Episode 141 Business Exit Planning Strategies with John Hancock's Tim King

Patti Brennan: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today, I'm excited to bring Tim King back onto the show. Tim is a real friend of the firm.

For those of you who are also financial advisors, I know there's a lot of you who listen to this podcast. You probably know Tim King from John Hancock. He's probably one of the best business consultants in the industry.

He really understands what we're trying to do for our clients, whether it be in the retirement planning side, the investment management side, or as in the case of what we're going to be talking about today, the exit planning side.

Tim recently got a third designation called "The Certified Exit Planning Consultant," or a counselor. What do you think? Did I get it right?

Tim King: Close – it's Advisor.

Patti: Advisor, CEPA. I know what it is as CEPA. Tim, welcome to the show.

Tim: Thanks, Patti, thanks for having me here.

Patti: 30 years with John Hancock? Wow.

Tim: Yeah, blink of an eye.

Patti: Blink of an eye, but you know, it just goes to show you, that's how good you are at what you do.

You establish relationships, and you help advisors like us be better at providing service for our clients.

Tim: That's the plan.

Patti: And anticipating it, which is what we're talking about today.

One of the things that we were talking about in a recent meeting was the issue that business owners face as they work through their business. They're getting towards retirement. They've got big decisions to make.

That's what you have learned about, right? This exit planning advisor.

Tim: Yeah, this topic hits close to home. I come from a family that had a small business. Just a little story, I was in college my freshman year, I had a 1.0 rounded up and I decided to go home and surprise my parents and say, "I think I'm ready to take over the business."

It was an oil business, four oil trucks. We had about six, seven hundred customers. We probably moved around a million gallons of oil.

It was a nice business. I'm a freshman in college, not doing too well. I come home Thanksgiving break, I'm going to surprise them, but instead they surprised me. They sold the business.

Patti, there's nothing worse in life when you know plan B is not going to work for you.

Patti: Oh dear.

Tim: I learned how to swim that day, and I've been swimming ever since. Now, fast forward to today, I'm now talking to my friends, talking to clients, talking to colleagues. The topic of exit planning or selling a business is coming up pretty frequently.

That's why I went back and got my certification or got my designation, the CEPA designation, because this is a topic that people are going to be talking about more and more. That's what the statistics tell us.

Patti: What is fascinating about statistics, is literally how few do it successfully.

Tim: It's stunning. Only 20 percent of businesses go to sale. There are people out there right now that are probably thinking like, "Well, I'll just sell this thing and get the money and move to Florida." More times than not, that is not the case.

More times than not, unfortunately, you sell under pressure because a divorce, death, disability, a disagreement with a partner, and it becomes almost like a fire sale. We think exit planning should be good business planning. You remember years ago, after September 11th, everybody was talking about disaster recovery.

That's how our mindset should be right now. You should be thinking about selling your practice or your business every year and should be prepared for it.

Patti: It's very interesting because I know with our clients, it's so important for them to get their personal side in order as well, because all too often they're waiting for that huge liquidity event, and it puts even more pressure on them.

You brought up a fascinating statistic that we've seen as well. What is it? 80 percent of a business owner's net worth is in their business.

Tim: In their business. Exactly.

Patti: That's tough. When you think about it, that's like having 80 percent of your net worth in your primary residence. It's great if you're going to downsize. Do we want to count on that? What are you going to get for the house? Where are you going to live in the meantime? How are you going to create income?

These were all important questions. What are the tax ramifications? It's not something that can be done overnight.

Tim: It's about the right questions, not so much the right answers. You're right, it starts with the person first. You almost must work backwards, and that is, it's a three-legged stool. You want to talk about the person, you want to talk about finances, then you want to talk about the business.

You want to sell this business? Why? Let's play it down. Let's say you do sell this business, and now you have all this money. How are you going to pay the taxes? What are you going to do on that Monday when you're not going to work?

75 percent of people who sell their business within a year have seller's remorse. That's the first thing we see. We must get the personal in check. Then we ask, do you have a financial plan? Do you have a financial team? Do you have the CFP, the CPA, the banker, the attorney estate planning?

We’ve got to get that in check. Then we can start talking about the business. Do you have owners? Do you have a family? Do you want to keep the business within the family or keep it with the employees? Do you want to find a strategic buyer?

You might try to enhance the value, and at the end of that you might say, maybe I can hold onto this. You can go out and look at what best-in-class type businesses are getting from a profitability standpoint and earning standpoint, and that's really your starting point. That's what you want to be working towards if you want to get the best valuation for your company.

Patti: It's fascinating that you started out with the personal. It reminded me of a story of a client who sold his business, got a bundle of money, and about a year later, we were talking, and he was almost depressed, because he had lost his purpose.

He had a lot of people who had to answer to him. He was leading a team, he was driving growth, and he lost his purpose even though he was still working in the business as an employee.

It was interesting because he brought up this idea that I thought was a great idea, and he asked me if I knew of any kind of network where business owners who have sold their businesses could get together and talk about their experience. My answer was, "No, I don't know of anything like that."

Tim: Like a business owner support group.

Patti: Exactly.

Tim: There probably are folks out there through Facebook. There is probably something very similar to that.

What's interesting for those of you who are maybe in private equity who have done deals like this, 95 percent of the time a deal doesn't get done because the business owner gets cold feet, or they try to sabotage it through one little issue, and they won't give up on it. That's why you need to be prepared to go down this road.

Patti: Thinking about why we're talking about this today, it's because of the issue, the opportunity that we have staring us in the face until the year, what? 2030. You've got another fascinating statistic.

Tim: Baby boomers own the majority of businesses out there. We know they're retiring. We're talking trillions of dollars that are going to be in motion. From what we know and what we see, your average business is just not prepared for it.

It's interesting because between the financial advisory world and the business owner, there's been a love-hate relationship because as a financial advisor, you want to manage money. That business owner, if they have a dollar, they're going to put it back into their business, but at some point, you need each other.

That business owner wants to monetize that business, and more than likely it's that financial advisor that's going to help them with that transition to be the quarterback, to bring in the lawyer, to bring in maybe private equity if it's a bigger deal, bringing in ESOP specialist if they want to keep the company in-house.

The role of the financial planner would be the quarterback, would get more and more important as we go along.

Patti: What's great about that, Tim, is that the financial advisor doesn't have to be an expert in all areas. The ESOP for example, or all the things that you would know in terms of that transition planning, it's just having someone who to quarterback and say, "Let's have this conversation."

One thing that we were also talking about is this idea of value enhancement, and how a business owner can again prepare for that moment in time by looking at ways they can enhance their value, whether they sell or not, it's just good business planning.

Tim: You had a guest a couple of weeks ago, Kathleen King. You hit on this topic about Tate's cookies. If you remember what she said, she said, "I wanted to leave at 55 years old." A business owner coming in with that type of clarity makes life a lot easier. If you remember what she also said, she's brought in a business coach.

They started to make changes and they started to execute. It was about a 10-year process, probably from when they started to when they sold, and that's what the value enhancement method is. You first want to discover where maybe your blind spots are, then you want to prepare and make those fixes.

Then when you get to the end, now you decide, do I want to sell? Do I want to keep? It's a process that could take months, it could take years. It really depends on where the business is and depends on the commitment of the management team.

Some of these people - might be a one-person company or a couple of people - and you ask them for financial statements, and they could be written out on cocktail napkins. You don't know what you get. The more organized they are, the better the transition will be.

Patti: 100 percent. I think that the key here is also not to fixate on price alone.

Tim: That's true. You're at a country club or you're at a restaurant and you hear, oh, so and so got this, so and so got that. Is it high? Is it too low? You don't know because there could be some variables at play. Who kept a note? Was it the bank or was it the owner? A seller's note. Maybe a seller's note was involved.

Were there kids involved? Maybe the owner wants to make sure their kids are taken care of. Maybe the business has significance in the community, so they wanted to keep it local.

To get the best value, it's best to bring it out to the market to get a strategic buyer. Maybe you might get less money, but you also may get something that's more efficient, more gratifying than maybe keeping it in-house. That's why the terms are just important as the price.

Patti: There are lots of ways to accommodate both. Again, the idea of the ESOP is keeping it in-house, and yet there is a liquidity aspect of ESOPs for the business owner that can work from a tax-efficient perspective also.

Tim: Business owners should realize they have options. They could bring in private equity, they could look for other partners. One thing that we're seeing now is that a lot of business owners think they solved the problem. They're saying, "I'm going to get older; I'm going to bring in a younger partner."

The problem with that is, a lot of times a younger partner in their 30s, early 40s, they've got two kids, they've got college education. Suddenly, again, you want to monetize this, and that partner can't step up. That's when you must bring in a third party. That's why it's so important to plan for these things.

Patti: The most important thing is to be real about it. Let's be realistic about what's possible, think about capacity. What is it that your business does?

Because at the end of the day, if you sell it and it falls apart, then what? I think that if people are hesitant to sell, it's because of that. It's their legacy, it's their name, it's their baby, and they don't want that to happen.

Tim: You got to be prepared for your baby to get called ugly, because that's a part of the process. I'm sure you've watched "Shark Tank." When they go in, they buy a business, they say, "If I give you a dollar, how fast am I going to get that back?"

I'm sure there's plenty of CFOs right now who are talking to their CEOs about possible mergers going, why? We can go to a bank and get cash risk free for over five percent. You want to go buy this company; we need to get a loan probably for eight to nine percent. How fast are we going to get our money back?

That's when math comes into play. These are the types of things that you've got to start to think about. It's like, how fast can we get our money back?

Patti: You mentioned something earlier, Tim, and for those people who are listening who may not understand the language, when you say multiples, what does that mean?

Tim: Let's think about real estate for a second. You do a comp, you see what the neighborhood is worth, you see all the different houses, there'll be a price on top of that. There'll be a little bit more of a cushion, because if you're a seller, you want profit. A margin is just...it depends on what industry we're talking about.

Margins could be two times over earnings, three times over earnings. It could be based off revenue; it could be based on assets. A lot of different ways to get to the number. The buyer is thinking about, if I give you three or four times, then how many years will that take me to get that money back?

The seller is thinking, I want three or four times because I know what this business is worth today, but I also have a good idea what this business is going to be worth, and I want to be compensated for that too. A multiple is how we get to that number.

Patti: Got you. Some industries command bigger multiples than others.

Tim: Exactly. 80 percent of business value is based on intangible, intellectual capital. That's harder to put a number on, especially if the person that holds probably the most intellectual capital is the one that wants to walk out the door. It's more of an art than a science, but you do have comparisons.

That's why I made the comparison about real estate because you do have comps out there. We can show you what a best-in-class company is getting. We can see what they're doing as far as earnings, we can see what type of multiple they get. Then you can benchmark where your company is today and hopefully work towards that.

Patti: When you think about figuring out what the business is worth, where do you go? Do you go to somebody like yourself or the CEPA. Who would be the best?

Tim: I would say, a CEPA would probably be a person to start with to get you in front of business valuation companies, and third parties that can probably talk about that more, private equity banks, things of that nature would probably be able to. I mean, you can get it off the Internet too, with ideas of what businesses are selling for.

You're a financial advisor, I'm sure you go to conferences, and this is a lot of what you're hearing around the lunch table.

Patti: You bet.

Tim: That's another place, just hear from your peers.

Patti: Exactly. For me, the most important takeaway is the timing of things. You don't do it when there's no other option. It takes planning, it takes thought, it takes some real digging also in terms of what's important to you. There can be a lot of priorities. You’ve got to figure out, what's one, what's two, what's three, what do you need to do, what do you want to do?

Again, that's where that personal comes into play. If you've got somebody who's already saved $10 million, getting a lot of money for their business may not be as important for their financial security.

Tim: You probably want to bring on a business advisory board to help you as soundboard, help you with your thoughts and as you go down this process. Also, a personal advisory board just to help you get your personal life in order.

A lot of people think I’ve got kids so I can just pass it on to them. Only 30 percent of businesses that go to the second generation are successful. Getting it to the third generation, now you're looking at finding a unicorn. Very rarely does that happen.

That's another reason why I got interested in this topic, because I'm starting to see succession planning on a daily basis. People that I started working with 10, 15 years ago and gave me an idea of what they might do down the field, now I'm starting to see it. The kids are coming in or they're selling or they're merging, so there's been a lot of activity that I've been kind of witness to.

Patti: We have too, and not all of it has been positive. It's so important too, if you're listening to this, if you have a business to sit down with people who have experience in this area, who will give it to you straight.

They aren't going to tell you what you want to hear, but maybe tell you what you need to hear. Then, they put you with the right people who are going to help you to get that business to where it needs to be, to get optimal value, and more importantly, get the terms.

Get the terms that you are looking for, as well as the things that you want, whether it be for your family, employees, customers, clients, etc., because there are so many things to consider in all of this.

Tim: Yeah, clarity and transparency are probably the two biggest things as you take this journey because people in the company are going to be wondering what they are doing, and what you are doing. If they are unsure, they are going to leave.

You've got to make sure that you communicate what your goals are here, and so it is very important.

Patti: Tim King, thank you so much for coming today. Thank you for your friendship, our relationship. I learn so much from you every time you come in.

Thanks to John Hancock for sparing Tim, yet for another day and for bringing him into my life because he has made me a better advisor.

Those of you out there who are advisors also who know Tim King, you're probably shaking, nodding your head saying, "Yeah, he is the best."

Thank you all for joining us today. Thank you, Tim.

Tim: Thank you, Patti. Appreciate it.

Patti: You bet. By the way, if you're not seeing this on video, he is pitch red.

Tim: [laughs]

Patti: He's blushing.

Tim: Oh, it doesn't take a lot. [laughs]The Irish blood.

Patti: Yeah. I don't think he gets to hear that enough. Thank you also. You are the reason that we exist. I have been getting such great feedback on these podcasts. We had people in yesterday who talked about the ones that they really enjoyed, which was terrific to know. We're going to do more of that.

Thanks to my production team. They are here. They've been here since 7:30 in the morning, setting up the video, setting up the microphones, doing sound checks.

Bernadette is here. She messed up her knee and she's on crutches, but she showed up. Carrie lives in New York. No, she's in Baltimore now. I can't keep track of where she lives anymore. She showed up, and Doug, who has been here from day one.

Thanks to all of you. We couldn't do it and I couldn't do it without you. Thanks for joining me. I hope you have a fantastic day. If you want to learn more about this topic or anything else, go to our website. By the way, it's a brand-new website. Go to keyfinancialinc.com and let us know.

It's easy, just write it in if you'd like to hear more about this or that. That's where we get the ideas for topics. In the meantime, I hope you have a great day. Take care.