

# Navigating Succession Planning

Options and Next Steps for Your Construction Company



[CLAconnect.com](http://CLAconnect.com)



# Disclaimers

*To ensure compliance imposed by IRS Circular 230, any U. S. federal tax advice contained in this presentation is not intended or written to be used, and cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed by governmental tax authorities.*

*The information contained herein is general in nature and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by CliftonLarsonAllen LLP to the reader. The reader also is cautioned that this material may not be applicable to, or suitable for, the reader's specific circumstances or needs, and may require consideration of non-tax and other tax factors if any action is to be contemplated. The reader should contact his or her CliftonLarsonAllen LLP or other tax professional prior to taking any action based upon this information. CliftonLarsonAllen LLP assumes no obligation to inform the reader of any changes in tax laws or other factors that could affect the information contained herein.*

# Housekeeping

- If you are experiencing technical difficulties, please dial: **800-263-6317.**
- **Q&A session will be held at the end of the presentation.**
  - Your questions can be submitted via the **Questions Function at any time during the presentation.**
- **The PowerPoint presentation, as well as the webinar recording, will be sent to you within the next 10 business days.**
- Please complete our online survey.

# About CliftonLarsonAllen

- A professional services firm with three distinct business lines
  - Accounting and Consulting
  - Outsourcing
  - Wealth Advisory
- 3,600 employees
- Offices coast to coast
- 2,700+ construction clients
- 200 professionals and 50 principals dedicated to the construction industry



# Speaker Introductions

- **Timothy J. Skelly, CPA, Managing Principal**

Tim is the managing principal of CLA's construction and real estate group and has been with the firm for more than 30 years. He spends a majority of his time serving general and specialty contractors, companies that service and supply the construction industry, as well as real estate related companies. Tim has significant experience with various acquisition, merger, and financing transactions as well as working with the tax, financial, and business planning aspects of privately-owned companies.

- **Brian P. Buwalda, CPA, Principal**

Brian is a principal in the firm's construction and real estate group and has more than 25 years of experience. He specializes in assisting privately-held businesses and their owners, including structuring and implementing plans for business succession. Brian also has significant experience with various acquisition, merger, and financing transactions ranging from hundreds of thousands of dollars to transactions valued at over \$1 billion.

# Learning Objectives

- At the end of this session, you will be able to:
  - Understand options to transition your business to new management and owners
  - Learn how to strategize for a smooth transition of your company by retaining key employees and minimizing business interruptions
  - Identify next steps to evaluate or initiate the process for a successful succession plan



## Topics

---

- Helping owners plan for their succession
- Concepts important to understanding valuation
- Impact on family and creditors

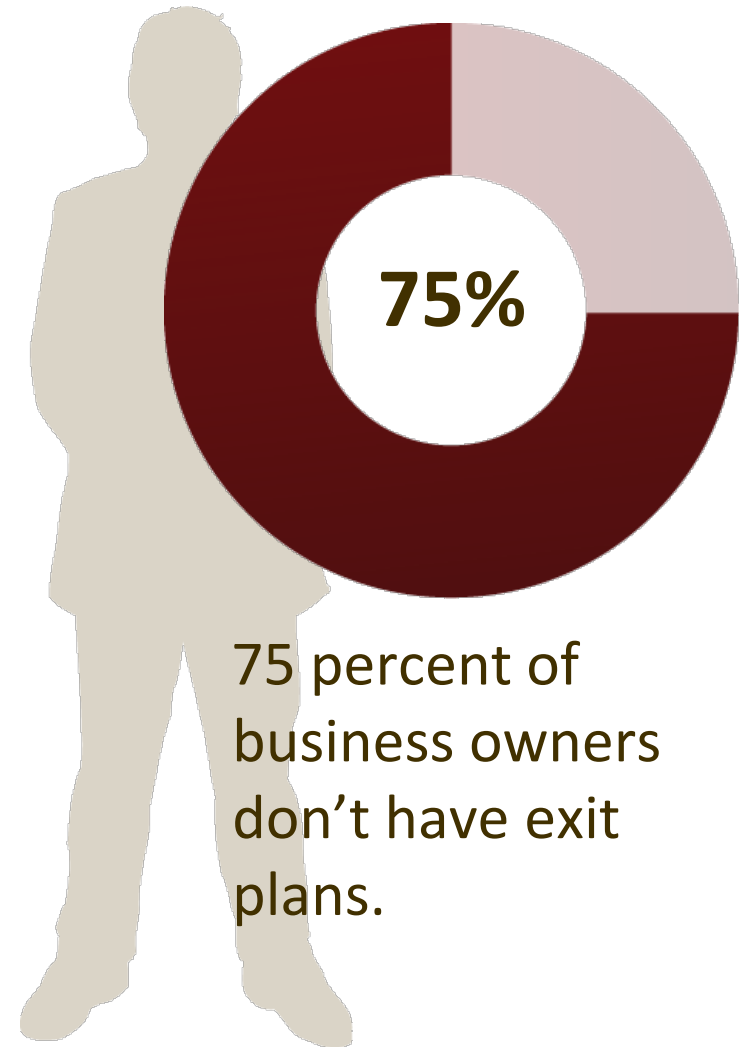
*Why are we talking about succession?*

## Some Expert Estimations About Baby Boomers

Around \$11 trillion will be transferred from one generation to the next.

9 million of America's 15 million business owners were born in or before 1964.

Most business owners will wait until the 11<sup>th</sup> hour to do a succession plan or determine the value of their business.



75 percent of business owners don't have exit plans.



# Importance of Succession Plans

- The Company represents the majority of wealth or primary asset of most owners.
- Construction Companies are highly dependent on effectiveness of Owners - as Leaders - average age of owners  $\simeq$  55\*
- Sureties – concern over demographic tidal wave of aging baby boomer ownership generation in the Construction Industry!\*
- < 50% Contractors have a formal management and ownership continuity plan in place\*



- 80% of companies rate the quality of their succession plans as low\*

\*FMI 2011 Surety Survey/Special Report

# Before we begin...

- Estate planning ≠ succession planning
- Retirement ≠ sale of the business
- Ownership ≠ management

*Succession planning is about creating options and flexibility for business transition that align with your goals and dreams.*

# Helping Owners achieve their dreams . . . dreams are as unique as each of us



- Business
- Family
- Community
- Health
- Faith

*“If you don’t know where you’re going, you might wind up someplace else.”*

Yogi Berra

# Priorities of Many Owners' Succession Plan

- Avoid selling to third party
- Provide for welfare of Company and employees
- Incent key employees to remain with Company through an ownership stake
- Prepare next generation to carry on business – family and non-family
- Provide orderly transition in a cost and tax effective manner
- Maintain structure and transactions straightforward /simple
- Retain equity base necessary for bonding and banking credit capacity – Remove personal guaranties and indemnities
- Create lasting business legacy – continued growth and success of the business beyond active involvement of its Founders.



# Challenges of Succession Planning

- Resistance, procrastination, avoidance
- Always something more urgent; focus on day-to-day threats and opportunities
- Focus on financial and tax matters – business operations and compliance
- Not in the ordinary course of business – once in a lifetime process
- 70% of family business transfers fail due to:
  - Lack of trust and communication between owners and/or family
  - Lack of development of the next generation of ownership/management. . . Leader(s)
    - ◇ Current generation entering a more complex business
    - ◇ Need for greater range of skills and capabilities than required by previous generation

\*FMI 2011 Surety Survey/Special Report

# Where Are You? Where Are You Going?

- Business lifecycles follow fairly predictable patterns
- Identify current and future challenges
- Sustainability: does the current leadership identify challenges and solutions in a timely and effective manner to impact value and create options for succession?



# Translating to Enterprise Value

## Environment:

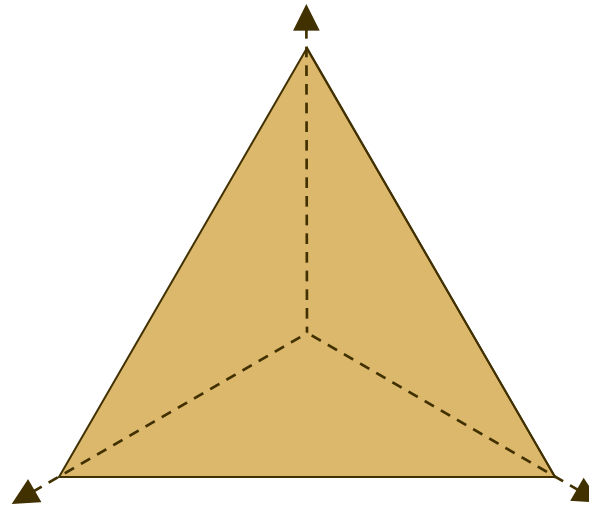
- Seller Motivation
- Access to Capital
- Economy

## Financials

- Strong earnings/management
- Consistent earnings
- Working capital mgmt

## Buyers

- Family
- Management
- Strategic Buyers
- Private Equity Groups



## Markets & Customers

- Growing markets
- Concentrations and Specialization
- Key Resources/Capabilities
- Competitive Bid vs. Negotiations

## Execution

- Management team
- Asset quality
- Information Systems

# It is about more than just numbers...

*Concentrations*

*Market Demands  
Consolidation*

*Workforce  
development*

*Business  
succession*

*Inflexible  
operations*

*Availability  
of capital*



# Valuation of Operations

- Older Companies may have accumulated “excess” value
  - Equipment, real estate, other assets
  - Current operations may not generate necessary cash flow to support value and buy-out
- Plans to extract excess assets or value of Company?
  - Ramifications to Creditors?
  - Tax ramifications may be prohibitive
  - Distributions of assets out of S-Corporations – at FMV
  - Distributions out of C-Corporations - double taxation



# Vision For Transition / Succession Plan

- No right or wrong way
- What does the owner desire?
- How to communicate your plans to those you trust
  - Ensure expectations are clear
  - Allow time for discussion, input and commitment by others
  - Demonstrate vision for ongoing success
- Allow for time and change – be flexible



# Family Succession

- Treating all your children fairly – in/out of the business
- Providing for spouse in case “something happens”
- Decisions made now – that you can control and influence vs. letting others sort out
  - Lack of information or experience
  - Poor decisions by the wrong people
  - Fire sale to pay estate taxes
  - Decisions by committee
- Evaluate dynamics of change in control and critical decision making



# Owners' Succession – Financial Conflicts

- Owners Needs
  - Personal Assets vs. On-Going Cash Flow & Liquidity Needs
  - Peripheral Operations, Hobbies, Incidentals?



# Take Time To Plan. . .Anticipate

- Don't think to execute a Plan all at once in its entirety
  - Set interim goals/milestone that contribute to success of plan
- Owners continued role? Transfer of control?
- Owner/spouse long term financial plan-necessary to maintain lifestyle?
- Plan will likely change – circumstances change
- Non-financial desire of owners? Legacy, Employees, Community?



# Surety and Bank Credit

- Managing partnerships between Surety, Bank and Contractor
- Credit signifies strength of contractor's financial plan
- Credit as a competitive differentiator in a field weakened by a 3 year recession
- What is your Company's bank and surety credit without the current Guarantor?





## Topics

---

- Financing the transition
- Tax strategies
- Business structures

# Financing

- Management Buy-Out Groups
  - Cash Resources?
  - Borrowing from Company
  - Borrowing from Sellers
  - Financing from Financial Institutions
- Who has the Risk Tolerance? Owners? Management?
- Be Realistic – Your Company finances the Purchase





# Financing – Example 1

- *Facts: Company with two owners each owning 50% of business. Company enters into a stock redemption agreement with one of the owners to acquire 50% of the company.*
- Assume that the value of 50% of the company is \$750,000 and the company will use \$250,000 of cash and finances the balance.

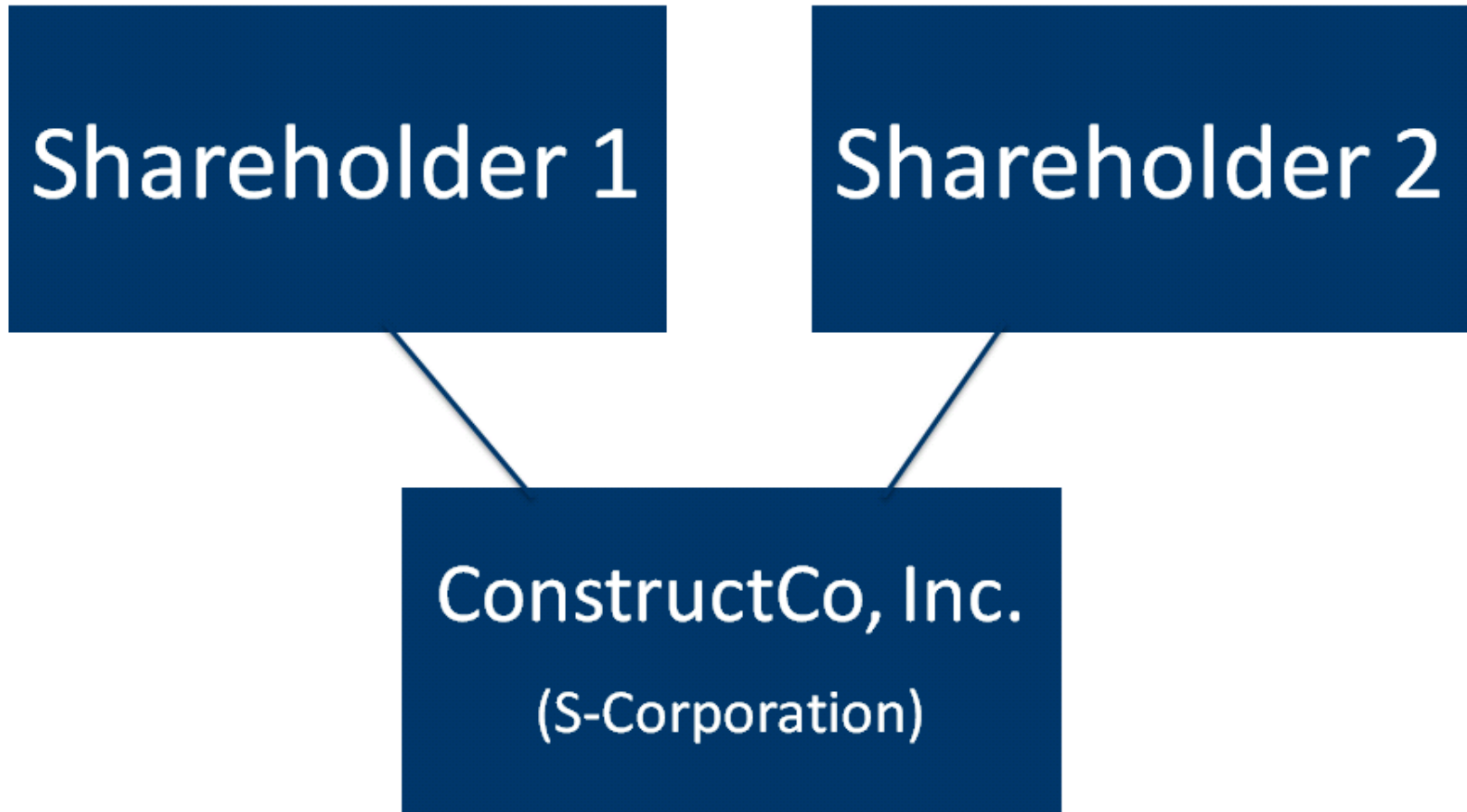
(in 000's)			
	Before repurchase	Transaction	After repurchase
<b>Current assets</b>	500	(250)	250
<b>Non-Current assets</b>	1,000		1,000
<b>Total assets</b>	<u>1,500</u>	<u>(250)</u>	<u>1,250</u>
<b>Current liabilities</b>	250		250
<b>Long-term liabilities</b>	250	500	750
<b>Equity</b>	1,000	(750)	250
<b>Total</b>	<u>1,500</u>	<u>(250)</u>	<u>1,250</u>
<b>W/C ratio</b>	2.00		1.00
<b>Debt/equity</b>	0.50		4.00

## Financing – Example 2

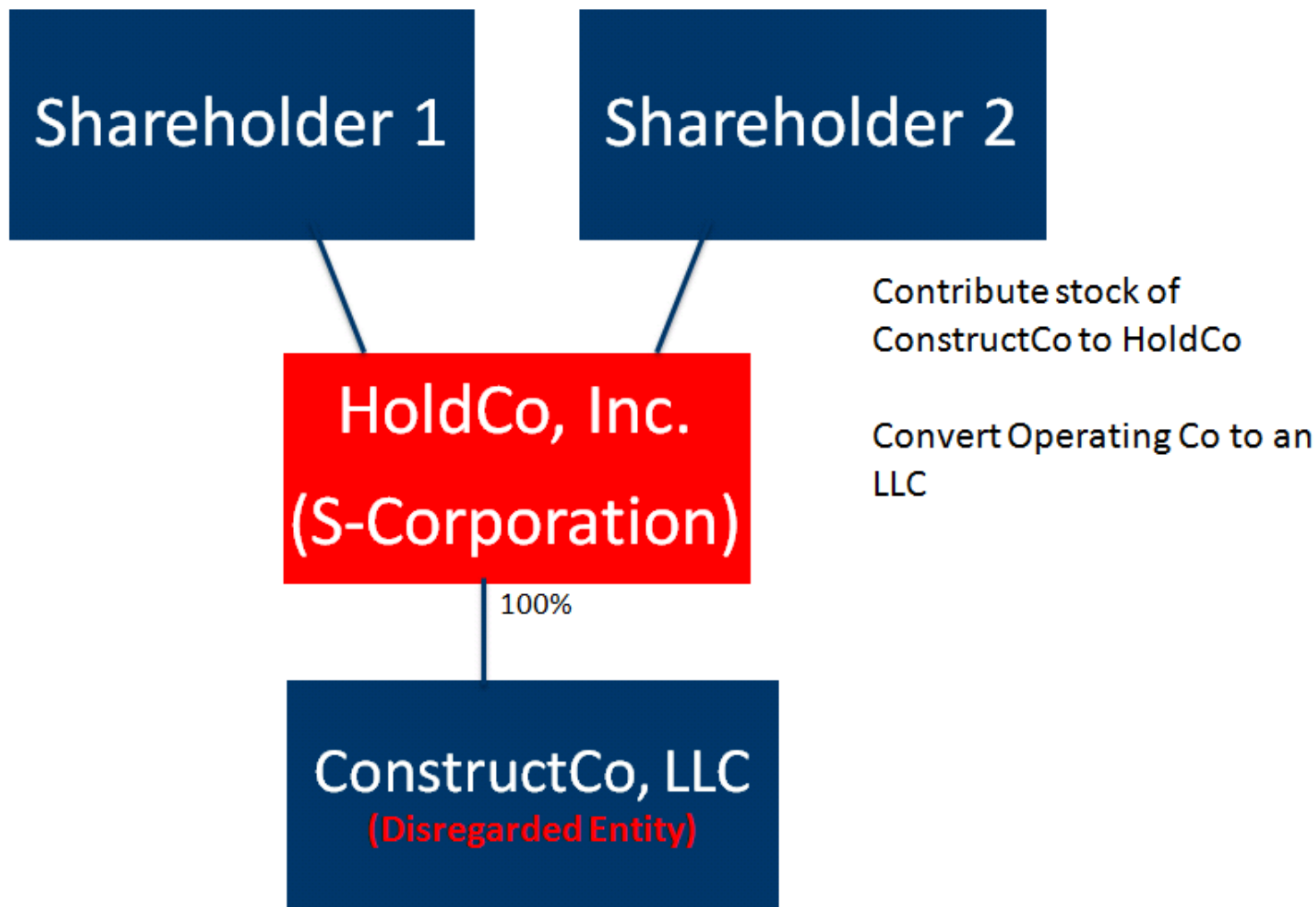
- *Facts: Same as previous example except instead of redemption agreement the two shareholders enter into a cross-purchase agreement whereby the exiting shareholder sells his stock for \$750,000 to the other shareholder under.*
- Furthermore, the company makes a distribution of cash after the transaction.

	(in 000's)		
	Before repurchase	Transaction	After repurchase
<b>Current assets</b>	500	(250)	250
<b>Non-Current assets</b>	1,000		1,000
<b>Total assets</b>	<u>1,500</u>	<u>(250)</u>	<u>1,250</u>
<b>Current liabilities</b>	250		250
<b>Long-term liabilities</b>	250		250
<b>Equity</b>	1,000	(250)	750
<b>Total</b>	<u>1,500</u>	<u>(250)</u>	<u>1,250</u>
<b>W/C ratio</b>	2.00		1.00
<b>Debt/equity</b>	0.50		0.67

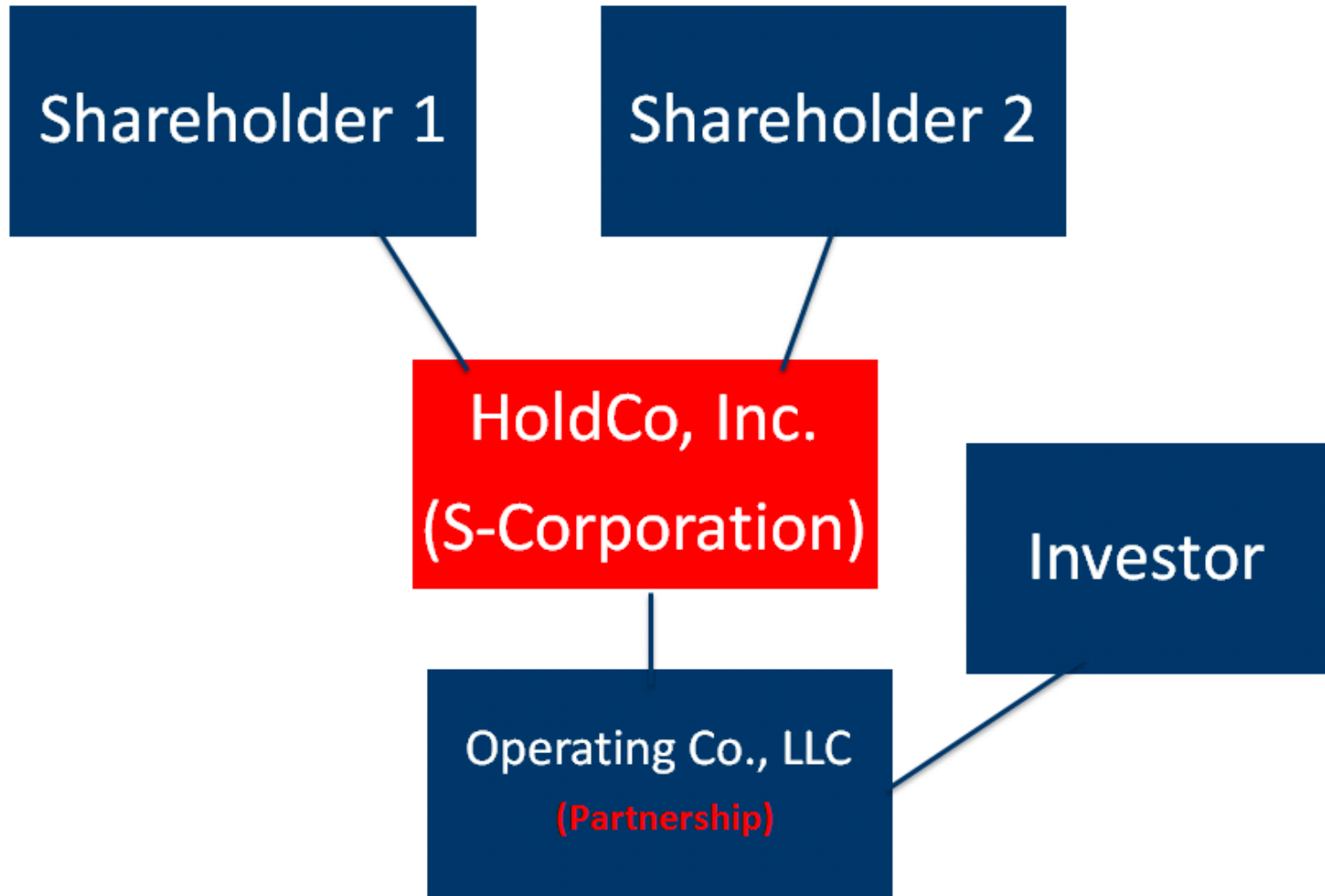
## Financing – Example 3



# Financing – Example 3 (continued)



# Financing – Example 3 (continued)



# Tax Consequences / Efficiencies to Succession

## Estate and Gift Taxes

- 40% Federal rate, \$5.25 million estate/gift exemption
  - To increase to \$5.34 million in 2014
- Individual “portability” for unused exemptions; \$10.5M/Joint
  - Will be \$10.68 million in 2014
- Annual gifting exclusion of \$14,000
  - Husband/wife – gift-splitting can achieve \$28,000 (or \$56,000 to a couple)
- Techniques now to “freeze” asset values

# Tax Strategies – Financially Effective Transfers

- Discounts on stock value – Provides flexibility in transfers, sales and gifting
  - Lack of control and marketability
  - Discounts in excess of 40%
  - Focus on <50% ownership and non-voting rights
  - IRS focus on eliminating discounts in family transactions



# Tax Strategies...continued

- Grantor Retain Annuity Trusts (GRATs)
  - Provide methodology to transfer significant value at deeply discounted amounts
- Intentionally Defective Grantor Trusts (IDGTs)
  - Treated as a gift/sale for Estate Tax purposes, but not for Income Tax purposes
- Deferred Compensation Plans
  - Disassociate with stock transfers/gifts
  - Tax efficient to Corporation – tax deductible when paid vs. stock redemption
  - Secure owners/spouses financial and personal needs in defined manner over time





# Business Structures

- Corporations may lack flexibility to effect most financially effective and efficient ownership transfer
  - C-Corporations – double taxation
  - S-Corporations – based on ownership and no special preference to any owner
- LLC's allow for greater flexibility and creative solutions



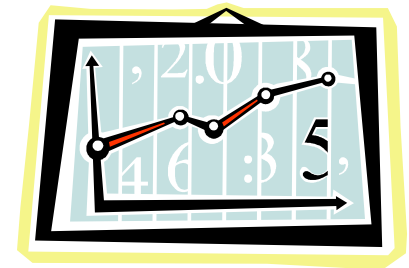
# Business Structures - Continued

- Restructure operations with a “drop down” LLC
  - Drop entire operations into newly formed LLC – wholly owned by Inc.
  - Existing ownership continues to own Inc. and other non-essential / operating assets
  - Use of LLC as platform from which restructured LLC takes place
  - LLC preferred returns and disproportionate distributions effectively freezes value of old Corporation
  - Allows new ownership group to slowly build value through related management LLC



# Overview/Summary

- Focus on developing Managers into Leaders
- Valuation considerations impact successor plans – Understand the concepts of valuation and impact on your Company and Plans
- Communicate plans with those you trust – soon and often
- Anticipate the impact succession plans have on surety and bank credit
- Realize there are tax strategies that favorably impact ownership transfer and succession plans
- Plan to integrate estate and personal financial planning
- Know that organization restructuring can:
  - Mitigate current tax impact to current owners
  - Allow successor management to begin to build financial strength and value



***When/How will you be comfortable in relinquishing control?***

***Allow for time and anticipate change to effect your plan – be flexible***



# Questions?

---

# Thank you



Timothy J. Skelly, CPA  
Managing Principal  
tim.skelly@CLAconnect.com  
612-376-4509

Brian P. Buwalda, CPA  
Principal  
brian.buwalda@CLAconnect.cm  
407-244-9322



CLAconnect.com

 [twitter.com/  
CLA\\_CPAs](https://twitter.com/CLA_CPAs)

 [facebook.com/  
cliftonlarsonallen](https://facebook.com/cliftonlarsonallen)

 [linkedin.com/company/  
cliftonlarsonallen](https://linkedin.com/company/cliftonlarsonallen)