

Welcome to Today's Webinar

Succession Playbook: Strategies for Defining Your Legacy

Thursday, Sept. 21, 2023, 2 p.m. Eastern time



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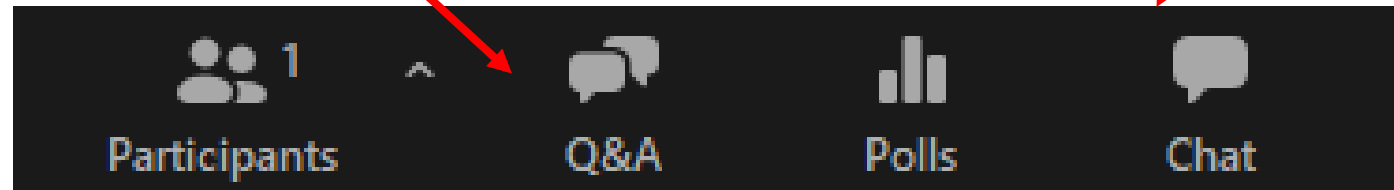
Ask a Question, Engage With Other Attendees

Q&A

Type your questions for the panel into the Q&A box

Chat

Start a conversation—say hello. Engage with panelists and other attendees.



Today's Presenter



Jerry Grady

partner, managing director

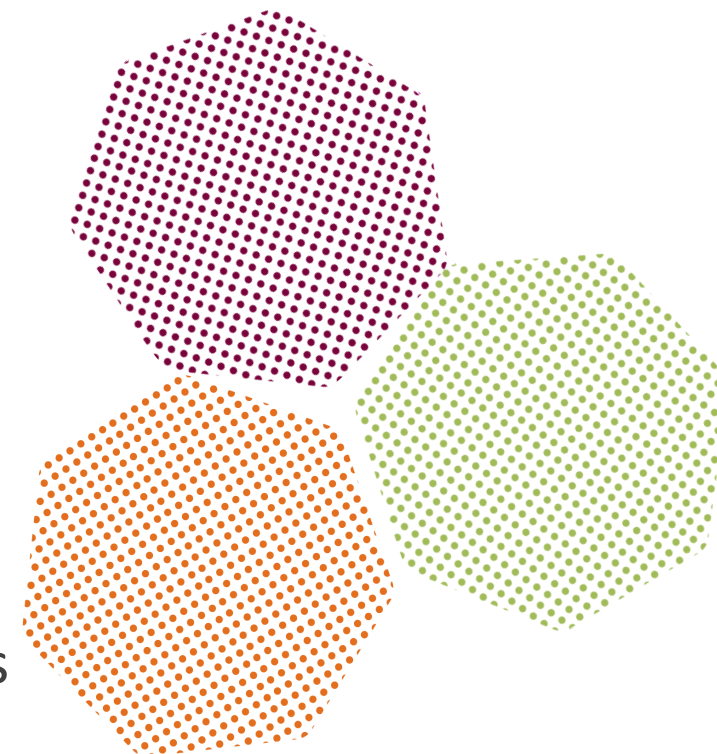
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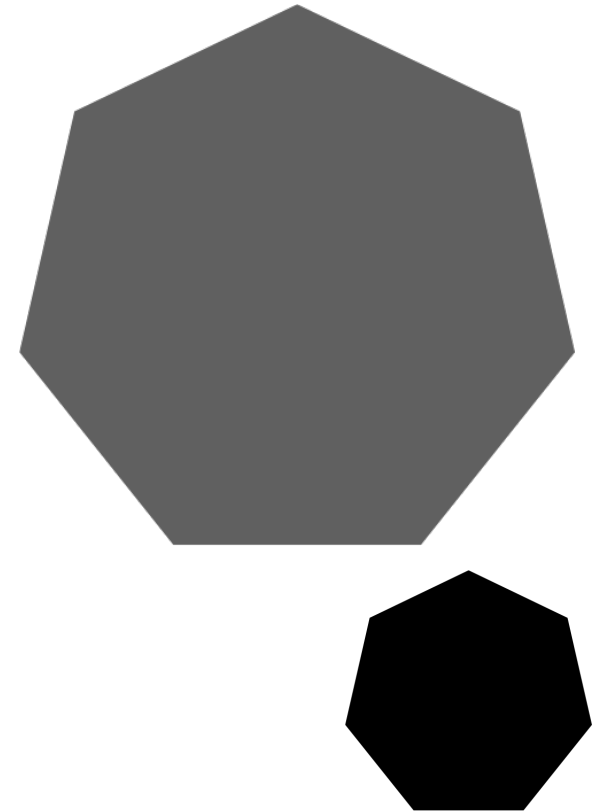
OBJECTIVES

- Succession planning – what does it really mean
- Understand the pit falls of not doing anything
- Family succession planning vs succession planning
- Understanding the four solutions available to determine your legacy
 - The advantages compared to the disadvantages
- Define your legacy and start planning
 - Trusted advisors should include your attorney, CPA, banker, and board



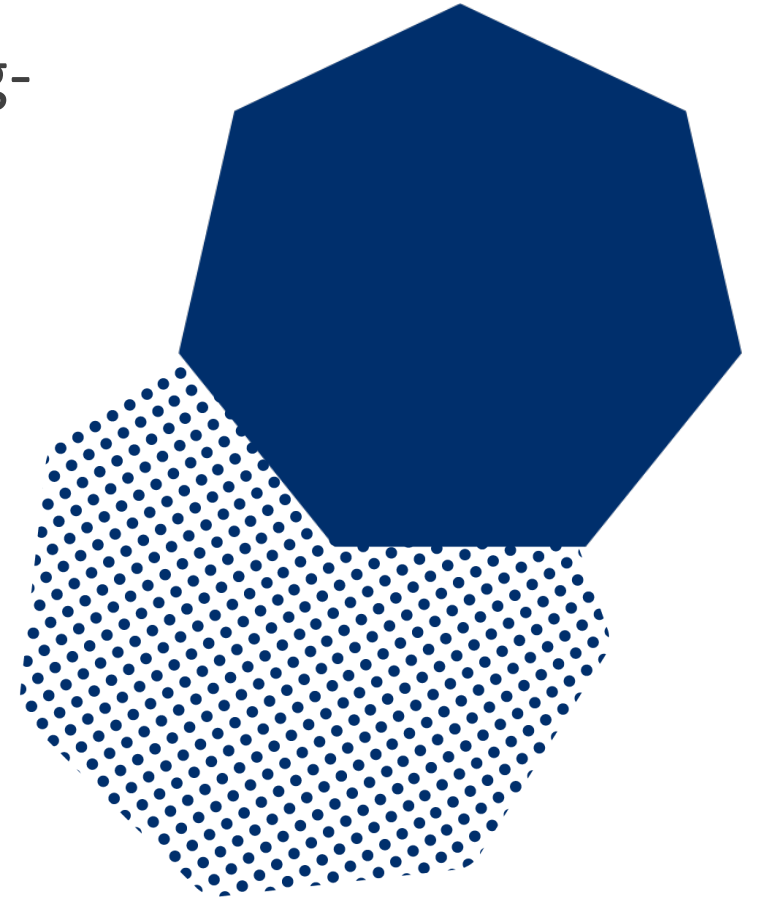
SUCCESSION PLANNING

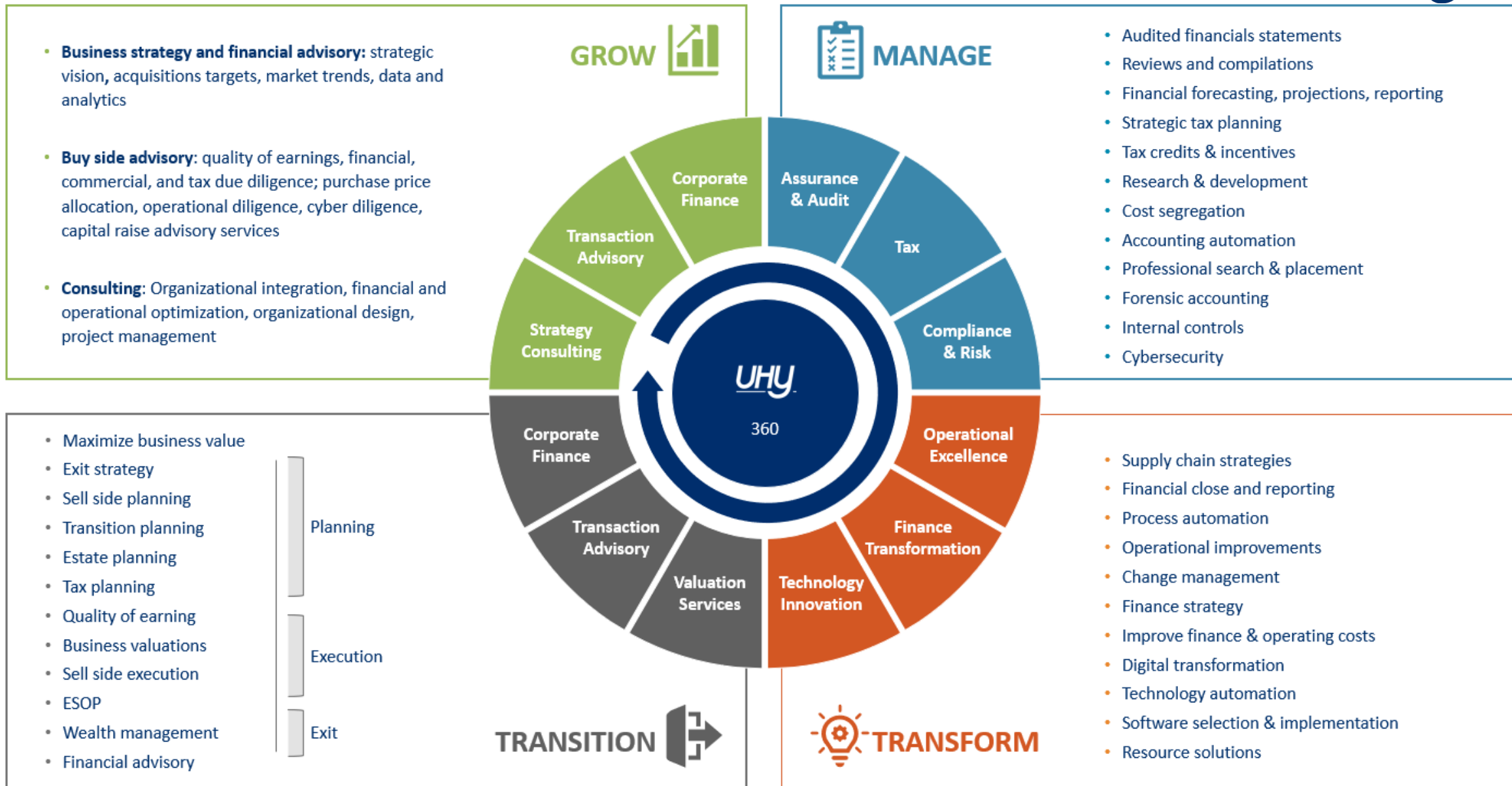
Succession planning is the process of identifying the critical positions within your organization and developing action plans for individuals to assume those positions.



FAMILY SUCCESSION PLANNING

Succession planning is key to achieving a long-term legacy in a family business by, among other things, defining when family members may work in the business, how profits should be distributed, who may serve on the board, how to plan for future leadership, and other matters such as taxes, liability, and estate planning





WHERE ARE YOU ON YOUR BUSINESS JOURNEY?

WHAT WILL YOUR LEGACY BE?



STRATEGIC QUESTIONS THAT ARE TOP OF MIND:

“I know the day is coming to make the biggest decision of my life, but I don’t know the best path forward. Can you help?”

“How do I go about transitioning my business to family or key management? What are my options?”

“When is the right time to exit my business?”

“What are my options if I decide to sell to a third party?”

WHAT IS A SUCCESSION PLANNING RISK OWNERS LOSE TRACK OF?



SUCCESSION PLANNING OPTIONS

Transfer To Family

Family Estate/Succession



Transfer To Management

MBO



Transfer To Employee

ESOP



Sell Out Right

Third Party Sale



FAMILY
SUCCESSION
PLANNING

IS THE WINDOW OF OPPORTUNITY CLOSING?

Estate & Gift Tax Exemption

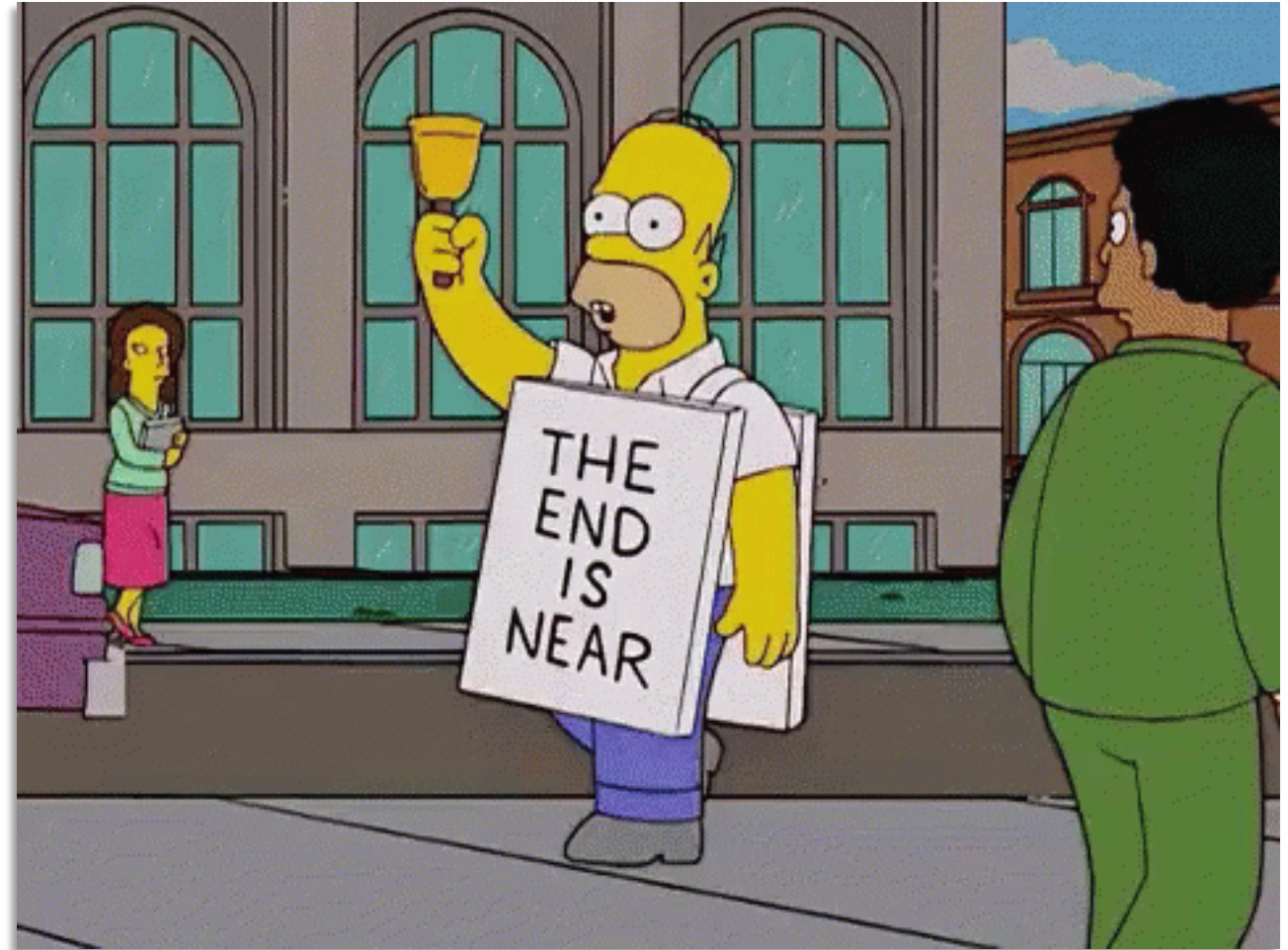
NOW

\$14.2M

JAN 1, 2026

\$6.2M*

*Adjusted For Inflation



Poll #1

An IDIT is:

- An indemnity clause in your contract
- An idiot who can't spell
- I'm guessing an intentionally defective irrevocable trust
- I know it's an intentionally defective irrevocable trust
- I have never heard this term before

FAMILY SUCCESSION ESTATE PLANNING OPTIONS

**Grantor Retained Annuity Trust
(GRAT)**

**Spousal Lifetime Access Trust
(SLAT)**

Dynasty Trusts

**Irrevocable Life Insurance Trusts
(ILIT)**

**Intentionally Defective Irrevocable Trust (IDIT)
AKA
Intentionally Defective Grantor Trust (IDGT)**

CASE STUDY

About Client

Business: Light industrial / IT staffing firm

Staffing firm located in Michigan that provides staffing solutions to Tier 1 and Tier II automotive and technology companies

Revenue \$98M in 2018

Key Stakeholders:

Father, 64, sole shareholder of LI entity, wife, 57, and brother, 60, are shareholders of IT entity

Legacy:

Transition business over a long term period to provide revenue stream to family and preserve wealth upon death of father



What Was The Challenge?

- Assess and mentor current president's ability to effectively manage the business
- Develop a plan to grow business with management team at the helm
- Identify succession planning options



Solutions Delivered

- Created advisory board with attorney, family, and myself to build long term strategic growth and succession plan
- Identified new COO and CFO for proper leadership
- Acquisition growth model to grow the business
- Recommended one succession planning option:
 - **IDIT (Intentionally Defective Irrevocable Trust)**



Results & Benefits

- Advisory Board drove strategy, focus and accountability
- 3 strategic acquisitions in the last two years
- Company has experienced 1.5x revenue growth in less than 5 years
- Intentionally Defective Irrevocable Trust (IDIT) was used to provide estate plan and preserve wealth for family with growth of over \$15M in estate value protected tax free

HOW AN IDIT WORKS

Key Ingredients:

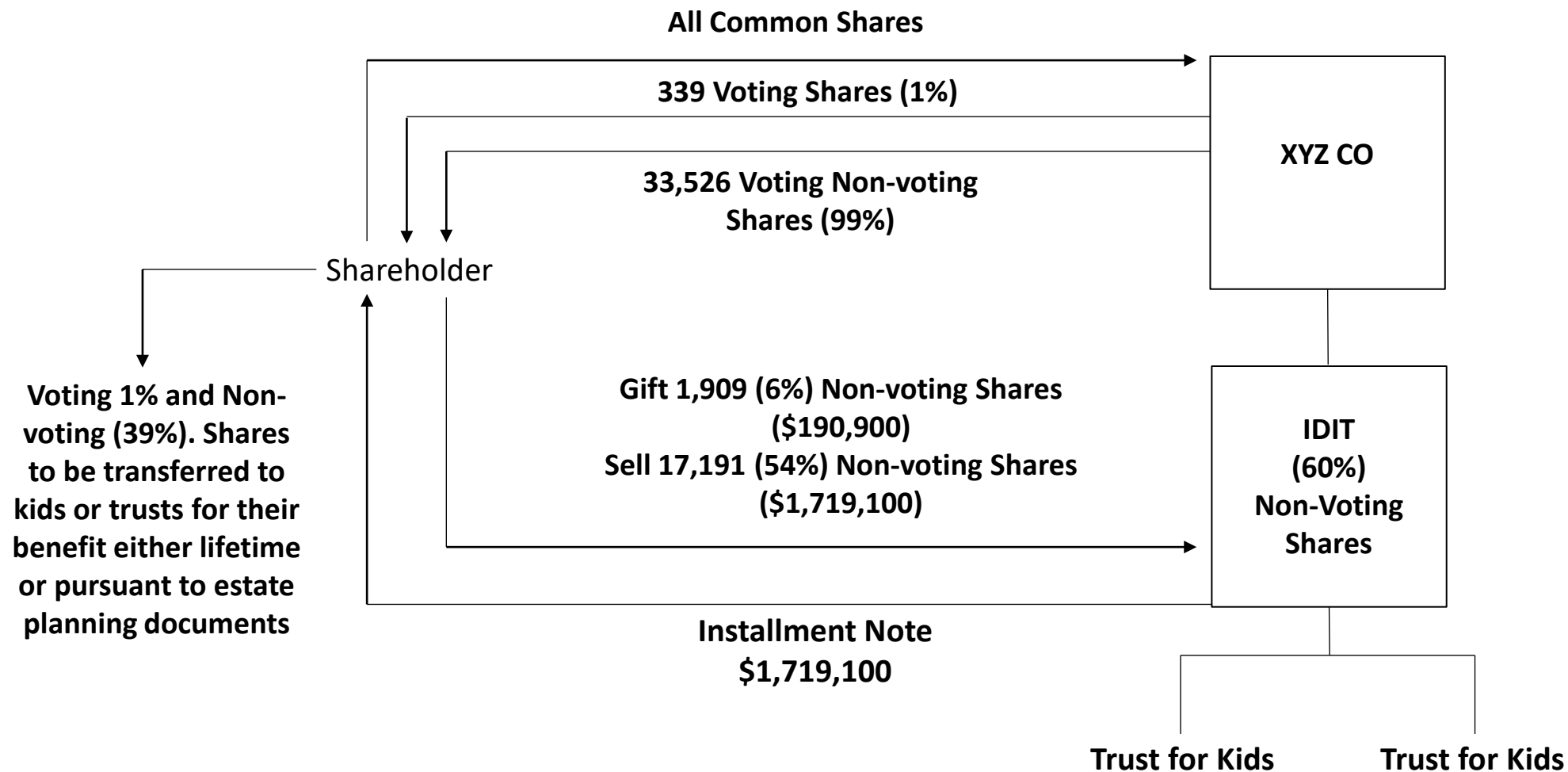
- Grantor wants an income stream over a period of time after selling shares in business
- Works well for income producing, highly appreciable business
- Family is looking to transfer wealth while considering valuation discounts
- Works well with S-corps and partnerships

How it Works:

- Grantor sells property (business) discounted to the trust in exchange for a note typically 5-9 years, mid-term AFR (today not as lucrative given higher interest rates)
- Under the note agreement, the trust is required to pay grantor principal and interest
- Grantor must also gift cash or property to the trust to provide it with sufficient value, typically 10% of the assets sold to the trust
- Upon death, only the note balance would be includable in the estate, if there is any remaining balance. This is a key point to consider.

SUCCESSION PLANNING IDIT SCENARIO

GIFT/SALE 60% OF STOCK TO AN IDIT



IDIT BENEFITS

1

Grantor pays no tax on sale of asset since receiving a note equal to value of property sold

2

Interest is not taxable since trust is “intentionally defective”

3

The post-sale appreciation is excluded from grantor’s taxable estate

4

Grantor still pays taxes on the income generated from business rather than trust until note is paid off, known as “Tax Burn”

IDIT can be a valuable succession planning tool!

IDIT DISADVANTAGES

1

If Grantor dies before full term of note, the balance is included in Estate

2

IRS scrutiny

3

Taxes due from trust income are paid by grantor

4

Important to fund with appreciable assets

5

To fund trust, may need to use some of your lifetime exemptions

Poll #2

Where are you and your business in your succession planning journey?



We haven't even thought about it yet.



We're starting to think about it.



We've started to draft plans.



We have a plan, but it isn't formalized.



It's all set up, but we might want to make changes.



We have a succession plan, it's legal, and we're happy with it.

MANAGEMENT BUYOUT

CASE STUDY

About Client

Business: Light industrial staffing firm

Light industrial staffing entity with more than 30 years in business providing solutions in six states.

Revenue \$65M in 2021

Key Stakeholders:

One shareholder aged 70

Legacy:

Son and CFO wanted to begin acquisition growth and establish new business venture in Virgin Islands with an economic development corporation



What Was The Challenge?

- No real succession plan in place when we were introduced with the exception of an IDIT
- One member of management was frustrated and looking to leave
- Shareholder was fat, dumb, and happy as is
- Assess management team and develop buyout scenarios for sole shareholder



Solutions Delivered

- Created advisory board with attorney and key management
- Business valuation and buyout structure terms
- Buyout structure 10% cash and 90% seller note, valuation not maximized under MBO (for family reasons)
- Recommended two succession planning options:
 - ✓ **First prepared calculation of value and structure to buyout shareholder**
 - ✓ **Plan for purchasing the IDITs out to maximize the use of the EDC for the future sale of the company**



Results & Benefits

- Founding shareholder sitting on the beach!
- Company has experienced 25% revenue growth in less than 2 years
- Management team is driving growth with acquisitions
- Company sold, with rollover equity, one division at 6x revenue
- Uncle Sam is paying for acquisitions due to favorable tax structure in Virgin Islands

MBO ADVANTAGES

1

Limited Due
Diligence

2

Confidentiality
can be
maintained

3

High chance for
business success

4

Fulfills owners'
legacy

5

Simpler, less
complex

MBO DISADVANTAGES

1

Likely lower
valuation

2

Seller takes note
over time

3

Limited funding
options

4

Managing
owners' exit

5

Risk of
Management
driving down
value

ESOP

CASE STUDY

About Client

Business:

Engineering Services with more than 20 years in business, located in Grand Rapids, MI, providing unique one-off product solutions to a variety of industries

Revenue \$20M in 2020

Key Stakeholders:

Three equal shareholders all in their late 50s

Legacy:

All shareholders were in agreement that a third-party sale was not to be explored. Their legacy was to identify key management to buy them out, but open to other solutions. Shareholders would like to stay on for five to six years



What Was The Challenge?

- Educate all shareholders on valuation and succession options
- Prepare calculation of value that would hopefully be in the range that all shareholders would find acceptable
- Explore all options except a third-party sale



Solutions Delivered

- Over 18 months, provided valuation and succession options
- MBO did not provide the valuation and terms that all shareholders expected
- Recommended ESOP planning option with the assistance of Lazear Capital Partners to drive additional education and planning scenarios
- Assisted in securing third-party financing at 2.75 x EBITDA, to fund down payment

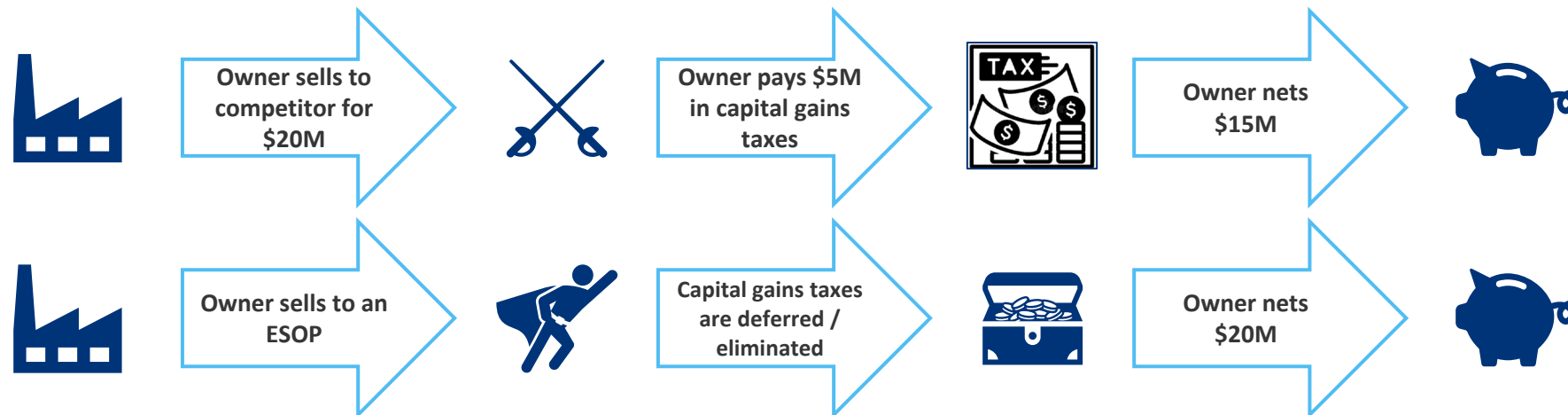


Results & Benefits

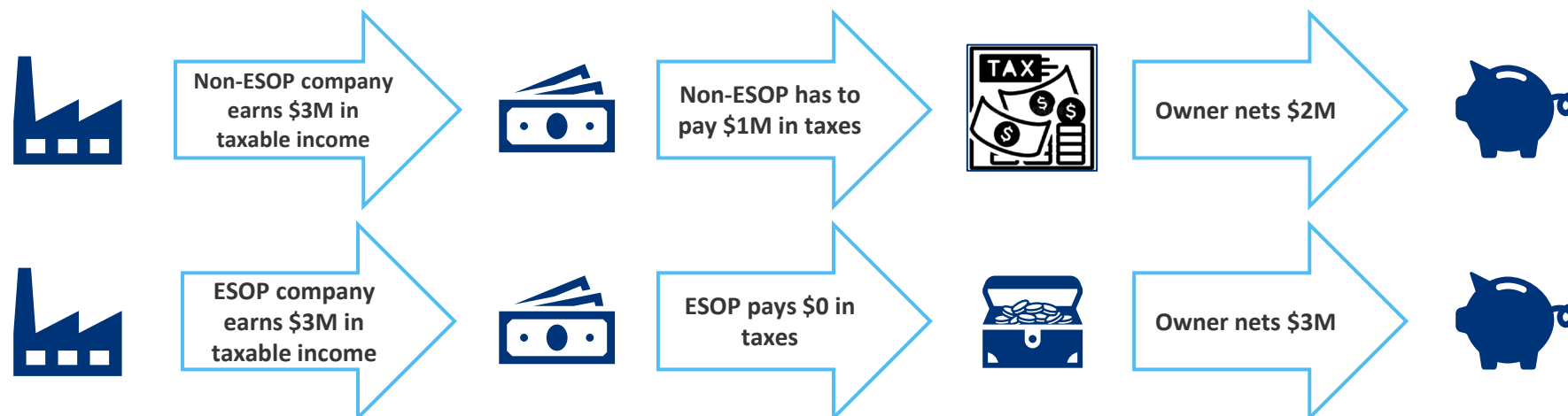
- ESOP maximized valuation that is likely higher than a third-party sale
- Sellers have strong seller note terms with warrant kicker for growth
- Two shareholders elected 1042 deferred tax treatment!
- Key management and employees are excited and feel the ESOP will be a great recruiting tool

ESOP SOLUTION A POWERFUL TOOL

The owner may sell his/her shares to an ESOP and either defer or eliminate the capital gains tax on the sale, thereby increasing the seller's net proceeds by approximately one-third when compared to any other type of sale.



Since an ESOP is a retirement plan, all the company's post-ESOP earnings may be federal and state income tax-free, significantly increasing the company's cash flow.



ESOP ADVANTAGES

- 1 Total Sale proceeds typically exceed other exit problems
- 2 Company can become federal and state tax free
- 3 Owner can contribute to run the company and maintain operational control
- 4 As owners, employees benefit from the success of the company
- 5 Third company studies show ESOP companies out-perform non-ESOP companies have better employee retention
- 6 Seller can potentially sell tax-deferred/tax free
- 7 Key employees have the ability to receive additional incentives
- 8 Due diligence is less intrusive, and confidential company information is not provided to competitors

ESOP can be a valuable exit planning tool!

ESOP DISADVANTAGES

1

Can be very complicated

2

Can be expensive with ongoing professional fees

3

ESOP valuation may not always bring the most value

4

Owners carry seller notes, so need to stay engaged

5

Will Management and Employees really have what it takes to succeed?

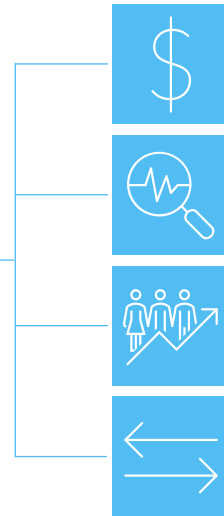
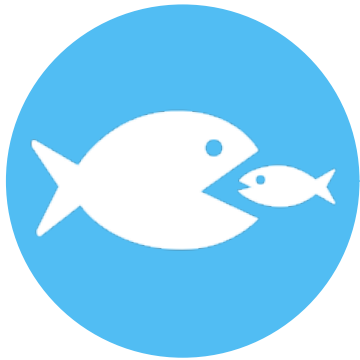
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With revolving employees, many times the pay window is constantly issuing small checks

THIRD PARTY SALE

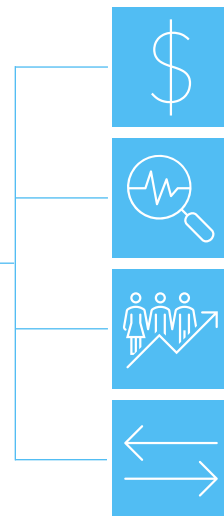
EXIT OPTIONS COMPARISON

Strategic Sale



- **Valuation:** Higher value possible due to “synergies”
- **Continued Ownership/Future Upside:** No potential
- **Transaction Length:** 6 to 12 months
- **Due Diligence Process:** Highly invasive
- **Operating Control:** Leadership and operational changes likely
- **Employee impact:** Unclear
- **Post-Close Seller’s Involvement:** Minimal commitment/involvement
- **Company Culture & Legacy:** Higher degree of change

Sale to Private Equity



- **Valuation:** Typically, lower value than strategic
- **Continued Ownership/Future Upside:** Yes, potential for 2nd and 3rd bites
- **Transaction length:** 6 to 12 months
- **Due diligence process:** Highly invasive
- **Operating Control:** Current management team
- **Employee impact:** Minimal
- **Post-Close Seller’s Involvement:** At seller’s discretion
- **Company Culture & Legacy:** Smaller degree of change

CASE STUDY #1

CIRRUS

About Client

Business: Health Care staffing firm

Travel nurse and local nurse staffing entity located in Ohio

Key Stakeholders:

100% owned by the founder and CEO (mid-50s)

Legacy:

Owner was seeking a go-forward partner to facilitate growth and potential sale of the company 10 years out



What was the Challenge?

- Weak management team with a family-oriented culture, but no viable succession plan in place
- Entered the travel nurse business in 2018
- High start-up operating cost and lack of leadership



Solutions Delivered

- Prepared valuation and buyout scenarios to develop a smooth transition plan
- Developed and vetted a targeted list of potential financial and strategic buyers
- Drafted investment materials for acquirers to review and evaluate the opportunity
- Managed an efficient process with over 200 private equity groups and industry buyers that received 10 indications of interest
- Hired new operational leader with management incentive contract
- Hired new division leader for travel nurse to drive business



Results & Benefits

- Valuation expectations were exceeded by 100% and the seller decided to roll a portion of equity into the NewCo on a tax deferred basis
- Negotiated all cash deal with two year incentive earn out
- Shareholder has begun a defined transition plan and building future charitable foundation for her community

CASE STUDY #2

CREATIVE MINORITY

About Client

Business: Minority IT staffing firm

Staffing solutions for Fortune 500 companies located in Chicago, IL

Key Stakeholders:

Single member shareholder aged 61

Legacy:

CEO was seeking a liquidity event and transition out of the business



What was the Challenge?

- Minority owned business limits strategic and private equity buyers
- Pandemic sale transaction started process in October 2020
- Ownership had not transitioned to next level of management
- Signed LOI in July 2021 and had to manage COVID during the diligence process
- No audited or reviewed financial statement
- Compilation was inaccurately prepared



Solutions Delivered

- Prepared valuation and scenarios to support the owner's decision-making process
- Positioned the company's key attributes and growth dynamics to potential acquirers
- Diligent in the selection of the buyers invited to management presentations
- Managed a seamless transaction process
- Pulled from our knowledge of minority-owned businesses who look for acquisitions
- Prepared and updated two years' worth of financial data to get a proper balance sheet and 12-month roll to maintain minority-owned business status



Results & Benefits

- Selected buyer that was best strategic fit and closed within 90 days of signing LOI
- Closed at value that exceeded owner's valuation expectations by 20% with minimal risk and no incremental tax exposure
- 100% all-cash deal
- Client shareholder is enjoying time with friends and family and took a one-month vacation to Jamaica upon close

KEY TAKEAWAYS

PREPARE TO TACKLE THE TOUGH ISSUES

- Be realistic about Company valuation when transitioning to family
- Be open-minded in addressing difficult conversations
- Define key roles & responsibilities
- Develop plans to hold your teams accountable
- Are you really prepared to transfer control?
- Don't assume you have time to sufficiently plan
- Take A Leap of Faith!

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 - Illinois Search & Staffing Association
 - Massachusetts Staffing Association
 - Missouri and Kansas Search and Staffing Association
 - New Jersey Staffing Alliance
 - Minnesota Recruiting & Staffing Association
 - Georgia Staffing Association
 - Florida Staffing Association

Thank You!



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