EXIT, WITH MONEY

ARTHUR KLEIN | How to maximize the proceeds from the sale of your business: a first tip is not to get too emotionally involved

In most scenarios, a share sale is a smoother transition for the buyer as well as the seller

So, you've decided to sell your business and your accountant tells you to sell shares. You chat with your buddy and he says you should sell assets.

Then you meet with a business broker who refers you to market research studies that consistently report the common perils of business sales: many businesses lack timely accounting records, owners have unreasonable price expectations, onerous terms and conditions, or are simply too emotionally tied to the business.

There's a lot to consider, but who is right and who is wrong? What should you focus on in order to maximize your sale proceeds?

As the answer is not a simple one. Here are the core things to consider when strategically planning to maximize sale proceeds.

TAX STRATEGY ■ If eligible, the vendor can take advantage of the capital gains one-time $824,000 (2016 threshold) exemption when selling shares, which has three critical measures per Canada Revenue Agency (CRA) rules:

- The qualifying small-business corporation shares have a minimum holding period of 24 months.
- Throughout the holding period, 50 per cent of the fair value of its assets were used in an active business carried on primarily in Canada.
- At time of disposition, the company must be a Canadian-controlled private corporation with 90 per cent of the fair value of its assets used in an active business.

This means that while business owners can plan to maximize capital gains exemptions in advance by allocation of shares to other family members, they must be prudent of their asset management during the holding period. One common example is where a company will hold non-operational assets in the form of securities, but choose to pay down liabilities, such as accounts payable, loans, mortgages, etc.

POTENTIAL LIABILITIES ■ Through the review of your accounting and material agreements, you will seek not only to quantify each of them, but to define the necessary mechanisms to manage the following:

- With material contracts, and where a change of control of the entity applies, the vendor may have to support transference or negotiation of change of control of the corporation clauses – allowing the purchaser to assume such contracts without the need to renegotiate, re-qualify or reapply for credit.
- Severance pay can also become a liability, should the firing and rehiring of staff by a different entity running the same business be deemed continuous employment. There are mechanisms to deal with this.
- If other than obligations to CRA, all potential liabilities can be managed through legal instruments. Vendors will need to be aware that as at closing, the shares and all assets shall be free and clear of all liens, claims, charges and encumbrances.

In most scenarios, a share sale is a smoother transition for the buyer as well as the seller. But what about the receivables and payables, you ask? Well, more often than not, they can be better handled through a share sale than an asset sale.

BUSINESS VALUATION ■ A key process you will want to undertake is that of a business valuation. Typically, this involves a systematic process by which a reasonable and critical assessment of an

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opinion of value will be derived, as justified by various methodologies, including the consideration of:

- normalized earnings of the business,
- what the company owns,
- present value of future earnings, and
- what the discretionary cash flow can support.

Other important factors considered by the assessor should also include the ability of the business to:

- support the required level of management,
- service debt and level thereof,
- provide a reasonable return on invested capital, and
- rationally predict growth potential.

Ideally, business valuations will be prepared by an independent and qualified assessor and not the company's accountant, and at least one to two years ahead of the planned sale to allow the business to effect necessary changes to enhance value and be organized to secure optimal terms of sale.

BUSINESS VALUE DRIVERS ■ Both the expected price and terms of the owner can be detrimental to a business sale. In conjunction with a valuation, the company needs to compare itself with expected business norms, or primary value drivers, such as historical profits, income risk, location and terms of the sale.

Owners should strive to enhance operating margins, reduce client concentration, and balance financeable earnings and assets while maintaining growth. At a personal level, owners should work to divest themselves from the business through delegation of duties or restructuring by putting effective management in place. This will also help with the emotional and psychological struggle that business owners often face when it comes time to sell.

A business sale is a complex issue, and one that needs to be assessed on an individual basis as each situation is unique. While in some cases such detailed assessments may not make much difference, under specific scenarios the lack of them could be a deal-breaker.

Before you follow the word on the street about what you should do, speak to a qualified, knowledgeable, professional merger and acquisition adviser or business broker.

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