

Exit Planning for the Estate Planner

Which Comes First:
The Exit Plan or the Estate Plan

Overview

-
- Why Exit Planning?
 - Owner Demographics
 - Similarities and Differences to Estate Planning
 - The Seven Step Exit Planning Process™
 - Exit Planning (or even Estate Planning) Client Management System

Why Exit Planning?

-
- At some point, every owner leaves his business – voluntarily or otherwise.
 - At that time, every owner wants to receive the maximum amount of money in order to accomplish personal, financial and estate planning goals.

Many Reasons to Consider Exit Planning



-
- Every business owner will exit his or her business.
 - If you don't help them, who will?
 - Provides opportunity to assist owners through the process.
 - Owner Demographics

Owner Demographics

-
- 50% over age 50.*
 - Average age of sellers is 56.**
 - Of companies in the \$5 million to \$150 million of value range, there's a two in three chance that a business owner plans to leave his or her company within the next ten years.
 - Yet, only 22 percent of owners report having done a great deal of succession planning.***

* Roger Winsby, President of Axiom Valuation

** International Association of M&A Professionals

*** Pricewaterhouse Coopers' "Trendsetter Barometer" released January 31, 2005.

Owner Demographics

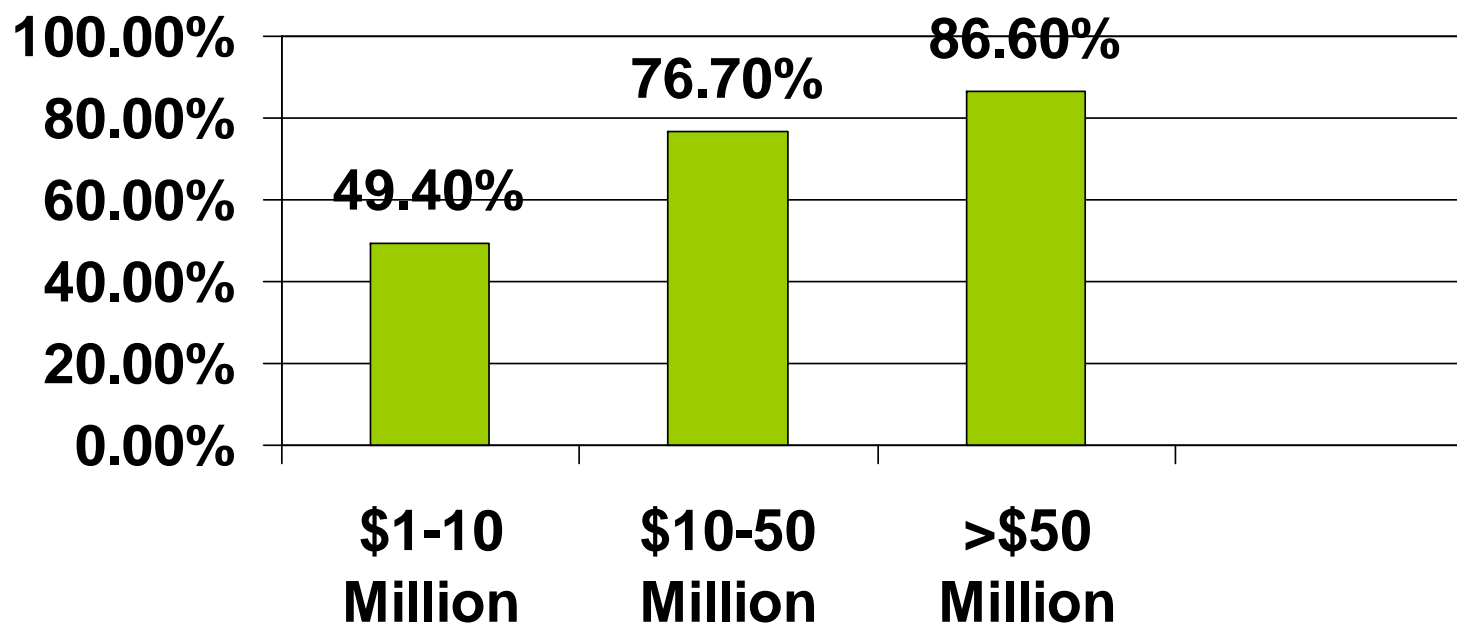
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- Nationally, there are approximately 500,000 U.S. households that have greater than \$5,000,000 in investable assets.*
 - By contrast, there are approximately 1.2 million businesses with ten or more employees. Income and investable assets rise dramatically as business size increases, especially at this size.**

*Brightwork Partners, "Perspectives on Small Business," January 2001

**U.S. Census Bureau, 2004 Report

Owner Demographics

Percentage of Millionaires Who Own a Business



■ Millionaire Households Who Own A Private Business

*Source: VIP Forum, Data Provided in The Journal of Wealth Management Fall 2007

Similarities

Exit Planning and Estate Planning

- Both are Planning Based; Client-Centric
- Both Focus on Tax Minimization
- Both are Multi-Disciplinary Processes

Differences

Estate Planning	Exit Planning
Estate Tax	Income Tax
Growing and Protecting Personal Assets	Growing and Protecting Business Value
Transition at Death	Lifetime Transition
Certainty of Outcome	Uncertainty of Outcome
Planning and Representation by a Single Professional	Planning Separate from Implementation

Role of the Exit Planning Professional; Your Role



Working with a Team of Advisors

- *Who is on the Advisor Team?*

- Financial Planner
- Insurance Advisor
- Investment Advisor
- Business Attorney
- Estate Planning Attorney
- CPA
- Valuation Specialist
- Business Broker
- Investment Banker
- Business or Management Consultant
- Banker
- P & C Advisor

Working with a Team of Advisors



Characteristics of an Exit Planning Advisor Team

- At least one advisor is experienced in Exit Planning.
- Team members are willing to work together on a timely basis.
- Team uses Action Item Checklists as its written road map.
- Team creates a written Exit Plan.

The Five Elements of a Successful Business Exit

-
- Written Road Map
 - Owner's Objectives
 - Accountability Checklist
 - Multi-Disciplinary Advisor Team
 - Cash Flow
 - Management

The Seven Step Exit Planning Process™



Exit Planning is a Systematized Process

- ***For Owners:*** allows them to run their businesses so they can leave in style.
- ***For Advisors:*** allows you to find, engage and permanently represent successful business owners in a multi-disciplinary setting.
 - ***Attracting Prospects***
 - ***Client Engagement***
 - ***Exit Plan Creation***
 - ***Implementation***

The Seven Step Exit Planning Process™



Step 1 – Identify Exit Objectives

Step 2 – Quantify Business and Personal Financial Resources

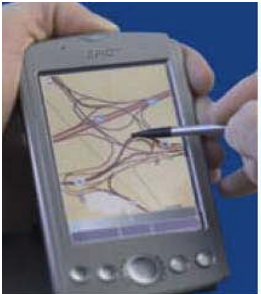
Step 3 – Maximize and Protect Business Value

Step 4 – Ownership Transfer to Third Parties

Step 5 – Ownership Transfer to Insiders

Step 6 – Business Continuity

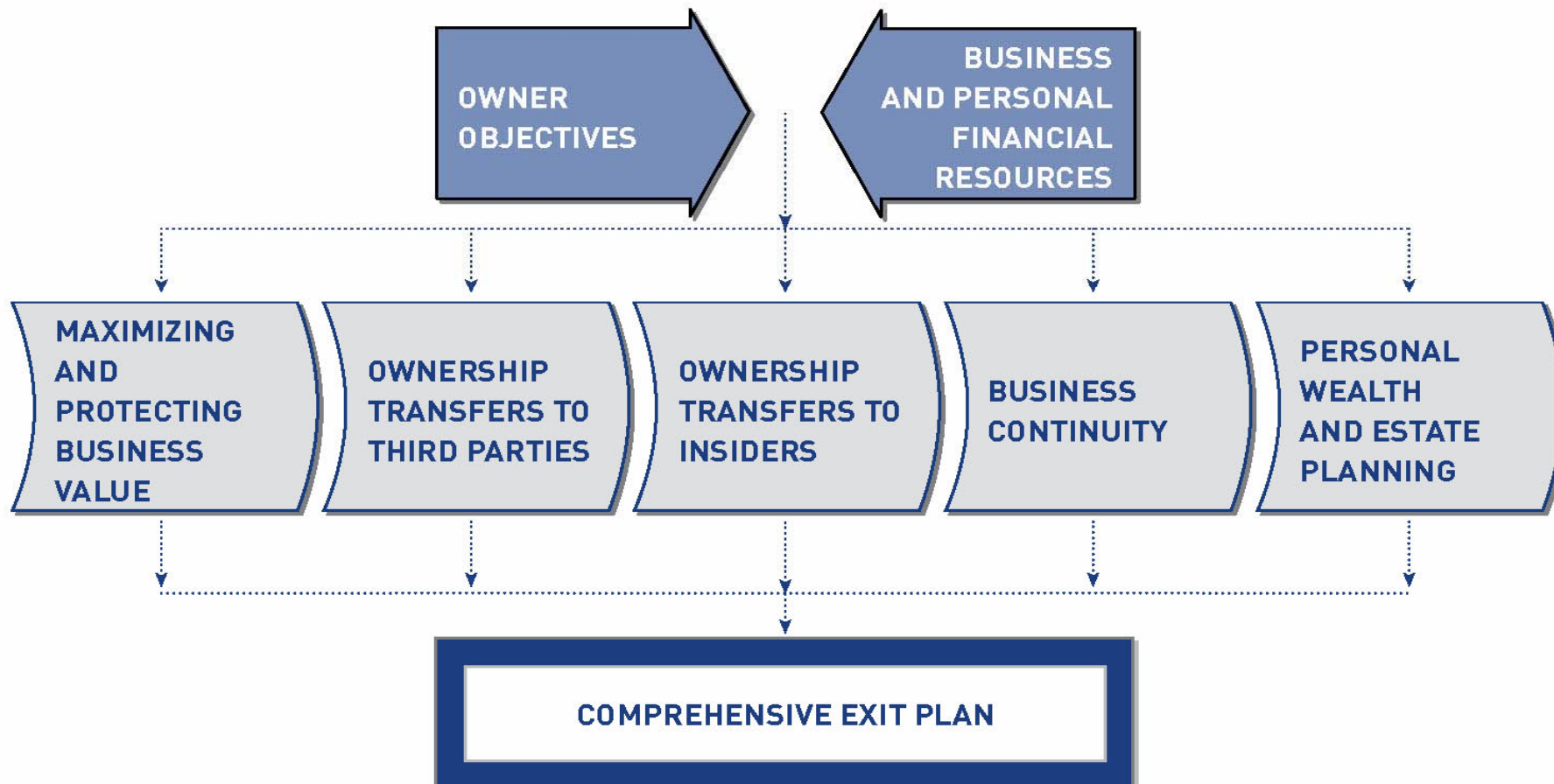
Step 7 – Personal Wealth and Estate Planning



COMPONENTS OF A COMPREHENSIVE EXIT PLAN

within

The Seven Step Exit Planning Process™





Identify Exit Objectives

STEP ONE

Benefits to Advisors

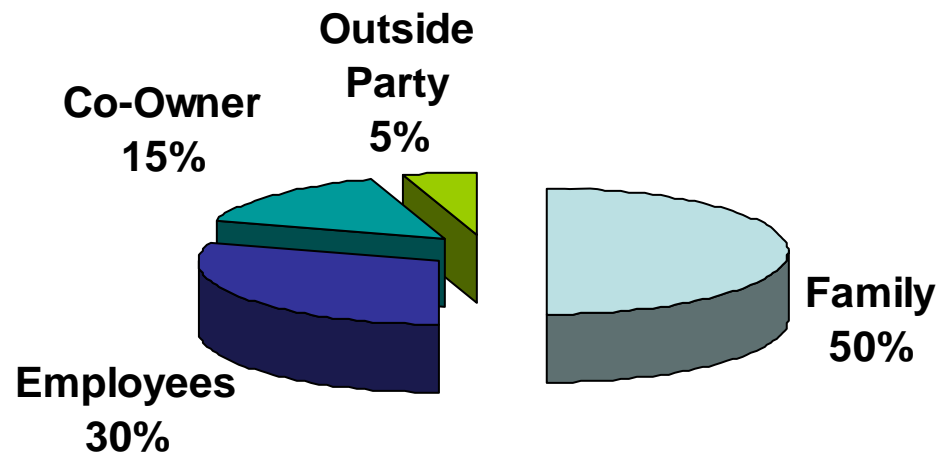
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- Establishes your interest in meeting clients' wants and needs.
 - Owner-centric planning
 - Establishes your planning ability.
 - Credibility
 - Puts you in the driver's seat.

Universal Objectives

-
- How much longer does the owner want to work in the business before retiring or moving on? _____ years
 - What annual after-tax income does the owner want during retirement (in today's dollars)? \$_____
 - To whom does the owner want to transfer the business?
 - Family?
 - Co-Owner?
 - Key employee(s)?
 - Outside party?
 - ESOP?

Universal Objectives

To whom does the owner want to transfer?*

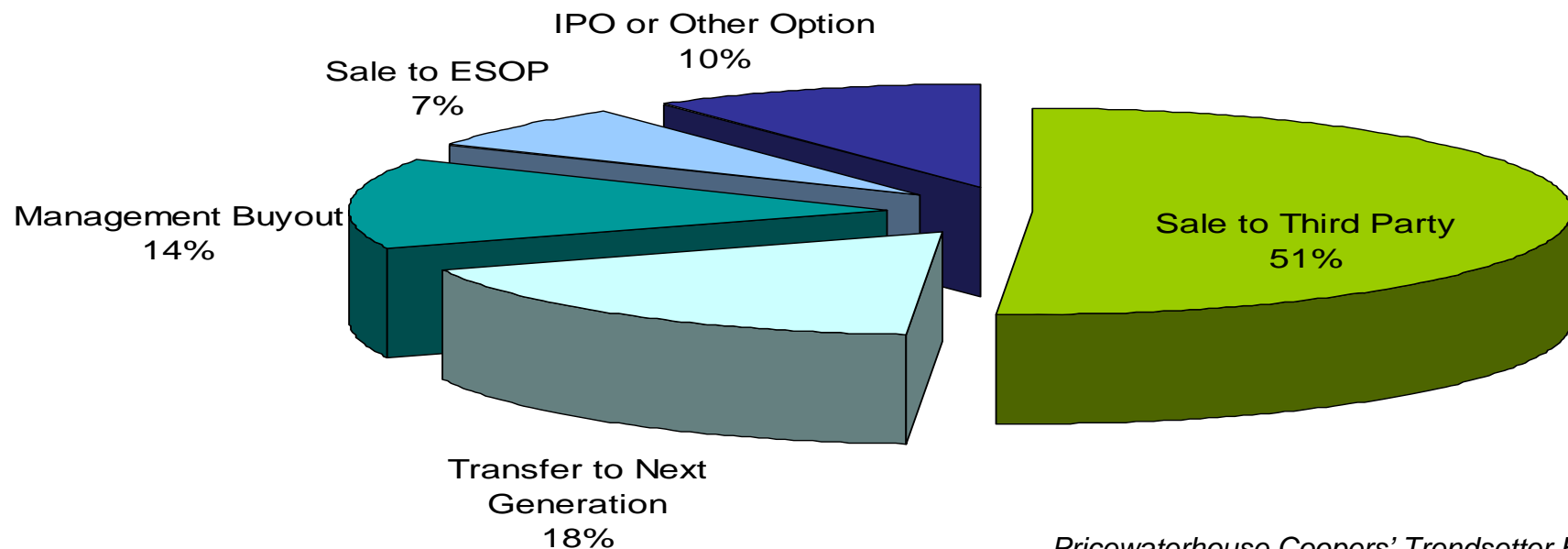


*Refers to companies with gross revenue of \$1 million to \$100 million.
BDO Seidman 1990 Pulse of the Middle Market Survey

Universal Objectives

To whom does the owner want to transfer?

A Pricewaterhouse Coopers survey of 364 privately-held fast growing U.S. businesses (with revenue between \$5 million and \$150 million) indicated:



*Pricewaterhouse Coopers' Trendsetter Barometer,
January 31, 2005.*

Additional Objectives

-
- Receive full value for the business.
 - Shift wealth to children.
 - Create a legacy.
 - Family Harmony
 - Provide charitable gifts or transfers.
 - Reward employees.
 - Take business to the next level.



Quantify Business and Personal Financial Resources

STEP TWO

Benefits to the Owner

- Measures business and personal resources both today and as a basis for future projections.
- Allows the owner to monitor progress toward the stated objectives.
- Determines whether an owner's Exit Objectives can be reached.
- Provides a basis for determining tax consequences of the various Exit paths.
- Provides a basis for tax minimization efforts.

Key Concepts of This Step

-
- Business Valuation
 - Estimated Future Cash Flow Projection
 - Personal Financial Planning



Maximize and Protect Business Value

STEP THREE

Benefits to the Owner

-
- Business owners are always interested in growing business value.
 - Business owners have rarely taken adequate steps to protect business value.
 - Business Owners have a limited understanding of income tax minimization strategies

Key Concepts of This Step

-
- Preserve Value—Minimize Taxes
 - Protect Value—Business Asset Protection
 - Promote Value---Value Drivers (including Key Employee Incentive Compensation Planning)

Minimize Income Taxes

- Charitable Remainder Trusts
- ESOPs
- Use of Lowest Defensible Value
- Choice of Entity: “C” or “S” Corporation
- Creation of Multiple Entities
- Qualified Plan Redesign



Ownership Transfer to Third Parties

STEP FOUR

Benefits to the Owner

- Sale results in cash to owner.
- Decreased financial risk.
- No family succession issues.
- Exit can be completed quickly.



Ownership Transfer to Insiders

STEP FIVE

Benefits to the Owner

- Achieves Exit objective of:
 - Selling to Key Employee Group (KEG).
 - Transferring to a child.
- Motivates and retains key employees.
- Planning reduces risk and increases amount of money received.
- Control can be maintained until all, or most, of the purchase price is received.

Key Concepts of This Step

Owners must understand the need to minimize income tax consequences to buyer and seller by minimizing ownership value of business.

Planning Techniques

Ownership Transfer Scenarios

- Sale to a Third Party for Cash
- Sale to Employee for Installment Note
- Cash Flow to Owner — Keeping the Business
- Two-Phase Transfer
- Oldco/Newco

Ownership Transfer Scenarios

Sale to a Third Party for Cash

Fair Market Value = \$1,000,000
Annual Cash Flow = \$250,000

Buyer
Cash for purchase



Seller
\$800,000 Net of Taxes

Timing: NOW

Ownership Transfer Scenarios

Sale to Employee for Installment Note

Fair Market Value = \$1,000,000
Cash Flow = \$250,000

Employee

Cash flow from business \$250,000
- \$150,000 (net of taxes)
Cash to Seller **\$120,000** (net of taxes)

Owner

\$800,000 Net of Taxes

Timing: 7 – 9 years

Ownership Transfer Scenarios

Cash Flow to Owner

Fair Market Value = \$1,000,000

Cash Flow = \$250,000

Owner

Cash flow from business \$250,000
(\$150,000 net of taxes) to owner



Seller/ Owner

\$800,000 Net of Taxes

Timing: 5 years

Ownership Transfer Scenarios

Two-Part Employee Transfer: Phase One

Fair Market Value = \$500,000 - \$1,000,000

Cash Flow = \$250,000

Employee

40% of Stock sold to Employee for \$200,000
(\$100,000 of cash flow per year to Employee)

Seller

\$50,000 After Taxes
\$150,000 After 3 Years

Owner

Cash flow from business
\$150,000 per year

Seller

\$106,667 After Taxes
\$320,000 After 3 Years

Ownership Transfer Scenarios

Two-Part Employee Transfer: Phase Two

Fair Market Value = \$500,000 - \$1,000,000

Cash Flow = \$250,000

Employee

60% of Stock sold to Employee for \$600,000



Seller

\$480,000 Net of Taxes

Total

\$950,000 After 3 Years

Timing: 3 years

Ownership Transfer Scenarios

Two-Part Employee Transfer: Phase One

Fair Market Value = \$5,000,000 - \$10,000,000

Cash Flow = \$2,500,000

Employee

40% of Stock sold to Employee for \$2,000,000
(\$1,000,000 of cash flow per year to Employee)



Seller

\$500,000 After Taxes
\$1,500,000 After 3 Years

Owner

Cash flow from business
\$1,500,000 per year



Seller

\$900,000 After Taxes
\$2,700,000 After 3 Years

Ownership Transfer Scenarios

Two-Part Employee Transfer: Phase Two

Fair Market Value = \$5,000,000 - \$10,000,000

Cash Flow = \$2,500,000

Employee

60% of Stock sold to Employee for
\$6,000,000



Seller

\$4,800,000 Net of Taxes

Total

\$9,000,000 After 3 Years

Timing: 3 years

Role of the Exit Planning Professional



-
- Develop strategies to transition ownership based on owner objectives.
 - Coordinate Advisor Team members in developing and finalizing recommendations needed to achieve owner objectives in area of Maximizing and protecting Business Value.
 - Organize and facilitate Advisor Team meetings and discussions with owner regarding strategies recommended and decisions to be made.
 - *Create a written road map or Exit Plan.*
 - **Opportunity:**
 - Earn Planning Fee
 - Earn fee for leading and coordinating the process.
 - Earn fee for post-planning implementation

Roles of the Attorney

-
- Analyze legal issues related to proposed transactions (state law, federal law, tax law, compliance with existing documents).
 - Draft summaries of proposed agreements.
 - Draft and implement agreements and other documents implementing transfer/s.
 - Draft documents providing incentives to key employees not receiving ownership.

Roles of the Attorney

-
- ***Opportunity:***
 - Generate revenue from creation of documents that implement one or more ownership transfers.
 - Ongoing consulting fee income and continuation of business representation through ownership transition.
 - Continued representation of business after the successor owner takes control.
 - Generate fees on a flat or hourly fee basis (if you must!) for document drafting, implementation and follow up.

Roles of the CPA

-
- Provide cash flow forecasting and modeling to illustrate and evaluate transaction structure.
 - Analyze tax ramifications of sale to insiders.
 - Propose tax savings or cash flow timing strategies.
 - ***Opportunity:***
 - Ongoing consulting fee income and continuation of business representation through ownership transition.
 - Continued representation of business after the successor owner takes control.
 - Collect fees for tax planning and structuring.
 - Charge flat or hourly fees for cash flow forecasting and modeling.

Roles of the Financial/Insurance Advisor

-
- Completion or update of the owner's Financial Needs Analysis to determine whether total after-tax value will be sufficient to meet objectives.
 - Evaluate and recommend funding strategies.
 - ***Opportunity:***
 - Collect fees for Financial Needs Analysis.
 - Provide key person insurance to buyer.
 - Provide insurance funding for Buy-Sell Agreement
 - Provide qualified plan design and funding
 - Provide design and funding of NQDC for non-owning Management.
 - Financial Planning and Needs assessment



Business Continuity

STEP SIX

Benefits to the Owner

-
- Helps owner to control the business at the departure of a co-owner.
 - Can force non-contributing owners to leave the business.
 - Provides consistency between lifetime and death objectives.
 - Ensures survival of the business for the benefit of others.
 - Preserves owner's "legacy."
 - Results in family receiving value of owner's interest, in cash.

Key Concepts of This Step

-
- Continuity of Ownership
 - Continuity of Leadership
 - Alignment of Objectives in Lifetime vs. Death/Disability

Planning Techniques

-
- Buy-Sell Planning
 - Transfer at Death
 - Lifetime Transfer
 - Valuation method/approach
 - Ownership Continuity
 - Stay Bonus Plan



Personal Wealth and Estate Planning

STEP SEVEN

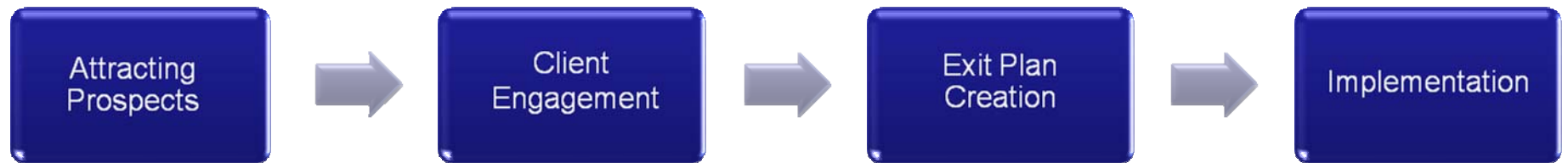
Benefits to the Owner

-
- Creates a plan that not only preserves wealth, but minimizes taxes using both lifetime and death planning tools.
 - Ensures attainment of Exit Objectives, whether owner lives or dies.
 - In effect, estate planning becomes part of business planning.

Key Concepts of This Step

-
- Coordinating and creating consistency among an Owner's:
 - Estate Planning
 - Exit Planning
 - Financial Planning

Client Management System



Thank You!



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