9 Mistakes To Avoid In Getting Your Business Ready For An Ownership Transition

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“By failing to prepare, you are preparing to fail.”

- **Benjamin Franklin**

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Topics

I. Introduction

II. 9 Mistakes to Avoid

III. Scorecard

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I. WHY PREPARE FOR AN EXIT

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What is Succession / Exit Planning?

Succession / Exit Planning is a proactive process that provides for a smooth transition or exit over time, along with specific tactics to deal with unexpected contingencies (e.g. illness, burn out, divorce or death).

Source: Exit Planning Institute

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Key Issues in Succession / Exit Planning

- Purpose of the plan:
  - Maximize the value of the business
  - Minimize taxes
  - Ensure the owner is able to accomplish his / her personal and financial goals in the process.
- Properly executed, the plan protects the business owner, their family and employees.

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Are You Ready to Sell?

Historical Success Rates

- Only 30% of all family-owned businesses survive into the second generation; 12% survive into the third generation; and only 3% operate at the fourth generation and beyond.
- 70 – 80% of businesses put on the market do not sell.
- 95% of M&A professionals believe a business owners unrealistic expectations of company value are the biggest obstacle to sale or transfer.

Source: Exit Planning Institute

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II. 9 MISTAKES TO AVOID

It's All About Healthy Growth and
De-Risking Your Business and the Transition Process

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9 Mistakes to Avoid In a Transition

1. Inaccurate financial statements or improper accounting methods
   - GAAP-based financial statements preferred
   - Audited or at least reviewed financial statements
   - Quality of earnings report

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9 Mistakes to Avoid in a Transition

2. Failure to identify all appropriate add-backs and pro forma adjustments to your earnings and balance sheet
   - Buyers price off of the core earnings of the ongoing business
   - Companies often have one-time expenses or income, and discretionary expenses or income that will not pass to a new owner
   - Clear information to support adjustments

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9 Mistakes to Avoid In a Transition

3. Failure to understand the value of a business before a seller gets into talks with a buyer
   - Get a valuation of the business before beginning a sales process or as part of any exit planning
   - Examine environmental, legal or other contingent liabilities that will affect the value of a company

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9 Mistakes to Avoid in a Transition

4. Neglecting to take steps to maximize the value of the business
   - Key Value Drivers
     - People—Strong management team with deep bench
     - Recurring revenue—sustainable and resistant to commoditization
     - Diversified customer base
     - Proven business model with growth prospects and scalability
     - Market and economic factors
     - Size matters
   - Business Continuity
     - Eliminate owner / key man dependency
     - Management / key employee retention
     - Customer relationships exist at multiple levels and can be transferred
     - Transferrable, scalable systems and processes

Size Matters

Markets Reward Larger Businesses

TOTAL ENTERPRISE VALUE (TEV)/EBITDA

TEV	2003 –2013	2014	2015	2016	2017	2018	Total	N =
10-25	5.5	5.5	5.9	5.8	6.3	5.8	5.6	1227
25-50	6.1	6.4	6.6	6.4	6.6	6.9	6.3	916
50-100	6.7	7.6	7.8	7.2	8.2	9.0	7.2	633
100-250	7.2	7.5	9.0	8.9	9.1	8.8	8.0	317
Total	6.1	6.4	6.7	6.7	7.3	7.2	6.4	
N =	1897	213	244	233	252	254		3093

Please note that N for 2003-13 encompasses eleven years of activity.

Source: GF Data, February 2019

Disclaimer: Some deals do not make it to the finish line. The above numbers are averages. If you take a 7 multiple, there may be a 4 and a 15 used to calculate the average. This means you may get lower results than the above multiples.

9 Mistakes to Avoid in a Transition

5. Lack of financial projections
   - Be able to communicate the vision for the business in concrete terms
   - Growth plan that contemplates risk, capital structure, assets and capital expenditures
   - Strategic plan that includes financial forecast and management goals with metrics

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9 Mistakes to Avoid in a Transition

6. Failure to formalize a succession plan or develop the next generation of leadership
   - Develop a strong management team and a deep bench
   - Even for family members, insist on proper training and screening
   - Manage family expectations about remuneration, and scale for growth
   - Appoint non-family mentors

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9 Mistakes to Avoid in a Transition

7. Neglecting to develop a plan to minimize taxes
   - What transaction structure will allow you to pay the least taxes?
   - Estate planning is also a part of this analysis
   - Do you plan to retain any assets that are currently inside the business?
   - Opportunities to increase price or decrease taxes under the new tax law

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9 Mistakes to Avoid in a Transition

8. Poor IT, HR, tax and management systems
   - Good systems add value and build confidence in the buyer and his or her financing sources
   - A pre-transaction assessment will ensure that a company puts its best foot forward and does not have a transaction ending or transaction slowing event
   - Good systems influence how representations and warranties are negotiated, and what indemnifications a seller is required to give a buyer in a sale agreement

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9 Mistakes to Avoid in a Transition

9. Failing to assemble experienced advisors and a good deal team
   - Experienced advisors will help you know your options, stay focused, avoid mistakes and alleviate the pressures of a transition
   - Experienced investment bankers will know the market and buyers, and will develop the competitive tension among buyers and funding sources that generates the best price and terms, and gets the deal done

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IV. IS THE BUSINESS READY?

SCORECARD

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Based on the 9 Mistakes Discussed:

- What is the thing your company is doing the best right now?
- What is the biggest pitfall you have yet to tackle?
- Does the need to compensate owners compete with the capital needs of your business?
- What are your ideas to develop the next generation of leadership, family or otherwise?

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Thank You!

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