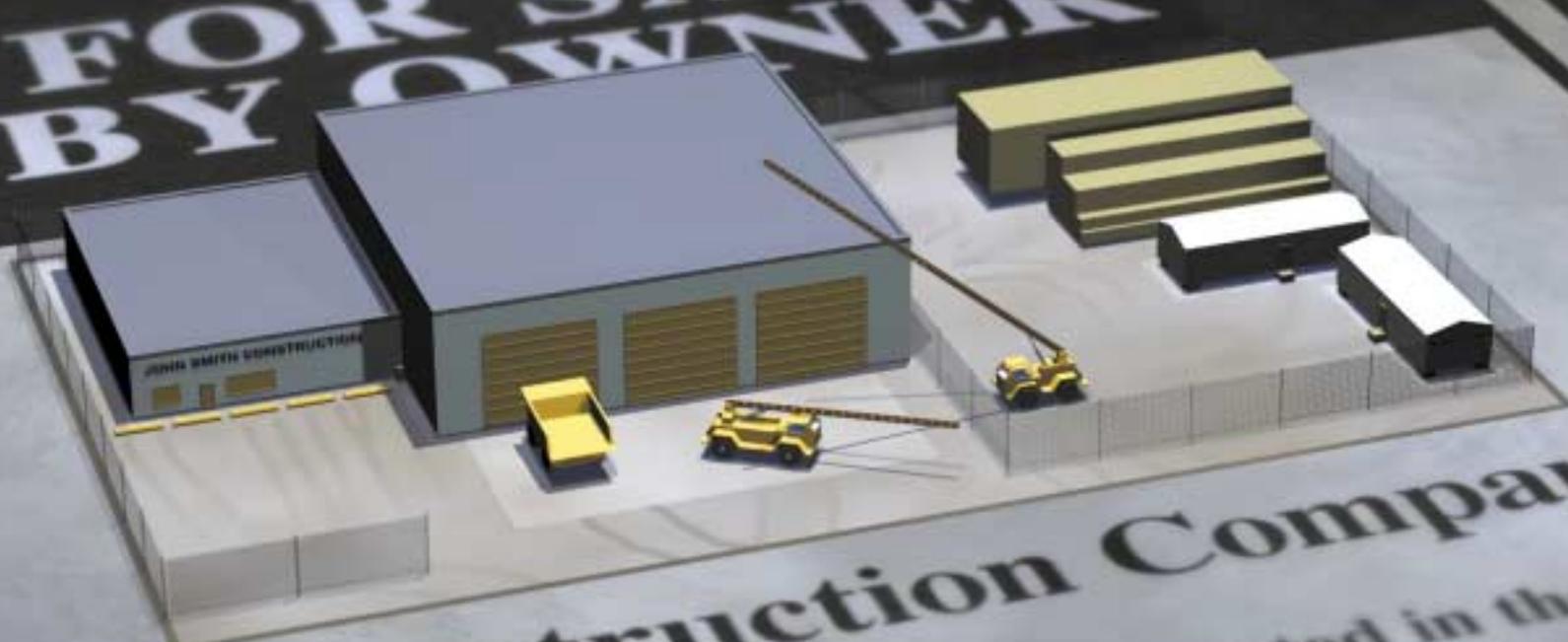


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# FOR SALE BY OWNER



## Construction Company

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area, includes furnishings, full  
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# BEST OFFER

**Getting the best price for your business requires careful planning and a solid understanding of the processes that contribute to a successful sale.**

Over the next 20 years, it's estimated that \$10 trillion of wealth will be transferred between generations in North America. In Canada alone, the number is estimated to be \$1 trillion. When this happens, it will be the largest transfer of wealth in history. A large portion of this wealth is contained within private businesses, including numerous companies in the contracting industry.

Most business owners who are considering selling their businesses started their companies in the late 1960s and early 1970s, and are now in their mid '50s and '60s. What is surprising is that the majority of these owners do not have a planned exit strategy. In order to realize the greatest value on the ultimate sale, it is important to have a plan in place.

There are basically two stages to selling your company that should be addressed to maximize your chances of obtaining the best price: Stage I – Preparing to Sell; and Stage II – The Sale Process.

Before we discuss the stages, it is important to understand what we mean by the “best price”. The best price offered for your company isn't necessarily the highest price. Why? While obtaining the highest price for your business is important, the structure and terms of the sale significantly impact the vendor's return. Selling your business for the best price involves achieving the maximum price offered, with the most suitable terms and conditions.

## STAGE 1

### *preparing to sell*

Once you have made the decision to sell, there are a number of things you can do prior to marketing the business to enhance the value of your company, as well as the potential value you can realize from the sale:

1. Increase the depth of your management team – buyers will pay more for a company when they see there is a strong management team in place that can run the company in your absence.
2. Improve your management information system – this will give buyers a level of comfort with your financial numbers, and the company's ability to make strategic decisions.
3. Clean up your financial statements – remove excess shareholders loans, strengthen your working capital position, etc.
4. Clean up your accounts receivable – if you have excess working capital, collecting your accounts receivable may allow you to withdraw cash prior to the sale.
5. Negotiate extended agreements with key employees – this will give buyers assurance that key employees will remain with the company through the ownership transition.
6. Consider tax planning well in advance – for example subject to legislated tax restrictions, you may consider isolating what is to be sold into a separate company.
7. Solidify your revenue stream – where possible, mitigating the risks associated with bid-based revenues by expanding your contract-based (i.e. service) revenues will help to support value.

A family-owned business is at serious risk when a son or daughter takes the CEO's chair. Our experience as a merchant bank, supported by U.S. studies, is that 70 per cent of family businesses do not survive to the next generation. The odds are a little better — just 50/50 when a business is sold to an outside buyer. In contrast, successions involving leveraged employee buyouts supported by key managers succeed in about 80 per cent of cases.

These numbers reveal a simple truth that institutions involved in financing private business acquisitions have known for years: those with direct experience in the business are a firm's best bet after a transition of ownership.

Yet a recent succession study by Deloitte & Touche reveals a disturbing fact. Only one-third of mid-market family businesses have established any process to select a successor, making them vulnerable to changes in ownership and management.

The study also suggested that 27 per cent of the owners of family businesses with sales of at least \$1 million will retire in the next five years; 56 per cent within 10 years and 78 per cent within 15 years. The sheer number of "for sale" signs that will be springing up all across Canada raises serious concerns about the future health of the family-business sector.

How great are the stakes? There are approximately 124,000 family-owned businesses with sales of \$1 million or more in Canada. These companies employ about six million Canadians and generate as much as \$1.3 trillion in gross annual sales.

## STAGE 2

### *the sale process*

#### **Strategy**

Before selling your company, it's important that you identify your objectives and develop a strategy. Your selling strategy should:

- capitalize on your company's strengths and opportunities;
- mitigate its weaknesses and threats;
- utilize a pricing model that supports the highest value;
- protect confidentiality; and,
- target the "right" buyers.

Engaging professional advisors to assist you with these issues will not only save you time, but will also enhance the likelihood of achieving the best price. For example, professional advisors can help address the following points that must be considered as part of your selling strategy:

1. **Timing** – due to the cyclical nature of the contracting industry, it is important to consider three factors in the timing of the sale: (1) your company's current and forecast performance; (2) the economic environment; and (3) the industry outlook. As well, the impact of seasonality should be considered in determining the appropriate timing.

2. **Pricing and Structuring** – financial advisors will help determine the appropriate price and structure of the sale for you, ensuring that you can focus on running your business at this crucial time.

Quick formulas and rules of thumb should not be used when valuing your company. Sophisticated buyers will understand proper pricing methodology, and you, as the seller, must understand the same. In order to negotiate the price of the company, you must understand the rationale behind the price and be able to articulate your rationale and base your negotiations upon it.

For example, industry issues such as equipment values, financing leverage available and the nature and sustainability of revenues will impact the price that can be justified, therefore must be fully understood.

# end of the line

## Only 30 per cent of family-owned businesses survive to the next generation...

Unless action is taken to support and stimulate succession planning, a likely outcome is that many of these firms will either fail outright or fall into the hands of strategic buyers — many of whom will likely be foreign — intent on rolling them into larger organizations.

We have seen a marked increase in such acquisitions within mid-market sectors as strategic buyers employ “rollup” strategies. The magnitude of this trend should be of concern to the federal government. Left unchecked, the result will be a general loss of jobs, fewer mid-market companies and a significantly higher incidence of foreign ownership aided and abetted by current exchange rates.

Specifically, what is needed is recognition by the federal government that tax laws should be amended to encourage leveraged, employee buyouts.

In the United States, where demographic trends are identical, there are significant tax incentives to encourage employee buyouts through employee share ownership plans (ESOPs).

American business owners who sell at least 30 per cent of their company to an ESOP are able to defer federal and state income tax by investing the proceeds in qualified U.S. stocks and bonds within 12 months of the sale.

Leveraged ESOP buyouts in the U.S. also provide a tax-advantaged financing vehicle to the employee group buying the company. The key consideration here is that principle payments on an ESOP bank loan are fully tax deductible, enabling all repayments to be made with pre-tax dollars.

These tax incentives are aimed at offsetting job loss and keeping American businesses in American hands. They also recognize that employee-owned companies enjoy the competitive advantages of highly motivated managers and workforces. By encouraging ESOP ownership, the U.S. government is also providing employees with a significant stock-based, incentive-oriented retirement plan benefit.

Today, in the United States, there are 11,000 public and private firms with ESOP-based retirement plans for employees, and 500 companies are owned by ESOPs. In the years ahead, the frequency of U.S. leveraged ESOP buyouts will skyrocket as baby boomers retire and awareness spreads that ESOPs are the last significant tax-advantaged financing vehicle for acquisitions.

Given the importance of Canada’s family businesses to jobs and the economy, the Department of Finance should take a page out of the IRS playbook and introduce similar tax incentives here. Such tax reform would provide owners and employees with highly attractive financing and investment opportunities and foster the continuance of a strong mid-market sector and all the benefits that flourishing family businesses bring to our economy.

*Rod Reynolds, RoyNat Capital Inc.*

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3. **Confidentiality** – it is important that confidentiality issues are addressed before moving to sell your business, as well as during the sales process. The more people that know of the sale, the greater the threat to the value of your business. As such, the divestiture process must be kept confidential and the sale offering must only be divulged to third parties on a need-to-know basis.
4. **Selecting the best buyers for your contracting business** – to find the “right buyer”, you have to understand the market, the industry and what your company has to offer. Once this is understood, you typically should have several interested purchasers simultaneously involved in the sale process. This process facilitates a level of competitive pressure that helps achieve the best price in the shortest possible time.

There are two general categories of purchasers, “strategic buyers” (e.g. competitors, larger industry players) and “financial buyers” (e.g. employees, private equity groups, individual purchasers).

Given the characteristics of the contracting industry (i.e. cyclical, competitive, lack of barriers to entry), the most logical purchasers are usually strategic targets as they can often generate synergies with their existing businesses. As such, strategic buyers may be more willing to pay a higher price for your company.

### **The Process**

Once an appropriate strategy has been developed, the sale process must be closely managed through to closure.

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The best price offered for your company isn't necessarily the highest price. Why? While obtaining the highest price for your business is important, the structure and terms of the sale significantly impact the vendor's return. Selling your business for the best price involves achieving the maximum price offered, with the most suitable terms and conditions.

Selling your company involves complex issues including:

- negotiation;
- tax;
- structuring;
- legal;
- capital sourcing;
- due diligence;
- valuation; and,
- marketing and operations.

Engaging experienced professionals to wear your "team jersey" while managing and negotiating the deal will greatly reduce your stress level and ensure your interests are protected. A qualified intermediary can directly manage the above issues, and also coordinate all of the other parties and steps involved in a sequenced timetable, increasing the probability of a successful close.

### In Closing

The buyer of your business will be the most important customer you will ever sell to. You must therefore approach the sale of your company with a level of attention commensurate with its importance. This is not the time to learn how to "do-it-yourself". A well-positioned and closely managed sale will increase the likelihood of obtaining the best price for your business, and realizing the significant portion of your net worth tied up in your company.

*Janice Fraser*  
Pricewaterhouse Coopers Securities Inc.