



Exit and Succession Planning Guide



NORTH DAKOTA
**SMALL BUSINESS
DEVELOPMENT CENTERS**

Your Ideas - Our Expertise - Your Success

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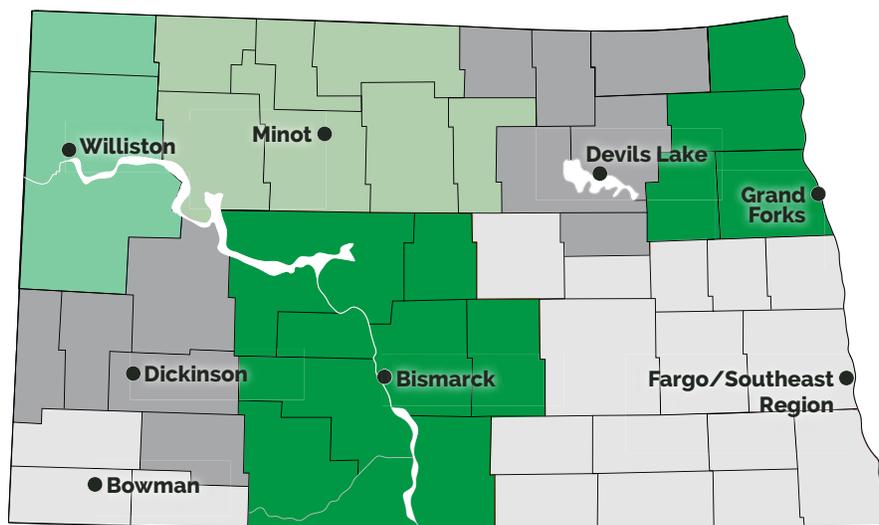
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ABOUT THE ND SBDC

The ND SBDC network of credentialed business advisors empower North Dakota small businesses and entrepreneurs to thrive. We accelerate business growth in communities across North Dakota by providing customized guidance and resources that help owners and entrepreneurs achieve their goals at every stage of their business life cycle. For over 35 years, our network has supported small business owners and entrepreneurs across the state. **When small businesses thrive, communities thrive, North Dakota thrives.**



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This guide was developed by the ND SBDC with the goal of helping North Dakota's business owners plan for a future, successful exit from business. This handbook is not meant to be used by itself, but as a supplementary tool to a business owner's business advising sessions.

Transferring ownership can be viewed by some as a highly emotional process, and the decision to sell at the right time is often ignored until the issue is forced upon the owner (failing health, divorce, disability, etc.) and usually at a fraction of the former valuation.

A business owner can transition out in several ways. Each has implications, not only for you as the owner, but for the business and the business advisor. An Exit or Succession plan will help you consider a variety of different options before you make the final decision.

By the end of this guide, a business owner should understand the importance of exit planning and succession planning and have a clear idea of what tools, information, and resources are needed to plan for their future exit from business.



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INTRODUCTION TO SUCCESSION PLANNING

Why Business Owners Should Prepare an Exit Plan

No matter how much you enjoy working in your business, inevitably there will come a time when you need to retire or sell your business.

- 50% of business owners are over the age of 50
- 76% of business owners either can't afford to retire or plan to use their business as the primary source of funding for their retirement
- Between 50%-90% of a business owners' personal wealth may be tied up in their business
- Only 30% of all family-owned businesses survive into the second generation
- 93% do not have a formal plan for life after business exit
- Alarmingly, only 20% of businesses listed on the market will actually be sold
- Two-thirds do not know all their exit options
- 78% have no transition team, 83% have no written transition plan, 49% have no plan at all
- 40% have no plans in place to cover illness, death, or forced exit
- 50% feel ownership transition plans require the company to remain profitable for plans to be properly executed, however, 86% have not completed a strategic review or a value growth review

Owners are leaving money on the table because they are focused on short-term income generation rather than long term value. In addition, 50% of exits are NOT voluntary. Remember the 5 D's that often force business exits before the owner is prepared:

- Death
- Disability
- Divorce
- Distress
- Disagreement

"Everyone is going to exit his or her business, it's just a matter of how and when!"

Peter G. Christman

What is Exit & Succession Planning?

Exit planning refers to the process of helping the business owner(s) leave or exit the business and ensures that a successful transition of ownership will transpire in a timely, efficient, and effective manner. The goal in most cases is to maximize the financial returns to the business owner. However, in cases of family succession planning, this may come secondary.

Succession planning, on the other hand, ensures that the business is not reliant on the current business owners. To achieve this, one should implement a management succession plan. This includes policies and procedures, a good business model, and good key employees who do not rely on the existing owners to perform their regular tasks. This plan should be implemented before the time of exit to be effective.



PREPARING FOR YOUR EXIT/SUCCESSION PLAN

Most business owners make more out of selling their business than they do through annual company profits. The majority of business owners do not think strategically about their exit from the business. Some sell when they have to and others wait until it is too late, causing the business to fail. Research suggests that there is a high probability that developing an exit plan 12-36 months prior to selling the business will dramatically increase the value of the business and the ultimate net proceeds that the business owner(s) will receive.

- Consider your personal vision of when and how you will exit the business
- Develop value creation and business growth strategies
- Consider the best tax planning, wealth planning, and risk strategies to put in place
- Consider "life after exit," what it could look like and whether you are personally prepared

Most business owners are only concerned with selling their business to a third party. Therefore, the primary driver for preparing an exit plan is to maximize the value of the business in this sales process.

To ensure you get the best price for your business if you decide to sell, you need to start planning for such a sale well in advance. You also need to consider the issues that could cause you problems.

An Exit Plan Will Review:

- The best time to sell/transfer the business, considering:
 - Personal timing
 - Business timing
 - Overall marketing timing issues
- To whom and for how much. This should consider the net proceeds that will be received by the owner(s).
- Details on what will need to be done to ensure that this transition will occur successfully.
- Details on life after exit, personal goals, and lifestyle expectations.



Before You Begin Planning, Ask Yourself the Following Questions

Do I know my desired retirement date?

Do I know how much I need to retire?

Do I have a successor in mind?

Do I know the current value of my business?

Do I have good books?

*Do I have a professional team?
Attorney, tax advisors, etc.*

Have I worked on tax planning?

Benefits of Exit Planning

Research proves that business owners that go through an exit and succession planning process are more likely to:

- Build a more valuable business
- Pay less tax and have more accumulated personal wealth
- Create a better managed business that is more profitable and leads to less stress and better personal health
- Have less regrets after they exit and more successfully move into a successful life after exit
- Have happier stakeholders and family members
- Protect the family wealth in the case of an unexpected event like death or disability

EXIT STRATEGIES

Most business owners that wish to exit their business will either sell the business to a third party or allow a family member or part of the management team to buy into the business.

Each option has its merits and drawbacks. However, it is essential that any decision regarding retirement be made early so that death or infirmity does not force an unfortunate decision on the owner or the owner's family. Below are some of the ways someone might transfer ownership and control of a business.

INTERNAL TRANSFER

Family Succession
Employee Buyout
Shareholder (*Buy/Sell*)
Lifestyle

Family Succession

Planned takeover of the business by the next generation or other family member. The largest portion of small businesses are family businesses and in some cases it is the wish of the owner to keep the business in the family. In a family business, it is essential that a succession plan is created, well documented, and that family members are aware of its contents. Some family members may automatically expect to be given first right of refusal for purchase of the business.

Employee Buyout

In some instances, the best investors are already a part of the organization. In a management/employee buy-out, an owner offers employees the opportunity to buy into the company, often funded over time, out of the growth of the business. There is risk attached to this arrangement because if the business's profitability declines, it may be difficult to make payments. For this reason, it is recommended that management/employee buy-outs only take place if the owner is a secured creditor and appropriate guarantees are in place.

While it's a complicated process, transitioning the

company to an Employee Stock Ownership Plan (ESOP) might be the best option. ESOPs give the owner/seller and participants various tax benefits. Companies set up a trust fund for employees and contribute either cash to buy company stock, contribute shares directly to the plan, or have the plan borrow money to buy shares.

Shareholder

Many businesses have multiple shareholders and, when preparing to sell the business, all shareholders need to be consulted. There needs to be an agreement between the shareholders about the sales process. It is important to check if the sales conditions are in line with any partnership or shareholder's agreement.

Lifestyle

In some cases, an entrepreneur may wish to exit a business but cannot find a buyer prepared to offer a commercially realistic price. Rather than reduce the sale price, an owner may decide to pull back from the day to day running of the business and appoint outside management.

Retirement from active involvement can include:

- Taking a new partner or appointing a manager
- Allowing existing partners or family to run the business and maintain a passive involvement

Sale

- Third Party (identified or unidentified)
- Business Broker Sale
- Realtor Sale

Public Listing

An Initial Public offering (IPO) is the process by which a company is listed on the Stock Exchange and it is usually a way for a medium sized business to obtain the capital needed to grow into a large business. It requires a sizable financial investment to prepare for listing and there are significant demands on the business owner's time in the lead up to the offering. An IPO is usually not an option for a small business.

Investor

Sometimes a buyer is not able to purchase the entire business but can afford to become a part time owner. In this situation it is important that the original owner thinks carefully about offering someone a majority stake in the business, as this effectively means he or she will lose control of all strategic and operational decision making.

A strategic buyer may be a competitor seeking to reduce the number of competitors in the market place. This is a strategy often used by large multinationals, which find it easier to purchase a

competitor than fight for market share.

Liquidation

Allow the business to cease and sell assets. Business liquidation can either be forced or be planned. In a planned liquidation, this would normally be where a buyer can't be found and the business owner needs to exit. In this case, all the assets would be sold and liabilities accounted for and the owner would walk away with the balance.

EXTERNAL TRANSFER

Sale
Public Listing
Investor (*Part or Whole*)



Common Problems at the Start of the Process

Most business owners:

- Feel their business is worth more than is justified by the marketplace
- Books and records may fail to reflect the true worth of the business
- Have backdated compliance and financial statements
- Have little systems and processes in place
- Have never reviewed their business from an "attractiveness to a buyer" perspective so there are fundamental problems that will drag the value down

THE EXIT PLAN

Looking at the big picture before beginning exit planning can help show business owners what they can achieve by the end of the process. Use the one-page exit and succession plan on page 12 to understand the big picture. Begin this process by considering the key components of your exit and succession plan below.

KEY CONSIDERATIONS

How much do you think your business is worth now?

Is this enough to retire or fund the next phase of your life?

How much could your business be worth in the future if you focused on building your profit and value?

What annual income would you need after you exit the business to fund your future lifestyle?

When would you like to sell?

What would you like to do after you exit the business?

Who would you like to sell or transfer your business to and what do you need to do strategically, operationally, or from a value perspective to achieve this outcome?

Focusing on your personal welfare, what plans can you put in place now to make sure you will enjoy this transition and have no regrets?

BUSINESS READINESS ASSESSMENT

MY BUSINESS READINESS SCORE

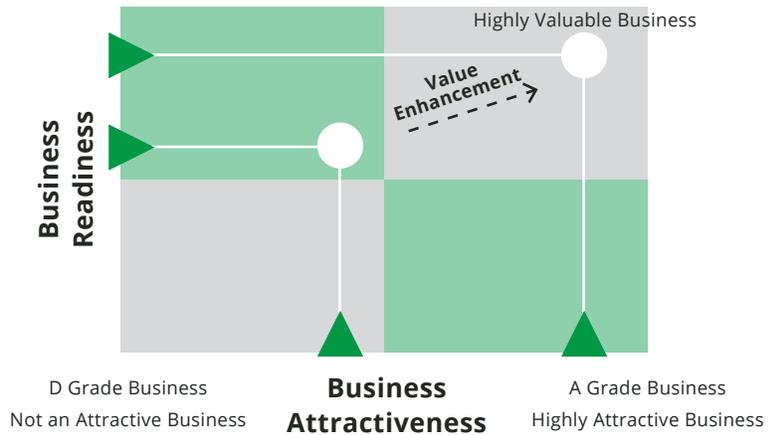


I will focus on the following issues:

- How do I make my business more attractive?
- How do I get my business ready and lower risk to the potential purchaser?
- How do I improve my profit and growth?
- How do I increase the value of my business?
- Does my strategic plan include an exit and succession plan that will improve value?

BUSINESS VALUE READINESS

What is your score?



PERSONAL READINESS ASSESSMENT

MY PERSONAL READINESS SCORE



I will focus on the following issues:

- How much money will I end up with?
- Have I improved my tax position?
- What will this mean to my entire personal wealth?
- Will I be able to afford my "life after exit" lifestyle?
- Do I know exactly what I will do after exiting and how do I ensure the maximum enjoyment?
- What happens to my business and my family if I die, become sick or incapacitated?

BUSINESS VALUE READINESS

What is your score?



THE THREE-LEGGED STOOL OF EXIT PLANNING

A business owner should create a master plan that integrates business, personal, and financial goals into their exit strategy. This process consists of three major components, referred to as the 'three legs of the stool.'



BUSINESS VALUE

Some elements of planning in this area:

- Should I sell now or wait?
- How do I build value?
- Is my business attractive and is the business ready to exit?



PERSONAL WEALTH, RISK & TAX

Some elements of planning in this area:

- Tax planning to take into account the business proceeds.
- Wealth planning.
- Preparing for unexpected events, such as death or disability, and dealing with estate planning and insurance.



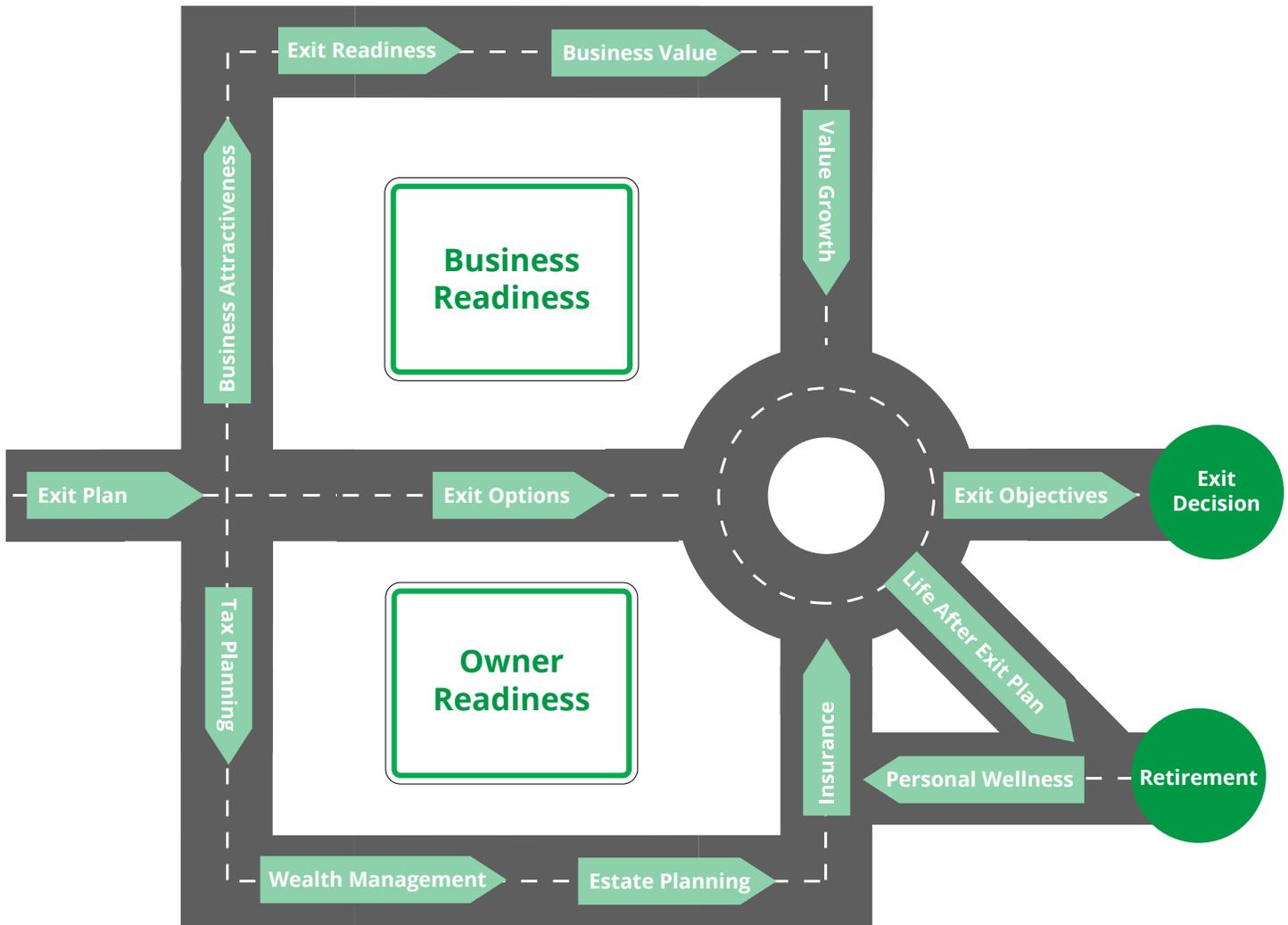
PERSONAL WELLNESS & "LIFE AFTER EXIT"

Some elements of planning in this area:

- What will you do when you exit the business?
- What are your lifestyle goals post exit and affordability of lifestyle?
- Strategies to emotionally replace the business as the number one priority.
- Wellness planning now and into the future.

Consulting an expert to help you answer these questions can help you begin planning for your business exit. Once you have this information you will be in a better position to make decisions around your exit options and timing. Be sure to continually update your exit plan and re-evaluate your answers to these questions as your personal life and the business world grows and changes around you.

EXIT PLANNING ROAD MAP



BUSINESS & PERSONAL READINESS ASSESSMENTS

Getting a realistic idea of where your business sits in terms of business and personal readiness is an important part of the process. The scores and grades you see as examples in this guide come from the MAUS assessments. These short questionnaires can be completed at no cost to you when you work with an ND SBDC advisor.

The ND SBDC network has several Certified Exit Planning Advisors that are available to work with you one-on-one. Learn more about the process and resources available at the end of this guide.

ONE PAGE EXIT & SUCCESSION PLAN

The sample below includes the details of the personal goals and objectives.

Business Overview	
When	To sell the business in three years
Buyer/Transition Target	To sell to a strategic buyer
How Much	To sell for \$15-\$18 million / John's Share (est. \$4.12m)
Owner Agreement	All the shareholders agree on timing and will be prepared to be open minded on commercial terms with a preference of 75% upfront
Life After	Grow personal wealth so John never has to worry about money
Business Owner Reliance	To ensure that the business is not reliant on the business owner by coaching and training staff to make key business decisions and implementing good systems

Business Value Goals	Now	+3 Years
Revenue	\$8,300,000	\$15,000,000
Profit	\$1,660,000	\$3,000,000
Multiple Range	4-5	5-6
Value Range	\$6.6m - \$8.4m	\$15m - \$18m

BUSINESS VALUE DRIVERS

	Now	+3 Years
Business Attractiveness Score	C-Grade	A-Grade
	67%	90+%

	Now	+3 Years
Business Readiness Score	C-Grade	A-Grade
	67%	90+%

Personal Wealth & Wellness Goals	Now	+3 Years
Estimated Net Proceeds of Business Transfer		\$4,000,000
Personal Investments & Wealth (Net of Family, House, & Business)	\$1,100,000	\$2,000,000
Total Capital After Exit		\$6,000,000
Likely Income Generated from Investments		\$300,000
Lifestyle Expenses/Spending	\$200,000	\$200,000

PERSONAL DRIVERS

	Now	+3 Years
Wellness & Life After Score	C-Grade	A-Grade
	67%	90+%

	Now	+3 Years
Personal Wealth, Tax & Risk Score	C-Grade	A-Grade
	67%	90+%

BUILDING YOUR VALUE



Key Questions to Ask When Building Value

- What is your business worth now?
- What could your business be worth in 12-36 months time if you worked on a value improvement plan?
- What is the “Value Enhancement Gap” or the financial benefit of working on the business? (i.e. the Answer to Question 1 minus the Answer to Question 2)

To increase your value enhancement gap, one must begin with improving sales and profitability in addition to working on other factors that will improve your value.

Money Tied up in Business can be a Threat to Your Wealth

Most business owners have as much money tied up in the business as they do in their house. Given that 70% of business owners plan to use their business as the primary source of retirement, this asset needs to be managed to maximize the value.

As current business owners near retirement and the average age of small business owners increases, the laws of supply and demand will come into play. In such a crowded marketplace business owners will need to present their business in an appealing, professional manner to stand out from the competition and achieve the maximum return.

There can be two “less-than-satisfactory” results when attempting to sell

- You may not be able to sell your business.
- You may have to settle for a lower price.

It stands to reason that the more you can sell your business for, the more you will have in retirement. That is why you need to understand this process and work on a plan to maximize the attractiveness of your business to potential purchasers. Most of this work is done 12-36 months before putting your business on the market.

*Business value increases over time!
Your business should become more valuable the more that you work on it.*

EXAMPLE

David is the owner of a software business with a net profit of \$1 million dollars. David originally thought his business was worth between \$800k - \$1.2 million dollars. This however was not enough for him to retire. Over a two-year period David worked with a ND SBDC Certified Exit Planning Advisor on key ways to improve the value of the business.

THE SUCCESS

At the end of this period David went to market and within 3 months had received a contract for \$2.6 million dollars.

This is simply an example. Success is not guaranteed by working through an exit or succession plan.

What makes a business attractive and worth more?

Buyers look for a return on their money. The higher the perceived return on investment the more attractive the business. And of course, the more attractive the business the more buyers are prepared to pay.

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Attractiveness:

This lists the factors that make your business attractive to a potential buyer.

Buyers will minimize their risk by carrying out thorough due diligence and investigate the business. Sellers can maximize their position by being prepared for the scrutiny that prospective purchasers will put their business under. The more prepared the seller the higher the ultimate price that they may negotiate.

- Ensure there is a sound financial history
- Provide record of a steady increase in profit for the last 2-3 years, with similar increase in sales over the same period
- Position the business as a good low risk return on the investment
- Highlight an established customer base, sound internal systems, market awareness and credibility, an operational framework and cash flow
- Highlight positive industry trends
- Highlight company awards, testimonials or even an ecologically responsible products or services
- Ensure the business does not appear to be reliant on the owner and the that there is a succession of employees that could take over the existing owner's job when he/she departs

Each potential acquisition will be judged on the level of future profits the buyer believes the business can generate and the level of risk attached to reaching these targets.

Utilizing a tool such as the "attractiveness index" provides your business with a benchmark guideline based on research into hundreds of different acquisitions. It will give you a guideline as to how attractive your business is to a potential buyer.

You may be the most attractive business in the world but if you are not ready to sell, then your value will be diminished. Readiness factors include areas such as employment contracts, up-to-date financials, trade-marks, supplier and customer contracts, etc.

Readiness:

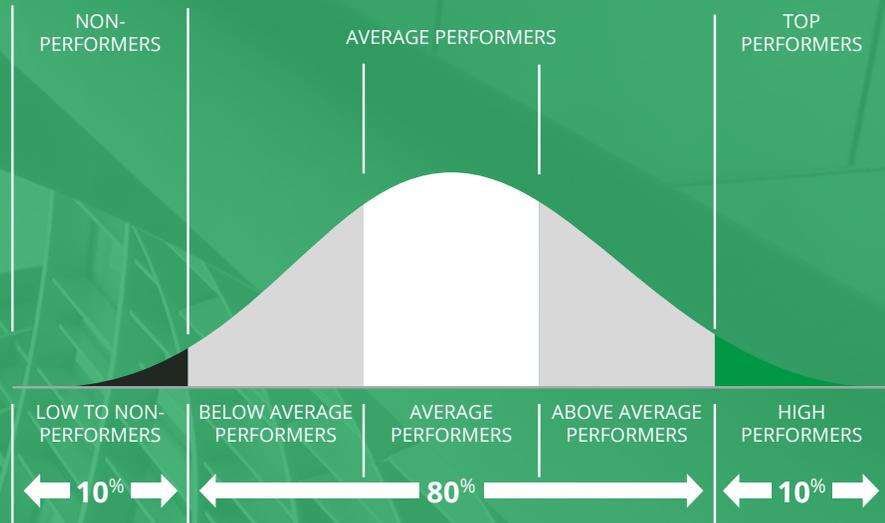
You may be the most attractive business in the world but if you are not ready to sell, then your value will be diminished. Readiness factors include areas such as employment contracts, up to date financials, trade- marks, supplier and customer contracts etc.

The primary reason someone buys a business is to get a return on the investment.



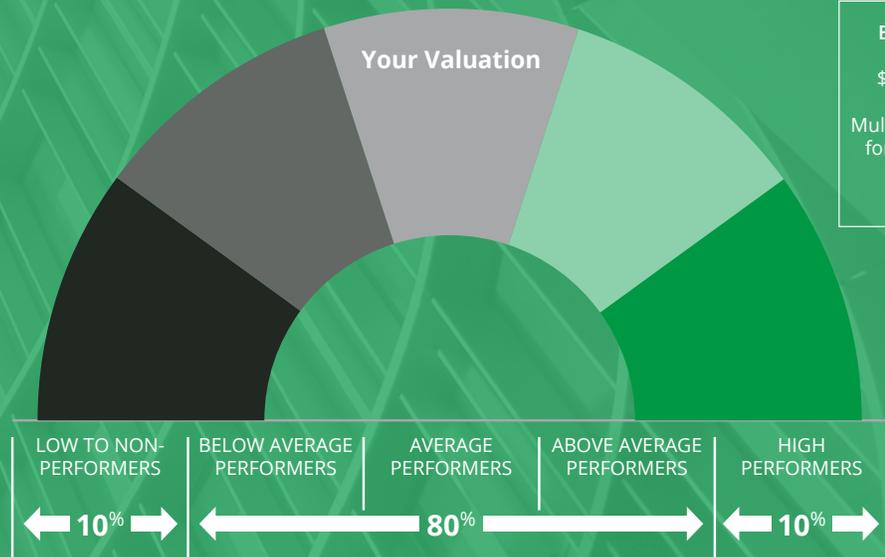
ARE YOU AN "A" CLASS OR "D" CLASS BUSINESS?

WHERE DO YOU SIT IN THIS RANGE?



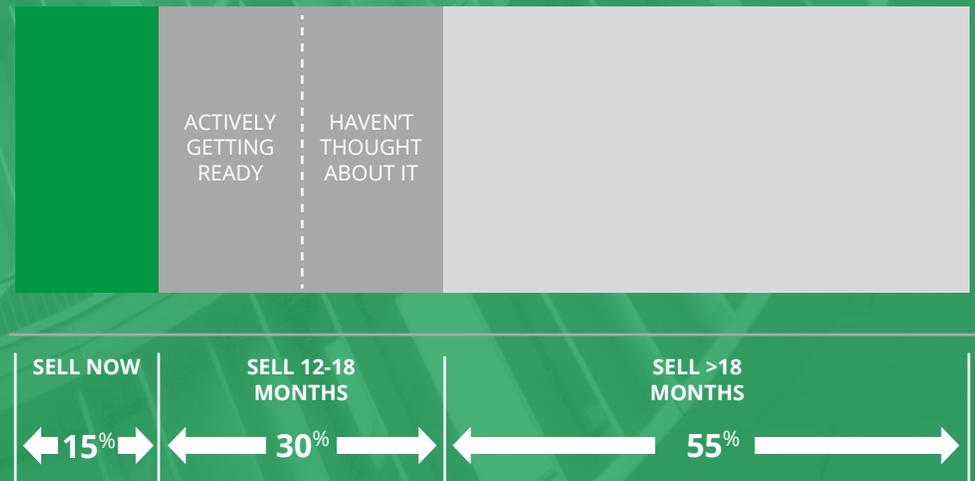
A CLASS BUSINESSES THAT ARE ATTRACTIVE SELL AT A PREMIUM

Each industry will generally have a range of multiples, that business sell within. The more attractive your business to a potential buyer then the higher your business valuation. Multiply your EBITDA x the multiple for your industry. (EBITDA = Earnings before interest tax and depreciation)



Example EBITDA \$400,000
Multiple Range for Industry x1 - x4

WHERE ARE YOU ON THE CHART BELOW?





TOP PERFORMER CHECKLIST

- Understand the time frame of exit
- Ensure that their family and stakeholders are informed
- Develop tax strategies 3+ years before exit
- Have active current wealth strategies
- Ensured that wealth planners, accountants, and other advisors are all informed 3+ years
- Be well planned in case of a sudden exit and include succession strategies as well as insurance and estate planning
- Plan which wealth strategies will change significantly in the event of retirement as goals change from wealth growth to passive income
- Develop a post-exit wealth plan
- Ensure you are satisfied with the business legacy
- Consider lifestyle and contingencies such as health as part of a post-exit plan
- Ensure you have enough income to finance that plan
- Develop strategies to ensure there is no regret and loss of identity after exit

WHY BUSINESSES DO NOT SELL

It would be nice to live in a world where every business for sale sold at top dollar. While there is no such thing as a perfect business free from all defects, there are a number of problems that can hinder a sale that could be remedied, if given enough time. Here are 10 reasons which are often cited as contributing factors in an unsuccessful sale or a completed deal for less than potential value. Business intermediaries need to be up-front with their seller clients, educating them on the challenges faced, and the likely impact that one or more of these issues will have on completing a successful transaction.

UNREALISTIC EXPECTATIONS

Valuation/Listing Price

- The price a business is listed at is one of the critical elements to a successful sale.
- An owner's emotional attachment to their business can create a misperception of actual value; it will be extremely difficult to defend the valuation when a business has been priced unrealistically.
- Overpricing a business will deter knowledgeable buyers from establishing communications.
- Once on the market for an extended period of time at the wrong price, the process of re-pricing and re-listing creates a whole new set of challenges, the least of which is maintaining credibility.

Unrealistic Terms and/or Structure

- Deal structure, asset allocation and tax management must be addressed proactively and early in the process.
- A seller could achieve a deal that provides a greater economic benefit when an experienced Tax Attorney/CPA assists with structuring the transaction.
- Issues with the terms in the agreement could be problematic. For example:
 - Seller insists on all cash at closing and is inflexible in negotiating other terms
 - The buyer's unwillingness to sign a personal guarantee
 - The lack of consensus on the Asset Allocation
 - Seller insisting on only selling stock (typically with a C-Corp)
 - Inability to negotiate equitable seller financing, an earn-out, or terms for the non-compete

PROFESSIONAL ADVISORS

The lack of professional expertise in this area decreases the probability of success. At a minimum, it is recommended that you have the following professionals in place:

- A Certified Exit Planning Advisor, such as those at the ND SBDC
- A business attorney who specializes in business transactions
- A competent CPA who is knowledgeable about structuring business transactions

DECREASING REVENUES/PROFITS

- When a business has a less stellar track record with varied results or possibly declining revenue and/or profits, complications with the business sale are likely to occur.
- Decreasing profits and revenue impact the availability of third-party funding and will likely have a material impact on the business valuation.
- Businesses are purchased based on anticipated future performance, but valued on historical earnings with the major focus on the prior 12-36 months.
- For those businesses which have deteriorating financials the seller should be able to articulate accurate reasons for the decline. Where there are two or more years of declines, the buyer and the lender will question "where is the bottom?" And what is the new normal? A decrease in valuation will be inevitable.
- Cash flow is the driver behind business valuations and business acquisitions. The consistency and quality of revenue and income will be key focal points when assessing an acquisition.
- It all relates to risk. Those businesses with dependable recurring revenue generated from contractual arrangements will generally be in greater demand than businesses who produce income based on a project based model.

INACCURATE OR INCOMPLETE BOOKS

- Accurate, detailed, and clean financial statements must match the filed tax returns.
- A business owner should ensure that the books are professionally managed and up-to-date.
- Financial statements will be the basis for the business valuation and they will be the criteria to qualify for bank transaction funding.
- Records that are messy, incomplete, out of date, or containing too many personal expenses will only give prospective buyers and lenders reason to question the accuracy of the books.
- Businesses that have a "cash component" will need to report 100% of this income for it to be incorporated in a valuation.

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CUSTOMER CONCENTRATION

- Businesses that have a handful of customers that produce a large percentage of the company's revenues, will probably have customer concentration issues, especially if one client represents greater than 10% of sales.
- A business lacking a broad and diverse base of customers possesses a higher degree of risk for a buyer as the loss of any one of these large clients could have material impact on future earnings.

THE OWNER IS THE BUSINESS

- When it becomes evident that the business cannot operate effectively without the owner's hands-on involvement and personal know-how, it becomes problematic.
- Particularly true with smaller enterprises, the owner plays a significant role in all facets of the company – sales, marketing, operations, management, and financials.
- If the customer does business largely due to their relationship with the owner, this can create customer retention issues when ownership transition occurs.
- Buyers want a business that can operate independently from the current business owner.

THE OWNER IS AGING AND HAS SLOWED-DOWN

- Sometimes a business owner can become complacent after running the company for an extended period of time. This complacency or lack of drive, effects the business fundamentals. The business is on auto-pilot.
- The company's performance slowly begins to deteriorate.
 - Time and effort dedicated to sales, marketing and promotion decrease.
 - Investment in equipment upgrades and ongoing maintenance have been cut back.
 - Innovation has ceased.
 - The financials are stagnant.
 - Lack of zeal and drive transfers to staff and clients.
- This situation can become even more pronounced when the owner finally makes the decision to sell the business and mentally checks out at the worst possible time.

INDUSTRY IS DIMINISHING OR THREATENED

- The future outlook for a given industry will have a direct impact on the valuation and marketability of the business during a sale.
- Businesses facing obsolescence or stuck in a shrinking industry will face an uphill battle when it comes time to transition or sell.
- Maintaining a diverse offering of products and services that are relevant to the market will enable a business owner to avoid this situation, mitigate the impact from declining sales and demonstrate to a prospective buyer that the business has a clear path to grow in the future.
- Industry concentration can pose complications when selling a business. Specialization can be a competitive advantage, however, the same narrow industry focus could be a detriment if it is perceived that the business does not possess a broad supply chain and ample options to source products and materials.

THE BUYER CHOSE THE WRONG LENDER

- Many deals have fallen apart during the time frame between application approval and transaction funding because the buyer became aligned with the wrong financial institution.
- Valuable time can be wasted causing the deal to be compromised.
- Buyers who are prequalified from the start and verify that the bank's lending criteria conforms to the type of business they are evaluating, will be the best positioned for successful acquisition.

COMMERCIAL PROPERTY ISSUES

- For some businesses, location is critically important to the value of the company.
 - If the physical location is of major importance, the business buyer will seek assurances that they can either purchase the real estate or be able to sign a long term lease.
 - Some businesses are not easily relocatable without affecting the current customer base.
- The type and size of facility can also have material impact on the sale.
 - If the facility is not large enough to provide the enterprise a sustained growth path, a buyer could be disinterested.

- Another situation could be the value of the property.
 - If the current owner purchased the land/building a decade or two earlier and the financials or recast do not reflect a current fair market value rent/lease payment, valuation problems will occur.
- Business transactions involving the sale of commercial real estate can be impacted by required environmental assessments. The buyer and seller should have a clear understanding of the costs to resolve any issues, which party is

responsible, and whether a price offset will be warranted.

- Zoning changes could require a property be brought up to new codes, and clear definition of who bears responsibility and the cost of the process.
- Transitioning property leased by the business must be in agreement with the landlord, be offered a lease takeover, or offered a new lease at comparable rates.

VALUATION

To create an effective exit strategy, it is vital to understand how businesses are valued. An accurate valuation allows the business owner to make a realistic estimate of the profit from a sale, and whether this is going to be sufficient to meet future needs.

Valuation Methodologies

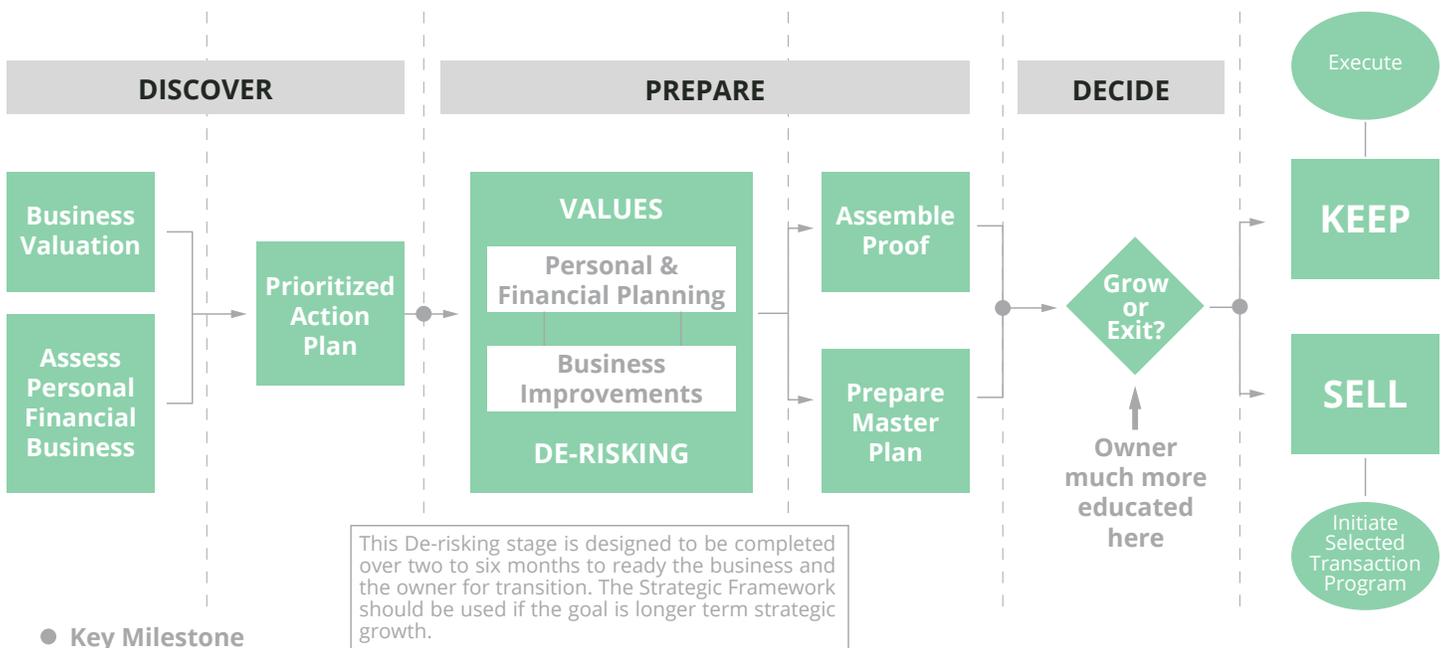
There are three different approaches that are commonly used in business valuation:

The income approach - The Income Approach generally looks at future income or cash and discounts it to today's value. An example is the "Discounted Cash Flow" method.

The asset-based approach - The asset-based approach bases its valuation on the assets of the business. For example "Net Asset Value."

The market approach - The Market Approach compares the business against other businesses in the same industry and takes into account size and location and other specific business factors. An example of this is the "Multiples of EBIT" approach.

VALUE ACCELERATION PROCESS





ND SBDC Process Description



ABOUT OUR TEAM

The ND SBDC network of credentialed business advisors empower North Dakota small businesses and entrepreneurs to thrive. We accelerate business growth in communities across North Dakota by providing customized guidance and resources that help owners and entrepreneurs achieve their goals at every stage of their business life cycle. For over 35 years, our network has supported small business owners and entrepreneurs across the state, including stepping up to provide an unprecedented volume of service during the pandemic. When small businesses thrive, communities thrive, North Dakota thrives.

In addition to a set of core areas of assistance that any of our advisors can assist with, each has additional areas of expertise or certification, including several of our team who are certified exit planning advisors and advanced business intermediaries. All services are provided at no cost. Learn more about our services or team, and set-up an appointment today!

NEXT STEPS

Get Started

If you are ready to learn more about the process of exit and succession planning, complete the personal or business readiness assessments, or dive into the process, contact the ND SBDC to register for services. There are also additional resources and tools available on our website (ndsfdc.org).

We would strongly recommend that you contact the ND SBDC 12-36 months prior to selling the business. You will need to have someone that understands the entire Exit Planning process. We can help you project manage the process and advise.

Scan the QR code to access additional resources or register with the ND SBDC.



Bail Team

Some of the areas you may need professional assistance:

- Personal & Business (including Shareholder Alignment & Timing, Strategy & Value Creation)
- Exit Planning
- HR & Succession Issues
- Financial Advice
- Access to Equity Capital
- Business Valuation
- Business Brokering & Transition Issues
- Legal Planning
- Investments
- Tax Planning

TERMS & DEFINITIONS

Appraised value or appraisal - A valuation or estimation of value of property by disinterested people of suitable qualifications. This process of ascertaining a value of an asset (or liability) involved expert opinion according to a specific methodology.

Assets - All types of property that can be made available for the payment of debts.

Basis - As used in accounting related to tax purposes, basis describes the value of an asset for the purpose of determining the gain or loss on its sale or transfer.

Business plan - A written document that defines a business' product, concept, potential customers, and necessary financial resources needed to achieve the objectives of the business.

Buy/sell agreements - Formal agreements that spell out terms of ownership transfers in case of death, divorce, disability, dissolution. They include information on valuation, discounts and any restrictions on asset transfers.

Chattel - An article of personal property (personal and movable). Machinery is an example.

Closely held business - A business organization in which the ownership is held by a limited number of people often the same family, rather than owned by the public at large.

Contingency plan - Provisions in a comprehensive succession plan that mitigate the financial devastation caused by untimely death, disability and/or deteriorating health.

Deed - A legal instrument used to transfer title to real property in the eyes of the law. Specific types of deeds may include the following:

- *Correction deed* - A document used to correct an error in a previously recorded deed.
- *Deed restrictions* - Provisions placed in deeds to control how future owners may or may not use the property.

- *Executor's deed* - A deed used to convey the real property of a deceased person.
- *Deed in escrow* - Papers prepared to transfer real estate to another owner and given to a third party for delivery at a later date or when the specified conditions are met. No transfer occurs until delivery is made.
- *Gift deed* - A deed executed and delivered without consideration (a deed that states "love and affection" as the consideration).
- *Guardian's deed* - Used to convey property of a minor or legally incompetent person.
- *Quitclaim deed* - A legal instrument used to convey whatever title the grantor has. It contains no covenants, warranties nor implication of the grantor's ownership.
- *General warranty deed* - An assurance or guarantee that something is true as stated, making it the highest quality title. A deed that usually contains the covenants of seizing, quiet enjoyment, encumbrances, further assurance and warranty forever.
- *Special warranty deed* - The grantor warrants title only against defects occurring during the grantor's ownership but not before that time.

Equal vs. equitable or "fair" distribution - In farm transition or estate planning, an "equal" distribution means that property is divided in equal percentages among heirs. In an equitable or fair distribution, property may be divided based upon the contributions and needs of the heirs; the monetary values of the shares may be different.

Escheat - Assignment of property to the state because no verifiable legal owner exists. Typically, where no heir to property exists.

Fair market value - The amount for which a piece of property (real or personal) would be sold in a voluntary transaction between a buyer and seller, neither of whom is under any obligation to buy or sell. A customary test of fair market value in real estate transactions is the price that a buyer is willing, but is not under any duty, to pay for a particular property to an owner who is willing, but not obligated, to sell.

Family limited partnership - A family organization with one or more general partners who manage the organization and assume debts and obligations, and one or more limited partners who are liable only to the extent of their investments.

Fiduciary - Includes personal representative, guardian, conservator, and trustee.

Gift - A voluntary transfer of property for which nothing of value is received in return. If the Internal Revenue Service is to recognize a transfer as a gift, the donor(s) must unconditionally transfer all title and control of the property to the recipient(s) at the time the gift is given. A partial gift may be given. For example: a sale at less than fair market value.

Gross estate - For federal estate tax purposes, the total value of all property real or personal, tangible or intangible, that a decedent had owned or had control over at the time of death.

Income statement - A document that lists all revenues, gains, expenses, losses and net income for a business during a specific period of time.

Intangible property - Property that only represents real value, such as bonds, stock certificates, promissory notes, certificates of deposit, bank accounts, contracts, and leases. In contrast tangible property can be seen. It includes land, machinery, and goods.

Intergenerational succession - Succession in property ownership in which the property is transferred from one generation to another, usually from members of an older generation to members of a younger. In business succession planning, it includes the transfer of management responsibilities and profit opportunities.

Lateral succession - Succession in property ownership in which the property is transferred between

members of the same generation.

Liabilities - Financial amounts owed by a person, family, or business. Everything owed to others.

Mentee - An inexperienced, new, or aspiring entrepreneur who is seeking the advice, counsel, or guidance of a senior or experienced business owner.

Mentor - A senior or experienced business owner who advises, counsels, or guides an inexperienced, new or aspiring entrepreneur in the aspects of business growth and development.

Operating agreement - A set of standard operating procedures and management policies specifically designed to maintain the operational integrity of a business. It may include a decision-making process, income/expense management, dispute resolution, ownership transfer and other terms and conditions of business ownership/management.

Personal property - Assets whose ownership arises out of physical possession of the property or as the result of a document showing ownership. Examples include livestock, machinery, stored grain, bank deposits, stocks, bonds, checking and savings accounts, automobiles, and other transportation and recreation vehicles.

Power of attorney (POA) - A written document in which one person gives another power to conduct certain acts on his or her behalf. May or may not need to be notarized, depending on the state.

- *Durable POA* - Allows the power of attorney to survive any disability the principal could suffer.
- *Health care POA* - grants powers related to healthcare decisions.

Real Property - Ownership rights in land and its improvements; for example, real estate, minerals, royalty interests, growing timber, land, and buildings attached to the land.

Right of first refusal - The right to have the first opportunity to purchase a piece of property (usually real estate) when such becomes available or the right to meet any other offer on the subject property.

Sale - A transfer of property from one owner to another for a consideration at fair market value.

Sole ownership - Title to property in one name.

Succession law - Law that governs the disposition of one's estate if no will exists.

Sweat equity - The increased financial value of a business (over and above money or tangible assets contributed) that was created by uncompensated mental and/or physical efforts.

Tangible property - Property that is capable of being perceived by the senses. Generally, tangible property is real estate, personal property, or movable property that has value on its own and is not merely a representation of real value. Land, machinery, buildings, business equipment, inventories, homes, and furnishings are examples of tangible property. In contrast, intangible property is not visible; for example, patent rights.

Tax basis (federal) - The owner's cost of an asset for income and estate tax purposes as determined under the Internal Revenue Code and IRS regulations.

Title - The right to or ownership of something. Terminology related to title may include

- *Deed* - A written document that, when properly executed and delivered, conveys title to real property. (See full *Deed definition for types and additional definition information.*)
- *Marketable title* - Title that is free from encumbrances and any reasonable doubt as to the owner. Title can be sold or mortgaged readily
- *Title by descent* - Laws that direct how a deceased's assets shall be divided to heirs when no will exists.



[NDSBDC.org](https://www.ndsbdc.org)