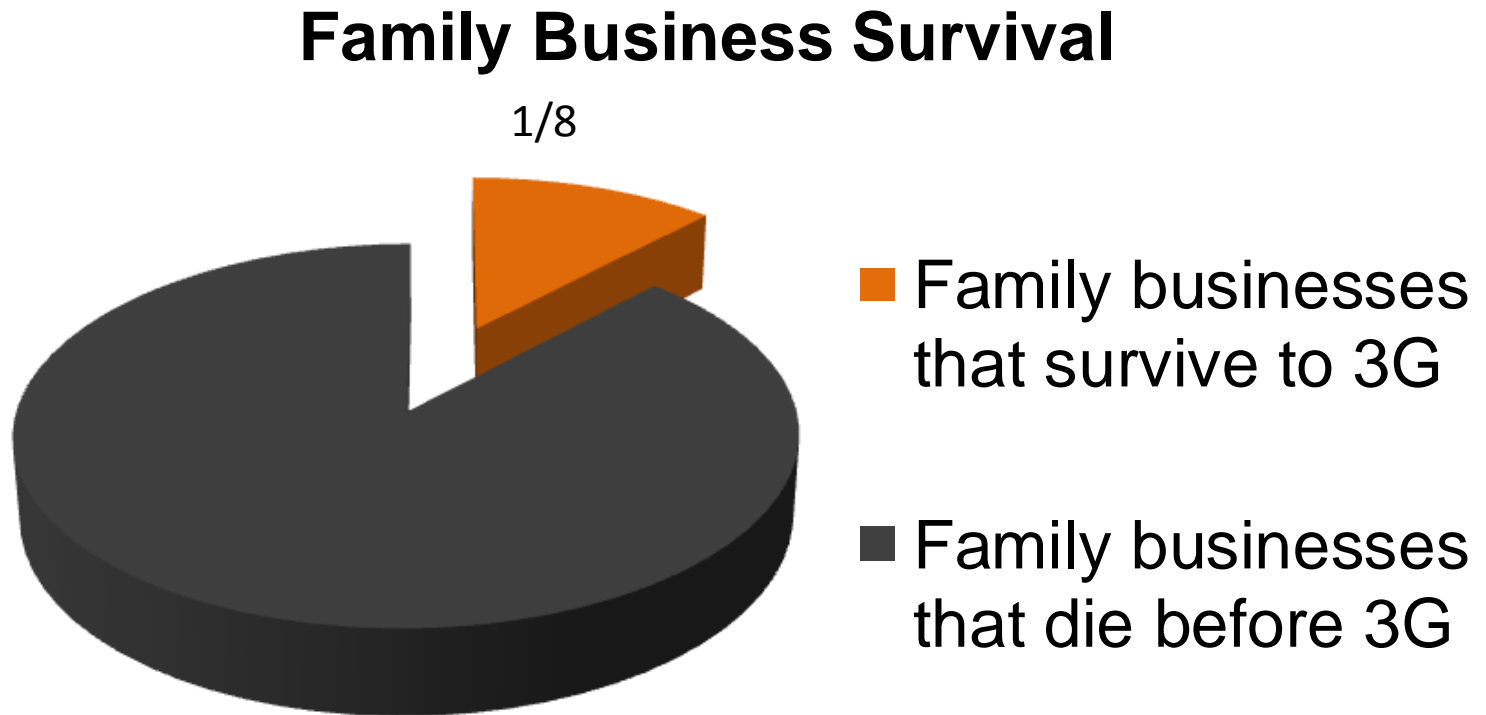
Understand importance of a long-term horizon



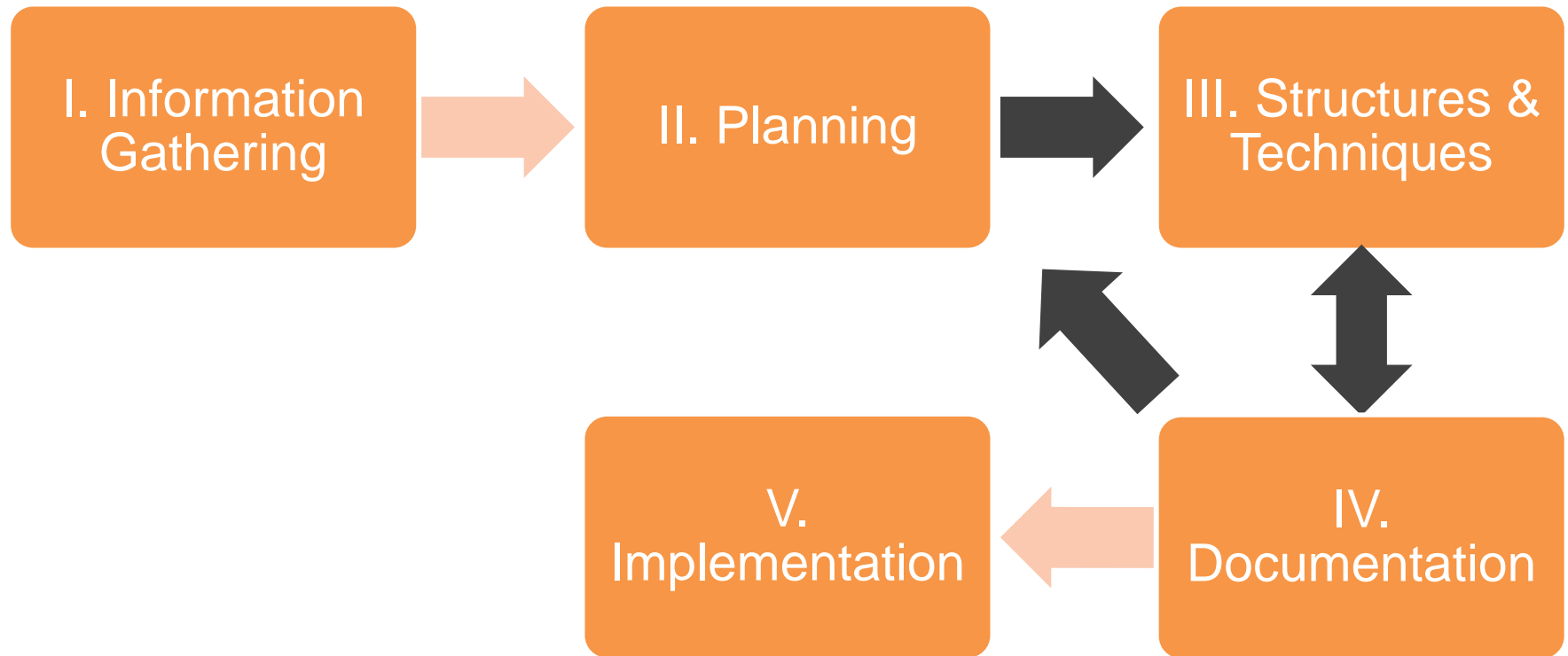
Appreciate role of private equity groups



Family Business Survival



Ownership Succession Process



I. Information Gathering

Quantitative information gathered:

Organizational documents including any existing buy-sell agreement

Financial statements for past 3-5 years



I. Information Gathering

Qualitative information gleaned from individual interviews:

Motives/goals

Challenges

Transferees



I. Information Gathering



Motives/Goals

- Legacy
- Reward employees
- Retire
- Maximize sales price
- Timing

I. Information Gathering



Motives/Goals

- Legacy
- Reward employees
- Retire
- Maximize sales price



Challenges

- Equitable
- Dissension
- Management in waiting
- Consensus

I. Information Gathering



Motives/Goals

- Legacy
- Reward employees
- Retire
- Maximize sales price



Challenges

- Equitable
- Dissension
- Management in waiting
- Consensus




Transferees

- Family
- Management
- Combination

I. Information Gathering


**Key considerations for both sides
to a succession transition:**



**Perpetuating
the company's
mission or culture**

I. Information Gathering

**Key considerations for both sides
to a succession transition:**



**Allowing or needing
the current owner to
remain involved
in the company**

I. Information Gathering

**Key considerations for both sides
to a succession transition:**

A photograph showing the backs of two elderly men sitting at a wooden table in a cafe or restaurant. They are looking out a large window. The man in the foreground is wearing a brown textured sweater, and the man further back is wearing a blue jacket. There are glasses and a cup on the table.

**Providing cash for
owners' retirement**

I. Information Gathering

Key considerations for both sides to a succession transition:



Continuing financial risk

I. Information Gathering

Key considerations for both sides to a succession transition:

**Support of
key players**

I. Information Gathering

**Key considerations for both sides
to a succession transition:**



**Having adequate
management**



Polling Question #1

II. Planning

Planning is an
**iterative and
long-term**
process

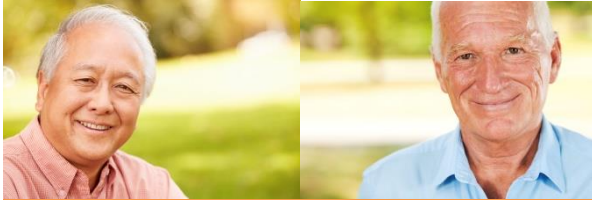


II. Planning



Standard of value
is typically fair
market value

II. Planning – Case Study



OldCo was owned by two owners with equal shares in OldCo (50/50 ownership).

II. Planning – Case Study

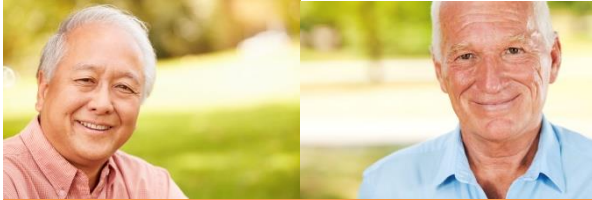


OldCo was owned by two owners with equal shares in OldCo (50/50 ownership).



Holding LLC was an entity formed to facilitate the transition to two new owners.

II. Planning – Case Study



OldCo was owned by two owners with equal shares in OldCo (50/50 ownership).



Holding LLC was an entity formed to facilitate the transition to two new owners.



NewCo was the new company formed to handle the operations of the business during the transition.

II. Planning – Case Study



OldCo was owned by two owners with equal shares in OldCo (50/50 ownership).



Holding LLC was an entity formed to facilitate the transition to two new owners.

88% profits-only interest

98% capital interest



NewCo was the new company formed to handle the operations of the business during the transition.

12% profits-only interest

2% capital interest



Polling Question #2

III. Structures and Techniques

Internal vs External Transfers

	Internal	External
Value	<ul style="list-style-type: none">• Fair/Reasonable• FMV – Bval	<ul style="list-style-type: none">• Maximize• Market/Strategic
Structure	<ul style="list-style-type: none">• Accommodative/Facilitative to buyer	<ul style="list-style-type: none">• Pro-seller
Buyers/Transferees	<ul style="list-style-type: none">• Private Equity Group• Family• Employees• Executive management team• Co-owners	<ul style="list-style-type: none">• Highest bidder
Goal	<ul style="list-style-type: none">• Create a LEGACY• Minimize Tax Impact – Especially Estate Tax	<ul style="list-style-type: none">• Maximize seller's net after tax proceeds and minimize seller's risk

III. Structures and Techniques

Value of Business Interest



Business Value

- Fair market value



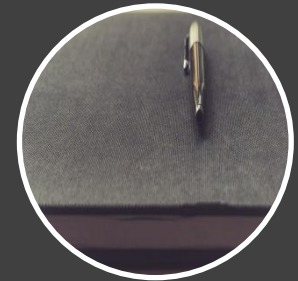
Income

- Uses benefits stream



Modified Book Value

- Book equity adjusted



Book Value

- Book equity



III. Structures and Techniques

Minimize Taxes Through Estate Freezing

Stock gifts

Private annuities

Self-cancelling installment notes

Grantor Retained Annuity Trusts

Family Limited Partnerships

Family Limited Liability Companies

Intentionally Defective Grantor Trusts



III. Structures and Techniques

A photograph of a modern conference room with large windows and a long table. The room is empty, with several chairs and a laptop on the table. The text "Transitions v. Transactions" is overlaid on the image.

Transitions v. Transactions

III. Structures and Techniques

Common Structures and Techniques – by Primary Beneficiary

Type	Sellers	Employees	Heirs
Annual & Lifetime & Gift Exemption			X
Cash Purchases		X	X
Company Redemption	X		
Earmark Incentive Bonus for Stock Purchase		X	
Cash Purchase Financed by Bank	X	X	X
Cash Purchase Financed by Seller/Company		X	X
Voting and Non-voting Equity Interest		X	X
Stock Options and/or Stock Purchased with Debt Forgiveness		X	
Non-competes or Payment for Personal Goodwill	X		
SERP (Supplemental Executive Retirement Program)	X		
IDGT's, FLP's, FLLC's	X		X
ESOP's		X	
Management Buy-Outs with Private Equity Group (PEG)	X	X	

III. Annual and Lifetime Gift Exemptions

“The best way to reduce estate taxes is to **give** away your assets before they appreciate.”

Sam Walton, 1953



III. Annual & Lifetime Gift Exemption

Minimize Potential Estate Taxes

Annual gift exclusion
- \$14k for 2015

Limitations to annual
gift exclusion

Estate unified credit
- \$5,340k for 2015

Impact of gifts in excess
of annual gift exclusion





Polling Question #3

III. Company Redemption

Company Acquires Equity Interest

Valuation of interest

Funding alternatives

Impact to remaining owners

Financial reporting concerns

Tax implications



III. Voting and Non-Voting Equity Interest

Control of Company

What is allowed within the entity structure

Why have different types or classes of equity

Temporary or permanent designation

Valuation implications

Liquidation





Polling Question #4

III. FLPs and FLLCs

Family Limited Partnerships and Family Limited Liability Companies

Value

Protection

Control



III. ESOP

Employee Stock Ownership Plan

What is it

Potential challenges

Benefits



III. MBO with Private Equity Group

Management Buyout with Financial Partner

Value outside the limits of debt

Owner wants limited risk

Management wants to grow the business rapidly

Retain local management and employee talent

III. Structures and Techniques – Case Study



IV. Documentation

If it works for Warren...

He requires all
Berkshire Hathaway
company managers
to submit a
regularly updated
succession plan!



IV. Documentation

Attorneys draft documents:

Ownership transfer which may include phases

Employment agreements

Covenants not to compete

Buy-sell agreements

Estate-planning documents



IV. Documentation

Buy-sell agreements:

Triggering events

Types of agreements:

- Fixed Price

- Formula

- Multiple or single appraiser

Funding with life insurance

Right of first refusal





Polling Question #5

V. Implementation

Successful plans incorporate:

Managers with right skills

Tax-efficient transfers

Sufficient cash flow for all owners AND business

Documents and buy-sell agreement in place

Financially diversified owners

Support of family and key executives



Costs of no succession planning

Loss of business to:

Estate taxes

Lack of liquidity to tide business over due to an unexpected death, etc.

Retiring owners demanding too much from the business to allow the next generation to earn a reasonable income

Sibling rivalry or other family disharmony



Thank you!



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