Preparing for a Business Transition

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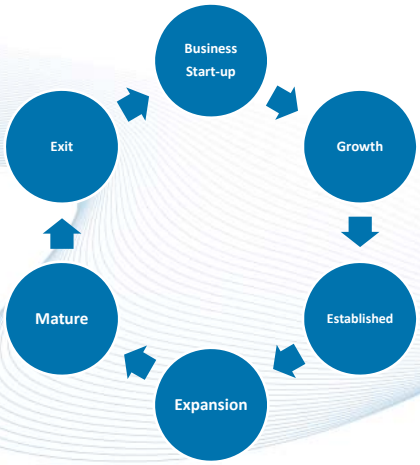
Lifecycle of a Business



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Assessing the Options

Business Continuity

- Next Generation
  - Qualifications
  - Interest level
  - "Equal" vs. Fair/Equitable
- Management Team
  - Financial Feasibility
  - Leadership Ability
  - Equity Partner

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Assessing the Options

Liquidity Event

- Outright sale of the business
  - Class of buyers
  - Profitability of the Company
  - Economic landscape of the industry
- Partial sale of the business
  - Retained interest with a "2nd bite of the apple"

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Management Team

- Do they have the desire and the ability to lead?
  - Identify skill gaps and a plan to develop them.
- Assess financial capability.
- Do you need to bring in additional resources?

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3rd Party Sale

- Understand the industry economic landscape
  - Growing or contracting?
  - Consolidation can yield opportunities
- The type of 3rd Party acquirer brings different considerations:
  - Private Equity Group
  - Competitor
  - Vertical Integration

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3rd Party Sale

- Are you prepared for the process?
  - Is your "house in order"?
    - Eliminate "discretionary" expenses
    - Related party transactions are on a third party /FMV basis
  - Are you ready for the emotional rollercoaster?

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Recapitalization Transaction

Partial Liquidity Event - Example

- Sell 75% ownership interest for cash
- Converts high risk, illiquid business equity into cash for lower risk investment opportunities
- Rollover 25% ownership into equity of Newco
- Stay on in key management role with Newco
- Aggressive growth strategy using PEG's capital
- "2nd bite of apple" upon sale of Newco
- Dilution in equity % is ok

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Recapitalization Transaction

Not A Good Option For Every Business Owner

- Cultural change from running your own business
- Possibly report to a CEO
- Strict, more detailed / more frequent reporting requirements – financial and operational
- Formal governance – outside Board of Directors
- Others share in key decisions – *less stressful?*
- Main benefit – aggressive growth in value (5-7 yrs) "2nd bite" value could be same or more than value received for 75% originally sold for cash

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The Private Capital Market

(Source: PitchBook)

- U.S. PE firms raised $75 billion in 1st half of 2015
- PE capital overhang at end of 2014 was $534 billion
- Puts PE "dry powder" at currently over $600 billion
- 37% of 2015 capital was raised by funds of $100 million or less – *invest in the lower middle market*
- Increased pace in *lower middle market* transactions the last 5 years
- Corporate buyers have over $300 billion in cash reserves

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First Things First

Understand what you need to "get out" before you "get in" to a process.

Personal Financial Planning is a MUST!!

- Standard of living
- Legacy
- Other financial goals

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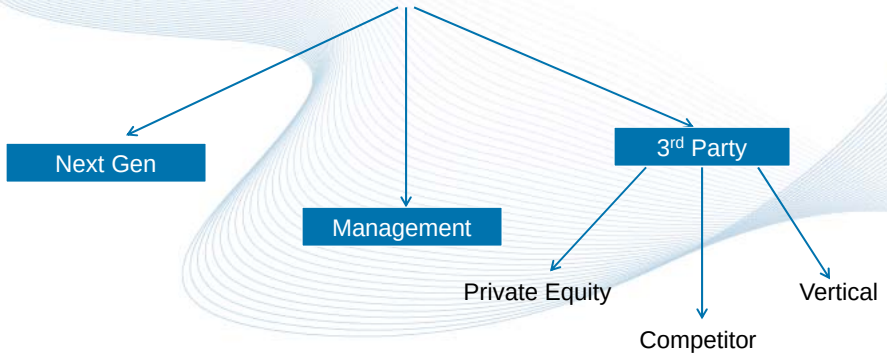
Understand Value

Need a realistic value of the business: Value can differ depending on the "buyer"



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Business Valuation Concepts

- Standard of Value –
  - Fair Market Value
  - Investment Value
  - Liquidation Value
- Valuation Approaches
  - Asset-based approach
  - Income approach
  - Market approach

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Business Valuation Concepts

- Effective Date of Valuation
  - Coordinate valuation date with date of transaction or gift
- Normalization Adjustments In Evaluating Business Earnings
  - Owner's compensation
  - Related party rent
  - Non-recurring or non-operating transactions

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Business Valuation Concepts

- Ownership Interest Being Valued
  - Controlling interest
  - Minority interest
- Valuation Discounts
  - Marketability discount
  - Minority interest discount
  - Size of the discount very subjective

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Techniques to Transfer Family Wealth Efficiently

- Take advantage of annual gift exclusions
- Transfer business interests when profits are down and economic/industry outlook is less favorable
- Transfer business interests prior to periods of rapid growth and increased profitability
- Take advantage of business valuation discounts

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Investment Value

- Value of the business to a specific investor
- Value is determined with consideration of the specific attributes of the Seller and the Buyer
- Typically yields a synergistic value
- Industry multiples and cash flow drive value

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Enhancing Value

- Understand the "value drivers"
  - Number of customers
  - Revenue
  - Cash Flow
- Develop the story around the numbers
- Identify the growth opportunities
- Build the backlog/pipeline

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Questions?

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