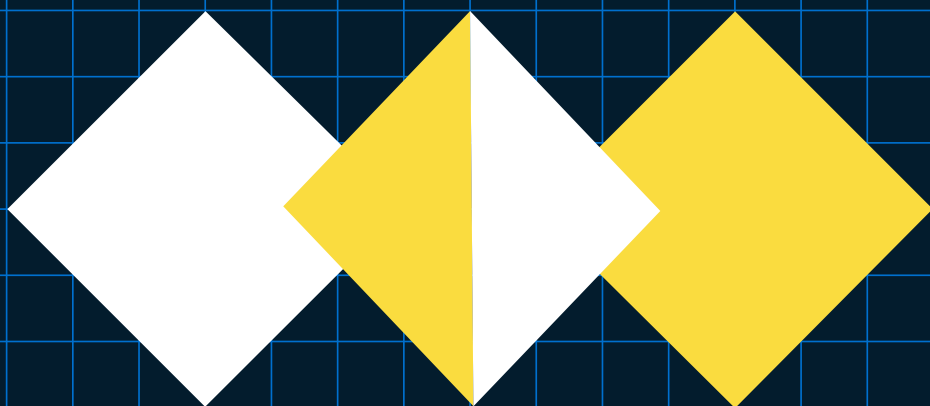


ATB

# ATB BUSINESS TRANSITION GUIDE





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# PLANNING FOR YOUR FUTURE

As the Baby Boomer generation continues to enter retirement, we are about to see a major shift in business ownership in Canada. According to the Canadian Federation of Independent Business, 76% of business owners intend to exit their business in the next decade with \$2 trillion worth of assets being transferred to new owners. This influx of businesses to the market could create a highly competitive buyer's market, as more sellers enter the market compared to buyers with a capacity to purchase. Maximizing the value of your business in this competitive market requires proper planning.



Without a proper succession plan, the future of both your business and family could be at risk. By planning well in advance, you have the opportunity to fully evaluate your options and be prepared in the event of an unanticipated exit. Even if you have no definitive timeline to exit your business, having a thoughtful and current business transition plan is essential should you unexpectedly experience one of the “5 D’s” (Death, Disability, Dispute, Departure and Divorce).

A transition plan is a bit like a parachute: when you reach for it, you really need it to be there. Transition plans can take up to five years to fully plan and implement. That’s why it’s never too early to start building a transition plan for your business—even if you’re years away from retirement.

This guide is designed to help prepare your business transition plan.

# WHAT IS TRANSITION PLANNING?

Transition planning is a critical part of the future success for any business. In simple terms, transition planning is structuring the transfer of a privately-owned business to a new owner and / or management team. It is a roadmap for how you will transition yourself out of the business and transfer the business ownership.



## What are the benefits of a good transition plan?

Planning early and having a good transition plan in place will help to:

- Ensure the company remains strong through a period of change
- Minimize confusion, stress and anxiety
- Maximize value from the transaction
- Allow time to properly plan to minimize tax costs
- Allow you to accomplish your personal financial goals

## Is transition planning the same as estate planning?

Transition planning is sometimes confused with estate planning, but the two are not the same. An estate plan includes a Will, Enduring Power of Attorney and Personal Directive, and focuses on what will happen to your personal assets when you are no longer able to make decisions about them. Transition planning is much broader in scope and relates to planning for your business. Of course, sometimes personal and work-related assets can overlap, so transition planning can involve some aspects of estate planning. An estate plan should be part of your transition planning process, but it does not replace a transition plan.





# 7 STEP PROCESS TO TRANSITION PLANNING

ATB has developed a 7 step process to guide you through the development of a transition plan.





## **STEP 1: SETTING AND MANAGING TRANSITION OBJECTIVES**

If you don't know where you're going, no roads appear favourable. Likewise, your transition plan can only be successful if you know what success looks like. Success is different for everyone. Transition objectives can include everything from dates (retiring by a certain age) to the sale price of your business to what executing your plan will achieve. As a general rule, "SMART" goals (specific, measurable, attainable, realistic and time oriented) are preferable. If you're struggling to pin down your goals, the following questions might help you think things through:

### **Why do you want to sell?**

Are you looking to retire, do you feel overworked, has there been a recent change in your personal life, or are you bored and ready for something new? Your reason for selling will help to keep you focused on the sale from start to finish and alleviate some of the anxiety you may feel as the sale process unfolds.

### **Do you know what you will do post-sale?**

Remain involved in the business, find a new venture, or travel the world? Being prepared can provide you with a new sense of purpose and motivation.

### **Am I financially ready to sell?**

Many retiring owners rely on the business sale proceeds as their primary source of income. A good understanding of the value to be derived from the business is crucial in your personal financial planning.

## What does a successful business transition mean to me?

At ATB, we understand the definition of wealth and success is beyond numbers and is deeply personal. When preparing your succession plan, it is important that you clearly define what success means to you. Is it the money and financial security? Is it attracting a buyer that will continue operating the business in a way that aligns with your values? Is it ensuring the employees have job security during the transition? Is it retiring with a purpose? Is it creating capacity to meet philanthropic goals?

## Will you be able to let go?

Often a seller will stay on as an employee/manager/consultant/ advisor to help transition ownership. Maintaining a small ownership in the business can also be considered in some situations. Easing out of a business may be the best approach for some business owners.



## STEP 2: SELECT YOUR PREFERRED EXIT STRATEGY

The next step in creating a strong transition plan is choosing an exit strategy for your business. The three most common exit strategies include succession to a family member(s), transitioning your business ownership to management or employees and selling your business externally. Other potential strategies include liquidation or initial public offering. There are pros and cons to each scenario, and as every business is unique, so is the solution.

As you think about choosing an exit strategy, keep in mind that the value of your business cannot be measured in dollars alone. The business you've built and run is more than a source of income; it's also a part of your identity. Setting aside some time to think through the personal side of selling can help you feel less stressed and more fulfilled throughout the transition planning process.



## STRATEGY ONE

### Keeping it in the family

While the owners of many family businesses would like to see their company passed on to the next generation, success is not always guaranteed. Far from it. About 70% of these transfers do not survive into the second generation, and even fewer make it to the third generation.

Before going down this route, business owners need to first evaluate if there are any capable and interested family members who are ready to take on the mantle of ownership.

Many business owners try to push the business onto one or more of their children. It's important to engage family members in discussions to determine if they have the skill and the willingness to carry on the business, as your retirement income may depend on their success.

For the transition to succeed, it's a good idea to establish goals and objectives. Establishing an independent board or retaining professional advisors can also help the business move into the next generation.

#### PROS

- Extending your legacy
- A greater sense of loyalty
- Smoother transition

#### CONS

- Finding a capable/willing family member
- Potential for family disputes
- Over 2/3 of transitions to family fail

## STRATEGY TWO

### Selling your business to management and employees

Selling, in whole or in part, to management and staff allows for a smoother transition with minimal disruptions. Also of note, the risk of exposing confidential company information and business advantages to outside buyers is eliminated. Owners will first need to identify which members of their staff are best suited to take the company forward, and whether they have the willingness and financing to undertake such a purchase.

The structure of the buyout is also critical in the future of the business. Business owners should consider if the purchasers would use outside funding to complete the sale, or if they are seeking a leveraged buyout where the sale is funded by using company assets as collateral and which shows up as debt on the business balance sheet. Or it could be a hybrid of both external and internal funding. It is important that a shareholder agreement is established to protect all parties in the sale and provide a resolution mechanism or shotgun clause in case of dispute or the death of one of the parties. Historically, management buyouts and employee share ownership plans are usually done at lower valuations compared to selling businesses to third parties. On the plus side, the timeframe for the sale is usually shorter than going to a third party, and the potential risk of a deal falling through is much lower.

#### PROS

- Existing team in place
- Little disruption to operations
- Confidential information stays confidential

#### CONS

- Lower valuations compared to external sales
- Potential need for external equity
- Possible need for a vendor take-back



## STRATEGY THREE

### Selling your business to an outside interest

After reviewing their options, some business owners may find that selling their company to a third party may be the best option. This could be to a corporate buyer, perhaps a competitor or to a private equity firm. This allows the business owner to exit the company, usually within three to five years, and can yield a high rate of initial return.

Consulting professional advisors can help business owners identify potential candidates within their industry or related fields, provide guidance in regards to keeping sensitive business information confidential, outline any tax implications and help verify that the buyers have the resources needed to make the purchase.

#### PROS

- Ability to sell whole business or part of it
- Options to structure sale for greater tax benefits
- Ability to leverage your company's expertise

#### CONS

- Lower valuations compared to external sales
- Potential need for external equity
- Possible need for a vendor take-back

## OTHER STRATEGIES TO EXPLORE

A couple of other succession strategies to consider include liquidation of the business and going public via an initial public offering (IPO). Liquidation involves selling off the business' assets and closing the doors. This commonly occurs when all other options have been exhausted or when health issues or deceased owners dictate this course of action. Liquidation does not usually provide the best return, as there are many costs involved with this route. Offering your business for sale through an IPO is an option that is primarily limited to larger companies. It can help secure the legacy of the business, as well as provide ready capital for the seller. Sellers should take note though that there are a lot of legal hoops and costs to consider before proceeding with this option.

## STEP 3: KNOW THE VALUE OF YOUR BUSINESS

Every business owner should know how much their company is worth as unsolicited offers happen more often than you'd think. When the time comes to craft a transition plan, it is essential to know what your business may be worth. For many business owners, their business is their most important retirement and estate planning asset. Knowing what it is worth is the first step towards receiving the best possible return on the sale.

The major choice you need to make with respect to valuation is whether your business needs a formal valuation or a pricing analysis. Both methods involve bringing in expert third parties to review key aspects of your business and provide an impartial assessment of its value. A formal valuation is more technical and complicated. Your advisor team can help you figure out whether a formal valuation makes sense for you.







For most business owners, a pricing analysis is the preferred approach. A pricing analysis is more simple than a formal valuation, but can still provide practical information regarding a realistic target price for the sale of your business.

The chief insight of a pricing analysis or valuation is determining the “multiple” of your business—a valuation metric used to calculate the sale price of your business. Different industries use different multiples (like multiples of cash flow, revenue, or profit), but the most common is earnings before interest, taxes, depreciation and amortization (EBITDA).

Some business owners might argue that because they know the multiple for their industry, they have a good rough estimate of the value of their own business. This only provides a vague approximation of the value of a specific business. When it comes time to sell your business, knowing its value as precisely as possible is a big advantage. The best tool in determining the value is with a pricing analysis or formal valuation from an experienced, independent third party.

## **STEP 4: ENHANCE YOUR BUSINESS VALUE**

In keeping with the timeless principle of “buy low, sell high,” most business owners seek the highest possible price when selling their businesses. Here are ten suggestions for growing the value of your business in preparation for the execution of your succession plan.

### **Prepare early**

Early preparation will ensure a sale that delivers optimal value for the business you have invested years or decades building.

Properly positioning a company can sometimes take years of advance preparation. As well, the sales transaction process may take several months to complete. The Pepperdine Private Capital Market Project found that 82% of business transactions require five to 12 months to close while 14% take more than one year. It’s also important to keep in mind that many buyers expect post-closing transition commitment from owners that can range from one to five years.

So, if your plan is to retire within the next five years, you should be preparing now.

### **Create an action plan**

In Step 3, we determined the estimated value of the business, and this may have highlighted a gap from your target selling price. Similar to preparing a house for sale, a business needs an action plan to achieve the target sales price. Professional advice can be particularly helpful in preparing this plan.

Experienced transaction professionals can objectively evaluate the strengths and weaknesses of your operation and the specific steps required for your business to achieve the best possible price and terms. This assessment yields insights into the quality of your operation, EBITDA margins, debt, cash flow, profitability, growth

expectations and risk. By having this assessment completed by an independent third party, you'll gain a better understanding of how these factors impact the overall value of the enterprise from the perspective of potential buyers. Documenting the findings and recommendations and establishing timelines transforms this information into a practical action plan. Your management team can regularly review this to monitor progress and continue building value.

## **Trim fat from the balance sheet**

Privately held businesses often hold personal assets that contribute little to operations. Items such as an owner vehicle, vacation home, boat, snowmobile, art and so forth clutter balance sheets and look messy to potential buyers.

Review the balance sheet for opportunities to eliminate items like these, along with equipment or other fixed assets that are no longer in use and won't add value to a sales transaction. Also, review off-balance sheet liabilities and contingencies for opportunities to enhance value. Items like purchase commitments, incentive plans and pending litigation and environmental liabilities should be addressed to minimize negative impact.

## **Separate the personal from the business on the income statement**

Most owners deduct some personal expenses through the business such as vacations, family member compensation, golf memberships, life insurance, personal vehicle expenses and mobile phones. Since these expenses are unnecessary for operating the company, purchasers will make "normalizing adjustments" to the seller's income statements when valuing a potential acquisition. This removes personal expenses, making it easier to determine the company's actual operating performance and financial position.

You can help clarify the returns from normal operations for prospective buyers. By removing personal expenses where possible or by clearly documenting items so they are readily identified when assessing business value, you can effectively normalize the income statement to increase value.

## Optimize the capital expenditure investment

Owners spend money on capital expenditures (capex) to either grow or maintain their business. When assessing a potential acquisition, buyers calculate free cash flows by determining the amount and purposes of the capex, as well as whether it is internally financed or relies on debt.

Buyers want to know if they have to use their own capital to fund growth; how much internal cash is spent on capex, since this detracts from funds available for debt payment; or whether the company is spending so little on capex that they would have to invest significantly in the business to achieve their goals. What they find could substantially influence the purchase price they offer.

Entrepreneurs with capital expenditures should track the amounts used to grow and maintain the operation and the amounts that are financed with company cash and bank debt. Transaction professionals can provide recommendations for the optimal capex balance to appeal to potential buyers.

## Clean up debt

To a potential purchaser, most of the value of a business lies in its ability to generate positive cash flow. Buyers consider company debt loads when determining the purchase price. If your business has a high debt capacity, this enables a buyer to borrow more cash against the company, which means they are likely to pay a higher price for it.

Prospective buyers will assess whether an owner is using debt astutely to support growth and expansion or whether the company is so highly leveraged that cash flow or profitability are negatively impacted. For future sellers, reviewing the capital structure and debt capacity of the operation and, if necessary, reducing detrimental debt, can generate excellent future returns.

## **Strengthen financial controls**

Comprehensive financial controls not only safeguard company assets, they also demonstrate effective business management to prospective purchasers. Buyers like to see an experienced controller or chief financial officer in place as assurance that financial controls are reliable, financial statements are accurate, reporting is timely and someone is tracking key performance indicators.

They also like to see audited financial statements for at least three to five years prior to a sale. Having a qualified individual overseeing financial statements and controls during this period of time provides reassurance to potential purchasers on multiple levels.

## **Establish a sustainable management team**

Buyers want assurance that a business can thrive in the absence of the owner. If your company is heavily dependent on the owner's skills and relationships with customers and suppliers, it will be less attractive to buyers.

Most purchasers want to see a team in place that can lead the business after the transfer of ownership. If your business has a second-in-command or talented managers, it's important to mentor them to lead the business. Without a reliable team in place, a financial buyer will likely ask for the owner's full commitment for three or more years post-sale in order to allow sufficient time to develop such a team. Buyers also like to be assured that key

employees will stay on; therefore, having employment agreements with key personnel increases corporate value.

As mentioned previously, not all business transitions occur on the timeline of the seller. Regrettably, the catalyst for a sale may be a consequence of a death or disability of the business owner. By having a strong management team, the enterprise is more likely to survive, and potentially thrive, during a transition period that results from an unforeseen event.

## **Update customer and supplier agreements**

Customer and supplier contracts translate to sustainable cash flow and revenue streams to purchasers. Buyers like recurring revenue models that limit the risk of customer terminations impairing the business.

Having up-to-date contractual agreements provides reassurance that customers and suppliers will continue working with your company after the transfer of ownership. Buyers also like to see diversified customer and supplier bases. If any single customer accounts for more than 10% of revenue, you should consider diversification options.

## **Communicate a clear vision and culture**

Buyers are focused on the future, or, the potential of an acquisition. A seller can therefore attract buyer interest by painting a compelling vision of its opportunities for growth. A powerful vision also helps to communicate the company culture.

Prospective purchasers want to know that the culture of an organization is strong and cohesive, employee morale is high and turnover is not a problem. Clearly articulating the vision and goals for your business and employees helps buyers visualize what is possible.



## STEP 5: PLAN TO MINIMIZE TAX IMPLICATIONS

Taxes can have a significant impact on the net proceeds realized when you sell your business. To maximize the after-tax results, it is important to develop a detailed tax strategy. An experienced tax advisor can be a great help in this regard. Here are some important considerations for the tax aspects of your succession strategy.

### Structuring the sale

Broadly, sales of incorporated businesses can be structured as share sales or asset sales. Share sales are generally considered more advantageous for exiting owners, in part, because this may allow the owner to use the capital gains exemption. Potential buyers will generally prefer an asset sale, as this may limit their exposure to existing liabilities of the business and potentially provide larger tax deductions in future years.

### Capital gains exemption

When you dispose of qualified small business corporation (QSBC) shares, you may qualify for the lifetime capital gains exemption. This can result in savings in excess of \$300,000 at a 24% capital gains rate for each individual Alberta shareholder. A two-year time period is considered when determining if a corporation is a QSBC, so it's important to engage a tax advisor well in advance of a sale.

## Capital gains reserve

This is a relevant consideration if you agree to receive the proceeds of the sale over several years. You have the option of deferring a portion of the capital gain realized on the sale by claiming this reserve. Generally, you must claim at least 20% of the capital gain in the year of the sale and each of the four following years.

## Transferring the business to the next generation

If this is your exit strategy, you may wish to consider an estate freeze, whereby the existing shareholder “freezes” the value of their ownership and any future growth accrues to the new shareholder. This can be helpful if the next generation doesn’t have the ability to purchase the business outright.

## STEP 6: PLAN TO ACCOMPLISH PERSONAL FINANCIAL GOALS

As discussed in Step 1, it is important to spend some time considering what life will look like after you transition away from your business. This process can also help to psychologically prepare you to transition from being a business owner into retirement. It is important to understand your on-going personal financial requirements into retirement and have a plan in place. For many business owners, the requirement to reinvest income back into their business means the proceeds of the sale of their business

represent a major component of retirement income. The Exit Planning Institute found that 75% of business owners regret selling their business after one year. This is often the result of spending too little time in postsale planning. It is never too early to develop a financial plan for retirement and work with professionals to get personalized advice.



## STEP 7: BUILD A TEAM OF TRUSTED ADVISORS

Succession planning is high stakes and requires diverse, deep knowledge. Anyone looking to create a robust succession plan will need advice from experts. At a minimum, crafting a detailed succession plan should involve a lawyer, a banker, a tax advisor, and a financial advisor. Depending on your circumstances, you may also find a dedicated M&A expert, business valuator and insurance advisor helpful.

Your ATB advisor can support you through the succession planning process and make recommendations on advisors to add to your team. The right advisors will make the process easier for you, and possibly result in a higher sale price for your business. You'll probably only do this once, and you'll be spending a lot of time with your advisors. It's worth taking the time to find advisors you trust and feel comfortable with since this enables a strong and effective working relationship.



# A SUCCESSFUL TRANSITION

Just three letters separate “success” and “succession.”  
The two concepts have much in common.

They are both hard.

They both don’t happen overnight. They take deliberate,  
considered planning and action.

Yet both success and succession are, in the long run,  
worth the effort. And both are made much easier with  
some long-term planning and insights from trusted  
advisors.

Fully implementing a succession plan can take up to five  
years. No matter how far you are from handing off your  
business, creating one will also strengthen your company,  
lower long-term stress, help you find the best offer for  
your business, and clarify the goals and purpose of your  
business.

Don’t leave your succession to chance.  
Start now and work with the best.

# HELPFUL RESOURCES

## Books on succession planning:

Built to Sell by John Warrillow

Walking to Destiny by Christopher M. Snider

The Master Plan - Exit Strategy for Successful

Business Owners by Peter G. Christman

## Additional ATB resources:

Farm Succession Guide

Tax considerations when selling your business

