

# PLANNING YOUR EXIT STRATEGY

BUTCHER JOSEPH & Co.  
INVESTMENT BANKERS

# CONTENTS

Introduction	3
Selling Your Business	5
Selling to a Strategic Buyer	6
Selling to a Private Equity Group	8
Selling to the Company's Management Team	9
Selling to Employees	11
Sources	13

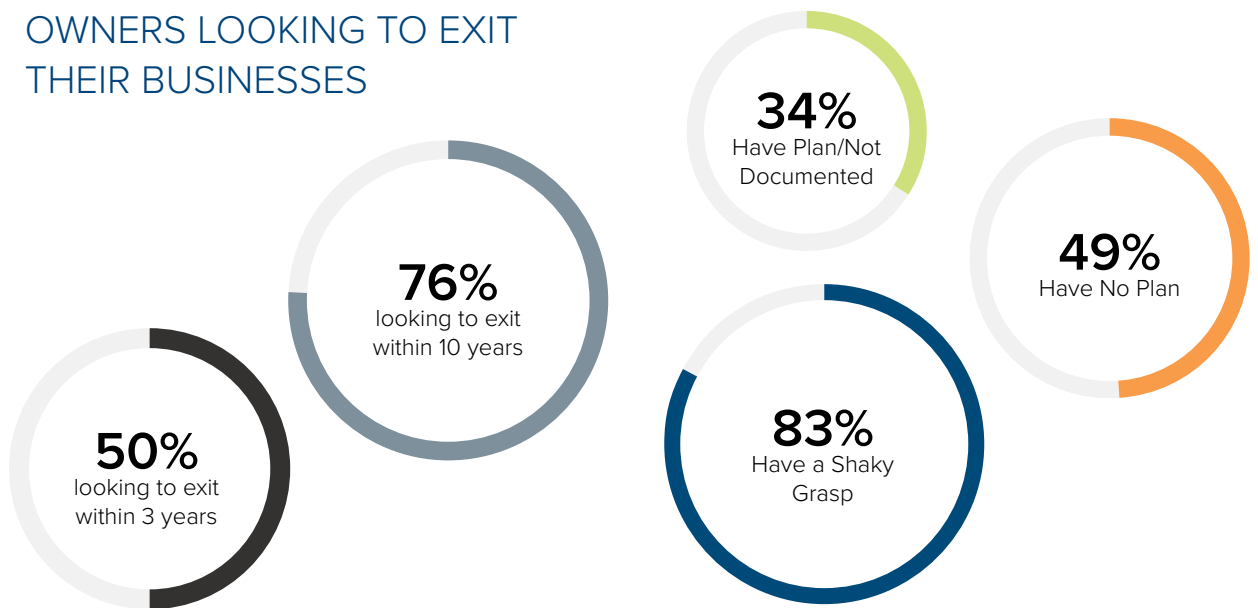
# INTRODUCTION

For most business owners, their company is their most valuable asset, and is often the key to funding their next endeavor. After devoting years to building a business, it can be difficult for an owner to relinquish responsibility to the next generation of leadership. Prudent business owners understand that planning a sound exit strategy is imperative to guarantee that their exit will occur on their own terms.

According to the 2013 Northeast Ohio Chapter of the Exit Planning Institute “State of Owner Readiness” Survey, 76 percent of business owners anticipate [transitioning from their business within 10 years](#), while nearly half plan to exit their businesses in the next three years. Despite the high number of owners looking to exit their companies in the near future, 83 percent have a shaky grasp on what that exit strategy will encompass. Of those, 49 percent admit to not having a plan in place, while 34 percent stated they have a plan but have neither documented it nor communicated it to anyone else.

Planning an exit can seem overwhelming, especially when business owners are immersed in the day-to-day operations. Nevertheless, owners should consider all available options regarding their transition.

## OWNERS LOOKING TO EXIT THEIR BUSINESSES



Depending on an owner's objectives, certain exit options will appeal over others. For instance, an owner seeking the highest value possible and an owner who is primarily focused on perpetuating their legacy will likely pursue different exit strategies to achieve their disparate goals. The following sections will illustrate which objectives may be impacted by each exit strategy, and how owners may focus their energy to achieve their unique succession planning goals.

# SELLING YOUR BUSINESS

Business owners often enlist an outside team of professionals for strategic advice to help them optimize the business for sale. Engaging an experienced advisor in the early stages of the process will provide the selling shareholder the best opportunity to maximize the value of their business.

Once owners decide to sell the business, they'll then choose between selling to a public or private entity. Potential buyers are typically identified based on the shareholders' objectives. The company's value at any given time is dependent upon a number of factors, including the performance of the company itself, general economy, industry trends, proprietary products or services, and even technology.

Owners should obtain a business valuation from an experienced financial firm. A realistic estimate of the business' value helps assess the selling shareholders' expectations. For businesses with multiple shareholders, an objective valuation can curtail potential disputes among the shareholders around purchase price, and thereby avoid significant frustration and lengthening of the sale process.

There are a few primary types of buyers in a market, including a strategic buyer, a private equity group, the company's management team and the company's employees.

## POTENTIAL BUYERS FOR YOUR BUSINESS



# SELLING TO A STRATEGIC BUYER

*Selling to a strategic buyer will allow business owners to maximize cash at closing; however, the acquiring company will likely eliminate duplicative staff and systems thereby damaging the selling shareholder's legacy in the community.*

Strategic buyers seek acquisitions that will enhance their existing product or service offerings or expand their current brand in some way. Acquiring another company is an attractive choice for this buyer as purchasing an existing business can be more cost efficient and yield a higher probability of success than attempting to build an entirely new business from scratch. Since these buyers tend to be the active party, sellers may be able to leverage their position for an increase in sale price.



These buyers will most likely be industry players with an understanding of the current market dynamics and future opportunities. In this case, they may very well be aware of the company and its operations. Shareholders and management teams should understand how the merging of the two companies will result in synergies, since this can also boost the potential sale price. Synergies combine features from the two companies for improved productivity, such as the integration of technology and expertise or the elimination of redundant processes and expenses.

Even though strategic buyers have the greatest potential for offering the highest price for a company, the new ownership team may have certain expectations around the former owners'

ongoing involvement; perhaps they prefer an exit on a timeline that doesn't align with the sellers' goals. Owners may envision an immediate exit or a gradual transition out of the business, both of which should be considered while weighing the options in light of the owner's overall objectives. Additionally, the new management may alter the company's culture, which can be a concern for some owners who wish to preserve the culture they've built amongst employees.

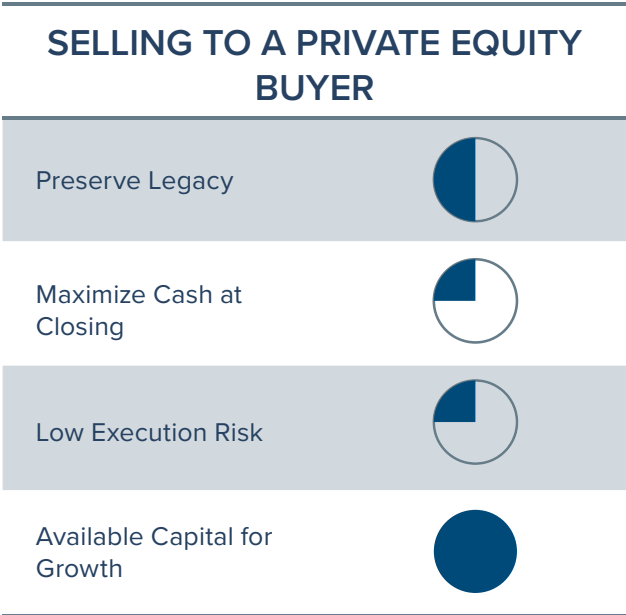
# SELLING TO A PRIVATE EQUITY GROUP

*Selling to a private equity group will allow the business owner to achieve fair market value for the business, but may not provide as high a valuation as some strategic buyers. Depending on the private equity group's mandate, the company may stay largely intact, preserving the selling shareholder's legacy.*

Another successful method of exiting a business is selling to a private equity group. These buyers typically seek out a company with a solid cash flow, strong market shares and a driven management team. Most private equity groups intend to invest in a company, focus on rapid growth opportunities, and then sell the business for a profit, anywhere between three to seven years later.

In addition to providing funding, a private equity group may offer additional operating experience, industry savvy and technical expertise to the company. This knowledge, when combined with any efficiency-boosting measures the group implements, can improve profitability. Private equity groups will need the management team to remain in place to handle the day-to-day operations.

Generally speaking, private equity groups will focus on growing the business to realize as much of a return on investment in as short a time as possible. Since these buyers tend to finance the acquisition using a combination of debt and committed capital from their investors, there is little room for failure during the projected growth period.





# SELLING TO THE COMPANY'S MANAGEMENT TEAM

*Selling the business to key executives often preserves the selling shareholder's legacy, but the purchasing party will likely not offer top dollar for the company.*

A management buyout (MBO) is a transaction in which the company's existing executives purchase the business from its current owner(s). This particular exit strategy appeals to a seller who wishes to maintain a high level of confidentiality around the business or finds that there is a limited or non-existent market of strategic buyers. For the management team, this strategy provides a means to gain a controlling interest in the company and creates significant entrepreneurial opportunity without starting a business from scratch.

In most cases, the management team will not readily have the capital available to purchase the business and will likely need to finance the transaction. In addition to specialty lenders, common MBO funding sources may include traditional banks, private equity groups, and the company's own seller(s). Depending on the selling shareholders' time horizon and liquidity needs, they may be interested and able to help finance the deal by loaning all or a portion of the capital needed, often referred to as seller financing or a seller note. This allows the management team to pay down the obligation to the seller(s) with the company's revenues over a reasonable period of time.

In order for any MBO to be successful, the management team must be sufficiently groomed and well versed in the business' operations. The departing owner must develop and train the successor CEO far enough in advance of the transaction so the next generation of leadership can adequately carry on

SELLING TO THE COMPANY'S MANAGEMENT TEAM	
Preserve Legacy	
Maximize Cash at Closing	
Low Execution Risk	
Available Capital for Growth	

the company's opportunities for growth and sustainability. While it can be difficult for some owners to step back and let go of the company's reins, it would be far worse for the new CEO and management team to fail because they weren't properly prepared for their new responsibilities.

Owners interested in pursuing a MBO need to start their planning early, since most experts estimate that the process of developing and training the next leader can take years to accomplish. Creating a timetable and adhering to its milestones allows the successor CEO, management and employees to be aligned and fully informed when its time to make the transition.

# SELLING TO EMPLOYEES

*While selling to employees does not offer the high multiple that selling to a strategic buyer offers, owners may be able to take advantage of unique tax incentives, allowing them to maximize the net proceeds from the sale. Selling to an Employee Stock Ownership Plan (“ESOP”) perpetuates the legacy of the selling shareholder by preserving jobs and rewarding employees and management.*

Owners can also sell their business to their employees through an Employee Stock Ownership Plan (“ESOP”). An ESOP is a qualified retirement plan that operates much like a profit-sharing plan. The selling shareholder sells all or a portion of his or her stock in the company to an ESOP trust. The company has the ability to borrow money from an outside source, such as a bank, to fund the purchase of the company through the ESOP. The company releases shares to the trust as the loan is paid down over time. Those shares are subsequently distributed to employee accounts using a formula based on the plan’s legal documents.

ESOPs appeal to owners for a number of reasons. They create wealth for the employees, they do not involve an outside entity taking control of the company, and they may offer tax advantages to the company’s selling shareholders and the company moving forward.

According to the ESOP Association, these ownership plans [cover 10.3 million employees](#) in the U.S., accounting for 10 percent of the private sector workforce.





While ESOPs are appealing to many owners, this strategy does not suit every company. An owner interested in selling to an ESOP structure should consult an advisor with significant ESOP experience to determine if an employee buyout is the best means to achieve the selling shareholder's objectives.

# SOURCES

[http://www.exit-planning-institute.org/wp-content/uploads/2015/05/State\\_of\\_Owner\\_Readiness\\_2013\\_Report.pdf](http://www.exit-planning-institute.org/wp-content/uploads/2015/05/State_of_Owner_Readiness_2013_Report.pdf)

<http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters>

<https://www.score.org/resources/developing-succession-plan>

<https://www.sba.gov/content/plan-your-exit>

<https://www.sba.gov/content/transfer-ownership>

<https://www.score.org/resources/developing-succession-plan>

[http://www.thesiburgcompany.com/articles/Eight\\_Essential\\_Elements\\_of\\_an\\_Exit\\_Strategy\\_for\\_Business\\_Owners-The\\_Siburg\\_Company.pdf](http://www.thesiburgcompany.com/articles/Eight_Essential_Elements_of_an_Exit_Strategy_for_Business_Owners-The_Siburg_Company.pdf)

<http://smallbusiness.findlaw.com/starting-a-business/asset-purchase-vs-stock-purchase-advantages-and-disadvantages.html>

<http://practice.findlaw.com/financing-a-law-firm/succession-planning-your-exit-strategy.html>

<http://www.hhcpa.com/blogs/business-valuation-litigation-blog/8-essential-elements-of-an-exit-strategy-for-business-owners-part-i/>

<http://www.dol.gov/compliance/laws/comp-warn.htm>

<http://www.bizfilings.com/learn/end-business.aspx>

<http://practice.findlaw.com/financing-a-law-firm/succession-planning-your-exit-strategy.html>