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Exit Planning is BUSINESS STRATEGY

**Frank Fantozzi, Founder and CEO
CPA, PFS, MST, CDFA, AIF®, CEPA**



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“

Managers and investors alike must understand that accounting numbers are the beginning, not the end, of business valuation. ”

Warren Buffet

The 5 D's

Have you planned for these contingencies?



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Death

Imagine right now; you are in the middle of an intersection and are T-Boned. What do you want your family, management team, and ownership team to know? What happens to your loans? Are the beneficiaries on your assets and life insurance correct? Who should family and management talk to for advice? Do you have a documented plan for those impacted by this event? What obligations does your business have to your estate for the value of your shares?



Disability

Now imagine that you had a stroke and cannot talk or write. Does your family know where your papers are? Do you have a power of attorney for financial and medical matters? Do others have essential passwords that enable them to pay your bills or interface with customers, vendors, etc? Will this event invoke a purchase of your shares? How will it be paid? Who has the right to vote your shares?



Divorce

Your spouse announces that he/she has grown apart from you and now wants to end your marriage while the two of you are still friends. How will your shares be valued in a divorce? Do you have a prenuptial agreement? How will the changes in your finances impact the cash needs of the company? Do you know your options on how to create a non-adversial process to make the decisions needed to unbundle your financial affairs at the end of a marriage and mitigate the impact on your business?



Disagreement

When multiple partners enter into a business, is it all roses and rainbows? They rarely prepare for conflict with a productive exit clause. Like all relationships, business partners sometimes decided not to co-own a business. How will your interest be valued? How will it be paid?

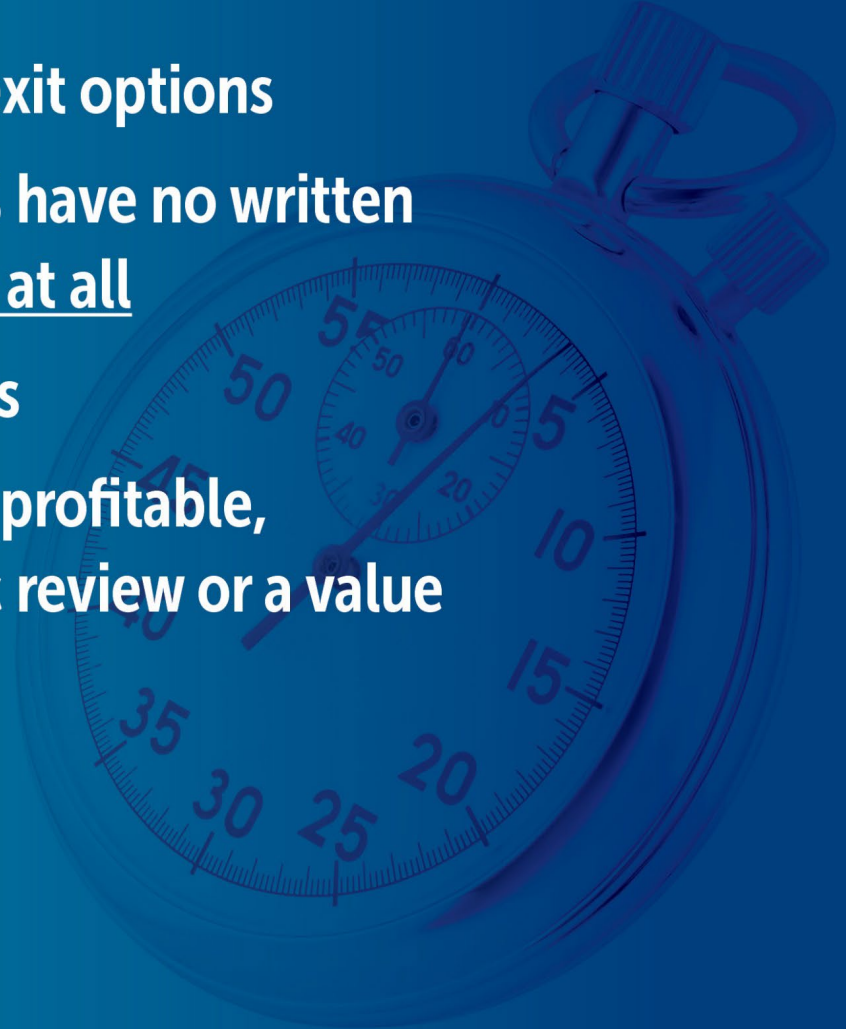


Distress

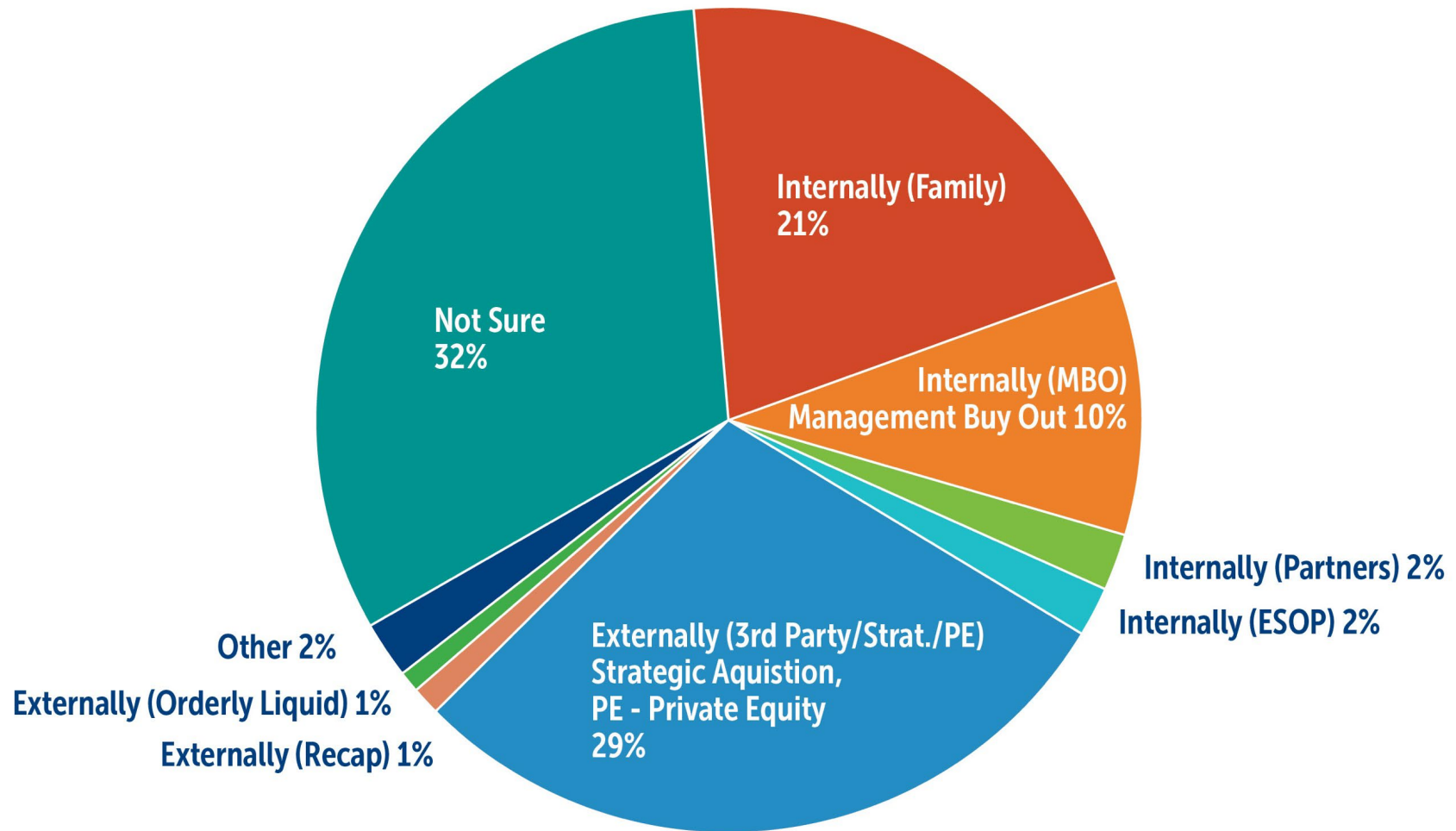
2020 has taught all of us some painful lessons regarding businesses interruptions and external threats we could never imagine. Many businesses suffered disruption to their business's productivity and the delivery of their products. What was the strength of your back up system? What insurances did you have to cover business interruption? Good contingency planning includes risk reduction strategies and policies to protect against everyday disaster situations, including data breaches, property disasters, supply chain disruption, work safety incidents, and critical employee loss.

CEPA's work together to create a plan that will "De-risk" the negative impact of these events. CEPA's will help you assess what you currently have in place, what you may need to do as your systems grow and change, and why this process should be reviewed annually.

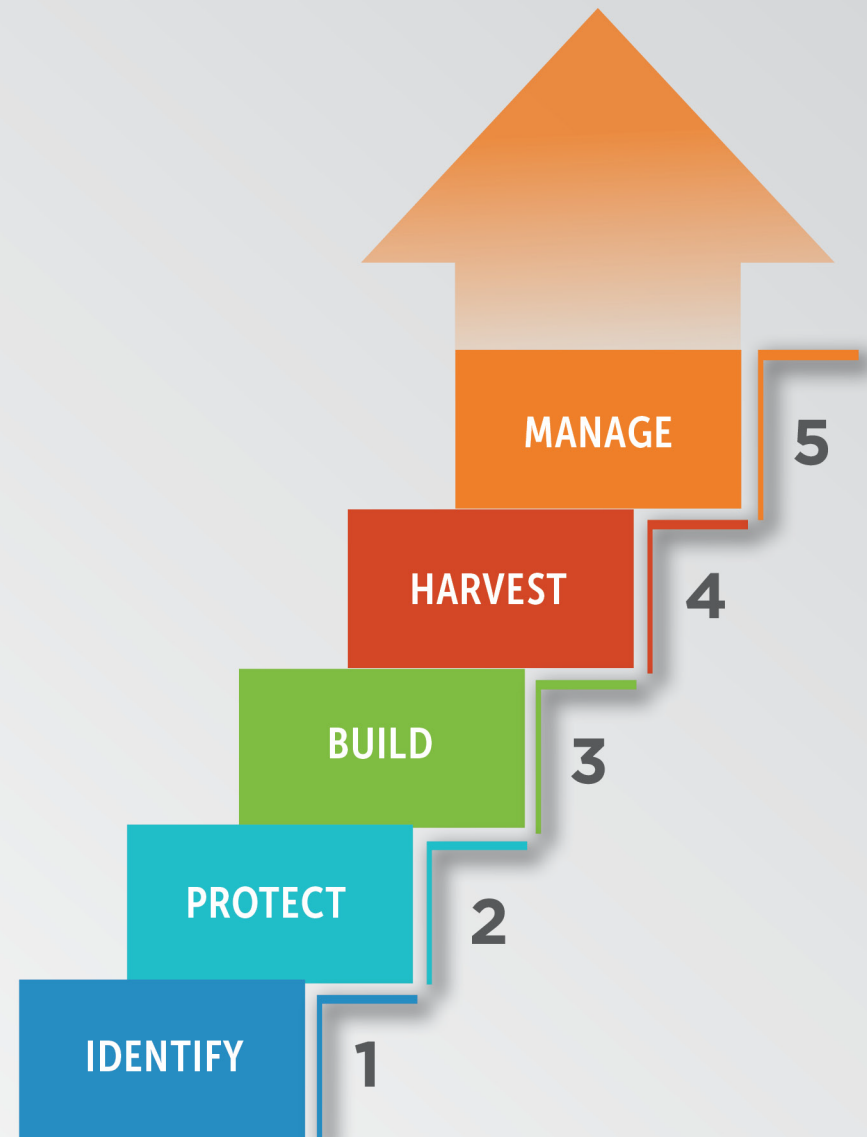
EPI (Exit Planning Institute) State of Owner Readiness

- Two-thirds do not know all their exit options
 - 78% have no transition team, 83% have no written transition plan, 49% have no plan at all
 - 40% have no plan to cover the 5Ds
 - Half need the company to remain profitable, yet 86% have not done a strategic review or a value growth project
- 

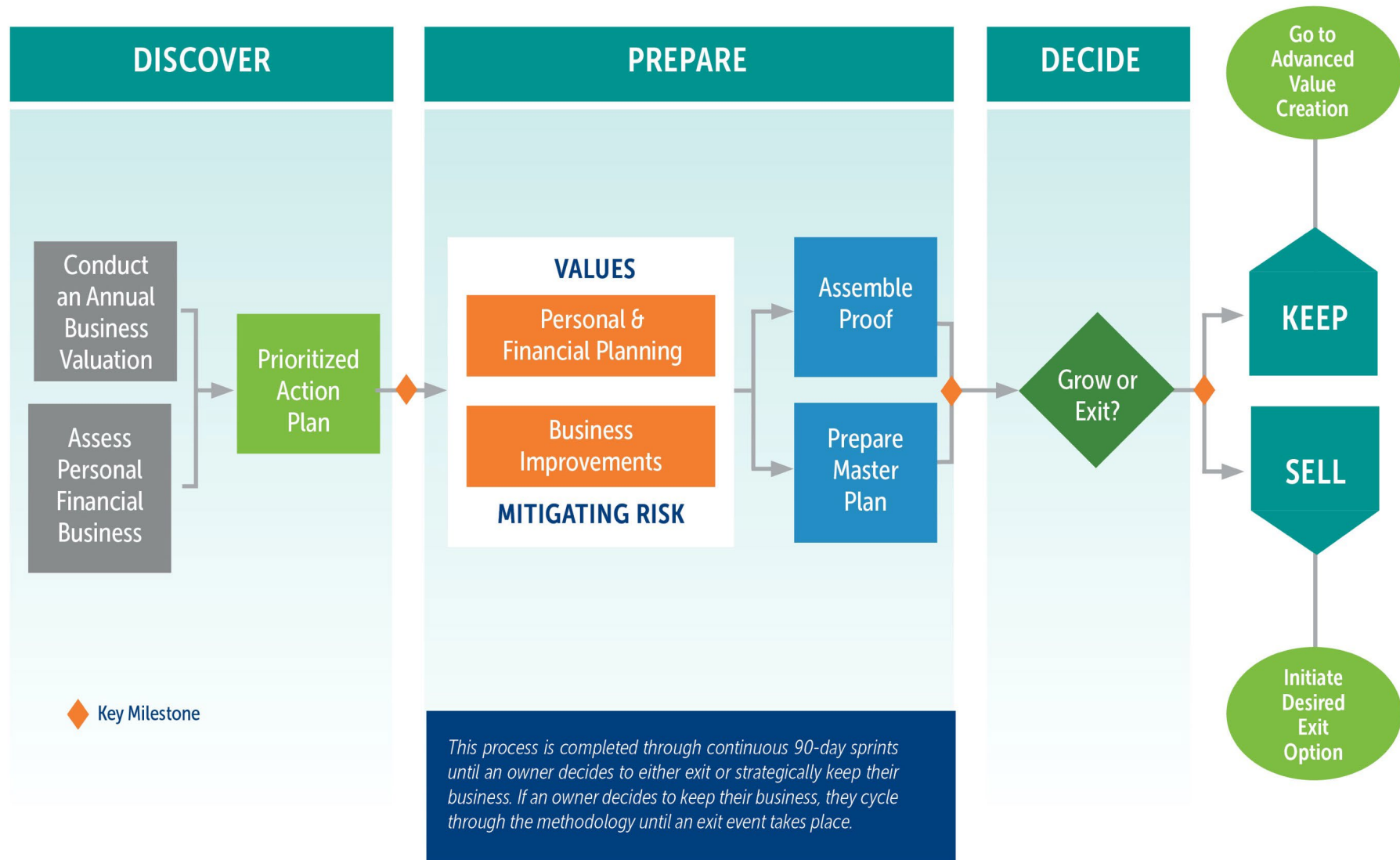
Transition Options for Private Business Owners



The 5 Stages of Business Value Maturity



The Value Acceleration Methodology



Business if **Dependent** on the Owner **VS** Business if **Independent** on the Owner

BUSINESS OWNER CHARACTERISTICS

- The owner works more than 55 hours per week in their business and their business likely defines who the business owner is
- Unbalanced personal and professional life, lacking purpose and vision

- The owner has a balanced life, feels fulfilled in their work, and likely operates at their highest and best use doing what they are passionate about daily
- The owner has a defined personal purpose and vision for the future inside and outside of their company

STRUCTURAL CAPITAL

- Intellectual Property, Standard Operating Procedure, and training programs are not documented, copyrighted, trademarked, or patented because the owner either fills the role or knows the role

- Clear vision, mission, core values and 3-year strategy documented and presented companywide
- All processes are documented and standard operating procedures can be followed by the leadership team

CUSTOMER CAPITAL

- The strength of the customer relationship is tied to the owner and not entangled with the brand
- Customers are highly concentrated and have a high likelihood of terminating their relationship without the owner involved

- Customers are diverse, engaged, and entangled with the company. In other words, they could not possibly think of operating without the company involved
- Customers are attracted to the brand the company has created and the belief in people, process, cause, and the solution (service or product) the company provides them

Decentralizing the Business Owner, continued

Business if **Dependent** on the Owner **VS** Business if **Independent** on the Owner

SOCIAL CAPITAL

- Company culture is intrinsically tied to the owner. The owner is synonymous with "the brand"
- If the owner exits, the culture disappears as well

- The culture, brand, and the way the employees work with each other do not depend on the owner at all. The business is the brand, not the owner
- Company culture is driven by core values, internal communication plans, the employees, and customers

HUMAN CAPITAL

- Owner must be involved with and approve company decisions, major or minor
- Executive leadership team struggles to manage daily operations without the owner around

- Well-formed executive leadership team with a documented succession plan
- Executive leadership team is empowered with the accountability and authority to make key decisions without the owner
- Hiring the right people in the right seats. Do they want it, get it and have the capacity.

Decentralizing the Business Owner, continued

Business if **Dependent** on the Owner **VS** Business if **Independent** on the Owner

BUSINESS VALUE

- Most of the perceived value is tied to the owner not in the business
- Lack of clear financial reporting historic and projected

- The company has a manageable level of risk and is predictable and scalable
- Higher valuation, driving towards best-in-class multiples

ULTIMATE SALE PRICE

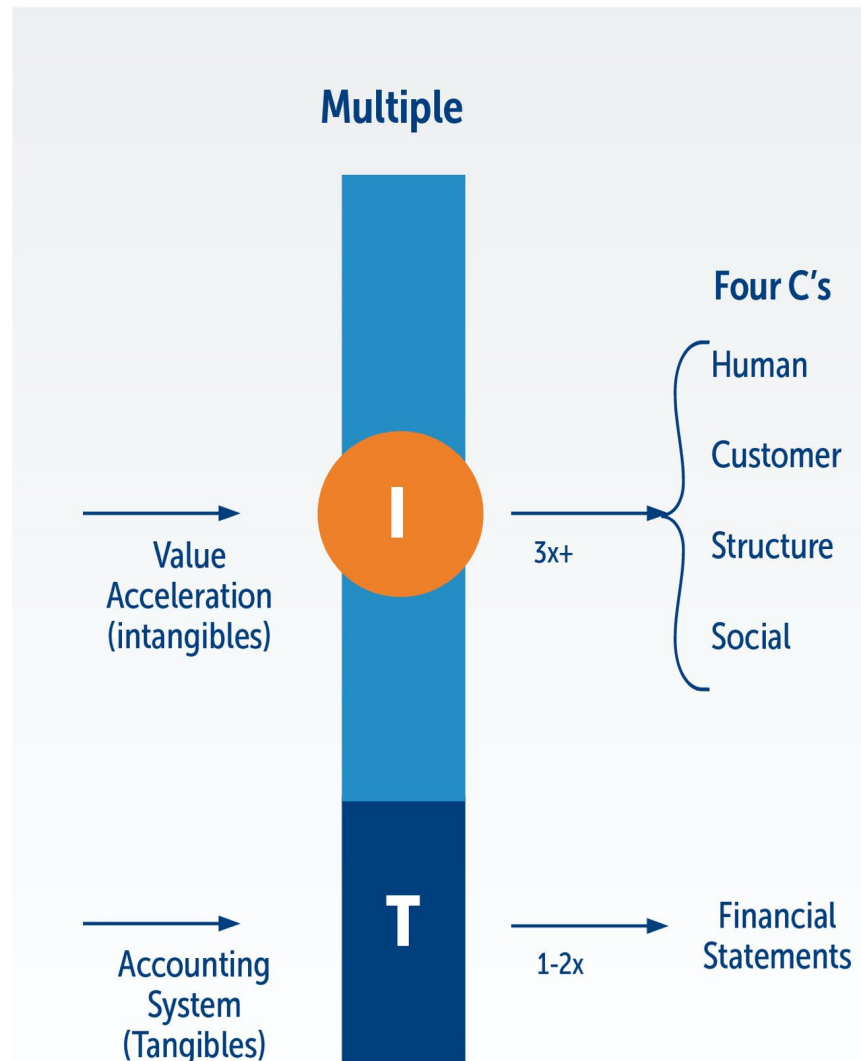
- Since the owner is the most valuable asset in the business, potential buyers are less likely to make an offer
- In the event that the business does sell, it will be for a lower multiple

- Due to strong tangible and intangible capitals, the business likely sells for higher multiples

Tangible Versus Intangible Assets

Traditional accounting systems are setup to provide regular feedback on **tangible assets** ... (*The Balance Sheet*)

... yet your **intangible assets** are the direct drivers of business attractiveness.



Value Acceleration measures the value of your intangible assets

Know Your Gaps

Three numbers every business owner should know and manage to meet their goals.

WEALTH GAP

WEALTH GAP = The additional wealth you need to accumulate to meet your personal goal(s)

= Your net worth goal – Your current actual net worth (not including your business)

KEY POINTS:

- For the purpose of this discussion, do not include the value of your business
 - It is not easily converted to cash
 - You may or may not convert it into cash depending on what you decide to do with it
- As you consider your net worth goal, identify:
 - What you truly need to live your life the way you would like
 - What you want

How will you bridge the gap?

1

PROFIT GAP

PROFIT GAP = The profit you're sacrificing by not operating at a best-in-class level

= Best-in-class profit at your level of sales – Your actual profit

KEY POINTS:

- For the purpose of this discussion, profit is best defined as earnings before interest, taxes, depreciate, and amortization (EBITDA)
- To ensure an apples-to-apples analysis, your actual EBITDA should be re-casted or adjusted for
 - Extraordinary or one-time events
 - Discretionary expenses that are tied to the owner
 - Expenses that are currently above or below market rates such as rent, compensation and others

What good could you do in the business with that extra flow?

2

VALUE GAP

VALUE GAP = The business value you're sacrificing by not operating at a best-in-class level

= Best-in-class value at your level of sales – Your actual business value

KEY POINTS:

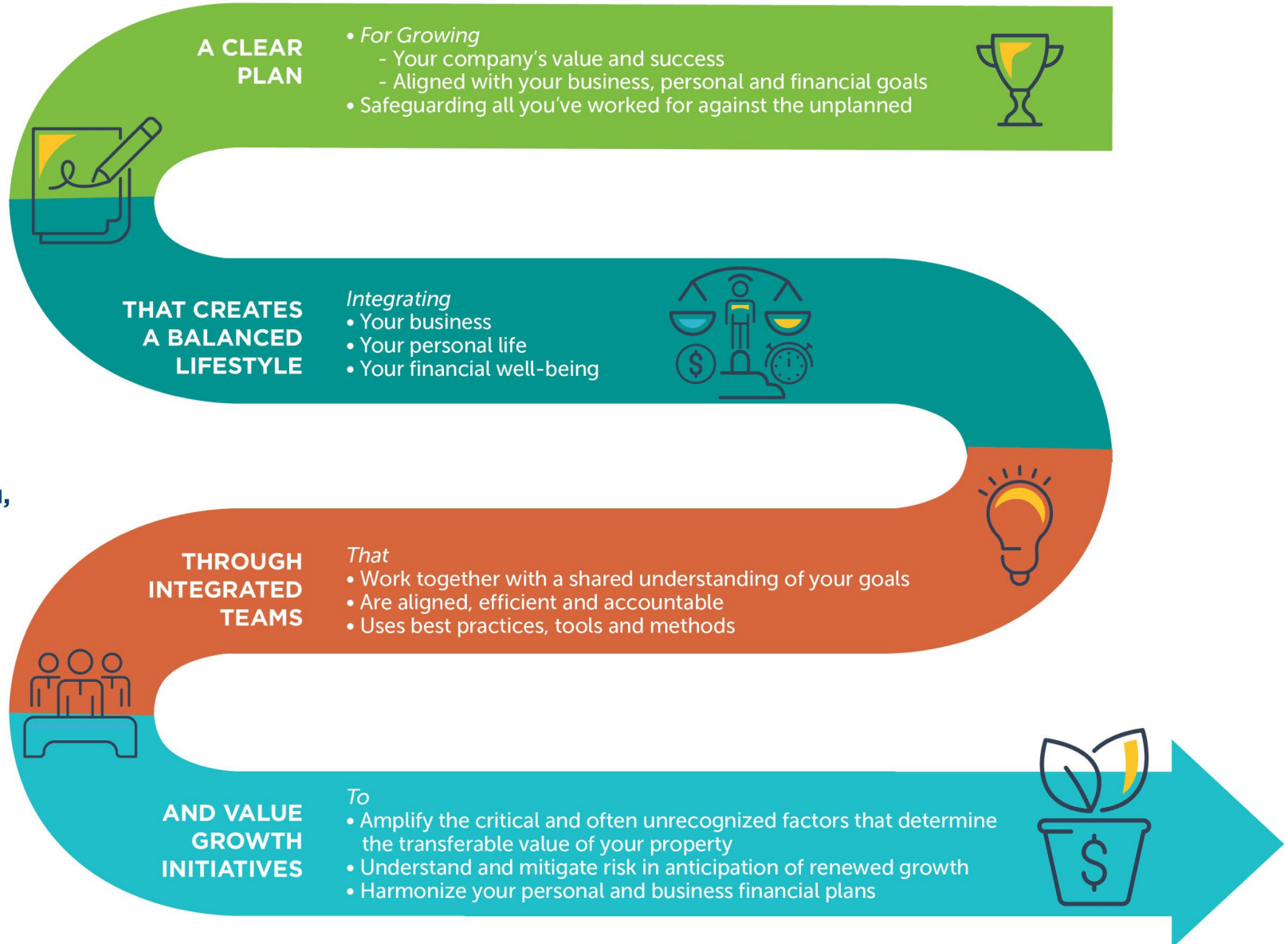
- The basis of the best-in-class value begins with the best-in-class profit at your level of sales (determined in the profit gap analysis)
- The best-in-class multiple is applied to the best-in-class profit
- Your actual value should be based on your actual re-casted or adjusted EBITDA

How quickly would narrowing your value gap close your wealth gap?

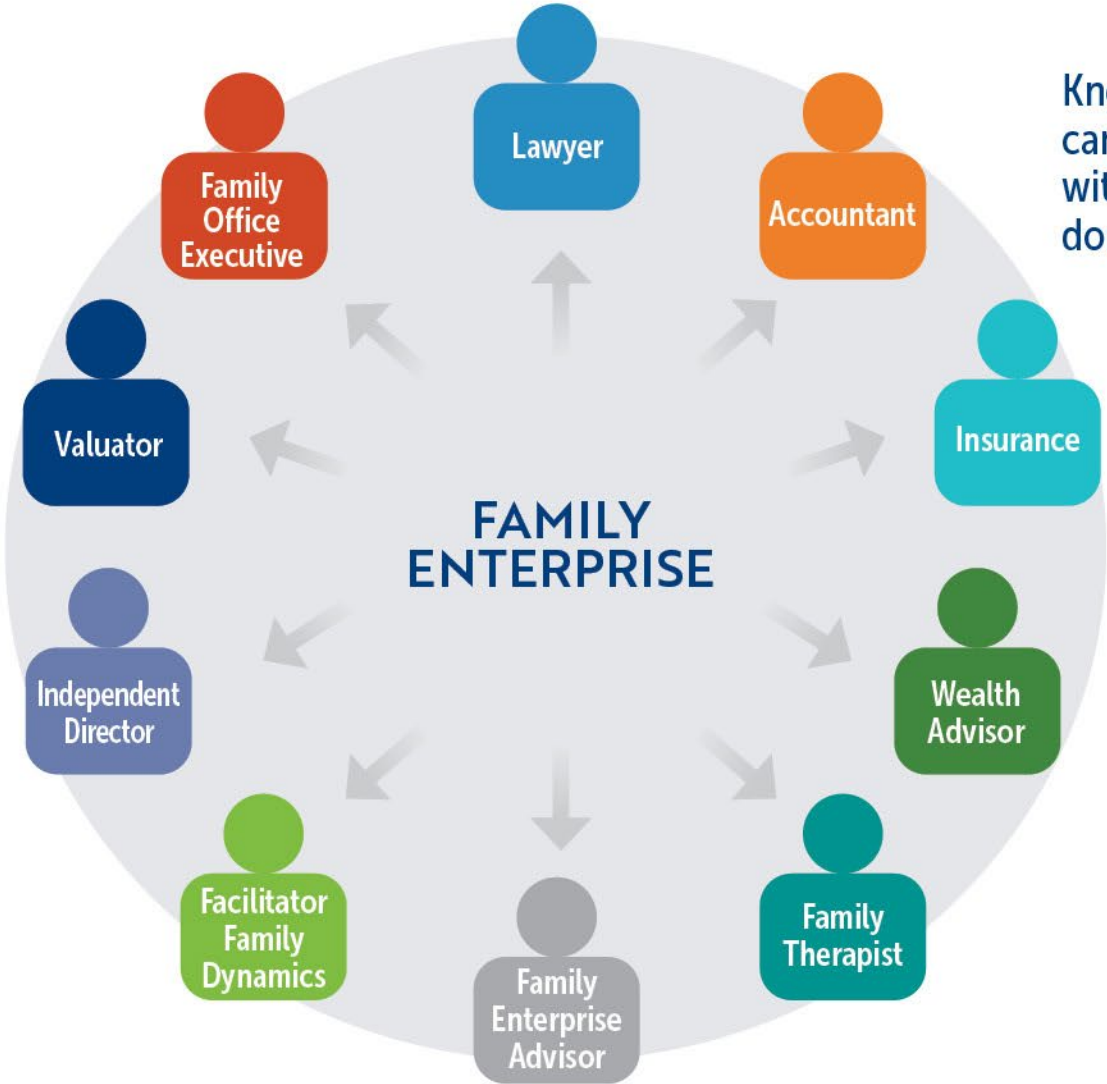
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Winning Teams & The CEPA Advantage

Working and collaborating with a Certified Exit Planning Advisor (CEPA) sets you apart and helps you improve your outcomes — for you, your business, and your family.



Who is on Your Team?



Know what you can or cannot do and partner with others to get the work done.

When should you bring in a family dynamics specialist?



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Planned Financial Services would like to thank you for attending today. For additional questions or assistance, please reach out to

Frank Fantozzi

Frank@PlannedFinancial.com

440-740-0130 x222



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The Middle Market Defined

There are many views about the definition of the “Middle Market” depending on the person asked and what markets they serve

	CHARACTERISTICS	PROFESSIONAL NEEDS
Main Street Businesses	<ul style="list-style-type: none"> • Sales below \$5 Million • Lifestyle businesses • Generally not growing fast • Family businesses • May have a board of advisors 	<ul style="list-style-type: none"> • Basic accountant or bookkeeper • Lawyer for major matters • Business broker for sale of business
Middle Market	<ul style="list-style-type: none"> • Sales greater than \$5 million, but more likely between \$10 million and \$1 billion in revenues • Large management structure and systems in place • Could be multi-generational family business • Many will have outside capital and a board of directors or board of advisors 	<ul style="list-style-type: none"> • Usually audited by CPA firm/Tax planning • Commercial banks - lines of credits/treasury management • Outside law firm actively involved • Investment banker utilized for capital raises and M&A
Large Company Market	<ul style="list-style-type: none"> • Companies with over \$1 billion in sales • Could be private or public • Likely will have international sales/operations • Sophisticated management team • Multiple divisions, conglomerate • Most will have outside capital and a board of directors 	<ul style="list-style-type: none"> • Audited financials/Complex tax planning • Multiple divisions/operating units • In-house lawyers • Large Institutional Investment banking firms with market making operations and public underwriting capabilities for IPOs, secondary offerings and bond placements

Risk vs. Return

	STRATEGIC ACQUIRERS	FINANCIAL ACQUIRERS
ADVANTAGES	<ul style="list-style-type: none"> • Financial Stability & longevity • Willing to Pay a Premium for Control • Relevant Industry Knowledge • Limited Dependence on Owner • Shared Service Cost Reductions • Extensive Capital Resources • Revenue Synergy Opportunities • Liquidity for Shareholders • Shorter Time to Exit 	<ul style="list-style-type: none"> • Broad Market of Active Investors • Continuity of Management Team • Ability to Maintain Control • Focused on Business Growth • Flexible Transaction Structures • Minority Stake Investors • Partial Liquidity for Shareholders • Access to Expertise & Network • Equity Participation Opportunities • Experience with Private Companies
DISADVANTAGES	<ul style="list-style-type: none"> • Limited in Number • Confidentiality Issues • Loss of Autonomy • Legacy Issues: Co. Name, Culture • Employee Layoffs • Possibility of a Limited Working Role • Strategic or Creative Differences • Integration Difficulties • Bureaucratic Structures • Culture Shocks 	<ul style="list-style-type: none"> • Focused on Niche Businesses • Require High Margins/Growth • Require Strong Management Teams • 3- 5 Year Investment Horizon • New Learning Curve • Complex Financial Structures • Highly Leveraged • Diminished Board Control • High ROI Hurdles to Meet

Demystification of Employee Stock Ownership Plans

COMMON TRANSITION STRATEGY:

- Alternative to selling to an outsider
- Tax benefits - Seller, Co. and Employees
- Gradual sale is possible from 1 to 100%



IN THE US

*6,624 ESOPs

14.2 million employees

\$1.4T in company stock

* As of 2016, 36% of all private sector employees own company stock

Business Entity Matrix Overview

CHARACTERISTIC	S-CORPORATION	C-CORPORATION	LIMITED LIABILITY COMPANY
S			
Simplicity of Organization and Administration	Formality of Board of Directors, officers, annual meetings and annual reporting. An S corporation is set up as a regular corporation. S corporations must make election to be treated as an S corporation by filing Form 2553.	Formality of board of directors, officers, annual meetings and annual reporting. A corporation is difficult and expensive to organize. Corporations must hold periodic board meetings and keep minutes. Corporations must comply with federal and state regulations.	Some formal requirements but less formal than corporations; Flexible. An existing partnership can generally register for LLC status in the state in which it conducts business. Registration is generally less complicated than forming a corporation.
Management	The corporation is managed by the Board of Directors who are elected by the shareholders	The corporation is managed by the board of directors who are elected by the shareholders	Members have Operating Agreement that outlines management
Assets	No Real Estate/Appreciating Property	No Real Estate/Appreciating Property	
Liability	Shareholders are typically not personally liable for the debts of the corporation	Shareholders are typically not personally liable for the debts of the corporation	Members not typically liable for the debts of the LLC or other members
Taxation	No tax at entity level; Income/loss is passed through to the shareholders on basis of ownership interest. An S corporation is taxed similar to a partnership. Income and expenses flow through to shareholders. Pass-through items retain the character in the hands of the shareholder they had in the corporation.	Corporation is a taxable entity: Double tax may be an issue. A C-corporation pays tax on its profits. When shareholders take profits from the corporation, the distributions are usually taxable dividends (double taxation).	If properly structured there is no tax at the entity level. Income/loss is passed through to members of the LLC. Same as a general partnership.
Wages and SE Tax	An employee-shareholder of an S corporation receives wages for services rendered. These wages must be reasonable. Additional profits are passed through to the shareholder and are taxable for income purposes but not for SE tax purposes. Double taxation of profits is avoided	Shareholders who perform services for a corporation, including officers, are treated as employees. Wages of corporate employees are subject to payroll and withholding. Wages paid to employee-shareholders must be reasonable. Dividend distributions are not subjected to SE tax.	Profits are subject to income tax in the same way as a partnership. Members' business income (including guaranteed payments) may be subject to SE tax.
Losses	Losses flow through to shareholders. Recognition of loss is limited by the shareholder-s basis, at-risk rules and passive activity rules.	Capital losses are allowed only to the extent of capital gains. Net operating loss of a corporation is carried back or forward against corporate income, but is not passed through to shareholders.	Losses flow through to members. Recognition of loss by member's basis. At-risk rules and passive activity rules.
Fringe Benefits	Generally included in income for employee-shareholders owning more than 2% of stock.	Owner-employees are entitled to the same tax-free fringe benefits as other employees (subject to discrimination rules).	Same as a general partnership.
Exit Opportunities	Good: Stock or Asset Purchase; Key Employee retention opportunity	Good; Stock or Asset Purchase; Key Employee retention opportunity	Good; Stock or Asset Purchase; Key Employee retention opportunity

Business Entity Matrix Overview

CHARACTERISTIC	SOLE PROPRIETORSHIP	GENERAL PARTNERSHIP	LIMITED PARTNERSHIP AND (FLP'S)
S			
Simplicity of Organization and Administration	Relatively few legal requirements; Business Licenses; Payroll Tax	Relatively few legal requirements. A partnership is easily organized. A written partnership agreement is recommended, but not required. The agreement determines how much income and losses are allocated to the partners	Need Written Agreement; Raise Capital
Management	Full control of management and operations	Typically each partner has an equal voice unless otherwise arranged in writing	Managed by the General Partner. GP has full control of assets and investments; LP needs to avoid involvement in management.
Assets			
Liability	Sole proprietor has unlimited liability	No personal liability protection: Partners have unlimited liability for own acts; Acts of other partners or agents/employees and for acts of GP	Each General Partner has unlimited liability. Limited Partners are only liable for their portion invested
Taxation	No taxable entity. Sole proprietor pay all taxes; Self Employment tax 15.3% of less than \$90k earnings	Each partner pays tax on his/her share of the income and can deduct losses against other sources of income. Partnership income and expenses flow through to the partners. Income is taxed to the partner whether or not distributed. Pass-through items retain the same character in the partner as they had in the partnership	Each partner pays tax on his/her share of the income and can deduct losses against other sources of income. Partnership income and expenses flow through to the partners. Income is taxed to the partner whether or not distributed. Pass-through items retain the same character in the partner as they had in the partnership
Wages and SE Tax	On Personal Return	A general partner's share of business income (including guaranteed payments) is subject to SE tax. A limited partner's share of business income is not subject to SE tax unless the partner performs services for the partnership.	Profits are subject to income tax in the same way as a partnership. Members' business income (including guaranteed payments) may be subject to SE tax.
Losses	On Personal Return	Losses flow through to partners. Recognition of loss by a partner is limited by the partner's basis, at-risk rules and passive activity rules.	Losses flow through to partners. Recognition of loss by a partner is limited by the partner's basis, at-risk rules and passive activity rules.
Fringe Benefits	Business ownership deciding in Personal Return	Generally included in partner's income as a guaranteed payment.	Generally included in partner's income as a guaranteed payment.
Exit Opportunities	Limited; Asset Sale	Limited; Subject to written Partnership Agreement	Limited; Subject to written Partnership Agreement