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PRIVATE CAPITAL

Immaculate Succession

Closed Case Files Perpetuation Chronicles™

EXCLUSIVE. THIS BUSINESS DOCUMENT HAS BEEN PREPARED FOR ENTREPRENEURS, BUSINESS OWNERS AND MANAGERS.

The Chronicles come from the exclusive files of Private Capital Corporation (PCC).

The case stories are true. Only the names and places have been changed to protect the privacy and confidentiality of PCC clients.

CLOSED CASE 27

CASE BACKGROUND It was 1955. Not the best of economic times for Porter Whittaker. But life was still good. Fresh out of a Marine uniform, the plucky Texan was back home in Amarillo with a modest nest egg and a hunger to fly high. He bought a shabby restaurant in a prime location and turned it into a city landmark. In two years, he paid off the bank. Three years later, he added two other restaurants to his business portfolio. Not only was he flying—Porter was soaring. "But," he asked himself, "for how long?" Twelve and sixteen-hour days in retail food service stretched his patience and health, and they made strangers of his wife and son. Exploiting his knowledge and contacts, Whittaker sold the restaurants and launched a food packaging and distribution business that gave him long-term stability and a more balanced lifestyle. His wife took an administrative role in the corporation; and after college, his son PJ jumped aboard. The company reached new milestones—100 employees and $15MM annual revenue. At his peak, Porter knew it was time to expand operations; but he needed capital. On the advice of financial advisors, the company borrowed $3MM and issued new convertible preferred stock via a 30% Employee Stock Ownership Plan (ESOP). With the arrangement, Porter was personally guaranteeing the $3MM in addition to an approximately $2MM line of credit. Several years later, preparing for his son's succession to the business, he attended a perpetuation workshop that identified mistaken judgment, a pending crisis and new strategic direction.

CASE CHALLENGE Whittaker faced a harsh reality. He was personally guaranteeing all bank debt. If he died, the bank would foreclose on his life's work. He learned there was no requirement for the company to put in place a 30% ESOP just to get new capital. The company stock was unnecessarily diluted; and worse, the company was faced with the immediate and potentially serious repurchase liability of the issued ESOP stock. Without corrective measures, Whittaker's eventual retirement status and family perpetuation were in jeopardy.

PCC RECOMMENDED ACTION

1. Conduct an ESOP Operational Review. Create a family estate plan that features a generation skipping trust to reduce future estate taxes. Assure lifetime income for wife Sarah and education for the Whittaker grandchildren.
2. The Family Trust becomes owner and beneficiary of a split dollar insurance contract on the life of Porter Whittaker. The corporation loans the Trust 90% of the premium with the policy's cash value serving as collateral. The founder gifts the other 10 per cent.
3. The corporation uses the insurance policy cash value as a back-up measure to fund its ESOP stock liability.
4. Negotiate an arrangement, that in the event of Whittaker's death, the bank would agree to sell the corporation's note to the Family Trust. In effect, the Trust becomes a family bank.
5. Through the Trust, Whittaker's heirs would receive principal and interest over a long period of time to take the place of his regular earnings.

EPILOGUE Four years after enacting perpetuation plans and putting PJ at the helm, Porter announced his retirement. But the son had misgivings. He was unconfident about stepping into his father's shoes and accepting debt liability. PCC found an outside buyer who agreed to retain all employees including PJ who received an executive contract. The Whittaker family became financially independent. Company employees rolled over their ESOP accounts into a 401K plan that PCC continues to administer. The company still thrives but no longer is privately held. It was sold a second time for a solid profit. Whittaker subsequently has passed away. PJ remains VP of operations.