

Sale of a Family Business: Best Practices and Costly Pitfalls to Avoid

September 14, 2021

Matthew W. Markatos, CFA
Senior Vice President, Senior Client Advisor
mmarkatos@whittiertrust.com

Elizabeth M. Anderson, CEPA
Vice President, Advisory Services
eanderson@whittiertrust.com

WHITTIER TRUST COMPANY

South Pasadena 1600 Huntington Dr., South Pasadena, CA 91030 | 626.441.5111

Newport Beach 4695 MacArthur Ct., Ste 1500, Newport Beach, CA 92660 | 949.216.2200

San Francisco 505 Montgomery St., Ste 1200, San Francisco, CA 94111 | 415.283.1850

WHITTIER TRUST COMPANY OF NEVADA INC.

Reno 100 W. Liberty St., Ste 890, Reno, NV 89501 | 775.686.5400

Seattle 520 Pike St., Ste 1415, Seattle, WA 98101 | 206.332.0836

Portland 111 S.W. Fifth Ave., Ste 3150, Portland, OR 97204 | 503.444.3428

FOR TODAY

- Moderated by David Shaw, publishing director, *Family Business Magazine*
- There will be time for questions. Enter them from your computer anytime during the presentation
- The webinar is 60 minutes
- The audio portion of this webinar will stream through your computer. If you are not hearing sound, please check the speaker volume on your computer and on the player (look for the volume icon on the upper left underneath the video box).

Today's Speakers



Matthew W. Markatos
Senior Vice President,
Senior Client Advisor
626.463.2556
mmarkatos@whittiertrust.com



Elizabeth M. Anderson
Vice President
626-463-2536
eanderson@whittiertrust.com
www.linkedin.com/in/elizabethmanderson



David Shaw
Publishing Director
Family Business Magazine
dshaw@familybusinessmagazine.com

Topics of Discussion

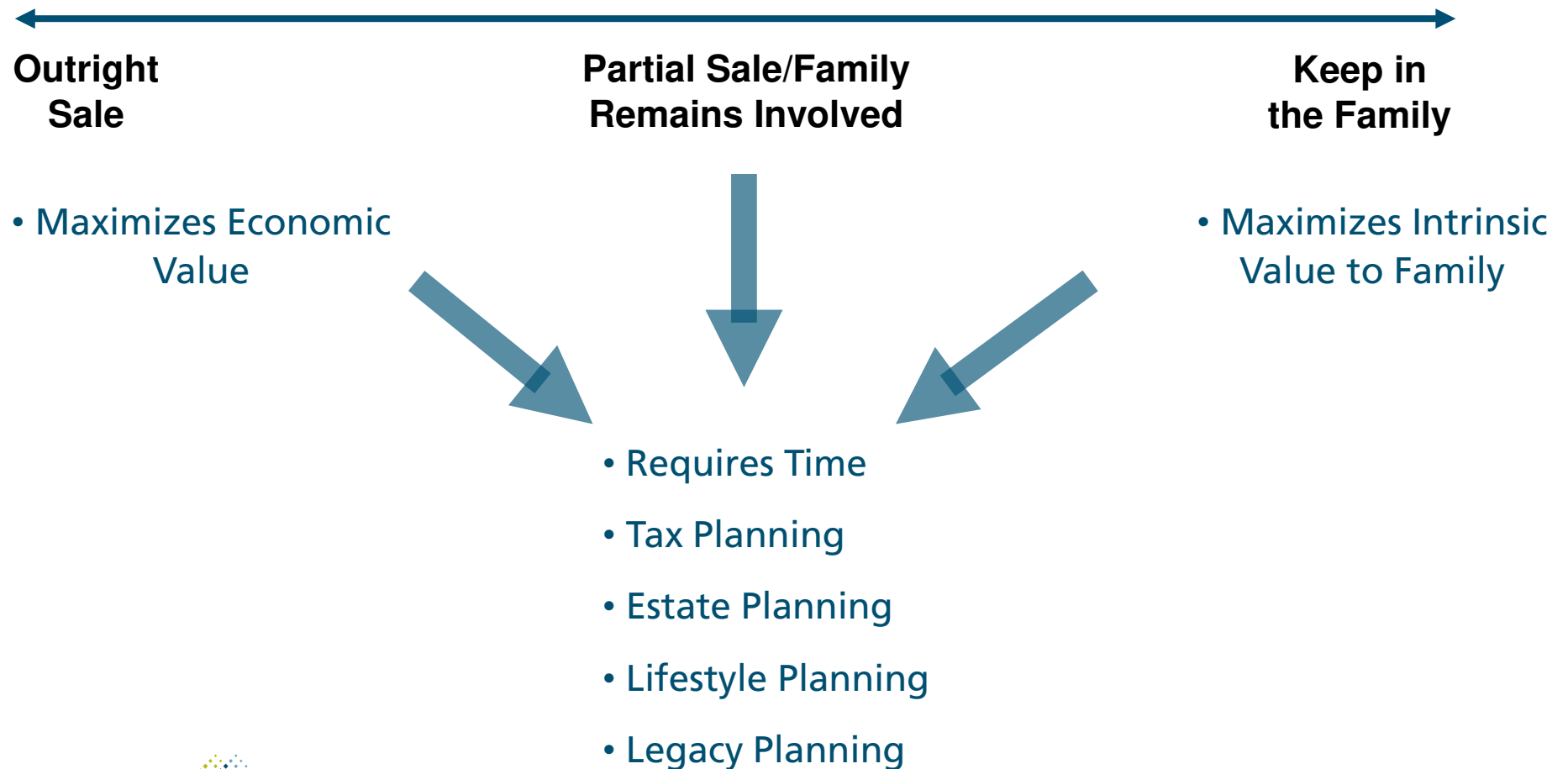
- The Continuum Between Attaining the Highest Economic Value vs. the Highest Intrinsic Value for a Family Business
- Framework & Best Practices to Achieve your Goals, Wherever you Fall on the Continuum
- Avoiding Costly Pitfalls – not just Monetary, but also Familial

POLL 1

If you are part of a family business, where is *your* business headed?

- Keep in the family
- Partial sale
- Complete sale
- Levered recapitalization

Where is Your Business Headed?



Best Practices

- Determine Owner's Objectives for Business
- Allow for Sufficient Time
- Assemble an Experienced Team of Advisors
- Holistically Prepare the Business
- Tax & Estate Planning
- Educate the Family
- Attend to Family Dynamics
- Address Legacy Objectives



Costly Pitfalls

- Impose Your Objectives for Business
- Rush the Transition
- Penny-wise, Pound-foolish
- Lack of Attention & Communication
- Excessive Taxation, Loss of Control
- Family is Ill-prepared For the Wealth
- Familial Relationships Implode
- No Legacy Established



Where is the Business Headed?



Family Transfer Scenario

Overall Objective - Keep Business in the Family

1. Maximize Intrinsic Value of Family
2. Requires Time
3. Business Planning
4. Tax/Estate Planning
5. Lifestyle Planning
6. Legacy Planning



POLL 2

How much time do you need to prepare for a family transfer?

- 3 months
- 6 months
- 12 months
- 3 years
- 5 years

Family Transfer Scenario

Family Dynamics - Maximize the Intrinsic Value of Family

Communication

Code of Conduct

- Positive Communication
- Overcoming Emotional Explosions
- Staying Focused & On Track
- Voice vs. Vote

Fair vs. Equal

Minimize Taxes for All Involved

Prepare Business to Succeed under New NextGen Owners

Promote Family Harmony and Purpose Around Legacy Business



Family Transfer Scenario

Time

At Least 3-5 Years of Active Planning

External Expert Advisors Are Key

- Founders Need to Transition Knowledge, Relationships & Roles
- Some Deadlines are Earlier Than Expected
 - Estate & Tax Planning*
 - Founders' Post Transaction Cash Flow Needs Estimate
 - Communicating Plan to Highly Valued Employees

Train NextGen for New Roles

Promote Family Harmony & Purpose Around Legacy Business



Family Transfer Scenario

Advisory Team

Assemble an Advisory Team

- Design a Coordinated Succession Plan, Tax & Estate Plan, and Post-Transaction Lifestyle & Financial Plan
- Engage Corporate/Transactional Attorney, Tax Advisor, Estate Planning Attorney, Wealth Manager, Business Consultant

Work with Additional Advisors to Provide Resources for the Plan

- Valuation Expert
- CFO/Auditor
- Banker



Family Transfer Scenario

Prepare the Business

Succession Plan/NextGen Training

- HBS Executive Education
- Business Consultant On-site

Healthy Financials

Owner Dependency

- Shadowing/Mentorship, Time Away From Business Prior to Transfer

Employee Retention

- Communication, Stock incentives

Valuation

- Coordinate with Key Advisors
- Look for Opportunities for NextGen to Add Value

Transparency/Communication

- Trust within the Business & In the Family



Family Transfer Scenario

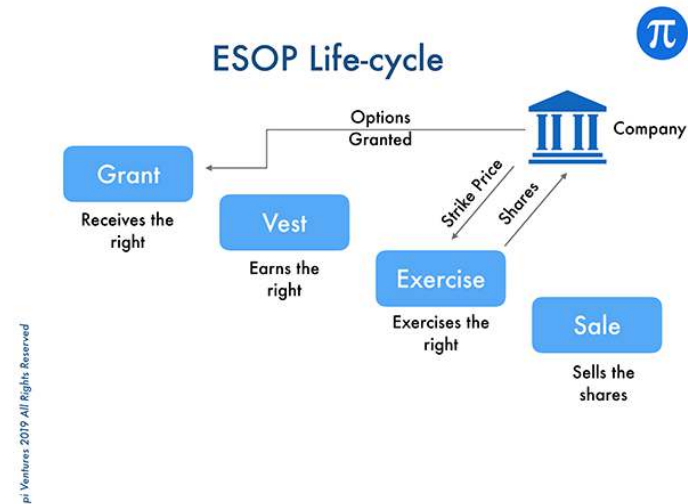
Process

1. Prepare Business to Succeed with NextGen Owners
2. Sell/Transfer Business to NextGen
3. Arrange Funding Source for NextGen
4. Minimize Capital Gains and Estate Taxes
5. Promote Family Harmony and Purpose Around Legacy Business

Family Transfer Scenario

Transfer & Funding Options

1. ESOP
2. Gift Shares
3. Intra-Family Loan
4. Bank Loan



Family Transfer Scenario

Post-Transaction Lifestyle & Financial Plan

Life After the Business - Hobbies & Activities

- Charitable Intent + Legacy Opportunity

Medical

Flexibility/Cushion

Cash Flow Needs



Family Transfer Scenario

Family Legacy



Confirm Vision

- Family Enterprise
 - Thinking About the Family Beyond the Business and Family Relationships
- Family In & Out of Business Collaborating on Many Levels
- Thriving Family Business + Philanthropic Engagement + Family Harmony

Where is the Business Headed?



A Pure Exit – Achieving for Highest Economic Outcome for the Family

Background



“Novelty Co.” sells high-margin, low-priced, impulse-buy products to large nationwide retailers

- Steve (patriarch) is the Sole Owner & NextGen is not involved

Steve has established a competitive moat around his business:

- Design team creates products with unique designs with practical use at low price points
- Outsources manufacturing to Asia
- Cultivates relationships with nationwide retailers
- Manages Inventory in-house with 2 Warehouses adjacent to Boise Airport

Steve wants to Exit the Business, Minimize Taxes and Pursue Other Life Interests

Overall Objectives

1. Assess the Business
2. Maximize the Exit Price & Minimize Taxes
3. Anticipate Life After the Sale



Objectives

1. Assess the Business

- Two very different, yet intertwined businesses:
 - Asset-Light Operating Business
 - Relies on Creativity (IP)
 - Strong Personal Relationships
 - Manufacturing & Sales Channel
 - Asset-Heavy Real Estate Business
 - Manages Inventory to Foster Success of the Asset-Light Business
- Monetize Both Businesses?



Objectives

2. Maximize the Exit Price, Minimize Taxes

- Timely Exit
 - Micro & Macroeconomic Cycle
- Maximize EBITDA and EBITDA multiple
 - Optimize Fin'l Statements & Quality
- Cash Deal?
 - Cash/Equity might be more Tax-Advantaged
- Tax Planning
- Short Retention Contract
 - Transition Business and Relationships



Objectives

3. Anticipate Life After the Sale

- Lifestyle
 - Cash Flow and Financial Resources
- Legacy
 - Charitable Intent – Family Involvement?
- Financial Independence for NextGen



Time

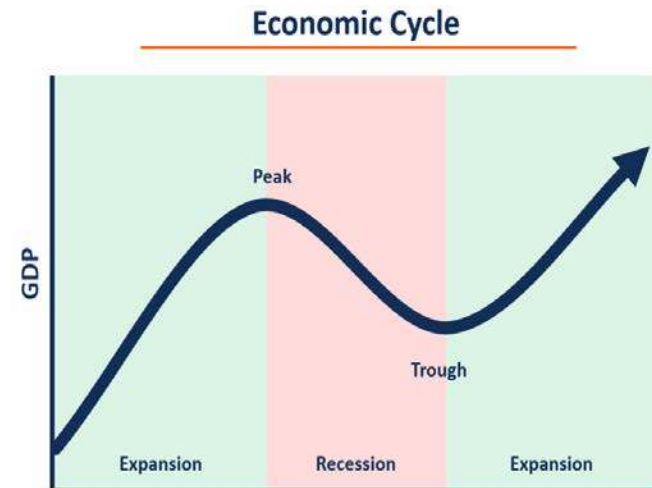
1. Timing & Type of Buyer Will Impact Valuation
2. Prepare for the Sale



Time

1. Timing & Type of Buyer Will Impact Valuation

- Economic Cycle
 - Cash flow Generation and Multiples
- Strategic Buyer
 - Add Scale to Product Offering
 - Add Scale to Distribution
- Financial Buyer
 - Private Equity Seeking Diversification



Time

2. Prepare for the Sale

- Seek Independent Appraisal of Current Value
 - Necessary for Tax & Estate Planning
- Assemble a Team of Independent Advisors to produce a Due Diligence Report
 - Institutional Reporting Leads to Higher EBITDA Multiples (valuation)
- Tax Planning and Estate Planning – Pre-LOI



POLL 3

Which part of “preparing for a sale” would you do yourself, if any?

- Financial Disclosures
- Corporate documents
- Human Resources
- Legal
- Suppliers & Customers

Case Study – Pure Exit

Team of Advisors

Produce a Due Diligence Report:

1. Financial Disclosures

- Audited Financial Statements
- Local, State and Federal Tax Returns
- Internal Financial Models and Forecasts

2. Corporate Documents

- Articles of Incorporation
- Shareholder Information & Related Documents

3. Human Resources

- Employee Handbook
- Organizational Chart
- Salaries, Deferred-compensation and other non-salary compensation/benefits

4. Legal

- All Agreements and Contracts
- Past or Current Litigation
- Regulatory Issues

5. Suppliers & Customers

- Analysis of Supply-chain
- Analysis of Customers by Revenue
- Any Open Complaints/Disputes with Suppliers or Customers



Case Study – Pure Exit

Estate & Tax Planning – Pre-LOI

Hire an Attorney to Engage in Off-Record Discussions with Suitors

Consider the Lifetime Federal Estate Gift Tax Exemption (Currently \$11.7mm per person)

- Gift Shares outright or in-Trust to Family Members
 - Discounts could be available & GST Transfer Opportunities

Establish an Irrevocable Nevada Trust

- Dynasty Trust (365 Years) with Asset Protection and No State Income Taxes

Establish a GRAT

Does the Business Qualify for QSBS Tax Exemption?

Discuss Any Philanthropic Intent – Charitable Remainder Trust (CRT)

- Tax Benefits, Income Generation & Multiple Remainder Beneficiaries

Case Study – Pure Exit

Valuation Matters – Is the Business Worth \$30M or \$60M?

Maximize Value

- Owners Often Go for the Easy Offer vs. Engaging an Investment Banker
- Strategic vs. Financial Buyer (Strategic Typically Pays Higher EBITDA Multiples)
- Where are we in the Macro and Micro-Economic Cycle?

Estate Planning Ramifications

- Minimizing Estate Taxes vs. Maximizing Liquidity/Cash Flow Needs
- Irrevocable Gifts
 - Accidentally Gifting too much to NextGen



Philanthropic – Charitable Remainder Trust and DAFs

- Difference in Value could mean too Small or too Large of a Gift
 - Ramification on Cash Flows Paid to Current Beneficiaries (Business Owner)
- No Tax on Sale of Business (State and Federal)
- Allows for Larger Charitable Gift Due to Discounts
- Educate the Family to be Stewards of Wealth

Case Study – Pure Exit

Legacy Planning

Legacy Through Philanthropy

- Charitable Remainder Trust (CRT)
- Donor Advised Fund (DAF)
- Family Foundation



Education Through Philanthropy

- Preparing the Family for Wealth
- Good Stewards of Wealth
- NextGen Learning to be Citizens of Wealth



Best Practices Followed

- Confirmed Owner's Objectives for Business
- Allowed for Sufficient Time to Prepare
- Assembled an Experienced Team of Advisors
- Holistically Prepared the Business
- Comprehensive Tax & Estate Planning
- Maximized Economic Outcome
- Planning Achieved Lifestyle Needs
- Created Legacy Objectives with Philanthropy

Costly Pitfalls Avoided

- Business Sold at a Discounted Value
- Only One "Vulture" Bid for Business
- Biased and Sub-Par Advice Leads to Poor Economic Value Outcome
- Key Employees Leave, Business Interrupted
- Excessive Taxation & Loss of Control
- Failure to Achieve Owner's Objectives
- Reliance on Children to Maintain Lifestyle
- Family is ill-prepared to be Stewards & Citizens of Wealth

Thank you.

Questions?



WHITTIER TRUST COMPANY

South Pasadena 1600 Huntington Dr., South Pasadena, CA 91030 | 626.441.5111

Newport Beach 4695 MacArthur Ct., Ste 1500, Newport Beach, CA 92660 | 949.216.2200

San Francisco 505 Montgomery St., Ste 1200, San Francisco, CA 94111 | 415.283.1850

WHITTIER TRUST COMPANY OF NEVADA INC.

Reno 100 W. Liberty St., Ste 890, Reno, NV 89501 | 775.686.5400

Seattle 520 Pike St., Ste 1415, Seattle, WA 98101 | 206.332.0836

Portland 111 S.W. Fifth Ave., Ste 3150, Portland, OR 97204 | 503.444.3428