SunTrust
CORPORATE | COMMERCIAL

Roadmap to a Rewarding Transition

Start early to transition with confidence

Everyone wants to sell at the top and transition, confident of having sold for the right reasons at the highest price, at the best time and to the right buyer. The results can be the perfect combination of maximum value for the business and the right package for the owner to enable whatever comes next. However, making that happen, even in a strong market, can be more challenging than it seems at face value.

For one, market forces move at their own pace, not the owner's or the business's. Most middle market owners have experienced the downturn that started in 2008 and saw that they were effectively blocked from selling by several years of low valuations. Conversely, a hot market can work to rush owners' timing, leaving them less prepared for transition In today's economy, middle market firms are performing well and are attractive targets: The National Center for Middle Market (NCMM) Quarterly Barometer reports year-over-year company performance in 1Q18 improved at the highest level since 2012. The market is awash in cash, which many companies and private equity firms are using to invest in acquisitions.

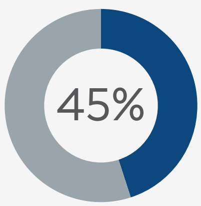
This excess cash increases the likelihood of unsolicited offers for well-performing companies. The NCMM Middle Market M&A survey found that 45 percent of all sales were opportunistic, confirming the importance of advance transition planning to ensure owners are prepared.

Inside this report

Add demographics to the market forces. Forty-five percent of middle market company owners or largest shareholders are age 65 or older*. Since the top reason for recent sales of middle market companies is to monetize the value of the business and one-half of sales are driven by owner retirement, the pressure to jump in – ready or not – is enormous.

The question for owners and shareholders is, “Do you want to leave preparation to the time when the inquiry call comes?

Be prepared for an offer



of sales are opportunistic

The lever to take control of your company sale and your personal future is transition planning. Planning allows you to take charge of the transition process and imparts confidence in the decisions you make. One hundred percent of businesses will transition, so why shouldn’t transition planning be an integral part of every company’s business plan – and every owner’s or executive’s personal plans? The question for owners and shareholders is, “Do you want to leave preparation to the time when the inquiry call comes?” It took hard work and careful, thoughtful planning to build your successful business. Transitioning the business will take just as much careful, thoughtful planning, and, the sooner that planning begins, the better the outcome for the business and the transitioning owner.

To be effective, transition planning is not a rushed affair. “The sheer fact that you engage in planning the transition process does not mean a sale or transaction is imminent. In fact, it shouldn’t be,” explains Russell Sanders, Managing Director, SunTrust Business Transition Advisory Group. “Three, four or five years before a transition is ideal to start the planning process, well before an acquirer or investor has reached out to you and your company.”

Planning early for transition will also bring significant opportunities to the owner and owner’s family that will likely be forfeited if plans are put off for later. The best results come when the owner is grounded and confident in the answers to the big questions. “The importance of stopping to ask yourself ‘What is all this for?’ ‘How do I see the business impacting my family?’ ‘How do I want this to affect my family when I am no longer running day-to-day affairs?’ ‘What will I do next?’ cannot be underestimated,” explains Mr. Sanders.

Key conversations with family, stakeholders and advisors in the early stages help ensure a well-thought-out plan and prepare participants for the inevitable changes. Well-timed planning allows for structures that use favorable valuations to reduce taxes and other costs, improving the economics of a transition. Starting sooner allows more time and flexibility for adjusting plans and structures along the way as business and circumstances evolve and people develop. Providing a framework early helps owners, family members and company employees understand and buy into the key phases of the transition:

Phase 1: Laying the foundation for transition

Phase 2: Leaving the business

Phase 3: Managing post-transition

Phase 1

Laying the foundation for transition

You can never be sure whether the market will move upward or experience a disruption. Beginning transition planning now, while the market is liquid and valuations are high, will help ensure that any transaction meets your personal and business goals. Early transition planning also provides unique opportunities for you and your family to retain more wealth after leaving the business. Five important elements of planning during your earning years will provide a roadmap for your journey through transition.

Life planning – separating from your company

Finances are one of the most important considerations in planning for life after the company. Before trying to determine how much you will need to live comfortably and support your family and future generations, you must first envision what your life will look like after you leave the business. "It is critically important to take this time, upfront, to think about your life goals, your legacy beyond your business. In other words, begin with the end in mind," says David Neubert, Managing Director, SunTrust Business Transition Advisory Group. "You do not have to have all the answers before starting to lay the foundation for transition. The process should help you articulate your vision. There are many strategies that can be deployed to protect and grow your proceeds from a sale. The best options will directly relate to your vision of your new future away from the business while still allowing flexibility to adapt to changing circumstances."

Thinking about stepping away is not always easy for owners and executives who have put their heart, soul and passions into their business. Many owners busily managing day-to-day business tasks simply don't think they have the time to engage in transition planning. Others take a wait and see approach, believing that there are too many unknowns for which to plan. For some, the thought of leaving the business triggers an emotional response that puts up barriers to the transition planning process.

Addressing three main transition topics early puts a framework around planning that is flexible enough to adjust as your needs and desires change over time.

What is your personal legacy?

In many cases, owners see little separation between themselves and their business. Transition planning asks owners to look beyond the business to determine what they want from their personal legacy. What will they be known for after they leave the business? There are many answers including philanthropic works, educational foundations, entrepreneurial endeavors, giving back to the community, etc. Personal legacy goals will inform wealth management tactics, e.g., foundations or trusts could be formed to support ideals and donations made or charities developed to support interests and causes. An ideal example of legacy – as well as transitioning into a second career – can be found in the creation of the Bill and Melinda Gates Foundation, born from the Gates' desire to promote equality and empowerment and supported by the earnings divested from his Microsoft holdings.

Think about what you want to do in the long-term

Many business owners can't picture a life without work. The entrepreneurial spirit is in their DNA, making it hard to think about leaving the business. Two-thirds of middle market business owners surveyed by Barlow Research Associates say they plan to work on a part-time basis after retirement*. Exercising their influence in the business world may mean staying on with the business in a reduced fashion after transition. It may mean starting a new business, creating and managing a charitable foundation or sharing their accumulated business wisdom with other entrepreneurs. The other one-third of owners plan to take a more leisurely retirement with traveling, recreational sports or volunteering.

Where do your plans fall? Knowing how you want to spend your time after you leave your business will provide direction for the wealth management and resources necessary to reach your personal goals.

Tackle difficult, emotional aspects of transition up-front

For goal-oriented business owners, it can be much easier to think about long-term financial strategies than to focus on the non-financial attributes of transition. The transition planning process looks at the intersection of financial and non-financial aspects to help move owners into the proper mindset for structuring their ultimate departure.

Most frequent issues owners struggle with today are:

- When should I/how can I let go of the business?
- How will my family adapt?
- What level of funds do I need to live-out my retirement comfortably?
- How much wealth goes to the family?
- How much of the sale proceeds are passed to employees?
- What percent of wealth goes to charity/ community?

These considerations affect the approach to transition, help to maintain the positive mindset necessary during transition and influence the structures put in place to conserve and manage your wealth on a long-term basis. Beginning transition planning sooner rather than later not only helps develop long-term personal goals, but it also allows you to create financial structures that deliver tax-efficient wealth transfers and keep your wealth deployed.

Positioning your business

Business and personal planning work in tandem when looking at the long game. Positioning your business for a transition usually means continuing to maximize the value of the business, while ensuring that operations are efficient and financial reporting is in order. Transition planning simply adds to the plan by incorporating your vision for the legacy of the business as well as your on-going role and identity with the business.

"In our experience, we see a lot of business owners who are more reactive than proactive in the sales process. Handling planning early, well before engaging in the full-blown sales or transition process, is a best practice that pays off handsomely in terms of wealth management for owners and their families."

David Neubert, Managing Director, SunTrust Business Transition Advisory Group

Maximize value – Business value is the single most important metric when using the business to fund retirement. Selling and/or transitioning will require a transaction based directly or indirectly on your business's value. While business growth plans typically focus on increases in revenue and profit, valuation relies on current and projected economic performance and capital utilization. Focusing on value early with a continued concentration on building value through growing market share, profits and capital efficiency, will serve business owners well when it comes time to secure their future retirement/ transition funding.

Prepare early – The key to a successful transition is to begin planning far in advance of the actual transaction. Many of the necessary steps are ongoing practices for many businesses. Knowing the type of information needed to sell or hand off your business and keeping that information available and up-to-date, will keep you prepared for a smooth transition.

Key steps include:

- Financial overview – keep your books in order. Prepare documents outlining the financials of your business. Reports such as accounting policies, summary overview, 12-month budgets, projected performance and balance sheets will all be valuable tools for possible investors or purchasers of the business. Consider a Qualities of Earnings evaluation to substantiate sustainability of earnings.
- Internal due diligence – update and document operating processes. Every business should have a basic overview, financial summary, regulatory compliance and detailed financial projection models that help guide management oversight of the business. These documents also inform acquirers of the overall scope of the business.
- Owner buy-in – inform family and shareholders about potential plans. Even at the early "planning-only" stage, discuss the planning process and ensure buy-in from all affected management and family members.
- Build an advisory team – create a sounding board for current and long-term plans. A strong advisory team consists of your company's executive team, business advisors, CPAs, attorneys, and bankers. For transition planning, add personal investment managers and M&A advisors to round out guidance for owners' and executives' individual wealth management after the event.

Consider the legacy of the business – A business legacy isn't formed overnight. It is the culmination of years of leadership and work to move the business forward, ensuring the long-term viability of the company. A legacy reflects a leader's approach to making the business stronger and more productive. It includes wins and losses and how the company's culture handles success and failure. A legacy also goes deeper, to the core of the purpose and values of the company. What does the business stand for? How does it affect others? What will be left behind for the next generation management? Define your vision for the company's legacy, then consistently communicate those ideals to ingrain them within the company beliefs.

Evaluate how embedded you are in the business – Strong leaders are often inseparable from their business identity. Steve Jobs was Apple. Bill Gates was Microsoft. Jeff Bezos is Amazon. Business identity tied to leadership/owner identity is not a negative while you are still active with the business. What happens when you separate yourself from that business? Just as creating a legacy doesn't happen overnight, ensuring the business will remain viable and can operate successfully without the current leader takes time as well. Understand the degree to which you are intertwined with the company in the eyes of the community, customers and partners. Then, actively reduce that dependency with a strong team and effective processes to move the business forward. Creating a team earlier rather than later makes it much easier to transfer the existing leadership's reputation to new management or ownership.

> "Understand that going through a sales process is a little bit like going to a doctor and being examined. It's necessary, but sometimes it can get intrusive. Business owners are often surprised by how intrusive a sale or transition transaction can become. Preparing early and understanding the basic information needed puts owners in a better mindset to handle the transaction."

Russell Sanders, Managing Director, SunTrust Business Transition Advisory Group

Setting your retirement plan

A mix of ongoing retirement savings and proceeds from transitioning out of the business – either via sale or transition – creates the retirement funding pool for most business owners. Directing the liquid wealth generated from the transaction can often take owners out of their comfort zone. Leaders understand business finances, but complex legal and financial structures used to protect wealth are not normally in their knowledge base. "Moving from owning an operating business that the owner intimately understands to holding cash is a radical transition. This difficult adjustment is often made worse with founders who see transition as giving up control," explains Mr. Neubert. "The owner needs to understand how liquidity will be deployed to meet their goals. Furthermore, by putting financial and governance structures in place well in advance of exiting the business, the founder gains more peace of mind when it comes time to move on to the next phase of their life."

Working with your financial advisor can help you distill the complex universe of financial choices to a few critical recommended actions that will most positively impact you and your family's financial well-being. Your advisor can also help you stay up-to-date on legal, tax and market changes and economic forecasts to drive informed decisions about how to appropriately align investment strategies to goals based on your comfort level with risk and return. Thinking ahead about tax implications, charitable giving, business tax valuations and upfront estate planning provides you with more options than waiting until a transaction is at hand.

Creating a balanced portfolio using various investments types and risk levels addresses asset concentration. Some industries offer the opportunity to structure the underlying business transition itself to control concentration risk. An example can be found in the real estate development industry. Many commercial real estate firms have a portfolio of business assets, ranging from divisions that develop and construct properties to those that handle the ongoing management of owned properties (apartments, hotels, etc.) This structure provides options for the business owner contemplating transition. An owner may consider retaining the management company for ongoing cash flow post-transition. Apartment buildings might be kept for the same reason of providing steady income. On the other hand, another division like hotel management may not be aligned with the long-term goals of the business, and those properties could be sold off singularly, in a group or as a portfolio sale to liquidate cash. "A big part of the discussion that happens with our clients is around managing diversity in their portfolio after they transition out of the business," explains David Mann, Group Executive, SunTrust Regional Commercial Real Estate Banking Executive. "Commercial real estate developers and investors understand, and are comfortable with, real estate investments. They want to keep those in their portfolio. However, the most successful transitioning owners are those who structure the continuing entity to blend the ownership of real estate with market investments that yield a well-rounded portfolio."

"Owners need to keep in mind that all these estate-planning techniques are means to an end, not the end themselves," explains Mr. Sanders. "Understanding what these techniques are, how they are implemented and then managing the assets once they become liquid requires education and time. Waiting until a transaction is imminent forces owners to react quickly, virtually throwing structures into place. While some options will still exist in last-minute situations, these rushed plans will not be as thoughtful or successful as plans where the owner engaged in the process much earlier and had a chance to understand the timeframe to shift the wealth, the structures necessary and the processes needed to ensure this sort of wealth is a positive, not a negative, for the family."

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Russell Sanders, Managing Director, SunTrust Business Transition Advisory Group

Creating a succession plan

Determining your vision for the business and developing a succession plan is one of the most important steps in securing the company's long-term viability. Succession choices are often one of the hardest decisions for owners reluctant to release the reins of a company.

This is particularly true of family businesses. Families often have a limited pool of family members interested in running the business. Many business owners have used their wealth to educate their children extremely well. In turn, those children have opportunities to pursue careers, dreams and passions that don't necessarily involve returning to the family business. This narrows the successor pool and puts an enormous burden on family businesses to seek out an appropriate replacement who will maintain the business as the owner wishes.

Once you make a selection, communicate succession plans to your existing employees and management team as early as possible to help them plan for the transition. Then, begin to ease the new leadership into responsibilities to create management continuity throughout the transition. Moving through the process, owners should be prepared to manage the transition with other owners, suppliers, customers and advisors who may have questions, concerns or simply need additional time to adapt to the idea of the new management taking over.

Consider the following factors when making succession choices:

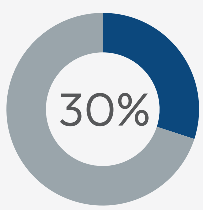
- What are the availability, skills and interests of possible employee or family successors?
- Is the successor candidate ready to step in?
- Will successors need mentors or specific industry or technical knowledge to help them prepare?
- If family members are under consideration, how well would the family work together, both those actively involved in the company and those with only an economic interest?
- Are there long-term employees who will be best-suited to run the company?
- Would an outside hire bring needed skills, perspective or energy to help the business succeed?
- Does selling the business to a third-party investor or company make more sense?

A cautionary note: Beware of slipping into old habits. Clear lines of responsibility need to be drawn when introducing new leaders. When issues arise that aren't solved as quickly or in the same fashion as in the past, employees tend to revert to old habits by seeking the advice of the founder. It is easy to be tempted to jump in and fix problems, however your "helpfulness" can create conflicts and confusion that often lead to frustrations. New leaders need the freedom to err and handle corrections in their own way. Being judged on their own results establishes their leadership while generating loyalty from those who are now their employees.

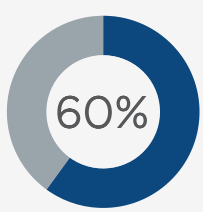
Meeting my financial goals

Upfront planning has one goal in mind: ensuring that you and your family have the appropriate amount of money to fully fund your retirement years. After laying out your legacy and ideas for the future, you will have a good understanding of exactly how much you need to fund your retirement. Previous planning discussions will also provide a loose framework around the source of the monies – how to best deploy funds from an outright or stock sale, where to best invest and manage cash taken out of the business or how to effectively manage ongoing equity payments. Mr. Neubert clarifies "Working with owners well ahead of a transaction allows us to identify strategies flexible enough to take advantage of opportunities, while giving the owner the level of control they are used to and the ownership and wealth structure so they can deal with future uncertainties."

Success rate for transferring wealth across generations is as low as



while as much as



of wealth-transfer failures are attributed to the breakdown of communication and trust within the family unit.**

Determining how to meet your financial goals also includes the important topic of wealth transfer to future generations. In this cash-rich environment, many owners have identified a level of funds needed to reach their personal goals and support future generations. Determining the right balance between sustaining wealth, ensuring it is used well, and providing for descendants who are active and productive is a topic that owners will address repeatedly throughout the planning process. Selling a business can, and often does, lead to a windfall for the owner, however the success rate for transferring wealth across generations is as low as 30 percent. Less than 3 percent of these failures are caused by poor estate planning or poor investment returns, while as much as 60 percent of wealth-transfer failures are attributed to the breakdown of communication and trust within the family unit.** Families who practice strong and open communication, have an established governance system, have properly prepared their heirs for the responsibilities of the inherited wealth and create a strategic plan for the family's wealth are in a much better position to combat the issues that can cause failures and erosion of wealth.

Phase 2

Leaving the business

The actual sale or transition of the business brings additional planning tasks as well as opportunities. From beginning to end, most transactions take between 3 and 12 months to complete, although 1 in 10 transactions take over a year to finalize. Pre-planning for your personal needs and those of your business will provide a huge advantage by moving the process along smoothly and by allowing you the flexibility to determine which investment and payout structures fit your transition plans.

Creating the best transaction framework

Your business sale journey will take a concerted effort on many parts of the organization including executive management, external advisors, employees and successors. While focusing on the business side of the transaction is the priority at this point in the process, you need to view the deal structure and its effect on your personal wealth as you leave the business.

The recent NCMM survey+ found that close to half of all sales were completed for all cash and another third using structured transactions such as earn outs. Financing for those deals was split fairly equally between private equity, cash on hand and equity financing. Each of these structures can affect your transition funding differently. Using the groundwork laid in transition planning will help inform the right direction of the deal structure, regardless of whether you are transitioning to family, employees or an outright sale. For instance, in an all-cash sale, your plans may be better served by exploring option beyond one large payment. Structuring the sale by staging the equity sale over time or spreading the proceeds to your employees may benefit your long-term goals better than simply accepting a lump sum.

Private equity (PE) transactions, 36 percent of all middle market deals[+], have unique implications for the business itself as well as for the transitioning owner. Even though PE offers may be attractive, with higher dollar values, owners need to make sure the sale is the right fit for themselves and the business by asking these questions:

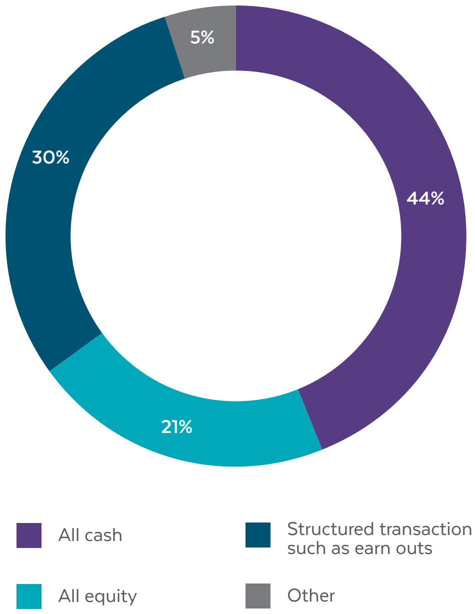
Business legacy: Does the purchasing company fit the culture of your company? How will the two integrate? Will the PE firm flip the company in 5 to 7 years (the typical timeframe for PE investment holdings)? How does this affect the longevity of the business, your employees, your legacy?

Day-to-day operations: How different is the new management's operating structure? Are they more financially/numbers-oriented, focusing on income statements and benchmarks, holding weekly management calls, actively watching margins for growth trends? Will they take the business in a different direction? Will they manage employees and teams differently?

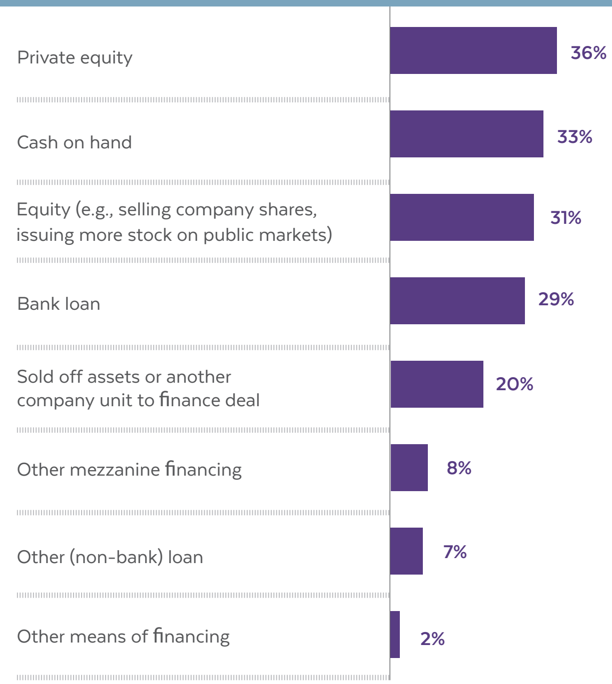
Owner life planning: Will you need to continue with the business for a period? How long? At what level of involvement? How will sharing control of the business with the new management affect you when you are still involved and working in the business?

Structure of most recent sale

Structure of sale



How transaction was financed



From a financial perspective, PE deals often offer appealing structures. Owners typically sell a majority stake in the business to the PE firm, taking an initial payout for the ownership share. Then, they hedge their bets on the remaining stock, wagering that it will increase in value as the PE firm improves the company. Understanding that PE firms typically do not hold onto equity investments for the long term, owners may anticipate a larger monetizing event, such as the outright sale of the improved business. This gives them a "second bite at the apple." When an owner strongly believes the remaining holdings in their company will increase substantially in value, it is best to incorporate the anticipated situation into planning sooner, rather than later. If the initial payout provides enough funds to meet current living needs, transferring the remaining equity into financial structures prior to the increase in value can have a very positive financial impact down the road, when it is time to take that "second bite."

Other structures include earn-outs, which defer payment to the seller based on agreed-upon future performance metrics of the business. A seller may receive as little as 50 percent or as high as 90 percent of the sales price, upfront, depending upon the perceived value of future performance. These types of deals ensure that the owner stays involved in the business after the sale, for continuity and expertise, particularly if the acquiring PE firm doesn't have expertise with the target industry.

While appealing on the surface, owners need to understand that PE investments have implications for valuation, and future transactions may end up leaving the company different than it is today. Owners, working closely with advisors, can assess a PE investment to find the right outcome for themselves, their family, the business and its employees.

Managing stakeholders, company team and family

Managing any transaction process can be a challenging task. The many due diligence chores, preparation of documents and involvement of new management, all while attending to daily operations, can prove stressful. Add in divergent stakeholder needs, and the process can seem overwhelming. Communication is the key to keeping a sale or transfer of management on track. Ensuring all parties – major shareholders, employees, management team, family members – are advised and up-to-date on the deal progress creates buy-in and acceptance. Reinforcing the reasons for the transition and the personal and business goals agreed upon in earlier planning helps keep all affected parties aligned. Rely on your advisors and peers to help you through these proceedings. The transition team you have assembled will help with all facets of the deal, including communications to all parties. Peers can lend a friendly ear and provide you with sound judgement and advice, as well as offer access to others who can share their business sale experiences.

Phase 3

Managing post-transition

The transaction has closed. Now it's time to put the techniques and strategies of your retirement planning to work for the next phase of your life.

Putting your money to work

Deploying your assets in the right mix is an on-going undertaking. No investment strategy is set in stone, and as your plans and needs change, so too will your asset mix. Working closely with your personal wealth advisor, you can manage and adjust as necessary to protect and grow your wealth. Tax and estate planning considerations may make additional trusts or foundations necessary, whereas your liquidity needs could drive more diversification into marketable securities. Frequent review of your and your family's needs and plans will help keep your funds working appropriately well into the future.

> "After a liquidity event, owners will take control of significant amounts of wealth. To some extent, managing assets after the liquidity event is like starting another business – a "second" family business – where owners can exert the same control and stewardship as they did with the original business."

Russell Sanders, Managing Director, SunTrust Business Transition Advisory Group

Meeting my life goals

After the constant flux of your working business life and the business transaction frenzy fades away, it is time to focus on the next phase of your life. Some owners find it difficult to accept life without their business, without the daily purpose or the influence they wielded. Seller remorse is all too common if you are not focused on your personal goals. This is the moment to reflect on your transition planning discussions including: why you transitioned, where your life is going, and the goals and plans you have put into place. Time is an asset," says Mr. Sanders. "When owners don't have enough time to plan, the transition can feel rushed. When discussions have taken place over the appropriate amount of time, the transitioning executive is in a much better psychological state to accept the changes taking place in their life."

Ongoing work involvement

The key to a successful transition into the next phase of life is creating the right balance between "retirement" life and work involvement. For owners who stay with the business for some designated period after the transaction, it may be easier to slide into the right balance of "retirement" life and work activities. Reduced hours on the job along with less responsibility and pressure actually help smooth the transition to their next stage of life. For those who exit the business completely and are not the "kicking coconuts" type of personality who eschew further work entirely, life after leaving your business will most likely include some sort of work – whether with a new business, a charitable pursuit or some other enterprise. The key to these new "semi"-retired executives is finding the right balance between putting in hours at their next venture and enjoying the fruits of the business they have just sold. "We see a number of cases where the head of the company has transitioned out, but still has some sort of ownership share," says David Mann, Group Executive, SunTrust Regional Commercial Real Estate Banking Executive. "They have liquified to some degree and are out traveling the world. But, they still have an office, and while they aren't there every day, they are still involved in certain decisions and fill a chair in some capacity."

Reach out to the experts

Transition will happen. How prepared you are for that transition and the liquidity that comes with it will be based on how early you begin your planning, and how closely you work with experienced advisors.

The SunTrust Business Transition Advisory Group is a dedicated source of personal and business transition knowledge and experience. Our teams can help you and your business "begin with the end in mind" to make good transition planning decisions and maximize the value of your business to fund the next chapter in your life. Talk to your SunTrust bankers to learn how SunTrust can help you and your company plan for the future. Because what you choose to do next matters.

* Barlow Research Associates "Entrepreneurship Through Business Acquisition" February 2018
** Preparing Heirs. Roy Williams and Vic Pressier, 2003. A wealth transfer failure is defined as "the involuntary removal of assets from the control of the beneficiary."
+ National Center for Middle Market M&A Survey 2018

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