



April 2011

Waiting to Sell Your Business? It May Not Be Worth the Wait

In an ideal world, every business owner would be prepared for a transition at any given time. However, many small business owners today are waiting for the economy to improve substantially before seriously planning for their transition. The reason for the wait is because many owners know that the value of their business is based upon their bottom line profitability, and those profits are lower than they were in the past. Others may want to work just a few more years. This newsletter provides a comparison to the benefits of waiting for an increase in profits against the drawbacks of being exposed to higher capital gains tax rates, higher ordinary income tax rates, a crowded marketplace of sellers, and a potential lost opportunity for appreciation in investment accounts.

The last two quarters have seen an increase in merger and acquisition activity somewhat due to the pending increase in capital gains due to occur with the expiration of the Bush Tax Cuts at the end of 2012. The capital gains tax rate is expected to increase from 15% to 20% on January 1, 2013. And with a country facing record debt levels and budget deficits, some speculate that capital gains as well as ordinary income tax rates could go significantly higher.

Example: Cost of Waiting

In order to make a simple point of whether or not it is worthwhile to wait to sell or transfer your business, let's take a hypothetical example of a company with \$1 million in cash flow which will sell in the current market for \$5 million. At a 15% capital gains federal tax (and assuming a basis of \$0 in the company), the exiting owner will pay \$750,000 in federal capital gains taxes and net \$4.25 million (not including state capital gains taxes).

But let's take a look at what happens if the same business owner chooses to wait until after December 2012 either because they don't want to transition until 2013 or because

they want to continue building cash flow. This business, at a future point, may have a \$1.2 million cash flow (a significant increase for a small business), and using the same selling multiple of 5 times cash flow, will sell for \$6 million. An extra million dollars to the seller appears to have been worth the additional time and effort. However, with an increased capital gains tax of 20%, the owner will now pay \$1.2 million in capital gains tax. That alone is an additional \$450,000 in federal capital gains tax. The net pay this business owner would then reap from the sale of their business is \$4.8 million (again, before state taxes). Although this equals an additional \$550,000 in the seller's pocket, it is not the \$1 million the owner had expected due to the higher tax rate. In addition, if the selling owner does not get capital gains tax treatment for the sale of the business, the ordinary income tax rates will yield even less to the owner. Further, if the marketplace of exiting owners gets crowded because everyone is done waiting, the selling owner may not fetch the same price as more selling baby boomers come into the marketplace. Finally, and not insignificantly, this owner needs to assume the risks of running the business to the future profit levels. This risk includes the opportunity risk of having liquid dollars today appreciate over the next few years.

Will there be buyers in the future?

Owners need to be aware that waiting to transition means that they will potentially further subject themselves to the influx of baby boomer business owners looking to sell their businesses because you can assume many of these boomers are also waiting for the economy to improve. There is the potential for a saturated market when you are ready to transition, potentially reducing your sales price further.

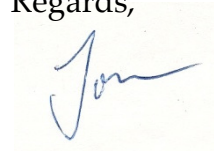
Concluding thoughts

All owners' businesses and their situations are different so this information and guidance may or may not apply to your business. Regardless of the specific application, it is helpful to think in these terms so that you can make a fully informed decision about planning for a transition from your business.

Owners need to take the time to look at the after-tax rewards they will get from delaying the sale of their business and weigh that against the risks of delaying; including the potential for increased capital gains, increased ordinary income taxes, a saturated market to sell into and the risk and opportunity cost of continuing to hold onto your business. In our example, waiting to transition may cost much more than

anticipated once taxes and the reduced price they may get from the sale of their business is taken into account. We encourage you to consult with your CPA about your particular tax situation and by all means call us to discuss your situation and how a formal transition strategy will help you increase the overall value of your business and the peace of mind you will gain from planning a transition on your terms and schedule.

Regards,



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Our Commitment to our Customers

Owner's Edge uses our client-owners' vision to create solid strategies to capitalize on opportunities and address systemic problems to make their profits sustainable and their business transferable. This creates true and meaningful value.

About Owner's Edge

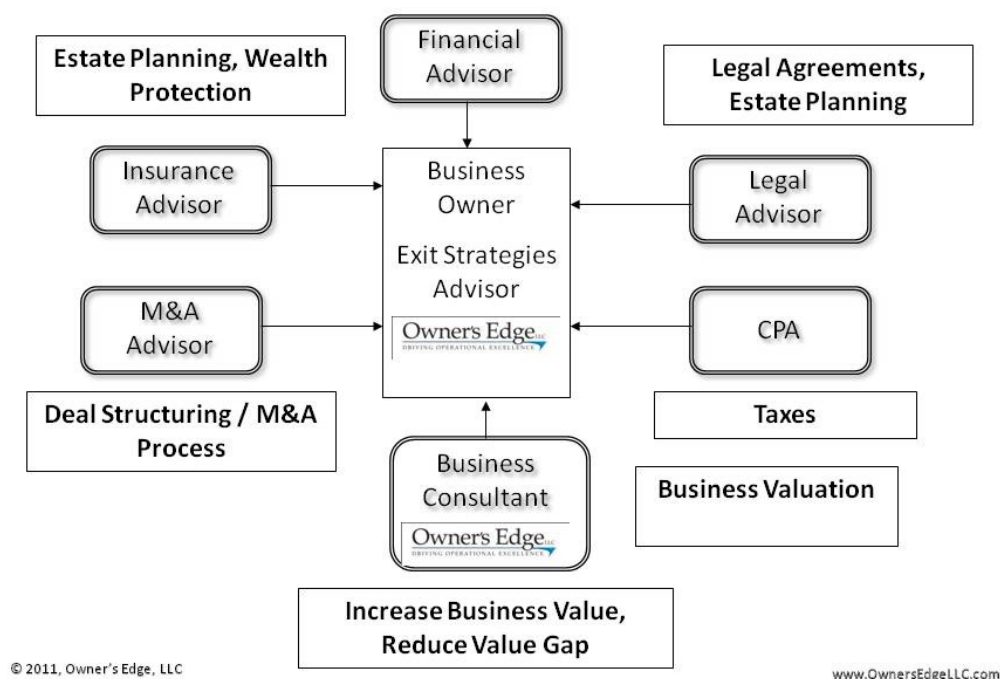
Owner's Edge is a business advisory and consulting firm specializing in helping business owners work *on* their businesses by devising and implementing strategies to drive operational excellence every day. We are one of the few advisor firms that can provide a formal and comprehensive Transition Planning service for business owners. Call us for a no-obligation consultation today.

Breakfast Seminar: Business Owner Transition Strategy Planning
Wednesday May 24 at East Greenwich Yacht Club; 8:00AM – 10:00AM

This free educational breakfast seminar is tailored especially for business owners and their key advisors. Learn why it is important to plan your transition, where you should start, what your transition options are, who is involved in the process and when they need to enter into the process. A continental breakfast will be served. Reserve your seat today and feel free to invite members of your advisory team. RSVP by May 19, 2011.

Call or email us for more information: 401-451-9799 or info@OwnersEdgeLLC.com.

Your Transition Advisory Team



A professional exit planner such as Owner's Edge can lead your trusted Transition Advisory Team you already have in place. Don't try to go it alone! Turn to the professionals at Owner's Edge to ensure your transition plan is structured and executed to leave your business on your terms.

Do you find it more convenient to use email? To receive our "The Edge Transition Planning Newsletter" by email instead of US Mail, please drop us an email. We will be happy to convert your delivery to our electronic version.