Bitterroot
CAPITAL ADVISORS

WHITEPAPER

Thinking Broadly about Exit Planning

An Exit should be more than a transaction

Introduction

In our wealth advisory practice, Bitterroot Capital Advisors works mainly with individuals and families who are wealth creators. Our clients' financial successes have followed from an intense dedication to an enterprise or career that produced an exceptional outcome. We often begin conversations with new or prospective clients as they start to contemplate their next chapter, what we refer to generally as an "Exit."

We believe in using a broad lens with respect to "Exit Planning." First, in addition to the need to manage and optimize the specific transaction(s) constituting the Exit, the larger context can often pose new questions about your goals and the assistance you need to achieve them in the next phase of your life. So, Exit Planning should include not only the transaction(s) but also preparation for managing wealth following an Exit. We believe this holistic approach is likely to result in an outcome best tailored to your needs.

Second, most discussions about "Exit Planning" tend to focus on the specific case of an outright sale of a business, but we prefer to consider an Exit more broadly as a shift away from whatever has been the wealth creator's singular focus. While an Exit may reflect a single liquidity event or a more gradual unwinding, the wealth being released may have also accumulated over a long, successful career. The trigger may be an immediate or phased sale of a business, the gradual liquidation of publicly listed shares or some other event. In each instance, the transactions should result from a planned process and preparation.

In this publication, we expand upon these concepts.

Planning Beyond the Transition

Whatever the type of Exit, there are distinct advantages to adopting a more holistic view on planning and doing so early – well in advance of a transaction. By holistic view, we mean identifying your goals and needs and putting in place the resources and structures to support them through the transaction and well beyond.

We have written a series of articles, *Ultra-High-Net-Worth Investors: Preparing for What's Ahead*, on identifying goals and common needs and the assembly and use of the resources required to meet them, so we won't dwell on these here. In brief, key early steps include (i) assembling the team of advisors that will help you formulate and implement a complete plan, (ii) identifying your goals and the types of investments best suited to meet those goals and (iii) putting in place legal structures and administrative processes to support both. BCA believes a coordinated, multidisciplinary process using professional experts is critical to achieving the best outcomes - and that applying such an approach should be considered a best practice.

Ideally, these steps are well-developed prior to an Exit to maximize their advantages. For example, there may be benefits to reorganizing ownership of assets, especially foundational asset(s) prior to a transaction. Moving them into a trust or corporate holding structure may serve estate planning objectives and support tax optimization, asset protection, ease of administration, and availability of funds.

Furthermore, early preparations can reduce delays once a decision is made to sell an asset. Even the best-managed sales process can move more rapidly (or slowly) than anticipated due to market and other external factors. On the other hand, market conditions can also alter opportunities for reinvesting proceeds from an Exit. Having plans and legal structures in place before receiving cash proceeds fosters maximum flexibility so you and your investment team can move nimbly if capital market conditions present rich investment opportunities. If market conditions are not particularly attractive, you will have suffered no harm – redeploying capital can proceed at a more measured pace commensurate with available options.

Types of Exits

While planning for life after an Exit has common elements, the resources and skills needed to execute the transaction or events around an Exit depend significantly on the nature of your situation. But one common advantage of having assembled your broad-based team is the expertise and perspective with which it can support you in the transaction itself. In particular, a wealth advisory firm that has transaction experience can add significant value. Because it serves in a fiduciary role and its compensation model reflects its broader advisory role (and does not include transaction fees), a wealth advisory firm is economically aligned with you and is thus better able to "stand in your shoes." It can also help you frame perspectives on aspects of the transactions within your wider planning objectives.

Sale of a Private Company

Let's begin with the most high-profile form of an Exit, the sale of a privately-held company. This typically merits the engagement of an investment banker (or business broker) or the like. In cases where a company has a private equity backer with a controlling position ("Sponsor"), the Sponsor will select the banker and negotiate the deal terms. You, the original business owner, will often be along for the ride.

While a banker or broker plays a vital role, their primary aim is to execute and close a transaction, and that's how they earn their fee. So, and regardless of whether you control the company, receiving complementary advice from a fiduciary wealth advisory firm can bring another important perspective. Leading up to and during the transaction, your wealth advisors should be able to provide you with insights into your position and what to watch out for during the sales process, especially if you do not have significant transaction experience. Your wealth advisor will represent your interests in the context of understanding your broader needs, evaluating the terms of a potential sale and considering the likely post-transaction results.

We at BCA often assist our clients in this manner by monitoring the bankers and the sale process they are running to ensure our client's broad interests are properly represented leading up to (and after) closing. This is especially true where there may be competing or varying interests among different shareholders, especially in the case of Private Equity-backed companies. Our business model intentionally excludes transaction fees, so our neutral incentives align with our promise to deliver Unconditional Advice whatever best serves your interests.

Selling a privately-held business usually involves evaluating a variety of tradeoffs. In some instances, this means weighing the form of consideration you receive. For example, an acquirer may offer as consideration a mix of cash and shares in the combined entity; sellers may indeed prefer or even request this where they see considerable opportunity for additional after-tax value. In such situations, your wealth advisors may provide perspectives on the risks and opportunities in such a deal. These should be balanced against other considerations, such as your broader cash needs, competing uses for that capital or other personal considerations.

Depending on their expertise, advice from wealth management firms can be quite technical. For example, as former investment bankers, we at BCA in some instances may also help analyze and structure the rights and preferences of the equity securities to be received, particularly where these vary among different share classes. We refer to these as “cap table” considerations, which can be among the most essential aspects of a sale agreement.

Your future cash needs should be an integral part of this plan since they can significantly affect outcomes and risks. Finally, in all cases, you should consider how retaining a residual equity stake may affect your resulting portfolio. When looking ahead, your investment advisor must find the right balance of expected returns and risks to suit you. The residual equity stake will likely be a concentrated position that will immediately become a consideration when developing an asset allocation plan that deploys the cash proceeds into investments that diversify and balance the overall portfolio.

Selling Down Publicly-Traded (and Other) Holdings

Our clients include company founders and both current and former officers and directors of publicly listed companies, and many have founders’ shares accumulated via stock-based executive compensation. By their nature, such holdings can, and for diversification purposes often should, be sold over time.

Sales of these shares represent other special types of Exits which can be accomplished via secondary offerings or open market sales. At BCA, we advise our clients on the pace and levels of such sales based on a fundamental view of a stock’s potential trajectory, comparing that with other return opportunities, taking into account their cash flow needs and market conditions.

When the stockholder remains an executive of the company and has Insider status, there is an additional dimension – managing sales within the constraints of regulations, company policies and market perceptions.

In these circumstances, we help craft “automatic” selling plans – known as 10b5-1 plans in the United States and Automatic Securities Disposition Plans (ASDPs) in Canada – that allow for sales while managing insider trading considerations, even in blackout periods. We help coordinate with company counsel and the company’s stock-based program administrator to formulate and file these plans. Once again, we typically start with a fundamental view of fair value, with the client’s input, as the basis of our recommendations involving size, timing and minimum prices of sell orders.

Finally, there is the case of partnerships (such as law firms, financial firms, professional groups, etc.) where a retiring partner receives payouts over time. Here an understanding of the size and timing of these payouts, along with any uncertainty that may be associated with them, is essential. And always there is ensuring that these anticipated cash flows are well integrated into planning for future portfolio development.

Summary

At Bitterroot Capital Advisors, we find it best to think broadly about an Exit not solely as a transaction but as the transition from a business or professional activity that has been the foundational source of your wealth to the next phase of your life and a new financial situation.

We thus recommend using a broad-scope approach to assembling a team and developing processes when preparing for an Exit. If an Exit does involve a transaction (or series of transactions), the critical activities required to navigate that process can become all-consuming. So, in our experience, having a well-coordinated team of relevant experts can be a great relief and benefit, delivering the best possible result for you and your family.

Exits can take many forms, and having wealth advisors with experience advising clients across a wide range of transaction types can bring significant benefits. With compensation not related to transaction fees, they can “stand in your shoes” and provide disinterested advice guided by the broader investment planning goals you have set out to achieve.