Best Laid Plans

Heading for the Exits: Preparing for the Sale of a Family Business—Part One

Even the best-intentioned business owners can get sidelined by the myriad obstacles that crop up when a family-run enterprise is put on the auction block.

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The decision to sell a controlling interest in a first-generation family business is seldom reached without reservation. For many business owners, the company has come to represent the entirety of their professional legacy and has been a central aspect of their personal identities. In most cases, the impact to the family will not be strictly financial.

Both the livelihoods and career aspirations of other family members and valued associates are closely tied to the future of the business, and they can often influence the outcome. With all the uncertainties that can arise in the process, family business owners often arrive at a critical question in the late stages. Exactly what is this company worth – now and in the future?

Experts have long anticipated that the retiring Baby-Boomer generation would be a catalyst for consolidation among family-owned businesses. Uncertain capital market conditions have compelled an even greater number of business owners to consider a sale. In this environment, businesses of all sizes are finding that obtaining financing from traditional sources has become more challenging.

While banks remain cautious in their approach to business lending, private equity firms have ample capital to deploy in pursuit of long-term investment returns. However, inaccurate or outdated business valuations have the potential to derail or delay proposed transactions. Private equity firms also recognize that it will take greater post-acquisition involvement with portfolio companies to unlock the inherent value of the businesses. Given its vertical industry expertise, the sector seems up to that task.

Rothstein Kass regularly publishes research reports designed to help clients and industry observers gain insight into the trends shaping a shifting competitive landscape. Our two-part report “Heading for the Exits: Preparing for the Sale of a Family Business” examines the motivation for and challenges to the sale of a family business. Part One – “Best Laid Plans” finds that essential questions regarding business valuations are often overlooked. Engaging advisors early in discussions will allow for greater flexibility in negotiations and lead to more positive outcomes even when market conditions are not optimal.

“Heading for the Exits” draws on the experience and expertise of the Principals in the Rothstein Kass Commercial Services Group and Family Office Group. We are confident that you will find this research helpful and informative, and we encourage you to contact us to discuss our findings.

Thank you for your interest and support.

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Key Themes

- About half of family-owned businesses that are preparing to sell a majority stake expect to do so within a two-year window. The remaining half of businesses are targeting a timeframe of at least two years or longer.
- Most family business owners consider selling their business to monetize a largely illiquid asset, and many perceive it as the best solution when there are no viable family members or other internal candidates to lead the company into the future.
- Lingering uncertainty regarding prevailing economic conditions and how they will affect the financial performance of both the company and its industry sector are key concerns regarding a potential sale.
- Most owners no longer see themselves as central to the ongoing success of the company, which eases a transition to outside ownership and allows for sustainable business results.
- Getting a formal business valuation is a critical part of the sales process, but often only obtained by those companies that are actively in sales discussions. More than half of firms with a time horizon longer than two years had never been valued.

Business owners are used to the daily crises that crop up in the course of running and managing a company. That's all good practice for the new range of obstacles that emerge when owners plan to sell the product of their hard work. Numerous issues—logistical, practical, emotional and familial—surround a change in corporate ownership. In some cases, these challenges prove too complex or distasteful to overcome and eventually sour the sales proceedings. This is especially true for family-controlled entities, since negotiations often expose intensely personal concerns, long-private disputes and unforeseen alliances.

About the Research

In the first quarter of 2010 we spoke with 382 C-level executives of family-owned enterprises who were actively engaged in conversations with advisors about selling their companies. Each of the companies that participated in the survey met the following criteria:

- A majority stake is controlled by the family
- A family member fills the senior-most position at the firm (e.g., chairman, chief executive officer, president)
- The generation that established the business continues to manage the business; it has not yet passed to a second or third generation
- Immediate and extended family members are employed by the company

A Profile of Family-Owned Businesses

Slightly less than half, or 44%, of the firms surveyed said they plan to sell within the next 24 months, while the balance of companies has a slightly longer time-frame of two years or more. (Figure 1)

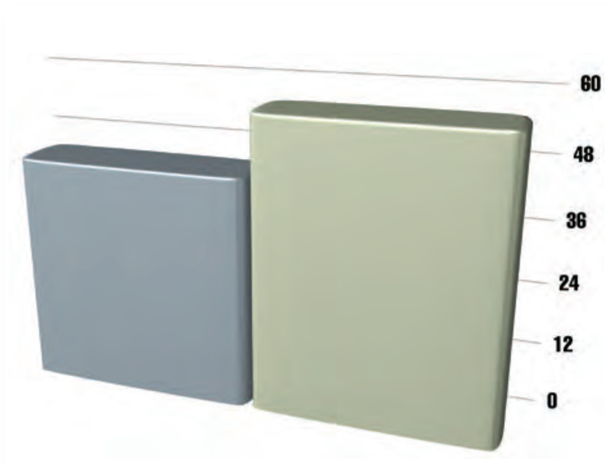


Figure 1: Planning to sell

<2 years	44.2%
2+ years	55.8%

N = 382 Family Businesses

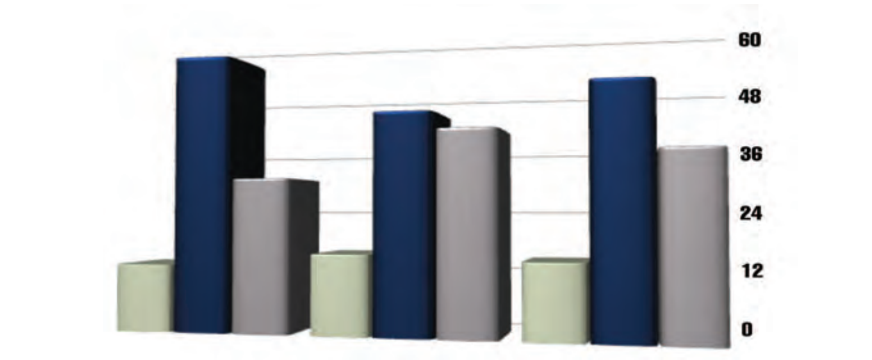


Figure 2: Sales in 2009

	<2 Years	2+ Years	Weighted Average
$10M to $30M	13.6%	16.0%	14.9%
$30M to $100M	55.6%	43.7%	49.0%
More than $100M	30.8%	40.3%	36.1%

About half of the firms reported sales between $30 million and $100 million in the 2009 calendar year. Slightly more than one-third posted sales in excess of $100 million, and the remaining 15% of companies had sales between $10 million and $30 million. (Figure 2)

“The recessionary economic conditions that might compel a business to pursue the sale of a majority stake affect both public and private entities across nearly all industries. Because such a large portion of their personal wealth, identity and legacy are tied to the success of a family business, many small-business owners were particularly exposed to frozen capital markets that have only recently begun to thaw,” said Tom Angell, Principal-in-Charge of the Commercial Services Group at Rothstein Kass. “However, liquidity is only one of the many possible motivations for a near-term sale of the family business as a generation of entrepreneurs nears retirement and ponders what lies ahead.”

Cashing Out

As any business owner can attest, nurturing a family business can easily become a full-time engagement. When the momentous decision to sell the business is made, it’s often for a myriad of reasons that have been apparent through time and experience. The most prevalent, however, is to achieve liquidity. Most business owners recognize that their hard work has created value and equity, but in the form of a relatively illiquid asset.

“For many business owners, achieving liquidity through a sale of the family business is an obvious solution to short-term challenges, but will occur in a highly competitive marketplace. With traditional lenders still restricting capital to middle-market businesses that represent potential acquirers, it is likely that family businesses will more frequently become the acquisition targets of private equity firms,” said Mr. Angell. “Recognizing that providing the required return on investment will necessitate more active involvement with portfolio companies, these firms will undertake extensive due diligence. By taking steps to understand their own competitive positioning now, family businesses greatly improve their chances for a successful transaction.”

Figure 3: Reason to sell	<2 Years	2+ Years	Weighted Average
Want the money that is tied up in the company	96.4%	96.7%	96.6%
No family member is able to take over running the company	89.9%	93.9%	92.1%
Expect to get the best price	62.7%	91.1%	78.5%
No one internal is able to take over running the company	82.2%	73.2%	77.2%
Don't want to work as hard anymore	77.5%	13.6%	41.9%
Want to do something different with his/her life	12.4%	15.5%	14.1%
Want to start a new company	5.3%	21.1%	14.1%

The decision to sell in order to monetize the business, whether in the near or intermediate term, is typically a difficult one. For many business owners, other factors come into play. The second most commonly cited reason for selling is one of succession—the current owners are ready to move on and there is no family member able or willing to assume control.

"Understanding the complexities of intra-family relationships and the challenges in managing a family business, we expected succession issues to be a factor. Surprisingly, however, more than 90% of survey respondents reported a lack of a worthy successor," said Rick Flynn, head of Rothstein Kass Family Office Group. "It's clear that family business owners need to become more effective at mentoring the next generation of leadership. Networking can play an important role in these efforts. By collaborating with other families that have confronted and overcome similar challenges, family business owners can gain a better understanding of the full range of options available in pursuing the sale of the company to outsiders or other family members."

Beyond liquidity and succession concerns, the timeframe for divestiture seems to have a more pronounced impact on reported rationale. For example, companies operating under a more compressed timeframe are more likely to recognize the need to bring in outside professionals to run the company when no internal employees have emerged as suitable candidates.

The majority of owners who plan to sell their firms within the next two years still expect to get the best possible price, but busines owners with a longer timeframe are even more confident.

"Nearly 40% of owners looking to sell within the next two years are not confident that they will get the best price, suggesting that some family business owners may be willing to sacrifice a little extra profit in favor of quicker proceedings," said Keith Bloomfield, President and CEO of Forbes Family Trust. "However, in many cases these companies might explore a short-term sale before electing to defer until market conditions are more advantageous. At the same time, the value of the business can be undermined if it is perceived that its owners are eager to sell. For some businesses, it will make sense to assemble a team of trusted advisors to propose a sale to a select group of potential acquirers."

Very few of the individuals planning to sell in the next 24 months express an interest in doing something altogether different or in starting a new business, indicating that retirement is on the minds of many. Three-quarters simply say they're ready to ratchet back the effort they put in day after day and enjoy some downtime.

The owners who are looking out several years are more likely to want to time the sale in order to maximally profit and are still interested in working hard to secure a higher valuation and achieve their personal goals. Notably, about four times as many of these business owners expect to start a new company once they are free of their current responsibilities. (Figure 3)

Figure 4: Concerns about being able to sell the company	<2 Years	2+ Years	Weighted Average
Being able to get a good price	94.1%	94.8%	94.5%
The financial performance of the company	91.7%	92.0%	91.9%
The financial performance of other companies in the same industry	89.9%	89.2%	89.5%
Causing a great deal of stress and fighting within the family	79.3%	54.5%	65.4%
The advisors knowing how to make the sale work best for you	61.5%	34.7%	46.6%
The availability of credit	68.6%	25.8%	44.8%
The need to ensure certain people have jobs after the company is sold	46.2%	33.3%	39.0%
The overall economy	18.3%	48.8%	35.3%

"Business owners planning a near-term sale seem much more inclined to enjoy a more leisurely lifestyle than those with a longer timeframe. Of those with a longer timeframe, only about 15% report that they don't want to work as hard anymore. Consequently, it is reasonable to expect that they will be more aggressive in seeking to retain minority stakes or carving out roles for themselves, family members and key non-family employees in the post-transaction entity. For business owners interested in engaging in this tactic, advanced planning will again be critical," said Mr. Bloomfield.

Outpacing the Competition

When it comes to selling the central family assets, the three greatest concerns are those that will have a direct and unassailable affect on the future comfort of the family members. They are securing a good price, continuing to deliver acceptable financial results and performing well relative to the competition. Outside of these concerns, other expressed concerns differ greatly depending on the timeframe of the business owner.

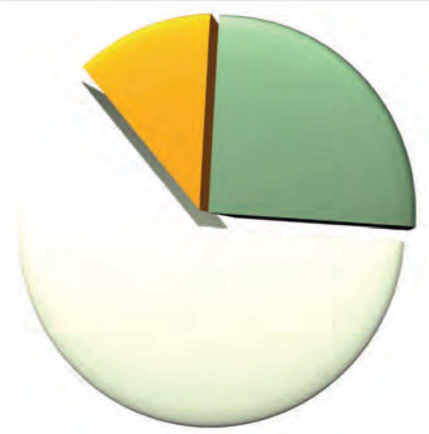
"As noted, most business owners we surveyed, regardless of their timeframe for sale, expect to get a good price. In fact, while nearly 80% of respondents agreed with this sentiment, almost all rated being able to do so as a top concern. This concern is well-founded, as experience has shown us that not everyone will. Even among specific industry segments, acquirers are likely to be able to identify several potential acquisition targets. How a family business performs in relation to its peers will be a key differentiator in due diligence processes," said Mr. Angell. "Additionally, companies looking to maximize the benefits of a transaction might consider alternative structures employing personal goodwill and other proven strategies in negotiating a sale."

Those who are planning to sell within the short-term cite squabbles among family members, the competency of their advisors, access to credit lines, and the livelihood and welfare of employees as major concerns. By contrast, far fewer owners of family-owned enterprises cite those concerns when the sale is not expected to occur for at least two years. These owners are, however, more concerned about the state of the economy, the company's ability to sustain itself and its financial results for the foreseeable future. (Figure 4)

"Immersed in the sale process, owners seeking to divest within two years are far more likely to appreciate the significant challenges that managing family, employee and advisor concerns represents. Many elect to designate an outside advisor to serve in a centralized Chief Operating Officer capacity to reconcile disparate but interrelated interests," said Mr. Flynn.

The majority of business owners, nearly two-thirds, say they are no longer critical to either the day-to-day operations of the company or the ongoing success of the firm, freeing them up to pursue other endeavors and to sell the firm without fear of failure or retribution. About one-quarter say they are somewhat critical, and just one in ten say their presence, experience and acumen are highly critical and can't be replaced now or ever. (Figure 5)

Figure 5:
How critical are you to the ongoing success of the company?



<2 Years

Very	11.9%
Somewhat	25.4%
Not at All	62.7%

2+ Years

Very	8.9%
Somewhat	33.4%
Not at All	57.7%

Weighted Average

Very	10.3%
Somewhat	29.8%
Not at All	59.9%

N = 382 Family Businesses

"The large number of family business owners who reported that they are no longer critical to the success of the enterprise caught us somewhat off guard. When contrasted against the figures regarding qualified successors, it is reasonable to conclude that they are underestimating their importance," said Mr. Angell. "Many of the individuals were the driving force behind the launch and growth of the business and can be the catalysts for a successful transition. In the interim, they remain essential to maintaining client relationships and projecting an image of stability as the company's fate is determined."

For those who expect some fall out from their departure, the plans to deal with the loss of their expertise vary depending on their timeframe. Half of those who want to sell quickly are looking for a buyer that understands the dynamic and is willing to make a concession, investment or commitment to the imbalance left without the founding partner.

Those with a longer timeframe to sell are handling it differently. Just over 40% are choosing to use the time available to conduct business as usual, preferring to deliver business results in the short-term rather than be distracted by a succession planning issue. And about one-third are actively seeking a replacement who can assume some or all of their responsibilities.

Very few of either camp were exerting any effort trying to transfer some of their responsibilities to someone inside the firm, whether they were a family member or not. (Figure 6)

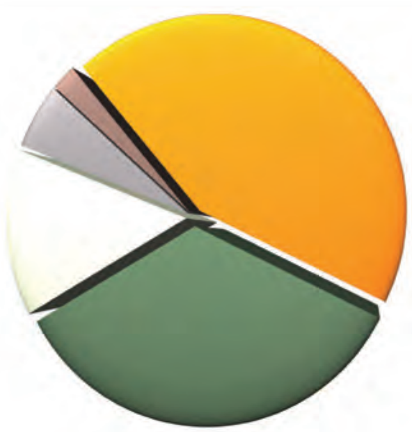


Figure 6:
If very or somewhat critical, what are you doing to change this situation?

<2 Years

Nothing; not concerned	19.0%
Looking to hire people to take over certain responsibilities	25.4%
Looking for a strategic buyer	50.8%
Working with internal people to take over more responsibilities	3.2%
Working with family members to take over certain responsibilities	1.6%

2+ Years

Nothing; not concerned	43.3%
Looking to hire people to take over certain responsibilities	34.4%
Looking for a strategic buyer	14.4%
Working with internal people to take over more responsibilities	5.6%
Working with family members to take over certain responsibilities	2.2%

Weighted Average

Nothing; not concerned	33.3%
Looking to hire people to take over certain responsibilities	30.7%
Looking for a strategic buyer	29.4%
Working with internal people to take over more responsibilities	4.6%
Working with family members to take over certain responsibilities	2.0%

The Final Countdown

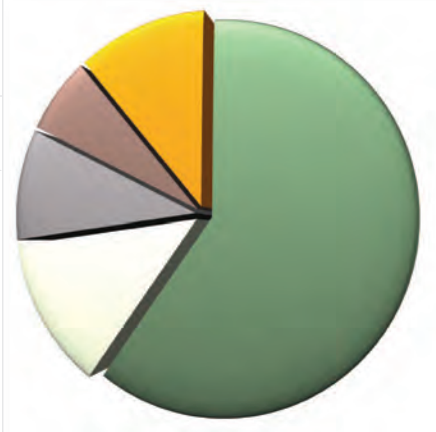
When it gets down to brass tacks, anyone selling a business wants and needs to know what their asset is worth in the current market in order to negotiate the best possible deal for themselves and their family members and begin to make plans for the next phase of their lives. A key part of this process is having the company valued by a third-party expert. As expected, the company owners who were planning to sell within a 24-month period were far more likely than their counterparts to have had at least one valuation, and most had done so within the previous three years. Notably, more than half of the firms with longer term horizons had never had their companies valued, and are operating with a vague, and possibly unfounded and inaccurate, sense of what the family's asset is worth. (Figure 7)

"As encouraging as it is that owners remain focused on the overarching objective of growing the business even as they pursue a sale, we were somewhat stunned to learn that over 70% of owners exploring a sale beyond a two-year timeframe had not had a formal valuation of the business performed within the last five years, and that more than half had not engaged in the process at all," said Mr. Angell. "Gaining a fundamental understanding of what a company is actually worth provides access to a range of advanced planning tools that help to ensure that a business owner will achieve the primary objective of obtaining the best possible price for the business."

Figure 7: Formal valuation of the company

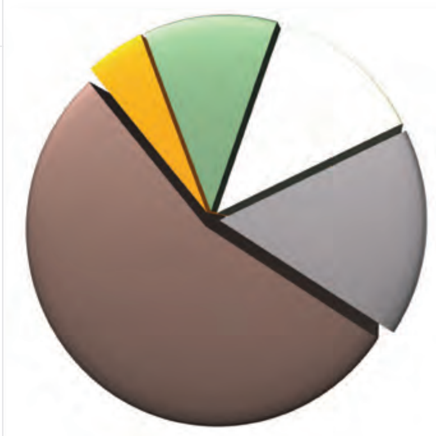
<2 Years

Less than a year ago	11.2%
One to three years ago	59.8%
Three to five years ago	13.0%
More than five years ago	9.5%
Never	6.5%



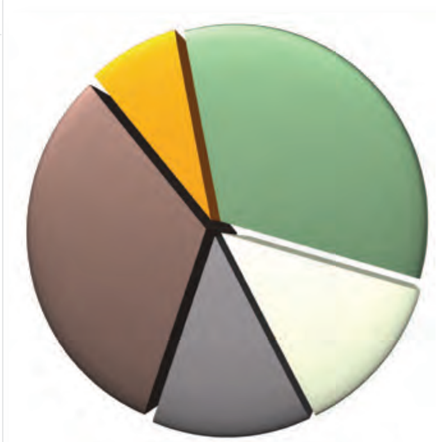
2+ Years

Less than a year ago	5.2%
One to three years ago	11.3%
Three to five years ago	12.7%
More than five years ago	16.0%
Never	54.9%



Weighted Average

Less than a year ago	7.9%
One to three years ago	32.7%
Three to five years ago	12.8%
More than five years ago	13.1%
Never	33.5%



About the Authors

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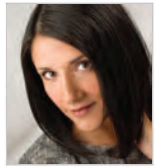

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About Rothstein Kass

A full-service certified public accounting and advisory firm, Rothstein Kass offers audit, accounting and tax services, and a full array of integrated services, such as strategic business counseling, SEC advisory services and family office services, through its Commercial Services Group. The Firm advises organizations, including public and private middle-market companies, private equity funds, investment advisors and other entities looking for financing/investment opportunities, as well as those looking to restructure as a business strategy.

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