

Business Succession Handbook



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Reasons to plan?

1. Taxes - Your business is the result of your work and time. How do you unlock this value in a tax efficient manner.
2. Risk - The longer that you prolong the more uncertainty may build.
3. Options - As time passes your potential choices can decrease.
4. Control - Increase your oversight versus leaving the outcome up to the Government or Attorneys.
5. Value - Determine value rapidly or controlled and planned.

*You are considering life changes, mortality,
and key personnel!*

Think about the exit when entering in the business

What would you want to see in the books and records?

What would you not want to see?

What type of transfer?

- Inter-family
- Buy - Sell agreements
- Gifting
- Management Buyouts
- Sale to Employees
- or Outsiders
- Liquidation

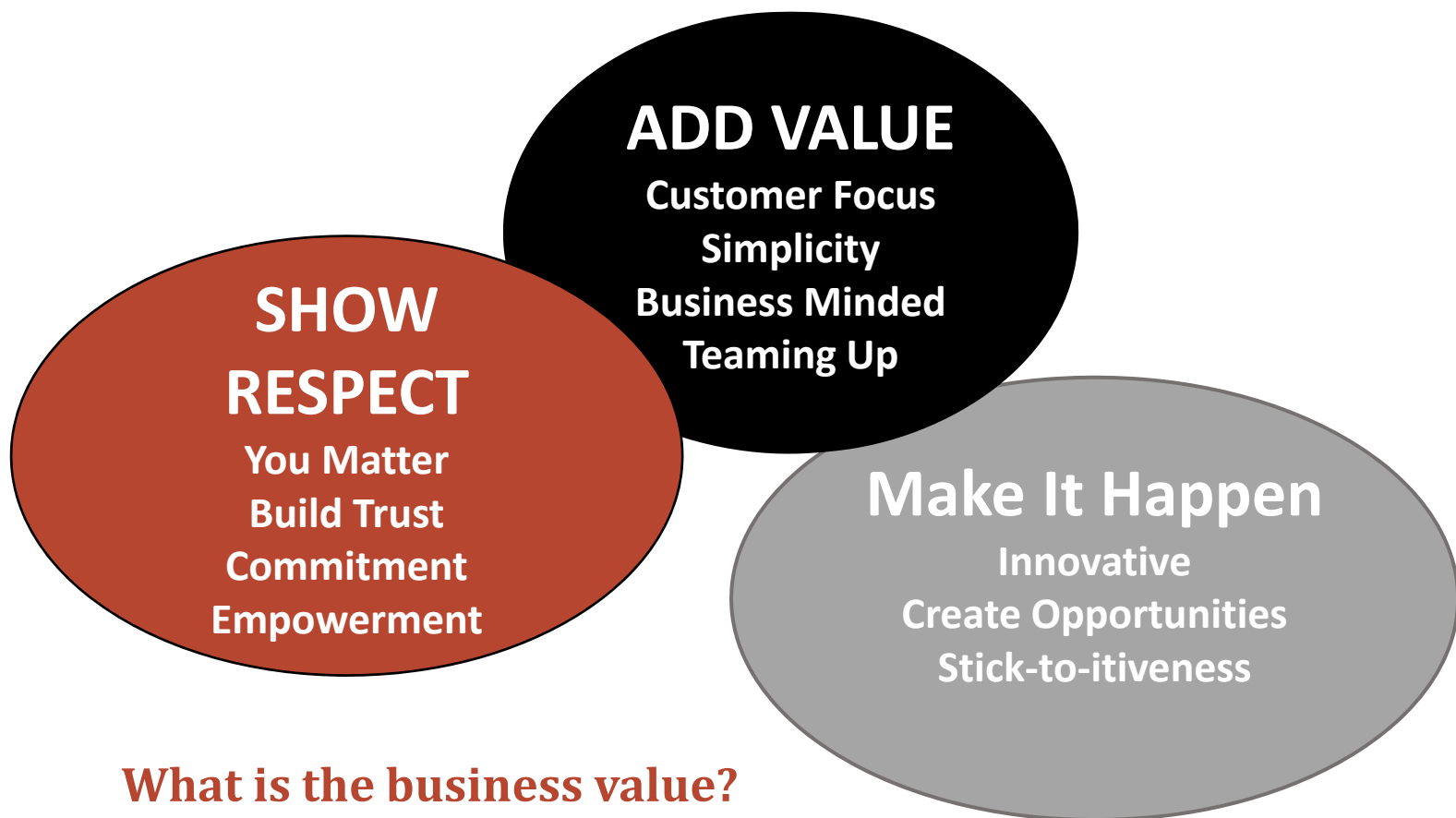
Who will be your successor?

Will it be natural succession to a family member, existing partner or partnership, will it be your partners family?

What if it is multiple people?

“Success is getting what you want. Happiness is wanting what you get.”

- Dale Carnegie



What is the business value?

How much is it worth?

CPA or appraised value & Methodology of calculation.

Fair Market Value?

The seller often feels their business has an increased value due to years of time and energy to acquire the skills needed to operate the business.

Competition - Your competitors or suppliers may be willing to pay a premium for your company.

Stand Alone Owner - The focus may be on cost and maximizing return for the successor.

Bottom Fisher - Strikes when the owner is a forced seller and gets a bargain price.

There are several ways to calculate the value of a business:

Asset Valuations

Calculates the value of all of the assets of a business and arrives at the appropriate price.

Liquidation Value

Determines the value of the company's assets if it were forced to sell all of them in a short period of time (usually less than 12 months).

Income Capitalization

Future income is calculated based upon historical data and a variety of assumptions.

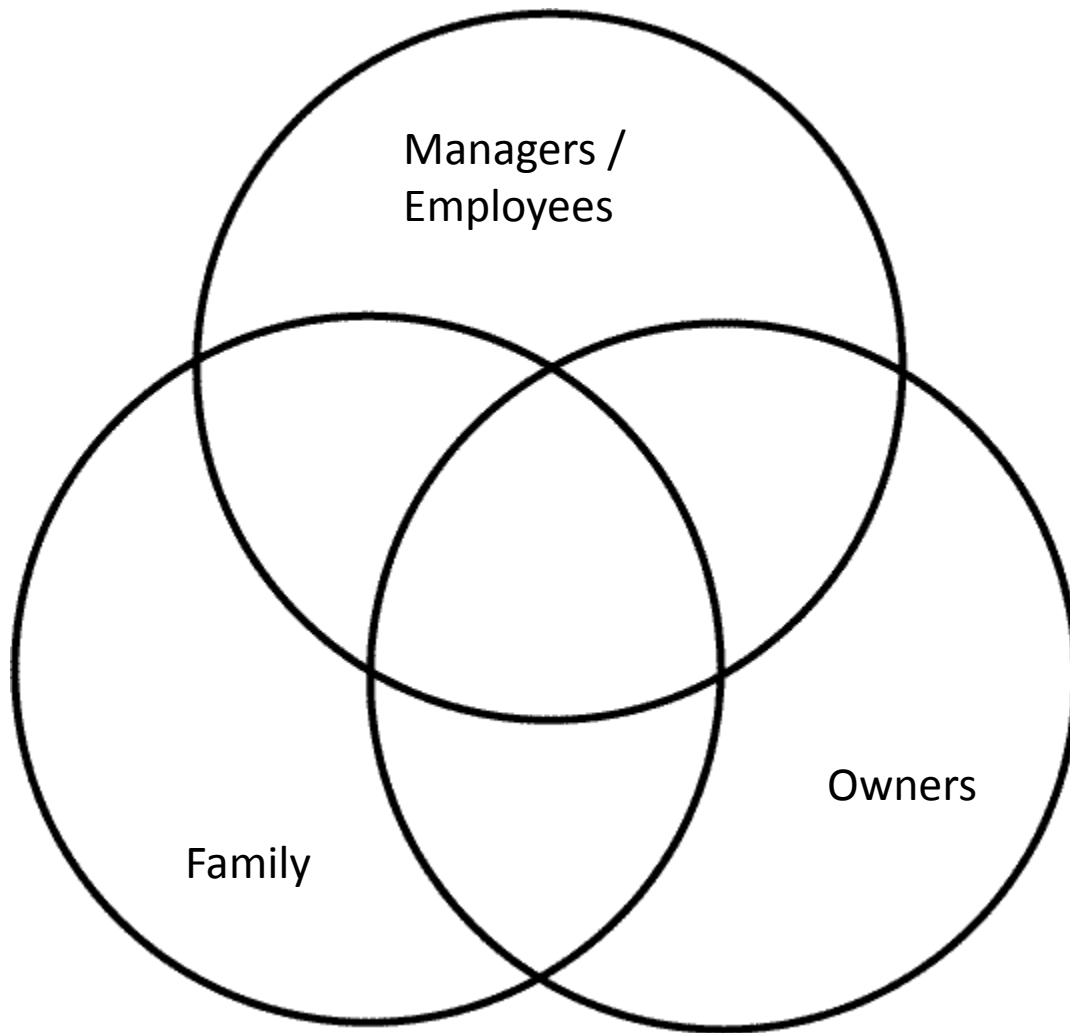
Income Multiple

The net income (profit/owner's benefit/seller's cash flow) of a business is subject to a certain multiple to arrive at a selling price.

Remember that valuations are not scientifically based; they're subjective.

- Use a variety of methods.
- Owner Benefits is the number on which to base your multiple.
- Uncover how the seller established the asking price.
- Valuation is a personal formula - What's the business worth to YOU?
- Consider the potential return on your cash investment.

Please Note: Abelow, Pratt & Associates does not offer business valuation, planning, or appraisal services.



Outline

1. Goals & Objectives
2. Decision Making Process
3. Identify Successors
4. Create Business & Ownership Plan
5. Transition Plan

Goals & Objectives

1. Identify the collective vision (Owners, Key Employees, and Family).
2. Importance of understanding role for continued family leadership and ownership.
3. Is outside management appropriate?
4. What are the personal needs for retiring owners?
5. Identify successor owner's goals.
6. Retain professional advisors if appropriate.

This really is multiple difficult decisions!

Decision Making Process

Determine how decisions will be made moving forward including how to handle:

- Governance Process
- Dispute Resolution
- Succession Plan In Writing
- Communicate Succession Plan to Employees and those involved.

Identify Successors

Manager & Owners Will Be Directly Impacted

What will your departure mean for your remaining partners and managers? What role will your successor take?

- Timeframes – What will the transition plan look like?
- Structure of Buyout – What terms will you accept? How will this effect your other partners?

Active & Non-Active Roles

- For ALL family members – Will this decision impact family members that may not be involved today?

Additional Support (Identify)

Specify if any is required from family members or other owners. Will you need to hire an outside manager?

Create Business & Owner Estate Plan

- Address tax implications to owner and business upon sale or transfer due to death, disability, partial sale.
- Review owner's estate planning to minimize taxes and avoid delays for transfer of stock.
- Create Buy – Sell agreement that is fair and reflective of the value of the business and minimizes taxes.

Management Succession

How will the transition impact business?

- Identify gaps and needs.
- What type of time commitment is needed to oversee a smooth transition?
- Understand Best and Workable solutions. Understand all choices.
- What are the successor's ultimate goals?
- What resources will be needed to achieve the new vision?
- Set new expectations with key employees. Will they require additional compensation or equity to remain with the company?

Contingency Planning & Unifying Goals

- Address needs and goals of owner and business upon sale or transfer due to death, disability, partial sale.
- Review needs and goals of other parties involved.
- Create Buy – Sell agreement that is fair and reflective of the value of the business and minimizes taxes.

Transition Plan

How

1. Outright Purchase
2. Gift or Bequest
3. Sweat Equity
4. Buy Out Over Time
5. Or Even a Combination of Them

Financing

1. SBA / Private / Bank / Specialty Broker
2. Owner Held Note

You need to keep your key personnel informed of the planned changes and what they mean for them. Will you need additional support?

OTHER IMPORTANT CONSIDERATIONS

Generational Issues & Alignment of Family Interests

Balancing Financial Returns

Interfamily or Partner Disputes

Estate or Inheritance Issues

Death / Disability / Retirement Provisions

Divorce / Remarriage Issues

Profit / Cost Changes

Formula To Re-value & Re-purchase Shares

Buy – Sell Agreements

Cross Purchase

A document that allows a company's partners or other shareholders to purchase the interest or shares of a partner who is deceased, incapacitated or retiring. A cross-purchase agreement is used in business continuation planning. The document outlines how the shares can be divided or purchased by the remaining partners, such as a proportional distribution according to each partner's stake in the company.

Entity Purchase

A type of business succession plan that is used by companies that have more than one owner. The plan involves having the company take out an insurance policy on the lives of owners in the amount equal to each owner's interest. In the event of death, the amount collected by the company from the insurance, which is equal to the deceased owners stake, is used to pay the deceased's estate for its share of the business.

Wait and See

A hybrid agreement that is implemented by the owners of a business to facilitate the orderly transition of a business interest in the event of the death, disability or retirement of an owner. With a wait-and-see plan, the business owners delay the selection of an entity plan or cross-purchase buy-sell plan until the actual death, disability or retirement of an owner. If one of these events occurs, both the company and the business owners agree to purchase the remaining business interest at a pre-determined priced based on the company valuation set forth in the agreement. The company has the initial option to purchase the available business interest. A second option to purchase any remaining interest then goes to the business owners themselves. Any remaining business interest must then be purchased by the company.

Funding

Cash

Sinking Funds or Cash has the perceived advantage of being simple and requiring no immediate outlay. The problem is that the purchaser does not know when or how much cash will be needed, and thus must always keep a large after-tax cash reserve available. Inevitably, cash sinking funds are inadequate, because death or long-term disability of a working shareholder is always, premature.

Debt

Borrowing has the advantages of being simple and requiring no outlay until death or disability occurs. The question is: Will a bank lend money to a business that has just lost its most important asset, the person who made the corporation what it was? If the bank makes the loan, will the terms or rates be reasonable and affordable from the borrower's viewpoint? How will the cash-flow demands of repaying the loan impact the operation and credit-worthiness of the business? How much will the total loan cost?

Installment Payout

An installment sale is simple and a relatively small outflow is required each year. Seemingly nothing is needed until death occurs, so action can be put off for many years. But the installment payout method merely delays the pain and obfuscates the full extent of the problem. From the buyer's perspective, an installment sale merely spreads out the obligation but does not provide the cash to effect the buy-out. The longer the term of the payments and greater the obligation, the more adverse the affect on the credit rating of the business. From the seller's (or seller's family's) point of view, an installment payout does not provide the large sums of cash often needed for estate settlement costs, living expenses, and debts. Furthermore, it entails great risk since it leaves substantial sums at the risk of a business which has just lost a key employee.

Life Insurance

Adequate life insurance makes it possible for a stockholder's surviving spouse or children to immediately receive the full fair market value of the decedent's business interest. Simple coverage can be obtained through Term Insurance and more complex compensation plans can involve life insurance with cash values. The presence of life insurance shows prudence to bank loan officers and other creditors that the shareholders are financially responsible. Premiums can be budgeted and incorporated into compensation plans so the event of the buy-out doesn't hurt the cash flow of the business. If the buyout occurs during lifetime, the cash values of a life insurance policy can be used to help provide a portion of the purchase price. These cash values can be obtained from the policy on a tax-favored basis either by policy loan, withdrawal, or by a partial surrender of the policy. There is, of course, a cost; premium dollars are an outlay with a delayed economic benefit. But this is far offset by the great peace of mind attained by all parties when the buy-sell is fully and properly funded.

Private Annuity

An agreement between two parties in which one party (annuitant) transfers an asset to another party (obligor) in return for unsecured payments for the remainder of the annuitant's life.

Gifts

Annual exclusion gifting

For businesses that have modest values, this can be an effective plan. Where there are two parents and multiple children, the \$14,000 annual exclusion can become a significant amount.

Use of the lifetime federal exemption

This can be used when a family business has a somewhat larger value. Also, if a business is expecting a quick or steady increase in value, the use of the lifetime exclusion can be especially effective to remove the future growth from the donor's estate.

Trusts

These methods will require more sophisticated planning involving tax professionals (CPA and estate attorney), the cost benefit must be analyzed.

Family (A B) Marital Bypass Trust

QTIP Qualified Terminable Interest Property

GRAT Grantor Retained Annuity Trust

CRT Charitable Remainder Trust

ILIT Life Insurance Trust

With income, gift, and potential estate taxes, it takes careful planning to prevent some (or all) of the business assets from being sold to pay the successor, perhaps leaving little for your beneficiaries. Therefore, business succession planning must include ways not only to ensure the continuity of your business, but also to do so with the smallest possible tax consequences. You'll want to consult a tax professional as well as your estate planning attorney to explore all strategies.

Worksheet

What level of involvement do you want in the business? For how long?

Do you want to cash out immediately, cash out over time, or maintain an equity stake?

Do you want to leave the business as a legacy?

Do you have any preferential items?

Who are the key stakeholders? (Family, Partners, Managers, Employees, Vendors)
-What are the goals of my stakeholders?

What are the most important roles in the business?
-How will these be covered?

What are your goals for your successor and former partners?

Are any incentives needed to retain stakeholders?

What is necessary to ensure a smooth succession?

Overview of Next Steps

Clean Up Books & Plan Exit Strategies

Package Your Business for Sale

Open Bidding

Terms of Sale & Negotiations

The information in this handbook is for educational purposes only and is not intended to provide specific advise or recommendations for any individual. Abelow, Pratt & Associates does not offer business valuation, planning, or appraisal services.

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