NORTH TEXAS

2018

THE LOCAL MARKET STUDY:

The State of Owner Readiness

BENCHMARKING LOWER MIDDLE MARKET BUSINESSES AND EDUCATING OWNERS ON THE DIFFERENCES OF "ATTRACTIVENESS" VERSUS "READINESS"

EPI Exit Planning Institute™

BNY MELLON
WEALTH MANAGEMENT

Raised in Arlington, Texas as one of four children, I was exposed to the daily life of a business owner as far back as I can remember. My parents owned and ran an ornamental iron fabrication and distribution company for 25 years. The company experienced some very profitable years, but overall served as a way to support and sustain our family's lifestyle and wellbeing. I remember the long hours, often seven days a week, and the commitment and hard work that went into building and maintaining a family business. However, no matter how many times he proposed it, my father could not convince his children to join the family business.

Today, 15 years after my father was forced to sell his company due to his declining health, I truly understand what a shame it was for the story to have played out that way. I saw firsthand how a lack of planning and access to the right resources exposed a proud and profitable business to a myriad of risks. It took me years to truly comprehend the missed opportunity for further value creation and a lasting legacy.

Many business owners hope their children will someday succeed them, but many simply ignore the danger of relying on one key person within the company, and the value of properly training a competent management team. Too many believe that the value of their company is solely derived by a multiple of earnings. They fail to evaluate the risks of the company and believe that its relative strength is evident.

Over the past 15 years, I have seen too many owners and their families struggle to maintain the wealth built through their businesses because they lacked the guidance to thoughtfully grow, strategically transition, or prudently maintain their lifestyle and wealth-transfer objectives.

In the coming decade, we can expect business transitions to grow steadily, along with the demand for advisors who are experts in working with business owners. Most business owners have a significant portion of their total net worth tied up in their business. A successful transition will be required to meet their future financial goals and objectives.

This takes focused and collaborative planning, but it doesn't have to feel like a burden.

My deep connection to, and appreciation of, business owners is the reason I became a Certified Exit Planning Advisor, and it's why I so enthusiastically joined with the rest of the local Exit Planning Institute's chapter to pursue the "State of Owner Readiness Survey" in the Dallas-Fort Worth market.

The North Texas economy is robust, and has endured many market cycles — growing, thriving and becoming one of the strongest in the country. Our market was built in large part by privately held businesses, with owners and leaders who are the backbone of our economy in North Texas. Many of these owners have built their companies into lucrative assets. However, many of those same highly successful owners are unaware of how non-transferable their companies could be. Like it or not, demographics suggest a wave of companies coming up for transition in the next 10 years, making for a more crowded beauty contest. Also, the economy, even in North Texas, will eventually slow down. When that occurs, statistics show that most business owners will be unable to sell and transition successfully.

Whether it's because of emotional attachments, trepidation about losing control or for fear of leaving money on the table, one of the key insights in this research is that owners don't feel ready to transition out of their business. Some also feel unprepared and are nervous about the perception of some negative aspect of their company. However, challenges in a company, if properly addressed, can sometimes be seen as attractive opportunities for investors. The path is not generally clear and business owners aren't as familiar with the vast options to transition as they should be. Multiple EPI Business Owner Readiness Surveys conducted in other parts of the country consistently show that only around 40% of business owners in the market indicated they were ready for a business transition and have actually taken the time to determine the amount of money needed to fund their future plans.

The good news is that we have the knowledge and tools to help business owners prepare for and handle their transitions effectively. For both owners and advisors, the best time to get a plan in place is now, and step one is to get educated. This comprehensive report can help.

My colleague, David Moody, and I lead the Business Owner practice at BNY Mellon Wealth Management in the regional market. Along with the North Texas Chapter of the Exit Planning Institute, we are committed to educating our business owner community.

As local advisors and exit planners, it's our job to eliminate confusion, familiarize the business owner with exit options, and educate him or her on what drives business value — as well as what depletes it. Will there be an appropriate personal and financial strategy in place to make the transition when it feels right for the business owner, and will the business be prepared?

It is imperative that owners see their business thrive. A team of trusted advisors can provide peace of mind, assuring a desired outcome that is on the owner's terms, not someone else's. For most owners, there is only one shot at getting the transition right. Exit planning isn't a singular event or the last action to take as the owner of a business, but should be viewed as part of an ongoing business strategy.

Business owners should plan now and take control of their own destiny. If I could go back in time, that's the advice I'd give to my parents.

Shei Unger, CEPA, CFP®
Wealth Director, BNY Mellon Wealth Management

THE STATE OF OWNER READINESS
2018 NORTH TEXAS REPORT

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Survey Overview

In 2018, the Exit Planning Institute (EPI) and the North Texas Owners Forum Council Partners, located in Dallas, conducted a survey of business owners in the North Texas region to determine their state of readiness to transition their businesses and unlock the wealth accumulated within them. We also compared the North Texas results to EPI's national survey and other regional surveys that EPI has conducted over the previous five years. Finally, we noted specific facets that both successful and unsuccessful business owners do and offer suggestions to all business owners (and business advisors) regarding how they can improve the probability of a successful transition and unlock this vast amount of wealth.

Roughly six million operating companies are privately held in the United States, representing approximately $30 trillion in sales. According to US census data, baby boomers aged 54–72 own 63 percent of these companies. Although baby boomers are holding on to their businesses for a longer period, all boomers will reach the age of 70 or older within 16 years and "retirement age" within 11 years. That represents nearly four million baby-boomer-owned businesses poised to transition. Assuming a business valuation of 50 percent of sales, which is reasonable by most standards, those same four million businesses represent $10 trillion of wealth poised to transition.

Unlocking this wealth should be of paramount importance to all business owners if for no other reason than **most owners have 80–90 percent of their financial wealth locked in their businesses.** Given the significance of these assets in an owner's wealth portfolio, the ability to monetize this wealth at some point will have a significant impact on any owner's financial security and lifestyle once he or she exits the business.

The significance of the business asset transition is of great importance beyond the owners and their family. Failure to provide for the continuity of the business affects not only owners' personal wealth and that of their family but also the future of all other stakeholders who depend on the businesses' successful transition.

"The business owner is the giver of life," wrote Dr. Leon A. Danco, a legendary expert on family businesses, in his book *Beyond Survival, a Guide for Business Owners and Their Families*. With roughly six million operating privately held companies in the United States, representing around $30 trillion in sales and $15 trillion in wealth, the continuity of owners' businesses matters not just to their family but also to their employees, vendors, customers, charities, and the surrounding communities, for whom the owner provides jobs and economic and social well-being.

What happens if the business does not successfully transition? The alternative is that the business shuts down. People lose their jobs. Families suffer. Communities suffer. In addition, and in many cases, an owner's life's work is liquidated for pennies on the dollar. Previous surveys conducted by the Exit Planning Institute, PricewaterhouseCoopers, the Alliance of Mergers and Acquisitions Advisors, Business Broker Press, and the Family Firm Institute have determined that **historical transition success rates are in the range of only 20–30 percent nationally.**

Changing this outcome is the mission of EPI and all Certified Exit Planning Advisors™ (CEPA) worldwide. The truth is that we have studied models (specifically the 20–30 percent of business owners who do successfully transition) that many business owners can emulate when they decide that a successful business transition is in their future.

The need to increase the number of successful transitions is becoming more urgent, as baby boomers, who own nearly two-thirds of all privately held businesses, face the inevitable fact of aging. Boomer-owned businesses represent roughly $20 trillion in sales and $10 trillion of wealth in the United States alone. Although boomers are holding onto their business longer than previous generations, they must face the reality that preparing for a business transition is now an urgent imperative.

The community of owners must realize that transitioning a business is a high-stakes—and for many, a once-in-a-lifetime—endeavor that requires significant focus, action, and time to do properly.

How do business owners benefit from transition planning?

Transition planning and value acceleration address several problems that prevent owners from achieving better transition succession rates and sustaining business growth. The typical issues we see include the following:

- **First,** when owners do decide to exit, they realize they have not allowed themselves enough time to position their businesses for transition, minimized taxes, or maximized net proceeds. Thus, they achieve significantly lower net proceeds.
- **Second,** they are unprepared when an unplanned event affects them and forces them into an exit that is not on their terms or timeline. Alternatively, they are fortunate to receive an unsolicited offer from a buyer. However, their lack of readiness prevents them from harvesting the value of their business in either situation.

- **Third,** when the time comes, owners can't sell. Private equity and strategic buyers are very seasoned and selective. They are unable to complete a sale (or even a partial sale) of the business to a third party because the business is unable to pass the test of due diligence.
- **Fourth,** they may also be unaware that they have eliminated their inside options, including transitioning to a family member, because the business cannot operate without the owner and is potentially undercapitalized, has insufficient cash flow or too much risk to succeed with an inside option.

The right approach to a business transition can have crucial benefits. For many owners, the business represents most of their wealth. With the average middle-market business, which we define as a business with sales between $5 million and $100 million that holds an average market value of $8.5 million, successfully transitioning represents the difference between having $2.1 million in pre-tax wealth to $10.6 million in pre-tax wealth. Even at an aggressive rate of 6 percent per year, the difference in pre-tax income is $510,000 ($637,000 versus $127,000) per year.

For the micro market, the consequences are even more compelling. The micro market, which we define as those businesses that do less than $5 million in sales per year, the average business value is just over $300,000. Most of these businesses are owner-operated, so the owner derives almost all their income from the business. Moreover, roughly 5.7 million (94 percent) of the six million privately held businesses fall into this category. Assuming again that, for many, 80 percent of their wealth is locked up in the business, successfully monetizing the business asset is the difference between having $400,000 and $100,000 at transition.

To successfully transition, a business owner must focus on three things: (1) maximizing transferable business value; (2) preparing financially for a lifestyle without the income from the business; and (3) planning personally for what they will do (as a "third act") after exiting the business.

The State of Owner Readiness research.

Since 2013, to understand business owners' present levels of readiness to harvest this wealth and their current financial preparedness outside the business, as well as to understand how well owners have prepared personally, EPI has been conducting State of Owner Readiness™ surveys of business owners with the help of its many strategic partners. The 2018 North Texas State of Owner Readiness Report is the third regional study to be released in 2018 and the ninth primary research report to be published in the State of

Owner Readiness series, which includes the following studies: 2013 National Report, 2014 National Report, 2017 San Diego County, 2017 Greater Nashville, 2017 Twin Cities Metro Area, 2017 Arizona, 2018 Georgia, and 2018 Long Island. Additional owner readiness surveys are underway in Manhattan, New Jersey, Los Angeles, and Wisconsin and are scheduled for release in 2018.

The survey results continue to demonstrate many business owners are not appropriately planning for business and personal transition, nor are they integrating the principles of value acceleration into their business. These are key reasons many transitions fail. The reports also demonstrate the need for massive education of business owners and business advisors regarding what actions are necessary to successfully transition privately held businesses.

The reader should note that the data reflects the surveyed owners' perceptions. Although the answers may be factual, they are not based on proof. The only way this can be accomplished is to complete a thorough personal, financial, and business assessment conducted by an independent credentialed advisor such as a CEPA.

Nevertheless, the data is useful for assessing a given owner's state of mind regarding readiness to transition from a business, personal, and financial standpoint.

Owners would be wise to consider obtaining a personal, financial, and business assessment to support their current perceptions and their business valuation as to avoid surprises when the time comes for executing the business transition. This is also necessary for proper estate and personal financial planning.

What we do know from past studies is that success rates in the United States are in the range of 20 to 30 percent—far below what they should be from an economic and social standpoint. Many of the owners' responses in this study (and all other State of Owner Readiness studies since 2013) demonstrate the business owner's misunderstanding or underestimation of what a successful transition requires. In other words, it may be a situation in which business owners don't know what they don't know. Although business owners do many things right, exiting one's business is, for many, a once-in-a-lifetime event that they have never undertaken. Certainly, their lack of formal education demonstrates that they have not received enough information on how to transition successfully.

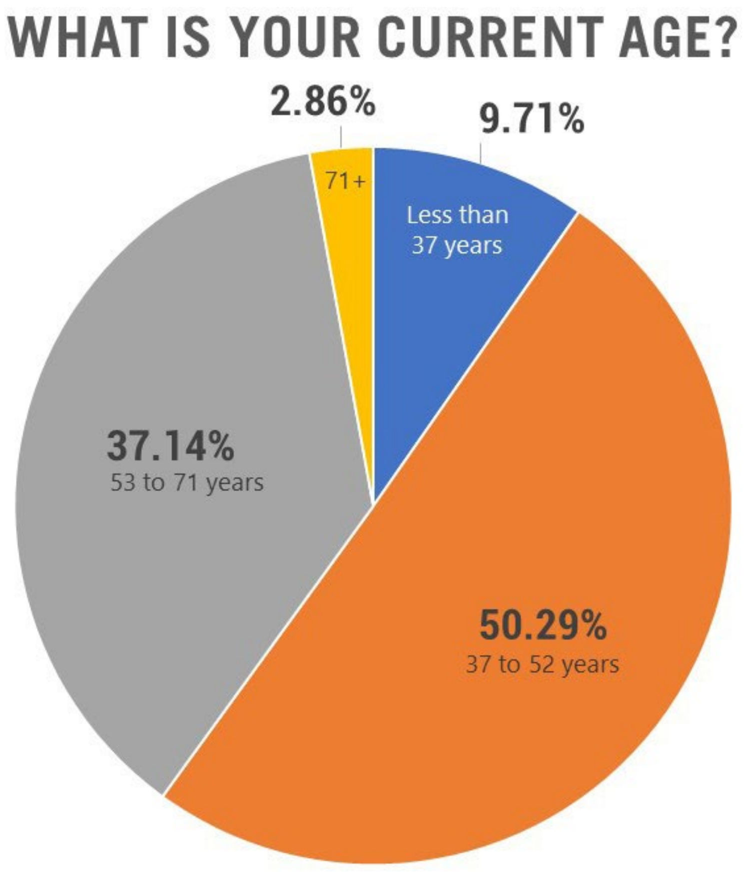
The purpose of this data is to create awareness that will initiate discussions between business owners and advisors to identify areas where education and assistance are urgently needed. Results should be reviewed with business owners to begin the process of understanding their situation, educating them on the critical success factors, and determining the probability of having a successful transition.

This report is divided into three sections: In Section 1, we make general observations about the data collected from the North Texas survey and how the data compares to the national surveys that EPI conducted in 2013 and 2014. In Section 2, we provide our analysis of the data and make observations regarding the data's implications for the business owner. In Section 3, we provide recommended actions business owners and business advisors should take to improve the probability of a successful transition and capture this hard-earned wealth.

In October 2018, the North Texas State of Owner Readiness report was drafted based on the 176 responses collected. The survey included 53 questions, organized as follows:

- Demographic information (age, gender, annual revenue, legal structure, industry, most trusted advisor, etc.)
- Current transition plans and thoughts
- Owner, shareholder, family, and company readiness to transition

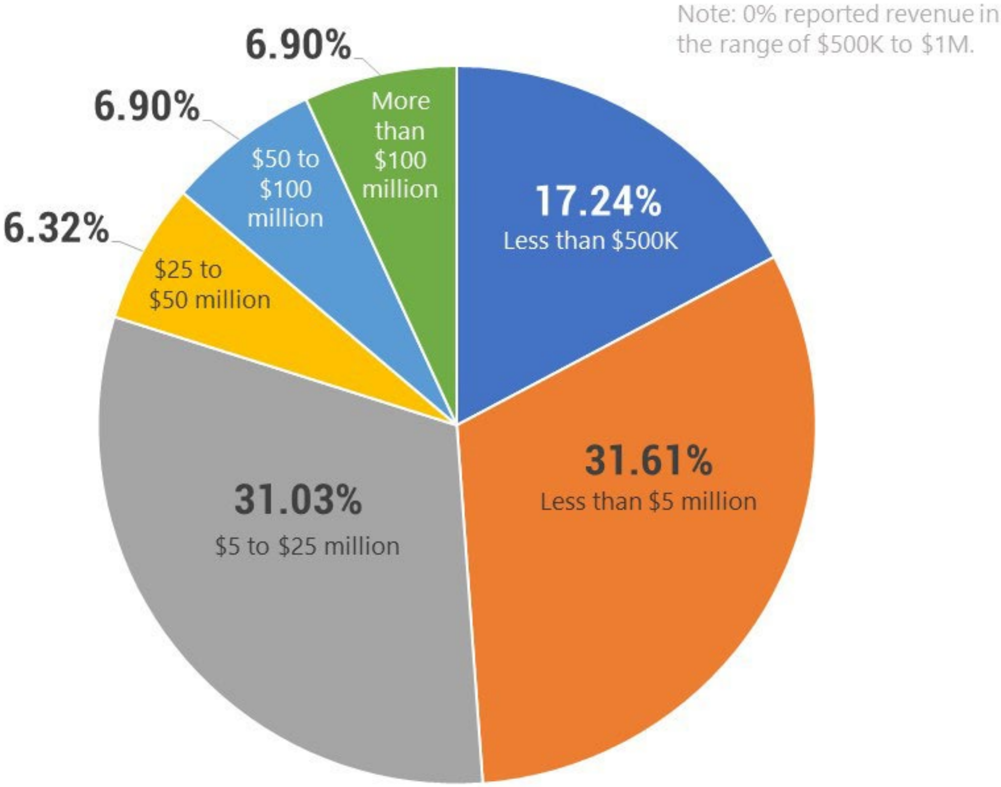
Section 1: Demographic Data



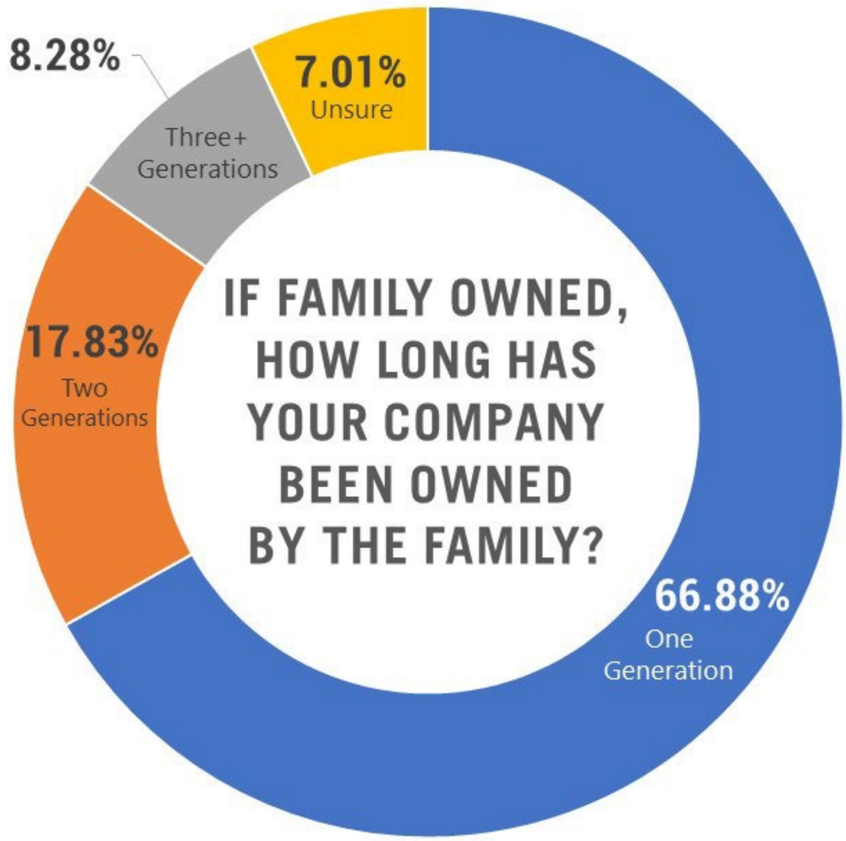
OWNER AGE: Only 37 percent of the respondents were baby boomers in this survey. This is much less than the latest US census data which indicates baby boomers own 63 percent of privately held businesses. This sample of business owners was generally much younger than the typical U.S. age profile. Only 40 percent of the North Texas sample were 53 years of age or older.

Note: 68 percent of business owner respondents to the survey were male; 32 percent reported as female.

WHAT IS YOUR COMPANY'S ANNUAL REVENUE?

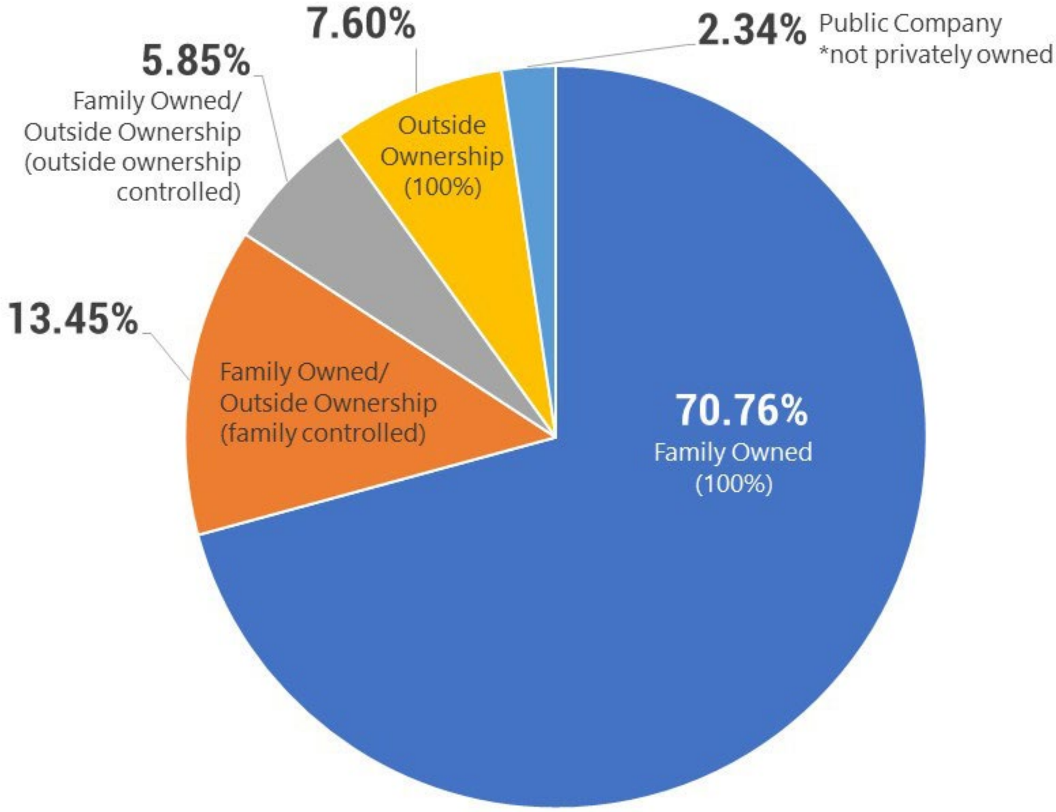


BUSINESS SIZE: Forty-nine percent had business sales of less than $5 million, 44 percent had sales in the range of $5–100 million, and 7 percent had sales of $100 million or more. The North Texas data shows a strong middle-market focus representing a greater share of businesses over $5 million in sales than that in the national US Census data (which indicates that 94 percent of all privately held operating businesses achieve $5 million in sales or less, 5.8 percent achieve between $5 million to $100 million, and only 0.2 percent achieve over $100 million in sales).



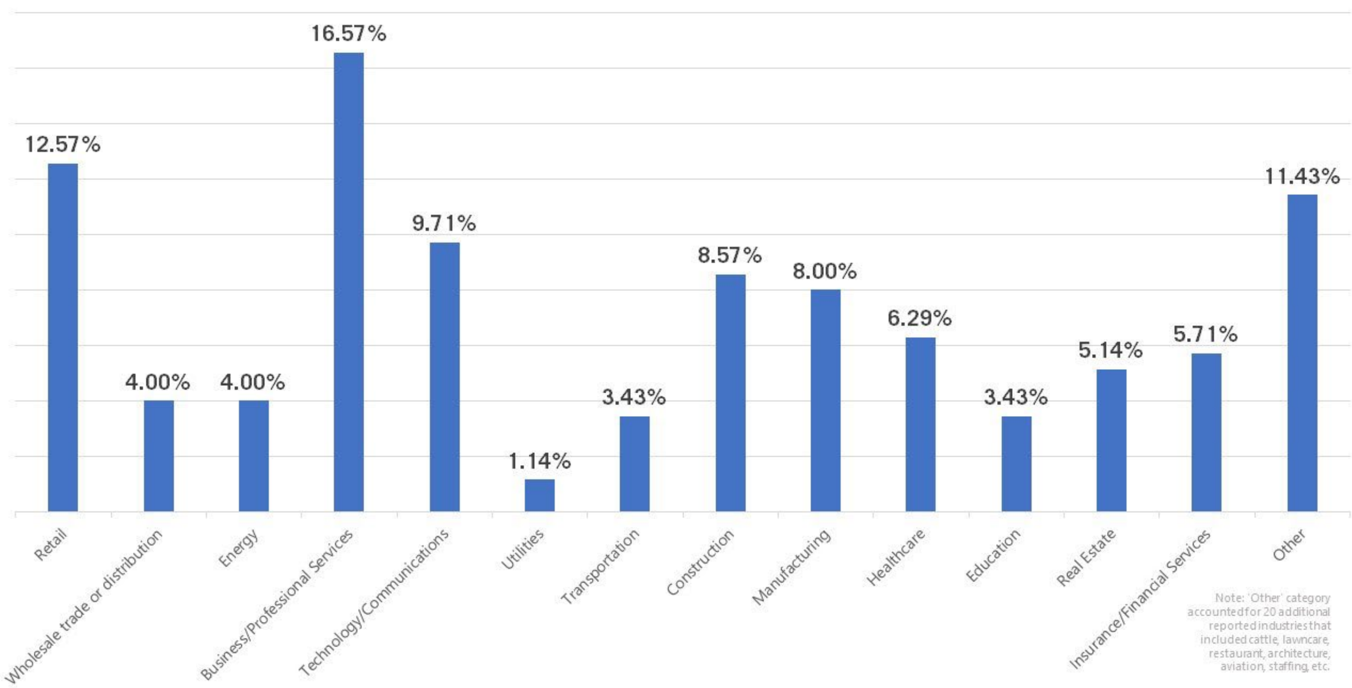
FAMILY OWNERSHIP: Seventy-one percent of businesses were 100% family owned, and 84 percent were at least family controlled, with 67 percent of the businesses being first-generation businesses, primarily started (72 percent) by the owner.

WHAT IS THE OWNERSHIP STRUCTURE?



OWNERSHIP STRUCTURE: Most businesses in the sample were LLC's (39 percent), followed by S-Corps (21 percent) and C-Corps (16 percent). Also, notable, this sample included a significant number of Family Limited Partnerships (18 percent) which was much higher than in prior EPI studies.

WHAT INDUSTRY ARE YOU IN?



INDUSTRY BREAKDOWN: The sample included a good cross-section of 33 industries with no industry domination which is consistent with the overall makeup of the North Texas marketplace based on publicly available data.

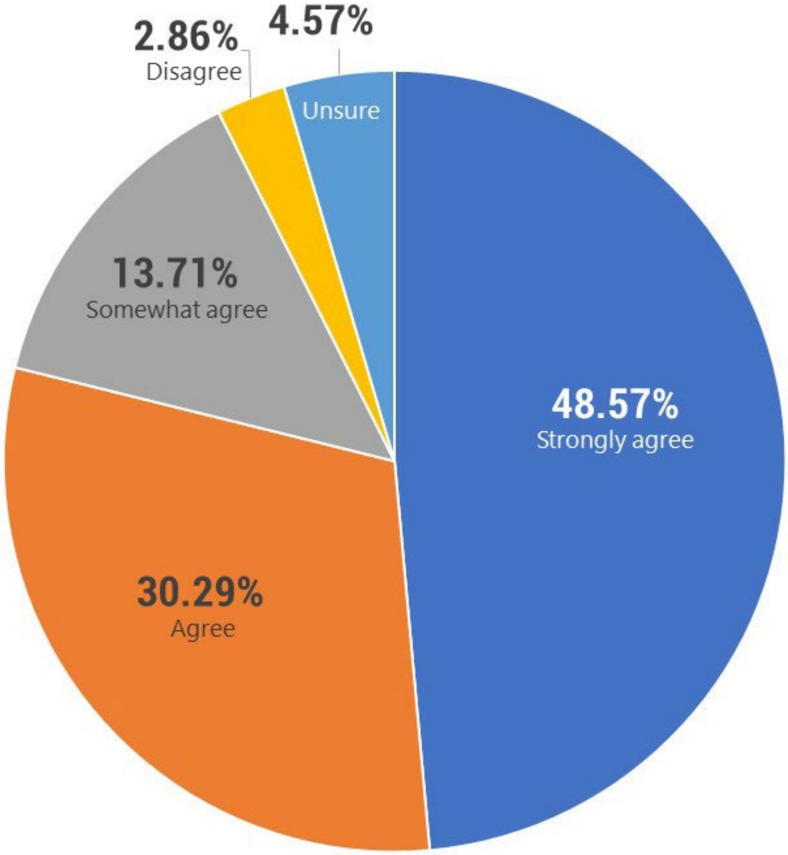
Note: According to local Chamber of Commerce reports, the greater North Texas/Dallas region is home to major industries including defense, financial services, information technology and data, life sciences, semiconductors, telecommunications, transportation, and processing.

Section 2: Analysis and Relevant Observations

Given the general lack of family and business transition readiness evidenced in the survey results, it is not surprising that 70–80 percent of transitions fail.

As you read through the rest of this report, bear in mind the following statement: Ninety-three percent of the business owners who completed the survey in the North Texas region indicated that they *agreed* with this statement:

"Having a transition strategy is important both for *my* future and for the future of the business."



Although significant improvement is still needed (in particular, better focus on value acceleration and financial and estate planning), it was encouraging that business owners in North Texas demonstrated better transition planning and more family involvement than in any prior study completed by EPI since the research's inception.

Why are North Texas owners demonstrating better trends toward transition readiness?

Although there is no conclusive evidence available, what is known is that Dallas is home to one of the most established, tenured, and cross-functional chapters of the Exit Planning Institute. This group of advisors has been driving exit planning awareness and best practices since 2012 in the Dallas/Fort Worth area, and it is possible that this community has been brining exit planning into the present for many years prior to the execution of this research study.

- Although only 44 percent had a written company transition plan and only 27 percent had done "no planning at all", this is much better than the average of all previous surveys of only 19 percent having a written transition plan and 53 percent had completing no planning at all.
- Only 16 percent had a written personal plan for what they would do after transitioning their business and another 16 percent, had not even thought about it. This is still far lower than needed to be prepared to personally transition. However, this again is better than in all previous surveys in which only an average of nine percent had a written personal plan and 23 percent not even a thinking about what they would do next.
- Only 20 percent had established a formal transition team. Yet, this is better than the average of all previous surveys of only 12 percent.
- Fifty-three percent had not sought any outside advice. This compares to an average of 67 percent from all previous surveys.
- Thirty-six percent had accomplished formal transition education. This compares to an average of 28 percent from all prior reports.

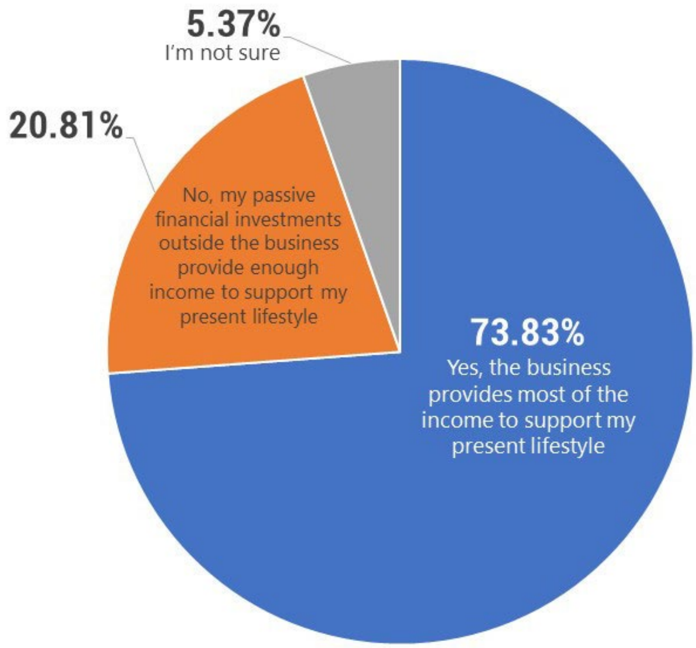
The above North Texas statistics, although encouraging when compared to data from previous surveys, are still alarmingly lower than needed considering that 71 percent of the owners indicated they would like to transition their business within 10 years and **nearly half (45 percent) of the business owners who completed the survey indicated that they would like to transition their business within 5 years or less.** Twenty-nine percent indicated that they had no plans to transition even though it is an inevitable fact the all business owners must exit their businesses at some point.

Many business owners who fail to plan for their transition face many regrets:

- Business owners realize they should have integrated a value acceleration process to prepare themselves and their businesses much earlier.
- They realize after the fact that they left money on the table because they did not maximize the value of the business at the time of exit.
- Personally, many are miserable post transition. In a survey completed by PricewaterhouseCoopers, 75 percent of business owners profoundly regretted the decision 12 months after selling, primarily because of poor personal planning for what they would do next. Business owners who fail to prepare a personal plan for how to fill their newly found windfall of time post transition are often missing a fulfilling life experiences post-transition.

Ironically, although 84 percent of business owners surveyed indicated that they had no written personal plan **and 27 percent indicated they had done "no planning at all,"** 79 percent of the owners responded to the question "what do you plan to do post-transition?" The most popular answers were "retire" or "semi-retire". Other popular answers included consulting, investing in another business or sitting on a board, and philanthropy. It is also worth noting, perhaps because the average age of the owner completing this survey was much younger than in previous surveys, that a significant number of owners indicated buying another business was something they would like to do after transitioning their present business.

DO YOU NEED THE INCOME PRODUCED BY THE BUSINESS TO SUPPORT YOUR PRESENT LIFESTYLE?

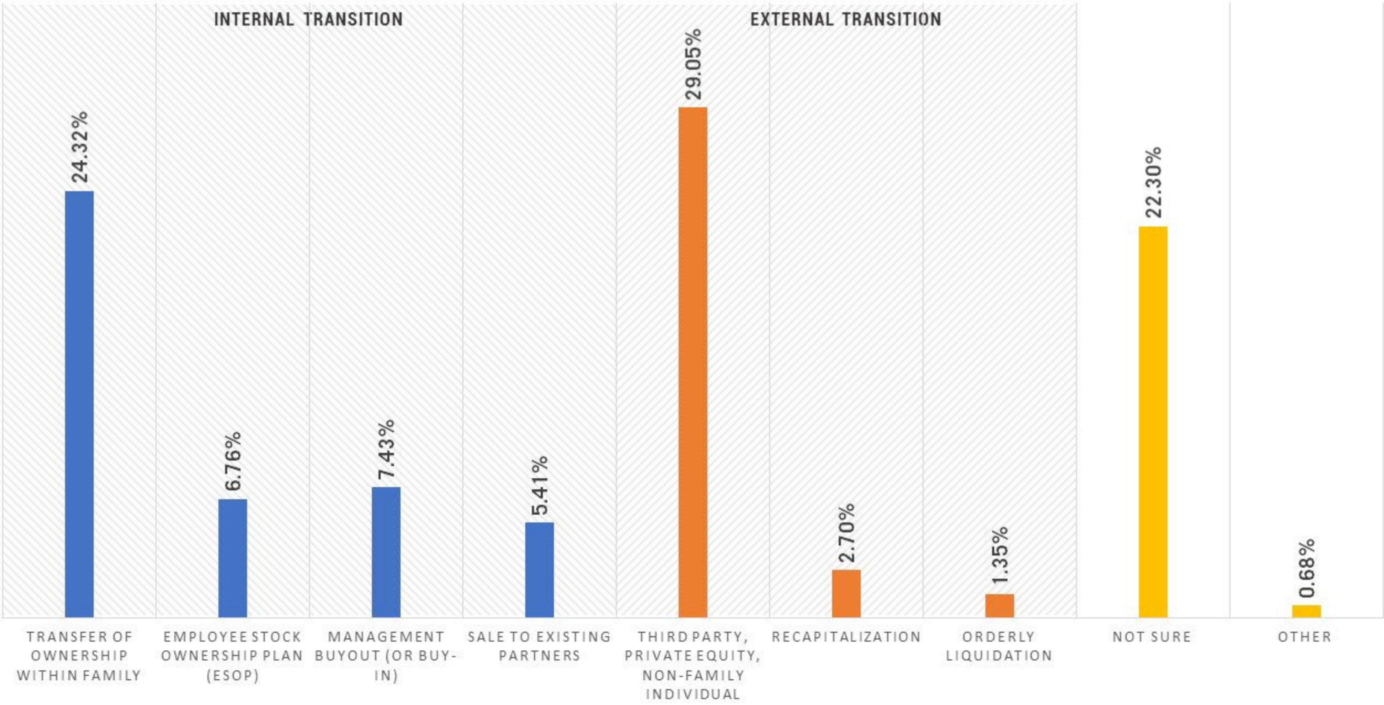


To execute their transition plans properly, most business owners need their companies to remain profitable.

Of the owners who said they had a plan, 79 percent indicated that it was at least "helpful" that the **company remain profitable for their transition plan to be properly executed;** 44 percent said that it was "critical." Many owners need the business to remain profitable because it can be several years after the actual exit from the business before they extract all their wealth because of seller financing, holdbacks, and earn-outs.

This is especially important for inside exit options such as ESOPs, family transitions, and management and partner buyouts. Usually, the owner does not achieve a windfall upon the transfer of the business assets and management. Rather, the owner is required to finance the inside buyout creating a dependency on the next generation of management and ownership to fulfill the terms of the agreement and accomplish this without the present owner leading the business.

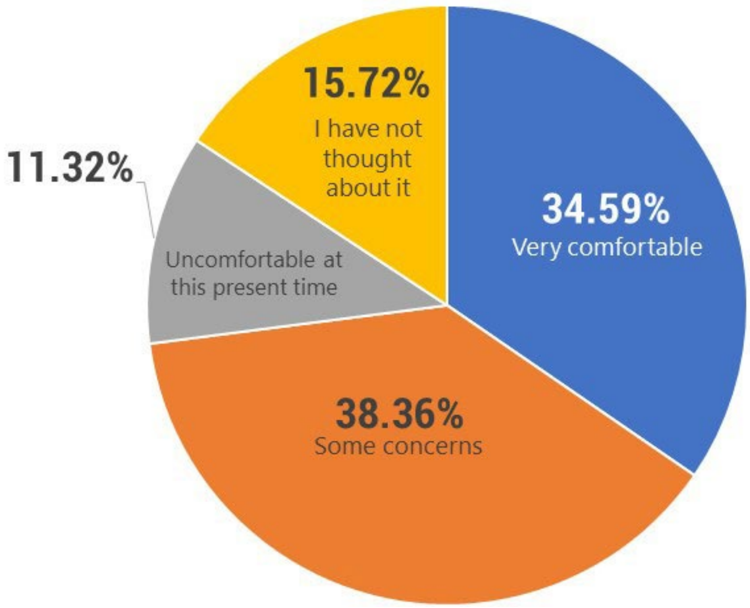
WHAT BEST DESCRIBES YOUR PREFERRED EXIT?



This makes sense when reviewing the North Texas sample considering that for the owners who had an exit option in mind, they had a greater tendency towards “internal” exit options (57%) versus “external” exit options (43%) when compared to data from previous surveys (internal: 51%, external 49%). More relevant, more North Texas owners had an exit option in mind (78 percent) versus the average of all previous surveys being only 65 percent.

Consider the age profile of the respondents. The high need for business profitability post-exit in North Texas could be related to owners being younger. Many Texas owners indicated intent to buy or invest in another business, meaning they need the proceeds from the transition of their existing business to fund their next act. This is a fairly significant contrast to prior surveys where many owners showed inclination toward retirement-related plans.

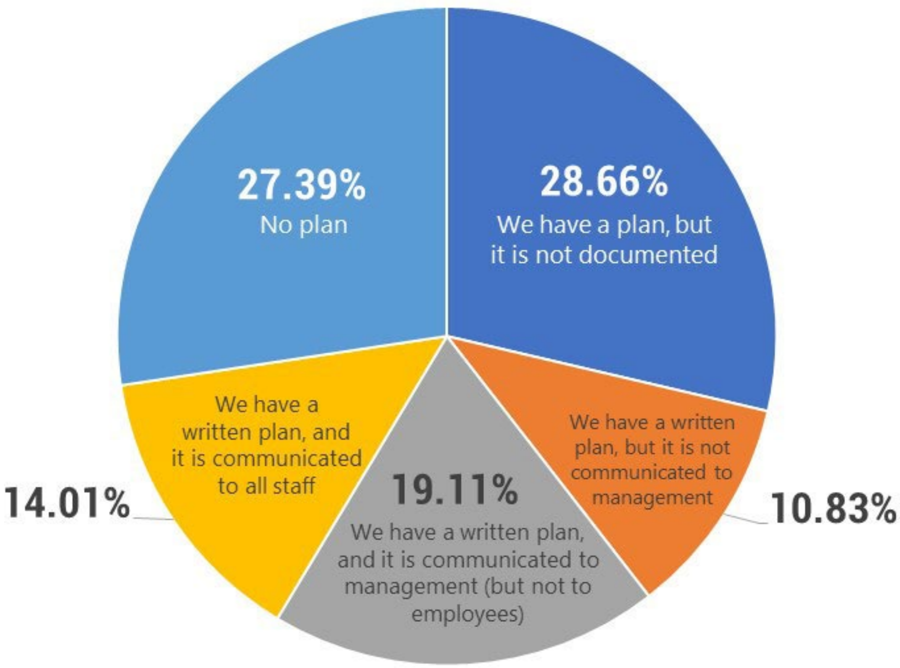
HOW COMFORTABLE ARE YOU THAT YOUR MANAGERIAL TEAM WILL BE SUCCESSFUL WITH THE NEW OWNERSHIP?



In fact, more North Texas business owners (64 percent) knew what they "needed" (vs. wanted) from the sale of their business versus the average of all previous surveys of only 42 percent. And significantly more North Texas owners (57 percent vs. 38 percent) indicated they needed to harvest the value from their businesses to support them post-transition.

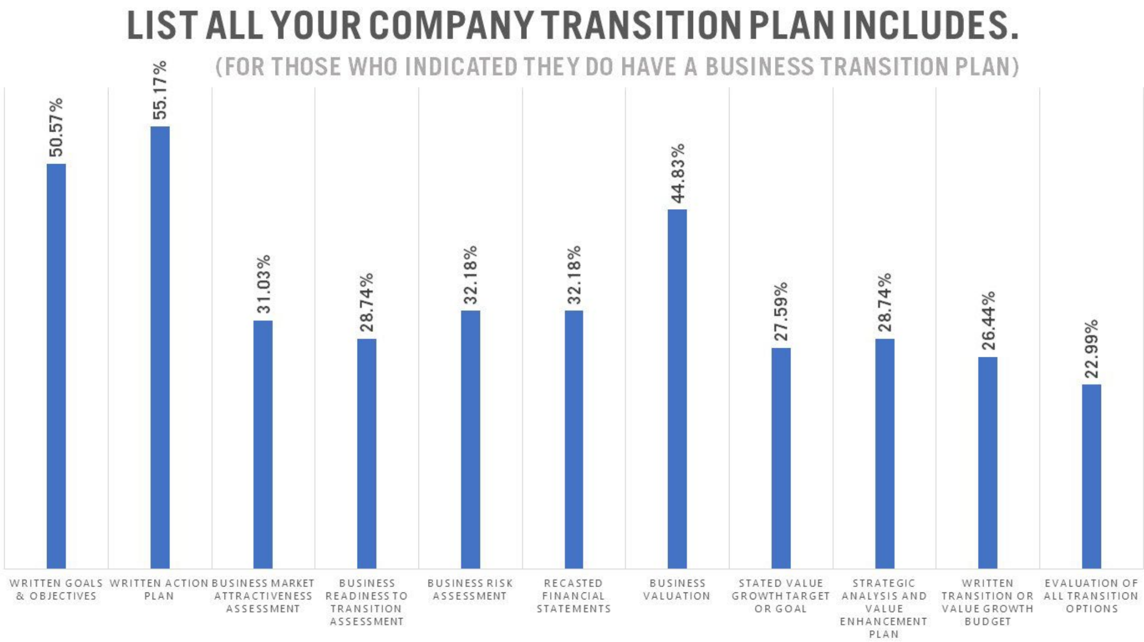
When asked, "How comfortable are you that your management team will be successful with the new ownership?", 16 percent of the North Texas business owners said they had not thought about it. In addition, half indicated they were uncomfortable or had at least some concerns about the future of their management team with new ownership. This would be critical in a situation where the owners depended on the company remaining profitable after they are gone.

WHAT BEST DESCRIBES YOUR COMPANY'S TRANSITION PLAN?



The 1979 Harvard Business School study made a correlation between written goals for the future and likelihood of achieving them, tying the results directly back to financial key performance indicators.

In Texas when asked, "What best describes your company's transition plan?" the respondents showed an embrace of the Harvard goal-setting mentality. Nearly 73 percent reported having a plan, though only 44 percent of business owners said they had a documented company transition plan.

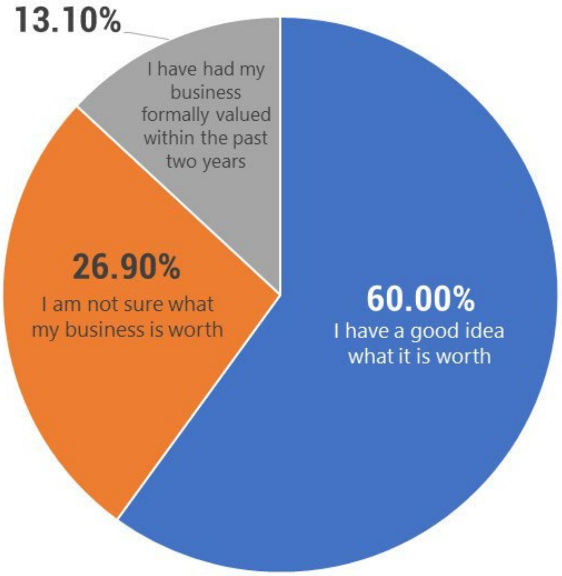


Business valuation and value enhancement are cornerstones of successful business transitions. From this angle it appears that owners in the North Texas area are still stuck in an old exit planning paradigm. Planning is important. But a focus on actions which preserve and build business value is the key to transition success. The data suggests that this is a big opportunity for improvement in North Texas.

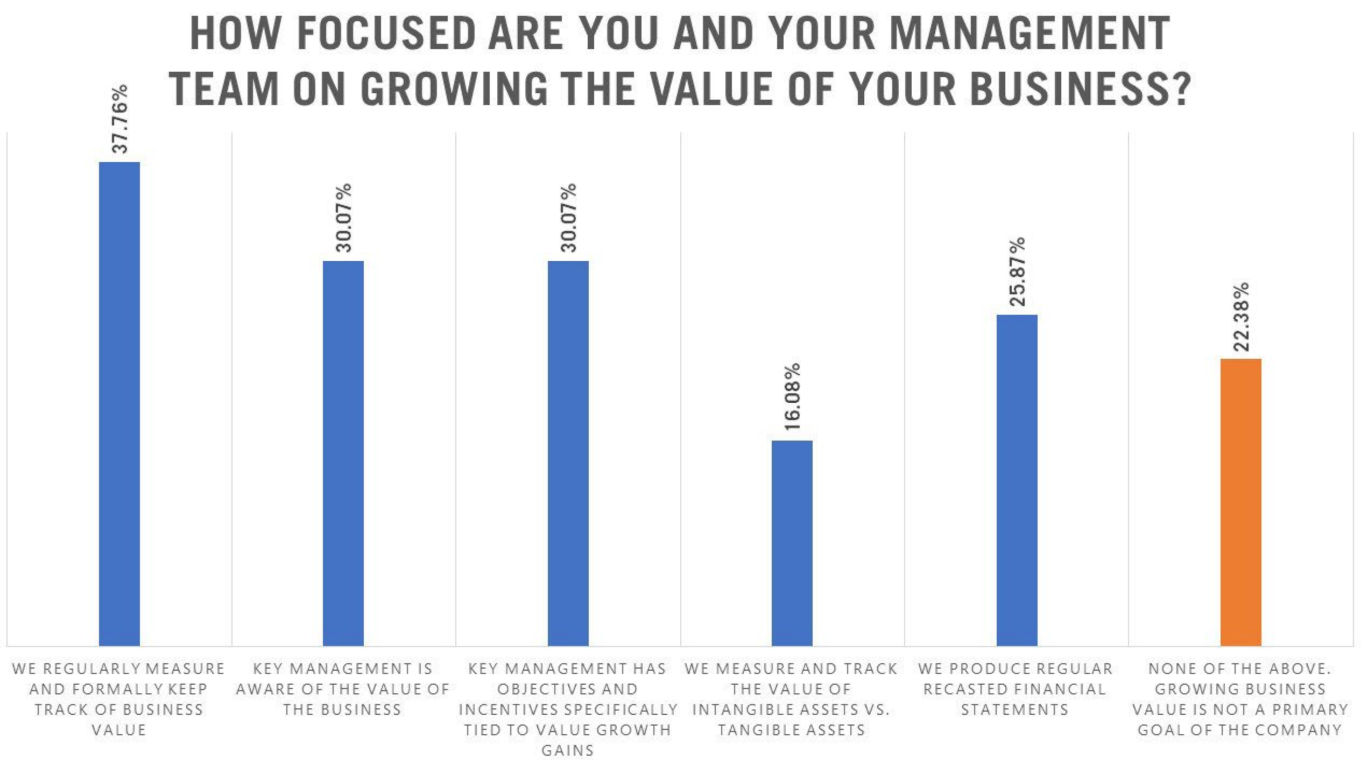
For those owners who said they had a plan, we asked "What do your plans include?"

- Only 45 percent indicated that their plans included a business valuation.
- Only 51 percent had written goals and objectives and a written action plan.
- Less than a third included recasted financials (32%), a business risk assessment (32%), a business market attractiveness assessment (31%), a business readiness assessment (29%), a strategic analysis and value enhancement plan (29%), a stated value growth target or goal (28%), and a written transition or value growth budget (26%), taking maximizing value off the table.

WHAT IS YOUR CURRENT UNDERSTANDING OF THE VALUE OF YOUR COMPANY?

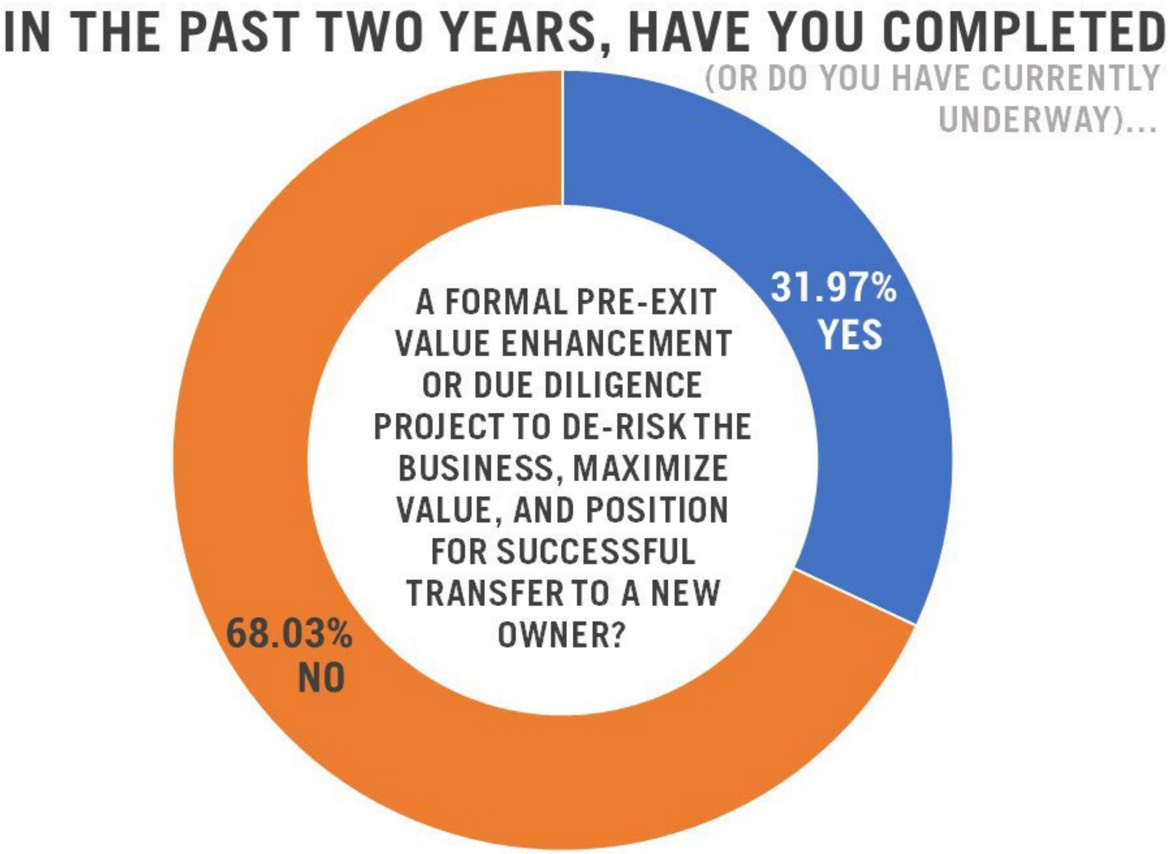


Overall, **only 13 percent of the business owners responding to the survey indicated that they had had their business formally valued in the last two years.** However, 60 percent said that they "had a good idea what it was worth." How could business owners know what the business is worth if the business has not been valued by a professional? One conclusion could be that owners are relying on hearsay and not on the facts that a formal business valuation produces. We believe this is a major reason why only 20 percent of businesses that go to market sell. In an Alliance of Mergers and Acquisitions Advisors study, 95 percent of mergers and acquisitions professionals indicated that the **owner's overestimation of value was the number one factor in failed deals.** Owners tend to focus on sales and income without giving appropriate attention to business value. **An owner mindset shift is vitally needed.** Maximizing business value (not income) is their primary goal. Although this sounds like a subtle play on words, it is a major paradigm shift. High income alone does equal a valuable business. Attractiveness *and* readiness are both needed for the business to be a transferable asset. Focusing on value first can produce more income. In fact, focusing on value produces all other positive outcomes.



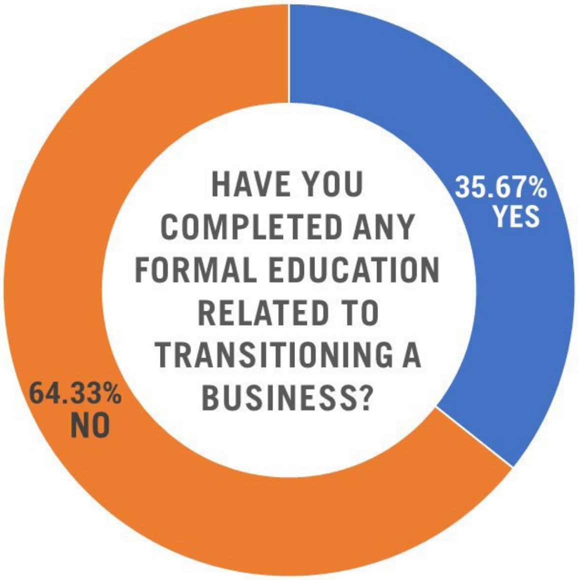
Only 22 percent indicated that growing the value of the business was a primary goal of the company. When we asked, "How focused are you and your management team on growing the value of your business?"

- Only 38 percent said that they regularly measured and formally kept track of business value.
- Only 30 percent said that key management was aware of the value of the business and that key management had objectives and incentives specifically tied to value growth gains.
- Only 16 percent said that they measured and tracked the value of intangible assets vs. tangible assets, even though this is where 80% of value resides for many businesses.
- Only 26 percent said they regularly produced recast financial statements, meaning that three out of four business owners are not seeing nor measuring one of the key numbers that drive value.



In fact, **68 percent of the business owners indicated that they had not taken on a value enhancement or de-risking project within the last two years.**

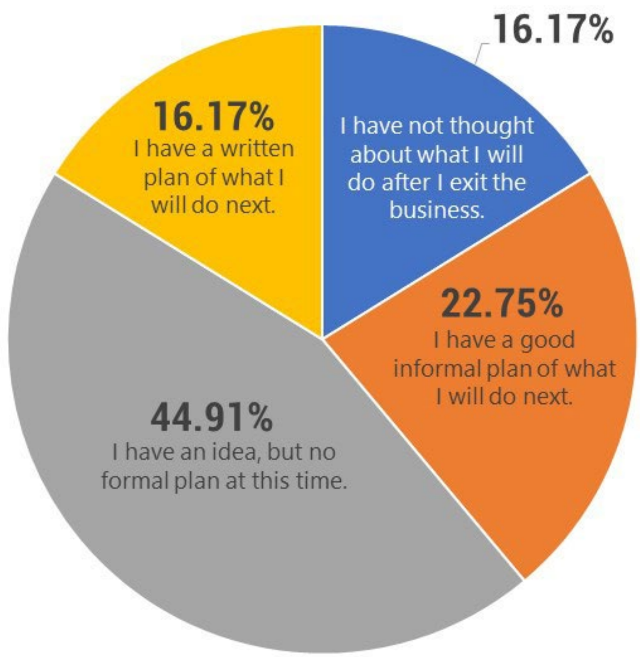
Thus, if many of the owners' transition plans do not include business valuation, goals and objectives; written action plans; exit options analysis; a risk assessment; or a strategic value analysis, budget, and value enhancement, **what do they include?**



Given that most business owners are business savvy, one can only conclude from these responses that *owners don't know what they don't know*. This lack of education is further supported in that nearly **two out of three business owners (64 percent) of owners completing the survey indicated that they had not accomplished any formal transition planning education.** The danger in that response is that business owners are significantly underestimating what a successful exit requires. Owners *think* that both they and the business are prepared because they have given some attention to their transition, perhaps focusing on plans and estate planning. However, successful transitions require much more than thought. They require solid, long-term business, personal, and financial plans grounded in action, focused on protecting and building value in the present tense, with specific deliverables completed along the journey well in advance of the actual exit from the business or formal turnover of children, management, or employees.

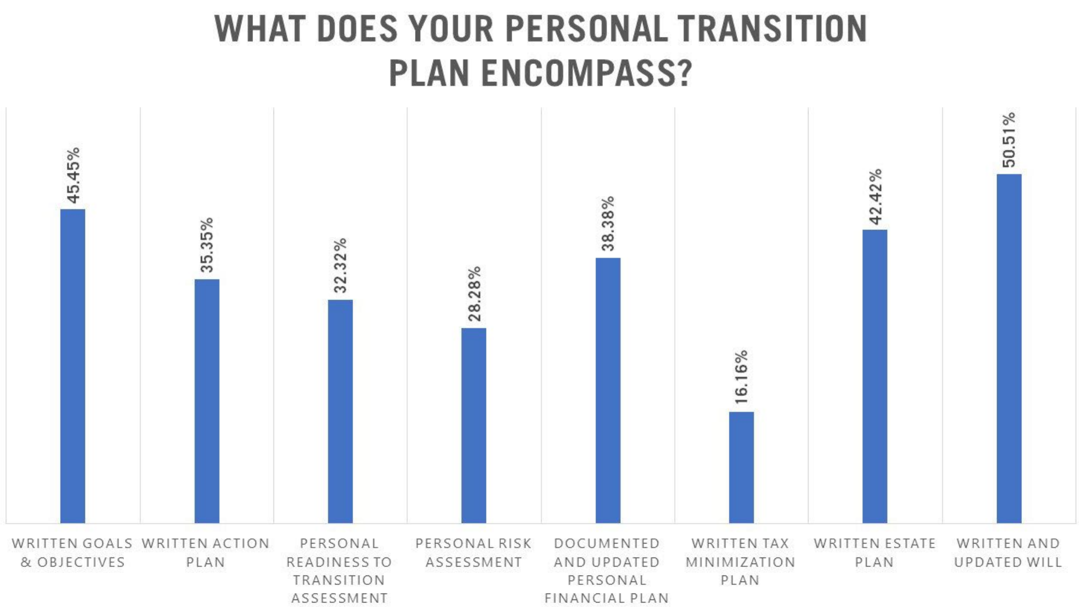
Given the lack of focus on value acceleration, it is not surprising that historical transition success rates are so poor. Business owner planning and actions required to build a growing and transferrable business are clearly lacking. The actions highlighted above are essential to sustaining growth and building a business ready to transfer and to position a business owner for what will be upon exit, a personal transformation.

WHICH BEST DESCRIBES THE STATUS OF YOUR POST-BUSINESS TRANSITION PLAN?



Owners scored poorly in personal planning, personal financial planning and estate planning despite its vital role in a successful business and life transition.

Personal planning (what next?) and personal financial planning (financial independence) are also essential to a successful transition and to living a fulfilled and financially secure life post-exit. Owner responses to the state of their personal plans regarding what they would do after they exit their business demonstrate that business owners are underestimating the importance of both personal planning and personal financial planning. **Only 16 percent of business owners indicated that they had a written plan for what they would do post-exit, and only 38 percent had a documented and updated personal financial plan.**



We asked those who did have a personal transition plan to indicate what the plan included.

- Only 45 percent indicated it included written personal goals and objectives.
- Only 35 percent had a written personal action plan.
- Only 32 percent had completed a personal readiness-to-transition assessment.
- Only 28 percent had completed a personal risk assessment.

Seventy-four percent of the business owners indicated they needed the income from the business to support their lifestyle. Furthermore, 57 percent of the business owners indicated they needed to harvest the value of their business to support their lifestyle post transition (13 percent answered “not sure”). Nearly two out of three (64 percent) business owners indicated they had completed the financial planning to know what they needed to net after taxes from the transition of the business to fund retirement and future goals. It would appear from these points that business owners had a handle on current and future income needs. But do they really?

(continued observations from page 28)

Only 41 percent of these same owners indicated they had an updated written estate plan. More than a quarter of them (26 percent) did not even have an estate plan. In addition, for those who said they had an updated estate plan, less than one-third (32 percent) indicated the transition of the business had been included into the personal financial and estate plans. Nearly half (48 percent) of them indicated their estate plan did not include the sale of the business and 58 percent of them said their estate plan did not include an updated valuation of the business. Only 37 percent had an updated tax minimization plan. And finally, only about half of them (51 percent) had an updated will; a very basic fundamental of proper estate planning.

How can estate and personal financial plans be accurate if they do not provide for the transition of business value which, according to most financial advisors, is usually 80-90 percent of the owner's net worth?

Many of the North Texas owner's estate and financial plans, therefore, are likely missing 80 percent of the owner's net worth, which is clearly important for one's personal financial strategy and mitigation of personal financial risk.

Let's take a moment to highlight the importance of these contradictions on the next page.

Recall that 74 percent of the business owners indicated they needed the income from the business to support their lifestyle and 57 percent of the business owners indicated they needed to harvest the value of their business to support their lifestyle post transition. In the survey, many owners admitted:

a) They are dependent on the income from the business to support their lifestyle;

b) They need to harvest the value of the business to support their lifestyle post transition;

c) They need the business to remain profitable post exit for their plans to be properly executed;

d) Nearly half of the sample would like to transition within five years and almost three-quarters would like to transition within 10 years.

Yet,

1) Only 35 percent said they were comfortable the management team would be successful with new ownership;

2) Only 13 percent of the business owners indicated that they had had their business formally valued in the last two years;

3) Only 22 percent indicated that growing the value of the business was a primary goal of the company;

4) Sixty-eight percent of the business owners indicated that they had not taken on a value enhancement or de-risking project within the last two years;

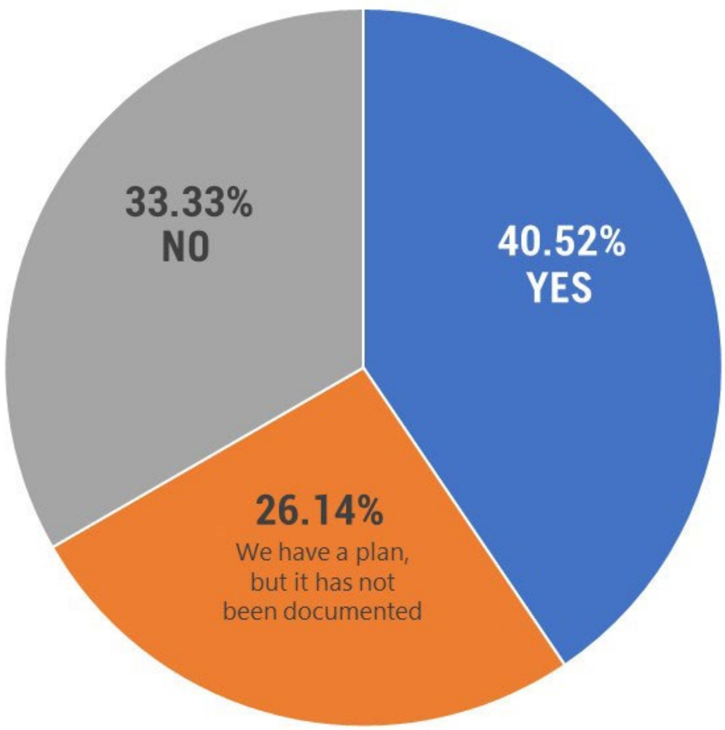
5) Only 41 percent of these same owners indicated they had an updated written estate plan;

6) Nearly half (48 percent) of them indicated if they had an estate plan, it did not include the sale of the business.

Do you see the contradictions?

DO YOU HAVE A DOCUMENTED CONTINGENCY PLAN?

(THAT ADDRESSES FORCED EXIT CAUSED BY DEATH, DIVORCE, OR DISABILITY)

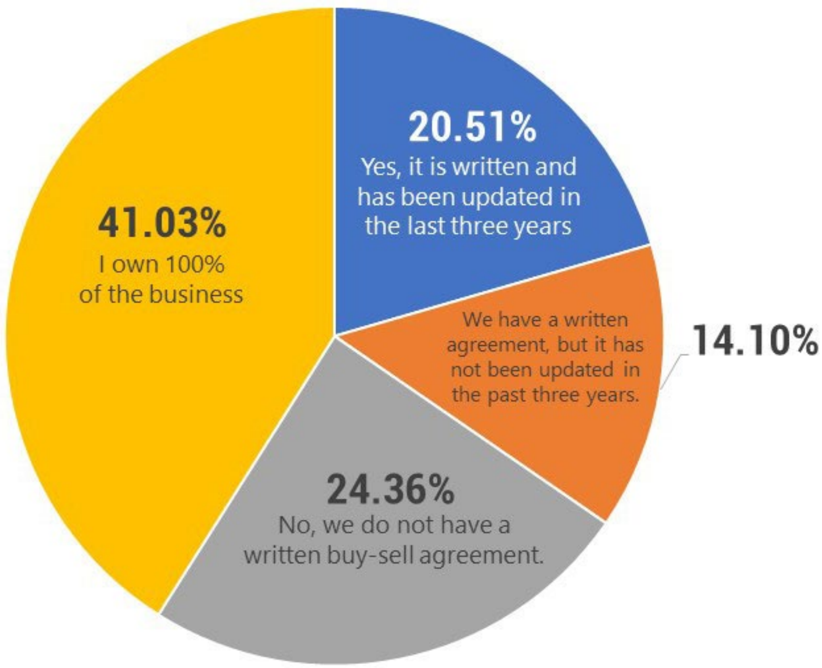


The transition planning process does not appropriately address management of business and personal risk.

In our study, only 41 percent of the owners indicated that, should they be forced into an exit, they had documented contingency plan. For those that did have a written contingency plan, less than half (47 percent) said it was funded by life and disability insurance.

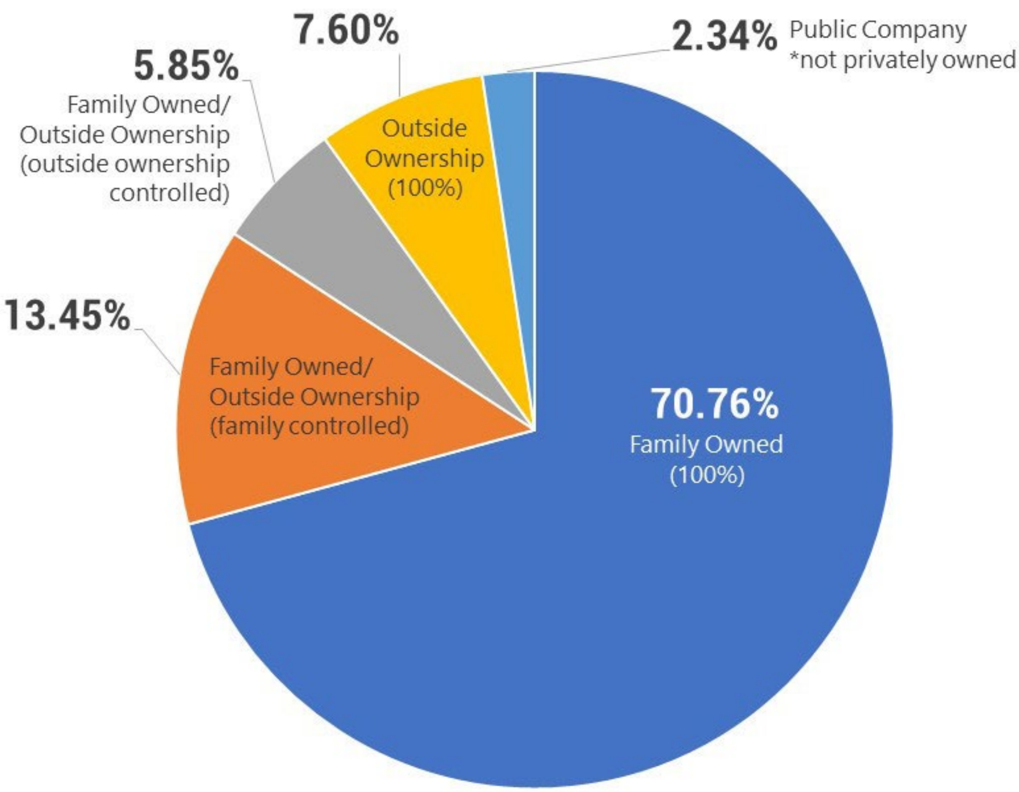
IF THERE ARE MULTIPLE OWNERS OR PARTNERS, DO YOU HAVE A WRITTEN BUY-SELL AGREEMENT?

(AND HAS IT BEEN REVIEWED AND UPDATED IN THE LAST 3 YEARS?)



Fifty-nine percent of the business owners surveyed indicated they had multiple partners invested in their businesses. Yet, only 36 percent said their buy-sell agreement was written and updated within the last three years. Only about half (53 percent) said it was funded by life and disability insurance. A buy–sell is like a business valuation; it should be revisited annually, even if it requires no changes. Moreover, ensuring that the buy–sell is funded is key to ensuring that the terms can be met if the buy–sell must be invoked.

WHAT IS THE OWNERSHIP STRUCTURE?



Family is still important, but is the family ready for the transition of the business and the potential lifestyle changes?

Seventy-one percent of the sample included businesses that were 100% family-owned, and 84 percent were family controlled. **Transitioning to family was the number one inside transition choice and number two preferred exit choice overall in North Texas.** The local owners in this survey demonstrated better family involvement as compared to past State of Owner Readiness studies, but improvements in communication and planning for family transition are still needed.

Twenty-seven percent indicated they had **never had a family meeting** about the business (as compared to an average of 49 percent from previous surveys). Forty-two percent indicated they had a family meeting about the business at least annually (compared to an average of only 25 percent in previous surveys).

Although only 53 percent of the business owners who said they had a plan indicated that **the family was aware of both the owner's management and ownership transition plans,** this is better than the average of 47 percent from previous surveys.

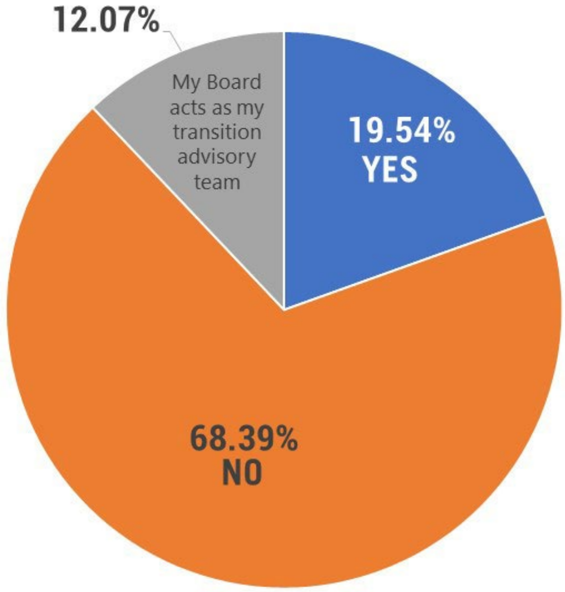
Seventy-nine percent of business owners who said their plans included filling key positions with family members said family members were at least somewhat or completely ready to fill key positions. Eight out of ten (80%) of these family members had received formal training.

On another encouraging note, although only 20 percent of the business owners surveyed had established a transition team; those owners who had one recognized the need to include family in this team**. Fifty-one percent of business owners indicated that their spouse or another family member were members of their transition team.**

The complexity of family dynamics is always challenging, especially when they involve the complexity of a business transition. In addition to complexity, we believe another reason why most family transitions are not successful is that business owners tend to do less transition planning when they have decided to transfer the business to family. **The family should approach the transition with the same vigor as they would if they were planning to sell it to a third party,** even if the family has decided on an intergenerational transfer.

The characteristics that make a business valuable to a third party are the same ones that make it valuable to the next generation; low risk, high transferable value. In addition, the personal and business actions associated to planning and executing successful business growth and transition using value acceleration can be also used as a tool for developing the next generation of family business owners leading to more frequently successful intergenerational transitions.

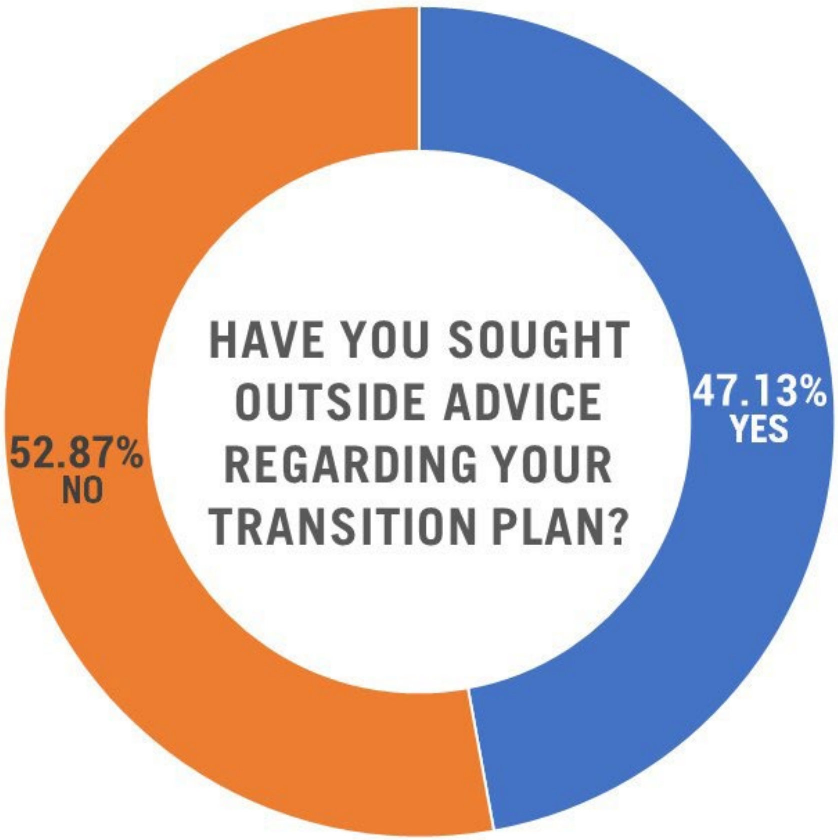
HAVE YOU ESTABLISHED A FORMAL TRANSITION ADVISORY TEAM?



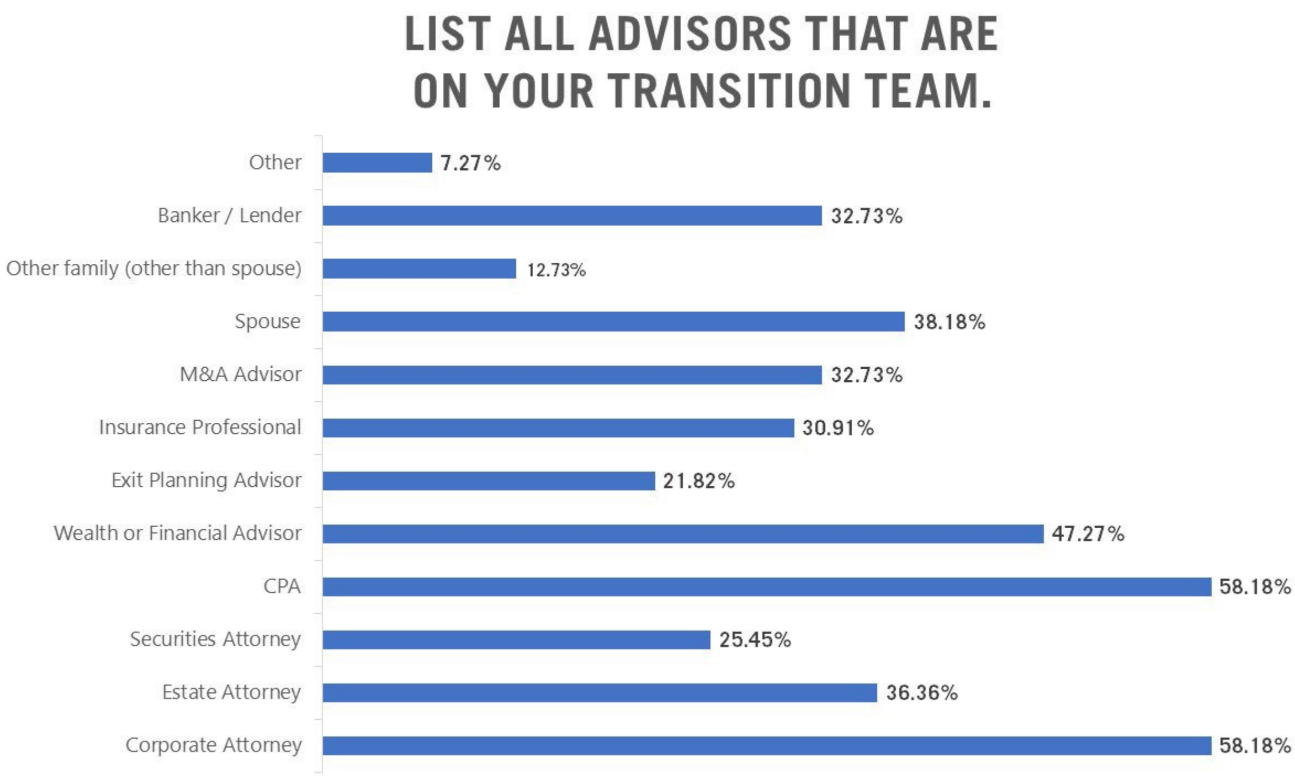
Improving the use of outside resources—in particular, a board of advisors that includes nonfamily members, would likely result in an increase in successful transitions and higher valuations.

From previous surveys, we have observed that using outside resources and an active board of advisors that includes nonfamily members are two characteristics correlated with better planning and preparation and a greater focus on maximizing value. The North Texas region business owners scored lower than is needed in both categories.

As noted previously, 80 percent of business owners indicated that they had *not* set up a formal transition team. Moreover, 12 percent indicated that they used their board of advisors as their transition team—usually a mistake. Most advisors and many owners should realize that the skillsets needed to transition a business can be much different from the skillsets of the members who sit on the owner's advisory board. Both are necessary and have distinct roles in supporting the business owner.



For the 20 percent of the owners who said that they had transition teams, the corporate attorney (58 percent) and CPA (58 percent) were the most highly selected professional advisor to be named to the transition team. The core transition team for the owner should comprise, at minimum, an attorney (typically a business attorney), a CPA, as well as a wealth manager/financial planner and a credentialed exit planning advisor such as a CEPA (Certified Exit Planning Advisor).

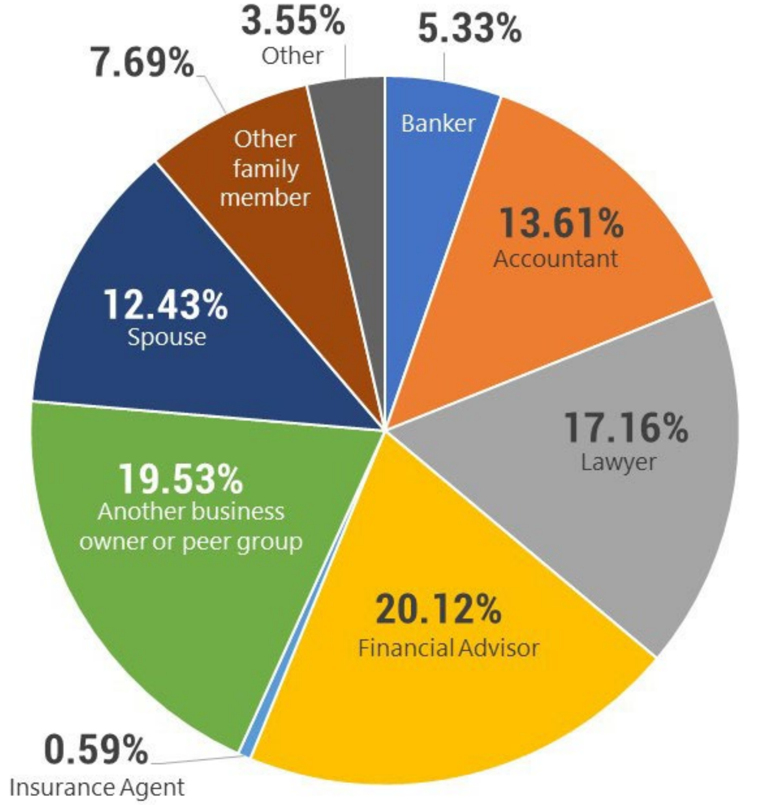


Although 58 percent of business owners seemed to recognize the need for a corporate attorney, CPA, several other key advisors were missing:

- Less than half (47 percent) included a wealth or financial advisor.
- Less than 40 percent included the owner's spouse (38 percent), estate planning attorney (33 percent), a commercial banker (33 percent), M&A advisor (33 percent), or insurance professional (31 percent).
- Only 22 percent included an exit planning advisor.

We found that only 53 percent of business owners had sought outside advice related to their transitions and only 33 percent of the respondents in the North Texas region had a board of advisors with non-owner/non-family members on it.

WHO IS YOUR MOST TRUSTED ADVISOR?



Significantly different than past results, the Accountant was not the most trusted advisor.

When North Texas owners were asked, "Who do you see as your most trusted advisor?" the results indicated that the most trusted advisory relationship was split between the financial advisor (20.2%) and another business owner or peer (19.5%).

Surprisingly, only 14 percent indicated their Accountant. In most EPI past studies, the CPA is "number one" on the list.

Notable considerations and concerns:

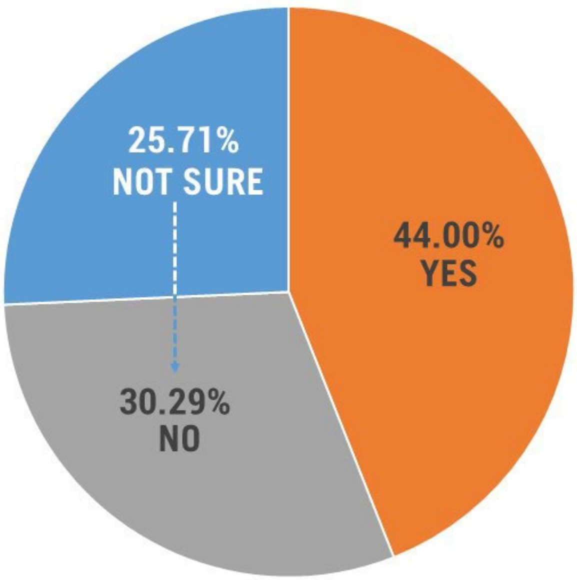
Although 47 percent of the owners indicated that the wealth manager/financial planner should be or is on the transition team, **only 20 percent considered the wealth manager/financial planner to be the most trusted advisor.**

This is a huge opportunity for the financial planning industry. Involving a wealth manager or financial planner in the transition process as early as possible is clearly a best practice. Designing a comprehensive transition strategy without involving the financial planner or wealth manager is impossible. The financial planner's role is critical for determining the owner's financial needs before, during, and after the exit. The financial planner's role is also critical in evaluating options to optimize the owner's post-business lifestyle and often dictates the available exit options and the structure of the exit transaction, whether it be an internal or an external option. In addition, after the owner's exit, the financial planner's role becomes even more important. The financial planning industry and owners themselves would benefit tremendously if the financial planning industry did a better job of educating owners on the importance of including the financial planner or wealth manager in transition planning in the years leading up to the actual transition.

Only five percent of the owners considered their commercial banker to be their most trusted advisor. Except for the CPA, no other advisor should be as familiar with the business as the commercial banker. We have consistently observed opportunities for improvement in this relationship. It certainly is a two-way street. However, given the potential significant role the banker plays in the growth and transition process, both owners and commercial bankers would benefit from an improved relationship.

Also, worth noting is that **only 12 percent of the owners indicated their spouse as the most trusted advisor despite 38 percent indicating the spouse was or should be on the transition team.**

ARE YOU FAMILIAR WITH ALL YOUR TRANSITION OPTIONS?

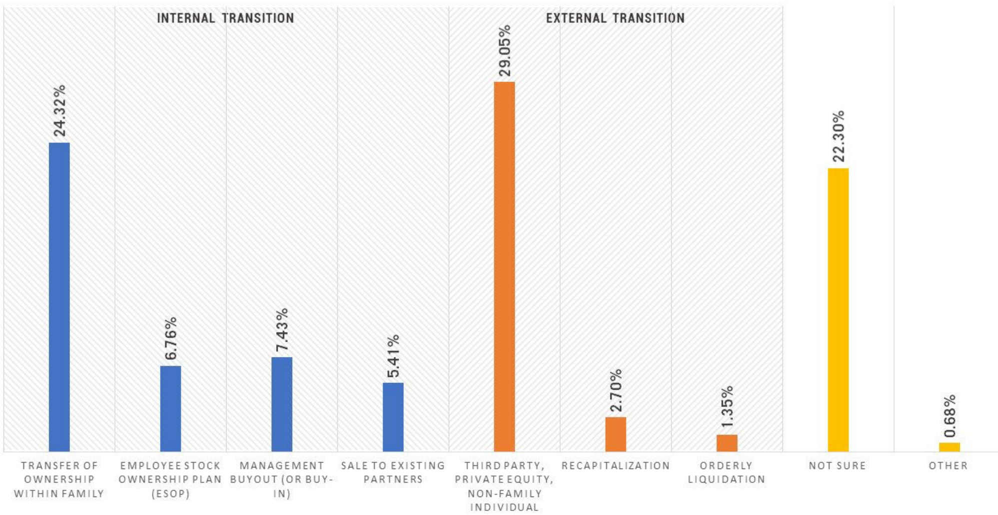


The evidence is clear that more education on exit options is necessary and that business owners are not spending enough time analyzing their exit options.

Fifty-six percent of the business owners surveyed said "no" or "not sure" (which effectively means no) when asked if they were aware of all their exit options. This was better than in previous survey, but still clearly points to the need for education regarding exit options. Not being aware of all their exit options means that owners risk leaving money on the table when they exit or structuring exits that are not ideal for their situations.

When asked, "What best describes how you are planning on transitioning your ownership?" only 22 percent indicated they were "not sure." This again was better than data from previous surveys where scores ranged from 20 percent to 45 percent and averaged 35 percent.

WHAT BEST DESCRIBES YOUR PREFERRED EXIT?



Most business owners in the North Texas region prefer to transition to family, employees, management, or partners, (57 percent), whereas 43 percent prefer an option to transition to a third-party, recap, or orderly liquidation.

The most popular choices for those who indicated they had considered exit options were a third-party sale (38 percent) or a family transition (32 percent). Third-party sales and family transitions are consistently the most popular transition options.

The owners in the North Texas region were more inclined towards inside transitions and less inclined towards outside than in previous surveys. Overall, for the 78 percent of respondents who had considered their exit options, more than half (57 percent) preferred an inside option (family, management, employees, partners) and 43 percent preferred an outside option (third-party sale, recap, orderly liquidation). Again, this indicates the North Texas region is more inclined towards inside options and less inclined towards outside options than in previous surveys.

Only four percent of the owners indicated an interest towards recapitalization. To see so few business owners considering recap as an exit option is disappointing and perhaps reflects their lack of focus on value acceleration. Our educated guess is that, again, this is due to lack of education. Recap is an excellent way for a privately held business owner to “take some money off the table” while at the same time bringing in capital and talent to accelerate growth.

Conclusion

At the end of each personal and business sections, provided all the questions, we asked owners to rate their overall readiness to transition their businesses and readiness to transition personally. Despite the evidence indicating more improvement is needed, just over half of the business owners (53 percent) still rated their business readiness as above average, and nearly half (48 percent) rated their personal readiness to transition as above average.

In addition, 62 percent of the business owners surveyed rated the strength of their personal financial position (strength of financial assets not including the business) above average even though:

- Fifty-seven percent indicated they needed to harvest the value of their business to support their lifestyle post transition;
- Thirty-six percent indicated they had not determined how much money they needed to net after taxes from the transition of their companies;
- Seventy-four percent indicated their transition plan required the company remain profitable for the plan to be properly executed.

Recall our opening statement in this section:

Ninety-three percent of the business owners in the North Texas region who completed the survey indicated they agreed with the following statement: **"Having a transition strategy is important for my future as well as the future of the business."**

Although this local community scored better in some areas than the other regional surveyed State of Owner Readiness markets, the data suggests there is still a significant disconnect and opportunity. Owners clearly recognize the importance of transition strategy but the evidence in this survey clearly demonstrates that more education and tangible action is needed to position themselves and their businesses for a successful business and personal transition in the North Texas region.

Section 3: Recommended Actions

Advice to Business Owners

Owners of businesses of all sizes must become much more proactive to improve successful transition rates and harvest their most significant financial asset. Success rates are not likely to improve as long as business owners view exit planning as "something I can do down the road" rather than an imperative integrated into the way they currently operate their businesses.

Exit planning is present tense. Owners must realize that they must redefine their present exit planning paradigm: until they do, progress towards improving successful transition rate will be limited.

> "Exit planning is simply *good* business strategy."

An effective exit plan is a strategic business tool that will create more income today, empower their management teams or children to take the business to the next level, create owner independence, and potentially increase the owner's wealth by 400–500 percent. In other words, exit planning is simply good business strategy. With ten trillion dollars of wealth at stake from an aging generation of business owners (remember, 40 percent of our survey respondents were aged 53 or older) and with a new generation of business owners at hand, a greater sense of urgency is required.

For owners, the best practice is for them to integrate the actions of a successful transition into the way they run the business every day. Owners can accomplish this by identifying what they have now (Identify Value), taking risk-mitigating actions to protect their wealth (Protect Value), tenaciously building value over time (Build Value), positioning the business to have multiple exit options—and, perhaps, multiple exit events (Harvest Value) —and always actively and holistically managing their wealth (including the business wealth) before, during, and after the exit event (Manage Value).

As previously pointed out, 80–90 percent of the owner's net worth is likely to be locked in the owner's business. Moreover, 70–80 percent of that business wealth is tied to intangible assets. To check this, owners need only look at their present income statements and balance sheets.

> Does the income recorded on the income statement (for tax purposes) really reflect the true cash flow benefit assumed by the owner or future owner? Often, the answer is no when the owner considers normalized income and expenses, discretionary expenses charged to the business, and one-time, nonrecurring charges.
>
> Does the owner's present balance sheet reflect the business's true "market value"? Again, not often. The balance sheet (again for tax purposes) reflects the book value of the owner's recorded business assets—not the true market value, which would include the value of the business' intangible assets.

Management systems must be adapted to give the owner strategy and feedback on the value of intangible assets; human, customer, structural, and social on a regular basis (read full '4Cs' concept in the book, *Walking to Destiny: 11 Actions an Owner Must Take to Rapidly Grow Value and Unlock Wealth*, by Christopher Snider).

Most accounting and management systems today do not provide feedback on the value of the business. Focusing on value first drives all other positive outcomes, including increases in sales and profits. Integrating personal and financial goals and plans with business planning prepares the business owner for all possible events from a personal, financial, and business standpoint (a concept called the "Three Legs" or "Master Planning"). Owners must realize that 50 percent of all exits are forced—that is, they do not occur on the owner's terms or timeline—because of one of the Five Ds: death, disability, divorce, distress, or disagreement.

By focusing on regular, consistent and relentless execution of actions to protect, build, and harvest business value owners position themselves to be able to harvest the wealth in their businesses in good times or bad.

Advice to Advisors

The CPA was not rated “the most trusted advisor” in the North Texas study.

This is a major contrast to prior State of Owner Readiness studies. In all prior surveys but one, the CPA is sits at the top of the “most trusted” list. While it may seem negative, this finding illuminates an opportunity for accountants in the North Texas region.

Of all the possible advisors, the CPA most likely has the best understanding into business financials and operations. Going beyond self-imposed boundaries and becoming more consultative with the owner can enhance your “trusted advisor” status. Offering insights about managing the value of the business and exit options is an opportunity to reframe and enhance the relationship between accountant and business owner.

Only 20 percent of the business owners surveyed indicated that their wealth advisors were their most trusted advisors. It is valuable to improve the relationship with business owners, given that the wealth manager is the one of the few advisors who will be with the owner throughout the entire process; not only leading up to the transition event, but afterwards. Wealth managers are charged with managing the owner’s windfall after the exit event.

The wealth manager is also vital in helping the owner and the advisory team select and structure the appropriate exit option.

The fact that very few owners indicated that the wealth manager was the “most trusted advisor” is another indication of how lacking the necessary information is. If owners were educated on all available exit options, they would understand the value that the wealth advisor provides; before, during, and after the exit event.

The exit advisor community is growing, but it is a blue ocean; an evolving cross-functional profession driven by the approaching wave of four million baby-boomer business owners who will be exiting their businesses and a next generation of business owners that will assume control in the coming years.

Too many owners are not aware that exit planning advisors exist. Professionals who can help grow value, unlock wealth, and position the business for transition success (regardless of the exit option in play).

That said, only 22 percent of the Texan business owners surveyed who indicated they had "designated a transition team" even employed an exit advisor in that mix. Although 22 percent is still much lower than it should be, it is a significant step up in recognition of the role of the exit advisor from previous research reports.

Other key advisors (including attorneys, insurance professionals, and commercial bankers) are all necessary to fill out a transition team. All three of these groups already have existing clients who likely match the demographics of this survey. For example, 63 percent of their existing client base are likely to be aged 54 or older.

It would thus be wise and financially beneficial for these professionals to go outside their subject matter expertise and attempt to develop a deeper, more personal, and more business-consultative role with their business owner clients. To accomplish this requires they reach out to other professionals and become more collaborative.

Thank you to our contributors.

This report was prepared and written by Christopher Snider of the Exit Planning Institute with the foreword by Shei Unger of BNY Mellon Wealth Management.

We would to thank and recognize the work of our valued partners at BNY Mellon Wealth Management, B2B CFO, Clark Hill Strasburger, Dailey Resources Inc, Dumas Capital Partners, LLC, Global Atlantic Financial Group, Insperity, Mobius Financial Advisors, Montgomery Coscia Greilich LLP, Murphy Business Brokers, Rockgate Financial Partners, Salmon Sims Thomas PLLC, and Vistage.

This research was a collaborative effort of many partners and organizations in the North Texas marketplace. Thank you to the survey respondents in the local region for their willing contribution to this study. Your participation has created an opportunity to educate and empower middle market business owners nationwide.

About the Exit Planning Institute

The Exit Planning Institute delivers innovative learning experiences, performance-enhancing resources and strategic tools designed to enhance the exit planning profession. Formed in 2005 to serve the needs of CPAs, financial planners and wealth managers, attorneys, commercial bankers, management consultants, M&A advisors, ESOP and family business advisors, the Exit Planning Institute is considered the standard trendsetter in the field of exit planning across the globe. It is the only organization that offers the Certified Exit Planning Advisor (CEPA) Program and qualifies for continuing education credits with eleven major professional associations, making it the most widely accepted and endorsed exit planning program in the world. For more information, please visit www.exit-planning-institute.org.

For more information regarding the key stakeholders and individual partners of the State of Owner Readiness Survey conducted in this region, visit **www.OwnerReadiness.com**.

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