Understanding Your Exit Options

Compete Smart 2016
Two General Categories for Private Ownership Transition

- “Inside” 4
  - Intergenerational Transfer
  - Management Buyout
  - Sale to Existing Partners
  - Sale to Employees

- “Outside” 3
  - Sale to Third Party
  - Recapitalization
  - Orderly Liquidation
  - IPO?
Are you familiar with all of your exit options?
Exit Options for Privately-Held Enterprises

- Orderly Liquidation
- Intergenerational
- Employees
- Management Buyout
- Partners
- 3rd Party Buyout
- Recapitalization
- Exit Options
What is your preferred type of transition?

- Intergen: 21%
- Employees: 2%
- MBO: 10%
- Partners: 2%
- 3rd Party buyout: 30%
- Recap: 1%
- Orderly Liquidation: 1%
- Not sure: 31%
- Other: 2%
- Other: 2%
Have you established a formal transition advisory team?

- Yes: 88%
- No: 7%
- My Board: 5%
Have you completed any formal education related to transitioning your business?

- Yes: 86%
- No: 14%
Which describes your post transition “life after business” plan?

- No thoughts
- Idea
- Informal plan
- Written Plan

0.00% 10.00% 20.00% 30.00% 40.00% 50.00%
Do you have provisions in place if key personnel or shareholders should get ill, die or otherwise exit the company?

- Yes: 33%
- No: 67%
Intergenerational Transfer

Transfer of business stock to direct heirs, usually children. 50% of business owners want to exercise this option – in reality, only about 30% actually do so.

**Pros**
- Business Legacy Preservation
- Planned
- Lower Cost
- More Control
- Less Disruption
- High Buyer/Seller Motivation

**Cons**
- Family Dynamics
- Illiquid Buyers/Lack Funds
- Lower Sale Price
- Key Employee Flight Risk
- Tradition May Outstrip Good Strategy
- Path of Least Resistance – but not always a path to growth or success
Owner sells all or part of the business to the company’s management team. Management uses the assets of the business to finance a significant portion of the purchase price.

**Pros**
- Continuity
- Highly Motivated Buyers (Pent-up Desire)
- Preserves Key Human Capital / Knowledge
- Planned
- Can be combined with Private Equity to access additional capital and resources for growth

**Con**
- Management “sand-bagging”
- Distraction
- Threat of Flight (Coercion of Owner)
- Illiquid buyers
- Lower price and unattractive deal terms for seller
- Heavy seller financing introduces risk
- Managers are not always good entrepreneurs
Success is closely linked to the existence and quality of a buy-sell agreement. Not available to single-owner businesses.

- **Pros**
  - Less disruptive
  - Planned
  - Well-informed buyers
  - Controlled process
    - if Buy-Sell Agreement in place and funded
  - Lower cost

- **Cons**
  - Lower sales price
  - Potential discord
  - Competency Gaps?
  - Buy/Sell may restrict selling options
  - Realization of proceeds from sale is often slower (and less)
Sale to Employees (ESOP)

Company uses borrowed funds to acquire shares from the owner and contributes the shares to a trust on behalf of the employees.

- **Pros**
  - Business stays in the “extended family”
  - Shares purchased with pre-tax dollars by the ESOP
  - Taxable gain on the shares sold to the ESOP by the owner may sometimes be deferred
  - ESOP is an employee benefit
  - May cause employees to think and act like owners

- **Cons**
  - Complicated and expensive
  - Requires securities registration exemption
  - Company compelled to buy-back shares from departing employees
  - Generally suitable only for gradual exit over time
Owner sells the business to a strategic buyer, financial buyer, or private equity group through a negotiated sale, controlled auction, or unsolicited offer.

**Pros**

- Higher price (highest of the options)
- More cash up front
- Walk away faster
- Stability of deal terms
- Business refresh (growth, new energy)
- Cost-effective
- Breaks deadlock @ management level with family

**Cons**

- Long process (9-12 months)
- Distraction / Loss of focus
- Privacy concerns
- Emotional for owner
- After sale tie-downs
- Highest absolute cost of options (but higher benefit)
- Complex – involves about 1000 professional hours
- Can be difficult to close
Finding new ways to “fund the company’s balance sheet.” Essentially brings in a lender or equity investor to act as a partner in the business. Can sell minority or majority position.

**Pros**
- Allows partial exit
- Reduces owner risk
  - diversifies asset concentration
- Provides growth capital
- Second bite at the apple
- Works well with other Exit Options

**Cons**
- Continuing accountability to partners (not a clean break)
- Loss of control
- Culture shift
- Slow transaction
- Expensive relative to benefit
The business is shut down through a simple, quick process. Makes sense if asset values exceed the ability of the business to produce income required to support an investment.

**Pros**
- Good option when Asset Value exceeds Value of Going Concern
- Sum of the parts are greater than the whole (asset division produces value)
- Efficient way to exit
- May be less expensive than some of the other options

**Cons**
- Uncertain proceeds
  - No guarantee
- No $ for goodwill
- Emotional
  - Stigma?
- Hard to predict costs
- Damage to employees/jobs
- Higher tax (C-corporations)
Thank you!

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