BUSINESS VALUATION NEWSLETTER FOR BUSINESS OWNERS & SPECIALTY PROFESSIONAL

As we race for 2021 what did we learn from 2020?

Valuation Pulse

ONYX PARTNERS GROUP
valuation experts who understand your industry

Inside This Quarter

Managing Partner Corner **1**

Family Limited Partnerships – Family-Owned Conversations.......... **4**

Franchises – Paying Fair Market Value... **6**

ESOP – Is It Time Yet? **8**

Managing Partner Corner

As 2019 came to a close, many were coming up with catchy phrases as how the coming new year would be and what it would mean to them. Phrases like 2020 is the year of focus, the year of vision, or the year of new possibilities. Whatever your catch phrase was, for many, it turned very quickly in March 2020 from focus or vision to a year of resilience and maneuvering through disruption.

The year 2020 brought a global pandemic, social unrest, and an economic downturn. Because of the global pandemic we lost thousands of loved ones and heroes . During the social unrest we experienced social and racial injustice at levels we have not experienced in decades. To add on to the human lost and social unrest, the country took an economic downturn, and thousands of businesses suffered, and many have even closed their doors.

As our country faced these issues, there has been an enormous amount of compassion and empathy that has run rapid through our country. First and foremost, we tip our hats to the first responders and all essential workers. There is no way to measure how thankful we are for their sacrifice and dedication to help us get through this pandemic.

In searching for the positive aspects in 2020, creativity and flexibility surfaced on many levels. We have mastered working remotely. Maneuvering Zoom and other virtual platforms have become second nature and a part of everyday life. Our services reach has become broader and wider. We can connect with others on multiple levels near and far and not having to leave our office and still provide remarkable content and information. We have seen that when we are faced with challenges, we can maneuver, adapt, and move forward with what we have and what we can reimagine. We have learned that we are resilient.

As 2020 ends, let us continue to come together and treat all as equals regardless of race, religion, or culture. Do not stop being kind and offering compassion. Most important, do not

stop having conversations with groups that are different from you. We have learned many new things about ourselves and what we can do to survive. Let us not let what we have learned fall by the wayside. Take this as a challenge to build our economy, our businesses, our social and racial relationships even better than they ever were before. Take this time to reflect on those that we have lost and be thankful for those that we still have. Let us remember, "It is always the right time to do what is right", (Dr. Martin Luther King, Jr.)

In this quarters report, join us as we explore how family-owned business can learn the benefits of a Family Limited Partnership. Rejuvenating business owners' thoughts and ideas of when and how to exit their business utilizing an ESOP as a platform. Lastly, we will discuss franchising and why having a valuation completed first could turn out to be the best initial investment for a franchisor.

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Valuation Pulse is a quarterly report distributed by Onyx Partners Group, an independent valuation advisory service company. Providing valuation services for an ESOP, Corporate Valuation, Bankruptcy, Gift and Estate Valuations and other areas of interest.

Onyx Partners Group

Continuing our growth as a company for all

Culture and Values

FLP: Family-Owned Businesses Conversations

The year 2020 has done something that can be viewed as positive…it has brought some families closer. One area that has created a lot of buzz this year has been opportunities that have been presented to family-owned businesses. It is often practical for families to form partnerships. These partnerships can either be a limited partnership (LP) or limited liability company (LLC). These partnerships are designed to hold their family business, real estate, or other assets. For wealthy families, especially those whose business or real estate portfolio is rapidly appreciating, it is often non-business purposes such as tax planning, creditor protection planning and succession planning. This type of planning is what ultimately compel families to choose the family limited partnership as their preferred organizational structure.

WHAT IS A FAMILY LIMITED PARTNERSHIP?

A family limited partnership (FLP) is a holding company owned by two or more family members, created to retain a family's business interests, real estate, publicly traded and privately held securities, or other assets contributed by its members. The purpose of creating such an entity is generally to achieve creditor protection and reduce gift and estate taxes while maintaining control over the management and distribution of the partnership's assets.

Establishing a FLP creates two classes of owners. The first of the two are called general partners (GPs). General partners are responsible for the management of the FLP and its assets. They are typically the business-owning parents, or a limited liability company owned by these parents to shield them from the unlimited liability of the operational risks of the business.

The second class of owners are referred to as limited partners (LPs). Limited partners have an economic interest in the partnership, but they lack the ability to control. Because of this, they do not direct or influence the operation of the FLP. In fact, limited partners typically lack the

ability to sell their interest in the FLP, unless it is to an immediate family member. These are typically, the children and grandchildren of the business-owning parents, or trusts established for the benefit of these descendants. They have the right to their pro rata share of partnership income and, are liable only to the extent of their investment in the partnership.

Effectively, the GPs are the operators of the partnership and the LPs are the passive owners.

PRESERVING CONTROL, SAVING TAXES

The family limited partnership is established by the parents donating assets in exchange for the general partnership and the limited partnership interests. Then the general partners gift those LP interests to their children and grandchildren over time.

Due to the lack of control and lack of marketability that limited partnerships possess, an opportunity arises to transfer these interests to future generations at a discount to their fair market value. However, discounts are not prescribed, it is not unusual for these non-controlling, illiquid interests to receive a discount ranging from 15 to 30%.

As a result of the Tax Cuts and Jobs Act of 2018, an individual can pass along $11.18 million to their heirs and a married couple can pass along $22.36 million, which would allow them to be free and clear of federal estate taxes. Assets above those exemption limitations are subject to a 40% federal estate tax rate. Many states will impose an additional estate or inheritance tax as well.

For this reason, families often will choose to gift large portions of their estate to their heirs using a family limited partnership while they are still alive. By doing so, they can avoid state estate and inheritance taxes entirely and stretch out their available federal estate tax exemption by transferring property at a discount to its fair market value. If planned correctly, a family could potentially pass 115% to 130% of the value of their exemption to their heirs, without paying estate taxes by placing assets in a family limited partnership. Encumbering assets is often exactly what a first-generation wealth creator desire. By a business owner to maintaining control of the family business or real estate within a family limited partnership while retaining the general partnership interests. This strategy enables the children to own an economic interest in the business while the parents retain full control over its operations and sale.

The real bonus for the children is this, once the transfer of limited partnership interests is made to future generations, any growth in the value of the underlying property of the family limited partnership occurs free of estate and inheritance taxes as well. What does this mean? It means that if a business, real estate, or investment portfolio is particularly fast-growing, this can be a very effective way of avoiding future estate and gift taxes.

Franchise: Paying Fair Market Value

The year 2020 has allowed opportunities to continue to flourish for franchises even in the mist of the global pandemic. This year, according to entrepreneur magazine, the top 10 producing franchises in 2020 are as follows:

1. **Dunkin'**
2. **Taco Bell**
3. **McDonald's**
4. **Sonic Drive-In**
5. **The UPS Store**
6. **Ace Hardware**
7. **Planet Fitness**
8. **Jersey Mike's Subs**
9. **Culver's**
10. **Pizza Hut**

In 2019, there were 773,603 franchise establishments in the United States. Franchising is a business concept where a franchisee is contractually permitted to use the franchisor's ideas and business model. The model certainly works. If the "right" business is selected and location is perfect, even going through a pandemic, a franchise acquisition can prove to be profitable. Studies have shown that franchising has even greater economic impact than is indicated by the activity in franchised businesses alone.

Franchised businesses stimulate additional economic activity of non-franchised suppliers through their own purchases and those of workers on their payrolls. The question then begs, "what is the right franchise business". Unfortunately, that is a tough question to answer. However, there are several areas that should be addressed for entrepreneurs that are interested in exploring this space.

It is a proven concept that franchises have a higher rate of success in comparison to a startup business. As a sizeable amount of work has already been achieved by the franchisor, high-brand awareness and recall has successfully been accomplished. According to International Franchise Association, franchise companies often have a revenue advantage over independents. Sometimes a very large advantage. In the food and retail sectors, for example, franchises make up only fifteen percent of the business units, but they receive 40% of the revenues. Another factor is that franchisors usually provide the training you need to operate your business model. Franchises tend to have a higher rate of success than start-up businesses. As a franchisor, you may find it easier to secure finance for a franchise. Meaning, it may cost less to buy a franchise than start your own business of the same type.

Onyx Partners Group has had the opportunity to value several franchises prior to the franchisor

buying into the business. Just as with privately held companies, determining the accurate determination of value is just as challenging for franchises. Valuing a franchise before the potential owner moves forward may prove to be one of the wisest moves that can be made before signing off on the contract. Your first business decision as it pertains to owning your franchise is to know that you paid a fair price and did not overpay for an investment.

The term, "Goodwill" is often expressed when it comes to understanding the value of a franchise. Franchises take advantage of customer's goodwill; this is accomplished in brand value. The challenge is the customer goodwill may not be found on a balance sheet.

Goodwill is viewed as an intangible asset. In allocating the intangible value between the franchisor and the franchisee, the valuation must determine the extent to which each party's actions created the intangible value at issue. However, in the great majority of cases, earnings probably result from the conduct of both parties to the franchise agreement.

There are key variables in allocating goodwill between the parties (franchisee and franchisor).

1. **Control:** Where the franchisee's operations are heavily regulated by the franchisor, the intangible value is more likely to come from the franchisor. Conversely, loosely regulated franchisees have considerable opportunity to acquire their own intangible value.

2. **Advertising and Brand Recognition:** In many businesses, advertising is essential to the development of a loyal customer base. Most franchise businesses concentrate advertising activity at the national or regional levels; therefore, that factor most often favors the franchisor.

3. **Location:** Location…Location…Location…Just as advertising often favors the franchisor in allocating value, location generally favors the franchisee. Location is obviously a factor where, such as in the fast-food industry, a particular desirable location is key to the earnings of the business. Where location is a factor, it should logically favor the party who has the right to use the location in the future.

Goodwill, the intangible value that is allocable to the franchisee will be determined largely by the franchise agreement. If the intangible value specific to the franchisee must be determined separate from the intangible value attributable to the franchisor, our job as valuation experts is to review the franchise agreement thoroughly so that the advantages of each party, as well as the transferability of the franchise, are well understood.

One last comment about the franchise agreement. The franchise agreement will also allow the valuation expert the opportunity to gauge the risks of the franchisee losing the franchise relationship and to factor that risk factor into the valuation process.

The goal for the valuation expert, in determining an accurate value is to uncover if it is determined that some of the intangible value is due to the attributes of the specific franchisee, the allocation should compare the franchisee's earnings to the typical earnings of others in the same franchise system.

ESOP: Is It time to Exit

Celebrations! Transferring the business. Expanding the business. Retirement. All three may have been discussed in 2019 with hopes of it coming to fruition in 2020. Then COVID-19 happened and created challenges that no one was prepared for nor could anticipate happening. Business owners were faced with the recession, which was created by the pandemic, which led many family-owned and privately held companies to postpone their celebrations of selling or transferring their businesses.

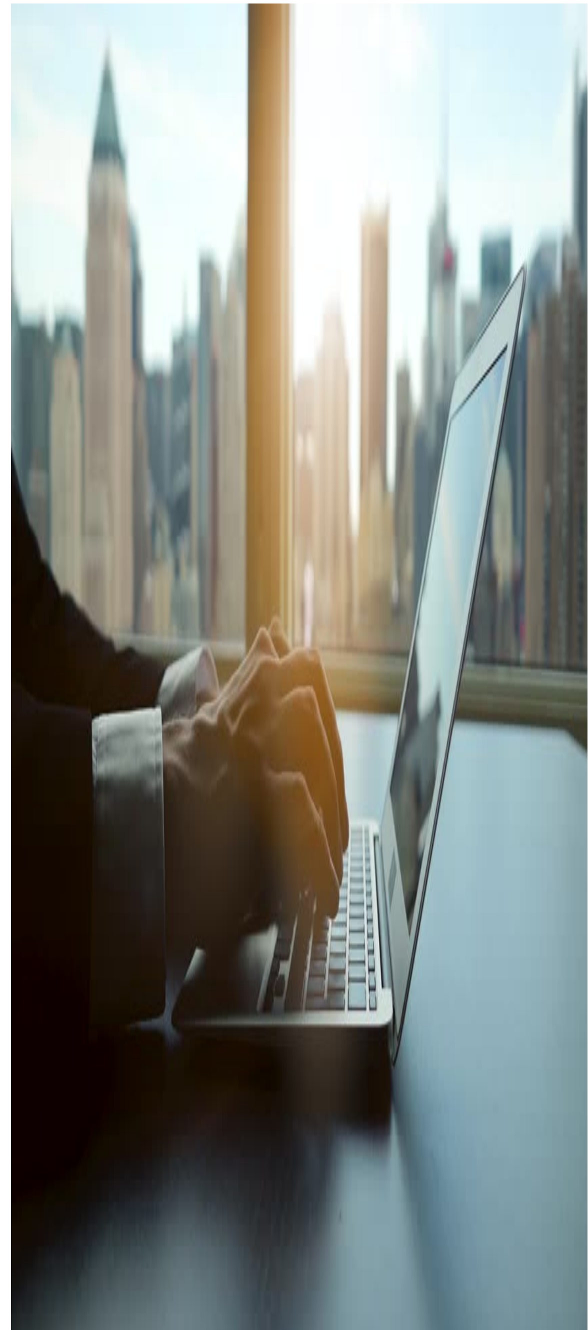
As the country began to slowly open their doors and some not all businesses began to operate as a “new norm”, the discussion has begun again, what is my next step? For those owners that were considering exiting their business and thought of utilizing the ESOP (Employee Stock Ownership Plan) platform as an option, the question is, “Is it the right time?”

In 2018, on average, 300 new ESOPs were established on an annual basis. ESOP is a platform that utilized across various industries and across the country. Studies have shown that ESOP companies are widespread, with hundreds and thousands of plans in the U.S. Operationally, a company sets up a retirement plan trust, similar to a 401(k) plan), for its employees and annually contributes or allocates company stock directly to the plan. Sellers can permanently defer capital gains, which may increase in the future, and their companies could be exempt from federal income taxes.

ESOPs outperform conventional companies during challenging periods. Research from Rutgers University’s Institute for the Study of Employee Ownership and Profit Sharing find that during the steep 2008-09 financial crisis, ESOP companies grew sales 11.1% while non-employee-owned companies grew by just 0.61%. And net employment at ESOPs climbed over 60% during 2001-2011 vs. no change elsewhere, concludes research by Alex Brill, CEO of consulting firm Matrix Global Advisors.

The significant tax advantages provided through the ESOP ownership structure continue to exist and can provide benefits to selling owners and companies. It is important to quantify tax impacts to fully understand proceeds from any sale.

ESOP companies have shown to better provide for their workers' employment and retirement security. Employee-owners were four times less likely to be laid off during the 2008 recession. The ESOP Association recently calculated that an employee at an ESOP company is 6.2 times less likely to be laid off than at a non-ESOP company.



valuation experts who understand your industry

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