
Contractor Succession SIMPLIFIED!

TRAVELERS 

Monday, January 29, 2018
Webinar

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Disclaimer

This material is for general informational purposes only and is not legal advice. It is not designed to be comprehensive and it may not apply to your particular facts and circumstances. Consult as needed with your own attorney or adviser.

What We'll Discuss Today

1. How to transfer your business
2. Succession SIMPLIFIED

Family Business Institute



Family Business Institute

Our mission is to facilitate lasting business
success and family harmony

What Do Contractors WANT?

1. Success (self and customers)
2. To beat the competition
3. Continuity; a bright future
4. Life balance

What Do Contractors FEAR?

1. The RISKS associated with construction
2. Failure:
 - individual jobs
 - succession fears
3. That they may not be man/woman enough to engineer a bright future

How to Transfer Your Business



How to Transfer Your Business

There are ONLY FOUR WAYS:

1. Close the doors
2. Give it away
3. Sell it to insiders
 - a. Family
 - b. Non-family
 - c. A combination
4. Sell it to outsiders

How to Transfer Your Business

Discuss:

1. Close the doors...
2. Give it away
 - a. Annual exclusion gifts (\$14,000 per donor per donee)
 - b. Unified Transfer Credit gifts (\$5.45 million)
 - c. GRAT, GRUT
 - d. IDGT
 - e. Charitable bailout
 - f. Generation skipping trust
 - g. etc., etc.

How to Transfer Your Business

The BEST WAY:

- Build it as if you're going to sell it to an **OUTSIDER!**
- What is the **DOWNSIDE?**

OVERARCHING GOAL:

The long term success of the company and its people

Seller

- Need for benevolence vs. greed
- Must meet needs and goals for retirement
- Must be able to take care of family in a fair and appropriate manner
- Responsibility and control must both transition
- Basic understanding that buyers will purchase with YOUR money

Timing

- Usually takes 10 years to implement
- Balance needs/desires of seller, readiness of buyer, and financial modeling for both sides

Buyer

- Align ownership with leadership
- Roles of family should align with their talents and interests
- Success is most dependent upon having the right “team”
- A plan is needed to develop and transition the successor team

Transaction

- Price and terms that facilitate deal getting done and do not harm the company's future
- Shareholder's Agreement is a must!
- Promissory notes (if needed) that protect the seller
- Many options for transaction structure. Most have the same result. Find the one that fits you best



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Value, Valuation, and Deal Structure

- Most companies are sold for Net Worth (adjusted for market value of assets) because this usually exceeds a “normal” multiple of earnings
 - If the company is carrying excess net worth, this may be distributed to owners before the sale
- If multiple of earnings is used, it is often equated to 4x average earnings which would mean a 25% return on purchase price (equity)
- Not coincidentally, it would take about 7 years of after tax earnings at a 40% tax rate to pay for a company valued at 4x earnings
 - With normal economic cycles and the need for retained earnings (for growth), it often takes 10 years to actually complete a transaction

Value, Valuation, and Deal Structure

- A valuation method is usually established in a Shareholders' Agreement (Buy-Sell)
- Discounting of value for lack of control and lack of marketability is generally done when gifting shares (family), but not in arms length, internal successions
- ESOP transactions often have a higher value because money can be paid out with pre-tax earnings
- An ESOP is a tax advantaged strategy which usually gives the seller a higher return but moves value to “all employees” in proportion to their salaries in an ERISA-governed retirement plan

Value, Valuation, and Deal Structure

- continued -

- Extraordinarily high earnings multiples on Wall Street can create an environment where sales to a “roll-up” can get the seller a higher price. But this often is not what is best for the company’s key people, and the historic success of roll-ups is not good because they can’t sustain their earnings growth except through more acquisitions
- Deal structure varies with the situation, needs, and desires of ownership, and often who advises them as each professional seems to have their favorite. Some methods are more tax-advantageous than others

Value, Valuation, and Deal Structure

– continued –

- Most internal successors don't have sufficient resources to come out of pocket, so the seller must fund* the purchase. This is typically done via one or a combination of the following:
- Bonus enough for them to make a down payment
 - Deferred compensation or phantom stock to accumulate down payment
 - Taking a promissory note which is then paid out of earnings distributions or “excess” bonus
 - Salary continuation to the seller

* Economically, all of these scenarios are essentially the same in that the company's earnings are used to provide the fuel for the buyer to pay, and the seller foregoes earnings that he would have received in order to receive that money as payment for the former ownership interest

Value, Valuation, and Deal Structure

- continued -

- Trusts and other vehicles are sometimes used to defer taxes or transfer wealth to children in family successions.
 - Gifting is usually the most tax friendly strategy, but is seldom used in non-family successions

- Control is maintained as long as needed or desired by:
 - Retaining the majority of shares until final exit
 - Establishing voting and non-voting shares and selling **ONLY** non-voting until final exit
 - Using a proxy until notes are paid off or until a specified time

Do's and Don'ts of Succession

Do:

- Find leaders with strong character
 - Look for servant leaders
 - Must be someone people will trust and follow
- Find leaders with drive who can take the company to the next level
 - The company, the seller, and the buyer all mutually benefit by increasing company success
 - You are looking for “Drive,” not “Greed.” Know the difference
- Develop talent at all levels
 - Remember that as leaders rise they must be back filled in the organization

Do's and Don'ts of Succession

Do: – *continued* –

- **Be sure the leadership team gets along and can work and collaborate together productively without you as referee**
 - **Get rid of any bad seeds**
 - **Don't leave your baggage for the next generation to take care of!**
- **Give responsibility, authority, and autonomy as soon as is practical**
 - **New leaders need the challenges and experience**
 - **Let them fail while you are still available to mentor them**

Do's and Don'ts of Succession

Don't:

- **Be greedy!**
 - Applies to both buyers and sellers
 - Best way to “kill the golden goose”
- **Designate leaders just because they are family**
 - You do children an injustice by putting them in position to fail or by giving them opportunity they haven't earned
 - If team members don't respect the children, you will lose good leaders and everyone will suffer

Do's and Don'ts of Succession

Don't: – *continued* –

- Hang on to control too long
 - Conservative tendencies can hold the company back from opportunity
 - The next generation deserves their shot, and, if chosen well, will achieve more than you alone could have
 - If you don't trust the next generation, you have the wrong team!
- Get confused between fair and equal in family business succession
- Get hung up on expecting employees to come out of pocket to make a down payment
 - The transaction goes just as well without it, and there is no real financial benefit to the seller

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Succession Planning White Paper

Here is the link to download the white paper on Succession Planning –

[https://www.familybusinessinstitute.com/
succession-planning-white-paper/](https://www.familybusinessinstitute.com/succession-planning-white-paper/)