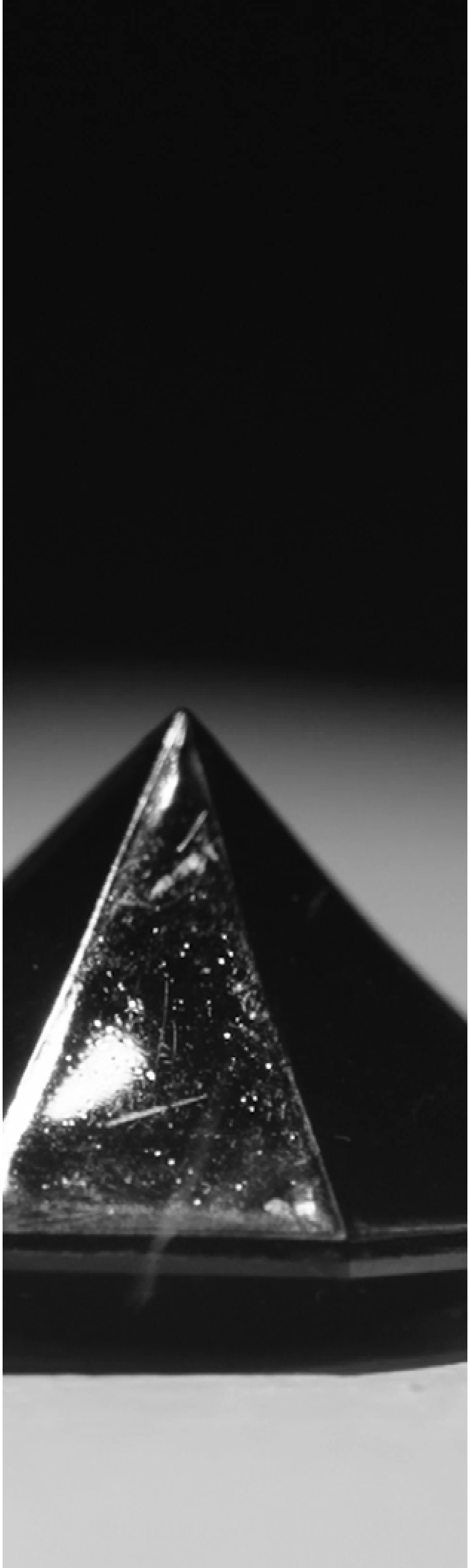
Thinking About Selling Your Tech Company? Here's What You Should Know.

BY: JOSH GULLY AND GHISLAIN GOURAIGE, CEPA®

Tech companies and their high-profile founders are all the rage right now. The assumption that most tech founders are young and in their early twenties when they launched their companies has long been prevalent. The story, after all, of college students creating the next billion-dollar startup from their dorm room has long captured the hearts and minds of most of us (think Facebook).

That notion, however, has been flipped on its head by a groundbreaking 2018 study published in the Harvard Business Review. This insightful study revealed that the average age of high-tech founders is actually in their early forties when they **establish their companies**. This data gives us a better understanding of the profile of the typical high-tech founder and why, several years if not decades down the road, the motivations behind exploring the sale of their businesses, which may be just to move on to the next chapter of their lives. If successful in their ventures, it's inevitable that the deals will come knocking, but are these founders ready to make an exit?

In this article, we will explore the strategies that founders should adopt to effectively prepare for exiting their businesses. The wealth strategy needs faced by the typical tech entrepreneur in their forties and fifties are quite different from the presumed twenty-something founder who is only a few years out of college. By recognizing these contrasting circumstances, there are several factors these older, more experienced founders need to keep in mind when seeking to exit their ventures.



Get Your Affairs in Order

Is the business actually ready to be sold? Before the founder can play ball, it's important to prepare a self-appraisal of the strengths and weaknesses of the business or better yet, hire an outside advisor to instill objectivity into the process.

Consider the company's business plan, profitability, management succession, and financial reporting.

- **BUSINESS PLAN -** A well-documented business plan makes the company more attractive to potential buyers. By having a plan in place, the business owner is signaling to the marketplace what the forward-looking value of the enterprise could be beyond the basic financials. Buyers may be willing to pay more when the future of the business is easier to predict.

- **PROFITABILITY -** The business plan should identify the industry average for profitability and demonstrate where the business stands against those standards. Tip: Now is a good time to consider expense control and discipline around lowering expenses.

- **MANAGEMENT SUCCESSION -** Is there someone who can operate the business apart from the business owner? If not, then the company is not ready for a sale. Buyers will require assurances that the business will not be in a position where it cannot function should the proverbial "hit by a bus" scenario occur.

- **FINANCIAL REPORTING -** It's time to check those balance sheets. Audited statements by an external partner put the company in the best position for a sale and are trusted more by potential buyers.

Assemble Your Deal Team

We believe working with a team of professionals that support the seller is one of the more essential aspects of exit planning. Founders may know their business best, but seasoned professionals know the tricks and trades of how to best negotiate and get the deal they deserve.

At minimum, an entrepreneur's Deal Team should consist of an investment banker, transaction attorney, CPA, and financial advisor.

- **INVESTMENT BANKER -** Represents the seller in the sales transaction and helps negotiate the most favorable terms and conditions while pursuing the highest valuation for the business.

- **TRANSACTION ATTORNEY -** Consider someone who specializes in mergers and acquisitions, negotiating contracts and regulatory issues common to the tech industry. It may be easy to use an attorney the entrepreneur is already familiar with, but specialized attorneys can make a big difference in the fine print.

- **CPA -** One who has experience with sales transactions and the resources needed to go up against sophisticated buyers who will be fully engaged with the numbers.

- **FINANCIAL ADVISORY TEAM -** Plays a pivotal role in ensuring that personal concerns are proactively addressed alongside the transaction, along with considering their overall wealth strategy plan and the after-tax consequences of the varying proposals. Acts as the quarterback and communicates with all deal team members to help ensure a comprehensive and advantageous outcome.

Establish and/or Refine Wealth Strategy Documents

A comprehensive Wealth Strategy Plan is more than financial planning, it encompasses estate and wealth transfer planning, risk mitigation, tax mitigation, business succession planning, next gen education, and family meeting facilitation. While all of these aspects can be relevant to the Tech Entrepreneur's experience at any age, we believe estate and wealth transfer planning as well as personal cash flow model are the key components of all successful pre-sale pre-planning.

Estate and Wealth Transfer Planning

For a business owner's overall wealth strategy, pre-liquidity planning entails a crucial aspect: a comprehensive review of the entrepreneur's wealth strategy, which may necessitate revisions or even the creation of an entirely new estate plan.

- This critical step is often overlooked, as evidenced by research conducted by the Exit Planning Institute, revealing that only 52% of business owners have an updated estate plan. Yet, updating an estate plan could yield significant benefits, including estate tax savings and a positive impact on the founder's family in subsequent generations.

- One potential advantage of an estate plan is its ability to facilitate the transfer of assets from the entrepreneur's personal estate to trusts for the benefit of the next generation. This includes the equity ownership in the business that will be sold. By leveraging valuation discounts for lack of control or minority ownership, substantial tax savings can be achieved. Notably, without careful planning, second-generation heirs often find themselves compelled to sell assets to meet estate tax obligations, which is avoidable.

- We believe trust instruments play a pivotal role in ensuring that wealth is not squandered by ill-prepared individuals. Establishing essential estate planning documents, such as a last will and testament, is crucial. A will enables the founder to specify how estate assets should be distributed. Without such provisions, the assets may be divided equally among heirs, subjecting the estate to lengthy probate proceedings. Moreover, designating a personal representative to oversee the probate process is vital. However, appointing a corporate or individual trustee becomes necessary if a suitable individual within the family is not available.

- Proper planning has the potential to reduce the taxable estate upon death, benefiting future generations. Decisions regarding when beneficiaries should receive their inheritance are also integral to this process. Surprisingly, many entrepreneurs who sell their companies later discover missed opportunities to minimize estate taxes. For those inclined towards charitable giving, various strategies can be employed in conjunction with a liquidity event to optimize tax benefits, including gifting low-basis stock and establishing philanthropic vehicles such as foundations or donor-advised funds.

- Lastly, it is imperative to execute the estate plan as devised. This not only supports the envisioned tax minimization strategies but also helps avoid difficult conversations about inheritance, account titling, and philanthropic endeavors.

By recognizing the significance of pre-liquidity estate planning and adhering to its principles, entrepreneurs can help safeguard their wealth, potentially minimize tax burdens and ensure a smooth transfer of assets to future generations.

Cash Flow Planning

A well-crafted cash flow plan serves as a valuable tool throughout the sale process, aligning with the goals and objectives of the entrepreneur. It encompasses various life events that require preparation, such as upcoming educational expenses or weddings. In addition to addressing extraordinary expenses, cash flow budgets can be prepared to help business owners effectively manage anticipated cash outflows.

- In our experience, cash flow planning has proven instrumental in enabling entrepreneurs to grasp the after-tax implications of a specific sales price on their financial well-being. For instance, it assists in determining the required after-tax proceeds to support the desired lifestyle goals of the entrepreneur. Cash flow modeling further aids in assessing the post-tax proceeds necessary to sustain the current and anticipated lifestyle. Understanding the precise amount needed in a portfolio of liquid assets to support this lifestyle is paramount. Armed with this knowledge, business owners can confidently establish boundaries regarding which offers to accept. For example, an all-cash offer of a lower amount versus a higher offer with earnout provisions may prove more appealing when considering the overall Wealth Strategy Plan.

- During the pre-liquidity planning phase, involving a Financial Advisory Team in the deal process becomes crucial. This allows for evaluating various deal terms and assessing their after-tax consequences through the lens of the personal Wealth Strategy Plan. Understanding the projected after-tax dollars at closing clarifies the purchase price amount that should be in cash and what can be deferred.

- The Wealth Strategy Plan can also incorporate assumptions about life after the liquidity event. We strongly recommend that tech entrepreneurs engaged in sale negotiations revisit and revise their Wealth Strategy Plan to evaluate how the available offers will impact their future lifestyle. Depending on the sale amount, the entrepreneur's lifestyle can undergo significant changes. Formerly, the sellers' net worth was predominantly tied up in the equity of their business, whereas now they find themselves with liquid assets that require professional management. By having a comprehensive plan in place and investing accordingly, concerns about what to do with the cash are mitigated. When the sale is announced, sellers often face a barrage of inquiries from family, friends, business associates, and charitable organizations, all eager to discuss potential partnerships.

The personal consequences of being unprepared are often uncovered after the deal has closed— and as the saying goes, you shouldn't count your chickens before they are hatched. Over the course of our 20-plus years of working with entrepreneurs, our team has learned that the idea of control is paramount. Having control is what has allowed some to succeed where others haven't. Knowing more than your competition and being at the center of decision-making has propelled many to thrive where others struggle.

Having your affairs in order, involving your deal team and financial advisor, and considering the future of your estate and financial plan will be sure to put tech founders at the top of their selling game.

Sources

The Exit Planning Institute

Harvard Business Review

Important Disclosures

The views and opinions included in these materials belong to their author and do not necessarily reflect the views and opinions of NewEdge Capital Group, LLC.

This information is general in nature and has been prepared solely for informational and educational purposes and does not constitute an offer or a recommendation to buy or sell any particular security or to adopt any specific investment strategy.

NewEdge and its affiliates do not render advice on legal, tax and/or tax accounting matters. You should consult your personal tax and/or legal advisor to learn about any potential tax or other implications that may result from acting on a particular recommendation.

The trademarks and service marks contained herein are the property of their respective owners. Unless otherwise specifically indicated, all information with respect to any third party not affiliated with NewEdge has been provided by, and is the sole responsibility of, such third party and has not been independently verified by NewEdge, its affiliates or any other independent third party. No representation is given with respect to its accuracy or completeness, and such information and opinions may change without notice.

Investing involves risk, including possible loss of principal. Past performance is no guarantee of future results.

Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No assurance can be given that investment objectives or target returns will be achieved. Future returns may be higher or lower than the estimates presented herein.

An investment cannot be made directly in an index. Indices are unmanaged and have no fees or expenses. You can obtain information about many indices online at a variety of sources including: **https://www.sec.gov/fastanswers/answersindiceshtm.html or http://www.nasdaq.com/reference/index-descriptions.aspx.**

All data is subject to change without notice.

NewEdge WEALTH

WWW.NEWEDGEWEALTH.COM