SAGE HILL
Advisory & Management

Sage Hill Protocol - Business Owner Personal Strategic Planning, Succession & Exit Planning

Our Approach
Consistent with the methods we employ while assisting families, we begin the process of counseling businesses and business owners with a lot of listening, listening, listening. Most often during these conversations, we find clearly defined *business* objectives with lesser developed *personal* objectives. Many times, we find a disconnect on how the wealth created within the business will impact personal goals; and to find a plan on how to integrate wealth created within the business to meet personal objectives is rare.

It has been acknowledged by many business owners that running a business takes up a great deal of time. A common expression reflects that working *in* your business may be necessary for its success, while working *on* your business is necessary for *your* success. Stepping back and looking at your business and your life, we are able to provide the balance needed to integrate the two.

Through specialized training and collaborative efforts, we have established a six step protocol that will assist you in realizing your business and personal goals.

Step 1–Identify Objectives
Step 2–Identify Business and Personal Financial Resources
Step 3–Maximize and Protect Business Value
Step 4–Ownership Transfer to Third Parties
Step 5–Ownership Transfer to Insiders
Step 6–Business Continuity

In steps one and two of the six step process, business owners establish their objectives and determine the value of their businesses. Often business values are not sufficient to satisfy their personal financial objectives. During step three, we help clients create the additional business value and cash flow necessary to achieve your financial objectives.

To increase business value, it is important to target the same elements of a business that professional buy-out experts believe drive business value upward and for which they are willing to pay top dollar. These elements — characteristics that both reduce risk and improve return — are commonly referred to as "Value Drivers."

Value Drivers come in two varieties: generic (common to all industries) and industry specific. The generic Value Drivers are:

A stable and motivated management team.
Operating systems that improve sustainability of cash flows.
Operating profit margins, at least as good as industry average.
Proprietary technology.
A solid, diversified customer base.
Facility appearance consistent with asking price.
A realistic growth strategy.
Effective financial controls.
Good and improving cash flow.

When the first three steps are properly executed, the process of transitioning from active participation in the business and/or the sale or gifting of ownership interest will be clearly defined. In steps four and five, a game plan for the patriarch or matriarch desiring to leave the business is developed. This may be a sound succession plan for the next generation of the business leaders from within the family or within the business, or, in some cases, the business will be in a position to realize maximum value in a sale to outsiders.

Integration of Goals

As we stated previously, there is often a disconnect on how business and personal goals are interconnected. We see goals as an intertwined web that fight for your resources. Acting as a catalyst, we seek to define in clear detail the following:

Your Goals and Objectives…
For the Business
For you Personally
For your Family
For your Community

Succession Planning

Assisting you with the preparation of a successor to you as the Chief Executive Officer of your enterprise can be a challenge. We have developed a collaborative relationship that has garnered excellent results. Proper execution fulfills the expectations of the Board of Directors, incumbent officers, shareholders, employees and other stakeholders. Four steps key to effective succession planning for a CEO include the following:

First, it is necessary to specify managerial dimensions and specific areas of expertise important to the enterprise.

Second, a series of exercises, case studies pertinent to the industry and role-plays relevant to operational issues help to elicit behaviors likely to be exhibited as CEO.

Third, the assessors collaborate and develop a profile report focusing on each assessed individual from within the organization. They report on dimensions where success is likely probable, as well as where further development is needed. They document complicating circumstances where relocation, personal life or job change would be impacted.

Finally, the assessors counsel the business leadership and officers about the prospects for success on the job by the individuals assessed.

More on Value Drivers

One of the most important Value Drivers in any business is its ***management team***. This team is comprised of those people who are responsible for setting company objectives, monitoring its activities and motivating the workers. In many small companies, this "team" consists of one person, generally the owner. To build a championship caliber organization, however, the management team should include people with a variety of skills.

In addition to talent, companies need management teams with staying power. One of the first questions prospective buyers ask is: "Who runs the company and are they willing to stay?" If the answer is: "The owner is in charge, has not yet identified a successor, and wants to leave soon after closing," the value of the company plummets and most buyers look elsewhere.

In most cases, negotiation over sale price and transaction structure revolves around the buyer's perception that future cash flows will not match, much less exceed, historical results. When buyers evaluate this risk, they focus on whether or not the existing management team is able, and willing, to grow the business. The stronger the management team, the higher the price. If the buyer perceives a business to be dependent upon an owner's personal relationships and reputation alone and subsequently concludes that, in essence, the owner is the management, the buyer will not pay a premium price.

How, then, do you help keep management in place until the sale of the business? An incentive compensation system, cash- or stock-based, that rewards key employees as the company performs (usually measured by increases in pretax income). No matter the length of the "pre-sale" period, it is crucial to keep a company's key management in place before, during and after the sale of the business.

In addition to building a solid management team, owners must also build reliable ***operating systems*** that can sustain the growth of the business. The second Value Driver then is the development and documentation of business systems that generate recurring revenue from an established and growing customer base. If an owner leaves shortly after the sale of the company, what remains? If the answer is capable management and highly efficient business, then the owner will be able to leave the business *in style*.

Operating systems are important Value Drivers because buyers want assurance that the business will continue to move forward under new ownership, and that the operations will not break down if (and when) the former owner leaves. This assurance can best be obtained when there are documented systems in place that will enable the buyer to repeat the actions of the former owner to generate income and grow the business. There are several business systems that, once in place, enhance business value whether the owner plans to sell the business now or decide to keep it.

These procedures include:

Personnel recruitment, training and retention.
Human resource management (an employee manual).
New customer identification, solicitation and acquisition.
Product or service development and improvement.
Inventory and fixed asset control.
Product or service quality control.
Customer, vendor and employee communication.
Selection and maintenance of vendor relationships.
Business performance reports for management.

Obviously, appropriate systems and procedures vary depending on the nature of a business, but, at a minimum, those resources and activities necessary for the effective operation of the business should be documented.

An ***Established and Diversified Customer Base*** is another important value driver. The value of a business whose cash flow is dependent on one or two customers will be discounted. Why would a buyer spend millions of dollars on a business only to have those customers go elsewhere after they've acquired the company? At the very most, a prudent buyer will structure a buyout to protect against the loss of a key customer, probably by making much of the purchase price contingent or requiring the seller to carry a note for the bulk of the purchase price. As a seller, binding the owner's financial security (for several years) to the former company and its customer is the last scenario that the owner would prefer.

Another Value Driver, then, is the development of a customer base in which no single client accounts for more than 10 percent of total sales. A diversified customer base helps to insulate a company from the loss of any single customer.

Although matching the business's "face" to its asking price is not usually a problem for business owners, some owners can be, shall we say, "economical" when devoting financial resources to the physical appearance of their places of business, or their business equipment. This is more often true of businesses whose facilities are not visited by the general public; for example, the offices of a phone-based or off-site sales organization, or a manufacturing or warehouse-based business. However, for the same reason that a retail facility is top notch, the other "hidden" facilities must also appear first class. A good-looking facility also shows buyers that the owner is proud of the business in every respect and the owner has made the necessary investments to keep it going. It also indicates that the owner has not deferred making necessary capital investments only to create future capital investment requirements for the buyer. Finally, a clean, well-organized office communicates the message that the business is also clean and well-organized.

Buyers pay premium prices for companies having a ***realistic strategy for growth***. That strategy must be communicated to a potential buyer in such a way so that a buyer can see specific reasons why cash flow and the business itself will grow after it is acquired. The growth is illustrated in pro forma statements that will be used by buyers and investment bankers when formulating a discounted future cash flow valuation of a company. This valuation typically determines what a buyer will pay for the business.

Since future cash flow is based on estimates of future growth, having a realistic growth strategy is vital for owners to reap top dollar for their business. A solid growth strategy can be based upon:

Industry dynamics.
Increased demand for the company's products based upon population growth, etc.
New products and new product lines.
Market plans.
Growth through acquisition.
Expansion through augmenting territory, manufacturing capacity, etc.

Building and documenting a positive growth story, however, is only 90 percent of the game. The remaining 10 percent is knowing *how, when, where and to whom* to tell the company's story. The storytelling takes place during the sale process and is done with the guidance and assistance of an investment banker or other transaction intermediary.

Another key Value Driver is the existence of ***reliable financial controls*** that are used to manage the business. Financial controls are not only a critical element of business management, but also safeguard a company's assets. Most importantly, however, effective financial controls support a claim that a company is consistently profitable. In the purchase of a business, the buyer will perform some level of financial due diligence. If the buyer's auditors are not completely comfortable when reviewing the company's past financial performance, the business owner will more than likely face a no deal (or at best a reduced value for the company). The best way to document that the company has effective financial controls and that its historical financial statements are correct is through a certified audit or perhaps a verified financial statement by an established CPA firm.

Ultimately, all Value Drivers contribute to stable and predictable cash flow. It is the cash flow that determines what a buyer will offer to pay. Buyers buy cash flow— and they pay top dollar for cash flow that they expect to increase after they buy the company.

It is important, especially in the year or two preceding the sale of the business, that cash flow be substantial and on an upswing. The buyer will also look for earnings of the company to continue to increase through the sale process itself (which can take a year or more).

Whether a buyer will pay a premium price for a business depends, in large part, upon the efforts of the owner to adopt and implement the Value Drivers described above. These Value Drivers were not dreamed up by a business school professor but are what professional, sophisticated buyers tell us they seek in closely held businesses. By focusing on what your business needs to become more valuable, you will put into place the elements necessary to drive the value of your businesses upward.

SAGE HILL / *SMITH* FAMILY
2010 Strategic Planning Meeting

-Sample Agenda-

1. Introduction – Sage Hill Advisory & Management

   - Sage Hill provides strategic planning, together with tactical implementation and resultant management for a select group of affluent client families throughout The United States. As such, Sage Hill overseas, all areas of Estate Planning, Business Valuation and Monetization, achieving and maintaining Financial Independence, Financial Asset Oversight, Due Diligence, and Management…and virtually all tactical areas of legal, tax, and financial oversight required for each unique family. Sage Hill has no investment bank or insurance company affiliation.

2. Mission

   - Sage Hill's mission in support of its client families is traditionally to pursue and maintain the family's true financial independence…together with helping families develop and manage robust multi-generational family functionality, mentoring, and long-term financial support, all within a very efficient estate tax sheltered structure. Tactically, each family's asset structure, whether it is predominantly a closely held business, real estate, financial assets, or otherwise, our focus is on creating and maintaining the proper technical structure and system to support these overarching family missions.

3. Virtual Vault

4. Agenda May, 2010 Strategic Meeting

5. Action List

<u>PERSONAL</u>

6. Financial Statements/Financial Independence Analyses

7. Personal Pension Plan Proposal

8. Estate Plan – Current Legacy Flowchart/ Future Value Projection of Need

9. Estate Plan/Life Insurance – Comparative Analysis

10. Long Term Care Insurance – Current / Sage Hill

11. Liability Protection

BUSINESS

12. Business Forecasts
13. Advisory Board Memo
14. Buy-Sell Agreement Memo
15. Business Monetization Roadmap

SMITH FAMILY BUSINESS MONETIZATION ROAD MAP

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Prepared By: ***Sage Hill Advisory & Management***
18 Division Street, Suite 210A
Saratoga Springs, NY 12866
Phone: (518) 871-1214
Fax: (518)871-1028
Email: ptoffel@sagehilladvisory.com
fantalek@sagehilladvisory.com

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