Session Title

SAT-B08 Ownership Transition and Succession Planning for the Future of Your Firm

Speaker

Bill Mandel, Partner, Fox Rothschild LLP, San Francisco, CA
415.651.1438, bmandel@foxrothschild.com

Bill is considered by his clients as a go-to source for strategic counsel regarding transition planning for architecture, engineering and design firms. He has helped develop ownership transition programs for a number of the leading professional service firms in California for more than 25 years and speaks extensively on the topic. He also advises professional services firms in such areas as contract negotiation, risk prevention, dispute resolution and employment law.

Learning Objectives

- Learn to implement effective plans to recognize new leadership, expand ownership and perpetuate the firm.
- Explore strategies and legal considerations to transfer ownership and leadership within professional services firms.
- Discuss the latest in the world of ownership transition.

Who Needs Ownership Transition?

- Owners contemplating transition now.
- Owners planning for eventual transition.
- Employees being considered for ownership now.
- Employees who would like to be considered for ownership

Notes:

Why Ownership Transition?

- To accommodate growth. Having more employees requires more leaders.
- To Expand: Geographic or disciplines.
- To retire founders.
- To provide continuity of the firm.
- To keep in touch with the marketplace. People tend to market best to people their own age.

Notes:

What are the Choices for Transition?

- Management Buyout (MBO) – Growing from within.
- Merger & Acquisition (M&A) – Selling to the outside buyer.
- Employee Stock Ownership Plan (ESOP).
- Combination of strategies:
    - MBO + ESOP
    - MBO leading to a M&A

Notes:

Determining Valuation

- Three Methods of determining valuation:
  - Multiple of Net Worth
  - Multiple of EBITDA (Earnings Before Interest, Taxes Depreciation and Amortization)
  - Multiple of Net Revenues

Notes:

Internal Valuation

- Multiple of Net Worth (primarily for internal sales)

Net Worth	$480,000
1.25 Times Net Worth	$600,000
1.50 Times Net Worth	$720,000

1.25 and 1.50: The Goodwill Multipliers

Notes:

External Valuation

- Multiple of EBITDA (primarily for external sales)

Example: Calculate weighted average of EBITDA for four years: $240,015
Multiply by metrics for internal/external sale.

2 Times Weighted Average (Internal)	$480,000
3 Times Weighted Average (External)	$720,045
5 Times Weighted Average (External)	$1,200,075

Notes:

External Valuation

- Multiple of EBITDA (primarily for external sales)

  Example: Calculate weighted average of EBITDA for four years: $240,015
  Multiply by metrics for internal/external sale.

2 Times Weighted Average (Internal)	$480,000
3 Times Weighted Average (External)	$720,045
5 Times Weighted Average (External)	$1,200,075

Notes:

External Sales (Alternative Method)

- Weighted Average of Net Revenues (primarily as cross-check for external sales)

  Example: Calculate Weighted Average of Net Revenues for 4 years: $2,000,000
  Multiply by metrics for internal/external sale.

Weighted Average: Average	$2,000,000
.25 Times Weighted Average (Internal)	$500,000
.4 Times Weighted Average (External)	$800,000
.8 Times Weighted Average (External)	$1,600,000

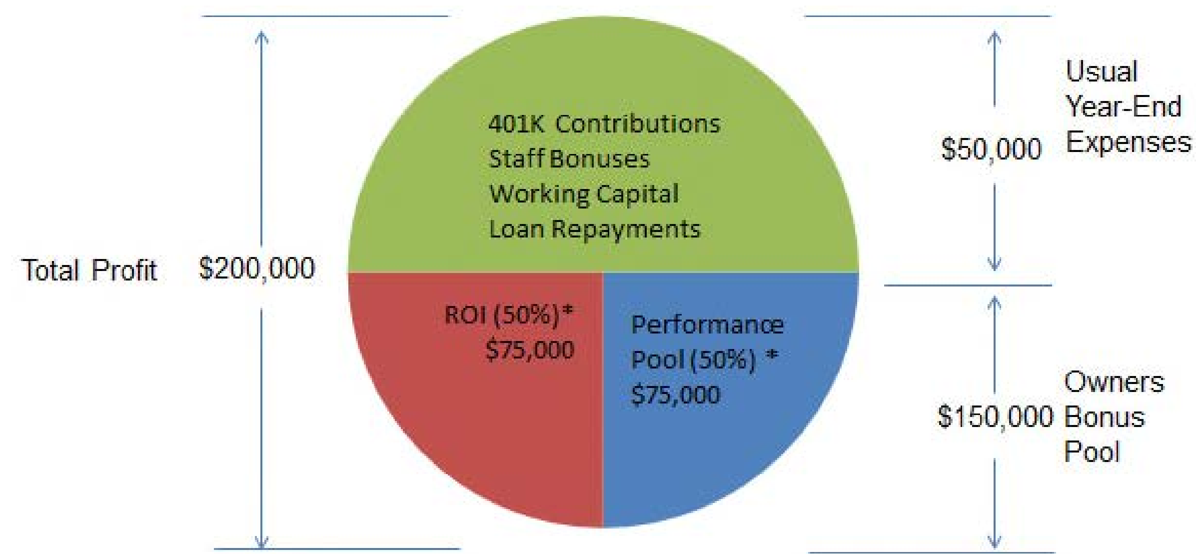
Notes:

What the Candidates Want – Answering the 3 "C's"

- Cost: What is it going to cost?
- Compensation: How will compensation change? (You are asking them to do more as owners. What are the financial rewards?)
- Control: Will they have a say in the governance of the firm?

Notes:

The Owners' Bonus Pool: How It Works



* The allocation between ROI and Performance may vary depending on the firm's needs. It is usually determined at the beginning of the program and rarely modified.

Notes:

Documenting the Program and Legal Considerations

THE DOCUMENTS

A. **Term Sheet**: A nonbinding document that contains the essential terms of the Ownership Program, including:
    a. Stock Being Offered
    b. Sellers: The Company or the Founders
    c. Number of Shares
    d. Purchase Price and Method of Valuation
    e. Payment Method: All Cash vs. Deferred Payments
    f. Summary of Buy Sell Agreement Terms
    g. Titles and Positions
    h. Compensation
        i. Base Salary
        ii. Owners' Bonus Pool
    i. List of Legal Documents
    j. Timetable
B. **The Offering Memorandum** (Full Disclosure Is the Goal)
    a. Description of the Offering
    b. Calculation of Value and Purchase Price
    c. Description of Business, Financial Information and Risk Factors:
        i. Liabilities, Leases, Claims Made
        ii. Interested Party Transactions
        iii. Other Risk Factors
    d. Summary of the Legal Document Terms
    e. Other Shareholder Information:
        i. Rights of Shareholders
        ii. Composition of Board of Directors
        iii. Benefits only for owners, including owners' bonus pool, vacation, perks
C. **Stock Purchase Agreement.**
D. **Promissory Note (if payments are deferred)**
E. **Stock Pledge Agreement**
F. **Buy Sell Agreement**
G. **Indemnification Agreement – All for one and one for all.**
H. **Corporate Resolutions to:**
    a. Adopt the Ownership Program;
    b. Authorize the Stock Issuance; and
    c. Adopt the Owners' Bonus Pool.

Notes:

Buy-Sell Agreement: Top 10 Points To Remember

1. Restriction on transfers of shares
2. Triggering events
    a. Death, disability, termination of employment
    b. Other possible triggering events:
        i. Bankruptcy
        ii. Failure to indemnify (Shareholder Indemnification Agreement)
        iii. By vote of other shareholders
3. Valuation: How to value? When to value?
4. Method of Payment: Down payment plus installment with interest
5. Annual limits on payments
6. Bring along/tag along
7. Possible additional compensation on sale of business
8. Non-solicitation of clients and employees
9. Purchase of spouse's interest upon marital dissolution
10. Special shareholder voting rights – high threshold:
    a. Issue or sale of shares
    b. Amendment or termination of this agreement
    c. Repurchase of existing shareholder's shares

Notes:

Trends in Ownership Transition

- Mandatory age-related sell down
  - Frees up stock for new owners
  - Does not mean employment termination for the sellers
  - Firms are extending the sell-down age
  - People are working longer
- The “Sunset” Clause
  - Recognizes that the valuation for MBO is depressed value
  - Allows sellers to share in the increase in value if the company sells to an outside buyer (M&A) within a short time after they sell
- Combining MBOs and ESOPs
- Increased sophistication of candidates
- Candidate skepticism about value of ownership
- Founders work longer: potential concern for next generation leadership group. When will the reins be turned over?
- Bank Financing
  - Bank loans money to buyers to buy stock
  - Keeps sellers out of the financing business
  - Sellers get their money quicker
  - Buyers will have to qualify with bank
  - Company will have to guarantee loans

Notes:

The Ownership Transition Process – Start to Finish

- Owners meet with their professional team (attorney, consultant and CPA) and develop program.
- Owners identify candidates and have them vetted by outside source (Owners are too close to be objective).
- Present program in "Term Sheet" form to candidates.
- Candidates decide to move forward.
- Present legal documents to candidates.
- Candidates review documents with legal counsel.
- Resolve questions and comments.
- Close and celebrate – This is Phase 1 of the program.

Timing: 3 to 6 months from time you start to develop your program. (It always takes longer than you think)

Notes: