KEEP vs SELL?

Follow up responses for submitted questions from the September 29, 2015 Insights for Business Owners webcast.

AT WHAT STAGE OF THE BUSINESS LIFE CYCLE IS IT MOST APPROPRIATE TO SELL?

Deciding the right time to sell a business depends upon many different factors: general economic conditions, industry conditions or industry valuation indicators, capital availability and company or owner-specific considerations (recent product launches, plant expansion/upgrade in progress, the owner or owners' desire for a liquidity event, etc.). Many times a sale decision is based upon weighing these various factors to determine if it's better to sell now or later. Advanced planning allows a business owner to proactively plan the sale of a business versus being forced to reactively sell the business due to factors such as: receipt of an unanticipated purchase offer, the need to address liquidity constraints, the loss of a key employee, etc.

As mentioned in the presentation, two important pieces of succession planning are:

- Financial plans for the owner
- A strategic plan for the business

When the needs of the two plans diverge (for instance, when the capital requirements of the business suspend dividend streams for the family, or when the family is uncomfortable with the riskiness of the strategic plan) it's probably time to sell.

WHAT ARE GOOD EXIT STRATEGY OPTIONS FOR A MINORITY SHAREHOLDER (FOR EXAMPLE, 14%) IN A SMALL PRIVATELY HELD AGRICULTURE BUSINESS WITH TWO OTHER OWNERS (FOR EXAMPLE, 72% AND 14% RESPECTIVELY) IF THE OTHER OWNERS DON'T WANT TO SELL THEIR SHARES?

Ideally, the owners of a private business would have a shareholders agreement (or a similar plan) in place to determine how shareholders are able to transfer/sell their interest. If your company has such an agreement in place, it would dictate the terms for an owner to exit. If there is no plan in place, the most likely buyers are the other shareholders and/or the company. In the absence of liquidity rights for the minority shareholders (stated in either the operating/shareholders agreement or in a side agreement among equity holders such as a buy-sell agreement) the minority shareholders' only hope is usually for the other shareholders to be accommodative, or for the majority shareholders to seek the minority shareholders' cooperation for something else, such as liquidity.

WHAT VALUATION METHOD DO YOU SEE MOSTLY USED WHEN SELLING THE BUSINESS TO EMPLOYEES OR OUTSIDERS?

Typically, a valuation firm would be retained to value the business and the valuation report would serve as the basis for a sale price. If the sale is to an ESOP, then an independent valuation report is required. This is the approach that is often utilized in selling a business to the employee group.

Depending on the size of the business, an investment banker could be retained to manage the sales process. The investment banker would analyze the company and prepare an estimate of value. They would then run a formal process to expose the company to prospective buyers on a no-name basis or subject to a confidentiality agreement. In an ideal situation, the sales process would result in 2-3 prospective buyers in a competitive bidding process. If the scope of the marketing effort is sufficient, the resulting sales price is representative of what the market would pay for the business. It should be noted that the ideal buyer may not be the one paying the highest price, but rather the one with the best deal terms and ability to close the transaction.

Regardless of whether a formal valuation or value estimate is utilized, the valuation methodology will vary based upon the subject company and the industry in which it operates. Generally, acceptable methodologies will include one or more approaches including a multiple of earnings (or EBITDA), discounted cash flows or reliance upon comparable company transactions. Additionally, the valuation needs to take into account company-specific factors such as the company's future growth prospects, risk factors, asset intensity, non-business assets, etc.

DO YOU HAVE ANY STRATEGIES FOR GIFTING SHARES IN A SUB S CORPORATION TO A CHARITABLE FOUNDATION?

There are a number of strategies which could be utilized depending on the goals of the owner and their willingness to cede control, as well as the size of the business. These various strategies tend to be situation-specific and should be discussed in the context of an individual's overall wealth plan. It is in the donor's best interest to work with experienced advisors, including a tax attorney, when developing strategies for gifting shares of sub S corporation stock to a charitable entity.

OUR BOARD OF DIRECTORS IS COMPRISED OF 9 FAMILY MEMBERS (4TH & 5TH GENERATION). HOW DO YOU GET PAST THE FEELINGS OF THE 4TH GENERATION TO PROTECT THEIR LEGACY WHILE ENCOURAGING THE 5TH GENERATION HEIRS TO TAKE A BOARD SEAT THAT THEY MAY NOT BE QUALIFIED FOR? HOW DO YOU GET ALL DIRECTORS TO CONSIDER WHAT IS BEST FOR THE COMPANY, AND NOT JUST THE ADDITIONAL COMPENSATION?

A formal succession planning process will help identify current and future board members. Thoughtful candidate selection, coupled with a plan for educating and developing current and future board members, helps assure that members have a base level of knowledge to effectively serve on the board. In addition, adding independent directors and management members will provide more balanced input to help focus the board on what is important for the long-term success of the business. An annual board planning session helps establish objectives and priorities, while an annual self-evaluation of the board's performance helps identify areas for improvement.

A family council may provide greater insight into the family's priorities and help inform the work of the board of directors. The family council can also be effective in training junior generation family members with regard to family values, legacy and the responsibilities and skills required for employment in the family business or board participation.

We've seen families name outside directors and/or senior non-family executives to mentor younger board members/potential board members. In addition, outside advisors can assist the family in creating a formal profile of what a board member should bring to the table and evaluate the junior generation's ability to fulfill the role. Finally, some families utilize observer rights, junior boards/shadow boards to help younger family members become familiar with a director's role, and help develop them as future board members. Each of these tools will help in assessing the readiness and receptiveness of the next generation to serve as a responsible board member.

We would note that if there is serious conflict between family members or the different generations, it may be necessary to focus first on resolving/addressing that conflict. In these situations, the company and the family would likely benefit from seeking guidance from a family business advisor who has experience with helping families work through what could be very emotionally charged issues around governance. Such an advisor can also help family members find ways to have difficult conversations in a manner that minimizes family discord.

HOW OFTEN DOES THE FAMILY COUNCIL MEET?

The frequency of family council meetings varies from family to family. The typical range is from 1 to 4 in-person meetings per year, as well as periodic conference calls, depending on the council's level of activity. Some family councils meet with the same frequency as the board of directors. Family council meetings typically precede board

meetings since, in many cases, the family council communicates family perspectives to the board on issues related to ownership.

More active family councils sponsor leadership development or training sessions for the junior generation which may be much more intensive, such as several weeks in the summer or a series of weekends. Also, as families get more dispersed, the family council can create opportunities for intra- and inter-generational interaction that may not be linked to formal meetings. These events could be designed for a smaller subset of the family members, such as an annual fishing trip for the Xth generation.

WHEN IS IT APPROPRIATE TO BEGIN AN ANNUAL VALUATION OF THE BUSINESS?

A periodic valuation of the business is generally a good practice as it helps provide a basis for much of the succession and financial planning work we discussed. If the company has a shareholder agreement or buy-sell agreement which provides owners with the ability to sell their shares back to the company or to other owners, an annual valuation becomes a necessity.

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