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Have a question?

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Would you like
a copy of *Profit
Crew's 2009 survey
on Best Practices
for Operational
Excellence?*

Contact Nicole Davis
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Points to Ponder

**"It's not a question of
who's going to throw the
first stone; it's a question
of who's going to start
building with it."**

-Sloan Williams



PROFIT CLUE™

Profitability Tips for Construction Businesses

Winter 2010

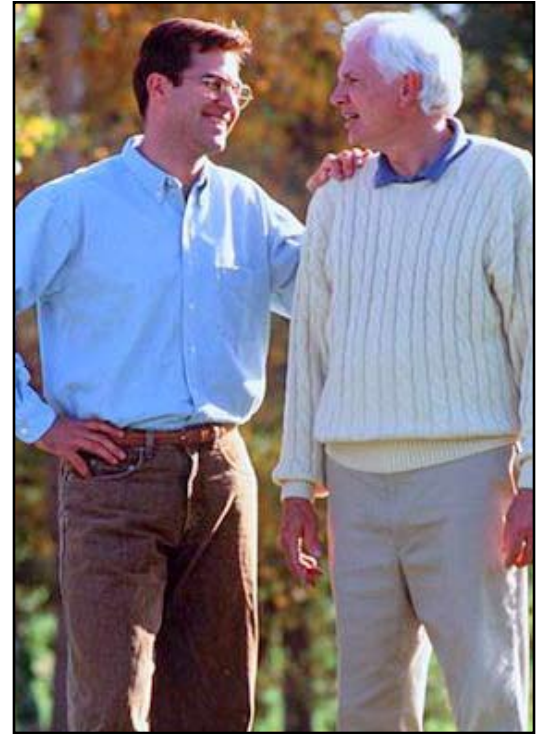
Exit Planning - Always a Timely Subject

While your primary concern these days may be just surviving the current business cycle, this might actually be a good time to start thinking about the transition to the next generation of owners. A graceful exit is one of the most challenging tasks you'll face as a business owner. That's especially true in the construction industry, where high risk and low margins can make buyers scarce.

Even if you pass on ownership to family members or senior managers, the absence of a market for your business makes it difficult to place an accurate value on the company's assets. Without this accurate valuation, objective decision-making often gives way to subjective guesswork about how much your equity is worth, and how best to finance the transition to new owners.

The industry's unique capital structure further complicates exit planning. Lenders and surety companies understandably prefer to see you leave greater equity in the business - at the very time you are trying to take equity out. You'll need to balance these conflicting priorities while still maintaining crucial financial relationships. That requires clear communication, careful planning, and adequate time for a smooth transition.

You also need time to groom successors. Start by delegating greater responsibilities to potential successors, and mentor young leaders in decision-making. They might make a few not-so-great decisions, but these can become powerful teaching moments. Review your incentive programs as well. Deferred compensation plans give key employees substantial incentives to stay with the company. A phantom stock plan (a contractual agreement



that mimics actual stock ownership) can give employees a vested interest in the company's success without diluting ownership.

Another option is an Employee Stock Ownership Plan (ESOP), a tax-qualified employee retirement plan that allows you to sell your stock to your employees as you gradually step out of the company. ESOPs carry heavy administrative burdens and other challenges, though, so get qualified professional help and investigate carefully.

So when should you start? Sooner is better. In fact, some say you should start planning how to get out of your company the day you open its doors. At a minimum, allow at least two or three years - longer if you can - to get the business in shape, identify new owners, and get the deal done. You have much to gain by planning early, and much to lose if you start too late. ■

Planning - The Key to Continuity

Construction is inherently a high risk business, so allowing control of a company to pass to a risk-averse owner can be disastrous.

It's all too common to see a surviving spouse, burdened by the challenges of ownership, struggling to make confident decisions. Soon the company loses momentum, revenue and market share, and often fails to survive. It's even worse if the Internal Revenue Service takes a large share due to inadequate estate planning.

One way to prevent such outcomes is to complete a continuity plan or buy-sell agreement, which addresses what happens in the event of your death or disability. In fact, your bank or surety company may require that you have such a plan in place. In addition to identifying a successor, a buy-sell agreement should cover the following subjects:

- Triggering events – What occurrences (death, disability or retirement, for example) would cause the agreement to go into effect?
- Valuation – What valuation formulas will be used to assess the assets and liabilities of the business?
- Funding – How will the purchase be financed? Installment payments, a bank loan, or a life insurance policy on the owner can provide cash to fund a buyout and keep the company going.

Because companies change over time, you should review a buy-sell agreement periodically. Contact your financial advisors to make sure yours is up-to-date. ■

Who's Who in ProfitCrew™

Who: *Doug Harder, CPA, is a senior tax manager and a member of Wolf & Company LLP's Construction and Real Estate Industry Group. He works with clients in various industries with a focus on construction and real estate both in the U.S. and overseas.*

What he does best: *Doug provides quality, personal, client service with a focus on preparing multi-state tax returns, international information reporting, and look-back calculations. He is knowledgeable regarding the various tax regimes of over 40 states and can provide assistance with the most complex tax issues with over 10 years of experience in construction and real estate taxation.*

In his spare time: *Doug enjoys sporting events and travelling around the world. He has been to over 35 countries on five continents. Doug and his wife currently reside in Glen Ellyn.*



Questions & Answers

Question

If I'm passing my company on to my family or a group of employees, why do I need a professional valuation? Isn't that an unnecessary expense?

Answer

The benefits of a professional business valuation go beyond determining the fair market value of your company. In fact, as critical as it is, fair market value alone should not be construed as the selling price, but rather as a benchmark from which to work.

If you're transitioning to family members or an insider group, as is often the case with construction businesses, your strategy will likely involve transferring part of the business at the lowest possible value in order to save taxes.

The value of a minority interest in your company would be substantially discounted, often by as much as 25 percent to 50 percent, due to lack of marketability. Part of the business valuation expert's job is to determine the amount of that discount.

Armed with the fair market value of your company, you can also make more informed decisions about your next steps, and design the transition of the company in a way that maximizes value and minimizes taxes.

In addition, a professional valuation can open your eyes to other crucial business information including your relative position in the market, potential risks, and current industry and market trends.