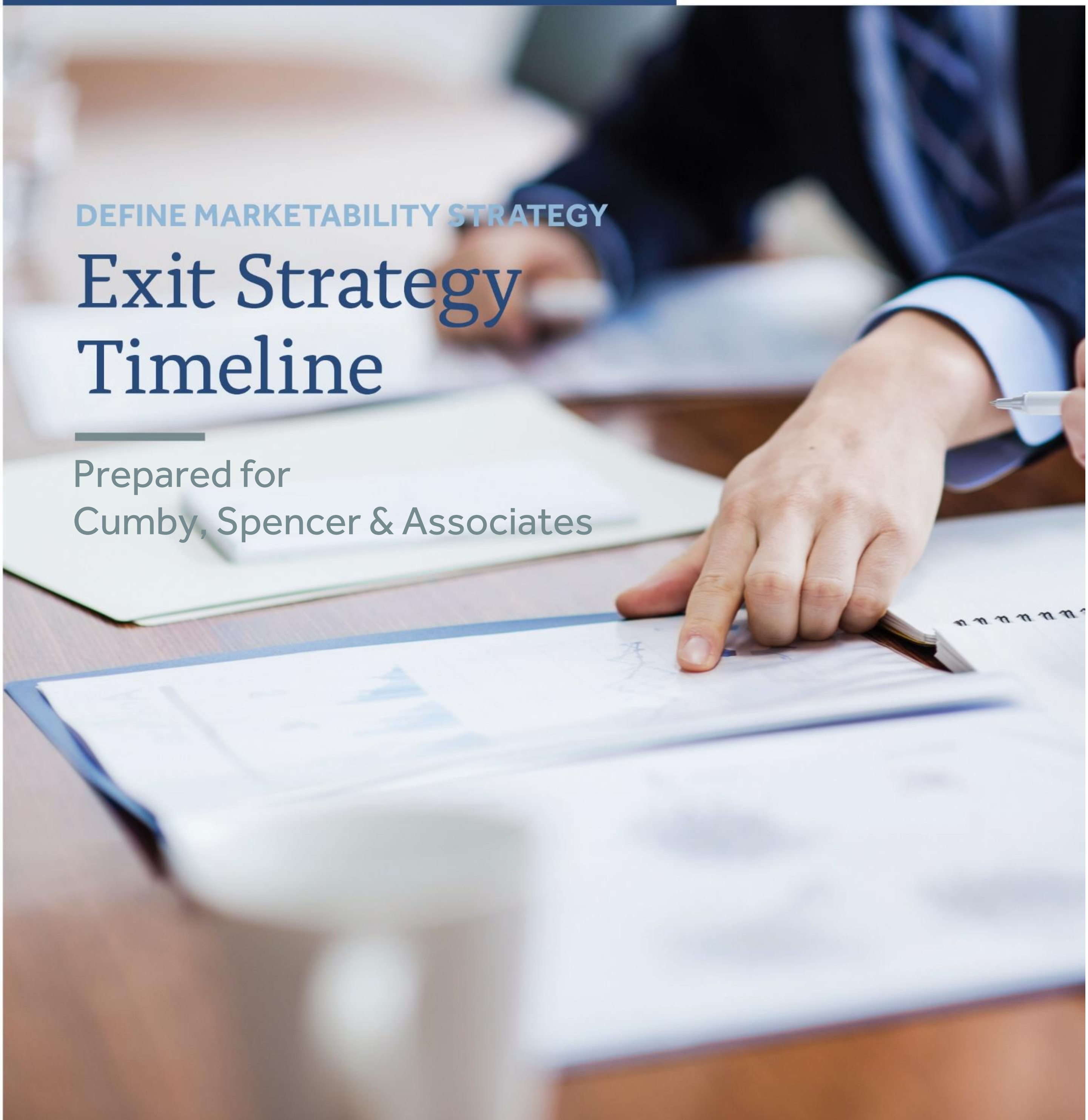
Cumby, Spencer & Associates Financial Group
Guiding your financial path



DEFINE MARKETABILITY STRATEGY

Exit Strategy Timeline

Prepared for
Cumby, Spencer & Associates

Exit Strategy Timeline

A business often represents the single largest asset on an owner's personal balance sheet. Failure to plan in advance can result in a forced transition that is dictated by external circumstances rather than one's own objectives.

A forced sale could forfeit much of a company's value, while incurring unnecessary taxes and other expenses. In contrast, a well-conceived timeline can help an owner leave the company at the best time possible, to the successor of his or her choice, and with an optimal amount of money for retirement.

An ideal exit planning timeline includes six steps:

1. Determine Owner Goals

The method and timing of exiting a business will be dictated by the owner's personal needs. An assessment of the owner's finances and projected retirement goals can determine how much cash an owner will require from the business and an ideal payment schedule.

2. Analyze the Business

An analysis of the business involves both external and internal factors. Externally, market conditions, industry-specific performance indicators, and company positioning can all affect the projected value of a company. Internally, the company's management team and key employees play an important role in continued profitability after a transfer. Continued profitability is important because it increases the value an owner can receive for the business—particularly when payments are made on an installment basis, rather than in a lump sum payment upon closing.

Most critically, management succession must be reviewed to ensure there is a team capable of running the company in the owner's absence. The owner can consider succession possibilities such as a management buyout, sale to private equity, or sale to an employee stock ownership plan. Additionally, steps should be taken to retain key employees. Retaining key employees provides stability to the business in a time of transition. The owner may consider employee incentive opportunities such as a deferred compensation plan with "golden handcuffs."

3. Estimate Business Value

A comparison of the owner's projected retirement needs to the preliminary estimate can help determine how much longer the owner needs to grow the business before he or she can retire.

Valuation methods:

- Market value: The market-based method estimates a potential price by looking at similar public companies or businesses in the industry that have recently been sold.
- Income-based value: The income-based method determines the company's current value based on its future income potential. Future income is calculated by capitalizing future earnings over one period or discounting future earnings.
- Asset value: The asset-based method determines the appropriate price by calculating the market value of all the assets in a business, net of liabilities.
- Liquidation value: The liquidation value is determined by how much the company assets might sell for in a short period of time (usually less than 12 months).

Choose a Transfer Method

- Transfer to a family member.
- Transfer to a co-owner or employee.
- Transfer to a third party.
- Liquidate.

Each transfer method has its own benefits and drawbacks. It is important to choose a transfer method that is suitable to the owner's goals, the company's performance, and prevailing market conditions. The transfer method should be determined far in advance of the departure date.

With both a transfer to a family member or to an employee, advanced planning will be required to provide time for the owner to mentor the successor and establish the successor's authority in the company. Lack of advanced planning can result in a forced quick sale or liquidation that garners a lower price and unnecessary taxes.

4. Determine Funding Sources

Most transfers involve financing from a third-party debt or equity sponsor such as a bank, mezzanine capital, or private equity. Absent financing from a third party, seller financing can be considered. Owners should consider how debt will affect the business operations as well as income tax liability.

5. Estate Planning

In 2021, estates worth more than $11.7 million are subject to a 40% estate tax. Most owners will hold a majority of their assets in the business. Thus, absent a forced sale of the business, there may not be enough liquid assets to pay off the tax liability. In addition, it may be hard to treat heirs equally where there are some children active in the business and others that are not. In this situation, the active children will receive an inheritance through control over the business. There are often not enough liquid assets to adequately provide for inactive children.

Life insurance can address both problems. Proceeds from life insurance held in an irrevocable trust are not subject to estate or income tax. It is a liquid source of funds for beneficiaries to pay off estate taxes due on the business. Additionally, it can serve as an inheritance equalization tool so that active children receive shares in the business, and inactive children are compensated through rights to the life insurance proceeds.

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Bruce Cumby is the President of Cumby, Spencer & Associates Financial Group. For more than 35 years, he has developed a niche for working with pre- and post-retirement Baby Boomer and business owner clients. Bruce specializes in designing comprehensive, holistic solutions for his client's retirement planning, estate planning, wealth management, and business succession needs, as well as executive and employee compensation and benefits. He focuses on clarifying his clients' goals while creating a road map for their success. He attended St. Joseph's University and earned a Master of Science in Financial Services from the American College.

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As a result of the Tax Cuts and Jobs Act of 2017 (TCJA), gift and generation skipping transfer (GST) tax exemption amounts increased to approximately $11.18 million per person (approximately $22.36 million for a married couple), effective in 2018. For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law ($5.49 million/single and $10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances. Please consult your own tax or legal advisor for advice pertaining to your specific situation.