



THE EXIT CHECKLIST

A 5-Step Personal Action Plan For a Happy
(And Lucrative) Exit From Your Business

Planning Your Successful Exit

For a successful exit, you need to be able to say a hearty “Yes!” to two important questions:

1. Is your business ready for you to exit?
2. Are you ready to exit?

Determining if your business is ready to sell can be done by completing the Value Builder Score (www.valuebuilder.com/score). Business owners who receive a score of 90+ on their company double the value and receive double the offers than the average business owner’s score. Get your score to evaluate how ready your company is for you to exit.

The content of this paper is dedicated to question #2: Are you ready to exit?

It’s an easy question to ask, but it can be difficult to answer. This is why we’ve created a five-step action plan to ensure you have a happy, lucrative exit from your business.

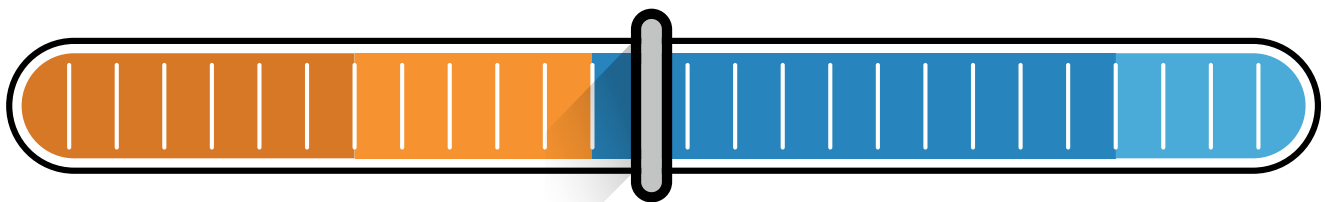
STEP 1

Get Clear on Why You're Exiting

Why do you want to exit your business?

In most cases, there are a combination of factors that are either “pushing” you away from your business or “pulling” you to something else.

Push factors are legitimate reasons to want to exit your business, while pull factors are things you want to do after you leave your business.



Typical Push Factors

- Reaching retirement age
- Feeling your business has reached its peak
- Worrying you have too much of your wealth invested in one asset
- Getting bored
- Experiencing a health issue
- Needing a break to reduce stress

Typical Pull Factors

- Travel the world •
- Get fit and healthy •
- Set up a charitable foundation •
- Start a new business •
- Spend more time with family and friends •

The happiest departures happen when there are just as many compelling pull factors as there are push factors.

TAKE ACTION

Find five minutes and write out a list of all the factors that make you want to exit your business (push factors). Then make a list of all the things you're excited to do after you leave your company (pull factors).

STEP 2

Align Your Exit Type with the Reason You're Leaving

Often, when we think about exiting a company, we conjure the image of a spectacular business sale where a strategic buyer swoops in, pays an enormous price, and the business owner rides off into the sunset.

The reality is that there are several different ways to exit the day-to-day operations of your business, and the smartest founders align their exit type with their reason for leaving. These are the most common exit types:

01

SELL OUTRIGHT



This is the closest exit to the stereotypical sale where you sell 100% of your business to a third-party buyer and walk away.

Best fit: You want completely out of your business and you have an attractive company to sell that is not dependent on you to run it.

02

RE-CAPITALIZATION



Under this scenario, you sell a portion of your equity, which allows you to take some of your “chips off the table” while you continue to maintain a portion of your equity in your company.

In a “minority re-cap,” you sell less than 50% of your business, and in a “majority re-cap,” you sell more than 50%. In both cases, the buyer is usually a private equity group, and very often you will be expected to stay on and continue running your business after the re-capitalization.

Best fit: You want to diversify your wealth and are still passionate about growing your business for years into the future.

03

LIQUIDATION



This is a “fire sale” where there is assumed to be little “goodwill” in your business and you simply sell its hard assets. Goodwill is defined by accountants as the difference between the market value of your business and the value of its hard assets.

Best fit: Your company is distressed and unprofitable, or you have an irresistible opportunity pulling you towards something better.

04

COO/CEO



Another option for exiting the day-to-day operations of your business is to hire a President & Chief Operating Officer (COO) to take over running your business day to day. With a COO in place, you continue to be responsible for major strategic decisions and would likely continue to work in your business and draw a salary.

Under this scenario, you would maintain most of your equity in the company but may choose to provide some sort of long-term incentive (e.g. shares or options) to your COO.

Best fit: You want to minimize the inevitable headaches of running your business, but you want to continue to handle strategic projects and don't mind retaining the majority interest in your business.

05

CHAIRPERSON



Like the COO/CEO exit type above, as a Chairperson, you would relinquish the day-to-day operations to another leader who you appoint as Chief Executive Officer (CEO).

In this scenario, it is unlikely that you would draw a salary or have any day-to-day responsibilities in your company, but you would likely retain all (or most) of your equity in the business and, as a shareholder, may continue to be able to draw dividends from time to time.

Best fit: You want to relinquish all day-to-day responsibilities in your company, don't need to draw a regular salary, and don't mind retaining your equity position.

06

TRANSFER
TO FAMILY

In this scenario, you could undertake a family transition where a family member(s) gradually take over running your business. Usually executed over many years, in most cases your shares would be purchased using the cash flow from your business.

Best fit: You own a profitable business, one or more family members are keen and qualified to run it, and you are prepared to manage through a lengthy transition period.

07

MANAGEMENT
BUY-OUT














Your manager or managers could choose to buy you out. Given their knowledge of your business, managers can often access bank financing or private equity to raise the money to acquire your business.

Best fit: Your senior management team is willing to take on the debt required to buy your business, and the company is stable and has the predictable profits required to qualify for bank debt.

Put a check mark beside the option or options below that best align with your reason for exiting (check all that apply).

Review the type of exit(s) you should consider.

TAKE ACTION

REASONS TO EXIT	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	RETIRE	MARKET HAS PEAKED	RISK AVERSION
	 SELL OUTRIGHT  TRANSFER TO FAMILY	 SELL OUTRIGHT	 RE-CAPITALIZATION
REASONS TO EXIT	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	BORED	SOMETHING ELSE YOU WANT TO DO	HEALTH
	 LIQUIDATION	 COO/CEO  CHAIRPERSON  SELL OUTRIGHT  LIQUIDATION	 LIQUIDATION  SELL OUTRIGHT  TRANSFER TO FAMILY  MANAGEMENT BUY-OUT

STEP 3

Figure Out Your Number

The ultimate judge of your company's value is the market itself. No matter how much you want for your company - or what you think you need - if the market says the business is not worth that, then you're out of luck.

In addition to getting a business valuation to understand what your company might be worth to a third party, there is another calculation you should make, which is to understand what your business is worth to you.

When the market valuation and your personal valuation coincide, it may be time to consider an exit.

To answer the question "What is your business worth to you?" it helps to be clear on your motivation for selling. What follows are a few examples, including retiring, being risk averse, and boredom.



RETIREMENT

If your goal in exiting your business is to retire, you'll want to ensure you will have enough investable assets to create the income stream you need to fund your retirement.

The first step is to calculate your retirement income needs. Consider the lifestyle you imagine and come up with a number. Let's imagine, for the sake of this paper, that you decide you need **\$100,000 per year once you retire.**

Most financial advisors agree that you can safely withdraw **3% to 4%** of your portfolio per year, so to make this calculation easy, you can simply take your retirement income needs and multiply them by 25 to calculate the nest egg you'll need (multiply by 30 if you want to be extra conservative). In our example, **$\$100,000 \times 25 = \$2,500,000$.**

If you have built up investments outside of your company, you can deduct those assets from your overall goal to determine what you need to get from the sale of your business. The safest way to do this math is to assume your principle residence is not an investable asset. For our hypothetical example, let's imagine you've built up **\$700,000** of investment capital outside of your business. Therefore, you'll need to net at least **\$1,800,000 (\$2,500,000 minus \$700,000)** from the sale of your company to fund your lifestyle needs in retirement.

We're not quite done yet. Next you'll need to consider the "frictional" costs of selling your business and add those to your number. Let's imagine you sell your business for **\$2,500,000**. You'll likely have to pay an intermediary to help you sell it. Intermediaries usually charge a percentage of the sale price of your company. For a small business, they will typically charge 10% on the first million dollars of value, **8%** on the second million, 6% on the third and so on. Larger businesses over \$10 million in value can expect to pay an M&A professional 3% to 5% of the sale price.

Therefore, an owner selling their business for **\$2,500,000** might expect to pay a **\$210,000** commission to an intermediary. Beyond that, you should budget between **2% and 4%** of the sale price for legal fees and then consider if there are any employees you want to reward. Finally, you'll need to consider the biggest frictional cost of all: tax. The tax you pay on the sale of your business will be dependent on your tax jurisdiction, so talk to an accountant well in advance of selling to explore ways to minimize your tax bill. For the sake of the example below, we've assumed a capital gains tax of **20%**.



Example of Frictional Costs in a 20% Capital Gains Jurisdiction:

Example of Frictional Costs in a 20% Capital Gains Jurisdiction:

Sale Price: \$2,500,000

Intermediary Fee: -\$210,000

Legal: -\$50,000

Employee "Thank You's": -\$250,000

Total Frictional Costs Before Tax: \$510,000

Subtotal After Friction Expenses Are Deducted: \$1,990,000

20% Tax on \$1,990,000: -\$398,000

Net Sale Proceeds After Tax: \$1,592,000

You'll also want to consider the currency you'll be paid in. Most owners assume (and want) cash when they sell their business, but some acquirers may want to pay some or all of your consideration using their company stock as the currency.

If retirement is your goal, ensure the cash proceeds of a sale will meet your minimum number.



RISK AVERSION

If your goal is to diversify your portfolio, calculating your number works a little differently. Start by analyzing what percentage of your net worth you're comfortable holding in your company's stock.

Next, you'll need to get an estimate of the market value of your business by getting a valuation done (talk to your Certified Value Builder™ or visit ValueBuilder.com/score and complete the Value Builder questionnaire to get started).

Once you know approximately what your company is worth and what percentage of your portfolio you're willing to dedicate to your company's stock, you can back into how much of your business you should sell in a re-capitalization.

Let's imagine you have a net worth of **\$5,000,000** and your company's value is **\$2,500,000**. That means **50%** of your net worth is tied up in your company's stock. Perhaps you would be more comfortable if only **30%** of your net worth was in your company's stock. **Thirty percent of \$5,000,000 is \$1,500,000**, so ideally you would hold \$1,500,000 of your portfolio in your company's stock.

Next you'll need to figure out what percentage of your company is worth **\$1,500,000**. \$1.5 million dollars is **60% of \$2,500,000**, which means you could sell **40% (100% to 60%)** in a minority re-capitalization to re-balance your net worth so that your company's stock represents no more than **30%** of your portfolio.



Example of a Re-capitalization from 50% to 30% of Net Worth

Example of a Re-capitalization from 50% to 30% of Net Worth

Net Worth: \$5,000,000
Business Value: \$2,500,000
Current Percentage of Portfolio: 50%
30% of \$5,000,000: \$1,500,000
\$1,500,000 as a percentage of \$2,500,000: 60%
Sell 40% at a valuation of \$2,500,000
After sale cash proceeds
(before tax and frictional costs): \$1,000,000

To simplify the calculation, we've assumed no tax or frictional costs in the example above, but like the previous example, you should estimate your frictional costs in selling as part of making this calculation.



BOREDOM

Some owners decide to exit because they are bored with their business and want to move on to another project that is exciting them. In this scenario, you may want to sell your business quickly and would be willing to take a discount.

To figure out your minimum number, you can simply estimate what you want to be paid for the time you've invested in your business to date.

Calculate how many years you've been running your business. Next, estimate your market-rate salary. In other words, what you would likely be paid if you went out in the market to find a job commensurate with your skills and experience.

Now, consider what you have paid yourself annually (on average) including salary and perks since you started your business. Most founders in early-stage companies realize they have paid themselves less than what they would have made had they gotten a job elsewhere. The difference between your market salary and what you have paid yourself is your investment. Multiply your investment each year by the number of years you have been working in your company and you have an estimate of the value of your time invested. Add to that number any personal funds you have invested in your company and you arrive at your total investment in your company.

Most owners looking to make a quick exit out of boredom or the desire to go do something else will be happy to make sure they receive enough cash compensation for their business to cover what they have invested to date.



Example of Replacing What You Have Invested

Example of Replacing What You Have Invested

Number of Years Since Starting Your Business: 7

Your Market-Rate Compensation: \$200,000

Your Annual Benefits and Perks: -\$120,000

The Value of the Time You Have Invested Annually: \$80,000

Value of Time Invested Since Starting ($\$80,000 \times 7$): \$560,000

Your Capital Invested: \$320,000

Total Invested to Date: \$880,000

TAKE ACTION

Decide what your primary motivation is in selling and estimate your number using the corresponding technique. If you're not sure or have a variety of reasons for selling, use the retirement calculation.

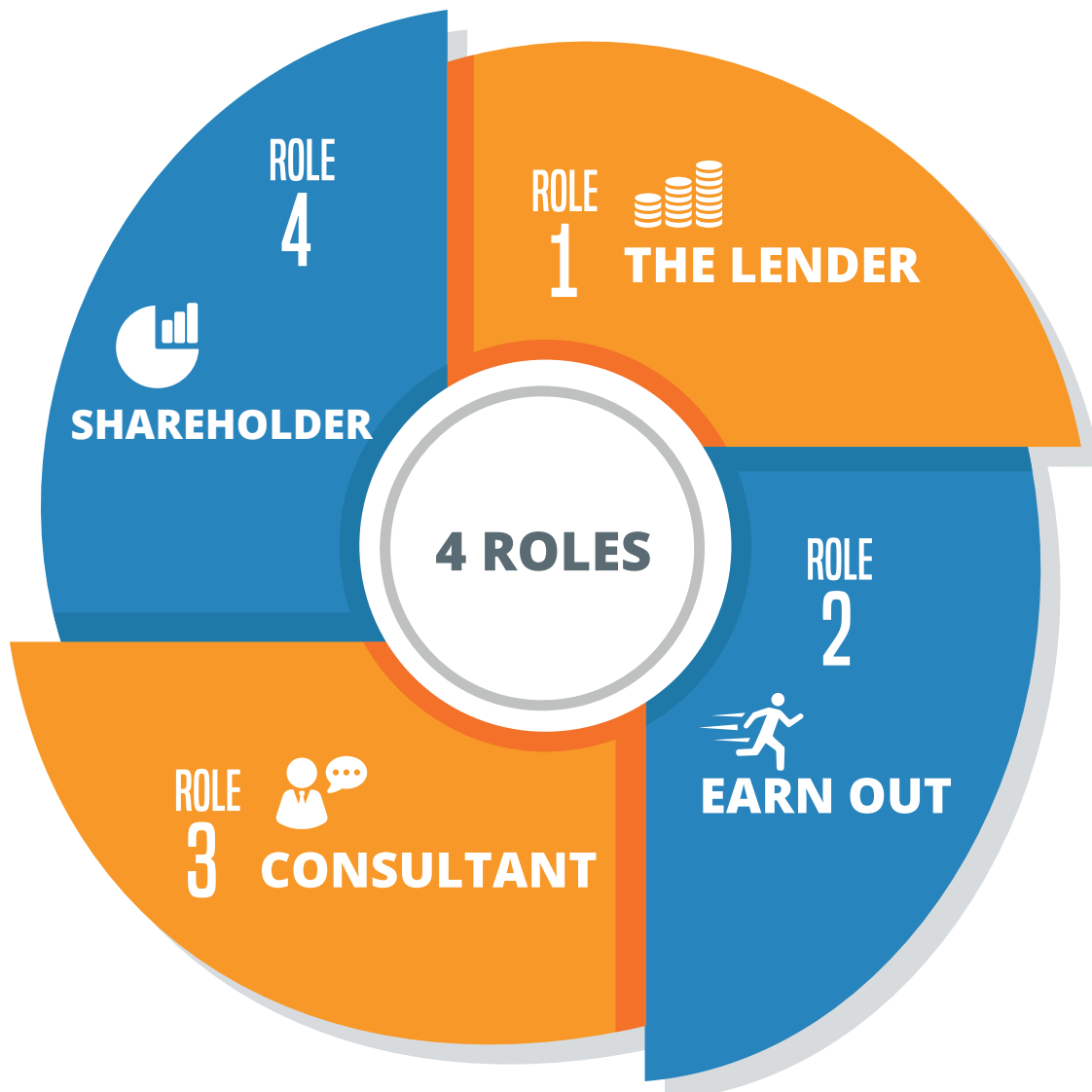
STEP 4

Decide What Role You Want to Play in Your Company in the Future

For most owners considering exiting their business, they imagine an all-cash offer and leaving their company shortly after depositing the check. However, most exits are more gradual and rely on the owner's continued involvement after the sale.

It's important to get clear on the maximum amount of both time and money you're willing to commit after a transaction. As a general rule, you stand to earn more money from the sale of your business the more willing you are to participate in a transition period, so the hypothetical examples below all assume you need to make a trade-off: accept \$5,000,000 in cash for your business and walk away, or stand to gain a larger payment for some continued involvement.

There are several roles you may be asked to play post exit. Here are some of the most common and their potential payback:





The Lender (i.e. Vendor Take Back)

When selling a smaller business, it's common that the buyer would ask you to finance a portion of the sale. This means instead of accepting cash for a portion of your proceeds, you would take part of your money in payments the acquirer makes to you in the future.

You may be offered interest (called a "coupon") on the amount you lend the owner. This loan is often guaranteed by your business, so in the event the new owner defaults on your loan, your recourse would be to get your business back.

Most owners have no interest in taking their business back after they've sold it, which causes exiting owners to be motivated to want the new owner to succeed. This means the former owner often plays the role of informal or unpaid consultant, helping the new owner become successful to ensure the security of their future stream of payments.

Assuming you trust the buyer, you may be very happy to finance them, especially if they are willing to offer an attractive interest rate. However, it's common for buyers to ask sellers to finance a large portion of a sale, so it's important to get clear before you start a negotiation to what extent you're willing to play the role of active lender post exit.

Example of a 20% Vendor Take Back with an 8%/yr Coupon over 5 Years :

Sale Price:	\$5,000,000
Cash at Closing:	-\$4,000,000
Portion Financed over 5 Years at 8%:	<u>\$1,000,000</u>
Total Proceeds After 5 Years:	\$5,212,840



Earn Out (i.e. Division President)

Another role you may be asked to play is that of a senior leader within your acquirer's company. In this position, you will be tasked with achieving a set of goals in the future in return for additional consideration for your business. This is called an "earn out," and acquirers use this tactic when they are buying a company that is dependent on its owner or they need to bridge the gap between what they are willing to pay for a business and what an owner wants.

Earn outs are especially common in service businesses, and their term typically ranges between 1 and 7 years (the average is 3 years). Your earn out goals will likely be tied to hitting a revenue or profit target in the future, the retention of a specific customer, or any other objective you agree to with your buyer.

Sometimes, earn outs work spectacularly well for both buyer and seller. However, there are many more examples where the owner leaves without ever realizing their earn out. One of the risks to consider with an earn out is that you will be operating as an employee within your acquirer's company. Although your lawyer will try to ensure you have the operational freedom to reach your earn out goals, many new restrictions put in place by the buyer may handcuff your ability to reach your goals.

In the examples below, an acquirer offers to pay "up to" \$9 million with a combination of cash and earn out. The upfront cash payment (known as the "down stroke" in M&A parlance) is \$3,000,000, and the seller has the potential to earn an additional \$6,000,000 if they achieve their goals over a three-year earn out:

Successful earn out -
Down stroke: \$3,000,000
Earn out payment: \$6,000,000
Total consideration paid: \$9,000,000

The scenario below contemplates an owner agreeing to the same earn out but who does not achieve their goals or leaves the acquiring company before their three-year term:

Unsuccessful earn out -
Down stroke: \$3,000,000
Earn out payment: \$0
Total consideration paid: \$3,000,000



Consultant

Another common role you may be asked to play is that of consultant to the acquirer of your business. This is usually a short-term arrangement where you agree to help the new owner in return for a pre-arranged consulting fee.

The consultant option is often used when an acquirer would like to quickly integrate your business and only sees a short-term need for your help.

Let's imagine a scenario where you're offered a cash payment with a consulting contract that guarantees you \$500,000 over time:

Consulting Contract:
Upfront Payment: \$4,800,000
Consulting Contract: \$500,000
Total Consideration: \$5,300,000



Shareholder (Re-capitalization)

Another role you could be asked to play is that of shareholder. In a re-capitalization of your business, you sell some of your shares but are usually asked to continue to hold a significant portion of equity in your business after the investor injects money into it.

Re-capitalizations are typically offered by private equity groups who want to invest in your business, make it more valuable over time, and then sell their position in your company at a much higher valuation at some point in the future. Private equity companies do not usually have operational leaders on staff, so you may be needed to continue operating your business as both CEO and significant shareholder.

When it works, you can end up earning much more from the sale of your business because you sell the second part of your equity for a higher valuation. This is referred to by private equity groups as “getting a second bite of the apple.”

However, similar to an earn out, in a re-capitalization where you sell only part of your equity, you continue to risk some of your wealth in your business because it's possible your equity will become worthless if your company fails after a re-capitalization.

In the hypothetical scenario below, the owner is offered \$3 million in cash for 60% of their business, with a real chance at another \$7 million within 3 to 7 years:

Example of successful re-capitalization:
Sell 60% of your shares: \$3,000,000
Sell remaining 40% 7 years later: \$7,000,000
Total consideration paid: \$10,000,000

6 Things Every Seller Must Negotiate

As an entrepreneur, it may have been a while since you negotiated your last employment agreement. Here are 6 things every employee (i.e. you) should negotiate in their employment contract:

1. Job description including scope of decision-making authority and budget
2. Salary, short-term bonus, benefits
3. Long-term incentives (e.g. stock options, etc.)
4. Severance terms
5. Vacation amount
6. What happens if your acquirer gets acquired themselves

TAKE ACTION

Based on the reasons for exiting you identified in Step 2 and your financial goals from Step 3, identify the kind of role you'd like to (or will need to) play within your company to successfully exit.

STEP 5

Pick Your Spot on the Exit Matrix

Your final step to a happy and lucrative business exit is to pick your spot on the Exit Matrix, which corresponds with two factors:

1. How important is it that you maximize the cash proceeds of a sale?
2. How long are you willing to stay on post sale?



At one extreme, you may have built up enough investable assets outside of your business to be financially secure, and you are willing to continue to be a shareholder in your company for the long run. If this is you, then hiring a CEO and relinquishing your day-to-day responsibilities may be your best exit option.

At the other end of the spectrum, you may have another business you want to start immediately and therefore want to maximize your cash proceeds and minimize your time in your company post sale. In this scenario, you would look to sell your business outright to a strategic buyer.

No one point on the Exit Matrix is better or worse than the other. The key to a happy and lucrative exit is to get clear on your priorities before you start the exit process.

TAKE ACTION

Find your spot on the Exit Matrix and start planning your exit.