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# Ownership Transition

**Four ownership models:  
third-party, management buyout,  
employee stock ownership plan,  
and family**



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# Overview

- **Why planning for ownership transition is important**
- **Transition options, and their pros and cons**

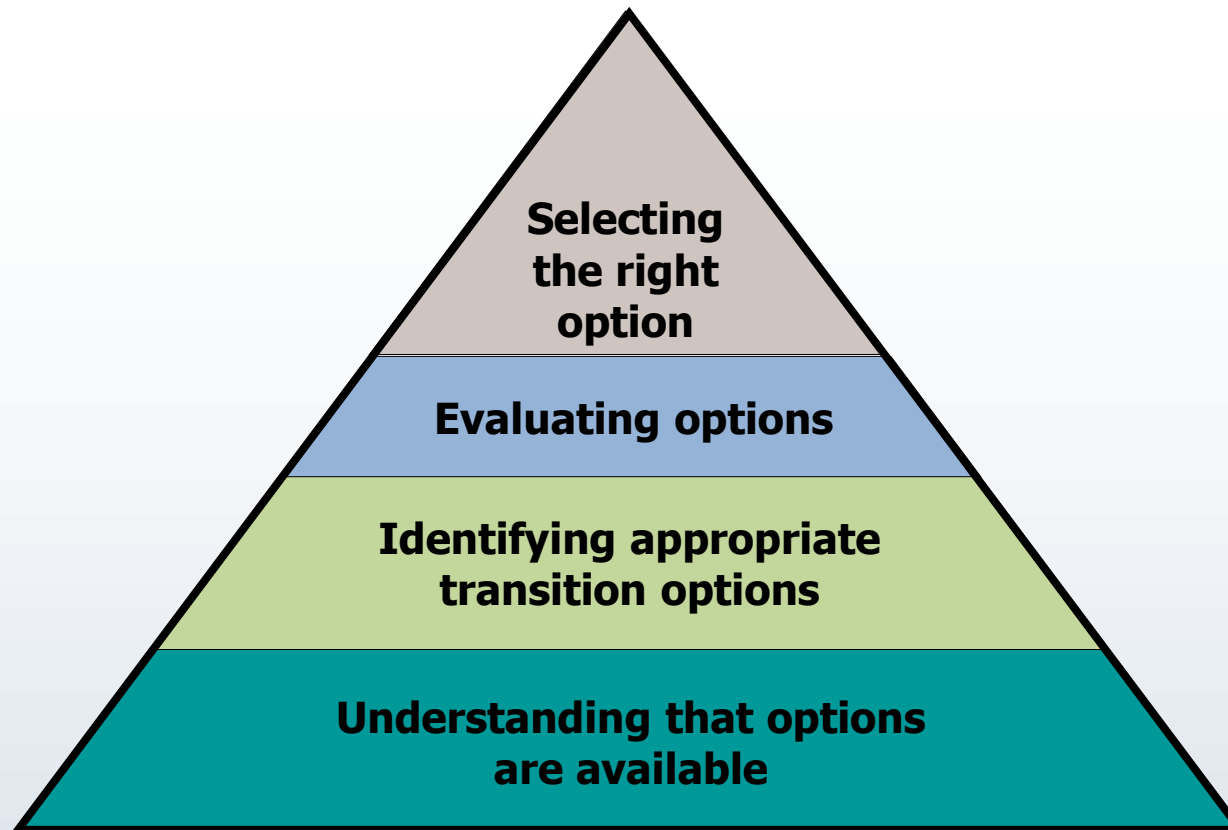


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# Ownership transition process





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# Why plan for ownership transition?

- **Determine whose interests need to be considered**
- **Anticipate liquidity issues**
- **Reduce estate tax liability**
- **Affects cash flow available for retirement**
- **Affects net amount available for heirs**



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# Why plan for ownership transition

- **Affects how you organize and operate your company (*Are you too busy tending to day-to-day business?*)**
- **Save time and money**
- **Issues apply to all types of business succession transactions**



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## **Mistakes to avoid**

- **Putting off/avoiding decisions (ostrich)**
- **Assuming insurance will take care of everything**
- **Assuming all companies are salable**
- **Not considering all options**
- **Transferring ownership to the wrong people**



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## **When to start planning**

- **How early should you begin thinking about transition?**
- **Is now the right time to transfer ownership?**
- **Planning saves taxes**



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## **Exit considerations**

- **Market conditions**
- **Maximization of value**
- **Sentimental attachment**
- **Potential for a family member to manage the company**
- **Other family issues**





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# Why valuation is important

- **Critical component of planning process**
- **Provides a reality check**
- **Helps identify value drivers and detractors**



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# Internal transition options

- **Transition within the family**
- **Management buyout**
- **Employee Stock Ownership Plan**
- **Hire a CEO to run company**



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# External transition options

- **Third-party sale**
- **Recapitalization**
- **Sale of minority interest**
- **Initial public offering**

# Third-party sale

- **Advantages**
  - Capture company's real value
  - Clean exit
  - Create career opportunity for employees
- **Disadvantages**
  - Lengthy
  - Due diligence and negotiation can be stressful
  - Potential post-transaction contingencies

## Third-party sale

- **Financial buyers**
  - Individual investor
  - Private equity group
- **Strategic buyers**
  - Related industry/sector
  - Competitor
  - Portfolio company owned by a private equity group

# Third-party sale – strategic buyers

- **Pros**
  - Synergies available
  - High multiples available
  - Don't always need management talent
  - Can deliver requirements for growth (i.e. capital, markets, technology)
  - Will often entertain earnouts
  - Provides career path for management and employees



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# Third-party sale – strategic buyers

- **Cons**

- Transaction may be slow
- Integration can be painful
- Don't expect to stay long
- Upside may be tied to the overall acquirer
- Process may be painful
- Shares in acquirer may be restricted
- Employees and business can be lost



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# Third-party sale – financial buyers

- **Pros**

- Can close deal quickly
- Quick, but informal, responses
- Opportunity to stay involved and have upside
- Management and employees can get options
- Business will retain its identity



# Third-party sale – financial buyers

- **Cons**
  - Want high rate of return, so lower price
  - Very driven—slow life gone
  - Require exit strategy
  - Possible loss of control
  - Non-performing friends and family employees are threatened



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# Third-party sale

- **Deal structure**
  - Merger
  - Stock sale
  - Asset sale
- **Corporate status**
  - C Corporation
  - S Corporation



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# Third-party sale – expectations

- **Price**
- **Terms**
- **Structure**
- **Timetable**
- **Fees**



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# Third-party sale – consideration

- **Forms**

- Stock
- Cash
- Notes
- Combination

- **Buyer  
protections**

- Earnouts
- Holdbacks
- Escrows
- Indemnifications



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# Family transition

- **Advantages**

- Keeps business in the family
- Parents can be the banker

- **Disadvantages**

- Be sure children can run the company
- IRS issues

# Family transition

- **Gifting or bequests**
  - Family Limited Partnerships (FLPs)
  - Limited Liability Companies (LLCs)
  - Closely-held stock (voting, non-voting)
- **Sale of assets or stock**
- **Transfer to family members**
  - Fair market value and terms
  - Adequate disclosure and valuation discounts



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# ESOPs

- **Advantages**

- Can be done in stages (less leverage)
- Independent financial, management transitions
- Draws on pre-tax cash flow
- Defers capital gains taxes

- **Disadvantages**

- Perceived complexity
- QRP restrictions



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## **ESOPs – why sell?**

- **Begins diversification process**
- **Reward employees for their efforts**
- **Philosophical belief in employee ownership**
- **Tax benefits**
- **Excellent opportunity for estate planning when transaction completed**



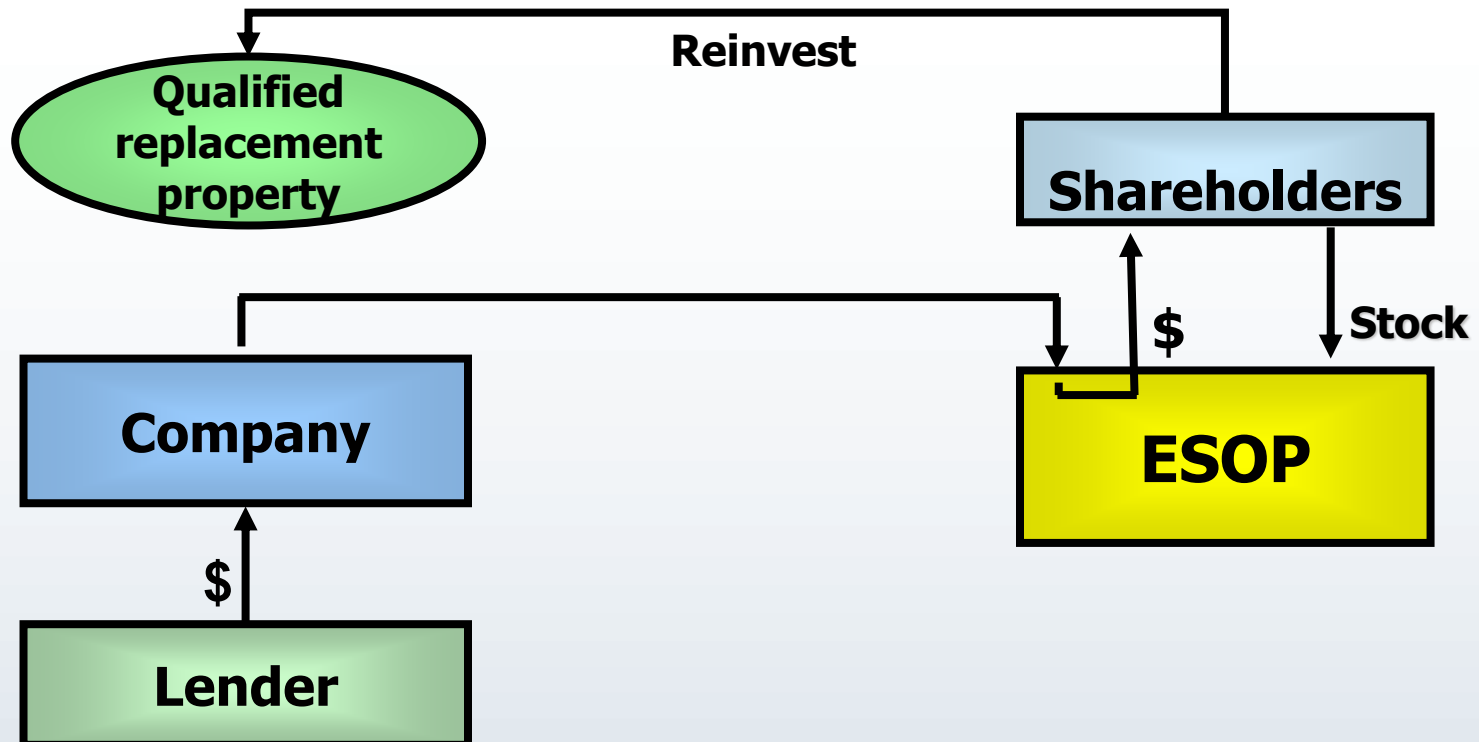


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## ESOPs



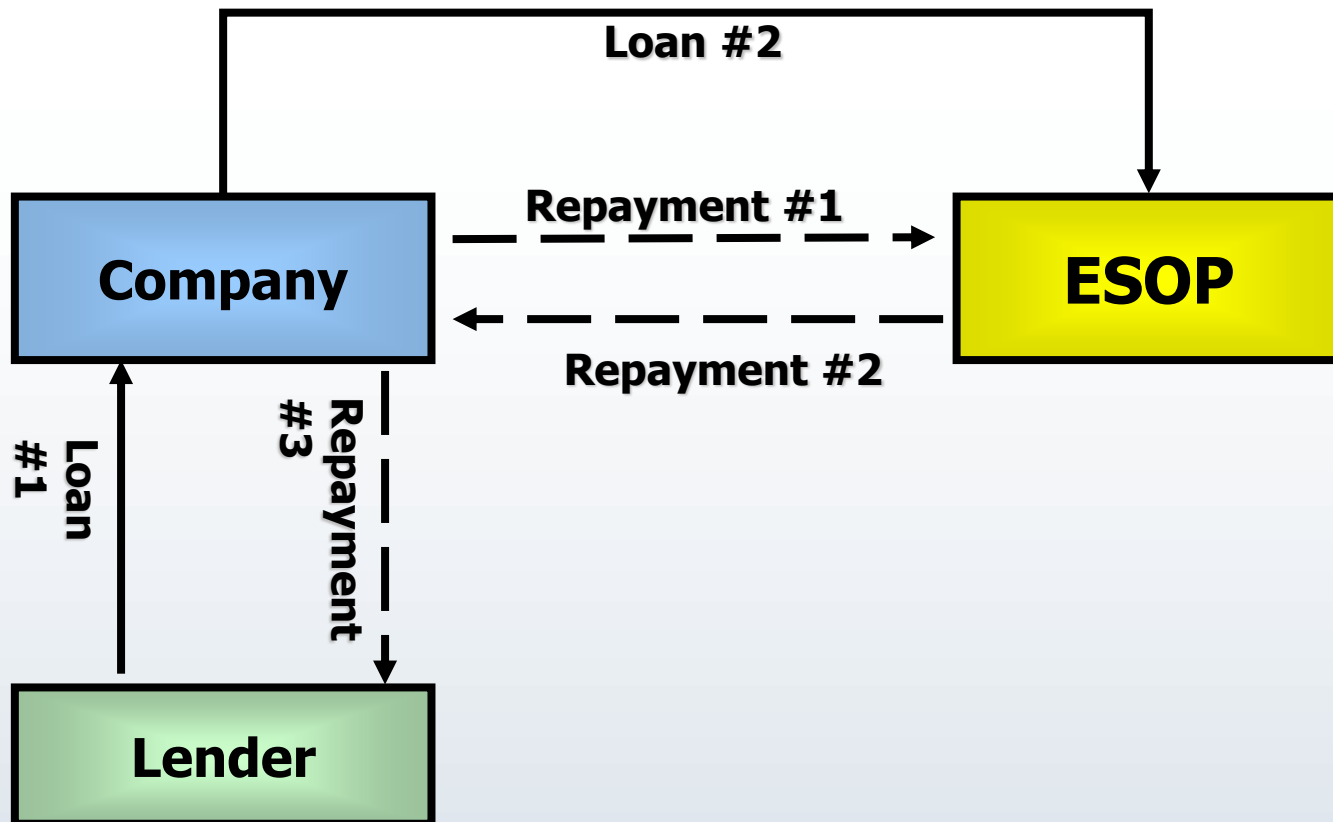


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## ESOPs





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# ESOPs

- **Benefits to shareholders**
  - Ready market for their stock (always a stock deal)
  - Tax-free rollover of sales proceeds
  - Maintain control of corporation, if desired



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# ESOPs

- **Benefits to the company**

- Increases productivity
- Repay principal portion of debt with pre-tax dollars
- Prepay loan with tax-deductible dividends
- Increases cash flow
- Exclusion of federal income taxes (S Corporations only)
- Keeps company rooted in the community



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# ESOPs

- **Benefits to employees**
  - Own a piece of the company and share in its growth at no cost to them
  - Improves morale
  - Account balances grow tax-free
  - Can diversify accounts, if desired



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# Management buyout

- **Advantages**

- Transaction financed with corporate assets, earnings
- Diversification for shareholders
- Management continuity

- **Disadvantages**

- Balance-sheet stress
- Owner won't receive highest price
- Management will need equity

# Management buyout

- **Ideal management buyout candidate company**
  - Second-line management team in place
  - Asset-intensive
  - Minimal debt



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# Getting started

- **Form advisory team**
- **Conduct ownership transition analysis**