Private Wealth Management

Business Owners Focus

Understanding the Business Sale and Dividend Recap Process

You put time, energy, and passion into growing your business.

Let us help you get to what comes next.

William Blair is here to guide owners of family or other closely held businesses through the big decisions, such as evaluating liquidity options as you consider next steps. We know that for business owners, the stakes are high—from both a financial and an emotional standpoint—so trusted expertise is essential as you take the next steps.

Understanding the structural and procedural steps to selling your business or completing a dividend recap process is as important as thinking about your personal wealth before a liquidity event. We offer guidance on:

SALE OR RECAP

- What to Consider When Deciding to Sell or Recapitalize Your Business
- How Do I Sell My Business…or Complete a Dividend Recapitalization Process?
- Side-by-Side Comparison of Business Sale and Dividend Recap Processes

WEALTH MANAGEMENT

- Be Sure to Think About Personal Wealth Well Before a Liquidity Event
- How Personal Wealth Planning Aligns with the Business Sale Process
- 10 Questions to Ask Yourself Before Selling Your Business

What to Consider When Deciding to Sell or Recapitalize Your Business

You may be considering selling your business or recapitalizing to realize greater wealth or increase liquidity. But which approach will work best for you? Following are key considerations for each.

Your Business for Sale–What to Expect

When evaluating whether selling your company is the appropriate path to pursue, you as a business owner should think about the following:

- Strategic buyers could be larger companies in your industry, similarly sized competitors, or companies in adjacent industries.
- Often the buyer—especially when it is a private equity firm—may request, or even require, that the previous owner stays involved in the business, either in a management or advisory role.
- Buyers may require sellers to "roll over" a portion of the sale proceeds as an equity stake in the acquiring company.
- There may be an "earn-out" component to the seller's compensation, where a portion of the sale proceeds are paid upfront, and the remainder is paid when/if the company meets performance or timing goals post-transaction.
- An outright sale may be an attractive option for a company whose owner is getting ready to retire and has no likely successor.

Pros and Cons of a Dividend Recap

With an equity recapitalization, which may also be referred to as a minority sale, your equity would be reduced by the amount sold to outside investors. With a debt recapitalization, you as the business owner would retain 100% of the equity ownership.

- Dividend recapitalizations can be an effective way for owners to "take some chips off the table" while retaining control of the company.
- In the case of an owner who wants to run the company for an extended period and believes that the company has significant growth opportunities over the next several years, a recapitalization exit strategy allows the owner to cash out some of his or her equity and still participate in a sale down the road (i.e., "take a second bite of the apple").
- Dividend recapitalizations can also work well in situations where some family members want to retain ownership of the company while others want to liquidate their positions.
- Not every company is a candidate for a debt recapitalization because taking on the additional debt could hurt the company's future performance. But for companies that have relatively low levels of debt, have a history of consistent profits and cash flows, and operate in industries with low cyclicality, a debt recapitalization may be an appealing option, especially when interest rates are low.

How Do I Sell My Business...or Complete a Dividend Recapitalization Process?

If you are a business owner, you may have considered selling your business or recapitalizing, immediately or in the future. You might want to realize greater wealth, or gain liquidity to reinvest or use for new projects. You may want to separate value from control as part of your wealth transfer planning. Your reasons are as unique as you are, and important to what comes next.

However, completing a business sales process or a dividend recapitalization is no small task. These are complicated processes with multiple steps and require coordinating with a number of professionals. The right advisor can help. So can reviewing best practices to ensure you understand the journey ahead.

We have outlined below a brief "business for sale" process, followed by dividend recapitalization considerations, and the pros and cons of each. There are many factors to consider. The opportunity to be acquired or to generate liquidity can be both exciting and overwhelming, and the stakes are high—from both a financial and an emotional standpoint. We help guide owners of a family business or other closely held businesses through these monumental decisions, working together to evaluate the options available to create liquidity.

How Do I Sell My Business...or Complete a Dividend Recapitalization Process? (continued)

What Happens When Selling a Business? What Steps Are Important?

A sale, also known as a merger or acquisition, involves selling all or a portion of the company's shares to a strategic buyer or a private equity firm (also referred to as a "financial sponsor"). In your case, the company up for sale may be owned by you the entrepreneur, or it may be a family business, or one with multiple, unrelated owners.

For business owners considering selling a company, it is important to understand the various steps of a sale process.

Step 1: Advisory Team Selection

Should I Hire an Advisor to Help Sell My Business?

Selling a business can be a complicated process, and the potential buyers on the other side of the bargaining table are often very sophisticated. It is important to have a team of trusted advisors with extensive experience managing these processes and representing companies in your industry.

Team composition: The team may include investment bankers, attorneys, accountants, wealth planning specialists, and analysts who perform quality of earnings reports and market assessments.

Take the lead: In most cases, an investment bank should be selected first because the investment bankers will lead the process and other advisors. The investment bankers can guide the sellers through the process of deciding 1) which type of transaction will be the most effective and 2) the timeline for pursuing a sale.

Involve your wealth advisor early: Business owners should begin discussions with their wealth advisors about strategies that may be used to minimize the taxes related to the sale and to achieve the owner's long-term financial goals. These discussions should include a review of the owner's estate planning documents, and should cover topics such as income tax implications of a transaction, wealth transfer and gifting objectives, and risk management.

Step 2: Preparation

What Documents and Information Are Required to Sell a Business?

At a formal kickoff meeting between the investment bankers and the owners, the team will start brainstorming about which type of buyers will have the most interest, when to launch the marketing process, how to position the company for maximum value, and what questions or concerns will come up during due diligence.

Marketing materials: Investment bankers will begin drafting the slide decks, financial models, confidential information memorandum, and other marketing materials that will be used to tell the company's story to the universe of potential buyers.

Data room: The investment bankers will begin creating the data room, which is a repository of financial statements, contracts, and other important documents that potential buyers who have signed non-disclosure agreements will be given access to in the due diligence phase.

Quality of earnings: A third-party firm will begin creating a quality of earnings report, which is a forward-looking analysis that attempts to strip out irregularities related to taxes, currency movements, and one-time events, and measure the company's ability to generate sustainable profit.

How Do I Sell My Business...or Complete a Dividend Recapitalization Process? (continued)

Step 3: Marketing

How Can I Find a Buyer for My Business?

This is the point when the investment bankers will begin reaching out to potential buyers to let them know that the company is available for sale and to gauge their level of interest.

Timing of outreach: Rather than reaching out to the entire universe of potential buyers at once, the investment bankers may decide to stagger the timing of when companies are contacted. This strategy, which is based on the investment banker's knowledge of individual buyers' aggressiveness and past behavior in deal processes can be helpful in creating a dynamic where the most interested buyers are able to stay involved until the final stages.

Non-disclosure agreement: Interested parties will sign a non-disclosure agreement (NDA) and then receive the marketing materials. The NDA is used to ensure that any trade secrets in the marketing materials are not used to adversely affect the seller's business.

Indication of interest: The interested parties will then submit an indication of interest (IOI), which outlines the range of prices that they would be willing to pay for the business and the assumptions they used to arrive at those prices.

Step 4: Due Diligence

How Do I Answer Business Buyers' Questions?

The investment bankers will determine which bidders will be invited to dig deeper to determine how much they would be willing to pay for the company.

Evaluating IOIs: Upon reviewing the IOIs, the investment bankers will determine which bidders will be invited to conduct their due diligence on the company. An experienced investment banker will have insight into which potential buyers are most likely to make it to the finish line with a final offer at the higher end of their IOI range.

Hosting management presentations: During the management presentations, potential buyers will meet with executives of the selling company to ask questions about the business and get to know the leadership team better.

Granting access to the data room: Potential buyers will be given access to the data room, allowing them to review details of employment contracts; customer, supplier, and vendor contracts; insurance policies; and other documents that contain important details about the company's operations, legal obligations, and financial background.

Follow-up meeting: Many potential buyers will ask to hold follow-up meetings with the executives to go over any questions that arise when reviewing the data room.

EXHIBIT 1

Steps of a Sale Process

1	2	3	4	5	6
Advisory Team Selection	Preparation	Marketing	Due Diligence	Best and Final	Signing and Closing
Should I Hire an Advisor to Help Sell My Business?	What Documents and Information Are Required to Sell a Business?	How Can I Find a Buyer for My Business?	How Do I Answer Business Buyers' Questions?	How Do I Choose the Right Buyer for My Business?	What Happens While Finalizing the Business Sale Transaction?

Step 5: Best and Final

How Do I Choose the Right Buyer for My Business?
After the potential buyers have completed their due diligence, bidders will be asked to present their best and final offers.

Reviewing the purchase agreement: In addition to giving a specific purchase price, the final offer will include a purchase agreement that stipulates details, such as how the purchase payments will be structured and financed, whether members of the seller's management team and other key employees will be required to remain with the company, and whether the sellers will be able to participate in the continued growth of the company via rollover equity contribution.

Selecting the winning bid: At this point, the owners and their team of advisors will be able to determine which bidder will make the best partner for the company. While price is certainly a major consideration, it is just one of many factors that need to be evaluated. Whether the bidder is a good fit culturally can make an enormous impact on the success of the company post-acquisition. The owners will also want to understand the bidder's plans for the company and how those could affect the company's employees. Other important non-price considerations include the timing of the closing and the degree of certainty that the bidder will make it to the finish line.

Assessing the tax consequences: The owner's wealth advisors should review the purchase agreements to determine what portion of the transaction will be treated as ordinary income vs. capital gains.

Step 6: Signing and Closing

What Happens While Finalizing the Business Sale Transaction?
Once the winning bidder has been selected and the final details have been negotiated, the final steps involve signing the transaction, receiving the funds, and passing regulatory review.

Getting to the finish line: Once the final agreement has been negotiated and signed, it becomes a binding contract.

Funds transfer: After the signing, typically there is a 15- to 30-day delay before the funds transfer to the owner's bank account.

Regulatory review: During this period, larger transactions will be reviewed by the Federal Trade Commission for compliance with anti-trust laws, and the buyer may be completing its financing arrangements.

Side-by-Side Comparison of the Business Sale and Dividend Recap Processes

Fueled by historically low-interest rates, conditions for selling a business or completing a dividend recapitalization have been generally favorable for owners over the past several years. Each approach carries a unique set of pros and cons; understanding both is critical to the process of gaining liquidity.

Dividend Recapitalization

This type of leveraged recapitalization involves a private company issuing new debt later used to pay a shareholder dividend, reducing the company's equity financing in relation to debt financing. The source of the dividends distributed is newly incurred debt, not the company's earnings. The recap impacts the company's capital structure since its leverage increases.

- **Debt**—Owners can take cash from the business and transfer the risk of investment into other asset classes through a debt recap. To enable the distribution of cash to owners, a financing source provides debt capital as senior and/or mezzanine debt.
- **Equity**—A company issues stock to buy back debt securities in the case of an equity recap. Its proportion of equity capital increases compared to its debt capital.

EXHIBIT 2

Side-by-Side Comparison

	SALE	DIVIDEND RECAPITALIZATION	
		Debt	**Equity**
Typical timeframe for completion (after the investment bank has been engaged)	12-24 months	2-3 months	2-4 months
Limiting factor for amount of capital that can be raised	Buyer's valuation of the company	Company's ability to take on additional debt and lender's willingness to lend	Owner's willingness to give up equity and investor's valuation of the company
Impact on management control	Transfers to buyer	Current owners retain control	Current owners typically retain control, but investors usually have voting rights and receive board assets
Opportunity to participate in future growth	Limited to rollover equity	100% retained by owners	Retained by owners but reduced by the amount of equity sold
Timing of liquidity	Majority received upon closing less earn-outs, rollovers, and vesting provisions	Received upon closing	Received upon closing
Impact on succession planning	May negate the need for finding a successor	No impact	Investors may be interested in expanding ownership stake and taking management control
Impact on company's future performance	Depends on the buyer's plans for the company	Debt payments may make company more vulnerable to business downturns; covenants may limit the company's operating flexibility	Limited impact

Be Sure to Think About Personal Wealth Well Before a Liquidity Event

When it comes to structuring the proceeds of a transaction and managing the wealth created by selling your business or completing a dividend recapitalization, the earlier you begin planning, the better.

How a transaction is organized can have a significant impact on the after-tax wealth generated for you as the owner. It is important to work with an advisor who has experience helping owners structure transactions in a way that limits the proceeds' exposure to income taxes and eventually estate taxes.

Personal Financial Planning for Business Owners–Frequently Asked Questions (FAQs)

Well before a transaction closes and the funds are received, you should begin working with your wealth advisor to think through the following questions.

1. How does my business structure affect my overall planning (or) a future liquidity event?

It is a good idea to consider personal planning considerations around a liquidity event well in advance—even when you are initially establishing your business structure. The right business formation for you may be a C-Corp or an S-Corp. For example, a C-Corp (in which the owners or shareholders are taxed separately from the entity) may allow for the ownership of a Qualified Small Business (QSB) stock. Among other benefits, with QSB stock, you may be eligible to eliminate tax on all or a large portion of your gain when you sell—the lesser of 10x your cost basis or $10 million. In the case of an S-Corp (this structure passes corporate income, losses, deductions, and credits through to shareholders for federal tax purposes), you can potentially benefit from a 338(H)(10) election. A 338(H)(10) is a tax election that re-characterizes a stock purchase as an asset purchase. This allows for asset depreciation and other benefits. Engaging your wealth advisor at the outset can help you understand how your business structure could have a meaningful impact on your personal wealth planning.

2. What are my goals and priorities for selling my business?

For most business owners, a sale or dividend recapitalization will elevate them to a new level of liquid or financial wealth and open a wide array of new possibilities. Before developing a plan for personal wealth management, identify what your priorities are and what you would most like to achieve in light of these new opportunities.

3. How can I avoid capital gains tax on a business sale?

The character of the income from a transaction will have a significant impact on the overall tax exposure for you as a business owner. The current top federal long-term capital gains rate is 20% plus potential exposure to a 3.8% tax on investment income. In contrast, the top federal rate for ordinary income is 37%. In most cases, rolled equity can be shielded from tax at the time of the transaction and may qualify for long-term capital gain treatment when realized. It is also important to understand elements of a purchase agreement that affect the ultimate value and the timing of the liquidity, including carried interests, performance-based options, vesting, and earn-outs.

4. Do my estate planning documents need to be updated before a liquidity event?

A liquidity event often creates opportunities to pass wealth on to younger generations, so work with your wealth advisor to evaluate whether the current estate plan will adequately adapt to the new wealth created by the transaction. Depending on your goals, and your overall wealth, it may be advantageous to establish trusts to shift portions of your equity well in advance of a transaction.

Be Sure to Think About Personal Wealth Well Before a Liquidity Event (continued)

5. What will my cash-flow needs be after the transaction?

You can work with your wealth advisor to develop a comprehensive financial plan that addresses any large one-time purchases that you as an owner would like to make. You may also want to replace the income that you would have previously earned from your business. Your wealth advisor can recreate a “paycheck” from a portion of the after-tax proceeds. The plan also needs to take into account the potential value of any equity rollovers and earn-outs.

6. What are smart ways to transfer wealth?

If you are looking to transfer wealth to younger generations and believe that the company will sell for more than its current valuation, you may want to transfer shares to a trust for children or grandchildren well before the agreement is finalized. Taking advantage of the pre-transaction valuation discount effectively increases the amount that can be passed to younger generations without being subject to gift or estate tax. You may also consider a GRAT, a grantor retained annuity trust, which minimizes taxes on large financial gifts to family members. Be sure to work with a wealth advisor to plan well in advance of selling your business, so you can reap the benefits of these and other planning strategies.

7. How do I avoid assignment of income issues?

Being proactive in implementing wealth-transfer or charitable strategies can help avoid running afoul of assignment of income principles that, if violated, could cause you as the owner to pay income tax on the contributed shares.

8. How can I achieve the most strategic approach to philanthropy?

Sale proceeds can be used to fund charitable vehicles, such as donor-advised funds, private foundations, charitable trusts, or outright gifts of stock, that generate a tax deduction for the donor. There may also be an opportunity to establish charitable vehicles ahead of a business sale or transaction that can avoid or reduce exposure to capital gains tax. Accelerating the donations into the year of the sale can help offset the taxable income generated by the sale of the company.

How Personal Wealth Planning Aligns with the Business Sale Process

If you as a business owner are going through the process of selling your business or completing a dividend recapitalization, your advisor will have experience guiding you through the process of developing a plan for managing the liquidity generated. This information shows how an owner's personal financial planning aligns with the investment banking process.

EXHIBIT 3

How Personal Wealth Planning Aligns with the Business Sale Process

	INVESTMENT BANKING GOALS	PRIVATE WEALTH MANAGEMENT GOALS
1. Advisor Selection	Building a team of trusted advisors • Investment bankers • Attorneys • Accountants • Consultants for quality of earnings reports and market assessments	Find an advisor with experience guiding business owners through liquidity events and structuring transactions in a tax-efficient manner
2. Preparation	Gathering information for potential buyers • Determine outreach strategy and timing • Draft offering memorandums, pitch books, and financial models • Begin creating data room	• Identify goals and priorities related to new wealth • Begin assessing tax consequences of potential transactions • Identify opportunities to minimize transaction proceeds' tax exposure • Review estate planning documents • Implement wealth transfer strategies to take advantage of valuation discounts and to avoid assignment of income
3. Marketing	Contacting potential buyers • Send marketing materials to universe of potential buyers • Collect non-disclosure agreements • Review initial indications of interest	
4. Due Diligence	Answering buyers' questions • Determine which bidders are invited to the next round • Conduct management presentations • Give access to data rooms	
5. Best and Final	Choosing the right partner • Review final offers and purchase agreements • Determine which offer is the most attractive in terms of price, certainty of close, and cultural fit	• Analyze final offers in terms of tax consequences, earn-outs, rollovers, vesting, and timing • Establish proceeds account and an escrow account for taxes • Implement a comprehensive wealth management plan—including short-term interest strategy for taxes, funding wealth transfer, and charitable vehicles—and begin portfolio deployment
6. Signing and Closing	Finalizing the transaction • Sign final documents • Clear anti-trust review • Transfer funds	

10 Questions to Ask Yourself Before Selling Your Business

The most critical decisions about selling your business are the ones made well before any potential buyers have been contacted. Achieving a high valuation and minimizing taxes certainly matter. But these issues are secondary to answering questions about what you are ultimately trying to accomplish—for the company, yourself, and your family. The answers to these questions are vital in determining whether a transaction makes sense for you. It is important to be working with a wealth advisor at this point to help you think through the implications of what you discover in this exercise.

For businesses with multiple owners, it is also important all owners think through these questions. By understanding each party's goals and identifying potential conflicts, owners and their advisors can better create a strategy for an optimal outcome.

10 Questions to Consider Before Selling Your Business:
When evaluating whether selling your company is the appropriate path to pursue, you as a business owner should think about the following:

1. What is my motivation for pursuing a transaction? (What am I looking to accomplish?)
2. What are my goals from a personal wealth planning perspective, in terms of retirement, transferring money to younger generations, and philanthropy?
3. What level of assets and liquidity are needed to achieve those goals?
4. What are my goals for the future of the company?
5. When am I looking to generate liquidity?
6. Where is the company in terms of its lifecycle and future growth opportunities?
7. How will the transaction impact our employees and our community?
8. Do I want to stay involved in running the company post-transaction? (Do my family members and younger generations want to be involved in the company going forward? Are there potential successors?)
9. How much longer do I want to be involved in managing the company?
10. Am I emotionally prepared to transfer some or all control of the business to an outside equity partner? (If so, what characteristics am I looking for in a potential investor or partner?)

At William Blair, we are committed to helping business owners evaluate their options and capitalize on the opportunities created by the success of their companies. As a privately-owned global asset management and investment banking firm, we are uniquely positioned to guide business owners through the investment banking and wealth planning aspects of selling a business or completing a dividend recapitalization. Contact your wealth advisor to get started.