Seven Steps to a Successful Exit Plan

Jose Freyre, MBA, CFP®, AIF®
Monarch Wealth Management

Overview

Today we are going to:
• Discuss what exit planning is
• Establish the need to proactively plan your exit
• Share our seven step exit planning process
My Experience & Point of View

Background
• Specialize in working with entrepreneurs as their “Personal CFO”
• Management/business consultant for 15 years
  – Experience helping owners improve their business
  – Experience in helping owners exit (or try to exit) their business
• Specialize training in M&A and exit planning
• I’m a business owner too!

On the Same Page

What is Exit Planning Anyways?
• A proactive process to:
  – Ensure you have a sellable business
  – Maximize the value of your business
  – Reduce the risk/challenges associated with a transfer
  – Reduce the tax ramifications of the transfer
  – Achieve the owners personal, business, and financial goals
Barriers to Planning

Is Your Plan in Place?

- In the early years of your business:
  - “I’m never going to leave!”
- In the later years:
  - “I’m too busy to deal with this right now. I got other priorities.”
  - “I don’t need to plan for this. It will just happen.”

Reasons to Plan Ahead

Sale to a Third Party for Cash

<table>
<thead>
<tr>
<th>Intrinsic Value = $1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual SDCF = $250,000</td>
</tr>
<tr>
<td>Multiples range = 3 to 4.5 times SDCF</td>
</tr>
</tbody>
</table>

Weak Value Drivers
Offer - $750,000

Strong Value Drivers
Offer - $1,125,000

Difference: $375,000
Ingredients of a Successful Exit

• A written Exit Plan that is reviewed/updated annually.
• An experienced team of advisors to design and implement the plan.
• Growing and sustainable business & cash flows.
• A strong management team in place.
• Time

Who is on the Advisor Team?

Exit Planning Advisor
Financial Advisor
Business Attorney
Estate Planning Attorney
CPA

Valuation Specialist
Business Broker
Investment Banker
Business or Management Consultant/Coach
Banker
Ingredients of a Successful Exit

*Why is a Team Necessary?*

- No one professional has all the answers.
- Diverse skills and talents are necessary.
- Team approach improves results and minimizes time and cost.
  - If properly facilitated and led.
Step One: Identify Exit Objectives

Benefits to the Owner
- Identifies goals and priorities.
- Focuses your (and your advisor’s) attention on desired outcomes.
- Focuses energy on most urgent concerns.

Universal Objectives
- How much longer do you want to work in the business before retiring or cutting back? ________ years
- What annual income do you want during retirement (in today’s dollars)? $________
- To whom do you want to transfer the business?
  - Family?
  - Co-Owner?
  - Key Employee(s)?
  - Outside party?
  - ESOP?
Step One: Identify Exit Objectives

**Additional Objectives**
- Shift wealth to children.
- Provide charitable gifts or transfers.
- Reward key employees.
- Have a backup plan

Step Two: Quantify Business and Personal Financial Resources

“Beauty is in the eye of the buyer.”
Quantify Business & Personal Financial Resources

**Benefits to the Owner**

- Measures business and personal resources both today and as a basis for future projections.
- Provides a baseline value and target
- Identifies the gap (if any)
- Allows you to monitor progress toward the stated objectives.

**Possible Component Outcomes**

- Increase personal savings
- Target business value that must be reached
- Go-No-Go decisions
Step Three: Maximize and Protect Business Value

“Making a silk purse from a sow’s ear.”

Benefits to the Owner

• Grow business value
• Reduce income taxes upon sale of business.
• Protect assets from potential business and personal creditors.
• Create ability to sell the business for top dollars/multiple.
• Motivate and keep Key Employees.
• Reduce perceived risk to buyers
• Have peace of mind!
Step Three: Maximize and Protect Business Value

**Promote Value Through Value Drivers**

- Focus on increasing cash flow.
- Develop systems that improve sustainability of earnings and cash flows.
- Establish better financial practices/controls.
- Improve company performance as measured by industry metrics.
- Pay down debt.

---

Step Three: Maximize and Protect Business Value

**Promote Value Through Value Drivers**

- Restructure organization
- Solidify and diversify customer base.
- Implement strategies to grow the company.
- Develop and protect proprietary technology.
- Establish “golden handcuff” for key employees
- Ensure you have IP, non-compete/solicit, confidentiality agreements
- **Build a solid management team and groom a successor.**
Step Four: Ownership Transfer to Third Parties

“Making a mountain out of a molehill.”

Benefits to the Owner

• Cash at closing.
• Eliminate/reduce financial risk.
• No family succession issues.
• Speed of exit.
Step Four: Ownership Transfer to Third Parties

No Guarantee that Your Business Will Sell

• 20 percent of businesses are for sale, but only about one out of four actually sells.
• Above $10 million per year, the odds improve to 50-50.

Third Party Sales – Not Just About the Business

• Ability to sell and business value are determined by:
  – Intrinsic Value: the value drivers.
  – Extrinsic Value: condition of the M&A and credit markets
  – Promoted Value: Effectiveness of the sale process (controlled auction).
  – Tax consequences
Step Five: Ownership Transfer to Insiders

“Making a molehill out of a mountain.”

Benefits to the Owner

- Achieves Exit objective of:
  - Selling to employee(s)/partner(s)
  - Selling/transferring to Children
  - Selling when you can't find an third party buyer
- Motivates and retains Key Employees.
- Planning reduces risk, reduces time to complete and increases amount of money received.
Step Five: Ownership Transfer to Insiders

**Methods**

- Sale of ownership interests
- Non Qualified Deferred Compensation & similar methods
- Employee Stock Ownership Plans (ESOPs)

Owners must understand the need to minimize income tax consequences to buyer and seller by minimizing ownership value of business.
Step Five: Ownership Transfer to Insiders

**Sale to a Third Party for Cash**

- **Fair Market Value:** $1,000,000
- **Annual Cash Flow:** $250,000

<table>
<thead>
<tr>
<th>Buyer</th>
<th>Seller</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash for purchase</td>
<td>$800,000 Net of Taxes</td>
</tr>
</tbody>
</table>

**Timing:** **NOW**

---

**Sale to Employee for Installment Note**

- **Fair Market Value:** $1,000,000
- **Cash Flow:** $250,000

<table>
<thead>
<tr>
<th>Employee</th>
<th>Owner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow from business $250,000 - $150,000 (net of taxes)</td>
<td>$800,000 Net of Taxes</td>
</tr>
<tr>
<td>Cash to Seller $120,000 (net of taxes)</td>
<td></td>
</tr>
</tbody>
</table>

**Timing:** **6.6 years**
Step Five: Ownership Transfer to Insiders

**Cash Flow to Owner**

Fair Market Value = $1,000,000
Cash Flow = $250,000

Owner
Cash flow from business $250,000 ($150,000 net of taxes) to owner

Seller/Owner
$800,000 Net of Taxes

Timing: 5 years

---

Step Five: Ownership Transfer to Insiders

**Transfer to Employee: Phase I**

Fair Market Value = $500,000 - $1,000,000
Cash Flow = $250,000

Employee
40% of Stock sold to Employee for $200,000 ($100,000 of cash flow per year to Employee)

Owner
Cash flow from business $150,000 per year

Seller
$48,000 After Taxes
$144,000 After 3 Years

Seller
$90,000 After Taxes
$270,000 After 3 Years

© 2009 Monarch Wealth Management, Inc.
Step Five: Ownership Transfer to Insiders

Transfer to Employee: Phase II

<table>
<thead>
<tr>
<th></th>
<th>Fair Market Value = $500,000 -$1,000,000</th>
<th>Cash Flow = $250,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee</td>
<td>60% of Stock sold to Employee for $600,000</td>
<td>Seller $480,000 Net of Taxes</td>
</tr>
<tr>
<td>Seller</td>
<td></td>
<td>Total $894,000 After 3 Years</td>
</tr>
<tr>
<td>Timing: 3 years</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Step Six: Business Continuity Planning

“Making sure the business continues when you don’t.”
Step Six: Business Continuity Planning

Benefits to the Owner

- Objectives can still be achieved if you don’t survive your exit.
- Retains ownership and control of company if co-owner departs.
- Can force non-contributing owners to leave the business.
- Ensures survival of the business for the benefit of others.
- Results in family receiving value of owner’s interest, in cash.

Business Continuity

If you die or become disabled, what happens to your business and your family?

- Co-Owned Businesses:
  - When was the buy-sell agreement last reviewed? Does your current agreement fully cover:
    - Current Valuation
    - Funding
    - Coverage of all Transfer Events
Business Continuity

If you die or become disabled, what happens to your business and your family?

• Solely-Owned Businesses:
  – Have you taken steps to make sure:
    • The business will continue if you don’t?
    • Key employees are incentivized to stay through a transfer?
    • The business is adequately capitalized?

Sole Owner Business Continuity

Ownership Continuity

The Solution:
• Communicate your wishes regarding continuity in writing.
• The Stay Bonus Plan
Sole Owner Business Continuity

The Stay Bonus and Salary Guarantee

• Provides for important employees to be compensated for their time and for their commitment to continue working until the company is transferred or liquidated.
• Provides cash incentive for these employees to stay: “The Stay Bonus.”
• A written, funded plan providing periodic bonuses (12–18 month time frame) for employees who remain with the company during transition.
• Bonus typically equals 50% of annual compensation.
• Salary guarantee typically equals 100% of annual compensation.

Business Continuity

Possible Component Recommendations

• Wage (Salary) Continuation Plan for Owners
• Stay Bonus Plan
• Business Continuity Guidelines
• Buy-Sell (Shareholder) Agreement
• Retaining Key Employees After Owner’s Death or Disability
• Disposition of Ownership Interest Through Estate Planning Documents
• Business Insurance for Continuity Planning
Step Seven: Personal Wealth and Estate Planning

“When the ‘slings and arrows’ of outrageous fortune befall you, fight back.”

- William Shakespeare (Hamlet)

**Benefits to the Owner**

- Preserve wealth, minimize taxes using both lifetime and death planning tools.
- Coordinates and integrates lifetime exit objectives wishes with estate plan.
- In effect, estate planning becomes part of business planning.
Personal Wealth and Estate Planning

Possible Component Recommendations

- Update or Create Estate Planning Documents
- Personal Asset Protection Planning
- Personal and Family Insurance
- Transfers of Specific Non-Business Assets to Family Members
- Personal Wealth Management Plan
- Allocation of Business Cash Flow After Death
- Bequests to Key Employees Upon Owner’s Death
- Transfer of Business Real Estate Upon Death

Exit Planning Readiness Assessment

At some point, every owner leaves his or her business - voluntarily or otherwise. At that time, every owner wants to receive the maximum amount of money in order to accomplish personal, financial, income and estate planning goals.