MOSSADAMS

Succession Planning Guide

PRESERVE YOUR BUSINESS AND YOUR LEGACY FOR GENERATIONS TO COME

OPPPORTUNITY UNBOUND

INTRODUCTION

Every business is different. So is every business owner. No matter what path you take to build and grow your company, there's one milestone you'll eventually approach: transitioning the ownership of your business to a successor. Whether that successor is a family member, your management group, or a third party, succession is an event that affects your business, your family, your wealth, and your future.

Whether you're thinking of transitioning ownership now or in 20 years, it helps to have a plan mapped out well in advance to help ensure business survival and a return on your investment.

For many, succession planning can be a complex undertaking filled with questions, such as:

- When do you want to transition out of your ownership role?
- How can you derive the greatest value from your business?
- Who's the best candidate to lead your company into the future?
- Do you have the right management team in place?

We can help you answer these questions.

The process of business succession may seem overwhelming at first, but when approached with a plan, it can be an orderly, reassuring, and satisfying journey—one we'd be honored to take with you.

What's Succession Planning?

Few owners adequately plan their exits from their business. Yet, just as every owner needs a business plan, every owner also needs a succession plan to map out the transfer of ownership, help ensure the future success of the business, and achieve his or her personal goals. Other elements must also be addressed to create a smooth transition, including estate planning and personal financial planning. The need for these elements exists regardless of whether the transition is to family, key employees, or a third party.

Without a succession plan, creditors and others will create a plan for you. The US government may also take a large portion of your business assets to satisfy estate taxes.

Succession planning is critical to avoid undesirable results. Your options decrease over time, which means the sooner planning begins, the greater the likelihood most, if not all, of your business and personal objectives will be met. Starting early also provides the opportunity to make changes to the plan when necessary.

However, many business owners avoid important succession issues because they touch on personally sensitive areas, such as family dynamics, retirement, and mortality. Often the result is an inadequate estate plan that reduces some future taxes but does little to fulfill the owner's vision for his or her family and business.

Great succession planning empowers you to build a lasting legacy. It should also be comprehensive, taking into account all the needs of the business, the owner, and the family.

The Five Elements of Succession Planning

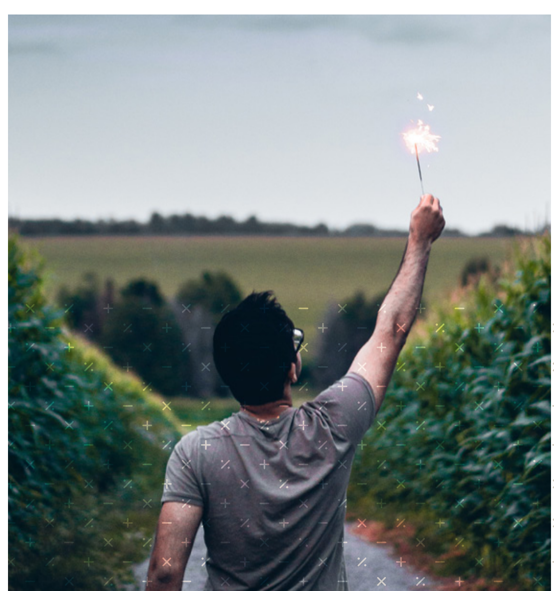
BUSINESS FINANCIAL PLANNING
Securing and growing your company's transferable value

PERSONAL FINANCIAL PLANNING
Creating sufficient personal liquidity and net worth to fund your lifestyle and tend to your family's needs and interests

MANAGEMENT SUCCESSION PLANNING
Developing key successors to enhance long-term performance, value, and transferability

ESTATE PLANNING
Planning for your family's legacy while helping to reduce the estate tax burden

OWNERSHIP TRANSITION PLANNING
Structuring the transfer of your business to a successor



It’s Not Just Business—It’s Personal

For business owners seeking a successful exit strategy, timing is everything. After all, getting the right value in a sale depends in large part on the life cycle stage of your business: Is it still growing? Has it reached maturity? Or is it in decline? Many owners fail to consider another key factor: their personal life cycle stage.

Why is this so critical? Because your personal life cycle stage—just like that of your business—plays a large role in determining the strategic options available to you as you transition ownership of your business and embark on your next adventure.

Understanding the relationship between your business and personal life cycle stages can help you map out answers to important questions, such as:

- Are you considering selling your business at the right time?
- Can you afford to sell and still maintain your lifestyle?
- Does the current value of your business produce replacement income consistent with your long-term personal and family financial needs?
- Are you confident your investment management skills can generate the best outcome?

GROWTH LEADS TO CHANGE

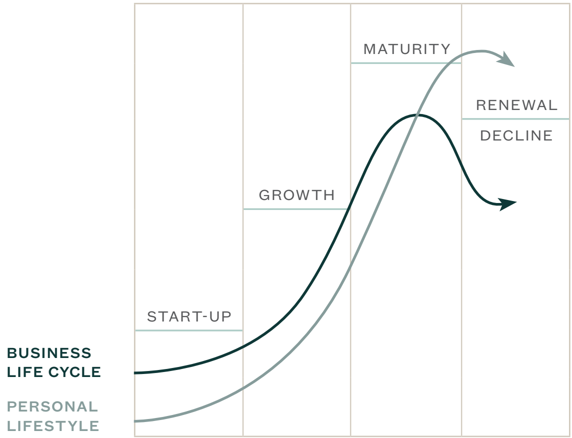
Your company’s needs fluctuate as it progresses through its business life cycle. Through start-up, growth, maturity, renewal, and decline, your business will experience different challenges and opportunities, such as:

- Maintaining its market position
- Managing cash flow
- Financing growth

Similarly, your personal lifestyle changes and needs fluctuate as your company grows. When your business first starts up, your personal lifestyle typically takes a backseat as you focus on building your company. As the business grows more successful and matures, you begin to enjoy the fruits of your labor.

At some point in the life of your business, it will be challenged to maintain or renew its competitive market position to continue being successful—or accept its decline. Consequently, you might be forced to inject more of your personal wealth back into the business at a time when your personal financial lifestyle and needs are still growing.

What’s more, if your business doesn’t renew its competitive position and maintain its value in the marketplace, the strategic exit alternatives for transferring ownership and receiving the highest value for your business, despite years of work, are much more limited.



Business and Personal Life Cycle Stages

Businesses and their owners have evolving needs. We coordinate those needs to help you grow your personal wealth at each stage of your business's life cycle.

Evaluating Your Choices

There's more than one way to approach ownership transition. How do you choose the best route for you, your business, and your family?

To understand your choices, you'll need to do the following:

- Establish your personal goals and financial requirements
- Determine the value of your business
- Develop business cash flow models
- Identify potential management successors

Generally, the goal of any seller in an ownership transition scenario is to maximize liquidity. Ideally, transferring ownership results in a win-win scenario in which the new owners have the liquidity to fund payments to you and you gain the liquidity to enjoy a comfortable retirement.

Aside from gifting, most business owners have two options when considering a sale of ownership to the next generation: selling it gradually (in small pieces) or selling it in large chunks. The former option is usually preferable, since it doesn't place a major cash-flow constraint on the business.

Building in flexibility is also necessary—many plans go awry when there's a failure at the outset to anticipate unforeseen business or personal circumstances.

That's why it's important to understand your options and select the approach that provides you and your successors with the greatest chance for financial success.

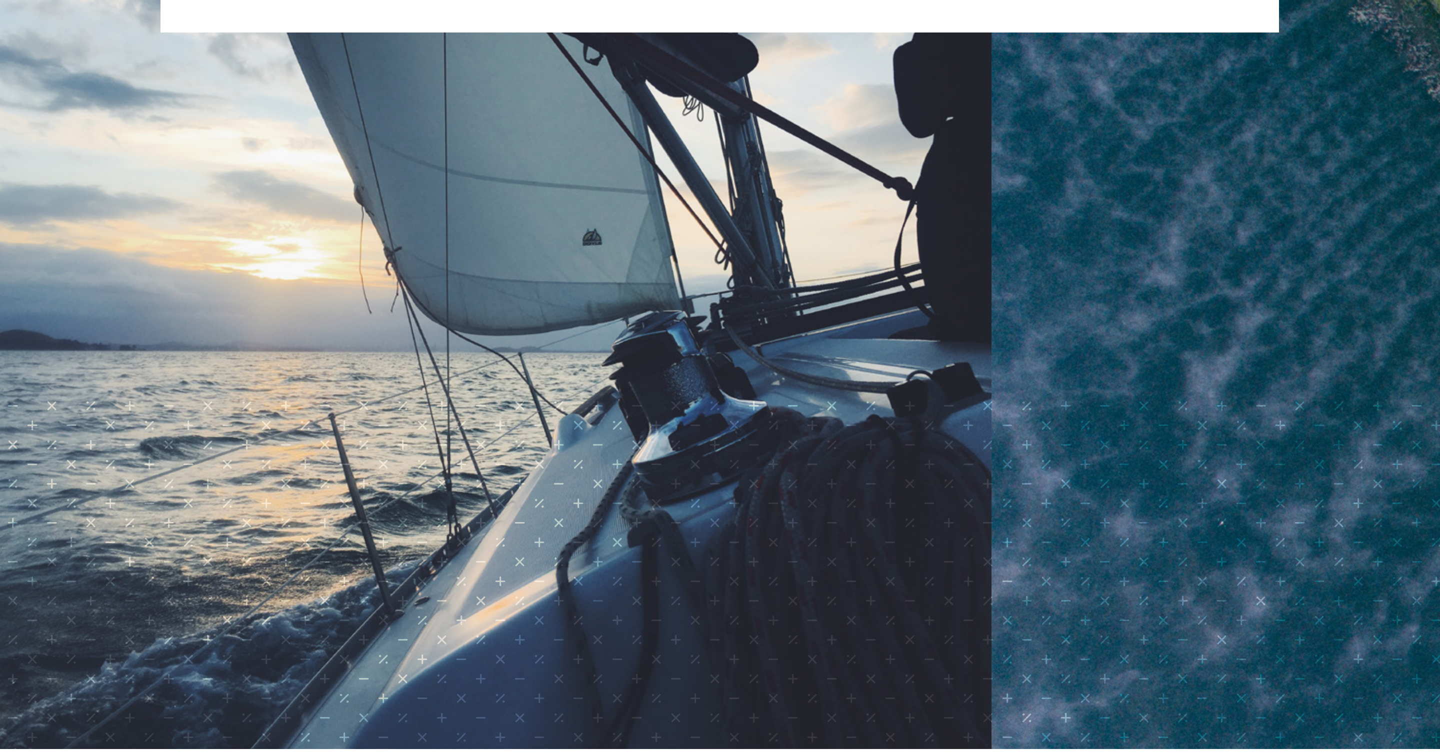
WAYS TO TRANSITION YOUR OWNERSHIP INTERESTS

OBJECTIVE LIQUIDITY

Objective	Transition	Options
OBJECTIVE LIQUIDITY	TOTAL SALE	Strategic buyer Financial buyer Competitor
	PARTIAL SALE	Minority investor purchases stock Spin-off IPO
	GRADUAL TRANSITION	Sale to insiders, family, or management
	LEVERAGED RECAPITALIZATION	Borrow to buy back stock Employee stock ownership plan
	GROW AND EXPAND	Be the buyer not the seller Grow bigger, then sell
	STATUS QUO	Wait and see Ignore change or procrastinate

Win-Win

The ultimate transition goal is a result that ensures the new owners have the liquidity to fund payments to the seller without incurring undue hardship.



Business Financial Planning

As an owner, you plan in order to meet the goals of your business, including inventory, equipment, materials, and target profit. Business financial planning for transitioning your ownership interests requires comparable diligence.

An effective business financial plan will help you build and sustain long-term business value—also known as transferable value—as well as improve profit and cash flow while providing fair compensation to the owners.

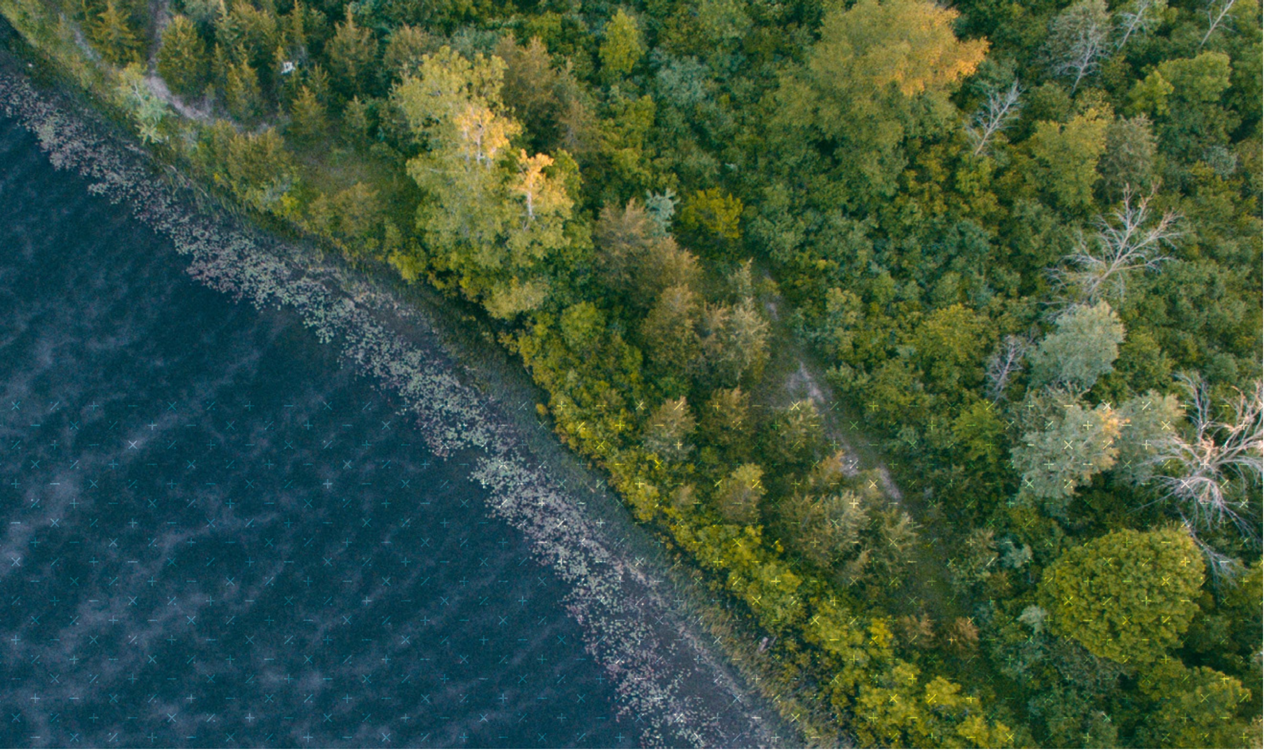
Like many owners of privately held companies, you may be a personal guarantor for your company's debt, having worked hard to cultivate close relationships with your bank and other creditors.

For the viability and future success of your company, you must transition these key business relationships to your successors. Business financial planning will also help you satisfy these key external stakeholders and set the stage for your release from personal credit guarantees.

Many lenders also look for a formal succession plan when determining the amount of credit to extend to a business.

Lender Concerns

- Whether your company can complete all pending and anticipated sales
- How it will secure future debt
- How you're developing your future management team to take over on an interim or permanent basis



Personal Financial Planning

Transitioning your business to a new owner represents a new phase of your life. The post-ownership years will bring new challenges and opportunities for you to explore.

A personal financial plan that's tailored to your unique needs is critical to ensure you're prepared for anything life throws at you.

How you structure the ownership transition of your business can have a substantial impact on your personal financial plan, both now and in the future.

Key Considerations

These questions, along with many others, should all be considered prior to settling on a final transition structure:

- How will the buyout of your ownership interests be financed?
- Is the timing of the cash payments you'll receive consistent with your future cash flow needs?
- Will your needs for life insurance change as a result of this transaction?

Management Succession Planning

Nothing is more crucial to your business's ongoing success than the quality and depth of your management team. Planning starts with written goals and a schedule for stepping away from the business. These goals become the milestones you can use to track progress and guide your decisions.

After establishing your goals, you'll need to identify successor candidates, evaluate their strengths and weaknesses, and benchmark them against an inventory of the ideal skills, talents, and abilities required for your management positions. This will clarify the action steps—such as training, mentoring, or personnel changes—you'll need to take to build the new management team.

By definition, management succession is about change. If current management isn't performing at an optimal level, this is a good opportunity to enact changes to strengthen the team's performance. Your plan should address whether your business has the right people in the right positions.

It's also important to evaluate your organizational structure and culture: Do your top managers want to be part of the future of the business? If not, how do you build a culture where key personnel want to stay? This is something that will help drive the long-term success of your business as well as the economic viability of your overall transition planning.

Managing the Tax Impact of Ownership Transition

Most business owners generally know how to manage their individual and business's annual income tax obligations. Yet few know how to integrate the best strategies for ownership transition when balancing the conflicting long-term income, gift, and estate tax ramifications.

Things also get muddled when parents try to figure out the following:

- How their personal finances will be impacted
- How children not involved in the business will be treated
- Whether the overall plan is fair to family members without unduly burdening the business's operations and future vitality

An ownership transition strategy that focuses too heavily on minimizing taxes may adversely affect family relationships. A solid, well-rounded ownership transition plan addresses each of these concerns.

Estate Planning

It's essential to integrate your estate plan with your business succession plan. After all, your largest asset is likely your business, and the wealth you generate from the transition of your ownership interests helps fund your estate.

The amount of estate tax owed and when it's due—nine months after death—are key elements in planning for liquidity. If you have a surviving spouse, estate tax might be deferred until his or her later death. Whether the tax is paid at your death or your surviving spouse's, it could be more than 50% of the net estate value. Estate planning will help you avoid a fire sale and the untimely liquidation of your business and personal assets to pay the estate taxes.

Your estate plan should be as unique as the people it aims to protect. Taxes, family issues, asset protection, and effective wealth transfer all factor heavily into estate planning decisions. You may wish to control the timing or criteria for distributions from your estate through trusts, gifting, or other tax-saving and asset-protection tools.

If you already have an estate plan, does it fit your current financial and personal situation? It may not if there have been significant changes in your finances, work, family, or relationships in the past few years. Does your estate plan leverage estate tax rates and exemptions effectively?

The planning you do now could result in greater tax savings for your heirs.

GETTING STARTED ON YOUR ESTATE PLAN

Your estate planning process should begin with gathering facts, both tangible—quantifiable business information and related legal documents—and intangible, including individual family members' distinct goals. The objective is to develop a comprehensive plan that aligns the needs of your business with those of your family.

The more thorough your planning, the more confident you can be that the details of your business operation are covered and you've done everything possible to maximize the value of your business for future generations.

The following documents are usually needed to get started. Since you're the owner, your business and personal finances are very closely intertwined. This means it's helpful to have both types of documentation handy.

Personal Documents

- ☐ Existing wills and trust agreements for both spouses
- ☐ Community property agreement, if applicable
- ☐ Insurance policies: life, disability, umbrella, and others
- ☐ Current personal financial statements or a current listing of assets and liabilities, noting form of ownership—community, separate, or joint property
- ☐ Personal financial plan, if available
- ☐ Retirement plans
- ☐ Family tree and family members' goals
- ☐ Most recent individual income tax return

Business Documents

- ☐ Buy-sell shareholders' agreement
- ☐ Business plan
- ☐ Operating budgets and forecasts
- ☐ Corporate organization chart
- ☐ Articles of incorporation
- ☐ Bylaws
- ☐ LLC operating agreements
- ☐ Employment contracts, noncompete covenants, and confidentiality agreements
- ☐ Real estate leases
- ☐ Loan agreements
- ☐ Most recent entity tax return
- ☐ Most recent financial statement
- ☐ Corporate life insurance policies

Understanding Your Strengths & Weaknesses

Succession planning requires just that—planning. However, many business owners aren't motivated to act until ownership transition is a clear, present, and pressing need. By then, it's often too late to make substantial changes.

Focusing on five fundamental areas—business financial planning, personal financial planning, management succession, estate planning, and ownership transition—early on and understanding your strengths and weaknesses in each, can increase the likelihood of a successful management and ownership transition.

For each area, it's important to evaluate your current plans and ascertain whether they're sufficient for you to continue as is, whether additional long-term assistance would be beneficial, or if you need to take immediate action.

SUCCESSION PLANNING FUNDAMENTALS

Business Financial Planning

Which areas do you need to focus on to make sure your business can maintain its competitiveness beyond the ownership transition process?

- Achieving a healthy balance sheet
- Providing fair compensation and returns to owners
- Maximizing profits and cash flow
- Securing greater transferable value
- Satisfying external stakeholders

Personal Financial Planning

Which areas do you need to focus on to save and invest for the long term while also protecting assets, lowering taxes, and managing your cash flow?

- Achieving financial independence
- Meeting your liquidity needs (cash flow management)
- Minimizing taxes
- Managing risk and asset allocation
- Planning for your retirement

Management Succession

Are you adequately training and developing the next generation of leaders for the business? Are you building the right corporate culture?

- Retaining key employees
- Managing through crisis
- Managing through ownership transition
- Revitalizing the business
- Rewarding employees

Estate Planning

Are you fairly balancing the needs of your family with the needs of your business? Does your estate plan make sense to you and your spouse?

- Meeting your liquidity needs (estate tax management)
- Dealing with unique family issues
- Controlling the transfer of your wealth and asset protection
- Minimizing estate taxes
- Achieving fairness

Ownership Transition

Which areas do you need to focus on to transfer ownership to a new generation most effectively?

- Understanding your choices
- Integrating your business and personal goals
- Maximizing the value of your business
- Coordinating your transition with your estate plan
- Achieving cash flow and liquidity

Making the Next Move

Once you've assessed your succession planning strengths and weaknesses, it's time to determine opportunities to improve your plan. Will your current tactics in each of the five fundamental areas be effective in supporting your succession goals? If not, how should you modify your plans? And what immediate actions should you take to avoid derailing your succession plans?

Below are some sample recommendations. These may or may not apply to your current situation or your strategy. It's important to remember that your business is unique, so the succession planning advice you receive should be just as unique.

Business Financial Planning

- Develop and implement a consistent budgeting process
- Formalize and implement a strategic business plan
- Create a formal plan to maintain, develop, and transition key business relationships
- Modify your entity structure to allow for greater flexibility for future exit strategy planning
- Update your corporate documentation (minutes, bylaws, buy-sell agreement, etc.)

Personal Financial Planning

- Formalize your personal wealth plan and investment strategy in conjunction with your goals
- Prioritize your assets for use in retirement
- Ensure that your personal wealth, ownership transition, and business plans are integrated and don't conflict with one another
- Evaluate your overall life insurance portfolio, analyzing policy type, structure, amount, and alignment with business transition and estate planning objectives

Management Succession

- Formalize a contingency plan
- Prepare a detailed organization chart and integrate it with job descriptions
- Develop a formalized, proactive management development and succession plan for future managers
- As the organization develops its strategic plan for the future, make sure you address current and future management expansion needs
- Keep family members and key employees informed

Estate Planning

- Address the issues of estate tax minimization and funding
- Update your wills and keep them current
- Ensure that your assets are titled consistently with where you want them to go
- Address the lifetime cash flow needs for you and your surviving spouse
- Ascertain that appropriate documents—durable powers of attorney, living wills, etc.—are in place in the event you become incapacitated

Ownership Transition

- Establish a baseline value for the business (or businesses, if applicable)
- Create and document your ownership transition plan and share it with your family
- Create a buy-sell agreement for the company
- Evaluate transition alternatives and choose the most advantageous strategy
- Gain an understanding of the commitment levels of those who will be involved

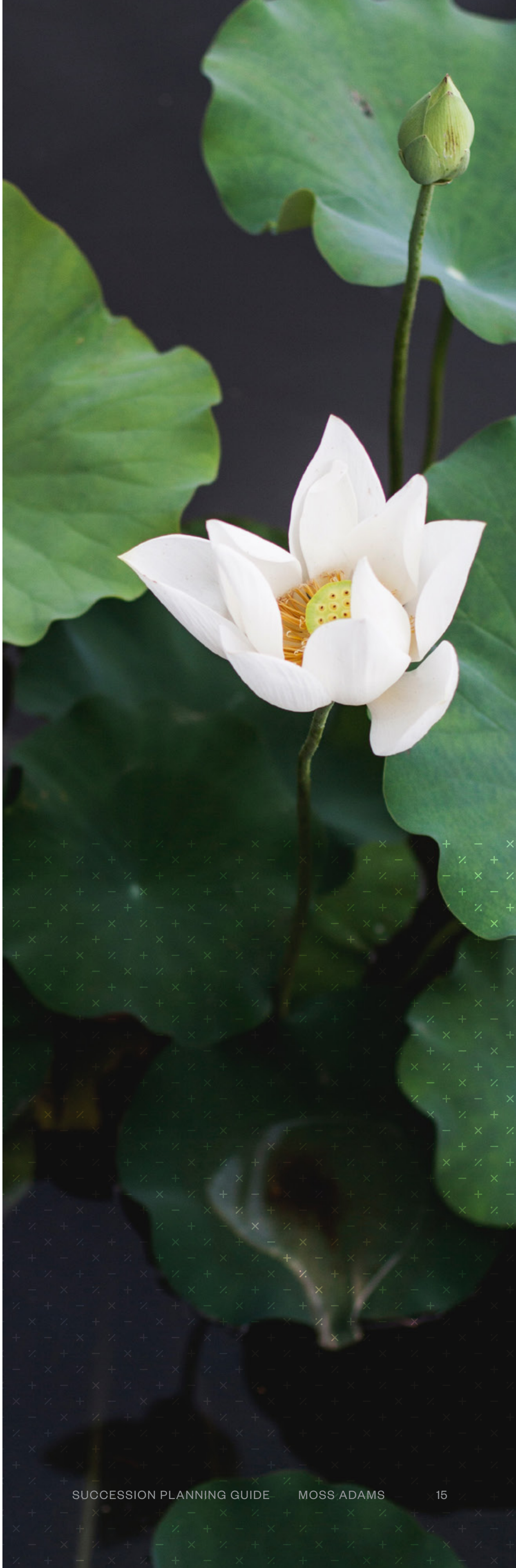
We're Here to Help

This document is intended to provide guidance as you explore succession planning options for your business. But as with most complex business undertakings, seeking outside expertise can help ease your path, strengthen your plan, and help your business remain financially healthy for generations to come.

Moss Adams has a keen understanding of the business and personal factors that influence your succession planning as well as your ability to build wealth. For decades, we've helped businesses and their owners prepare and execute succession plans. Our knowledgeable yet sensitive approach combines tax and estate planning considerations with the complexities of management succession and ownership transition. We offer guidance and perspective on succession strategies that work—and those that don't—to help increase both your personal and business wealth.

With nimble teams backed by the resources of the largest accounting and consulting firm headquartered in the western United States, we can respond quickly to your needs with valued solutions. Contact us to learn more about our process or to begin your planning.

For help developing or refining your succession planning strategy, contract your Moss Adams professional or visit **mossadams.com/succession.**



NOTES

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