Exit Planning

Estate Planning Council of Rockland County
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What is Exit Planning?

Exit Planning is the creation and execution of a strategy allowing owners to exit their businesses on their terms and conditions. It is an established process that creates a written roadmap or Exit Plan, involving efforts of several professions facilitated and led by an Exit Planning advisor who ensures not only the plan creation, but its timely execution.

The Seven Step Exit Planning Process™

Step 1 – Identify Exit Objectives

Step 2 – Quantify Business and Personal Financial Resources

Step 3 – Maximize and Protect Business Value

Step 4 – Ownership Transfer to Insiders

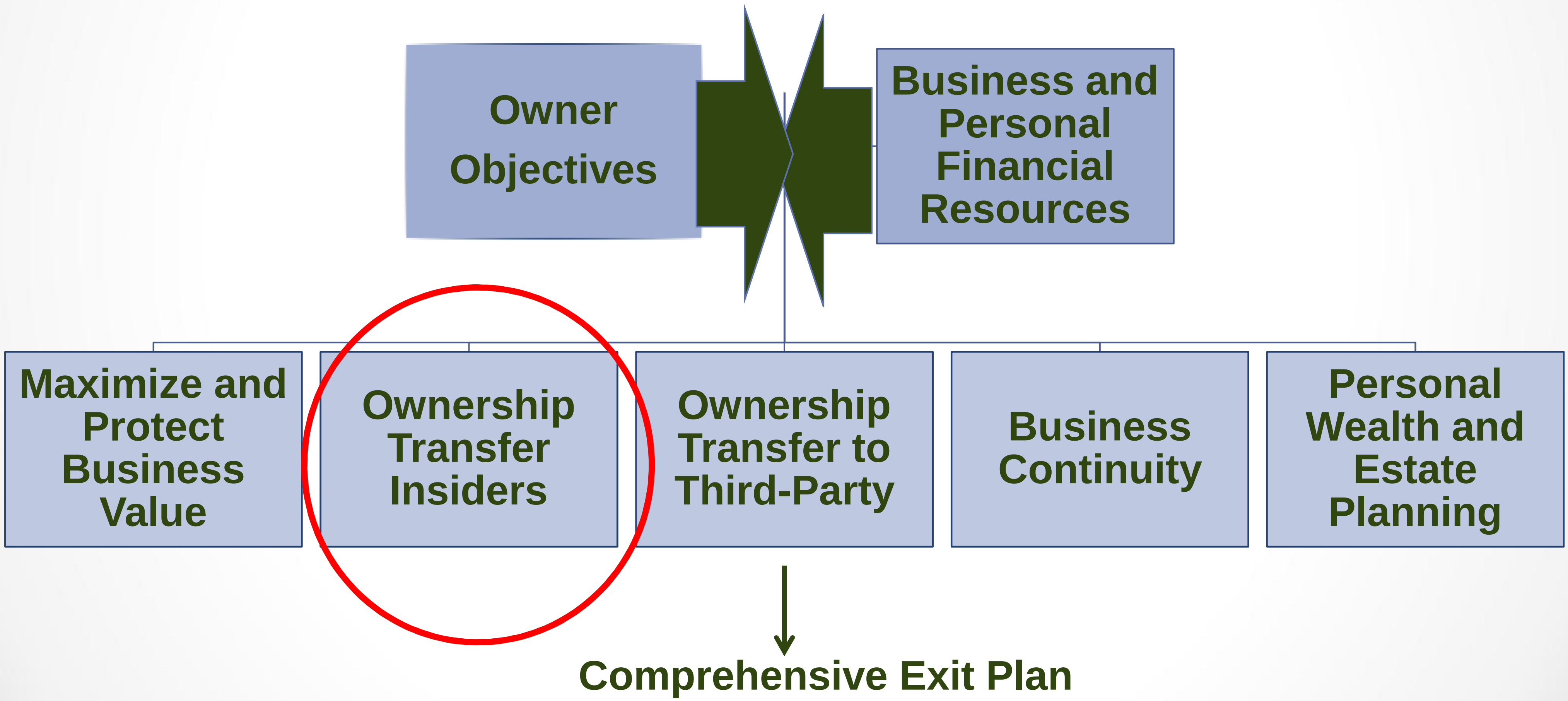
Step 5 – Ownership Transfer to Third Party

Step 6 – Business Continuity

Step 7 – Personal Wealth and Estate Planning

Components of a Comprehensive Plan:

The 7-Step Exit Planning Process™



Transfers to Key Employees or Children

The Dilemma:

- Insiders (children/employees) don't:
  - oHave much money
  - oHave much credit

Guiding Principals For Transfer to Insiders

- Owner maintains control unti exit
- Financial goals are secured
- Time frame is a matter of choice

Disaster in the Making

- Typical Insider Business Sale
  - Low or no down payment
  - Owner finances purchase with promissory note
  - Insiders make payments with post-tax dollars
  - Owner pays capital gains on receipts

Total tax burden can be as much as 47% of company profits!

Case Study:
Transfer to Insiders

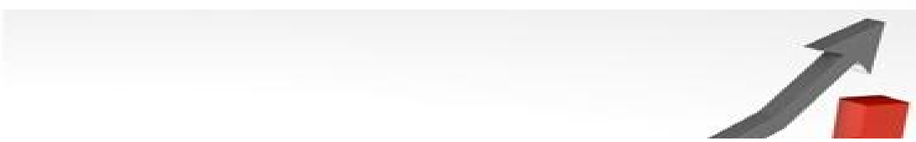
- Owner's Exit Goals:
  - o Departure time frame: 7-Years
  - o Chosen successor(s): Key Employees or Fa
  - o Cash needed for retirement: $4 Million
- Current Business Value: $1,000,000
- Personal (Non-Business) Liquidity: $1,500,000
- Company Cash Flow: $250,000

Gap Analysis	
Financial Goal	$4,000,000
Non-Business Assets	$1,500,000
Needed from Business	$2,500,000
Current Business Value	$1,000,000
Gap	$1,500,000

Show me the money!

Question: How does this Owner expect to grow the value of the business from $1.0 million to $2.5 million in 7-years?

Answer: He doesn't. The Exit Planning objective is not to triple business value. It is for the Owner to receive $2.5 million after tax from his business over the 7-year period.



Finding $2.5 Million

- Employees earn stock purchase incentives for increasing cash flow
- Owner receives money via:
  - Increased value of remaining equity
  - Increased salary and distributions
  - Employee payments on stock purchases
  - Non-Qualified Deferred Compensation

ey Employees Cash the Owner Ou

- ey Employees obtain lender financing
- uring the transfer period, Key Employees have
  - Purchased almost 50% ownership (collateralizes loan)
  - Established creditworthiness
  - Assumed management responsibilities
- wner maintains control until fully paid (can delay exit if goals not met)

"But…it's *my* money!"

- ll companies finance their own transfer with cash ow
- otivated employees can actually increase net roceeds
- anned transition avoids post-sale commitments for wner
- ontrol over time and methodology

Plan Design Features

- May "jump-start" through stock or cash bonus
- ime: gradual transfer and to grow cash flow and va
- ncentives designed to increase cash flow and value
- Key Employees can buy stock if meet goals for year
- Key Employees' efforts increase cash flow and value
- Owner receives money from multiple sources
- Consistent valuation formula for IRS purposes
- Owner remains in control until financial goal met

Ownership transfer to children: Special Considerations

- arget Proceeds may be determined more by need than valuat
- Children in and outside the business
- Availability of income tax strategies unique to family transfers
- Values-Based Goals, e.g. family identity; children's expectations
- Multiple layers of complexity with unexpected death/disability

Ownership Transfer to Children: pitfalls

- Transferring to child who isn't capable
- Premature transfer to keep the peace
- Inability to surrender paternal (maternal) oversight
- Family discord
  - o Favoritism
  - o Defined authority
  - o Estate balancing

Professional Firms

mited buyers; Typically, Transfer to Insiders

wnership generations/levels

alue: Use Low Value to Achieve Tax Efficiencies;

ompensation: Productivity; Business Development

uy-In Eligibility: Productivity; business development

onsistent Buy-In and Buy-Out Expectations

uy-out triggers, e.g. retirement

chieve financial security before exit

Compensation for Additional Value

- Junior Owners' compensation may be lower than senio
owners' compensation
- Compensation changes as seniority increases
- High Personal Tax Rates
- Deferred Compensation: Vest Today; Do Not Pre-Fund
- Maximize Qualified Retirement Plans, e.g. Shift Timing o
Tax to Lower Bracket Period

Additional Planning Opportunities

Former Owners Often Continue Working

Not All Junior Professionals Require "Full" Ownership

- o Non-Equity Arrangements May be Sufficient, e.g. Phantom Equity

Related Activities

- o Real Estate, Software, Management Services, Products, Training, Etc.
- o Separate Business Can Have Different Ownership and Exit Strategy

Related Recommendations

Plan to Recruit and Hire Key People

Incentive Plans

Buy-Sell / Buy-Back Agreement

Covenant Not to Compete (if allowed)

Non-Qualified Deferred Compensation

Wage (Salary) Continuation Plan

Insurance: fund buy-sell; key person; personal life and disability

Creation of New Entity (for outside business activities)

ractice Continuation Agreement (“PCA”

- Firm will continue a Practitioner’s practice in case of his/her disability or death
- Firm will step-in if temporary disability or death: Own rates; Do best to provide services; Right to decline clients
- Firm will buy Practitioner’s practice in the event of permanent disability or death
- Preserve value of business for family (and employees)

PCA: Key Protections for Buyer

Malpractice Insurance and a 3-year tail

Do not take on liabilities prior to effective date

Not required to hire Practitioner's employees

Do not have to assume any leases

Can refuse to accept clients for reasonable cause

No price constraints on billing

PCA: Promises to Seller

Firm will:

- Operate Practitioner's business in good faith;
- Not solicit Practitioner's clients while PCA active
- Assist Practitioner with in-house resources, e.g. CP

Practitioner not responsible for buyer's acts

Practitioner or heir can inspect books and records

Your clients need you!

- ***Every Owner will exit***
- ***Largest financial transaction of his/her life***
- **YET:** Owners are NOT having the discussion about exiting
- **2014 BEI Survey results:**
  - Less than 13% had spoken to their attorney
  - Less than 12% had spoken to their CPA
  - Less than 6% had spoken to their financial planner

Help Owners Understand

- Entering a long-term buyer's market
- Risk-averse acquisition lendi
- Internal transitions maintain control of
  - o Time frames
  - o Proceeds
  - o Decision making

Opportunities for Professional Advisors

- CPAs
- Financial Planners
- Bankers
- Money Managers and Private Bankers
- Business Valuation Professionals
- Tax, Trust and Estate and Business Attorneys

Resources

BEI White Papers

- *Inevitabilities*
- *Business Continuity*
- *Family Business Transfer*
- And others

eNewsletter (*The Exit Planning Review*)

Private Executive Consultations

Questions?

THANK YOU

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