PRIVATE BANKING &
INVESTMENT GROUP

YOUR GUIDE TO A SUCCESSFUL EXIT

From planning to execution, all the strategies that can help you maximize the promise of today's resurgent deal market for privately owned companies.

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Your Guide To A Successful Exit

As the largest cohort of entrepreneurs in U.S. history approaches retirement, record amounts of capital sit waiting to purchase well-run private companies. Here's the advice you'll need to help make the most of what could be a once-in-a-generation opportunity.

The decisions that lead someone to start a business and build it over years or decades are often singular and personal to the entrepreneur. But the decision to sell is often based on two clear indicators. The first is that the business owner is ready to retire or move on to other ventures. The second is that the market is right for a sale. For those people who are ready, today's market is a seller's one, and big and small businesses are cashing in. With interest rates still low, and equity investors chasing fewer international deals, some might say the deal market for mergers and acquisitions (M&A) is at a fever pitch.

Yet, despite the lure of the market, there's a lot that needs to be considered before a sale. Supply, demand, volatility, capital flow, generational differences, and the baby boomers' retirement all must be carefully thought through.

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For the last two and a half years, the M&A market has experienced a bull run, generating capital from both private equity and strategic buyers, which are large private or publicly traded companies that are interested in acquiring smaller companies. As a result, there has been an unprecedented boom in the "middle markets," where sales focus on companies with valuations ranging from $25 million (so-called lower-middle) all the way up to $1 billion (upper-middle).

Increased volatility in the stock market has been a factor driving the current M&A market. "Volatility creates uncertainty, and the global markets are rife with uncertainty," says Brooks Gallagher, who heads the Private Sales Referral Network (PSRN) at Bank of America Merrill Lynch. "This volatility has driven more buyers to focus on the middle markets, since global buyers are attracted to the company base we have in the U.S. The middle market is where they are focused, and buyers have turned out at a higher level than we have ever seen."

Selling businesses is on a lot of minds, as the 3.5 million members of the boomer generation have now started retiring.

2014 was the strongest M&A market on record, and the 2015 numbers look to be a close second, with PitchBook documenting $154 billion in transfers for the first half of 2015. Of these deals, 82.4% were in the range of $25–$500 million—representing the lower end of the middle market.

Often entrepreneurs—even those with successful businesses—aren't ready for a successful exit. While the decision to sell is theirs, many of those approaching retirement think that their ability to grow and manage a company means that they already have the necessary knowledge required to make a successful sale in a competitive market. Yet, there's often more to a sale, and understanding all the benefits for a seller is essential, so bringing in professionals may be a very good idea.

Selling of businesses is on a lot of minds, as the 3.5 million members of the boomer generation have now started retiring. And more sales of businesses are predicted than ever before, in part because of the disinterest of rising generations to take over family businesses.

At the same time, commercial banks, whose debt financing is often critical to making these deals work (see "How the Deals Are Put Together," on page 5), have shown more willingness to extend capital.

HOW THE DEALS ARE PUT TOGETHER

A brief seller's—and buyer's—guide to the sources of funding for lower middle-market companies.

Though many aging business owners are looking to sell their companies and retire, current market dynamics have sparked the ambitions of many other entrepreneurs around the country. One business owner, a food distributor in his sixties, mentioned recently to his advisor that he should probably take some money off the table. But knowing that a lot of his competitors were wounded because of the recession, and some of them didn't run their businesses very well, he wanted to be able to acquire some of them. He hoped that going on a growth spurt would enable him to cash out on a much larger scale some years ahead. Still, how would he pursue such a consolidation strategy without taking on an inordinate amount of risk? One option is to find a private-equity fund to put money into his company, providing some of the capital for future deals. The business owner thus becomes akin to a financial buyer, which makes it crucial to understand the structure of acquisition financing—details that are relevant not just to potential buyers but to sellers as well.

MOST FINANCIAL BUYER DEALS CONSIST OF THREE PARTS	
SENIOR DEBT	Called "senior" because the creditors that extend it (generally commercial banks) are first in line for recompense if the business fails. In today's market, according to bankers, senior lenders have been willing to extend leverage at multiples 3 to 5 times EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization), depending on the company and the EBITDA itself. Broadly speaking, as a company approaches $5 million in trailing 12-month EBITDA, at least some senior bank debt is likely to be available, but not enough to close the gap between the cash equity portion (see "Equity Financing," below) and the top-line sale price.
MEZZANINE OR SUB DEBT	Usually extended by a private-equity or hedge fund that specializes in filling the financing gap. Mezzanine funds charge more in interest than do commercial banks; they also take an equity piece of the business in the form of a warrant in addition to the regular return that the company must pay over a prearranged term. When the term is over, the company must buy out the fund's stake. The good news: Mezzanine debt funds raised a post global financial crisis record in 2015,* and they too have a window to use the money. Growing competition among them for high-quality companies has thus tamped down the overall cost of mezzanine debt.
EQUITY FINANCING	The least secured form of capital, usually provided by a private-equity fund that in turn receives a substantial equity stake in the consolidation alongside the acquiring entrepreneur. The relative size of the equity positions (which can also include a minority share for the owners of the target company) will, of course, depend on the amount of capital the private equity fund is contributing to the deal, the amount of cash the acquiring owner wants to take off the table and the amount of leverage (see "Senior Debt," above) that goes onto the books of the new combined entity.

* Preqin 2015 Private Capital Fundraising Update. Mezzanine debt funds raised $19 billion in 2015.

Some $5 trillion in assets will change hands in the United States between 2011 and 2025, just from the transfer of privately held businesses.

Banks appear to understand the opportunity in financing acquisitions of those companies that are well run and have survived the recession with healthy cash flows.

We're in a seller's market where supply is low and demand is high, so we are also seeing a shift in focus from a particular subset of buyers, Gallagher says. "There are buyers, both private equity and strategic, that used to only focus on companies valued at $500 million to $1 billion, who are now turning their attention to opportunities below $500 million, and sometimes below $250 million." And while Gallagher acknowledges that this is a positive position for business owners who are now thinking about selling, he strongly advises caution. "These folks buy companies for a living and they are experts at doing so," he says. "And if you are an entrepreneur trying to face-off with them and you're not represented, they may eat your lunch."

"We're in the kind of market that business owners see only once in a long while," says Gallagher. The PSRN connects lower-middle-market businesses with vetted boutique investment bankers who specialize in industry-specific M&A. (See "A Network Scaled for Your Needs," on page 7.) "We help our clients across every industry, and it is a rarity today if they haven't already been approached by a private-equity group or a strategic buyer."

The Transition Wave

According to some estimates, more than 9 million companies remain in the hands of the baby boomer owners who founded them. Over the next decade and a half, every one of them will need to come to terms with the notion that the time has come to take money off the table or cash out entirely so that they can transition away from the companies they've spent their careers creating. According to Headwaters MB, an investment bank headquarted in Denver, 83% of all middle-market private companies will be forced to make key strategic planning choices around the retirement of their baby boomer CEOs during the next 15 years.[1] As a result, Headwaters estimates, some $5 trillion in assets will change hands in the United

[1] Headwaters MB proprietary research.

States between 2011 and 2025, just from the transfer of privately held businesses.[2]

This nascent bull market for private companies will most likely create a major inflection point for millions of entrepreneurs. As baby boomer owners look back on 40 years of hard work, including an incredibly difficult end to the last decade, many are wondering if this could be their opportunity to exit the fray.

On the other hand, the current conditions may also encourage those business owners in a more expansionary frame of mind. Indeed, some owners, particularly toward the upper end of the middle market, are becoming serial acquirers, working with private-equity funds to pursue consolidations of other businesses and creating the opportunity for an even more substantial exit plan down the road.[3]

But the decision isn't as simple as "grow or sell." It's about setting and meeting your goals. As Gallagher notes, "Companies have a certain life cycle, from the high-growth phases to more advanced stages of maturity. Depending on where yours is in that cycle, you're going to approach this from a very different place. Fortunately, we have people who can help no matter what part of the curve you're in." If

A NETWORK SCALED FOR YOUR NEEDS

Generally speaking, the world's largest, or "bulge bracket," investment banking firms don't take on companies with an enterprise value of less than about $150 million; smaller deals simply aren't large enough to justify the fees. Filling that recognized gap is the role of the Private Sales Referral Network. Founded in 2000, the group helps Bank of America Merrill Lynch's lower-middle-market business-owner clients find investment banking advisors with particular expertise in navigating the M&A deal market for companies with up to about $25 million in 12-month trailing EBITDA. "Our ceiling is our own investment bank's floor," explains the Network's managing director, Brooks Gallagher.

Over 30 boutique investment banks based in every region of the country and covering every industry are part of the network, which Gallagher and his team manage. If you consider that more than a thousand boutique advisory firms ply their trade in the U.S., you will start to understand how selective the Referral Network is in choosing its membership. "We've done an extraordinary amount of due diligence on these bankers," Gallagher says. "To get into our network today, you have to bring something special to the table. We're really only looking to add folks with a robust Rolodex of buyers and a long track record of success in their industry." Even more than that, Gallagher adds, "you have to show us you have the ability to service the privately owned side. This isn't the Fortune 500. These are entrepreneurs. Before you even take them to market, you have to convince them that they need you." If you think you might be convinced, ask a Merrill Lynch advisor to arrange an initial consultation with a member of Gallagher's team.

[2] Ibid.

[3] A consolidation is the acquisition and merger of two or more smaller companies in the same sector to create a larger entity across geographies.

entrepreneurs aren't yet ready to retire but want to take money off the table, they may choose to sell a portion of equity to a third party through a minority or majority recapitalization. Or they may decide to sell part of the company to employees through an employee stock ownership plan (ESOP).[4] Family businesses, with children in line to take over equity and management, have still more options to consider.[5]

Even for a confirmed seller, the process of working through these decisions governs the type of buyer one eventually approaches. If you want to retire, a strategic buyer is the better option. That's because corporations tend to better grasp the nature of the business and pay more for assets than would private-equity funds or other financial buyers. Strategic acquirers also tend to welcome the departure of the management at the company being sold, because they often value the increased profitability that comes from creating their own business plans and efficiencies.

There's a saying among private-equity funds: "We don't buy companies; we buy management."

Financial buyers, by contrast, often want management to stay in place, maintaining the operational expertise that will help the company grow, thus increasing its value for the day when the new owners make their exit through an eventual merger, an outright sale or an IPO. Indeed, there's a saying among private-equity funds: "We don't buy companies; we buy management." All in all, the choices entrepreneurs make along these lines will amount to some of the most important moves in their careers. The stakes are high. In many cases, the companies boomer entrepreneurs have built represent their largest single assets by far. "These are their 401(k)s,the inheritances for their children, the legacies they leave for their communities," says Gallagher. "They've got only one shot at this, and they've got to get it right."

The Right Deal Team

Some have equated a business owner going to the deal market alone to representing oneself at trial. That might be an exaggeration,

[4] In an ESOP, employees are issued (or are sold) shares in the company for which they work as a benefit of employment, usually under a qualified retirement plan. ESOPs receive some tax benefits.

[5] Ibid. The $5 million individual lifetime gift and estate tax exemption, which had been scheduled to expire on December 31, 2012, was made permanent as part of the American Taxpayer Relief Act of 2012, signed into law on January 2, 2013. Indexed for inflation, the exemption for 2014 is $5.43 million.

but not by much. Building the precise deal team—when appropriate for your goals, one that includes an investment banker, an M&A specialist attorney and an accountant, who can all work with your advisor to fit the plan within the larger context of your wealth management strategy—is often the key to realizing the full potential of an exit. Best practices suggest that a deal team should be put in place as early as 18 months before going to market.

Gallagher knows that many entrepreneurs consider investment bankers, especially, an unnecessary expense. "I love entrepreneurs," he says. "They're the backbone of this country. Every day they get up and fight for their businesses. And maybe they think, 'I don't need anybody. Why would I spend so much in fees for an investment banker when I can do this myself?'"

There are several answers to that question. A good investment banker can help screen out unqualified buyers and identify sources of demand that might not occur to owners. The banker can also help even the playing field, defending the value of a business and driving a premium. Consider the battery of seasoned private-equity dealmakers or corporate negotiators you're up against as a seller—if you're not careful, they won't just eat your lunch; they'll go to dinner and put the tab on your credit card. If you represent yourself, adds San Francisco–based Merrill Lynch Private Wealth Advisor David Waitrovich, "you're basically going up against someone with a Ph.D. in negotiation."

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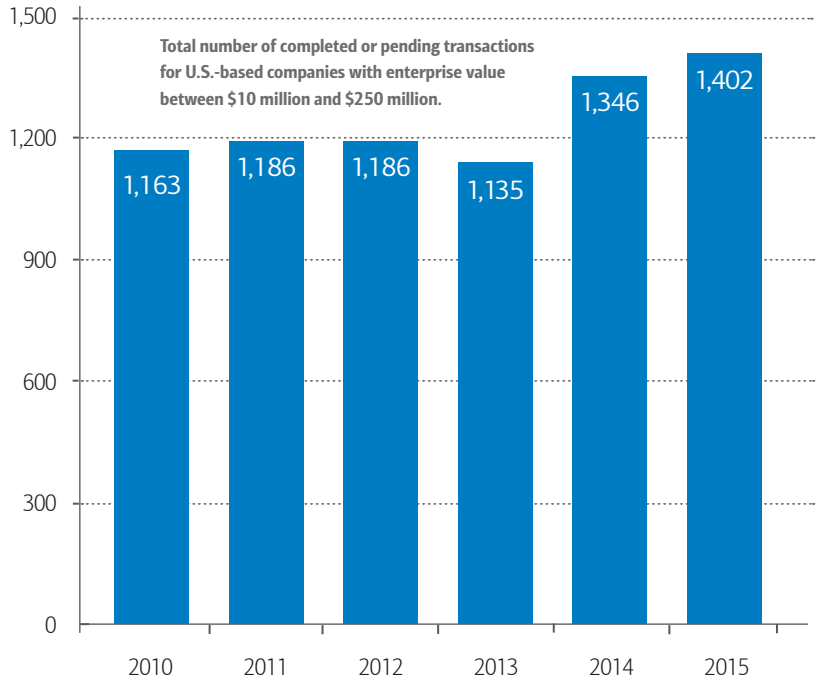
DEAL VOLUME

Merger and acquisition numbers remain high.



Source: Factset Mergerstat, 2016.

If you represent yourself, you're basically going up against someone with a Ph.D in negotiation.

What makes for a good investment bank? First and foremost, the firm's deal team must click with the owner and his or her management staff. Once a company goes to market, the typical sale process takes approximately 6 to 9 months, but can take as long as 18 months depending on the outlook of your company. "You're going to be spending nights and weekends with your bankers," Steve Moiles, director and M&A PSRN specialist at Bank of America Merrill Lynch, warns, "so you'd better like them." Perhaps most important, though, the bank should have deep experience advising companies in the same industry and the same geography, with a long record of successfully shepherding those clients through completed deals. The world is full of independent business brokers with little experience who simply hang up shingles outside the local country club.

To find a banker that is the right fit for you, business owners should evaluate several firms. Known in the business as a "bake-off," it's the process in which bankers from each firm give presentations, highlighting their capabilities and specific strategic plans for marketing the company. Several boutiques competing for an assignment not only helps bring fees down but also allows for business owners to compare and contrast, assessing chemistry.

Preparing a Business for Sale

Even the finest homes need sprucing up before going on the market. The same goes for companies. Because of the complexities of product lines, employees, physical equipment, real estate, suppliers and more, preparations should begin before you even hire an investment banker, and ideally as much as three years in advance of a sale, says John Stewart, a director of the PSRN.

That may seem like overkill, especially if an owner remains unsure about pursuing a sale at all. But because the process amounts to a stringent, thorough quality review, it can only make a company stronger, whether a sale ends up happening or not. "What you're saying is, 'let's create value, let's build an organization that other people want,'" says Ted Clark, executive director of Northeastern University's Center for Family Business. Laying this kind of groundwork, in other words, is something a business owner should be doing all the time.

Some advisors, including David Waitrovich, suggest that companies big enough to make the extra expense feasible (typically greater than $20 million in enterprise value) hire an outside board of directors to introduce some fresh perspective on their business. "Of course, the owner has the ultimate veto," says Waitrovich, "but at least you're going to find out about some issues that you may not have found on your own."

If you're planning to sell to a strategic buyer, or even if you're targeting a financial buyer and looking to retire with the sale, you'll need to assure the new owners that your business can seamlessly survive your departure. If yours is one of those companies where the CEO, CFO and COO jobs are all rolled into one, you may want to consider shifting into more of a chairmanship role and grooming your best employees to assume daily management and hiring outside leadership as needed. Again, an early start is strongly advised. Installing a new masthead too close to going to market can communicate disarray.

Other presale steps are perhaps common sense but worth highlighting nonetheless. Owners need to thoroughly understand how their companies are valued within their specific industries and then strive to position their businesses as closely as possible to enhance those key metrics. Sales per employee, sales per square foot, utilization ratio, customer lifetime value, circulation—"whatever the business," Gallagher says, "the seller will have to provide confidence that the company is executing profitably in that particular arena."

Similarly, owners must make sure that their tax records, any previous issues in the business's past, and their accounting methods and financial statements will be able to withstand the exhaustive review that prospective buyers will give them.

Jack Maier, head of investment banking at Headwaters MB, a middle-market investment banking firm that provides M&A services, says that preparing a business's records for a successful sale is a balancing act that requires the timely participation of various professionals.

"There is a whole range of information that ought to be kept current," says Maier. "Typically, you would involve your accountant, your lawyers and

You'll need to assure the new owners that your business can seamlessly survive your departure.

perhaps an outside consultant in maintaining and preparing books and records for any sort of financial transaction."

Sloppy records can result in hesitation from the buyer, or a price reduction much later in the sale.

Maier, who has advised business owners in many such transactions, reiterates that sloppy records can create uncertainties in the mind of the buyer, resulting in a price reduction much later in the sale.

"There are a myriad of examples of buyers walking away and proposed purchase prices dropping," he says.

Maier has seen many of these longtime cautionary scenarios play out in business sales, but in recent years has seen a new trend, a Quality of Earnings Report (Q of E), performed by an auditor or third party firm at the request of the buyer, where mismatches of earnings versus reported earnings are discovered, resulting in a drop of up to 10 percent of the purchase prices.

"Maybe inventory wasn't accounted for in accordance with generally accepted accounting principles (GAAP) or accruals weren't made properly," says Maier. "We advise clients to take an offensive approach and conduct their own Q of E reports before going to market to identify any issues early in the process, thereby improving chances for a successful sale."

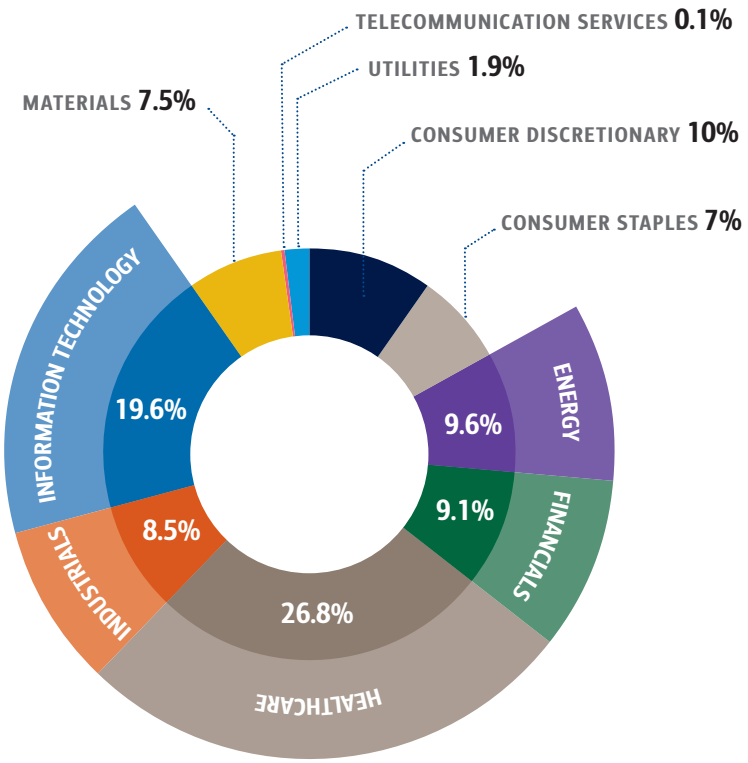
One common stumbling block on the accounting front involves nonbusiness-related matters that may appear on the income statements of family-owned and -operated companies. It's true that buyers generally view family businesses favorably. "They can be a very attractive acquisition candidate, because there is typically room for improvement," says Maier. "A financial buyer may salivate at the opportunity to professionalize the company."

But if prospective buyers find it difficult to gain a clear picture of actual financial performance, it may be viewed as a sign of overall sloppiness, or worse. Anytime owners have mingled the two—using business proceeds to finance family vehicles or school tuition, for example—they need to start drawing clear delineations.

If there were a mantra for these presale preparations, it would be: Buyers hate surprises. "What you don't explain up front will be seen as violating trust," says Tom Spillane, an attorney who works with Merrill Lynch advisors to help clients with their business sales. Any discovery that raises questions about financials, equipment quality or labor issues—even if the omission is an innocent oversight—could cause the prospective buyer to lower the offer price or walk away entirely.

WHERE THE DEALS ARE: AN INDUSTRY BREAKDOWN

Statistics show that private sale activity is occurring across much of the industry spectrum. Here, the distribution of all the transactions for lower-middle-market companies in 2015.



Source: BofA Merrill Lynch Global Research.

Going to Market

The process usually goes like this: Your newly engaged banker makes a study of your company, delving into its books and gaining a strong understanding of its strengths and weaknesses. Eventually, the first inquiries are discreetly made and it comes time for the auction. Arguably this is the most important service the investment banker provides: rounding up enough real, prospective buyers in order to best position the company and maximize its price.

The banker will, of course, screen potential buyers for capability and seriousness. Extensive due diligence must go both ways, the buyer scrutinizing the seller and vice versa—yet another reason to have an experienced banker on the sell side. In some cases, companies won't sell to the highest bidder. If the slightly lower offer price comes from a private-equity group that has a vision for the company more in line with the vision of the entrepreneur, it could make for a better deal. In the

end, that kind of "fit" could increase the company's odds of reaching its financial performance goals after a sale.

Once the process begins in earnest, owners need to be patient. Sale processes fail for many reasons, but one of the most common is impatience on the part of the seller, says Gallagher. That's especially true after negotiations begin. A prospective buyer might offer $35 million, say, and then stridently caution the seller and her banker that this is the upper limit of what he can do or even afford. The seller and her banker, meanwhile, have long agreed that $50 million is what the company is legitimately worth. Gallagher has seen owners lose patience at this key juncture, throwing up their hands and pleading with the banker to just accept a deal or let the buyer walk. But this is part of the process. Often enough, the buyer does have room to raise. "We tell owners to continue to run your business. Let the bankers handle the bids," says Gallagher. Indeed, another potential obstacle to a successful sale process is that, as negotiations drag on, the company's business begins to slide as the owner pays too much attention to the nitty-gritty of the deal-making and not enough to operations.

Sale processes fail for many reasons, but one of the most common is impatience on the part of the seller.

Still, once negotiations enter their final phases, discussions can become contentious. Maier maintains that preparation is key, since discovering new, negative details at the last minute often results in a reduced sale price. A business owner who plans to still play a role in the company after the sale, for instance, must make sure a relationship with a prospective owner is protected. A potential buyer may want to speak with the business's top clients, a step that should be taken only when it's all but certain a sale will happen. A company's marred environmental record can surface last minute, breaking apart final-stage negotiations.

"We see it all the time," says Maier. "So when we are hired by a business, we want to know all the issues up front, because any negative information is going to come out during the due diligence process."

The owner will be called upon to consider a host of details. For example, the prospective buyer may not show interest in acquiring certain company assets—assets that may nonetheless have considerable value. Tossing these into the deal essentially means giving them away. There

can be a good payoff elsewhere for almost any asset that buyers don't want. Real estate is a prime example, as is proprietary in-house software or other technology. In one instance, a glass installation company had developed a glass cleaner for its own use. When the buyer showed no interest, the owner removed it from the deal and gave the license to one of his children, who built the cleaner into a successful business. Other significant issues will likely require attention as final terms are being discussed. Buyers, for example, almost invariably insist on keeping funds in escrow and releasing them over time. That's their way of trying to ensure that the warranted claims the seller has made about historical performance, productivity, assets and other factors pan out in reality.

If those claims don't hold up post-purchase, the seller could lose out on a substantial portion of the agreed-upon price. That's another reason for having an experienced investment banker and attorney partnering with your advisor in negotiations. "Your team's job is to remove teeth from the terms of the sale," says John Stewart. These "teeth" could include the number of warranted performance metrics, the size of the escrows and the length of the escrow period. Generally speaking, the more the company's performance depends on its existing management and employees, the more the buyer will want to hold in escrow until it's clear that he or she will get the same high level of productivity. Each item is up for negotiation. With so much on the line, it's vital that the seller feels comfortable with every item warranted in the contract.

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The Deal for the Rest of Your Life

Entrepreneurs are often better at growing their businesses and building wealth than they are at making sure they and their families reap the full measure of those rewards when the time comes to sell. A 2015 Bank of America U.S. Trust survey of wealthy business owners found that 61% of business owners had not considered a business succession plan when it came to selling their own companies.[6] This suggests that owners caught up in the day-to-day pressures of running a business often put off thinking about the personal side of selling until a sale is actually in the works.

While understandable, such neglect can result in missed opportunities and a huge reduction in what owners and their families actually take home. Adding to the fallout is the fact that many owners have most of their

[6] 2015 *U.S. Trust Insights on Wealth and Worth.®*

personal and family wealth tied up in the business. "I've got clients with businesses valued above $100 million, whose investment portfolios are $1 million or even less," says Scott Cooper, managing director of the Merrill Lynch Wealth Structuring Group. "With so much at stake," adds Anthony Olmo, director of Tax Services for Merrill Lynch Family Office Services, "if you wait until the deal closes, you're far too late."

One of the first things a prospective seller should contemplate is the mechanics of wealth transfer.

In the average deal, taxes and paying off the company's pre-existing debt end up consuming about 40% of the full sale price, says Gallagher. The rest will accrue to the sellers—but only if they plan well and work with their advisor to think through how they want to use the sale to meet their long-term family and other personal goals.

According to many advisors, one of the first things a prospective seller should contemplate is the mechanics of wealth transfer. Simply selling the business and then divvying up the proceeds isn't realistic, given the potential tax costs. First, the owner would pay tax on gain from the sale; then, as he or she distributes what's left by gift or upon death, any amount greater than the gift- and estate-tax exemption ($5.45 million per individual, $10.9 million per married couple, starting in 2016) would be taxed a second time at a rate of up to 40%.[7]

Fortunately, there are plenty of alternatives. Say an owner has two heirs. She could choose to give nonvoting shares in the company to each heir (this should be done well before a deal is in the works, because it may invite all manner of negative scrutiny from the IRS). Because those shares are nonvoting, their market value is less than what it might be when the company is eventually sold. That means the owner can give away a larger share of the company while still keeping the value of that equity below the $5.45 million gift-tax exemption. And because the value of a company often peaks when it's sold, those shares could be worth much more when a sale goes through—and the proceeds would be taxed only once, rather than twice.

The structure of a deal will also play a big role in helping the owner achieve his or her wealth management goals. In essence, there are two basic ways to

[7] The $5 million individual lifetime gift and estate tax exemption, which had been scheduled to expire on December 31, 2012, was made permanent as part of the American Taxpayer Relief Act of 2012. Indexed for inflation, the exemption for 2016 is $5.45 million.

structure deals: as a sale of stock or as a sale of assets. The difference is far more than a technicality.

A stock sale, also known as a share or entity sale, means the seller is turning over the entire company to the buyer as one package, including everything from equipment and receivables to goodwill and office furniture. In addition to being straightforward, this approach generally has the advantage of allowing the seller to pay tax on any gain at the long-term capital gains tax rate of up to 20%.[8] Hence, most sellers hope for a stock sale.

In an asset sale, by contrast, the business entity sells its assets to the buyer. Although this process may be more complex, buyers usually prefer an asset sale because it can help them avoid any potential liabilities belonging to the company that owns the target assets. It also could come with certain tax benefits for the buyer—for example, the ability to claim increased depreciation deductions as a result of the stepped-up basis in the acquired assets. Unfortunately, the seller can suffer, because gain on the sale of many assets typically ends up being taxed not at the lower long-term capital gains rate, but at the ordinary corporate income tax rate, and then the after-tax sales proceeds generally are subject to a shareholder level tax upon distribution to the owner.

The issue arises for any business classified as a C corporation, or for certain S corporations that formerly were C corporations. The gain recognized by these companies can, in effect, be taxed three times: First, at the 35% corporate rate; second, when the after-corporate-tax proceeds are distributed to the owner as dividends; and third, when the wealth is transferred to the heirs.[9]

Because of these conflicting benefits, the choice between an asset sale and a stock sale is a crucial negotiating point. While buyers may

A stock sale, also known as a share or entity sale, means the seller is turning over the entire company to the buyer as one package.

[8] The long-term capital gains rate starting in 2013, as determined by the American Taxpayer Relief Act of 2012.

[9] Income and gains generated by C corporations, including gain recognized from an asset sale, are taxed at the corporate tax rate, and amounts that corporations distribute to their owners as dividends generally are taxed again at the individual shareholder level. Income and gain generated by S corporations (a classification sometimes used by small businesses) are "passed through" to the tax returns of their owners, and thus generally taxed only at the individual shareholder level. However, for certain S corporations that previously were characterized as C corporations, the C corporation rules could apply to all or part of the corporation's gain on the sale of its assets.

insist on an asset sale, Olmo says, that's not necessarily an automatic disadvantage for the seller. In exchange, the business owner may be able to exact concessions on other sticking points or obtain a higher sale price. Likewise, "if you can negotiate a stock sale, the buyer will usually insist on paying less," Olmo adds.

These detailed negotiations are where your experienced deal team comes to the forefront. For example, a seller might choose to accept part or all of the payment in the form of shares of the buyer's company, to be sold later and taxed as capital gains. This will raise the investment risks associated with any concentrated stock position, but, using sophisticated hedging strategies, such as options or exchange funds,[10] your advisor can then help you offset that risk until you're free to diversify your holdings.

Engineering a successful exit starts with keeping an open mind and trusting the process.

In another example, a pre-sale company might have a board of directors that includes family members instead of business professionals. "You want to construct a board like a public company would," says Maier. "You need professional members who actually add value to the business. Doing so will help to ensure you attain the highest possible value for your company and create a useful sounding board for the owner.

"It comes back to preparation," concludes Maier. "We can identify and recommend potential changes to a company's growth and investment plans, then enlighten them about how to position the company in the most favorable light to help increase value and attractiveness to buyers."

Engineering a successful exit starts with keeping an open mind and trusting the process. Entrepreneurs who are seeking to transition away from their company should consider talking to their advisors and transition teams as early as possible. Advisors can begin helping any entrepreneur sort through the options to determine what steps may be best to help provide financial security for the entrepreneur and the entrepreneur's family. A solid transition plan is one of the keys to protecting and growing any legacy.

[10] Exchange funds let investors with concentrated positions diversify without triggering capital gains tax by exchanging a large block of their stock for units in the fund's portfolio. Investors should keep in mind that investing in exchange funds is speculative and involves substantial risks including the risk of investment loss. In addition, there are fees and expenses associated with investing in exchange funds, which may make them more expensive and/or less attractive to a particular client. Also, exchange funds may provide tax benefits only when certain conditions are met. This is not a complete list of the risk considerations for exchange funds. Please contact a Merrill Lynch Financial Advisor to learn more about the additional risk considerations.

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