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ESTATE PLANNING

Selling Your Business

Maximize the Sale

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I often joke that it took me only 27 years to become an overnight success, a sentiment surely shared by many business-owner TaxLetter® readers.

I've been helping fellow business owners for so many years. The experience has taught me that it's no coincidence that we all have a lot in common. Most started out with the kernel of an idea, added long hours of planning and hard work, and suffered triumphs and defeats along the way to building a profitable business. Today, they are successful, enjoying the fruits of their labours, often with more than they need to sustain their families and their lifestyles. Every successful business-owner client dislikes paying high taxes, and most prefer to give generously to family and charity instead of the tax department. Read on.

If you are a business owner approaching retirement, your biggest challenge may lie ahead -- selling the business. Many business owners believe (and hope) that one of their children will enter the business and grow it exponentially. But according to The Family Firm Institute, only about 30 per cent of family businesses survive with the second generation of owners;12 per cent are still viable when the third generation owns the business, and only about 3 per cent of all family businesses are still operating by the time the fourth generation has taken over. Do you remember shopping at Steinberg's or Eaton's?

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After the Sale

If your family members aren't interested in or capable of taking the reins, only one option remains: sell the business. And therein lies the problem for most business owners. They were so busy taking care of business for years, carrying everything on their own backs, catering to their customers, their suppliers, their staff and the bank, to the point where they didn't couldn't dedicate time to preparing the business for the ultimate sale or properly plan for their own future. They might have not even been aware that there is a right way and a wrong way to sell a business.

Sure, you were diligently building your business and investment portfolio. But, were you also developing a protection portfolio, with key components such as Life Insurance, Disability, Critical Illness and Long-Term Care coverage? Were you thinking about what might happen to your business if you couldn't come to work tomorrow? Or, who would look after your clients, your staff and your suppliers?

Business owners 60 years of age and older should consider a corporate insured annuity. This is an ideal solution for a major shareholder of a private corporation with surplus capital that isn't needed to operate the business. Through the use of both a corporate-owned life insurance policy and a corporate-owned life annuity, an insured annuity can guarantee higher after-tax investment returns and a larger tax-free payout to your estate on death.

Don't do it alone

Since you've probably spent a considerable portion of your life building your business, the eventual sale will be a true "life-altering transaction." To do it right and achieve the best financial outcome, you'll need to do lots of preparation in areas that are generally unfamiliar to you and most business owners. Just as you need an insurance professional to guide you through the maze of protection products, you also need a specialist with the expertise required to help you maximize the selling price of your business.

That is the role of Stephen Arvanitidis, CFA, Managing Director at Manulife Capital Markets. His work as a mergers & acquisitions advisor takes more than just concern off your shoulders.

"We always recommend business owners hire an advisor to guide them through the sale process," says Stephen. "When business owners do it alone (BODA) they usually end up doing things that ultimately lead to a lower value for their business than if they had hired an advisor."

Most business owners simply don't have the knowledge or time required to prepare the right information about their business, and then conduct a formal sale process with multiple bidders. Stephen says that a proper sale process requires a minimum of 800 to 1,000 hours of dedicated time to complete successfully. You have to ask yourself if you really can do that and still have time to run the business?

Those who take the BODA approach tend to focus on one bidder at a time. If, as and when that bid falls through, they move along to the next hopeful bidder. An advisor, on the other hand, negotiates with multiple bidders concurrently. He/she may also have prospective buyers in other parts of the world and engage potential buyers the seller-owner never knew existed. They may be in the same or related field or thinking about expanding to it. Stephen and his team qualify prospective buyers to determine at the outset if they have the financial capacity to close the transaction.

Don't sell yourself short

Business owners who try to sell their companies by themselves tend to have inadequate information prepared up-front when they talk to a potential buyer. "But the reality is that a buyer's information requests are exhaustive," says Stephen. Advisors can anticipate the information that the buyer may want and package it professionally in advance. Such information includes a Confidential Information Memorandum, and historical, audited financial statements from a reputable accounting firm. An advisor also understands how buyers value businesses, key metrics that buyers look at including EBITDA (Earnings before interest, taxes, depreciation and amortization), and how company values are calculated using a multiple of the underlying EBITDA.

They are fluent in "business speak," able to discuss free cash flow, working capital, quick ratios, etc.

Most professionals like Stephen also conduct due diligence on the bidders and create "competitive pricing tension," often resulting in a higher selling price than the one originally envisioned by the seller. In his experience, prospective buyers usually pay more if they deal with the owner and an advisor rather than with the owner alone.

Stephen says sales values are also maximized if buyers are provided with a realistic three-year-to-five-year financial forecast model, a step many in the BODA camp omit.

An advisor makes a big difference

In addition to preparing and packaging your business for consideration by bidders, Stephen and his team also manage the entire sale process. "This includes effectively positioning and pitching your company to a global network of potential buyers and managing the bidding and negotiating processes."

He recalls the example of a company called Titan, which received four letters of intent (LOI) in the first round of bidding, with the highest bid coming in at US$30 million. It came from a buyer that the owners never knew existed. Manulife Capital Markets generated a competitive bidding process and had a second round of LOI submissions. By the end of the second round of LOIs, Titan's selling price had risen by US$7.5 million, to US$37.5 million.

After signing an LOI, it's not uncommon to see many deals die during the due diligence stage that follows. However, a professional advisor assists in the negotiations, and helps maintain buyers' interest, as well as the value of the business. The Titan sale successfully closed at the end of this stage for US$37.5 million.

The single most valuable asset for many business owners isn't their home, RRSPs or investment portfolio - it's their business. Having an experienced professional on your team to help sell your company is a distinct advantage.

If your biggest asset is indeed your business, you should know that your silent partner (the government) is patiently waiting to take a nice chunk of your assets when you die. If you are in the highest tax bracket (54 per cent in Ontario, for example) and haven't done the right planning, more than half of your assets will go to the government when your spouse dies. Holding companies get taxed at up to 45 per cent, and if you have an operating business, 26 per cent of capital gains will go to Ottawa.

If you started your business with $1 and it's now worth $10 million, the Canada Revenue Agency will expect their share (your payment) of $2.6 million. Wouldn't you prefer to see that money go to your family or favourite charity instead?

And how would you come up with that pile of money for the tax bill? If you don't have the money in the bank, you may have to borrow the funds. Keep in mind that interest payments are not tax-deductible. The only way that some people can come up with the required tax dollars is by selling the business or other assets.

The government does have a capital gains exemption for business owners. Some owners have Canadian controlled private corporations, but to qualify for the capital gains exemption, owners must meet certain tests. For the disposition of qualified small business corporation shares, the exemption is a lifetime maximum of $835,716 of capital gains.

The easiest and most cost-effective way to fund your tax liability is through inexpensive life insurance, which literally costs pennies on the dollar. It enjoys unique treatment under Canada's Income Tax Act and is one of the few remaining investments left - other than your home - that is entirely tax free. It also bypasses probate and your will. For many people, life insurance's best quality is the financial security it provides for your family.

Business owners are usually forward-thinking when it comes to their own area of expertise. But they sometimes don't recognize the importance of and need for outside experts. Just as you seek professional help from your lawyer, accountant, and insurance advisor, you should engage the same level of experience and expertise when it comes to selling your biggest financial asset – your business. ❑

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He guides successful business owners, who are already challenged for time, through the complex process of ensuring the people and organizations they care about are taken care of.
If you are like his other successful business owner clients, you are looking to reduce your tax obligations, preserve your wealth and leave a legacy. Incompletions rob us of energy. Mark collaborates with your professional advisory team to achieve your desired outcomes.
His approach is simple. He makes sure what is important to you gets done. He gets you organized, provides a big picture view of your financial affairs, determines your strategy and helps you to take action. He will simplify the complicated so you and your family can rest easy. He can be reached at 416-364-2929, toll-free at 1-866-566-2001 or
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