WELLS FARGO Wealth & Investment Management

Advice and Planning Update

Three keep/sell considerations

December 2023

Key takeaways:

- Understanding the risk of the asset you own (your company) is a first step in evaluating your keep or sell options.
- External dynamics such as tax, industry, or economic shifts may have a significant impact on your exit.
- Determining who will be the next owner of your enterprise may be the most important decision you make.

What this may mean for you:

- Narrowing your focus to risk, timing, and control can help bring clarity.

Is it the time to keep or the time to sell? Is it better to continue to live off the annual cash flow (and perks of ownership) or take the lump sum? These decisions are often not straightforward because there can be many variables to evaluate that are not concrete, for example risk, timing, and control. As a result, this can cause a delay in owners engaging in the evaluation process and becoming overwhelmed with multiple "what-if" scenarios. Understanding the three keep/sell considerations can assist with an efficient transition process.

Investment and Insurance Products: ▶ NOT FDIC Insured ▶ NO Bank Guarantee ▶ MAY Lose Value

Consideration: Evaluating the risk

A challenge for most owners is evaluating the risk of the asset owned versus the risk of an alternative asset class. Often, the owner has become so accustomed to the risk of owning a business that it is difficult to perceive.

One way to measure risk is to understand the discounted cash flow value of your enterprise. This valuation method considers the future cash flow of the business that would accrue to the owners, adjusted (or discounted) for the risk in that cash flow. For example, a software licensing company with multiyear subscription contracts has very stable, cash flow that can last years. The risk of this cash stream declining may be mitigated by the multiyear and fixed-price nature of the contracts. Conversely, a company that sells snacks to sports venues may be dependent on seasonality, with demand impacted by the team's popularity, weather, etc. Without a multiyear contract, this cash flow could be very unpredictable, and higher risk.

Once you understand the potential risk and reward of the asset you own, it may become easier to compare it with other assets you could potentially own such as cash or a diversified investment portfolio.

Consideration: Timing is everything

When choosing between keeping a business for a few more years or selling to the next owner, many owners consider personal objectives such as lifestyle, health, or leadership succession preparation.

Often overlooked, but more significant economically, are the external dynamics that can affect the timing of a transition. These include tax law changes, economic cycle dynamics, cost of capital and valuation trends, and future lifestyle cost escalation.

In a changing tax environment, capital gains and ordinary income tax rates can influence your decision. Keeping your enterprise to maintain current compensation and distribution levels may not be the most advantageous choice if your incremental annual cash flows are offset by a tax liability.

Industry and economic trends influence timing as well. Buyers generally prefer to acquire companies when the prospects for the future are still on the upswing, influencing valuation and favorable terms.

Finally, availability and the cost of capital, especially debt, can impact your options. This is particularly relevant if you hope to sell your business to an employee stock ownership plan (ESOP), to key managers in an installment sale, or to a private equity group.

Financial modeling of different scenarios can help you decide which path forward makes the most sense under a given fact pattern. Evaluating your options and understanding how they translate into net proceeds is important to make a fair comparison.

Consideration: Be in control

Many owners value control, especially as a transition approaches. The decisions are complicated and impact many. Your leadership of the process, timing, and structure of an ownership transition may enhance the outcomes for the company and the new owners. And your involvement may help ensure your economic and noneconomic goals are attended to simultaneously. Most owners have a point of view on who the next best owner should be. Why not be in control of that decision based on your objectives and circumstances?

Actionable next steps: Clarity is the goal

Addressing these top three considerations often brings clarity to owners and provides the confidence to move forward. Three action steps to consider:

- Assess the risk of your business cashflow. This can be as simple as drafting a list of operating and financial risks of your enterprise and the offsetting factors. A formal approach is to engage a valuation professional to conduct a risk review. The objective is to recognize the risk of your cashflow relative to other influencing factors, and your risk profile.

- Become acquainted with economic and business trends through research and resources such as your CPA, an investment banker or business advisor. Their perspective on timing your transition will inform your decisions.
- Document your ownership priorities and preferred outcomes, and share them with your heirs, management team and professional advisors. Their input could enhance your transition success.

Contact your Wells Fargo relationship manager to learn more about our resources and how we can help you.

Disclosures

Wells Fargo & Company and its affiliates do not provide legal or tax advice. In limited circumstances, tax advice may be provided by Wells Fargo Bank N.A. Please consult your legal and/or tax advisors to determine how this information, and any planned tax results may apply to your situation at the time your tax return is filed.

Wells Fargo Wealth & Investment Management (WIM) is a division within Wells Fargo & Company. WIM provides financial products and services through various bank and brokerage affiliates of Wells Fargo & Company.

Wells Fargo Bank, N.A. (‘the Bank”) offers various banking, advisory, fiduciary and custody products and services, including discretionary portfolio management. Wells Fargo affiliates, including Financial Advisors of Wells Fargo Advisors, may be paid an ongoing or one-time referral fee in relation to clients referred to the Bank. In these instances, the Bank is responsible for the day-to-day management of any referred accounts.

© 2023 Wells Fargo

PM-06082025-6129674.2.1