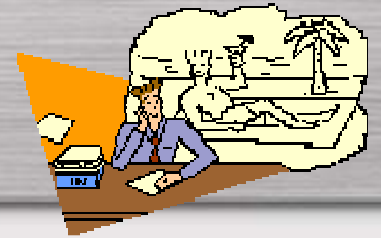


Exit Strategies



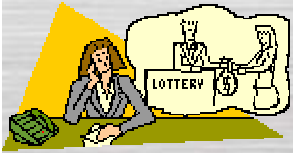
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What is an Exit Strategy?



A road map to successfully sell a privately held business.

Done properly an Exit Strategy will:

- ✓ **Control how & when the owner exits**
- ✓ **Maximize company value regardless of business conditions**
- ✓ **Minimize taxes from sale**
- ✓ **Ensure business & personal goals are achieved**
- ✓ **Ensure continuity of the business**



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Top 10 Reasons an Exit Strategy is not Done

- 1. Not sure how to start or how to do it***
- 2. Too busy running the business & putting out fires to plan for the future***
- 3. I'll do it next year (same reason as last year)***
- 4. Not really committed to planning for this***
- 5. I'll start planning as soon as we get to \$X million***
- 6. Don't know where to go for help***
- 7. Shareholders can't agree on how & when***
- 8. Owners don't think they can get enough \$***
- 9. Uncomfortable discussing this with family/others***
- 10. Unsure of what they will do after the sale***



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Preparing to Sell

- **Develop & Implement an Exit Strategy**
 - ✓ **Increase the price you realize**
 - ✓ **Reduce your time on market**
 - ✓ **Increase the odds of a successful sale**
 - ✓ **May lead to qualifying the business for an SBA loan and reduce or eliminate the need for seller financing**
 - ✓ **Keep your options open – you have nothing to lose and everything to gain \$\$\$**



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Why You Need a Professional Team

There are many aspects to developing an Exit Strategy, each aspect of the plan should be developed with a professional experienced in that field.

- ✓ **Tax planning**
- ✓ **Business evaluation & valuation**
- ✓ **Deal structure, negotiation, due diligence**
- ✓ **Estate planning**
- ✓ **Financial planning (post sale & pre sale)**

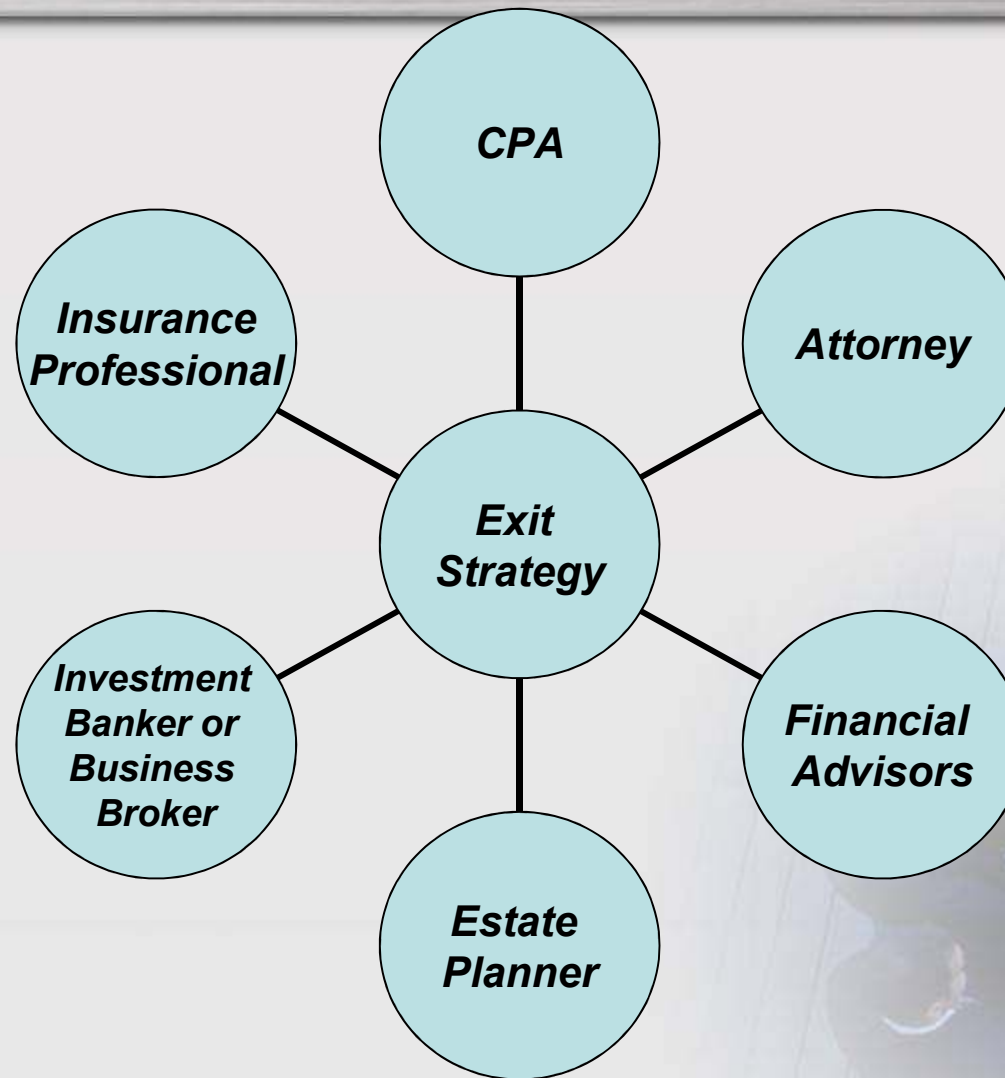


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Building Your Team



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Key Elements of Your Plan

Your Exit Strategy should include:

- ✓ **Timeline: when do you plan to exit**
- ✓ **Buyers: strategic or financial**
- ✓ **Valuation**
- ✓ **Your advisor team**
- ✓ **Management team & transition plan**
- ✓ **Financial statements**
- ✓ **Action plans to achieve financial targets**
- ✓ **Key metrics: evaluate EVERY month**



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Contingency Plans

Your Contingency Plan is your Plan B. This plan outlines how the business will operate in the event of serious illness, disability, death, or other unplanned events.

- ✓ **A contingency plan provides for continuity in the business when faced with unexpected events**
- ✓ **Without a contingency plan the business is at risk of chaos or even dissolution when facing these events**



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Your Contingency Plan

**Develop this with your CPA, Attorney,
and Financial Advisor.**

Key points:

- ✓ **Life & disability insurance**
- ✓ **Business insurance**
- ✓ **Shareholder buy/sell agreement**
- ✓ **Emergency action plans**
- ✓ **Key employees & management transition**



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Exit Options

Most associate exiting the business with the eventual sale of the business. There are other options such as:

- ✓ **Transfer of ownership to family members**
- ✓ **Sell to other shareholders**
- ✓ **Sell to management**
- ✓ **Sell to employees (ESOP)**
- ✓ **Sell to a third party**
- ✓ **Go public**
- ✓ **Liquidate the business**



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Who will buy My Business

Two Basic Types of Buyers

1. Economic

- ✓ **Value of business driven strictly by ROI**
 - ♦ **Value driven by present cash flow & classic valuation methods**

2. Strategic

- ✓ **Value of business driven by “strategic” value of the business**
 - ♦ **Future sales & growth**
 - ♦ **New markets/customers**
 - ♦ **Valuation based on strategic value/future cash flow**



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Stock vs Asset Sale

**Two types of sales, Stock & Asset
Why does it matter?**

- **Sale type & structure directly affects your taxes**
- **Requires advance planning to save taxes**
- **Complex issue, some CPAs and other professionals not well informed on this**



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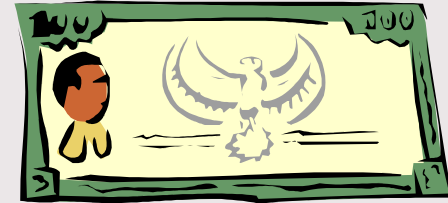
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Stock Sale

- **Stock Sale**

- ✓ Tax benefits for seller
- ✓ Tax disadvantage for buyer
- ✓ Successor liability issues & risks for buyer
- ✓ Complex transaction, requires experienced CPA & Attorney
- ✓ Make sure the details are done right
- ✓ Typically longer transaction to complete
- ✓ Requires an experienced buyer & team



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Asset Sale



- **Asset Sale**

- ✓ Tax advantages for buyer
- ✓ Tax disadvantages for seller
- ✓ More straight forward deal structure
- ✓ Reduced or minimal successor liability
- ✓ Typically a quicker and easier transaction



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Company Structure is IMPORTANT

The structure of your company, C Corp, S Corp, LLC, or Sole Proprietor has a MAJOR impact on your taxes in the event of a sale.

- ✓ C Corp
- ✓ S Corp & LLC
- ✓ Sole proprietor
- ✓ If you are a C Corp discuss tax planning with your CPA and discuss tax implications of an asset sale



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What do I do with the \$

You have the money, now what...?

- ✓ **All cash transaction not necessarily the best**
- ✓ **Investment of the proceeds is a key part of your Exit Strategy.**
- ✓ **Get advice from & develop a plan with your CPA and Financial Advisor well in advance**



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Financial Statements

Financial statements are *CRITICAL* in valuation and in the sale of your business. Your financial statements must be accurate and complete as these statements are used for both valuation and due diligence (buyer's review and verification).

- ✓ P&Ls must match tax returns
- ✓ Must be accurate and complete
- ✓ Owner's benefits are OK, but must be verifiable



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What Drives Value

- 1. Cash flow: EBITDA & DE***
- 2. Growth: historic for both economic & strategic, potential/future growth strategic buyers *ONLY!***
- 3. Management infrastructure: gets it sold, does not add tangible value**
- 4. Assets: minimal if any impact!**



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What is EBITDA & DE?

- **EBITDA**

- ✓ **Earnings Before Interest Taxes
Depreciation & Amortization**

**EBITDA = Pre Tax Profit + Interest +
Depreciation + Amortization**

- **DE**

- ✓ **Discretionary Earnings**

**DE = Pre Tax Profit + Owner's Salary &
Benefits + Depreciation + Amortization**

Or DE = EBITDA + Owners Salary & Benefits

aka SDE, SDC, Owners Benefit, etc...



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Preparing to Sell

- **How do I prepare to Cash out?**
 - ✓ **Maximize EBITDA for 2 to 3 years**
\$ Every extra \$ of EBITDA = \$2 to \$5 in your pocket when you sell!
 - ✓ **Growth – buyers love a growing business**
 - ✓ **Clean up the books & records**
 - ✓ **Operations must be capable of running without you involved in day to day issues**
 - ✓ **Staff training**
 - ✓ **Clean up the office & building**



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When & Why to Sell

- **The best time to sell is when**
 - ✓ Sales and profits are peaked or nearly so
 - ✓ The company is operating well & stable
- **Why to Sell**
 - ✓ Retirement
 - ✓ Reduce your risk
 - ✓ Cash out



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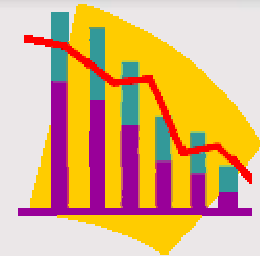
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When Not to Sell

- **You waited too long if:**

- ✓ Earnings have dropped substantially
- ✓ You must sell “quickly”
- ✓ Your competitors have already passed you by



**PRICE
Reduced**

- **You should wait if...**

- ✓ You expect substantial growth soon
- ✓ You *KNOW* things *WILL* improve



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When to Sell Anyway

- **You should move on and sell if:**
 - ✓ Earnings are not likely to improve
 - ✓ Competition is growing stronger
 - ✓ Market is getting weaker
 - ✓ Product pricing and margins are eroding
 - ✓ You are burned out and simply aren't willing to do what needs to be done
 - ✓ If health or age are a concern and a successor is not in place



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Why Buyers Buy

- **Top Reasons for Buying a Business**

- ✓ **Cash flow**
- ✓ **Growth**
- ✓ **ROI**
- ✓ **Strategic fit (typically larger deals)**
- ✓ **Taxes (typically larger deals)**
- ✓ **Intangibles**



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What Buyers Want

- **Good Books & Records**
 - ✓ 3 years P&L's and tax returns
- **Good Earnings**
 - ✓ Must be able to support debt service, buyers income & a return on investment
- **Good Price & Terms**
 - ✓ Market price, sensible earnings multiples
 - ✓ Bank or seller note financing
- **Easy or Manageable Transition**



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Recasting the Financials

- **Financials must be recast to reflect the company's true earnings. Typical expenses added back are:**
 - ✓ **Owner's salary**
 - ✓ **Owner's benefits**
 - ♦ Insurance, vehicles, pension, other perks
 - ✓ **One time extraordinary expenses**
 - ✓ **Family member's salaries if above market rate or not actively involved in the business**



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Seller's Valuation Methods

- **I know what my business is worth:**
 - ✓ I checked the newspaper ads & internet
 - ✓ My accountant told me...
 - ✓ My attorney told me...
 - ✓ A friend told me...
 - ✓ I invested that much and it has potential!
- **Sellers Valuation Equation:**
Original Investment + Salary + Inventory + All Assets + Whatever I Want = Selling Price



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Pricing Rules of Thumb

- **Some typical pricing multiples are:**
 - ✓ **DE 1.5 X to 3 X (plus inventory & A/R)**
 - ✓ **Overall average DE = 2.15 X**
 - ✓ **EBITDA 3 X to 5 X**
 - ✓ **Average = 4 X**
- **You can get comparable sales data from www.bizbuysell.com or Pratt's Stats. BizBuySell offers a value estimate. Best to contact a professional for a valuation or value estimate.**



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Financing & Deal Structure

- ***There are only 2 real choices for Small Businesses:***
 - ✓ ***Bank or SBA loan – will finance up to 90% of deal but you still need collateral***
 - ✓ ***Seller note – typically 50+% down with a 5 year, 7% note. Also can supplement SBA loan to lower down payment i.e. 10% to 15% down***
 - ✓ ***All cash – rarely occurs, and usually at the expense of the asking price***



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Financing & Deal Structure

- **M&A Financing – *a bit different, but...***
 - ✓ Still rarely *ALL* cash.
 - ✓ May still require a seller note
 - ✓ Often includes earn-outs such as employment contracts, severance, non-compete, consulting, commissions, bonuses on sales or other targets, etc...
 - ✓ May include stock of buyer's company
 - ✓ Deal is generally too big for SBA loans, must use other debt financing



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Reading & other Resources

Books & Reference Guides

- 1. “Own Your Future, Straight Talk About Buying a Business and Building Your Future”, William Grunau**
- 2. “The Complete M&A Handbook”, Tom Taulli**
- 3. “Selling Your Business, How to Attract Buyers and Achieve the Maximum Value for Your Business”, Russell Robb**
- 4. Valuation Handbook – Dr. Pratt**



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More Resources...

- **Web Resources**

- ✓ www.vrbbs.com (VR Business Brokers)

- **Valuation & Comp Resources**

- ✓ *Bizcomps*

- ✓ *Pratt's Stats*

- ✓ *Business Evaluation Systems*

- ♦ (www.besappraisals.com)



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