SRG
|Succession Resource Group|

CASE STUDY

Succession Planning In Action

HIGHLIGHTS

- Using a modest **6% growth rate** recommended by SRG, the owner **received full value for the business** and his successors made more money every year net of debt service.
- The owner **sold the company in 3 traunches over 10 years** and retained control until retirement.
- Started with a $2.8 million valuation by SRG, the owner reduced his workload, shared equity with Gen 2, and **received $3.8 million in total value and 10 years of compensation.**
- **39% greater value** than if he had sold his business to a competitor and stayed for 10 years.

THE SITUATION:

Joe Smith owned a successful wealth management firm in Texas, which he started in the mid '90s after years with a large regional firm. Joe never desired to be a business owner. He just wanted greater freedom and flexibility, so he eventually transitioned to an independent broker-dealer.

His book of business grew into a substantial practice with two staff members and a small office, which he branded as Smith & Associates. He continued to do good work with and for his clients, and grew the practice to $120 million in assets under management. By this time, Joe had three staff, two of which were licensed, and together the staff took care of 80% of the service work, allowing Joe to meet with his "A" clients and do prospecting.

His total overhead was approximately 40%, not including his compensation. For all intents and purposes, Joe had been very successful and was earning a great living doing what he loved.

THE CHALLENGE:

Like so many of his peers, Joe ended up building a business (almost in spite of himself).

He leased a small office with room to grow, and was handling IT/HR needs as issues came up. He was also meeting with wholesalers, dealing with compliance, doing research and staying current on developments in the markets. In addition, he had clients/centers of influence that were referring him business, and a small team of professionals that wanted a career path and growth.

While he was very successful, he was now 60 years old and starting to think about when and how he'd retire, and what would happen to what he had built. He could not envision his two licensed staff buying him out of his growing company worth an estimated $2.8 million, and he wasn't ready to retire yet, but he also didn't want to keep running the business full-time into his 70s like so many of his peers.

THE SOLUTION:

Joe and his two key professionals, Andy and Susan (his Gen 2 buying syndicate), worked with Succession Resource Group starting in 2013 to develop a plan that would allow Joe to maintain control of the company he founded until he was ready to retire (in approximately 10 years), but share equity to retain his two key team members. This allowed them to all share in the expected growth in the coming years, and allowed Gen 2 to start learning what it meant to be an owner. They also had the shared goal of no one making materially less money over the next 10 years as a result of the plan.

Given the goals and timeline, SRG's recommendation was to rebrand the company name to something less tied to the founder's name, then immediately start integrating Andy and Susan into the meetings with Joe's "A" clients.

Based on their growth rate, compensation, and timeline, SRG recommended selling the business in three segments. This allowed Joe to pull out some of the equity and ensured that his Gen 2 could afford to buy him out. This also enabled him to share equity with his Gen 2 since they would be responsible for sustaining the company's 6% growth in the coming years as Joe stepped back. SRG recommended the first sale to occur in 2014, selling 30% total to Gen 2, paid for in cash using bank financing. Based on the company's net operating profits, a modest increase in Gen 2 salaries and their share of profits allowed them to use the after-tax dollars to service the note to the bank.

Based on SRG's pro forma models, the next sale would be in 2019, with Joe selling 19%, allowing him to retained control until the final sale in 2023.

For Joe, he started with a company worth $2.8 million, received $800,000 cash in 2014, another $700,000 in cash in 2019 (when the value of Joe's equity will be almost $2.8 million again), and a final $2.4 million in 2023 – all while continuing to work, draw a salary, and mentor his Gen 2. Joe will receive a total of $3.9 million in value (at long-term capital gains rates), and Gen 2 will make more money every year of the plan, net of debt service and taxes.

This strategy ensured that the company Joe founded will be here to service clients for generations to come, that he is afforded a gradual retirement, and that his Gen 2 is positioned to start thinking like an owner. Instead of losing clients at the founders retirement like his peers, Joe's business will only see growth on the horizon despite the "changing of the guard."

Note:

No equity compensation or minority discount was needed to make the deal work – two common elements in plans like this.