LIQUIDITY EVENT LESSONS

WITH LATTICE WEALTH MANAGEMENT

[00:00:04.03] - Ryan Ross

Okay. All right, everybody. Give people a few minutes to shuffle in, and then we will get started with the show. We have a great panel today talking about Team, Time, and Tenure: The Liquidity Event Decision Framework for Business Owners. As you can see on the screen, we have a panel of experts that I have focused specifically on these things. We have Mike Morales, Sean Flynn, Matt Cohen, and this panel will be moderated by Mike Ross of Lattice Wealth Management Group. In just a few seconds, we're going to do a few intros, but I want to cover some housekeeping items before we do that. This panel is live and interactive. If you have questions, send them through. We are happy to answer your questions. If you want to get in touch with any of the panelists during the webinar, preferably after the webinar, we're going to enable you to do that, and we're going to put up some polls to help you tell us, Yes, I definitely want to be in touch with them. Look for that throughout the webinar. We're going to be talking about taxes, selling a business, buying a business, what to do when that happens.

[00:01:18.07] - Ryan Ross

This is all about liquidity event lessons. So, without further ado, I'm going to switch it over to the moderator, Mike Ross. Okay, take it away.

[00:01:27.13] - Mike Ross

So, ladies and gentlemen, looking at you can tell that we're not going to do a presentation on middle-aged men hair products or hair care. Ryan, why don't you go through some of the bio-ones? Why don't you hit me with the first bio page, and I think it's Sean. Sean, give us 30 seconds, a minute on what you do while people look at your background.

[00:01:54.18] - Shawn Flynn

Hey, everyone. Thank you for having me here. I'm the Principal at Global Capital Markets. We're a boutique investment investor Bank, focused on mergers, acquisition, and growth capital. Here's my LinkedIn if you want to connect with me. A little bit about my background. I spent eight years overseas, a lot of the time between US and China, before hopping into the investment bank where I've been as first-journey ventures and now global. I really am happy to be here. This is an exciting panel. I've known Matt and some of the people here for quite some time, and I'm really excited to have a great conversation and to learn from everyone as well.

[00:02:28.24] - Mike Ross

Thank you. Ryan, next slide, please, Ryan. Mike, why don't you give us a little bio on yourself, please?

[00:02:36.17] - Mike Morales

Thanks, Mike, and thanks for having me. Hi, everyone. My name is Mike Morales. I'm a tax principal at Abbott Stringham Lynch, a local CPA firm in the Silicon Valley. I specialize in closely held businesses such as S-corporations and LLLCs, as well as high net-worth individuals. I work with people day in and day out minimizing their tax bills and figuring out what they owe and when they owe it and what they can do. I have a master's in taxation, and I'm also a licensed CPA. Thanks again for having me.

[00:03:06.14] - Mike Ross

Of course. And Matt, please.

[00:03:11.22] - Matt Cohen

Well, good morning, and thank you. My name is Matt Cohen. I'm a partner at a boutique M&A firm called Synesis Advisors, and I specialize in the sale of privately held companies. Most of the projects that we do at Synesis are B2B, service businesses, import companies, some manufacturing, and quite a few projects in licensed trades in the past few years. Most of our deals are under $25 million in sales, with the sweet spot being 5-10 million in sales.

[00:03:46.02] - Mike Ross

Fantastic. Ryan, next slide. So, my background is I've been a financial advisor for almost 35 years. I've dealt with a wide range of clients. In any given day, I'm dealing with accountants,

attorneys. I've talked to both of those skills since today, as a matter of fact, dealing with different client needs, one of which is having clients who are at the point they want to sell their business and then directing traffic amongst the professionals. To give you an example, why don't you go to the next slide, Ryan. I'll give you two key examples, And the example number one is I was doing a visit with a physician last week for a very minor, very trivial surgery, and he proceeded to tell me all the idiosyncrasies of what he was going to do in this very minor surgery. And I list them a little bit. It's like I'm thinking, This is your deal, not mine. And then at the end, either I said, or he said, I think I profit. I said, “How many things have you done?” He said, “I've done in the thousands.” And that's when I started feeling good about the surgeon. Another example occurred literally last Tuesday.

[00:05:11.12] - Mike Ross

I walked into a long-time client's office who owned both a medical practice as well as another medical organization. And she announced that she was in the process of selling the medical organization. And she had an attorney and an accountant, and they were just fine. Everything was going to be fine. And the tone of her voice suggested, I got this all under control. So afterwards, I texted her and said, “Look, I know you know you have the right people but humor me. I'm going to send you a series of videos from colleagues of mine that do these types of transactions all the time. Will you at least look at them?” And what I've discovered in my career is that in way too many cases, clients will rely on someone who they've been working with for a long time for that reason and that reason only. They have a person they're working with, the team they're working with may or may not have the skill set, but they don't even know the right questions to ask. So, this is why this panel discussion is so very important to give everyone who listens to this, be it live or later, an idea of the kinds of questions to ask.

[00:06:29.02] - Mike Ross

So, Ryan, if you can switch over to the page with all of our pictures, I'm going to go through and ask all of our panelists a series of questions. And throughout this, there's a way to communicate with you guys in the audience. We're going to throw up some polling questions. Ryan, if you want to go ahead with that.

[00:06:47.22] - Ryan Ross

I'm bringing it back down.

[00:06:49.17] - Mike Ross

What's that?

[00:06:50.12] - Ryan Ross

I'm going to bring down the slide, so we'll just have everybody's face.

[00:06:54.16] - Mike Ross

That's fine. Again, guys, let's not talk to anybody about our hair care products. Sean let's go with you first. Why don't you tell us, John, what are some of the questions a business owner should be asking themselves about selling their business?

[00:07:14.04] - Shawn Flynn

Actually, I've done a bunch of research on hair care products, so this question has caught me by surprise here. There are so many questions that a business owner should be asking themselves before doing this transaction. Because this is such a major That's the thing in many people's lives. In fact, you'll hear stories of people that have gone through divorces, that have lost pretty much everything to keep that business alive, to grow that business over the years. One of the first questions they should really ask themselves is, what are they What are you going to do post-transaction? Have they really mentally prepared for that transition period of maybe working 60, 80 hours a week to now, Hey, now I have this time. Do I have hobbies? Do I have some friends and family relationships? Do I know what I'm going to be doing post a transition, post an acquisition? So, one of the things, ask yourself, What are you going to do after? Also, you have to ask yourself, Will this exit give me what I need for the rest of my life or next steps. And that's when talking to Mike, to yourself and going, Hey, my company is valued

in this range based on what my investment banker, my business broker, my M&A advisor, whoever I'm working with, the valuation expert has given me.

[00:08:35.16] - Shawn Flynn

Now, is that enough to carry on the way I want to live? Or do I need to grow this business a little bit more? Or have I already passed that? And then they need to ask themselves, going to other Mike on the screen, Mike with hair, how do I structure this deal or the tax plan and what conversations I need to have before so that when we do this process that I'm getting the maximum result and that whatever I'm getting from this transaction, how it's structured makes sense. Then there's also the conversations of, Okay, let me talk to my family about this transaction. There's a long list of items and questions that they should ask themselves. They should take an inventory of their situation before starting along this process because it is such a time-consuming process, and it is one of those major moments in your life that you may have spent 10 years building up, 20 years building up, 30 years building up. It's going to seem like that, but it's a grueling 6-9 months or however long it takes to get this. I could go on forever, but I don't want to take up everyone's time.

[00:09:48.06] - Shawn Flynn

If it's a hair care product company, those things sell like that. So don't need to worry about it.

[00:09:55.04] - Mike Ross

All right. Given that one of the things Sean was discussing was valuation. Matt, give us some insight into how small businesses are valued and maybe how the buyer's opinion and the terms differ from a professional valuation before.

[00:10:12.04] - Matt Cohen

Yeah, thank you. I think most people that own a business and have put any thought at all into selling it understand that earnings or EBITDA is the gold standard for determining business value. I mean, it measures the company's profitability and financial performance, and it This is

the primary driver. There are other methods for valuations, which I won't talk about today, but they're equally as important. But professional valuations, they're incredibly important. And professional evaluation people help us so much with what they do. What's often not considered, though, are a variety of operational issues that can affect the business's ability to generate EBITDA going forward. I want to highlight a couple of things that buyers will pick out. We'll look at this through the buyer's lens. What do they see that is risky for them? I'll just hit a few of them. We can have a nice EBITDA in a multiple of that EBITDA and a nice valuation. But when you look at things like sales trends, are sales trends going up or are we looking at a over a period of years? That's a really important factor because if this business owner is unable to grow the business, how can a new buyer be expected to do that?

[00:11:41.01] - Matt Cohen

The second one that I see a lot, particularly among baby boomers, is who are selling, is what management is left in this business after it trades? So, we know the owner won't be there, whether they're going to retire or do something new, they're not going to be there. But if they have key managers, key staff responsible for that are also not going to stay. That's an incredible risk for a buyer, whether it's a corporate purchaser or an individual who's purchasing the business. And one that really is a big thorn in my side is customer-based and customer analysis and customer agreements. So, I have a lot of buyers, particularly older ones, that have handshake agreements with their customers. Their contracts, they have no teeth. There are quick cancelation clauses. This is a big problem if you're buying a business. How do you know that these customers are going to stick around? And on that same note, what if one customer makes up 10, 20, 30 % of sales? What is a buyer supposed What's it supposed to do if that customer leaves? That's an incredible risk for buyers. And these items here are often not measured in the business valuation.

[00:12:56.07] - Matt Cohen

I guess the last there's others, but the last one I'll highlight today are financials and quality of financials. A lot of small businesses don't have data. They don't have financial information that allows buyers to really understand what's going on. The seller knows what's going on because

it's their business. They have a lot of it in their head. But if the data doesn't support that and tell the story, again, it creates risk for buyers, and it can change what the price is and how the terms are for a deal.

[00:13:30.02] - Mike Ross

Makes perfect sense. Thanks very much.

[00:13:32.03] - Mike Morales

Mike, can I chime in real quick?

[00:13:34.13] - Mike Ross

Yeah, please.

[00:13:35.14] - Mike Morales

I think Sean and Matt brought up some great points about the business just as a whole. One thing that really hits on the nail is you need to sell at the right time, the life cycle, the business. Meaning if you just started a new office or another section, you just dumped a whole bunch of money into it. And the next year is looking very promising because you're going to have a whole new revenue stream, selling right then and there is probably not ideal. And waiting for that second office or third or when you just open to pan out could be very lucrative in waiting out that. So I think they brought up some really important points about the life cycle of the business and where you're in an ideal world, choosing the right time and the growth aspect of the business to sell it.

[00:14:25.04] - Shawn Flynn

Excellent. Can I piggyback on that? Sure. But right time, perfect. Reality is it's never the right time. Exactly. Something happened were, Oh, I've been shaping this business to sell. I've been focused on the last two years, and some law changes, and they know the next year or going

back to Matt, customer concentration, this one contract not renewed, or out of nowhere, there's a sickness or divorce, something. Everyone starts planning, but the reality is sales normally do not happen at that right time. In fact, the person you'll talk to will shake their head and go, Oh, at any other time, but I just have to right now. And you're like, so... I mean, this goes back to planning.

[00:15:11.02] - Mike Morales

It's a double-edged sword. Yeah, it is. I agree.

[00:15:15.03] - Mike Ross

Mike, shifting a little bit. I mentioned the client that I met with and her set of circumstances. What? I'm catching my nose. When, I should say, should a business owner assemble a team to start working on this and who should be included in that team?

[00:15:41.18] - Mike Morales

Yeah, so I'm really as soon as possible. I know that sounds corny, but really, ideally, when the decision that you're going to sell the business is made is when you should start thinking about tightening up things and getting the right advisors and advisors that have done it hundreds of times, they can do it with their eyes closed. And the right CPA, attorney, financial adviser, business broker, investment banker. I mean, you really need a whole team. And sometimes people that really want to dig in, they'll even do a quality of earnings report. So that's just like another layer in valuation, of course. So starting that process is really key. And starting not just when you're about to sell, but really, it should be three years in advance, almost in a perfect world. Because what happens is when you go into that, when that sale finally starts, the deals are happening, they're going to do a whole bunch of due diligence, and they're going to look back at the last three years' tax returns, and they're going to want to see clean stuff. If anything's questionable or you have anything going on, your price is going down.

[00:16:50.19] - Mike Morales

As soon as possible is what I would say this way it makes a smooth and successful transaction.

[00:16:57.17] - Mike Ross

Got you.

[00:16:58.20] - Shawn Flynn

Mike, just A lot of these experts that work with these transactions, they want to get to know you as early as possible. They want to build that relationship so that when the time is right, you're thinking of them. It's, Oh, Matt, you're Matt has helped me and given me advice for the last three years on position my company so that it has the best valuation when it's time to go out to market. He's given me all this advice for years. I'm going with Matt when I sell. Or Mike, They give me so much financial advice on the tax strategy. When time is right, he's my man. Experts, they want to build those relationships, and they can give so much advice and point you in the right direction and steer you over here and tell you what's going on from their conversations. Don't feel that it's too early to reach out and start having those conversations and start building that team because they want to be there early on and get in their advice early on also really helps everyone. When the time is right or if it's not right, people can move fast.

[00:18:06.08] - Mike Ross

Matt, you want to chime in on all that before we, do it?

[00:18:10.03] - Matt Cohen

Well, I would just say that in most of my closely held projects, which are small in the scheme of M&A, it's really more a function of the seller's life. What's going on in their life when they want to sell? If the kids are gone, they want to move out of state or some other unfortunate life event, like Sean spoke about earlier, affects that. They're not a large professional corporation where the owner can sit back and let the second layer management wait around until these other things happen. So, I mean, I 100% agree that if you can affect change and sell at the right time, that's the way to do it. It's just not so much the reality in the projects that I work on.

[00:18:54.11] - Mike Ross

Got you. All right, so now Brian is going to put up a polling question. I would ask everyone in the audience to give us some insight. We're going to go on to a second round of questions, but if we could have everyone look at the polling questions, take 10 seconds, go through them, that'd be really helpful. While people do that, let me tee you up for the next question, Sean. The next question involves what we've been talking about, but not completely. The next question is, the next conversation, not a question, what are some of the creative deal structures that you have seen used in M&A transactions?

[00:19:37.08] - Shawn Flynn

That's a whole MBA course right there. You can go on forever of this amount, earn out is tied to this, or this much is rolled over, or this software, every new state it goes into, you get a piece of that revenue from that state as long as the revenue is over for this amount of time where year one, it's this percentage, year two, it's this, year three, and then it tapers off to even negotiate the employment agreements for what that looks like and bonuses and titles. It's crazy how many components can be part of the negotiation based on the meaning of the people involved. There are founders that I've worked with that really don't care about price and terms. They just care about having the logo who acquired them on their LinkedIn to share moving forward. You're sitting there going, you're leaving all this money on the table from these other offers you're saying no to just because you want this one logo for ego? Okay, I mean, if that's what means a lot to you and that's what's important, great. We'll go in that direction. Then you'll get the other person that super risk averse, wants all cash on closing, just wants to walk away, or that other person that says, Listen, me and my co-founder, we founded this together.

[00:21:13.16] - Shawn Flynn

I want the cash. He wants the equity in this deal where we're rolling over this much equity into the new company. We have the LOI, but we have a separate agreement on the side of how we're going to split the proceeds and all these things. Basically, what I'm trying to say is a lot of people go into negotiations not really understanding all the components that could be

discussed. As they start to understand those components, then it just opens up almost an unlimited area that could be discussed from money now to that second buy of the Apple to titles, to hours committed after the transaction, to this, to that. It can go on forever. For creative deal structuring that I've been involved with or that I've heard of, we're talking deals where this bit was put in holdback with this amount tied to new states for software being deployed based on milestones, and it just goes on forever. That's why we're part of the deal. That's why we're hired, is to bring that knowledge and expertise of just, Hey, these are possibilities, these are options. Then in advance of knowing who we're working with, we know, Okay, this is what they value.

[00:22:45.20] - Shawn Flynn

This is what they put emphasis on in the transaction. So, let's focus on that versus these others. And then also talking with Mike yourself of how that impacts post-acquisition with what they plan on doing the rest of your life. These earnouts, these things, they're not guarantees. They may be worth nothing. This equity portion may go down to zero or it might be the biggest win from the whole transaction. How does that impact a person that's 65 versus someone that's 30 that's going through this transaction? It's talking about all these different components, talking to experts, the team, putting the bundle while structuring the deal and running the process.

[00:23:29.11] - Mike Ross

Got you. Matt, I bet you have more to add on that. And as you do, also talk about how small business transactions are typically financed.

[00:23:39.09] - Matt Cohen

Sure. So, in our world, which is smaller deals, half of our deals are done using... The buyers are using SVA, 7A money. And I represent sellers. And my partner and I spend a great amount of time, an ordinary amount of time, ahead of putting the business on the market, helping the seller understand what the deal looks like through the buyer's lens and how it can be financed. So many businesses don't qualify for 7A for a variety of reasons, for SPA money for a variety of reasons. And when we roll up our sleeves and help conduct an operational analysis and pick

out some of those things that I was talking about earlier and get ahead of them and get them out in front, we can avoid risk mitigation strategies. We can avoid putting a business on the market with the expectation that it can be financed by the SBA when it's very, very unlikely, we know for a fact that it can't. Half our deals, 7A, if it qualifies. The other half are lately private equity-backed ventures or corporate purchases. In those cases, they have their own money, or they have their own lending facility or they're borrowing against their own balance sheet.

[00:25:02.21] - Matt Cohen

They have a lot more control of how they pay for things, what they pay for things, than a buyer that's relying on 7A. I think in a minute, we're going to talk about risk mitigation strategies, and I'll talk about how some of those are really subject to the type of financing that's available.

[00:25:24.19] - Mike Ross

Got you. Mike, give us an insight into beyond the financial aspects, what other things need to be considered presale? What other dimensions beyond just finances?

[00:25:39.23] - Mike Morales

Yeah. So, beyond presale, what you need to start thinking about, even though the sale hasn't gone through, is estate planning and legacy planning. What are you going to be doing with this money? What I've noticed when people sell their businesses for a lot of money is they don't have an estate tax issue. And then they sell and make a lot of money, and now they have an estate tax issue. So, you're totally changing the makeup of your tax profile when you get that windfall, which is great. But you just add a lot more complexities into your tax situation that you need to start paying a lot more attention to. And why? Because it's your money for one and two, it's your family's money and whatever's left for when you're gone. Because the government wants some of that. State tax is 40 %, which is pretty serious. So, estate planning is really key. So, thinking about that. And then I know this is philosophical, but what Sean was saying earlier is, what are you going to do after you're done selling the business? You're going to have a

stockpile of money. You need to talk to Mike Ross here and figure out what to do with the money.

[00:26:47.13] - Mike Morales

And then you also need to talk to me about, after you talk to Mike, how are you going to be tax-efficient with that money? And again, you're changing your whole profile. What are you going to be doing? And then And along the sale, while you're going into the presale stuff, besides the legacy and estate plan, I like to try to remind my clients as they're going to these discussions is, are you going to stay in the business or are you out? You just want the cash. Are you going to try to earn out? What's the plan? And then have you considered non-competent arrangements? Are you going to open shops across the Bay Area? Are you going to go to another state, start over? And then the new thing with private equity is equity rollover, meaning people giving up some of their equity to roll into the new company that's buying them and them having a stake in this new company. It's pretty popular right now. Is that something they're even interested in? Maybe they just want to get out and be done and take the cash and run. Some people, like Matt and Sean have said that they've been in this business for years and founders, and they don't really want to give up everything yet.

[00:27:59.09] - Mike Morales

They'll give up 70% or 80% to pay on deal a term. But actually, I would like to hear what Sean and Matt have to say about the equity rollover stuff because it's pretty hot right now.

[00:28:11.24] - Mike Ross

Yeah, let's go off on a tangent. Matt, you and I have talked about this before, the increasing presence of private equity into deal structures. Then, Sean, I'll have you make a comment on that, too. Matt, what do you see in your world in terms of private equity acquisition?

[00:28:28.13] - Matt Cohen

Well, we've certainly seen them come what I would say is downstream. I've been at this for over 20 years, and I've done north of 100 transactions. And in the last maybe five years, I've never seen so many private equities or private equity-backed, what we call search funders, looking at our projects, which have half a million, a million, two million in EBITDA. They just used to look at so much larger projects, and they can be really excellent, excellent buyers. The problem is that the businesses that I sell often don't have the data. They don't have the infrastructure that these folks require. These are professionally trained, highly educated people who are expecting things to be presented in a certain way. And a lot of the businesses that I sell just don't have that information, don't have that data, don't have that management processes in place, which can make it really tricky to get a deal Well done with that.

[00:29:31.11] - Mike Ross

Sean, do you have some comments?

[00:29:33.15] - Shawn Flynn

No, especially as Matt had mentioned, the search funds. My inbox is getting filled with people saying, Hey, I'm backed by this family office, or I just graduated with an MBA from this, and I'm looking for this type of company. I was on two calls yesterday with different search funders, and they were just asking, How I get access to these deals? I seem to use the same grata and these data sets that everyone's using and emailing these business owners. They say, If they do get in contact with the business owner, the business owner is saying, Yeah, you're the I get 10 of these emails a day, and my phone, it's just... They're having real difficulty separating themselves and standing out amongst the crowd. But yeah, going down, going down the street, like Matt said, I There's private equity groups. A couple of years back, we wouldn’t look at anything under 2 million EBITDA. Now it's, Oh, we got this platform. We're looking for something to add to it. Five hundred thousand EBITDA we'll take a look at. There's just so much dry powder on the side and these people sitting on money that need to deploy those businesses that a few years ago would never have been looked at are now getting inundated with emails from these groups.

[00:31:02.04] - Shawn Flynn

That's actually one thing that I want to mention to business owners. If you get these emails, it doesn't mean that they want to buy your company. That's something that a business owner will come in, Oh, yeah, I got so much interest from private all I'm like, No, you're on an email list, and that email list got passed around, and there's some analyst, there's someone in India or the Philippines that's job is just to email everyone in these geographic areas and these sectors and that, and they'll take a meeting because they need to have so many meetings every quarter for the partners there to check off on the work. The analysts are doing whatever it is but take it as a grain of salt that it's not a sale, that it's just an email. Right now, it's easier than ever to email people. So just keep that in mind. So, I don't know. It went off on a tangent there.

[00:31:53.12] - Matt Cohen

I have something to add. I have something to add. And Sean's 100 % right. I represent sellers. That's my job. And if you respond to a single search fund person or search fund outfit, and you think you're going to get a deal done without having someone make a market for your business and create competition, You're putting yourself at a huge disadvantage. You need someone like Sean or myself to package the business, organize the information, and create competition. The other thing I'll say is that a lot of these folks, these search funders, it's not their money. And if you're not driving the bus, if you're a passenger, you're not a good buyer, really. So, my partner and I, we what we call stress test our buyers. We insist that they bring in their financial partners at the very beginning of the process and that their financial backers, the big PE firm that they worked at for two years after they got out of business school. We want those folks to look at the deal at the same time so that we're not doing having everything all over again or having them walk away because the backer says, why I would never do this?

[00:33:07.15] - Mike Ross

So, we got a question in the Q&A, and I'll encourage everyone to use the Q&A if they'd like to. From a buddy of mine who actually is a valuation guy. And the question was, are there certain industries, and this is for all three of you guys, but especially Matt and John, are there certain

industries that search funds are either focused on or not focused on? Is there a sense of direction or is it all over the map?

[00:33:33.23] - Shawn Flynn

The things that are in my inbox, they're literally all over the map, and they all have the same idea. We're looking for that first company, and then we want to acquire three or four others in the space, bundle them together, and then flip them to a private equity group in five years. Just recently, I've had one for a search funder for a logistics company, one for software as service company, one that was looking to do a dental roll-up, one that I've had them all over. But whoever, I guess the commonality is the search funder that's doing it says, This is my background. I have experience in this industry, and this is what I can bring to the table, and this is why you should introduce me to anyone that you know that's in this sector, business, or the size and that. But I've seen search funders look for everything, and they just try to play in that spot that most of the time too small for private equity and too big for mom and pop to buy, that little niche.

[00:34:42.03] - Mike Ross

Matt, do you have any thoughts?

[00:34:43.24] - Matt Cohen

Well, it's been the licensed trades. In the last four or five years. My partner Randy and I have done projects in landscaping, roofing, HVAC, flooring, plumbing, janitorial. These are the kinds of deals that we rarely did for the first 15 or however many years of my career. A lot of these businesses are being sold to PE-backed entities, big ones, ones that you read about in the Wall Street Journal, and they have a plumbing rollup now, and we're selling them to a plumbing company to bolt onto that.

[00:35:24.14] - Mike Ross

So, oddly enough, I'm in a couple of different PE funds, and that was their spiel is they were I want to be a private equity fund. I own some long service business in the Northeast, so I get what you're saying. I'm seeing you shake your head, Mike.

[00:35:40.08] - Mike Morales

You want to leave your comment? Yeah. So, it seems a little It's focused is what I'm noticing. I don't do all the deals. I just help with my clients. But what I'm noticing is the roll-up, like Sean and Matt were saying, where they're taking a couple of landscaping small businesses, rolling it up together, making in sync and in line with all each other, the businesses, and then selling all that to a bigger company. It seems also the time on the deal when PE gets in is 5-7 years. Generally speaking, because they don't buy it and try to flip it in two years. No, they want to do some work and make some changes and make it a little more profitable, so it looks better on paper and then sell it up and make some profit. It also gets the people that put the money in out of the deal if they want to in that five, seven-year investment, or they roll into the next deal depending on what the fund is doing. But yeah, doctors, landscapers, a lot of service, plumbing, all that stuff. If they can buy a couple of the businesses, combine them into one, it's pretty valuable.

[00:36:45.23] - Mike Ross

We could do an entire panel discussion on private equity buys, and I have my own commentary around that. It's not terrific. Matt, we got another question, which I really think fits your profile. All right, you represent the sellers. Are there questions that are coming from the buyers that make you recognize the buyer is serious? Is there a series of questions that you want to see from buyers Are you sure now they're serious?

[00:37:18.03] - Matt Cohen

Well, I run a process where I'm able to determine pretty quickly if the buyer is serious. It's how they deal with me first. I don't involve my clients for quite a while. I'm speaking to the buyer. I'm looking at their financials. I want to make sure they have adequate capital and liquidity to do the deal. I'm looking at their resume. I'm looking at their business model, at the deals they've done, if they're institutional. To pass through my stress test or my qualification process. If I introduce them to the seller, they're serious. Otherwise, they don't ever get to talk to the seller.

[00:37:56.07] - Mike Ross

Got you. All right, let's shift our attention here because this is a great conversation, but we have to get some closure on a couple of things. Let's go to the risk side of this. Sean, what are the potential risks and downsides of an M&A transaction? I think I know the answer, but I'd like to get your perspective.

[00:38:16.12] - Shawn Flynn

Well, there's an infinite number of risk in that. I mean, if people know that you're thinking of selling your business, and next to you know, your competition comes and poach all your clients or your employees, or During this transaction, you get sidetracked because of the involvement it takes. Most people have no idea the number of hours and work that goes into a transaction. And maybe the company starts missing milestones. Some of the metrics go in the wrong direction. Company's valuation goes down. Maybe the added stress takes a toll on your health, your body, because of this 6–9-month transaction, however long it's taken and those emotional ups and downs. Mental health is a serious thing in these transactions. There are so many risks from financial, emotional, relationship, the core of the business itself that come into play during one of these transactions that you just can't pick one. There are infinite numbers of areas that could result in some catastrophic things, to be honest.

[00:39:29.11] - Mike Ross

Matt, I'm going to I'll have you weigh in on this. But before I do, I think Ryan has another polling question that he wants to throw. I think I missed it after Mike spoke because we went off on that tangent. Ryan, if you want to throw a poll out there, go right ahead.

[00:39:43.18] - Matt Cohen

Sean couldn't have said it better. Life happens, and it is a long process, and clients get burned out, particularly if you enter into an agreement and you go through a due diligence and a quality of earnings and months go by and the buyer walks. The seller had already thought about how they were going to retire. It can really, really impact on their ability to do it again and to support us as the intermediaries the way we need to be supported. It's a partnership. We don't do this alone in any way. I've had sellers pass away during deals. I've had their spouses pass away during deals. There's been a pandemic. I mean, lots of things can happen that can create or deals and really impact the mental health of sellers. We are therapists, really. I mean, half of our job is emotional support and just providing some therapy to our clients.

[00:40:49.20] - Mike Ross

I think you just answered this question, but the question I was going to ask is, how do buyers mitigate their risks in the transaction? I think you've already hit that, but you want to reinforce Can we voice it one more time?

[00:41:01.05] - Matt Cohen

This for Matt?

[00:41:02.10] - Mike Ross

Yeah.

[00:41:03.02] - Matt Cohen

Okay. I mean, there's quite a few structures, and again, some structures were limited based on the financing source. The SVA just doesn't allow certain deal structures. But The one that I find really useful, and sellers can usually swallow is the escrow holdback. So, some portions of the proceeds are held in escrow for a specific period of time against reps and warranties. Specific, that's pretty palatable. Then there's earnouts, there's seller notes with rights of offset if certain things happen. Sometimes we can get those done. Sometimes it's just a matter of lowering the

deal price. The buyer says, “Look at seller, I don't want an earnout. It's like, Okay, well, the deal price has to come down to mitigate this risk.

[00:41:53.24] - Mike Ross

Makes sense.

[00:41:55.18] - Shawn Flynn

Could I add something to that, too? Yeah, of course. And buyer I mean, a way to mitigate this also is to get to know who's representing the seller. I mean, to be honest, getting to know someone like Matt. When getting to know Matt, they're going to, okay, this person Matt's representing, he must have done the due diligence before taking on this client.

[00:42:19.04] - Matt Cohen

I don't always represent my sellers in that way. We don't always know what they're up to. We don't take on that risk necessarily. They hide from us, too.

[00:42:31.06] - Shawn Flynn

Trying to put you on a pedestal here, Matt.

[00:42:32.23] - Ryan Ross

Fire beware.

[00:42:34.07] - Matt Cohen

But you're right. We don't take crappy clients and crappy projects. And I'm sure you don't either, Sean. We do our best to get motivated sellers with good businesses.

[00:42:45.23] - Shawn Flynn

I mean, one of our things, because for us, we're so highly success-focused, right? Yes, we charge retainers. Retainers, that is one way that we vet our clients. If they don't pay retainers, that's a way for us to know they're not serious. Another is that we're success focused. So that makes it so we've done our due diligence on the client before we want to take them on. And those two things, and plus all the preparation that goes in, the data from the market, all these things, That's alerting the buyer. Okay, they're serious or they wouldn't have hired this group to represent them. We have to trust that this group has done their due diligence on the client. Now, there's always those situations at the 11th hour where the greatest deals on the table and the seller still goes, I'm out of here. I'm walking away. But because of all those things that have happened before, that risk is really mitigated quite a bit by the whole process taking place.

[00:43:48.05] - Mike Ross

Mike, why don't you walk through some case studies or examples of where well-executed exit strategies led to better outcomes for the seller? Give us some insight on what you've seen as the use of that.

[00:44:02.24] - Mike Morales

Yeah. So, generally speaking, the deal structure is everything, obviously. But in today's environment, most of it is a stock sale legally. And for tax purposes, it's an asset sale, meaning the buyer wants to buy the assets from a tax standpoint, so they get a step-up in basis. And the seller usually just wants to sell their stock so they can just have capital gain, but that's not usually what the buyer wants. In essence, the seller ends up having some ordinary income for selling their assets from inventory, depreciation, write offs, and accounts receivable. But what really goes into it is, are they getting made whole for those extra taxes on the ordinary income then versus the stock sale? Sometimes it's pretty minimal for the overall deal, but sometimes it's very wild swings. If you're going to have to pick up four or 5 million of ordinary income from AR collections, that's going to swing things in a different manner than having a million dollars in AR. Then other things to consider are, again, case studies that have gone well is people that have really good books and records. For example, state tax compliance. It's like, Oh, we're not going to file there because we don't want to deal with it.

[00:45:33.14] - Mike Morales

That's what we hear all the time. Oh, okay, next year comes. Oh, we still don't want to deal with it. We'll do it next year, Mike. Well, the next year, they go into the sale and under due diligence, they go, Hey, what's your exposure to state filings? And, Oh, we didn't file on that state because we didn't feel like it was necessary. Now, the buyer is going to have to take on that liability, deal with the state compliance, file those two back returns, file the current year, and you just threw something a wrench in the wheel. And now it's like the buyer is going to have some more questions. So the most successful stories I've had are about people that have everything in line. And when they're going to do diligence like, Oh, you need that? Boom, here it is. Oh, we do this because this is our procedure. And that's why working with Matt and Sean beforehand, well in advance, is also good because they're going to ask you some questions that the seller is going to ask and being ready for those questions and I had someone who's going through a deal right now, and they asked about a specific journal entry two years ago, and it was really interesting, but they're just checking things.

[00:46:40.16] - Mike Morales

What were they checking? They were making sure that the S corporation, one class of stock, didn't get skewed because everything has to be pro-rata based on ownership. If you mess that up in one of the previous year's they're looking at, you might blow the whole deal because now you don't have a valid S selection. Now you're C-Corp, and that changes everything for the buyer. One other successful thing I want to really bring up that's very popular in today's tax environment is California, specific to California, but California passed through any tax credit. Basically, Basically, if you do an asset sale, the business can deduct the Pass-through Entity Tax for the shareholders, for S-corporation. Basically, they're getting a 37% deduction on every dollar they're paying for the pass-through energy tax. And what ends up for the shareholders is they have California prepaid taxes because it passes throughout to them. And it could be a substantial deduction and a substantial tax savings by doing that. And what really matters is making sure you're hitting that election and doing the right election at the right time. Because if

you miss it, if you don't hit that 6:15 first estimate and you don't do it right, you've blown for the election.

[00:48:00.22] - Mike Morales

If you sell for millions and millions and you can't do the election, you've lost out a lot of money. That's just easy money. Pass through any tax. Of course, I'm talking about California, but they have it almost in every state now. What the Passive Energy Tax came from was a $10,000 salt cap for itemized deductions. In 2018, they limited how much you can deduct for state taxes to $10,000. States have come out and done this to work around to allow you to get that deduction through the business and pass through individually. That is huge. Having a CPA on top of that and the planning that goes into that is also key. Then one last tangent thing besides state taxes that they're going to look at, the buyer is state taxes, use taxes, unclaimed property taxes that no one wants to talk about. They're going to ask these questions at some point during the deal, and you just need to be ready to answer them. The more prepared you are, the sooner the transaction, the more successful.

[00:49:05.24] - Mike Ross

Excellent. All right, let's go around the virtual table one last time. We've been working on this thing for about 50 minutes. Sean let's start with you, Sean. Number one is any closing thoughts. Number two, how do people get a hold of you?

[00:49:23.09] - Shawn Flynn

Never too early to prepare for one of these transactions. I mean, honestly, even if you think it's five years down the line, start today about the team, that exit, that amount that you want, what you want to do, host with your life. Keep those relationships now so you have those later on. So more than anything, plan early. Best way to get a hold of me, if you're watching the video, scan the QR code that goes to my LinkedIn, connect with me there. If not, my email is sf@globalcaptivemarkets.com. Look forward to conneconnecting everyone and just having a conversation, learn more about your business and what you're working on.

[00:49:59.12] - Mike Ross

Fantastic. Can I help?

[00:50:01.19] - Matt Cohen

Well, I get a lot of... I have a buyer friendly competitor. I have a buyer who has contacted me. If you have one buyer, you don't have that buyer. They have you. So, you really need to find someone to help you organize your data, put together a thoughtful marketing plan and execute that marketing plan to create competition and to hold buyers, to have them put their best foot forward. That's my thought. To contact me Our website, synesisadvisors.com, all our data is there. I would also say you need to speak to your investment advisor and your accountant early, early, early. You want to know what you're going to end up with because I can help you understand what your business is going to trade for and what the terms are likely to be. I don't know what you're going to end up with, though. That's a function of your personal tax picture and your personal financial situation. So, folks like the two mics that are on the screen here, you want to talk to them before you even talk to me or Sean.

[00:51:05.13] - Mike Ross

Mike. Mike with hair. Hey.

[00:51:08.24] - Mike Morales

Yeah, my final comment is, if you're going to sell or even thinking about it, start preparing now. And be ready for those questions when you're in those conversations and come prepared, because that's all I'm going to put more money in your pocket. And then the other thing is not only being prepared but having the right team. Just because you work with someone 15, 20 years doesn't mean they're the right person to go to the sale. And it's pretty simple. If you're not sure, just ask them, how many sales have you done? What do you offer to your clients when they're in the transaction? How do you support them? Just pick their brain. If they don't have

quick answers that you like, you'll probably need to check out some more advisors. You can catch me on our website at aslcpa.com, and I'm also on LinkedIn. My email is emmerales@aslcpa.com.

[00:52:04.19] - Mike Ross

Guys, thank you very much. This was really, really helpful. We've answered a lot of questions. Everyone in the audience knows how to get a hold of all of us. Ryan, I'll pass it back to you, sir.

[00:52:18.19] - Ryan Ross

Wonderful. So, thank you, everybody, for joining. Thank you to our panelists, Mike, everybody with very little hair, by the way. This has been a great conversation. There was a lot of engagement as well from the audience side. Thank you for the audience for spending your time with us. We know your time is valuable and we appreciate you joining in. Also, thank you, Julia and the wealth management team at Lattice for helping us put this on. It's been really excellent working with everybody. We will make sure that everybody's connected with the panelists as they did in their vote. We'll make sure that happens. Then we want to plan more webinars, so we're just looking at the next month and seeing, Oh, October sounds great for something spooky, so let's talk about death and taxes. Tentatively, we're looking at the 22nd of October, so plan that in your calendars. Once again, thank you to everybody for joining, and we will see you next time. Let me just end this, and then we will end the webinar there. All right. Bye, everybody. We'll see you later.

[00:53:19.19] - Shawn Flynn

Thanks. Thanks, Mike. Thanks, Ryan. Thanks, everyone.

[00:53:22.12] - Mike Ross

Very helpful.

Disclosure