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## Sticking a Toe (or Two) in the Exit Planning Pool

In this issue, we attempt to dismantle the most common objections owners have to undertaking the planning necessary to exit their companies successfully. Excuses to avoid Exit Planning include the following:

1. The business isn't worth enough to meet my financial needs. When it is, I'll think about leaving.
2. I will be required to work for a new owner for years.
3. I don't need to plan. When the business is ready, a buyer will find me.
4. This business is my life! I can't imagine my life without it!

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successor you choose, on the date you choose, and for the amount of cash you want, you might ask, “How do I, as an owner, jump into Exit Planning?”

Let us suggest that one of the best places to jump in is to take some measurements.

First, owners should retain a valuation expert to perform an estimate of the company’s value to find out what it is actually worth. (If you plan to sell to a family member, co-owner, or employee, retain a certified business appraiser. If you foresee a sale to a third party, ask a business broker or investment banker for a “sale-price estimate.”) The transaction advisor an owner chooses (an investment banker if the company’s likely value is at least \$5 million and a business broker for smaller businesses) should be able to give the owner a range of value for the business in today’s mergers and acquisitions (M&A) marketplace. Regardless of the state of the M&A market, though best guesses and educated opinions are nice, they are weak foundations for Exit Planning.

Second, owners should sit down with their financial advisors to figure out how much cash they will need to meet their financial goals. Tapping into the expertise of a financial advisor to help objectively analyze an owner’s future needs and make realistic, risk-sensitive assumptions about investment rates of return is paramount.

To illustrate how assumptions, rather than objective measurements, can lead owners astray, let’s look at Sam Reed, a hypothetical business owner who went into a transaction armed only with assumptions.

*When Sam Reed began thinking about selling his business, he started paying close attention to what competitors were getting for their companies. He applied his industry’s rule of thumb to his company, compared his company to others, and figured that his company was worth about \$20 million. He calculated that he’d take home about 75% of that after taxes. Since he needed \$6 million to pay off business debt, he thought he could cash out for \$9 million.*

*Sam hadn’t put a lot of thought into what income he’d need for a comfortable post-exit life, but figured that at his age (50), \$9 million, yielding 8% per year (\$700,000+ annually), would be an adequate replacement for the \$850,000 salary and distributions he currently took from the business.*

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*given the flatness of his company's cash flow and the state of the M&A market. The best offer on the table was \$14 million, of which \$11 million was in cash, leaving him with about \$2 million net at closing (after taxes and debt payoff), and another \$3 million in future payments.*

*When Sam learned from his financial advisor that the realistic return on the net proceeds (\$2–5 million depending on whether he actually received the \$3 million in future payments) was 4–5%, he had no alternative but to back out of the sale process.*

Sam made two critical mistakes: He miscalculated the proceeds he'd receive at closing and unrealistically overestimated the rate of future investment return. He would have saved time, effort, and money if he had (1) gotten a sale-price estimate that allowed him to realistically estimate how much he would net from the sale and (2) forecasted a realistic, risk-sensitive rate of investment return (as part of a financial needs analysis). With these two pieces of information in hand, Sam could have made a more informed decision.

Many owners don't have the luxury of time. We suggest that you at least stick your toe in the Exit Planning pool by obtaining these two simple measurements. Test your assumptions: You may be surprised by the results.

Call us so we can help you get started on a plan that can make your company more valuable today and help you achieve the future exit you desire.

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