Exiting Your Business on Top: You Can Learn from Jay Leno

Riding high in the ratings, Jay Leno's successful run as host of *The Tonight Show* ended with him at the top of his game. Jimmy Fallon (in sidecar) took over the coveted spot in February 2014.

BY MILES Z. EPSTEIN
EDITOR, COMMERCE

ACCORDING TO A RECENT WELLS Fargo/Gallup Small Business survey, "one third of business owners think the best time to sell their business will be in the next three years." That's a big decision and a major financial transaction that ultimately puts a price on a lifetime of blood, sweat and tears.

Just ask Jay Leno—Steve Kroft, co-host of CBS's *60 Minutes* did exactly that in an interview that discussed Leno's February retirement from *The Tonight Show,* and his replacement by the younger Jimmy Fallon.

"I think I probably would have stayed if we didn't have an extremely qualified, young guy ready to jump in," Leno told Kroft. "Jimmy Fallon is probably more like a young Johnny [Carson] than almost anybody since. And he's really good. So you go with the new guy."

Although Leno's exit was certainly not by choice, he recognizes the lesson that others can learn from him, as he steps down while his ratings are

still sky high. "For the last 20 years, we've been the number one talk show all the way through, and we're ending the number one talk show," he said.

Exiting on top should be the goal of every business owner, and Curtis Kroeker's article for Inc.com, "As Jay Leno Leaves *The Tonight Show*, Think About Your Own Exit," made a comparison between Jay Leno's career and a successful sale of a business.

"Leno spoke frankly about stepping down while his ratings were still strong and mentioned the need to bring in a host that had greater appeal for a younger generation of viewers—affirming the age-old [pun intended] adage that it's best to go out at the top of your game," writes Kroeker.

Indeed, exiting a business on top requires planning, experts and an honest assessment of what the business is really worth, backed up by detailed financial statements that can withstand the scrutiny of an educated buyer.

"Business exit planning helps business owners to clarify their business transition and exit planning goals, objectives and motivations, including identifying when and how they intend to transition from the business or retire," says Richard C. Watson III, senior director of planning for business advisory services at Wells Fargo Private Bank.

According to Watson, the exit planning process consists of the following sequential steps: identify business exit planning goals and objectives; analyze the business; determine a preliminary range of values for the business; identify transition options; review options for funding or financing the transition; and develop an implementation strategy and timeline.

"Consider establishing a buy-sell agreement and fund it with insurance," says Kevin J. Hansen, CPA, a co-managing director of Hunter Group CPA LLC. "This is a legal document that establishes both a leadership transition and funding mechanism in the event of one owner's untimely demise. It also protects against unintended partners, such as children, in-laws or spouses, from gaining ownership rights or even forcing liquidation."

The family dynamic can make business relationships complex and hard to manage. That's one good reason to have a succession plan in place before, and not after, a problem.

While business transitions can be complex, adds Watson, "following a disciplined process can help owners to confidently plan and execute a successful business transition and maximize outcomes for all stakeholders."

Keep in mind that "whether selling the entire company or raising growth capital in the form of debt or equity, what you are really selling is the future cash flow of the business," explains Kenneth H. Marks, author of *The Handbook of Financing Growth* (John Wiley & Sons), and the founder and managing partner of High Rock Partners. "While past performance provides credibility to management's claims, future cash flow is the foundation for valuation."

COMMERCE asked many of New Jersey's top law firms to identify the key best practices for mergers and acquisitions involving family-owned businesses in New Jersey, and to discuss any legal issues that are unique to family businesses. The following attorneys provided their expertise:

- Archer & Greiner, P.C. Partner Gianfranco A. Pietrafesa, Esq.
- Connell Foley LLP Partner John D. Cromie, Esq.
- Dunn Lambert LLC Managing Partner Richard J. Lambert, Esq.
- Genova Burns Giantomasi Webster LLC Counsel Matthew R. Kaplan, Esq.
- Gibbons P.C. Director Robert F. Coyne, Esq.
- Greenbaum, Rowe, Smith & Davis LLP Co-Managing Partner W. Raymond Felton, Esq.
- Herrick, Feinstein LLP Parnter Glenn L. Stein, Esq.
- Lindabury, McCormick, Estabrook & Cooper, P.C. Shareholder Robert W. Anderson, Esq.
- Lowenstein Sandler LLP Partner Nicholas San Filippo, Esq.
- McCarter & English, LLP Partner David F. Broderick, Esq.
- Norris McLaughlin & Marcus, P.A. Management Committee Member Bob Gabrielski, Esq.
- NPZ Law Group Managing Attorney David H. Nachman, Esq.
- Pashman Stein, P.C. Member of Firm Bruce Ackerman, Esq.
- Riker Danzig Scherer Hyland & Perretti LLP Partner William G. Connolly, Esq.
- Wilentz, Goldman & Spitzer, P.A. Shareholder Brett R. Harris, Esq.
- Wolff & Samson PC Member of the Firm Laurence M. Smith, Esq.

Archer & Greiner, P.C.

By Gianfranco A. Pietrafesa, Esq., Partner, Corporate Practice Group

Many family-owned businesses operate too informally, which can cause problems when it's time to sell the company. Problems run the gamut. Some are

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easily correctable, such as failing to complete the incorporation process by holding an organizational meeting to adopt bylaws, issue stock certificates, etc. and not holding annual shareholders meetings. Others are more complex and time-consuming to correct, such as failing to protect intellectual property and confidential information and not having written contracts with key employees providing them with financial incentives and restrictive covenants to keep them with the company. Family-owned businesses should prepare themselves for sale by doing their corporate housekeeping before planning to sell the company. Buyers like companies with good, profitable businesses, but they love companies that also have good corporate records. Not only does it inspire confidence in ownership and management, but it expedites due diligence and makes it less costly. There are no delays looking for or preparing missing documents. Maintaining formalities and tending to corporate housekeeping results in an expedited sale process.

Connell Foley LLP
By John D. Cromie, Esq., Partner

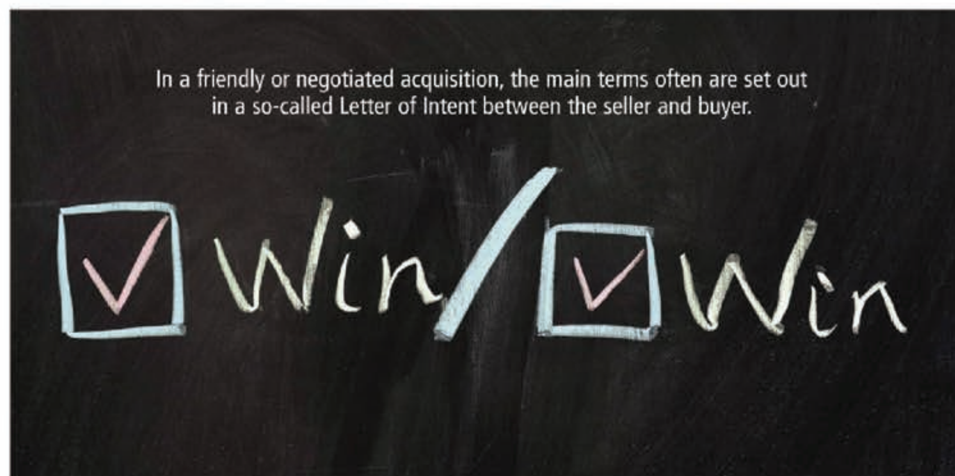
Family-owned businesses face a unique set of opportunities and challenges when planning for and implementing merger and acquisition transactions, but share similar life cycles. First generation owner(s) start the business, take on significant risks and pursue their vision. Through hard work and luck, the business prospers. The original entrepreneurs rely on the help of family members who share a common ethic. As a business grows, entrepreneurs are faced with the challenges of how to expand while remaining true to original values. These issues are magnified when subsequent generations take over as owners, directors and officers. It is important to ensure that shareholders and directors are in agreement on whether to pursue a sale or purchase transaction. Tax considerations and succession planning are critical factors. Financing structures and potential personal liability also play significant roles. Employment contracts, restrictive covenants, earnouts and post-closing indemnities all must be considered against the historic backdrop of the family business. M&A counsel need to be mindful that there are a multitude of interpersonal and intergenerational issues in order to ensure a successful transaction.

Dunn Lambert LLC
By Richard J. Lambert, Esq., Managing Partner

The family business owners who obtain the most money for their businesses are those who begin to plan for a sale at least two years in advance. Other best practices include assembling a team of professionals to assist you in the sale process, including an experienced M&A attorney, an accountant and an intermediary, among others; and making yourself expendable. It is counter-intuitive, but buyers are generally willing to pay more for your business if you have systems and support staff in place that allow the business to run smoothly even if you are on a beach somewhere. One potential problem that is somewhat unique to the family business is the family member (usually younger) who works in the business and owns a small percentage ownership interest in the company. Most of the time, the buyer will insist that this minority shareholder-employee enter into a non-compete agreement that will effectively prevent the employee from working in the industry after the closing. However, the minority shareholder-employee will usually not receive enough money from the sale of business to retire. What does the family do? There is no one solution to this quandary, but the family needs to address this.

Genova Burns Giantomasi Webster LLC
By Matthew R. Kaplan, Esq., Counsel, Business Law & Commercial Transactions Practice Group

Many family businesses suffer from either a lack of outsider participation at the management and board levels or a "rubber stamp" syndrome from their outside executives and/or board members. Family members, as well as outsiders inclined to appease the business owners, are often less willing to ask tough questions and raise difficult issues because of a fear that arguments or hard feelings with other family members will ensue. These businesses are deprived of objective advice from individuals with critical experience and knowledge derived from outside the family business and may never reach their peak potential. Selling a family business often requires satisfying conflicting interests. For example, in a business owned by a father and his two adult children, the father separately owns the building in which the business operates. The father wants to retire but maintain a steady income stream, and he insists that the buyer enter into a long-term lease for the building at an above-market rate. The buyer agrees but, in turn, lowers the purchase price for the business. To offset this inequity to the children and secure the children a similar income stream, the seller can negotiate for the post-closing employment of the children with the buyer.



In a friendly or negotiated acquisition, the main terms often are set out in a so-called Letter of Intent between the seller and buyer.

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Gibbons P.C.
By Robert F. Coyne, Esq., Director, Corporate Department

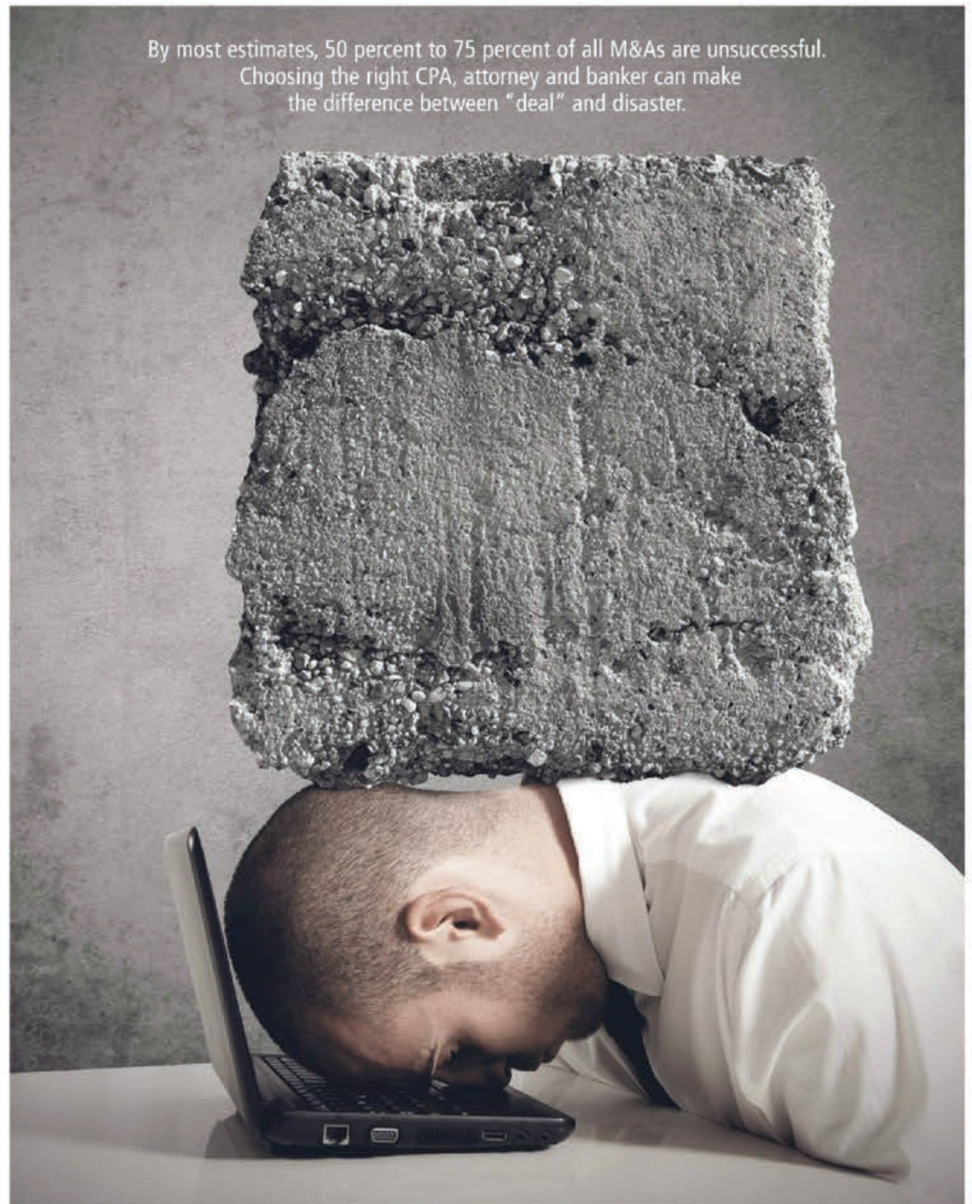
First, as a family business owner, make sure the deal you are considering supports your strategic objectives. Are you selling a controlling or minority position? Do you want to stay on in a management capacity? Is there potential for future upside, and how will it be achieved? Structure the deal to match your strategic goals. Next, maximize your leverage by understanding your core business and that which makes your company desirable. Each deal will have a unique, central asset, whether it's a manufacturing facility, know-how, or synergistic customer list. That asset needs to be protected and preserved to strengthen the buyer's desire. Additionally, make sure you develop a strong rapport with the principals on the other side of the deal. You will need such a relationship when difficult issues come up during the negotiations. Finally, put together a deal team (lawyers, accountants and other trusted advisors) who will strengthen your rapport and who understand your goals and core business. You and your family have spent years building value in the business, and, at the end of the day, you want to achieve finality in the sale and do not want to have to give back any of the hard-earned consideration.

Greenbaum, Rowe, Smith & Davis LLP
By W. Raymond Felton, Esq., Co-Managing Partner and Corporate Department Chair

The family-owned business has long been a foundation of our economy. Too often, however, these companies run into trouble by neglecting certain business components of the enterprise. A family relationship among principals is no reason to disregard good business practices and, in fact, may even be a reason for running a tighter ship. Start by considering the exit strategy. Whether the plan is to sell the business, go public or pass it on to the next generation, it's important that business records such as accounting books, personnel files, contracts and other legal documents be kept properly and completely. A buyer may discount the value of a business with shoddy records by questioning the integrity of the reported results. Similarly, the IRS may challenge the business valuation on a gift or estate tax return due to inadequate documentation. Another overlooked item is a shareholder or operating agreement among the related owners. A good agreement addresses management issues as well as the disposition of ownership following death, disability, resignation, retirement and termination of employment. Those events happen in family businesses just as in other companies. The bottom line is that a family-owned enterprise is still a business and must operate accordingly.

Herrick, Feinstein LLP
By Glenn L. Stein, Esq., Partner

Find experienced counsel. This isn't the time to hire that third cousin who argues traffic cases and occasionally does a home closing. Finding qualified counsel experienced in representing buyers and sellers of businesses is critical. Experienced counsel will help negotiate and document the best deal for the client and save time and expense in the long run. This also applies to accountants and financial advisors, who should be integral in the sale process and work closely with counsel to structure the transaction taking the family's overall estate and



By most estimates, 50 percent to 75 percent of all M&As are unsuccessful. Choosing the right CPA, attorney and banker can make the difference between "deal" and disaster.

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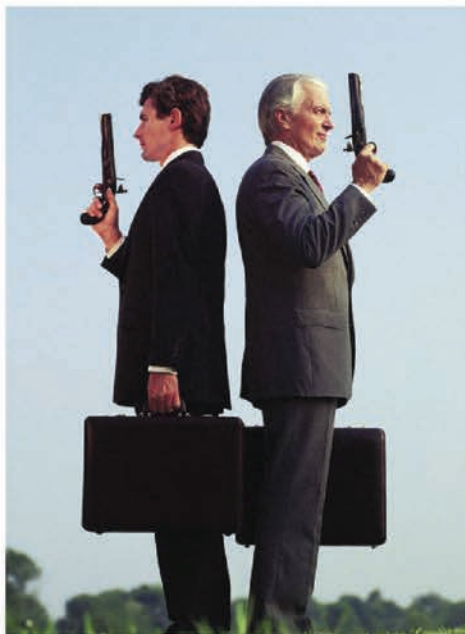
tax planning into consideration. Since family-owned businesses often operate without corporate formalities and internal controls, buyers will want to review books and records, corporate governance documents, capitalization tables, financial statements, tax returns, etc. Are these in order? Do they even exist? During the two years preceding a sale, sellers should work with counsel to organize these materials in anticipation of sharing them with buyers during due diligence. Due diligence is aimed at flushing out skeletons in the closet. The more sellers discover on their own, and address prior to initiating a sale process, the smoother the process will be and the more likely the sale will close.

Lindabury, McCormick, Estabrook & Cooper, P.C.
By Robert W. Anderson, Esq., Shareholder

One of the unique aspects of mergers and acquisitions in the context of a family business is that very often the "acquirer" is intended to be the next generation of family members. This can create certain tensions in balancing the interests of the older generation with those of the new acquiring generation. Does the older generation require cash to fund future living expenses? Is the younger generation in a financial position to provide that funding in the acquisition? Is the older generation ready to cede control of the business during their lifetime? Does the younger generation have the skills needed to operate the business and make it thrive, or is some external management resource needed (at least initially) to guide the business's operations? In each case, the parties will presumably want the proposed acquisition arrangements to be addressed in the most tax-efficient manner possible. These sorts of issues all need to be resolved within the dynamic of existing family relationships, which can be complex in their own right.



Unless you want to go "old school" for control of your family business, experts suggest having a succession plan.

Lowenstein Sandler LLP
By Nicholas San Filippo, Esq., Partner, Co-Chair, Corporate Finance & Securities Practice, Co-Chair, Business Divorce Practice

Honestly assess the strengths and weaknesses of your key employees and advisors, and don't be deferential to loyalty or longevity. In most cases, buyers of family businesses have acquired many businesses. The buyer executive leading the team, his counsel, his financial advisor and his accountant have a track record together. Their goal is to pay as little as possible and assume minimal risk in acquiring your company. Further, appreciate that they are probably very competent. If your CFO or accountants are not ready for the challenge, replace them. If your attorney has not closed several deals of a similar nature, retain one that has. If you have never sold a business before, hire an experienced investment banker. Most important, do all of this at least a year before you begin marketing your business. Work with your new team to remove risk, proactively address issues that reduce enterprise value and make the business lean to maximize EBITDA. The right professionals will cost, in the aggregate, about 4 percent to 7 percent of the purchase price, but they will create at least that much value in increased purchase price and reduced post-closing risk—all while greatly maximizing the likelihood of the deal closing.

McCarter & English, LLP
By David F. Broderick, Esq., Partner

Well in advance of any proposed sale of a family business, it should go through the exercise of preparing restated financial statements to better reflect its "true" historical financial performance. That is, it is not unusual for family businesses to have certain additional expenses and costs, which a buyer should be able to eliminate or reduce. These could include, for example, above-market compensation paid to employee family members; luxury car leases; above-market rental payments for family-owned properties, and similar items. The inclusion of these items causes the historical financial performance of the business to be understated. In order to demonstrate to potential purchasers what the financial performance would have been had these items not been present, the business should prepare restated financial statements showing what the impact of removing these expenses would have been. This should have the effect of maximizing the profitability of, and therefore the potential acquisition price of, the business.

Norris McLaughlin & Marcus, P.A.
By Bob Gabrielski, Esq., Chair, Business Law Group, Member, Management Committee

While business founders spend countless hours building their companies and constantly refining their growth strategies, many spend very little time thinking about an exit strategy or whether they may want to transfer some or all of their business to the younger generation. When it comes time to retire, sell the business or transition it to that younger generation, or perhaps to employees, many of these businesses are not prepared. Their stock book, shareholder and operating agreements may not properly reflect what the owner believes is the current ownership. They may not have accounted for their operations according to GAAP or had reviewed or audited financial statements. Do they want to sell the business outright (a

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typical M&A strategy) or do they want to transition some/all ownership to the younger generation (an estate planning tool) or management/employees (an MBO or ESOP strategy)? M&A strategies typically involve a complete sale of the business with a consulting/earn-out component. Estate planning strategies generally involve the founder remaining in the business for some time while transfers/gifts take place. ESOPs allow the founder to sell, retain some control and take money off the table. Think ahead, prepare and consider all the options with your advisers.

NPZ Law Group
By David H. Nachman, Esq., Managing Attorney

Several immigration issues are associated with the closing of a family or small business transaction. First, employee visas or pending applications could potentially be affected by the deal. Second, all U.S. employers are barred from hiring unauthorized workers and are required to maintain I-9 Forms demonstrating that each worker is legally permitted to work. Companies may be required to file new paperwork, on the closing day or before, regarding the status of their employees. Corporate changes that typically have immigration consequences are stock or asset acquisitions, mergers, consolidations, initial public offerings, spin-offs, corporate name changes, changes in payroll source, and the relocation of an employer or its employees. There is no "one-size-fits-all" approach to advising clients about the effect of a transaction on the immigration consequences of a merger or acquisition. Rather, there are a number of important questions to ask as the due diligence process begins. How is the deal structured? What is the timing? Is there enough time to file new documents and/or petitions? For I-9 Forms and E-Verify filings, will the employees have to prepare new I-9s? In many cases, immigration issues are not addressed during the due diligence period and they really need to be.

Pashman Stein, P.C.
By Bruce Ackerman, Esq., Chair, Corporate Law Practice

A closely held family business must consider succession planning. If the family is going to take over the business, then the sale of the company requires special considerations. This type of family succession planning is a dynamic issue because it involves either several children or other relatives, and even key employees. This is a process that needs to be planned and put in place for many years to achieve the transition and have these family members "buy into" the process. Their future roles in the business must be redefined the same as with job descriptions today. In the same way, compensation and ownership needs to be carefully defined to avoid uncertainty later. The process begins with having the business appraised so that everyone is invested in the process and believes in the valuation. Once valued, everyone needs to agree upon the method to pass that wealth to the "elders," while allowing the business to keep thriving and for the younger generation to keep living the same lifestyle as they do today. Usually, because of the family dynamic, the elders can coordinate the sale value with estate planning, annual gifting and other structures to pass on that wealth.

In many M&As, terms are often more important than absolute valuation. Both factors can build the road to success needed for a successful M&A transaction.

Riker Danzig Scherer Hyland & Perretti LLP
By William G. Connolly, Esq., Partner

Two words of advice for a family business considering a sale: plan ahead, and that means estate planning. Equity can be gifted to family members at minimized gift tax cost during a business downturn, while the business valuation is depressed. This can result in proceeds not subject to estate taxes going to the next generation upon a later sale. Another key is clean up any messes. For example, before a buyer begins due diligence, clean up unorthodox financial reporting, environmental conditions, regulatory issues and other complications. This will prevent a buyer from reducing the value it puts on the business due to unknowns. Since you only sell once, make sure you screen professionals and obtain the best advice. Gather recommendations for investment bankers, attorneys and accountants specializing in M&A and interview multiple candidates. Also, as a family views its business differently than a buyer, make profits and costs transparent. Normalizing inter-family arrangements by owning business real estate separately, interacting with affiliated entities on an arm's length basis and normalizing compensation allows a buyer to more appropriately value the

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business. You want family buy-in, so ensure everyone in the family is ready to sell and has a post-sale plan.

Wilentz, Goldman & Spitzer, P.A.
By Brett R. Harris, Esq., Shareholder, Business, Nonprofit and Technology Attorney

When counseling family businesses in transactional matters, not only is it necessary to have a substantive knowledge of the corporate issues involved, but counsel must always be mindful of the family dynamics. Early on in the engagement, it is critical to clearly identify who the client is, given that law firms are often asked to represent both the company and the shareholders. In any small business situation, interests of shareholders may not be completely aligned. This can be exacerbated when the shareholders are family members. Joint representation is possible under the applicable court rules provided that there is adequate disclosure to the parties as to potential conflicts of interest and all are offered an opportunity to seek independent counsel. At the onset of the matter, discuss the intended lines of communication, including whether all family members/stockholders will be involved in document review and negotiations, or whether one family member will be designated as the liaison to counsel. The lawyer must constantly be aware of the personalities involved. Conflict identification and resolution skills are particularly useful, and the attorney may find it appropriate to refer the clients to business psychologists or counselors with practices focused on advising family-owned businesses.

Wolff & Samson PC
By Laurence M. Smith, Esq., Member of the Firm

Effective M&A counsel to a family-owned business should attempt to insulate the business from the family. In other words, try to ensure that intra-family factions, feuds and emotions play no role in corporate decision-making. To that end, put in place governance documents to achieve economic fairness (which may not mean parity, as all family members may not be actively involved or play the same role within the company) and to ensure that business decisions are made by officers and directors, with shareholders acting in limited circumstances as provided by law. Complete democracy within a business may result in paralysis. The governance documents should include dispute resolution mechanisms that discourage litigation. Adherence to corporate formalities will promote harmony while the business is owned by the family and facilitate an exit, if and when the decision to sell is made. Instill the need to rely upon outside, objective professionals who can help make critical decisions (to grow, to downsize, to sell, to acquire, etc.) free of any feelings of nostalgia or personal attachment. The business is not a member of the family, and there is no shame in deciding to sell it. ■

While it is a good idea to study past performance, future cash flow is the foundation for valuation and usually the primary reason for buying or investing in a company.