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Value Series: Part Seven

Sell the business, sail into retirement

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While many business owners focus on sustaining or growing their company, each eventually needs an exit strategy. Last week, we shed light on a new strategy that leaves a business in the hands of its employees, through an employee stock ownership plan.

This week, we examine a more conventional but no less complex exit strategy: Selling.

As baby boomers age, it's no secret that many business owners in the demographic will soon be retiring.

According to Statistics Canada, as of July, more than 14 per cent of the population was over 65. By 2026, the agency estimates seniors will comprise one-fifth of the population.

Selling will be the most popular exit strategy for boomers looking to retire, according to the business monitor survey published in the year's first quarter by the Canadian Institute of Chartered Accountants and the Royal Bank of Canada.

But that hasn't meant mergers and acquisitions activity is up. In fact, according to experts, it's actually down thanks to the recent financial crisis.

Why?

"The primary reason is valuation," said Allan Bronstein, a corporate lawyer at Toronto-based firm Torkin Manes, which specializes in M&A.

"Part of the reason for the slowdown in that activity is sellers still have their dreams of what they could have gotten three years ago, and buyers are not willing to pay those prices."

But Farley Cohen, the chair of the board of the Canadian Institute of Chartered Business Valuators and a principal with Cohen, Hamilton, Steger & Co., says valuations are now going back up.

Thanks to a low interest environment and more institutions lending money, Mr. Cohen predicts M&A activity will increase. “There's going to be more transactions, and the better companies will get the better prices,” he said.

There has been a slight increase in private equity buyouts over the last year, which could be indicators of Mr. Cohen's predictions.

According to the most recent numbers from Canada's Venture Capital and Private Equity Association, there were 88 buyout deals – including those that are pending – between January and September of 2010.

For the same time period in 2009, there were 74 pending and completed deals.

There have also been some high-profile investments from international private equity investors, such as a $238-million (U.S.) deal in Laricina Energy, and West Face Capital's acquisition of a $119-million (U.S.) stake in Maple Leaf Foods.

“These figures indicate that the Canadian buyout market continues to pick up speed largely as a result of increased investments by Canadian funds both here and abroad,” said Gregory Smith, president of the CVCA and the managing partner of Brookfield Financial.

“The healthy fundraising of the past three years is now being actively put to work to take advantage of accelerating business opportunities.”

If economic conditions co-operate, private business owners could see many advantages to selling their company.

For one, there are tax benefits that don't come with other exit strategies. A business owner can take advantage of the capital gains tax, which is a much lower percentage than income or dividend income tax.

According to Matthew Tevlin, a corporate lawyer with Torkin Manes, there is also a capital gains exemption. Every individual who sells shares in a private company can claim up to $750,000 in their lifetime.

“When you sell a company, you can bring a lot of money in on a tax-free basis,” Mr. Tevlin said.

For those eager to retire and cut ties with their company, a sale can take between three and nine months to finalize. But leaving responsibility behind also means losing control.

Many business owners are the original founders of the company, and as with any exit strategy, it can prove difficult to let go. Entrepreneurs who sell and cut ties have no say in how the business is run or how employees are treated after the transfer of ownership has been made.

Managing operations and employees while negotiating a sale can be also be extremely difficult.

“If you have people traipsing through your office, it becomes to clear to [employees] that something is going on,” said Lawrence Wilder, a corporate lawyer with Cassels Brock.

“You might have to manage with limited disclosure by saying things like, 'Something might be up, we don't know yet.'“ But the most challenging aspect of selling a business is the concept that one isn't selling the company as it is. Rather, one is selling its future, so it is crucial to have a solid business plan in place before entering any negotiations to sell.

On Friday, we'll delve deeper into the process of a private company sale and explain what factors every business owner should carefully consider in order to maximize the valuation of their company.
