Strategic Positioning for the Private Business Owner

Tuesday, October 1, 2019
2 p.m. ET | 11 a.m. PT

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Agenda

- Introduction by April Hall, senior editor, *Family Business Magazine*
- Time for questions (enter them from your computer) during and after the presentation
- 60 minutes
- Presentation and supporting material will be emailed to all participants after the webinar
Today’s Speakers

JOE FAHEY
Sr. VP & National Director
Business Succession Planning
PNC

MARK BUXTON
Sr. VP & Regional Director
Wealth Strategy
PNC
Primary Advisor Attributes

- **Objective advice**
  - Team of specialists
  - Has my best interest and “coaches” me

- **Holistic and integrated planning**
  - Important decision – most are "stuck"
  - No “patchwork” for ownership transition

- **Ease of doing business**
  - Pleasantly persistent
Five Key Questions

1. **How should I transition my business?**
   - Keep? Sell? ESOP? IPO?
   - Pros, cons and math (financial snapshot)

2. **When should I transition my business?**
   - Competitive position
   - Capital market conditions
   - Shareholder objectives
   - Attractiveness and readiness (pre-transition planning: business)

3. **What is the value of my business?**
   - Strategic – Financial – Estate

4. **Who should benefit from the wealth generated from my business?**
   - IRS, family, charities and employees
   - Attractiveness and readiness (pre-transition planning: personal)

5. **How should this be designed and communicated to meet my objectives?**
   - Integrated business – family financial “blueprint”
   - Team of specialists
   - Family communication
### Strategic Positioning

#### Business and Personal

<table>
<thead>
<tr>
<th>Corporate Team</th>
<th>Wealth Team</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business vision and strategy</strong>&lt;br&gt;– Industry dynamics and plan&lt;br&gt;– Competitive positioning</td>
<td><strong>Shareholder vision and strategy</strong>&lt;br&gt;– Family dynamics and plan&lt;br&gt;– Philosophy and governance</td>
</tr>
<tr>
<td><strong>Financial</strong>&lt;br&gt;– Sources and uses&lt;br&gt;– Distribution policy</td>
<td><strong>Financial</strong>&lt;br&gt;– Income, liquidity and risks&lt;br&gt;– Estate taxes</td>
</tr>
<tr>
<td><strong>Administrative</strong>&lt;br&gt;– Leadership and demographics&lt;br&gt;– Initiatives / incentives</td>
<td><strong>Administrative</strong>&lt;br&gt;– Family leadership and governance&lt;br&gt;– Optimal shareholder and asset</td>
</tr>
<tr>
<td><strong>Emotional</strong>&lt;br&gt;– Keep, sell or ESOP&lt;br&gt;– Communication strategy</td>
<td><strong>Emotional</strong>&lt;br&gt;– Trust and estate fairness&lt;br&gt;– Communication strategy</td>
</tr>
</tbody>
</table>
# Integrated Strategic Positioning

## The Process

### Phase I: Discovery
- Business dynamics
  - Vision and strategy
  - Financial
  - Administrative
  - Emotional
- Shareholder dynamics
  - Vision and strategy
  - Financial
  - Administrative
  - Emotional
- Meeting preparation
- Document review

### Phase II: Assessment
- Facts and assumptions
- Goals-based objectives
- Succession options: Keep; Sell; ESOP
- Pros, Cons and math
- Insights and discussion points
- Financial peace of mind
- Integrated financial blueprint

### Phase III: Implementation
- Coordinate with team of specialists, including legal, tax, accounting and product and services
- Business and shareholder education
- Formalize communication plan

### Phase IV: Monitoring
- Set periodic meetings
- Pivot off existing body of knowledge
- Assess changes in business and shareholder dynamics, objectives, tax, accounting, economy, industry
- Make revisions
- Update communication plan
Choices: Objective Advice

Internal
- Family
  - Sale
  - Gift
  - Combination
- Employees
  - Management Buyout
  - ESOP

External
- IPO
- Strategic
- Private Equity Investment
### Business Pro-forma Cash Flow

#### XYZ INC
- **Cash Flow Illustration**
- **Family Business Governance**

#### Assumptions
- 2020 results as base case
- Growth Rate: 6.0%
- Tax rate: 40.0%

<table>
<thead>
<tr>
<th>Year</th>
<th>Reinvestment Rate</th>
<th>Distribution Rate</th>
<th>Net after Senior Debt</th>
<th>Debt Repayment (Senior Debt)</th>
<th>Net After Taxes</th>
<th>Net Income Before Taxes</th>
<th>Net Income Before Interest &amp; Taxes</th>
<th>Net Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$6,947,587</td>
<td>$3,016,047</td>
<td>$10,098,453</td>
<td>$12,027,419</td>
<td>$10,098,453</td>
<td>$8,987,587</td>
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<td>2018</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$11,221,953</td>
<td>$4,402,150</td>
<td>$17,024,077</td>
<td>$19,052,037</td>
<td>$17,024,077</td>
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<tr>
<td>2019</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$14,324,848</td>
<td>$5,808,200</td>
<td>$23,136,847</td>
<td>$25,164,808</td>
<td>$23,136,847</td>
<td>$21,138,802</td>
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<tr>
<td>2020</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$16,095,399</td>
<td>$6,430,150</td>
<td>$29,525,549</td>
<td>$31,553,600</td>
<td>$31,553,600</td>
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<td>2021</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$17,789,566</td>
<td>$7,180,200</td>
<td>$36,049,765</td>
<td>$38,078,865</td>
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<td>$36,049,765</td>
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<td>2022</td>
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<td>10.0%</td>
<td>$19,544,432</td>
<td>$7,980,200</td>
<td>$42,614,637</td>
<td>$44,643,797</td>
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<td>$42,614,637</td>
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<tr>
<td>2023</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$21,399,301</td>
<td>$8,800,200</td>
<td>$50,319,537</td>
<td>$52,348,697</td>
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<td>$50,319,537</td>
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<tr>
<td>2024</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$23,364,848</td>
<td>$9,640,200</td>
<td>$57,174,687</td>
<td>$59,203,848</td>
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<td>2025</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$25,544,399</td>
<td>$10,500,200</td>
<td>$64,174,637</td>
<td>$66,224,900</td>
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<td>$64,174,637</td>
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<tr>
<td>2026</td>
<td>10.0%</td>
<td>10.0%</td>
<td>$27,889,566</td>
<td>$11,400,200</td>
<td>$71,644,808</td>
<td>$73,769,900</td>
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<td>$71,644,808</td>
</tr>
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**Total Achor Value Calculation**
- **Balance OOF** 0 as $0
- **Return on Investment** 5.0% as $0
- **New Investments (ODF)** 0 as $0
- **Balance ODF** 45.0% as $0

### Personal Financial Snapshot

#### BOB’S ESTATE
- **In Estate**
  - Total: $3,269,001
  - Current Situation 2020: $2,865,001
  - In 10 Years: $1,720,643
  - In 20 Years: $250,657

#### JANET’S ESTATE
- **In Estate**
  - Total: $3,269,001
  - Current Situation 2020: $2,865,001
  - In 10 Years: $1,720,643
  - In 20 Years: $250,657

#### Total to Heirs: $2,269,001

- **Current Situation (2020)**
  - Net To Heirs: 100.0%

- **In 10 Years**
  - Net To Heirs: 100.0%

- **In 20 Years**
  - Net To Heirs: 100.0%
Keep: Paths to Ownership Transition

**Conflict**
- Many Active & Inactive Members
- Cross Purposes
- Unmet Needs
- Nobody Happy
- Litigation Risk
- Forced Sale Risk

**Governance**
- Business & Family Alignment
- Align Active & Inactive Members
- Fiduciary role & responsibility
- Rules for Control, Entry, Compensation & Promotion
- Dividend Policy (distribute or re-invest)
- Embodiment of Family Wealth Philosophy
- Community Involvement

**3rd Generation**
- More owners in picture
- Children starting to join business
- Business viewed as "Cash Cow"
- Stakes are rising

**Transition**
- Ownership = Control
- Few Formal Rules
- Daily Collaboration

**Red Tape**
- Too many rules
- No reason for them
- Inefficient operations
Sell: Pre-Transition Planning (example)

- Three owners: 60%, 30% and 10% (S Corporation)
- Strong growth opportunities in industry, just a matter of cloning in other markets
- Efficiency of scale with each new market location (improving margins)
- Generating $3MM EBITDA; could sell for approximately $18MM
- Dilemma: Keep vs. Sell financial snapshot: cash vs. cash flow
  - 60% owner independently wealthy and wants to exit business ASAP
  - 30% and 10% shareholders; proceeds would not meet financial objectives
1. **Competitive Dynamics**
   - Next generation lacked skills to maintain competitive advantage
   - Could grow from $3 to $9mm EBITDA in 5 years
   - Competitive advantage were the senior technical managers
   - Constrained by supply of senior technical management

2. **Capital Market Conditions**
   - Equity capital available but attracting talent slowed growth
   - Debt capital low cost and available to grow business
   - **Multiples** ranged between 6-9 times EBITDA

3. **Shareholder Objectives**
   - Obtain **financial peace of mind** for all 3 shareholders
   - 60% wanted to **maximize wealth for future generations**, then leave **balance to charities** ("My zero tax plan")
   - Reward, retain and protect key employees regardless of keep-sell decision
Value Drivers: Business
Attractiveness and Readiness

- General economic conditions and industry growth prospects
  - Size of company (revenue, EBITDA)
  - Leading competitive position (niche; low cost producer; muddle middle)
  - Differentiated products and services
  - Diverse customers and suppliers

- **Operational knowledge:** link marketed opportunities, backlog, revenues and profits

- **Financial knowledge:** predictable earnings growth (actual vs. budgeted)
  - Audited financial statements (several years)
  - Above industry average profit margins and growth

- Depth and breadth of talent with “carry over” golden handcuffs

- Strong culture of integrity and communication strategy

- $18MM vs. $81MM
Value Drivers: Personal
Attractiveness and Readiness

- **Financial snapshot (peace of mind) for family**
  - Personal balance sheet, cash flow, liquidity, risk profile and asset protection
  - Macro-multi generational wealth transfer plan (**$7 vs. $48**)
  - Voting-equity-income decisions

- **Optimal shareholder-optimal assets**

- **Beneficiaries: IRS, family, charities and employees**

- **Depth and breadth of family leadership**
  - Family wealth philosophy and communications
  - Rules of the road: control, entry, exit, compensation, promotion, dividend, community involvement
  - Written family mission statements

- **Updated legal documents**

- **Strong culture of integrity and communication strategy**
Achieving Your Goals Starts with Creating a Plan

Through our personalized approach to wealth planning, a strategist meets with you to help identify your goals and integrate your vision into a plan. We provide professional experience and guidance, and will help you successfully navigate the complexities of planning in each of the listed areas as are appropriate to your situation.

- Business succession strategies
- Executive compensation planning
- Real estate succession strategies
- Multi-generational family wealth
- Philanthropic planning
- Elder relatives and friends
- Special needs relatives and friends
- Financial planning and cash flow needs
- Retirement planning
- Education planning
- Family estate planning
- Wealth transfer and gifting strategies
- Asset protection planning
- Family governance and communication
- Planning for the modern family
- Risk management and insurance
# Federal Transfer Taxes

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2018 – 2025</th>
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<tbody>
<tr>
<td><strong>Estate Tax Exemption</strong></td>
<td>$5,490,000</td>
<td>$11,180,000</td>
</tr>
<tr>
<td><strong>Estate Tax Top Rate</strong></td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td><strong>Gift Tax Exemption</strong></td>
<td>$5,490,000</td>
<td>$11,180,000</td>
</tr>
<tr>
<td><strong>Gift Tax Top Rate</strong></td>
<td>40%</td>
<td>40%</td>
</tr>
<tr>
<td><strong>Capital Gain Tax At Death?</strong></td>
<td>No; Basis “step-up”</td>
<td>No; Basis “step-up”</td>
</tr>
</tbody>
</table>

Source: irs.gov
Self-Assessment: Business

How would you answer the following questions on a scale from 0-5, with 0 being low and 5 being high?

- How strong are your financial controls and how well do your historical budget projections match actual performance?

- How would you rate the depth and breadth of your leadership team to manage the company if you were suddenly unavailable for three months or longer?

- How well does your incentive plan reward senior leaders to identify, train, develop and retain future leaders and key employees?

- How confident are you that your business has the attractiveness and readiness to sustain a due diligence process in the event you choose to sell to a third party or institute an ESOP?
Self-Assessment: Personal

How would you answer the following questions on a scale from 0-5, with 0 being low and 5 being high?

- How well does your business plan align with your personal plan and the financial needs of other shareholders?
- How well does your plan reduce estate taxes and protect and preserve your assets?
- How comprehensive is your plan, and do you believe it will deliver financial peace of mind to you and your family?
- How effective are your family meetings?
- How prepared is the next generation to maintain your values and philosophies?
- How experienced and integrated is your professional advisor team?
Next Steps

- **Think strategically and holistically**
  - Anticipate and embrace change and conflict
  - Integrate corporate and wealth strategies

- **Set a meeting with your team of advisors to**
  - Review your facts and objectives
  - Identify gaps and positioning opportunities
  - Know your options: pros, cons and math (“financial snapshot”)

- **Customize and implement your ownership transition plan**
  - Build in efficiency and flexibility
  - Update legal documents to align with plan
  - Develop strong communication strategy
Questions?
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