



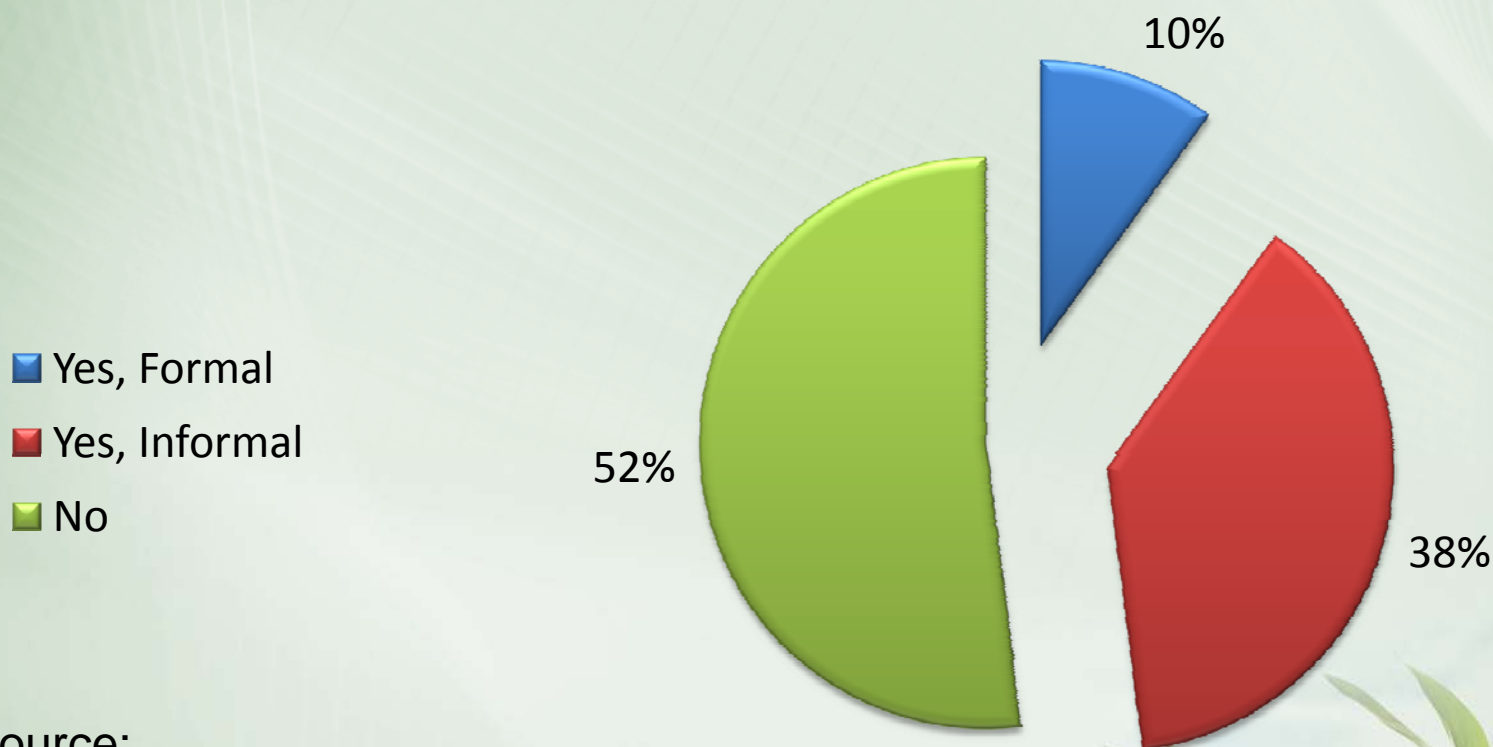
LANDSCAPE ONTARIO CONGRESS:

Succession Beyond the Family

John Chisholm & Trevor Hood | January 11, 2011

Existence of a Succession Plan

(% respondents)

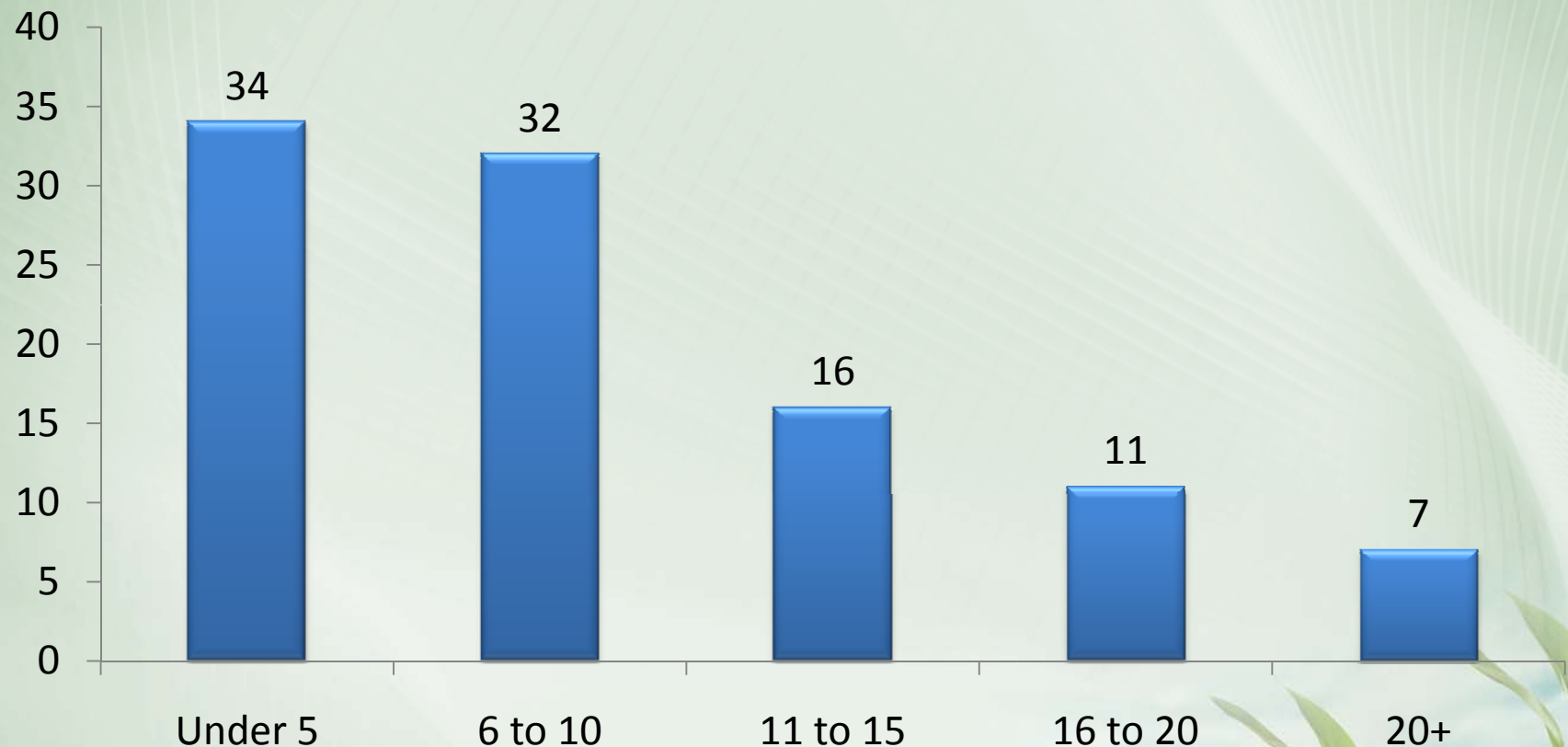


Source:

Canadian Federation of Independent Business Survey, 2006

When SME Owners Plan to Exit Business

(% response, years)

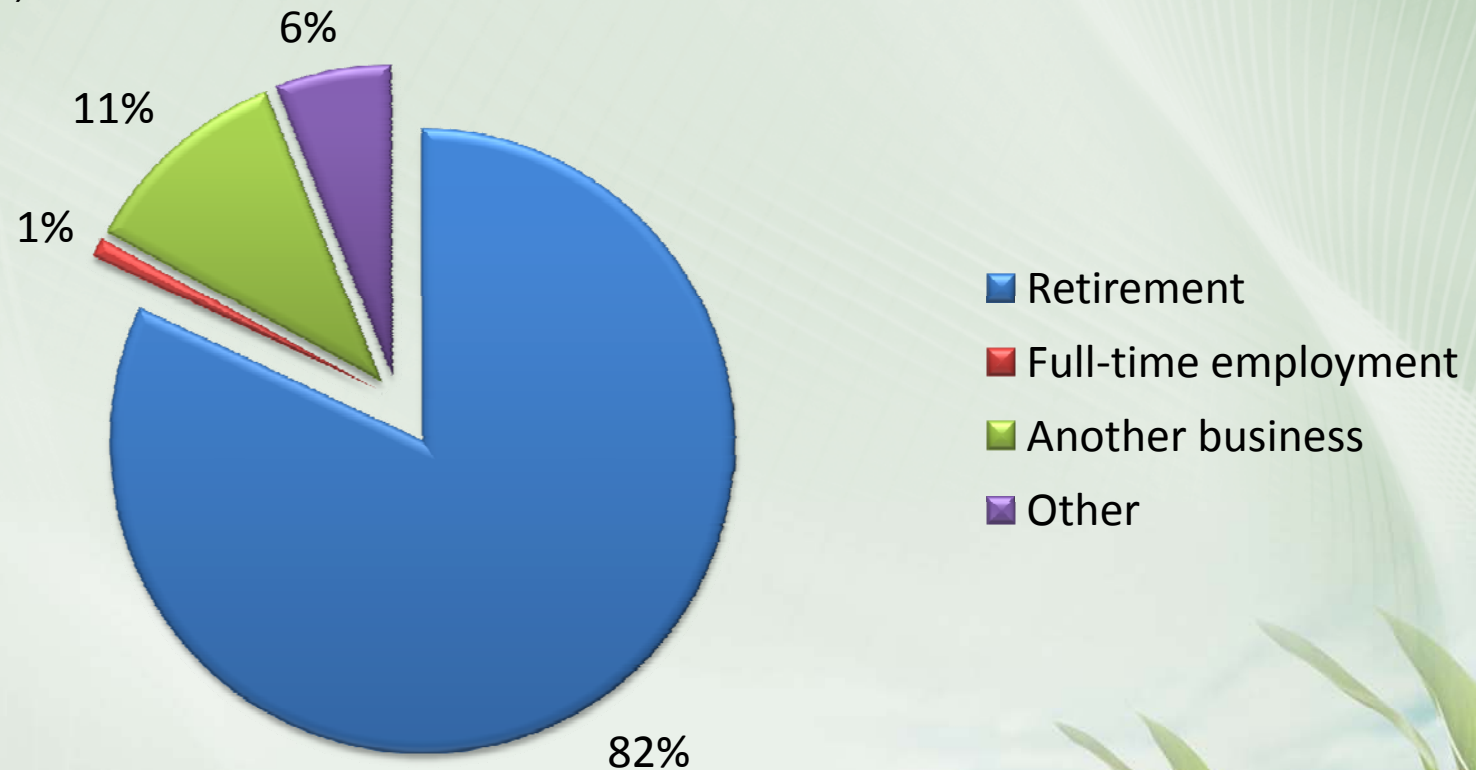


Source:

Canadian Federation of Independent Business Survey, 2006

Reasons for Anticipated Exit from Business

(% response)



Source:

Canadian Federation of Independent Business Survey, 2004



Highlights

- Only one third of businesses have a succession plan – the majority of these plans are informal.
- 66 per cent of SMEs want to exit their business within the next 5 – 10 years.
- SMEs with succession plans are not adequately addressing “soft” issues and are providing little time for the training of successors.

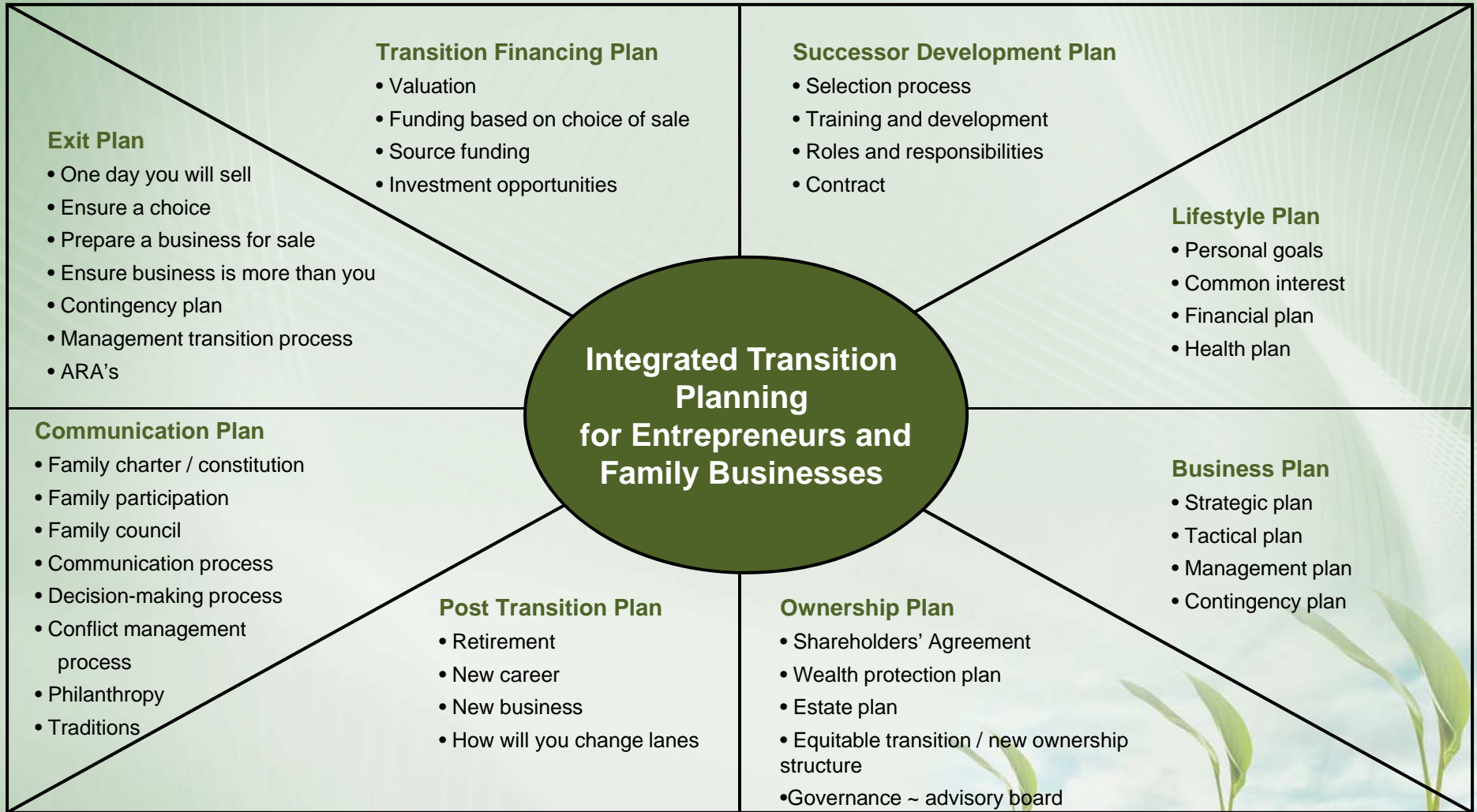


Highlights (continued)

- Recent successors cite significant benefits from the succession plan of previous owners.
- SME owners also cite significant benefits to succession planning – well in advance of their succession.



An Integrated Transition Plan



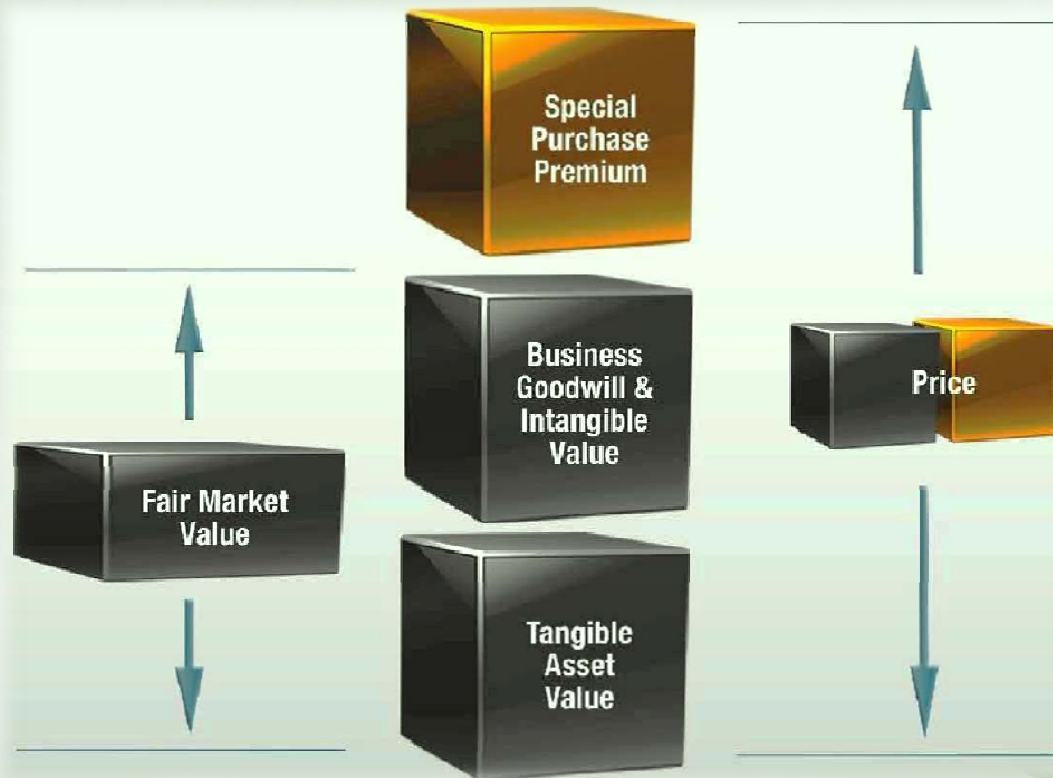
Business Valuation

- Business valuation – process of determining value of a business, business ownership interest, security or intangible asset along with the quantification of the worth of the business.
- The value of a business can vary significantly depending on who you are talking to – especially from the perspective of an entrepreneur



Business Valuation

- Fair market value is defined as “the highest price obtainable in an open and unrestricted market between informed and prudent parties acting at arm’s length and under no compulsion to act expressed in terms of money or money’s net worth”



- The actual price transacted in the market place



Valuation Approaches

- Asset based approaches
- Rules of thumb
- Earnings/Cash-Flow methodologies



Asset-Based Approach

- Approach is based on the underlying value of a business' assets and liabilities.
- Consideration is given to a going concern approach vs. liquidation approach.
- Application of this approach includes:
 - Underperforming businesses
 - Specific industries
 - Personal goodwill situations



Rule of Thumb Approach

- Approach is based on industry specific guidelines.
- Normally based on a multiple of revenues or other easily determined basis.
- Benefit is their simplistic nature but the simplicity can be dangerous.



Earnings/Cash Flow Based Approach

- Approach based on a multiple of selected earnings factor:
 - After-Tax Cash Flows
 - EBITDA
 - After-Tax Earnings
 - EBIT
- The two key drivers in this approach – earnings and the earnings multiple



Earnings/Cash Flow Based Approach

(Continued)

With the earnings factor,

- Important to “normalize” the historical earnings:
 - Eliminate discretionary revenues and expenses
 - Remove non-recurring or non-operational items
- Focus needs to be on the future earnings capabilities (i.e. what are the earning trends)



Earnings/Cash Flow Based Approach

(Continued)

With the earnings multiple,

- Linked to comparable rates of return in the marketplace
- Function of the inherent risks in the level of maintainable earnings:
 - Industry-related risk factors
 - Company-specific risk factors



Earnings/Cash Flow Approaches – Other Considerations

- Implied Goodwill/Intangible Asset Value
- Redundant Assets



What are Business Value Drivers?

- Critical factors important to business valuation and business pricing in the marketplace
- Can be broken down into two categories:
 - Controllable types
 - Uncontrollable types
- Recognize that both “positive” and “negative” business value drivers may reside in your business



Controllable

- Products
- Management & human resources
- Markets / customers / branding
- Gross margin performance
- Purchasing / suppliers
- Production
- Costs / expenses
- Operating systems
- Financial reporting
- R&D/technological innovation
- Balance sheet structure
- Internal controls over financial reporting
- Effective decision making models
- Intellectual Property Protection
- Competitive superiority
- Protection of assets
- Financing structure
- Tax-efficient structure
- Removal of redundant assets
- Policies & procedures documentation



The Sales Process

- Targeting potential buyers
- Information requirements
- Disclosure



The Sales Process

- Negotiation process
- Legal considerations
- Due diligence



Tax Considerations

- Corporations
 - Capital Gains Exemption (CGE)
 - \$750,000 per individual
 - Corporate tests
 - 50% active business assets
 - 90% active business assets



Tax Considerations

- Corporations (continued)
 - Individual tests
 - 24 months
 - Cumulative Net Investment Income
 - Allowable Business Investment losses
 - Family Trust



Tax Considerations

- Planning to keep company eligible:
 - Transfer redundant assets to holding company (Holdco)
 - Pay dividends and/or salary



Tax Considerations

- Incorporate Holdco:
 - Transfer operating company shares to Holdco on a tax-deferred basis
 - Declare dividends to Holdco and transfer redundant assets
 - Assets, other than cash, may result in tax issues if fair market value is greater than assets cost



Tax Considerations

- Incorporate Holdco (continued):
 - Tax problems if dividends paid immediately prior to sale
 - Creditor proofing



Tax Considerations

- Multiply number of shareholders:
 - Create potential for multiple \$750,000 capital gains exemptions
 - Consider when Holdco established or when \$750,000 value is reached
 - Family Trust could be established
 - Determine which entity shares are to be purchased



Putting it all Together

- The process has lots of challenges and can be very time consuming
- Your business is a significant asset and you want to ensure the transition is done properly
- Important to utilize your professional advisors and get the expertise required



Questions?

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