LIQUIDITY EVENT **LESSONS**
WITH LATTICE WEALTH MANAGEMENT

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[00:00:00.160] - Ryan Ross

[00:00:26.500] - Mike Morales

Yeah, thanks. I'm Mike Morales. I'm a tax principal at Aber, String and Melinch, a local county firm in Silicon Valley located in Campbell, California. I've been doing this about 17 years. I specialize in closely held businesses and high net worth individuals and looking forward to talking about stuff today.

[00:00:46.700] - Ryan Ross

So this conversation is specifically for people that are before or after a liquidity event, I want to call it on the precipice, but we also talk to people after they've had one. Right. So with that in mind, like, how often do you get involved in business exits?

[00:01:04.750] - Mike Morales

I regularly get involved with business exits. You know, it could be small sale of assets or a full blown merger acquisition deal, depending on what the client's got going on. But several pop up during the year. Sometimes we plan for them several years out, and sometimes I get the client out after it's all done.

[00:01:23.870] - Ryan Ross

Yeah. Would you say it's like multiple times a month that people are coming, or is there any, like, seasonality that you see?

[00:01:31.050] - Mike Morales

Yeah, every couple months. But the seasonality question goes with mostly economics, right. When the economy is really hot, people are interested in buying businesses. There's more broker deals doing, going on then and more ipos in relation. And then when the ipos pull back and economy gets tight, kind of like currently. Right now, the people are not throwing money out to buy businesses. They're kind of looking at costs currently. So it is cyclical with the economy. But there's, you know, in Silicon Valley, there's deals happening every month all the time, you know,

[00:02:05.530] - Mike Ross

so, Mike, you've seen this stuff over the years. As you reflect upon it, what mistakes have you seen business owners make in their exits? And if you were to kind of wave a magic wand, what changes would you suggest these guys to eliminate those mistakes, either pre or post exit?

[00:02:25.990] - Mike Morales

Right. Typical mistakes are inadequate preparation for the tax implication of the sale or the exit. Another thing in common is, like, overlooked, important tax planning strategies. So some of the strategies happen before the sale, during and after. So when someone comes to me after the fact that the deal has gone through, you know, we've just missed all the pre tax planning items and, you know, so the recommendation is tax planning in advance is very helpful. Implement those strategies such as structuring the transaction to maximize capital gains treatment, understand your cash flow from the deal and utilizing available tax credits or timing. Because, you know, hey, maybe I didn't put solar on and maybe it's the year since I sold a whole bunch of, made a whole bunch of money, now is the time to do it. So working with an advisor on timing in the year it happens is also helpful. And then the thing that people forget that I really want to point out is understanding the valuation of the business and its assets. I bring this up because a lot of clients will tell me, hey, I think my business is worth x million.

[00:03:35.840] - Mike Morales

And I go, okay, great. And then the valuation comes through and it's worth half. It's very typical. People think it's worth more, but, you know, it's not worth as much because, you know, we just got out of COVID It's not a Covid proof business. So it's cyclical with some of the cycles. So a lot of things go into the valuation and that's why, you know, we recommend professional to do the evaluation instead of, you know, you back a long envelope based on your industry. So the bottom line is the further advance you know, you can look into exiting, the better the outcome.

[00:04:12.490] - Ryan Ross

What is like a time that. So if you're saying the further in advance you can look, is it like a five years, ten years? Is that like the window or does it depend on the business?

[00:04:22.810] - Mike Morales

Generally speaking, it's two to three. Five is ideal. Definitely, definitely a minimum of one. The two to three year suggestion I brought up is usually because the buyer wants to see at least two years of financials and tax returns, sometimes three and then sometimes five, for the larger, larger scale transactions. So if you only just plan six months before the sale, then you're leaving all this stuff on the table. Whatever happened, happened where if you're planning towards it, you can clean up the financials in a very clean way and clean up the stuff on there along the way. To get to that exit, I want.

[00:05:08.010] - Ryan Ross

To ask you about like bringing advisors into the fold. But before I do that, I want to ask about. You said often people undervalue, they undervalue their business assets in addition to the business. Right. So they're not thinking about the two holistically. Is it often that they're here?

[00:05:49.080] - Ryan Ross

Okay. I want to ask about bringing in outside advisors, but before I do that, you mentioned that often people, they underestimate the valuation of their business and the assets. Now, is it, is it, is there like a balance to that? As in, like, oh, they think their business is worth more and their assets are worth less? Or what is, you know, any, like, discrepancy between their expectation and reality?

[00:06:15.800] - Mike Morales

Well, most of it comes to the intangible asset of the business, meaning, you know, my client list or my widget or, you know, my SaaS software or whatever, you know. So some people just think it's worth a lot more and there's more capabilities than there really are. Usually people think it's worth more than what it really is. That's the, you know, I would just.

[00:06:39.050] - Ryan Ross

I guess that's the ego playing, right? You're like, this is definitely worth more. Is. And one follow up question, then we'll go to the advisor's question. Do people, does that vary across industries? As in, would software, would there be like an inflated sense of what the valuation is versus, like a service business or like, h vac repair? Things like that.

[00:07:02.270] - Mike Morales

Right. I work with a lot of service businesses and it's across the board, everyone thinks it's worth more. And the reason I bring up the whole valuation to begin with is because if you go get a real evaluation from an evaluation expert, you know, they're going to show you the trends of how you get to their previous years and future years, and they're going to come up with a number and that's going to be your value. And it's based on industry standards, it's not based on, hey, my friend's company is sold for XYZ, so mine's worth more than that because I have this cool future or something. Right. In reality, maybe it's worth like half of what the person thinks because that new future is not very valuable, you know, interesting. And then the valuation person says, hey, yeah, it is valuable, but it's worth this on the market. Yeah.

[00:07:53.610] - Ryan Ross

So you say like a new future, as in, like, in the future, it's that that service will not be as useful. Is that like.

[00:08:01.470] - Mike Morales

Yeah, it all depends on the industry and the valuation per person that does the evaluation. Looks at it industry specific, usually. And they have some pretty cool analytics that they do.

[00:08:13.060] - Ryan Ross

Wow. Well, now that we're speaking about external providers, like valuation experts, how common is it for people, business owners to hang on to, outside advice, advisors, cpas, attorneys, things like that, who really aren't, like, up for the job of a transaction because, you know, they're buddies and they play golf together, things like that. Maybe they don't want to, like, ruffle feathers. How often does that happen in your experience?

[00:08:40.810] - Mike Morales

Very common people have these long term relationships and they get comfortable. Right. They get comfortable with the person, they get comfortable with the processes. And yeah, it might be okay, but as an advisor, I encourage these business owners to evaluate all their advisors objectively based on their experience and capabilities, because, you know, there's a lot of things that go into a sale, and if these people haven't been doing exit sales and stuff like that, they're not going to know the whole buildup, you know, to it. Right. So there's a big difference between a tax preparer and a tax advisor. So I'm a tax advisor. The difference is a tax preparer gets your information, prepares your return, and sends you on your way until the next year. Right. Generally speaking, the tax advisor works with you before those documents are available at year end, then gets the documents from you and then oversees that. What we planned at year end is actually the results of the tax return. So, you know, it's the difference of the advisor looking forward versus the tax preparer looking backwards. So a lot of times these people that they just have tax preparers and they're going through their business throughout the years.

[00:09:53.750] - Mike Morales

Long term relationship. Right. And then they sell. Well, you know, that advisors, they can't advise because they're preparers. They're not advisors. So knowing the difference of when you need an advisor and when you need preparer is crucial. And everyone that comes talk to me looking for a CPA, that's the first thing I explain to them. Do you need a tax preparer or do you need a tax advisor?

[00:10:13.670] - Ryan Ross

I see. So there's. Because all these types of advisors or consultants or whatever, because their roles are so specialized, they're much more useful when you know, when to put them in the game.

[00:10:25.740] - Mike Morales

Right, right. And Mike, Mike, you might have some comments on this, too.

[00:10:29.710] - Mike Ross

And, you know, I've. This bit. This has been a revelation to me over the last few years on the breadth of different types of financial advisors in my world. And I've come up with a handful of questions that people should be asking their advisors. I am guessing, though, that in the certified public accounting world, you can think of two or three questions that you ought to be asking that longtime accountant to figure out whether they're the right guy or gal for that next role. Give us some perspective on the kind of questions you ought to be asking.

[00:11:03.430] - Mike Morales

Yeah. For the CPA. And this is coming from yourself. You say, do I fully understand the tax implications for both myself and the business? Right. Because if you don't understand it, that means your current CPA hasn't explained it to you. So that's like a simple question you can ask. And if they don't know and you don't know because they haven't told you, then that's probably a time to get a new advisor.

[00:11:26.890] - Mike Ross

Yeah, gotcha.

[00:11:28.620] - Ryan Ross

I see. Are there any other questions you can ask?

[00:11:32.500] - Mike Morales

Yeah. So, like, for the business broker, you know, if you're going to sell, you know, before you go to a business broker, the question you ask yourself is, am I confident in my ability to negotiate the terms of the transaction to achieve my financial goals? You think it's worth this, but in reality it's not. Well, the business broker is going to tell you what reality is and what you're going to get to it. Going back to the cyclical cycle of deals, the business broker is going to be like, the market's hot, now's the time to sell. Or everyone's pulled back from buying businesses. Maybe we should work towards selling when the economy gets back into swing. For the valuation expert, the question is, do I have access to expertise in business valuation? Do I know the worth of my company? Do I really know? 99% of the time is no, because most people aren't valuation experts. Then two more I got for the business attorney. You might have a great attorney, but there's complex legal implications with the exit that are going to require some specified knowledge. And you might need a transactional attorney just to get through the exit.

[00:12:44.080] - Mike Morales

So, you know, you might have a great corporate attorney, but the question is, how often does that great corporate attorney deal with exits? Is it every couple of months?

[00:12:52.960] - Ryan Ross

Yeah.

[00:12:53.240] - Mike Ross

And then ego gets into it too, because, you know, I've bumped into this. Oh, yeah, I know how to do all that stuff. Have you ever done it? Well, no, but I've read the books on it. Have you ever done it? No. No. Okay. Yeah, it's an experience thing. You gotta have someone who does this stuff regularly.

[00:13:08.690] - Ryan Ross

Yeah, I found it on YouTube. That's good enough, right? Learn how to change my brakes on YouTube. The car stops.

[00:13:14.540] - Mike Morales

Right. And you can, you can ask, you know what, you can ask the advisor, any advisor, when was the last time you went through this? You know how recent?

[00:13:22.540] - Ryan Ross

Yeah.

[00:13:22.960] - Mike Morales

What was the outcome? What. What was your success from the client, you know, story that you can share with me, you know? And then the last question I have for advisors, which people forget about. Right. And, Mike, you're gonna love this one. So have I considered alternative exit strategies for potential tax and financial implications? Right, right. So you might have a great financial advisor. Right. Well, you just sold the business for $40 million. Does that financial advisor know what to do with 40 million versus 5 million? That's a great question. So the question is, you know, how many of you know financial advisors, sir, ma'am, do you have a lot of clients with, you know, $40 million of net worth that you're dealing with? I don't know.

[00:14:07.780] - Mike Ross

And, Mike, I found that you better ask that question face to face, because if you ask it over the phone, you may have hear a pause and then some, some dancing. But it's a good question because there's a very finite number of people in my world that know how to deal with that type of net worth.

[00:14:29.080] - Mike Morales

Right. And it completely changes the landscape, you know, for me on, since I deal with the high net worth individual return, you know, after the exit, you know, the client before, you know, got one or 210 99s. Right. And now the, like, you know, the new brokers got 610. They all do different things, and there's, like, a lot of complexity. And then they buy PTPK ones, and then they're in hedge funds and because they're hedging their wealth. So it makes sense. But does your tax prepare know how to do all those k one's reporting and tracking?

[00:15:03.760] - Ryan Ross

Yeah, I guess you don't want to be a guinea pig for an advisor, right. It's just kind of like, I do. I do triathlons and, and I found this coach, and he's like, oh, yeah, I can. I can do triathlon. I can teach you how to do triathlons. He was an Olympic triathlon coach. Olympic is the distance. It's not like the Olympic rings or whatever. And I'm like, I'm going to do an Ironman. He's like, oh, well, I've done one. I can help you out. And I'm like, I don't know if that's what I'm looking for, man. I want somebody that's coached real people. So it's kind of similar with this case. Right. You don't want to be the guinea pig for somebody that's, you know, that's. Oh, I can. I'll take the certification. No, you. You want to make sure that they are a doctor that's, that's delivered a baby before. You don't want to be the first one.

[00:15:49.800] - Mike Morales

Several. Several babies.

[00:15:51.110] - Ryan Ross

Several babies, yeah. You know, when they're a professional, they go in and they just get it done. Okay, so any good, like resources out there for business owners to educate themselves on, on the exit process? This is when they maybe want to go to YouTube. Don't know, maybe they want to speak with a professional. Any like good resource resources that you can recommend to people that are pre exit, post exit.

[00:16:15.540] - Mike Morales

Yeah. So you know, of course there's a classic, you know, books and publications, forums, conferences, networking events. The more intricate ones are like the online platforms to your specific industry or courses around educational content for exiting. So those are some things I would look at, but just generally speaking, because I know everyone's just going to go on Google right now. Right. So when you're on Google, you know, if you're looking at a CPA firm, one of the big four like KPMG, and they got an article on exit strategy, you know, I could tell you generally speaking, that's going to be, you know, valid article and have some good input. When you go across these other random small CPA firms that just put something in chap GDP and spit out an article that has no authority or no substance, those are not the ones you want to be reading, you know, so you want to go to the more of the, you know, the CPA firms that put out the literature, you know, like ASL, we have articles that come out every other month and blog posts, you know, that's coming from like a real CPA firm versus these one off people that are just trying to get video likes and, you know, and their social status up, you know, that's great.

[00:17:30.300] - Mike Morales

But some of the information may be wrong, misleading, and they could tell you one thing that could lead you down a road that you're not going to want to go.

[00:17:36.660] - Ryan Ross

Is there any indication of who has the most credibility? Because not every CPA firm, not every advisor is going to be like a top ten, right? But they do still have like, credibility. Is there any certification or any sort of signal that that is quality information that they're putting out?

[00:17:59.630] - Mike Morales

Well, any reputable CPA firm, you know, in the industry should be okay, generally speaking. But these smaller, smaller ones, and I'm talking more like the mom and pop CPA firms, it's harder for them these days versus in the past because the tax law is changing every day. We're all specialized here at ASL. You know, we all have different specialties. And these smaller CPA firms don't have the bandwidth to have the specialties. They have to be generalists. And unfortunately, in this day and age in accounting, there's no more new generalists. The only generalists that are still working are people that have been doing it for 30, 40 years almost.

[00:18:37.260] - Ryan Ross

I see. Okay, so that means that they are, they're going to be, well, the people at the smaller firms, they're going to be really, really specific in the type of any thought leadership that they would put out. So would they be harder to find or would, would the best resource, I guess, be going to the major firms? And then after you've educated yourself, then find somebody that's more local, that's more niche for you.

[00:19:02.660] - Mike Morales

That sounds like a good, good approach.

[00:19:04.960] - Ryan Ross

Or you could find a financial advisor and they can say, hey, talk to.

[00:19:07.730] - Mike Morales

This guy and they could send you some articles. Because, like me looking for exit article that has authority and substance, I probably could find in three to 5 seconds, you know, a regular person that doesn't know tax law and everything could spend three to five minutes looking and they not looking for the right thing. Right.

[00:19:26.160] - Ryan Ross

Yeah.

[00:19:26.520] - Mike Morales

So, you know, again, you know, working with the right professionals is key. And another thing I want to point out, and Mike, feel free to chime in on this one, is working with professionals that work together, because you can have a great CPA, great attorney, great financial advisor, but if none of them talk together, you know, and you can't build a team, your success is going to go down. So I always tell people, you want advisors that can work with better advisors. You want advisors are easygoing and flexible and they're going to listen and not just be closed minded, you know, because, you know, when I get into some of these deals, things can go one way or the other. The allocation of the purchase price is huge. So working with the business broker to make sure they get the right allocation on the fixed assets and then moving things to capital gain treatment is crucial and paying that advisor to do that, the tax savings are way bigger.

[00:20:23.570] - Ryan Ross

So question about after the exit. Are there any issues that traditionally come up that you see all the time that you wanna, like, warn people against or what are the types of issues that come up?

[00:20:34.950] - Mike Morales

Right? Yeah. So some of the issues that come up when the deal is about to close and everyone thinks they got their money and everything's ready to go is salt income tax issues, meaning sales tax, state taxes, city taxes. So the problem is a lot of our customers are on the web and they're across the United States, and they may go into other states and not file there. Well, what happens during the sale process is the buyer does their due diligence and they check to see, should this entity be filing in the states, should this entity be paying sales tax it hasn't been paying. And the problem is, when this stuff comes up in the 12th hour, when you're not getting in front of it again, your price is getting reduced. And so what you want to do is you want to be on top of that before they figure it out. So are you caught up on all your financials, as they say? Is there any skeletons in the closet? What's the status of your employee retention credit? Have you gotten it? Are you for sure getting it? Is it going to be a liability?

[00:21:38.870] - Mike Morales

You're going to have to pay back, you know, because you're banking things on government shutdowns. And then the other thing is for S corporations, you know, it's one class of stock, and they need to be pro rata distributions. If the distributions go non pro rata, you just blow in your s corp. And now your C Corp.

[00:21:58.310] - Ryan Ross

You can be. You can. You can have an. You can go from being a C Corp to an s corp, and you.

[00:22:03.710] - Mike Morales

Can go from S Corp to a.

[00:22:04.870] - Ryan Ross

C Corp. Not by your own accord, if you.

[00:22:08.190] - Mike Morales

Yeah, yeah.

[00:22:09.830] - Ryan Ross

It's. It's so. It's like a forced transition.

[00:22:12.650] - Mike Morales

Well, yeah, you don't purposely do it, but, yeah, yeah, it can happen.

[00:22:15.990] - Ryan Ross

Wow. That's so strange. Well, that's also. Did we ask about the, like, steps involved to make sure you have the right CPA after an accident? I don't know. Did we cover that yet?

[00:22:28.640] - Mike Morales

I don't think so. A little bit.

[00:22:30.840] - Mike Ross

I think in the context that my experience is that the business seller is so fully focused on getting the deal done that they forget to think about themselves when. And so it's only, you know, I bump into this all the time. It's only well after the deal is done, because then they got to help make sure that the two companies mold together and things like that. So it ends up being that they need to do the shopping, but they run out of time prior, and that's when they revert back to their old advisor. And as you pointed out, Mike, if you go from being worth 2 million to 20 million, you got a different set of problems, and you got to find someone who can address those problems, and it's usually not the same person. So, Ryan, I think we did cover it in the context that you got to go out looking. And, Mike, you just brought up a really key point. You got to have a situation where advisors will play in the same sandbox together. I have countless encounters reached out to a client's accountant, and they don't want to talk to me because it represents more work and they're afraid to bill the client for that extra work.

[00:23:49.930] - Mike Ross

So you got to find people who'll play nice in the sandbox together.

[00:23:54.780] - Ryan Ross

Interesting. Okay, well, that makes sense.

[00:23:57.020] - Mike Morales

Yeah. Can I add one thing to that? Yeah. You know, again, back to the CPA. Right. And working with advisors, like Mike is talking about. So the thing with people when you ask for cpas is, what's a CPA's availability?

[00:24:11.520] - Mike Ross

Yeah.

[00:24:12.600] - Mike Morales

What is a CPA's industry experience? And then the last thing is, what's the approach to client service? Like, what's the deliverable? Like, you're going to go do a return for me. How are you going to give it to me? You're going to do a projection for me. Well, how are you going to relay my estimates and how I'm doing? Is there a process? Is it streamlined? Because I streamline it with my clients to make it easy? Because, again, like Mike said, these people are busy. They want a 32nd blip of what they owe, when they owe it, and what's going on with their business and where they're heading for the year.

[00:24:47.320] - Ryan Ross

Makes sense. How can people find out more about you, Mike?

[00:24:55.360] - Mike Morales

I'm on LinkedIn. I'm on aSl's website@aslcpa.com. dot. I'm in networking groups. I'm in local chapters.

[00:25:07.080] - Ryan Ross

You're based in which city?

[00:25:08.430] - Mike Morales

San Jose.

[00:25:09.860] - Ryan Ross

And where do you service?

[00:25:11.750] - Mike Morales

So west coast. So, you know, California, Washington, oregon, and some in Nevada and Arizona and stuff like that. But mainly west coast is my specialty.

[00:25:22.140] - Ryan Ross

Wonderful. Dad, anymore questions?

[00:25:24.740] - Mike Ross

I think we're good. Thank you, guys.

[00:25:26.080] - Ryan Ross

Okay. Thanks, Mike.

[00:25:27.940] - Mike Morales

Thank you.

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