

Growth Options and Sources of Capital Available to Mid-Market Canadian Businesses

April 19, 2016

WindsorEssex
ECONOMIC DEVELOPMENT CORPORATION

Capital Assist
VALUATION INC. 

NEWPOINT
MID MARKET INVESTMENT BANKING

MCTAGUE
LAW FIRM LLP

BDO

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1. Introductions

PRESENTER BACKGROUNDS

Federica Nazzani Capital Assist (Valuation) Inc.
Founder & President



- 20+ years of valuation and corporate finance experience
- Fellow Chartered Professional Accountant and Chartered Business Valuator
- Master of Accounting and an Honours Bachelor of Arts from the University of Waterloo

Ken Moore NewPoint Capital Partners
Managing Partner



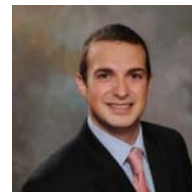
- 25+ years of M&A experience in investment and commercial banking
- Chairman of Algonquin Power & Utilities Corp. and a director of numerous private companies
- Holder of Chartered Financial Analyst and Chartered Director designations

William Willis McTague Law Firm LLP
Partner in the Business Law Department



- Extensive experience as legal counsel on complex mid-market financing and M&A transactions across various industries
- Currently the 2nd vice chair of the University of Windsor, a member of the Board of the United Way, and a sessional instructor at the University of Windsor Law School

Ferruccio Da Sacco BDO LLP
Partner



- 17 years of public accounting experience in the area of accounting and auditing, taxation, operational analysis and financial management
- Serves on boards and committees such as Autism Service Inc., the Windsor Essex Gift of Life and Windsor Asthma Allergy Education
- Holds Chartered Professional Accountant Designation

Rakesh Naidu Windsor Essex Economic Development
Interim CEO



- Oversees all operations at the WEEDC
- Responsible for initiating and executing strategies and activities to attract and retain new investment to the Windsor-Essex region
- Chemical Engineer with a Post Graduate Diploma in Business Management

2. Regional Perspective

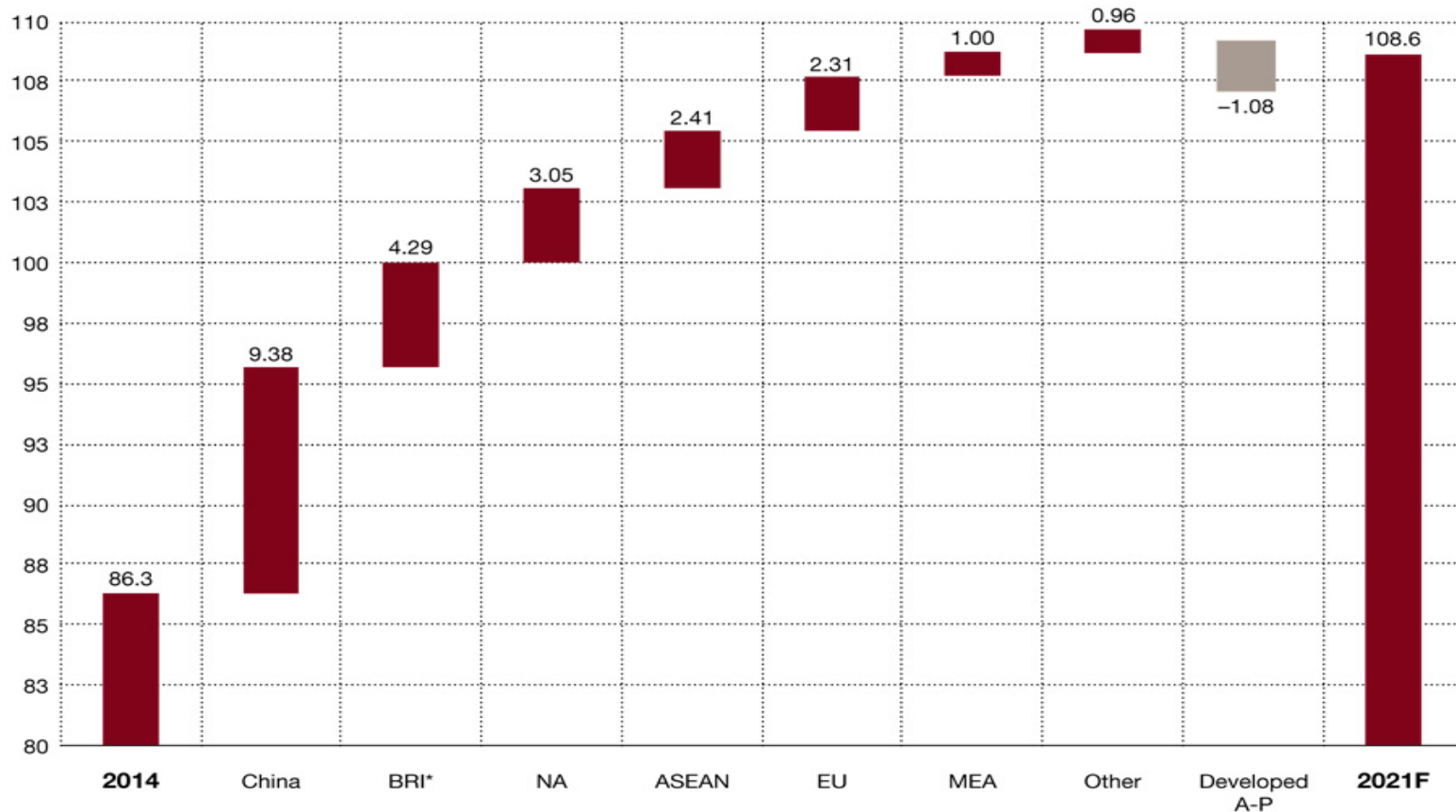
The Current Landscape

- Over 400 MTDM companies before recession - 250 Stronger companies today
- Availability of funds dried during recession. Access to funds through conventional channels can be challenging
- Industry is hot
- M&A is increasing
- Asian OEMs and suppliers are coming
- OEM's looking for stronger companies, with bigger footprint and global reach
- TPP & CETA will change the landscape



Projected Growth in Global Vehicle Production

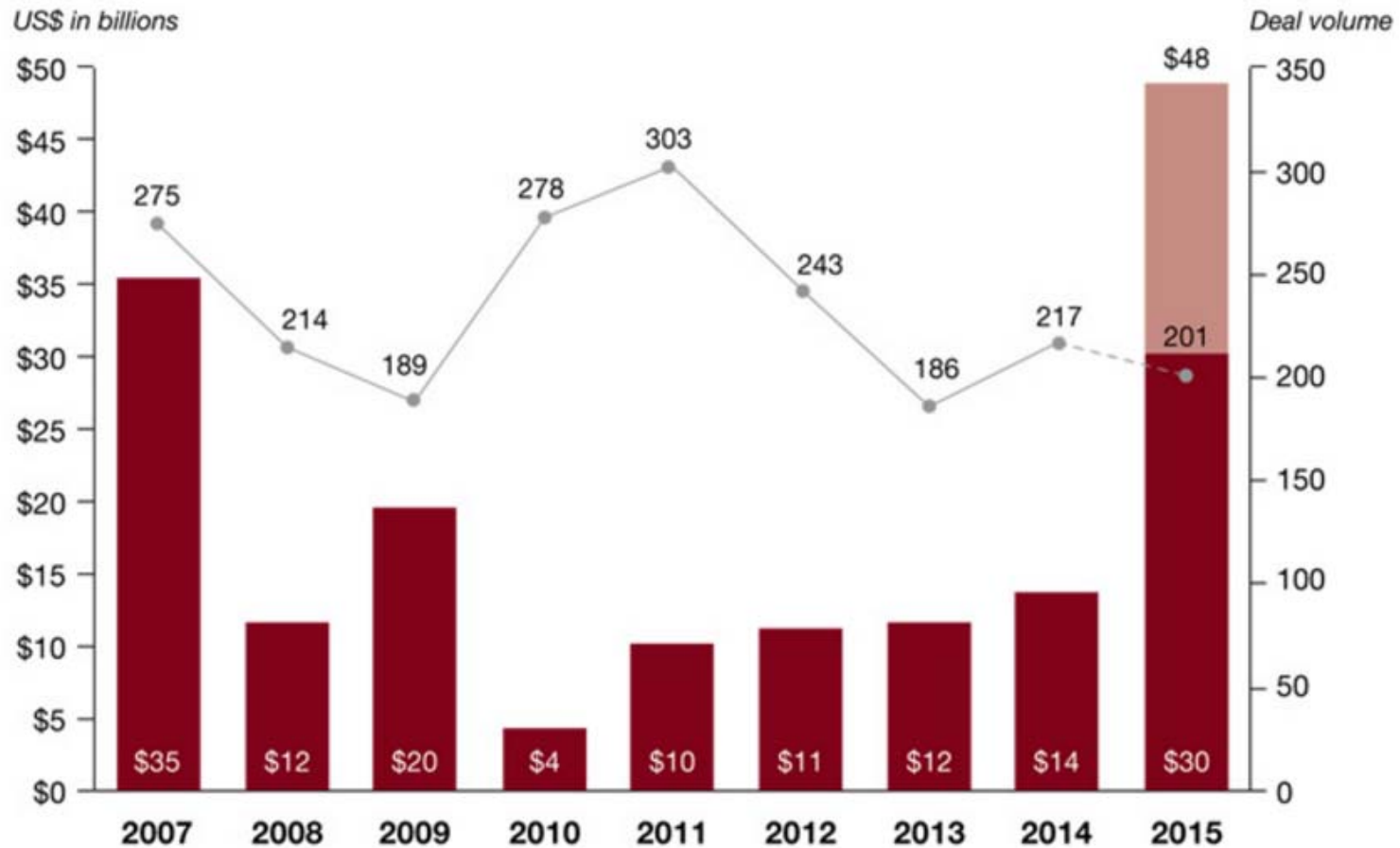
Global Auto Production Volume, 2014-21 (in Millions)



* BRI=Brazil, Russia, and India.
 Source: PwC's Autofacts 2015 Q3 data release
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Supplier M&A Activity

(Only closed deals, by year closed) 2017-15YTD



Source: Thompson
Reuters: Capital IQ

■ Disclosed deal value
■ Forecast for first half of 2015
● Deal volume

Largest Consolidators

#1 North American Suppliers



Followed by: Europe, South Korea, Japan, China

EBITDA Margins of The Top 9 Global Consolidators

Type of company	Country	# of acq (2009-13)	Company-level growth				EBITDA margin growth
			Sales 2009 (US\$, M)	Sales 2014 (US\$, M)	EBITDA 2009	EBITDA 2014	
Global 100 engine management Tier One	Germany	39	\$35,039	\$40,291	\$2,294	\$3,558	35%
Global 100 steel supplier	South Korea	34	\$17,003	\$32,191	\$2,955	\$3,028	-46%
Global 100 seat Tier One	United States	18	\$14,533	\$21,842	\$609	\$1,670	82%
Global 100 drivetrain Tier One	United Kingdom	12	\$3,468	\$5,984	\$301	\$708	37%
Global 100 interior Tier One	France	12	\$13,317	\$22,791	\$301	\$1,488	189%
Powertrain Tier One	Spain	10	\$1,647	\$2,674	\$167	\$359	33%
Diversified Global 100 Tier One	Canada	10	\$16,876	\$36,641	\$408	\$3,459	290%
Driver assistance electronics Tier Two	Italy	9	\$147	\$199*	-\$4	\$23*	498%
Global 100 CV engine manufacturer	United States	8	\$7,236	\$12,878	\$594	\$1,678	59%



Source: Price Waterhouse Cooper

It Pays For Automotive Suppliers To Be Acquisitive

From 2009-2013:

- More than **70%** of top consolidators outperformed peer group in EBITDA growth
- 5 of the 10 top consolidators grew EBITDA margins by more than **50%**



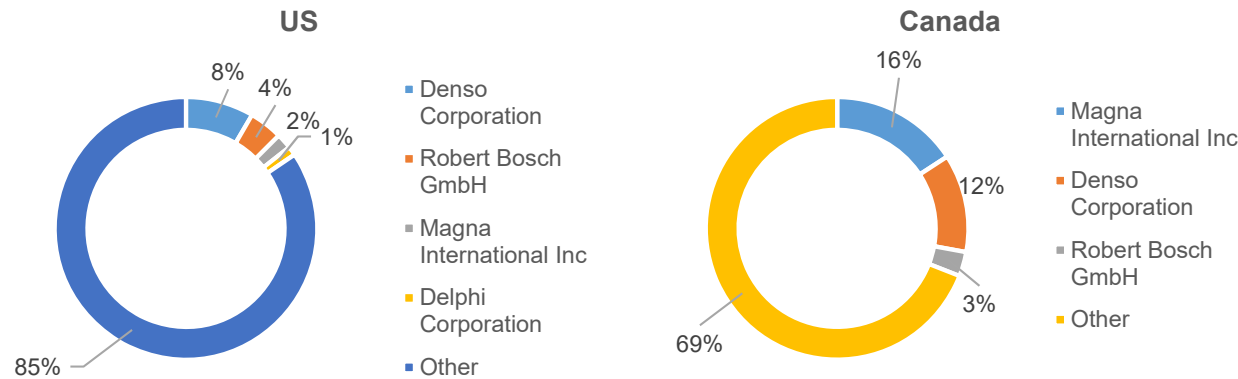
How can we help you grow?

- Too many companies chasing customers that want to do business with fewer firms
- Growth - Organically or through M&A?
- Funding Sources?

3. M&A Activity Levels for Industry Sectors Relevant to Companies in the Windsor-Essex Region

INDUSTRY SNAPSHOT: AUTO PARTS MANUFACTURING

Market Share of Key Industry Players

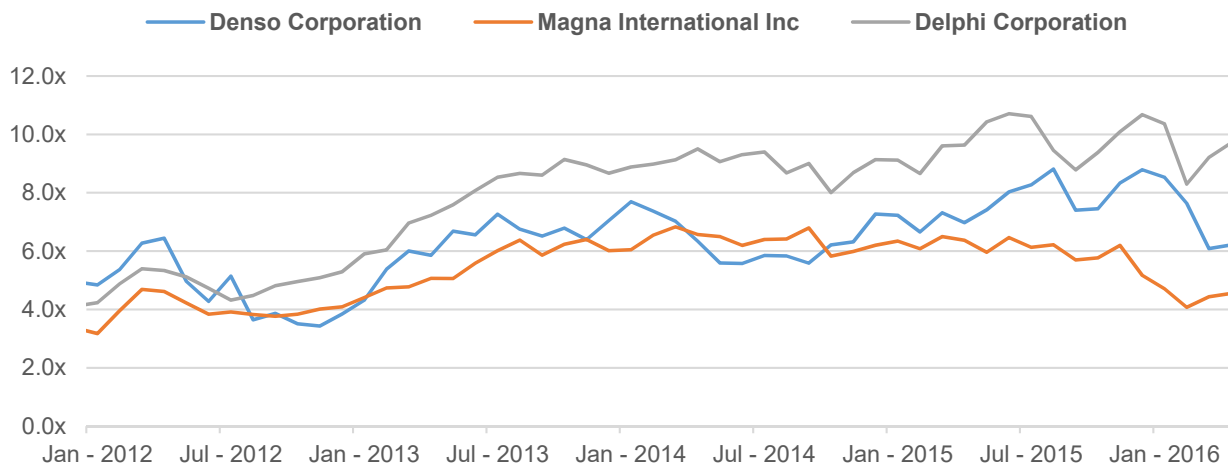


Key Industry Stats (USD)

United States

2015 Revenue:	\$67.2B
CAGR '10 – '15:	7.6%
CAGR '15 – '20:	0.7%
Profit:	\$4.1B

Select Industry Players: Trailing EV/EBITDA Multiples



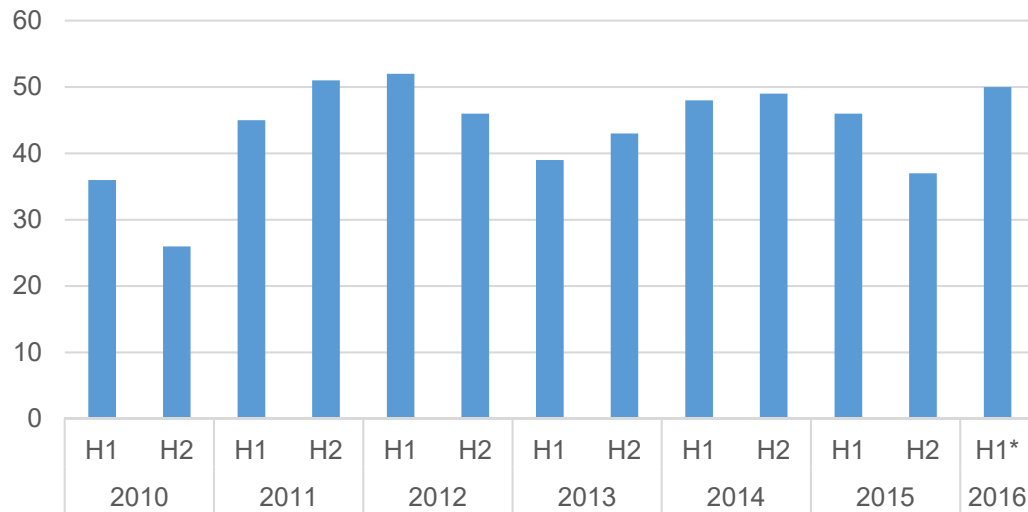
Canada

2015 Revenue:	\$6.2B
CAGR '10 – '15:	3.5%
CAGR '15 – '20:	0.3%
Profit:	\$336.1M

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: AUTO PARTS MANUFACTURING CONT.

Announced Transactions



* 2016 H1 amounts are pro-rated using Q1 transactions


Canadian Mid-Market Transactions




ACQUIRED




ON OCTOBER 3, 2014
FOR \$23 MILLION



ACQUIRED



ON APRIL 24, 2015
FOR \$22.3 MILLION



ACQUIRED



ON FEBRUARY 25, 2011
FOR \$35 MILLION

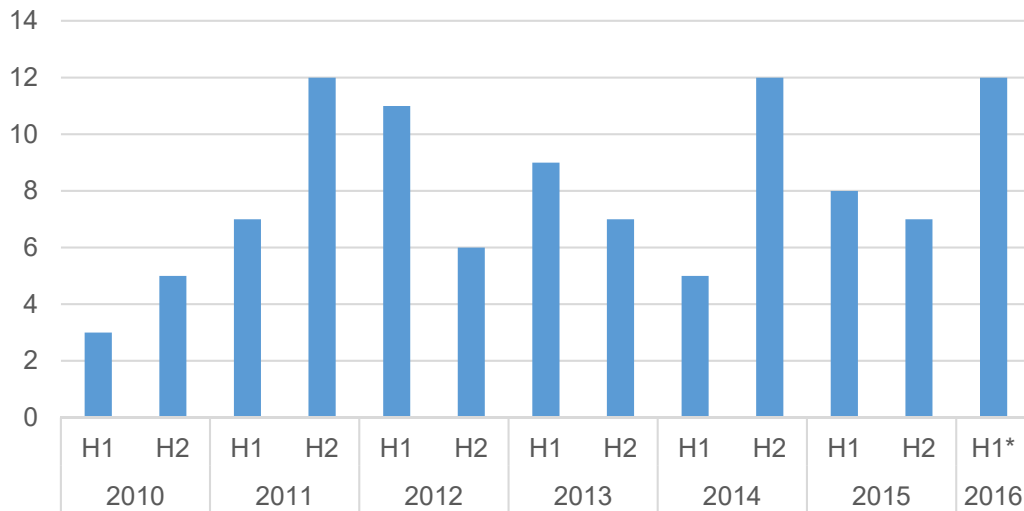
Active Buyers

- Lippert Components, Inc. has made 8 acquisitions in this space since 2010. These include:
 - Actuant Corporation, Recreational Vehicle Business for USD \$35.5M on June 13, 2014
 - Certain Assets of Schwintek, Inc., for USD \$35M on March 16, 2010
- LKQ Corp. has made 6 acquisitions in this space since 2010. These include:
 - Pittsburgh Glass Works LLC for USD \$635M announced on February 29, 2016
 - Pièces Automobiles Lecavalier Inc. for an undisclosed amount on February 24, 2012
- Lund International, Inc. has made 6 acquisitions in this space since 2010. These include:
 - Roll-N-Lock Corporation for an undisclosed amount on February 29, 2016
 - Bridgeway Enterprises, Inc. for an undisclosed amount on August 28, 2015

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: AUTO PARTS MANUFACTURING CONT.

Private Equity Firm Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

Mid-Market Transactions

WYNNCHURCH | CAPITAL

ACQUIRED

ON SEPTEMBER 26, 2011
FOR \$37 MILLION

ACQUIRED

ON MARCH 20, 2013
FOR \$33 MILLION

ACQUIRED

ON SEPTEMBER 25, 2014

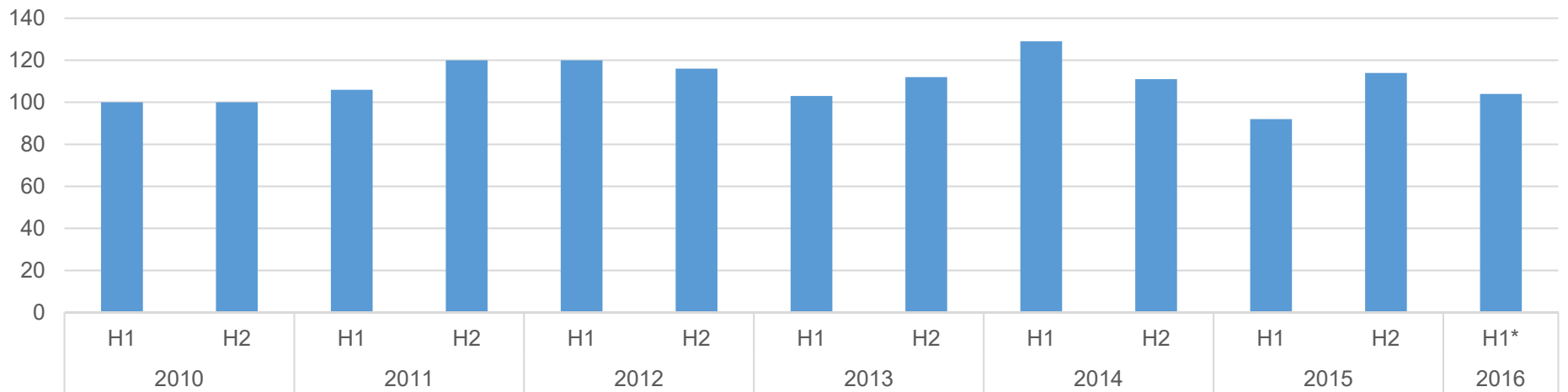
Active Private Equity Investors

- Audax Group has made 4 investments in this space since 2010. These include:
 - Acquisition of equity stake in AP Exhaust Products on January 16, 2014
 - Audax backed AP Exhaust in an acquisition of Eastern Manufacturing on September 29, 2015.
 - Acquisition of CURT Manufacturing on March 4, 2014
 - Audax backed CURT in an acquisition of Luverne Truck Equipment Inc on February 8, 2016
- Trive Capital has made 3 investments in this space since 2010. These include:
 - Acquisition of a minority stake in AGM Automotive on January 31, 2014
 - Trive backed AGM in 2 acquisitions in 2014 and 2015.
- Wynnchurch Capital, LLC has made 3 investments in this space since 2010. These include:
 - Acquisition of Fabco Automotive Corporation for USD \$37M on September 26, 2011
 - Wynnchurch backed Fabco in 2 acquisitions for Tier 1 manufacturers in 2012 and 2013.

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: FOOD PROCESSORS

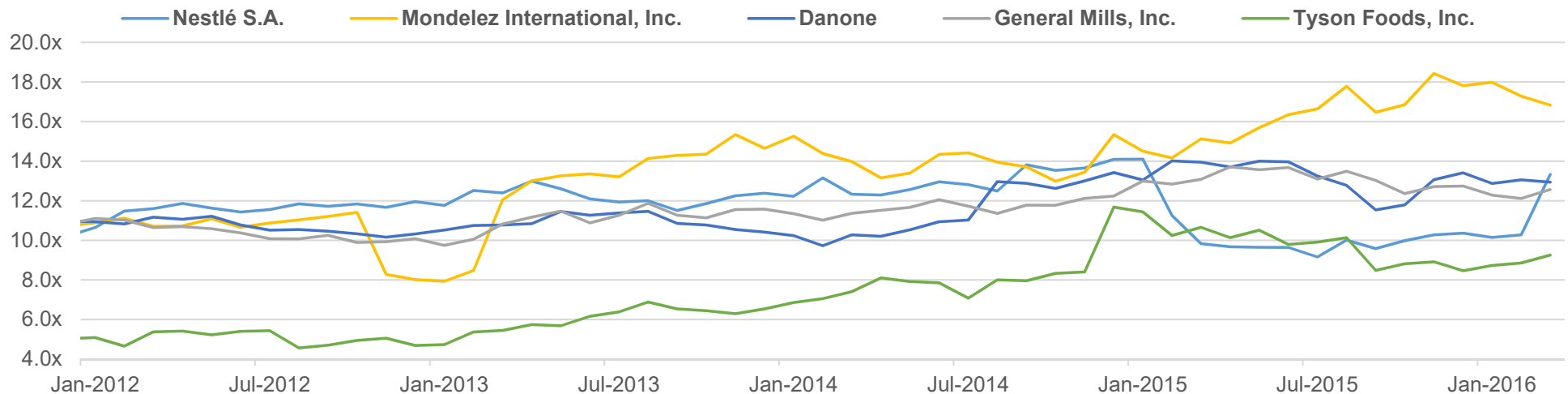
Announced Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

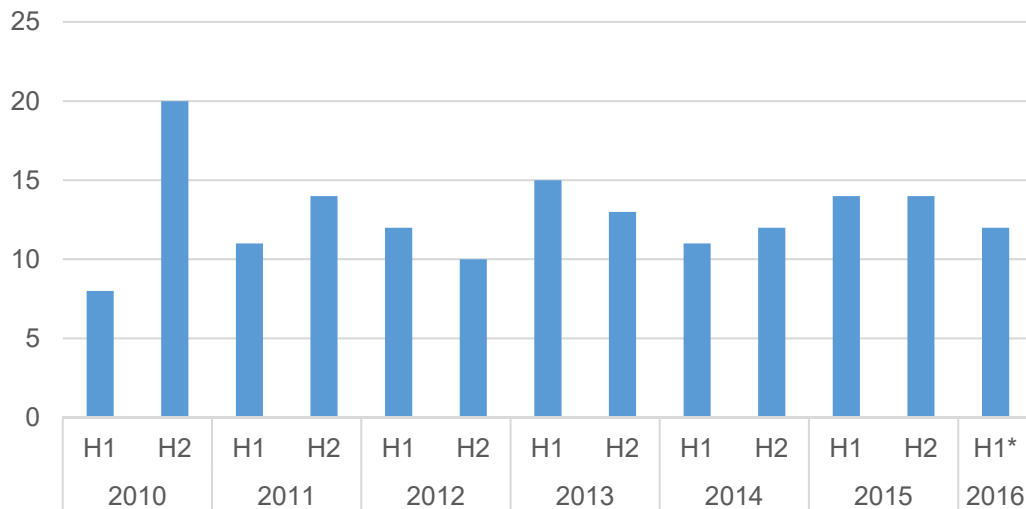
Sources: IBISWorld, Capital IQ

Large Industry Players Trailing EV/EBITDA Multiples



INDUSTRY SNAPSHOT: FOOD PROCESSORS CONT.

Private Equity Firm Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

Recent Canadian Mid-Market Transactions

ACQUIRED

ON FEBRUARY 10, 2016

ACQUIRED

ON DECEMBER 1, 2015

ACQUIRED

ON MAY 4, 2015

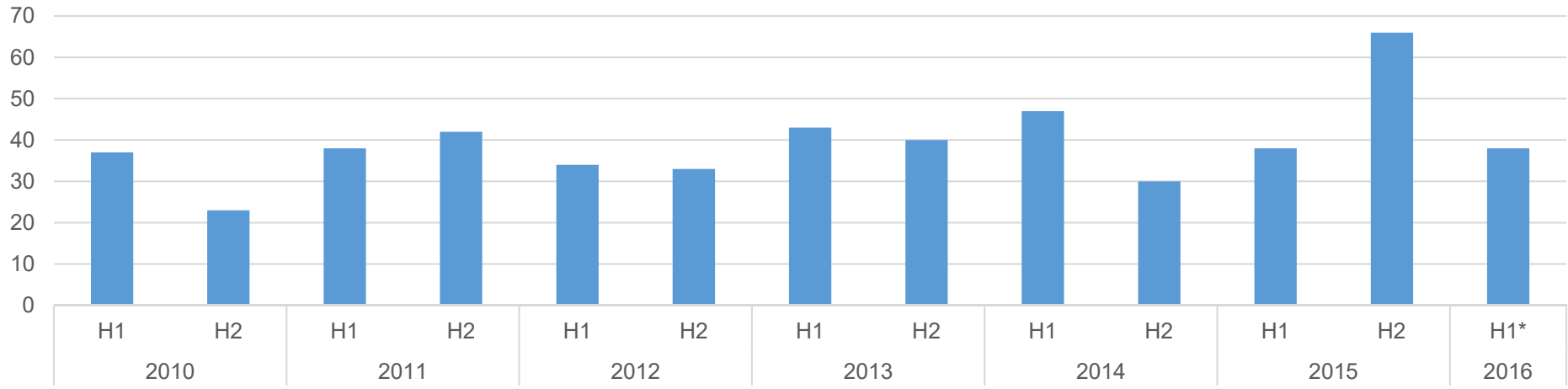
Active Private Equity Investors

- Wind Point Partners. has made 4 investments in this space since 2010. These include:
 - Acquisition of Shearer's Foods, Inc. for USD \$500M on October 31, 2012. Wind Point partnered with CJ Fraleigh, Mistral Equity Partners, and Teachers' Private Capital for the transaction.
 - Wind Point and its financial partners have backed 4 add-on acquisitions for Shearer's Foods; 3 in 2014 with an average size of USD \$156M, and 1 announced in 2015.
- Brynwood Partners has made 4 investments in this space since 2010. These include:
 - Acquisition of a majority stake in Back to Nature Foods Company on April 10, 2013. The company had revenues of between USD \$50M-\$75M.
 - Brynwood backed Nature Foods Company's acquisition of SnackWell's Cookies and Snacks on December 30, 2013
- Arbor Private Investment Company has made 5 investments in this space since 2010. These include:
 - Acquisition of an equity stake in Concord Foods, LLC on June 10, 2015.

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: BEVERAGES

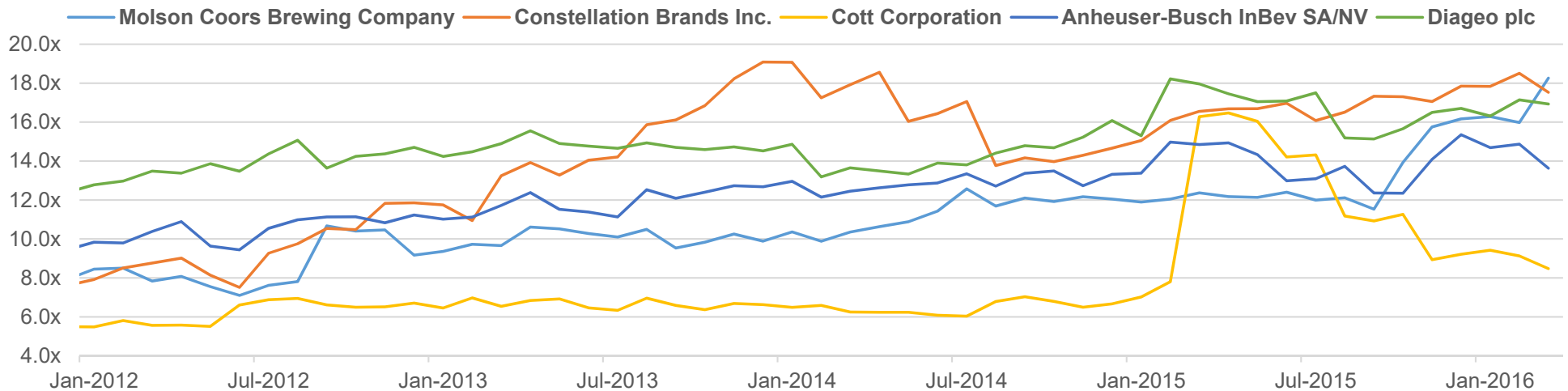
Announced Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

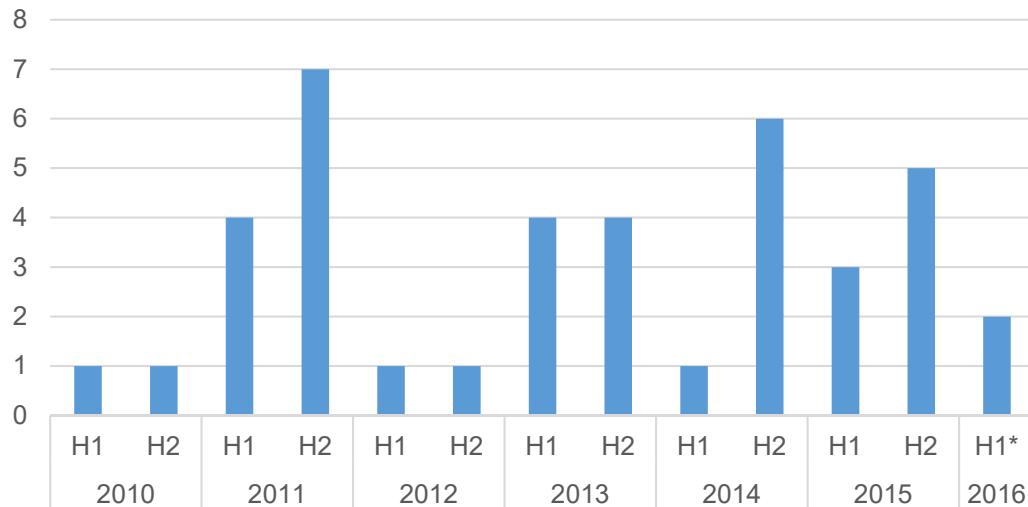
Sources: IBISWorld, Capital IQ

Large Industry Players Trailing EV/EBITDA Multiples



INDUSTRY SNAPSHOT: BEVERAGES CONT.

Private Equity Firm Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

Recent Mid-Market Transactions

LNK PARTNERS
INVESTED IN

ON SEPTEMBER 29, 2015

PRAEDIIUM GROUP LLC
ACQUIRED

ON JULY 27, 2015 FOR USD \$69.7 MILLION

encore consumer capital
ACQUIRED

ON MARCH 9, 2015

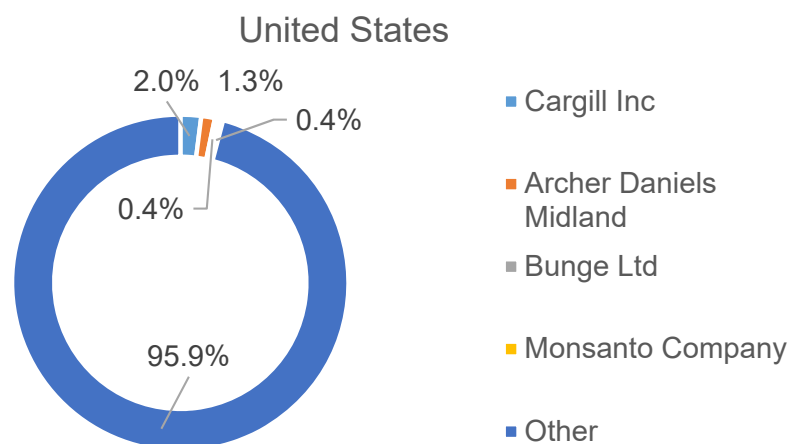
Active Private Equity Investors

- Brazos Private Equity Partners invests USD \$25M - \$100M of equity. One of their representative investments is an 89% stake in The Winebow Group, acquired on December 31, 2011. Since then, Brazos has backed the Winebow Group in 7 acquisitions of importers and distributors of alcoholic beverages. Of these acquisitions, 4 were announced in 2015.
- Seidler Equity Partners invests between USD \$5M - \$100M in companies within this space. One of their representative investments is Sunny Sky Products. Sunny Sky Products manufactures and markets dispensed beverages to a variety of distributors and customers including convenience, foodservice, on - premise, healthcare, education, concessions, and supermarkets.
- TSG Consumer Partners invests in companies with more than USD \$20M in revenues, and looks to invest over \$15M in equity. Two of their representative investments are Sweetwater Brewing Company, and Pabst Brewing Company. Both companies are beer breweries.

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: AGRIBUSINESS

Market Share of Key Industry Players - US

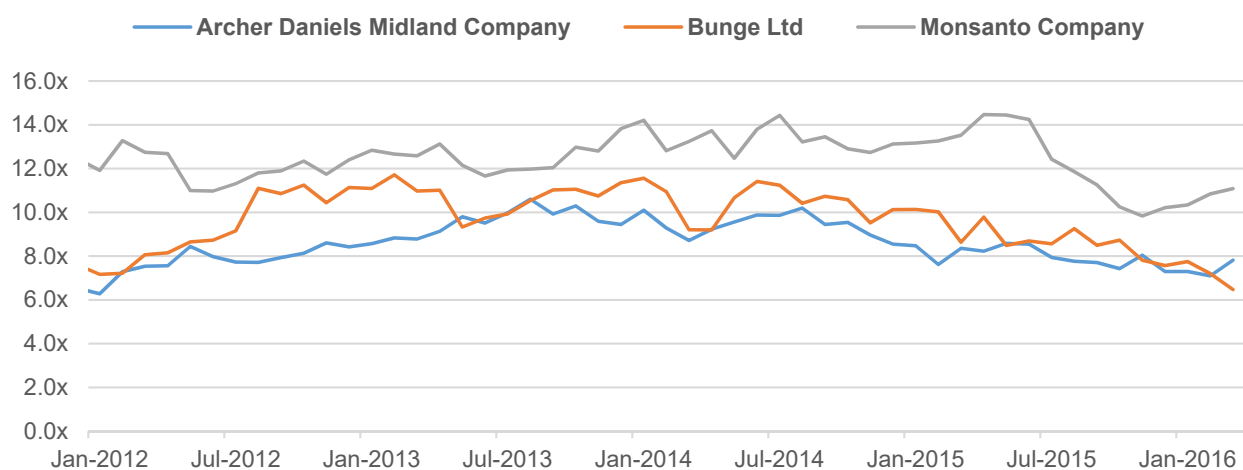


Key Industry Stats

United States

2015 Revenue:	\$2.5T
CAGR '10 – '15:	2.4%
CAGR '15 – '20:	1.3%
Profit:	\$142.5B

Select Industry Players: Trailing EV/EBITDA Multiples



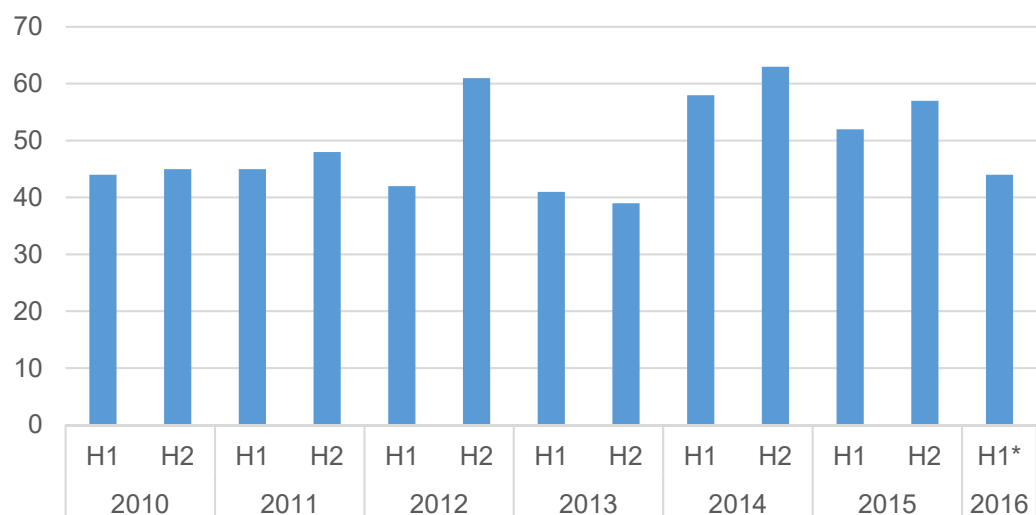
Canada

2012 Revenue:	\$103B
% of GDP (2012):	6.7%
Employee Base (2012):	2.1M
Number of Farms (2012):	205.7K

Sources: IBISWorld, Capital IQ, Agriculture and Agri-Food Canada

INDUSTRY SNAPSHOT: AGRIBUSINESS CONT.

Announced Transactions: US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

Mid-Market Transactions

ACQUIRED

ON APRIL 1, 2014
FOR \$95.5 MILLION

ACQUIRED

ON MARCH 31, 2015
FOR \$18.5 MILLION

ACQUIRED THE
MAJOR ASSETS OF

ON NOVEMBER 23, 2015
FOR CAD \$93 MILLION

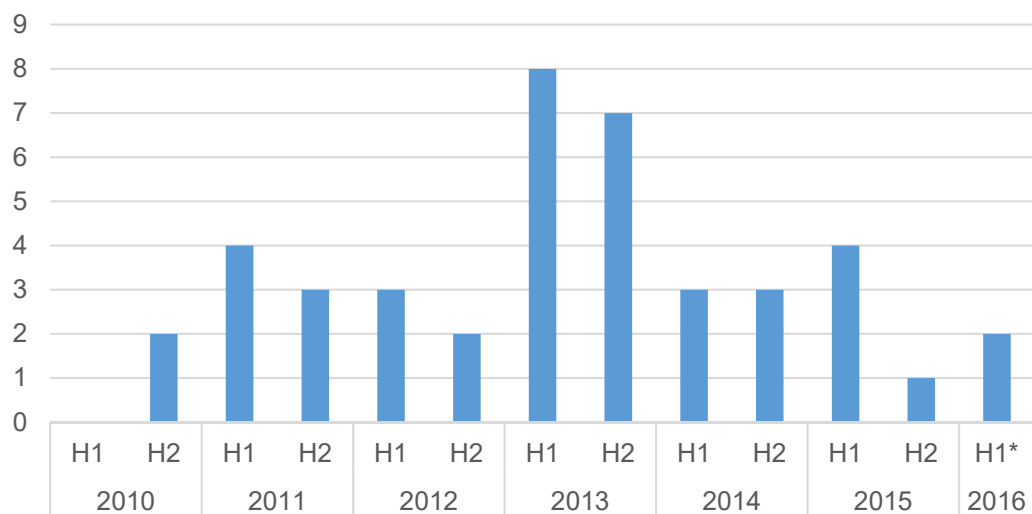
Active Buyers

- Farmland Partners Inc has made or announced 13 acquisitions in the space since 2010. These include:
 - Hudy Farms US, Inc. for USD \$24.5M on June 12, 2014
 - Two Farms in Louisiana and One Farm in Nebraska for USD \$10.7 on December 11, 2014
- Titan Machinery Inc as made or announced 10 acquisitions in the space since 2010. These include:
 - Toner's Inc. for USD \$13.9M on November 1, 2012
 - Virgil Implement Inc. and Victors Inc. for USD \$13.2M on September 2, 2011
- Pinnacle Agriculture Holdings, LLC has made or announced 9 acquisitions in this space since 2010. These include:
 - MRM Agricultural Service, LLC for an undisclosed amount on October 5, 2015
 - Reck Aviation, Inc. for an undisclosed amount on November 13, 2014

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: AGRIBUSINESS CONT.

Private Equity Firm Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

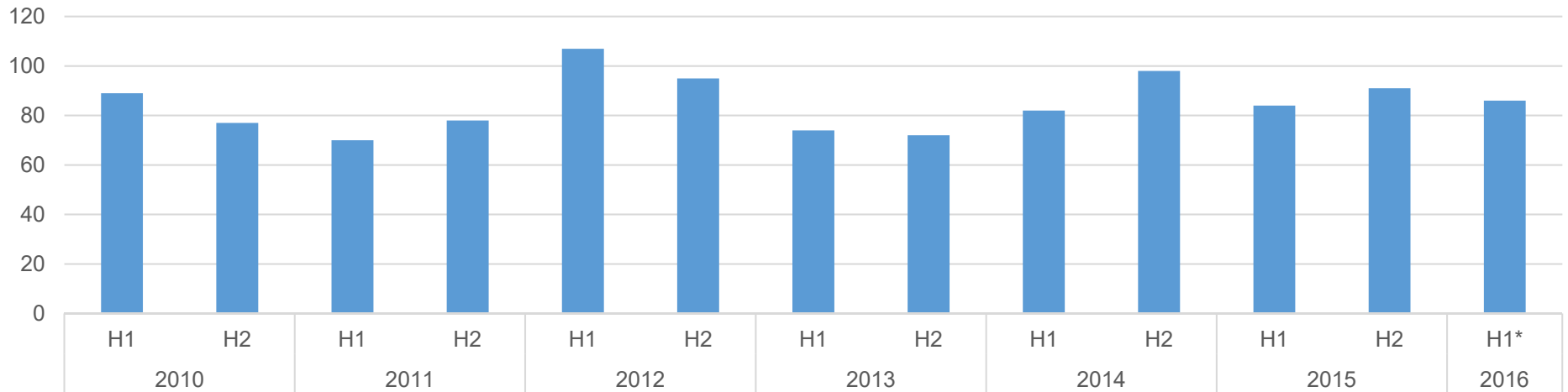
Recent PE Investments

- Platte River Equity acquired PROFILE Products LLC on May 21, 2015
 - Platte River backed PROFILE in an acquisition of the erosion control and landfill cover business segments of Central Fiber Corporation on October 20, 2015.
- ShoreView Industries acquired Edstrom Industries on February 29, 2016
- Agricultural Capital Management acquired Griffith Farms, TreeSource LLC, and Suntreat Packing & Shipping Co. on November 13, 2015
- ONCAP acquired 50% of North American Tillage Tools Company for USD \$70M on June 1, 2015
- Centre Lane Partners acquired Easy Gardener Products Inc on May 21, 2015
- Freeman Spogli & Co. Incorporated acquired Plantation Products Inc. on January 7, 2015

Sources: IBISWorld, Capital IQ

INDUSTRY SNAPSHOT: ADVANCED MANUFACTURING

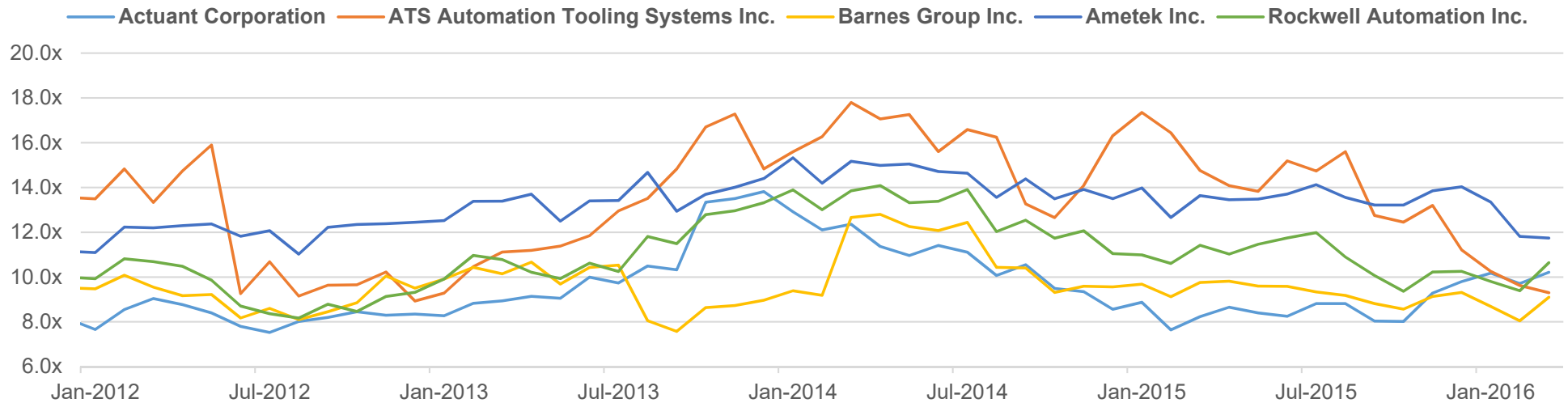
Announced Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

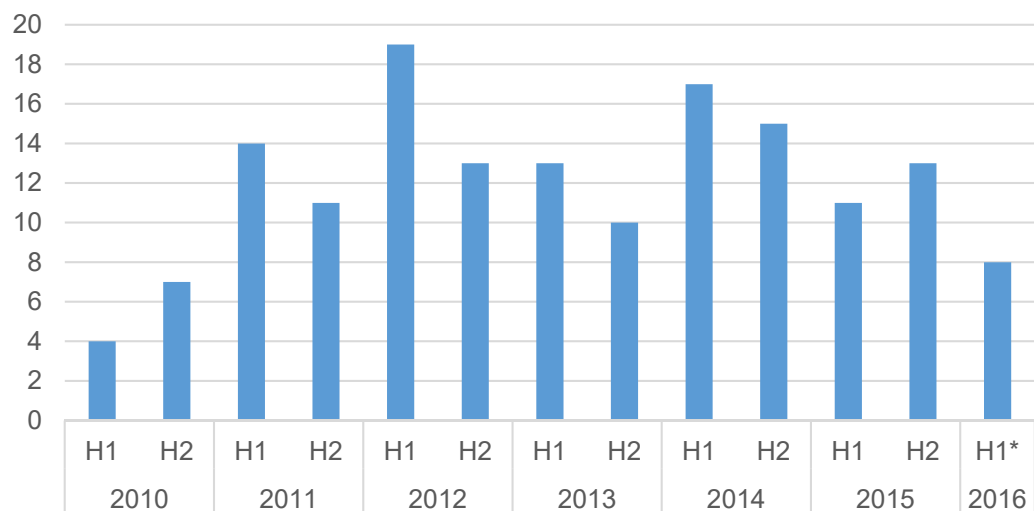
Sources: IBISWorld, Capital IQ

Large Industry Players Trailing EV/EBITDA Multiples



INDUSTRY SNAPSHOT: ADVANCED MANUFACTURING CONT.

Private Equity Firm Transactions – US & Canada



* 2016 H1 amounts are pro-rated using Q1 transactions

Recent Canadian Mid-Market Transactions

 <p>ACQUIRED</p>  <p>ON JUNE 30, 2015</p>	 <p>ACQUIRED</p>  <p>ON AUGUST 13, 2015</p>	 <p>INVESTED IN</p>  <p>ON MAY 31, 2015</p>
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Active Private Equity Investors

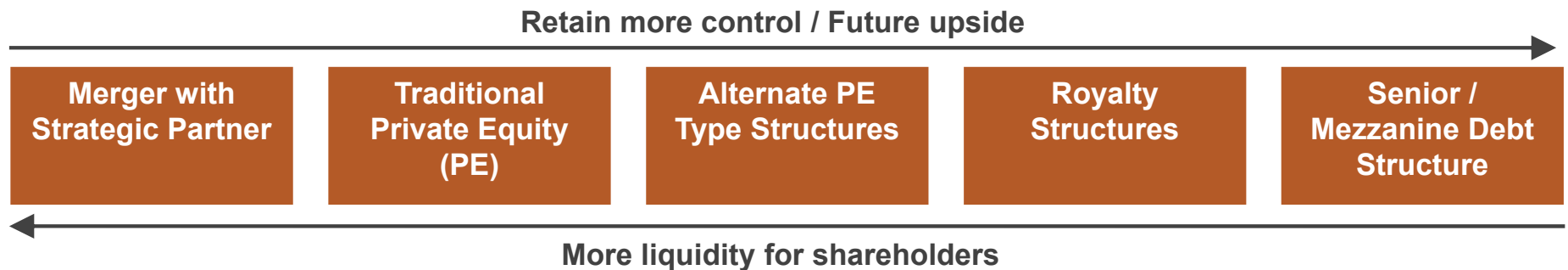
- Berwind Corporation has made 2 investments in this space since 2010. One such investment is the acquisition of TASI Group June 4, 2014. TASI Group, through its subsidiaries, provides test and inspection instrumentation and systems, flowmeters and flow control products, measurement instrumentation, and automated assembly and test systems.
 - On August 27, 2015, Berwind backed TASI Group in an acquisition of SignalFire Telemetry, Inc.
- Capital For Businesses Inc. has made 2 investments in this space since 2010. One such investment includes DIT-MCO International Corporation on January 6, 2016. DIT-MCO designs and manufactures wiring analyzers for automated testing applications.
- The Riverside Company has made 3 investments in this space since 2010. One such investment was the acquisition of Fisher/Unitech Inc. on November 10, 2014. Fisher/Unitech offers 3D printing and rapid prototyping services.

Sources: IBISWorld, Capital IQ

4. Financing Growth

SOURCES OF GROWTH CAPITAL

- Key considerations:
 - Retain control vs. Ownership dilution
 - Succession planning issues
 - Strategic and management resources
 - Cash flow impact to the business
 - Shareholders' liquidity



SOURCES OF GROWTH CAPITAL CONT.

Merger with Strategic Partner	Traditional Private Equity (PE)	Alternate PE Type Structures	Royalty Structures	Senior / Mezzanine Debt Structure
<ul style="list-style-type: none"> - Often improves management expertise - Dilution of equity, possibly below 50% - The cultural and strategic fit is very important - Some shareholders may be able to exit and/or take cash off the table 	<ul style="list-style-type: none"> - Purchase 25% - 85% of equity - PE firm will help identify and execute add-on acquisitions to accelerate growth - Management usually expected to stay on 3+ years - Take some “chips off the table” 	<ul style="list-style-type: none"> - Purchase 25% - 85% of equity but future growth may go disproportionately to existing shareholders/ management - PE firms’ investment would be in preference of management, thus carrying lower risk - Otherwise similar to traditional PE 	<ul style="list-style-type: none"> - Retain 100% control, while monetizing up to 2/3 of business value - Management expected to continue operating the business - Additional capital is available for future growth opportunities - Very accretive if add-on acquisitions made, or significant organic growth is achieved 	<ul style="list-style-type: none"> - Capital provided as debt - Investor will provide no operational support and management continues operating business - Least dilutive to current shareholders, but high leverage may restrict business growth

TYPICAL TRANSACTION TEAM

- Legal Counsel

- Key Roles:

- › Drafting of agreements,
 - › Advising on structuring deal,
 - › Understanding and advising client based on market norms for similar transactions,
 - › Be able to bring in experts in various fields of law (employment, environmental, IP),
 - › Working with capital provider's counsel to resolve issues expeditiously

- Accountant/Tax Advisor

- M&A Advisor/Investment Banking Firm

TYPICAL TRANSACTION TEAM CONT.

- Legal Counsel
- Accountant/Tax Advisor
 - Key Roles:
 - › Assisting in accounting due diligence
 - › Identify and execute efficient tax structuring for shareholders,
 - › Minimize tax liability risk
- M&A Advisor/Investment Banking Firm

TYPICAL TRANSACTION TEAM CONT.

- Legal Counsel
- Accountant/Tax Advisor
- M&A Advisor/Investment Banking Firm
 - Key Roles:
 - › Determine go to market strategy,
 - › Find and reach out to capital providers,
 - › Conduct auction process to determine best offers,
 - › Advise on valuation,
 - › Negotiate term sheets,
 - › Assist in due diligence
 - › Coordinate with other deal professions including those from capital provider

5. Lessons from the Trenches: Case Studies of Private Equity Deals

CASE STUDY 1

PRIVATE EQUITY FIRM

Purchased 70% of the equity of

COMPANY A

Situation

- ❑ Growing niche manufacturing business started by two partners 20 years ago
- ❑ One of the partners, a minority shareholder, wanted to exit the business to pursue other interests

Needs of the Shareholder/Business

- ❑ Company required capital and management expertise to grow
- ❑ Minority shareholder wanted to sell his/her stake, but majority shareholder wanted continuing role in the growth of business
- ❑ Majority shareholder wanted some liquidity to diversify personal wealth

Solution

- ❑ A specialist private equity firm purchased majority stake in business, providing an exit opportunity for the minority shareholder, while majority shareholder retained significant stake and continued as CEO
- ❑ PE firm provided access to significant network of industry contacts
- ❑ PE firm provided financial backing during cyclical downturn in industry

CASE STUDY 1 CONT.

Investment Mechanics:

- Assume debt free business generating \$4M EBITDA per year
- PE group buys 100% of the business for \$20M.
- The \$20M is funded with 50% debt and 50% equity (cash).
- Management shareholders are required to reinvest a portion of their \$20M proceeds so they have a 30% stake in the new levered business.
- The new company has \$10M of equity (and \$10M of debt), so Management needs to only invest \$3M to receive 30%

Conclusion:

- Management receives \$17M (85% of the value of the business) net for their business and continues to own 30% of the business going forward.

Note: this example excludes fees, taxes and other transaction related expenses

CASE STUDY 2

PRIVATE EQUITY FIRM

Purchased a 25% position

COMPANY B

Situation

- ❑ Growing healthcare distribution business with diverse shareholder group with different backgrounds and areas of expertise
- ❑ Different shareholders had different visions about go-forward strategy of the business

Needs of the Shareholder/Business

- ❑ Company was capital constrained and required a cohesive strategy to execute on significant growth opportunities
- ❑ Shareholders could not agree on strategy and required a third party to buy out dissenting shareholders

Solution

- ❑ A private equity firm partnered with two of the key operating shareholders and bought out other shareholders
- ❑ PE firm and remaining shareholders own business on a 25/75 basis
- ❑ PE firm helped find and execute acquisition opportunities, doubling the business in 12 months

CASE STUDY 2 CONT.

Equal Ownership Example:

- The business is owned by six shareholders, two of the key management shareholders owned a combined 37.5%.
- PE group buys 100% of the business for \$20M.
- The \$20M is funded with 50% debt and 50% equity (cash).
- Two shareholders roll in their proceeds to retain 75% ownership in the “Newco”. In order to do so, they roll-in \$3.75M each, as \$7.5M represents 75% of the \$10M of equity in “Newco”.

Conclusion:

- The four shareholders are paid out fully and the two key management shareholders were able to increase their equity stake meaningfully without investing any additional funds into the business

CASE STUDY 3

MEZZANINE FUND

Invested in

COMPANY C

Situation

- ❑ Growing manufacturing company had opportunity to expand abroad to China and India to service key customer
- ❑ Despite growth, business was not generating meaningful cash flow to support loans, and the investment, as it was in Asia, was not financeable by bank debt

Needs of the Shareholder/Business

- ❑ Shareholders wanted to minimize equity dilution while raising required capital for expansion to China and India
- ❑ Company required meaningful cash investment in order to finance expansion plans

Solution

- ❑ A mezzanine lender provided a subordinated loan that carried no principal payments until maturity
- ❑ The shareholders were able to raise the required capital while minimizing equity that was given up
- ❑ The business has tripled in size and its India and China operations are thriving

CASE STUDY 3 CONT.

Mezzanine Debt Example:

- Raise \$15M of capital to facilitate growth expansion.
- No principal payments required

Conclusion:

- Even though the Mezzanine debt has a higher cost of capital than Senior debt, it has less of a cash flow impact than senior debt as it is typically interest only.
- Additionally, if the Mezzanine debt was equity, existing shareholders would have to give up control of their business.

6. Anticipating and Addressing Legal Issues in a Transaction

Getting Started



- Letter of Intent is Key to Achieving Objectives
- Final legal agreements typically reflective of the framework established early on

Papering The Deal



- Letter of Intent
- Share Purchase Agreement

Limiting the Selling Shareholder's Liability



- Representations and Warranties
 - Step 1- Make Sure they are Accurate!
 - Step 2- Limit Scope
 - Step 3- Impose time limits
 - Step 4- Indemnity Thresholds
 - Step 5- Indemnity Cap

- Escrow Holdback

Selling Shareholder's Post Closing Role

- Employment/Consulting Agreement
 - Compensation
 - Benefits and “Perks”
 - Role in management
 - Duties and time commitment
 - Role in strategic direction
 - Reporting obligations to PE partner
 - Succession planning
 - Early termination rights
 - Incentive units



“As chairman of the board, I’d like to first request chairs.”

Protecting the Selling Shareholder

A Shareholders Agreement Primer



- Valuation of shares on exit
- Minority protections
- Exit strategies

Restrictive Covenants



- Non-Competition Agreement
- Non-Solicitation Agreement

Succession Planning for the Selling Shareholder



8. Preparing for the Deal: Accounting issues and tax strategies before starting a transaction

Accounting Issues and Tax Strategies

Overview

- The following area will be discussed
 - Capital gain exemption and planning
 - Using a Holding Company
 - Family Trusts
 - Considerations for US buyers

Accounting Issues and Tax Strategies

Capital Gains Deduction

- Deduction from capital gains on disposition of a share of a “qualified small business corporation” (QSBC)

- Limits of deduction for QSBC shares –
 - \$412,088 (**\$824,176** X 50%) minus previous claims *[for 2016]*

Accounting Issues and Tax Strategies

Capital Gains Deduction

■ Eligibility

- Individuals **resident** in Canada throughout the year other than trusts
- An individual who was resident in Canada at any time in the year is deemed resident throughout the year, if they were resident throughout the preceding or following year

■ Three Tests

- The following **three tests** must be met for QSBC status:
 - › Determination Time Test – 90% Rule
 - › 24 Month Ownership Test
 - › Holding Period Assets Test – 50% Rule

Accounting Issues and Tax Strategies

Determination Time Test

■ What is a CCPC?

- A private corporation that is a Canadian corporation other than a corporation that is listed on a designated stock exchange or that is controlled by non-residents and/or public corporations
- Company owned 50% by non-resident (or a public corporation) and 50% by Canadian resident is a CCPC
- Control is ordinary voting control, or de facto control

Accounting Issues and Tax Strategies

Determination Time Test

- Which of the company's assets are used in an active business?
 - Undertake a line by line analysis
 - Consider:
 - › Significant cash
 - › Marketable securities
 - › Vacant land (inventory or capital)
 - › Trade accounts receivable from related corporations
 - › Pension surpluses
 - › Insurance policies - CSV

Accounting Issues and Tax Strategies

Purification

- Process where non-qualifying assets are generally removed from a corporation, in order for corporation to obtain SBC status so that the CGE may be used immediately
- May also involve removing non-qualifying assets to put company onside of the holding period asset test; however access to the CGE will be delayed for another 24 months
- Purification may be necessary on a more continuous basis to avoid corporate attribution where a company is prone to accumulate passive assets

Accounting Issues and Tax Strategies

Purification Methods

■ Non-taxable Methods

- Pay liabilities
- Pay shareholder loans
- Pay capital dividends
- Pay RDTOH dividends
- Invest in business expansion

■ Taxable Methods

- Pay salaries or dividends
- Pay passive assets as dividend in kind
- Sell passive assets and pay down debt/invest in active assets

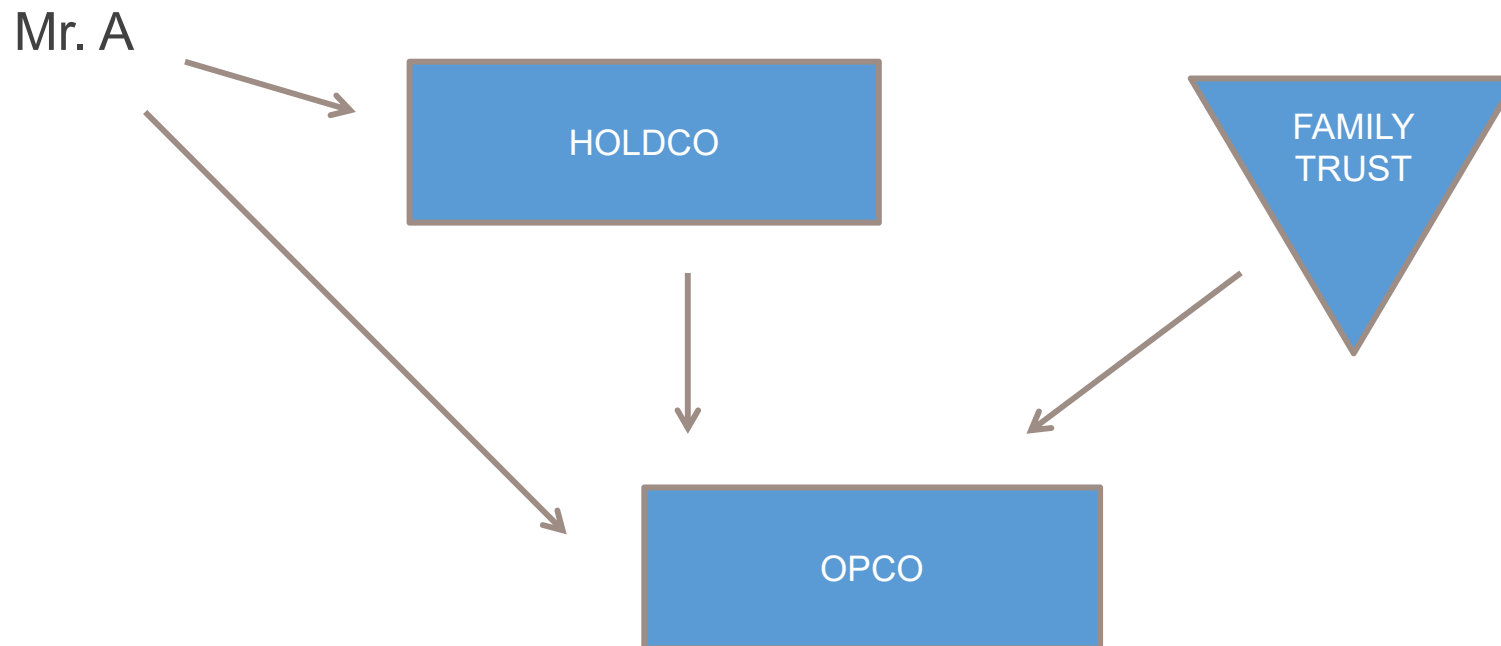
Accounting Issues and Tax Strategies

Purifications

Ongoing Methods

Holding Company Structure

Mr. A crystallizes his capital gains exemption

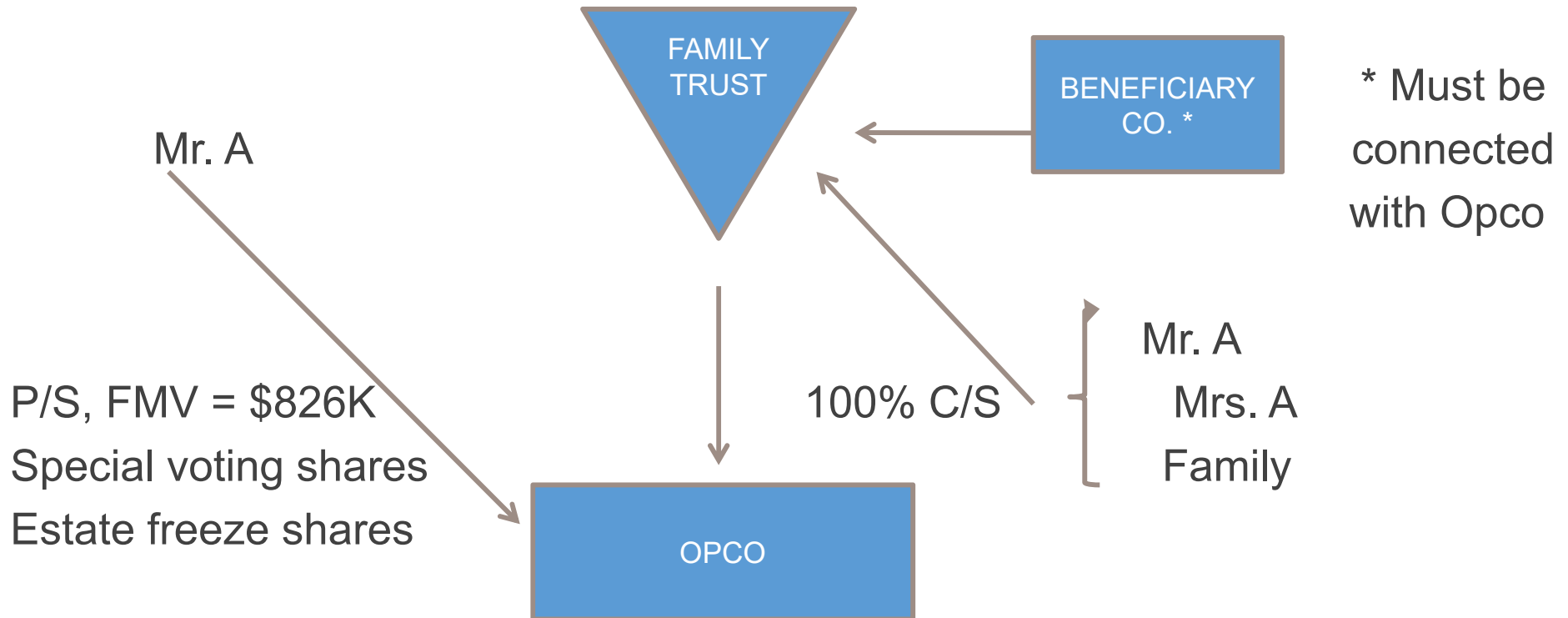


Accounting Issues and Tax Strategies

Purifications

Ongoing Methods

Corporate Beneficiary Structure



Accounting Issues and Tax Strategies

Share Sale – Planning

- Clear RDTOH balance
- Pay out Capital Dividend Account
- Pay out “GRIP Balance”
- Consider retiring allowance

Accounting Issues and Tax Strategies

Asset Sale - Planning

■ Considerations

- No capital gains deduction
- Characterization and allocation of purchase price
- Timing – CCA and recapture
- Replacement property rules
- Consider use of Individual Pension Plan
- Retiring allowance if company being wound up
- Owner- manager remuneration issues

Accounting Issues and Tax Strategies

Types of Earnouts

- **What is an Earnout?**
 - Method of establishing value of asset
 - Based on future production/results – generally a percentage of net income, gross profit or revenue

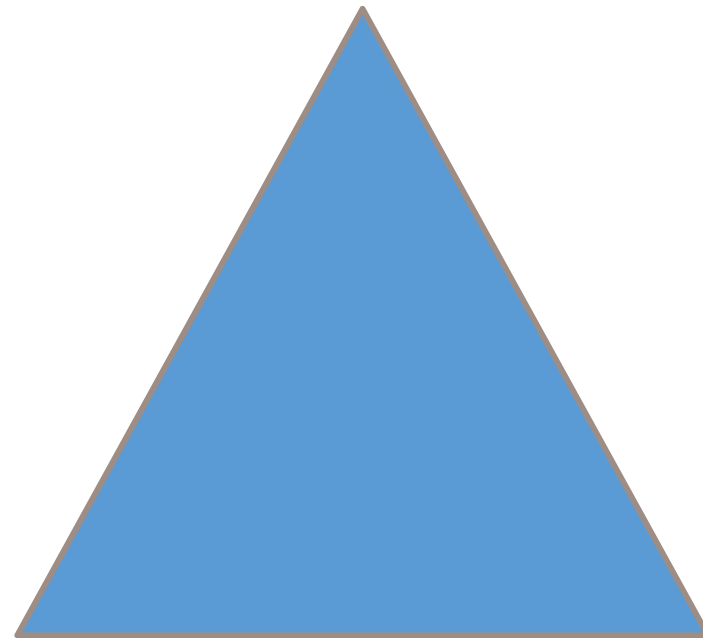
- **Common earnout arrangements are:**
 - Base period earnout
 - Cumulative earnout
 - Reverse earnout

- **Work closely with your advisor to ensure best possible tax outcome**

Accounting Issues and Tax Strategies

■ Trusts

- Fundamentals
- Taxation
- Planning



Accounting Issues and Tax Strategies

Trust Fundamentals

■ Nature of a Trust

- A trust is a powerful tool as it allows for the separation of the control and management of an asset from its ownership
- “A trust is an equitable obligation binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property) for the benefit of persons (who are called beneficiaries or cestui que trust), of whom he may be one, and anyone of whom may enforce the obligations”

- Underhill's Law Of Trusts And Trustees

- In law, a trust is an agreement and not an entity

Accounting Issues and Tax Strategies

Trust Formation Considerations

■ Reasons to Use a Trust

- To protect assets against business risk
- To protect assets against claims in a divorce or marriage breakdown situation or in the event of death
- Control over assets held for the benefit of others
- Confidentiality
- Avoiding probate and succession duties
- Making income splitting easier
- **Multiplying** the capital gains exemption without giving up control of the shares, if a sale does not materialize
- Allowing more control when splitting capital gains eligible for the capital gains exemption

Accounting Issues and Tax Strategies

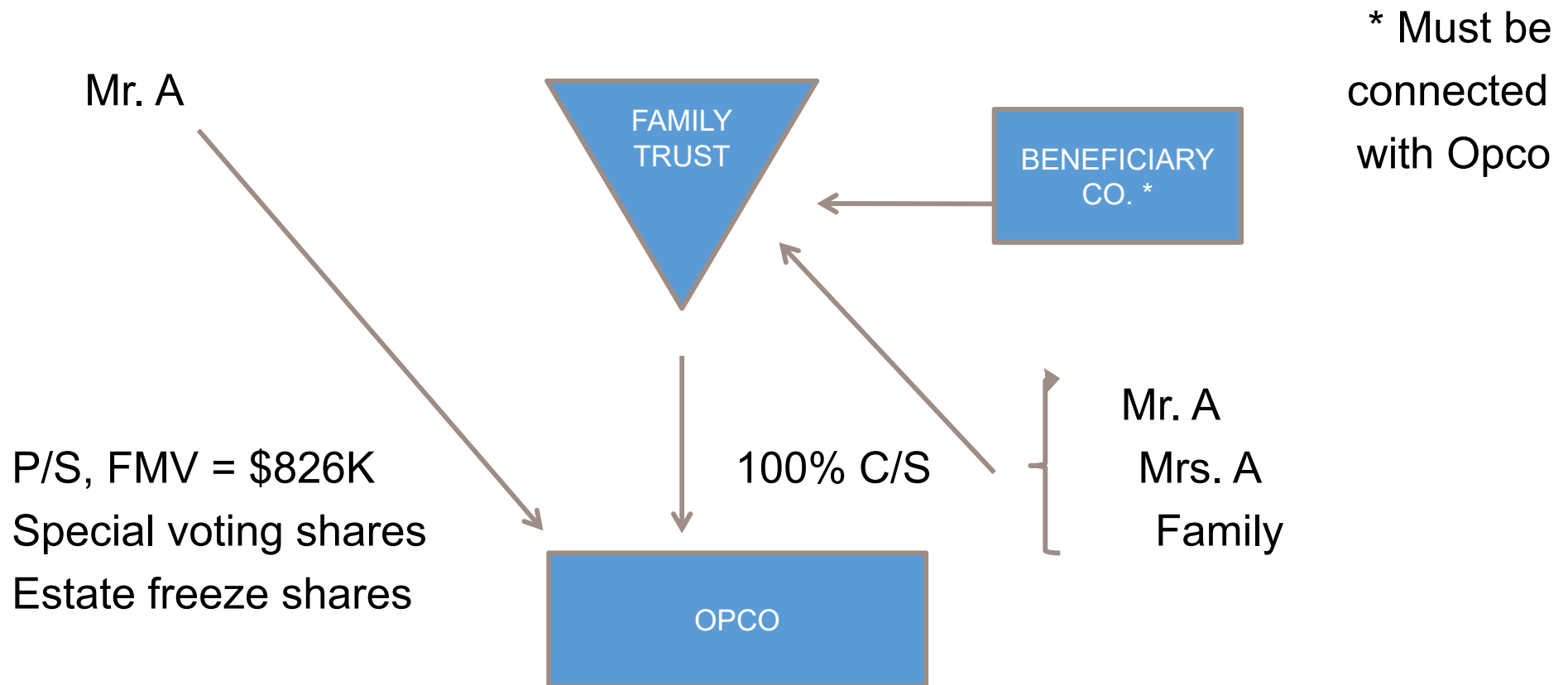
Trust Formation Issues

- Discretionary or Non-Discretionary?
- Discretionary trust benefits
 - Discretionary trusts can adjust to changes in income levels of beneficiaries
 - Discretionary trusts allow clients to adjust to family changes - family disagreements, marital problems of beneficiaries and changes in cash needs of beneficiaries

Accounting Issues and Tax Strategies

Family Trusts

Corporate Beneficiary Structure



Accounting Issues and Tax Strategies

US investor considerations

- What to be aware of when dealing with US investors?
 - The corporation would no longer be considered a CCPC.
 - If you retained equity, would no longer qualify for CGE
 - Not eligible for the small business deduction (15.5% vs 26.5%)
 - SR&ED is not longer refundable and rates are substantially lower
 - Payments to non-resident will be subject to withholdings
 - These could cause issues when calculating Normalized EBITDA

8. What Is Your Business Worth?

VALUATION PRINCIPLES

Governing principles in understanding the value of a business interest and/or asset prior to sale



Value is determined at a specific point in time; changes in value may be dictated by things within the control of management or imposed by circumstances external to the business



Value most likely does not equal price; difference may be attributable to negotiating skills of buyer, seller and advisors, competition for the acquisition, impact of possible ‘special interest purchasers’



Value is based on the ability to generate future discretionary cash flows (net of working capital and capital investment requirements); historic results only a guide



No common approach or valuation metric applies to the business; each valuation and buyer is unique

COMMON VALUATION APPROACHES

The basis of business valuation is applied in both a notional market and open market context. The relevant facts matter in each case.



Asset-based Approach

- ▶ Adjusted Book Value/Net Assets
- ▶ Liquidation
- ▶ Holding companies



Income Approach

- ▶ Capitalized Earnings/ Cash Flow
- ▶ Discounted Cash Flow



Market Approach

- ▶ Comparable transactions
- ▶ Public market multiples
- ▶ Secondary approach



Rules of Thumb

- ▶ Secondary/ tertiary approach
- ▶ Small Business primarily
- ▶ Revenue/Earnings Multiple (beware of data sources)

VALUATION CONSIDERATIONS

- ▶ Tax, accounting and legal implications of a sale of outstanding shares or net assets of a business to a buyer and seller

- ▶ Enterprise Value (EV) vs Equity Value
 - Cash (non-operating asset)
 - Working capital target
 - Debt
 - Redundant assets (land and building)

- ▶ Private companies in the middle market are usually valued between 4 – 6x earnings before interest, taxes and depreciation (EBITDA)
 - Differences between market multiples on valuations of publicly traded companies (capitalization) and transaction multiples

- ▶ Typically, seller retains all cash and has to pay off all debt at closing; normally not defined in the LOI stage
 - Identify items that require closer consideration early in the process (during due diligence) to avoid delays at closing

FACTORS IMPACTING VALUE

A comprehensive and objective assessment of the both the quantitative and qualitative elements of the business is essential

▶ Internal factors

- Visibility on revenue (recurring, contractual, prospective)
- Customer and geographic concentration
- Dependence on key management (sales, executive personnel)
- Capital intensity
- Competitive advantages (product differentiation, price, niche)
- Barriers to entry
- Sale “readiness” (management presentations, good processes, update to date reporting)

▶ External factors

- Size of the market (market share)
- Growing industry (maturity, fragmentation, rate of change)
- Competitive landscape
- Industry consolidation
- Rate of technological change
- Availability of skilled labour
- Regulatory environment
- Local, regional and global economic indicators (borrowing rates, currency fluctuation, consumer demand, global trends, rates of raw materials, etc.)

KNOW YOUR BUSINESS WORTH



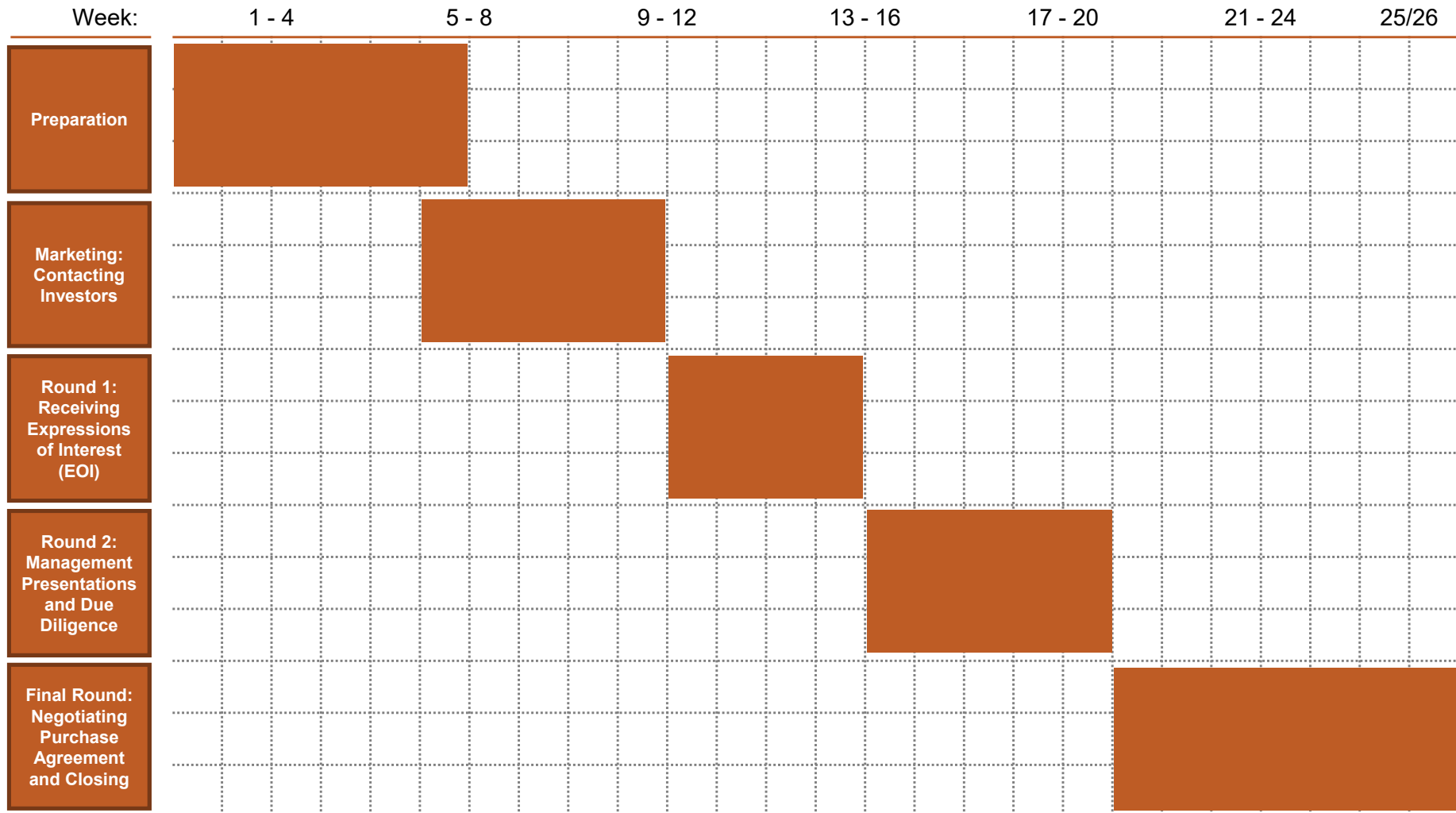
Advantages

- ▶ Business exit planning – increase value over time
- ▶ Manage value and price expectations to close the deal
- ▶ Identify key value drivers to manage and maximize wealth
- ▶ Capitalize on market timing
- ▶ Basis for negotiations and price with potential purchasers or transfers to next generation (succession planning)
- ▶ Tax and estate planning
- ▶ Life insurance coverage

9. Different Stages of the Transaction and Closing the Deal

TYPICAL TRANSACTION TIMELINE

Well-run and successful transactions can be completed within six to seven months.



TYPICAL TRANSACTION TIMELINE CONT.

Well-run and successful transactions can be completed within six months.

Week of	1	2	3	4	5	6	7	8	9	Responsibility
Preparation	Fin. Advisor Due Diligence, draft Confidential Information Memorandum (CIM) and Teaser									Company/Fin. Advisor

- The Preparation phase consists of

- Gathering information about the company
- Understanding financial results and projections
- Assessing value and formulating a sale strategy
- Preparing a comprehensive investors list encompassing strategic and financial investors
- Drafting a teaser detailing investment highlights
- Preparing an information memorandum

TYPICAL TRANSACTION TIMELINE CONT.

Well-run and successful transactions can be completed within six months.

Week of		6	7	8	9	10	11	12	13	14	15	Responsibilities	
Marketing: Contacting Investors	Call prospective investors	[Activity]											Fin. Advisor
	Distribute Teaser		[Activity]										Fin. Advisor
	Negotiate and execute NDAs		[Activity]										Lawyers/ Fin. Advisor
	Distribute CIM and EOI Process Letters		[Activity]										Fin. Advisor

■ The Marketing phase consists of

- Contacting potential investors and presenting the investment opportunity
- Distributing teasers to prospective investors
- Facilitating the terms and of confidentiality agreements
- Finalizing and distributing the information memorandums
- Distributing “Expression of Interest” Process Letters to gauge interest levels and valuation ranges of prospective investors

TYPICAL TRANSACTION TIMELINE CONT.

Well-run and successful transactions can be completed within six months.

Week of		10	11	12	13	14	15	16	17	18	19	Responsibilities	
Round 1: Contacting Investors and Selecting Preliminary Offers	Investors Review Confidential Information Memorandum	[Activity]											-
	Expressions of Interest Due				[Activity]							-	
	Evaluate Expressions of Interest, select participants					[Activity]						Company/ Fin. Advisor	

■ Round 1 consists of

- Allowing prospective investors to review the information memorandum
- Liaising with prospective investors and answering questions based on the information memorandum
- Collecting the Expressions of Interest
- Evaluating the Expressions of Interest and selecting participants for the next round

TYPICAL TRANSACTION TIMELINE CONT.

Well-run and successful transactions can be completed within six months.

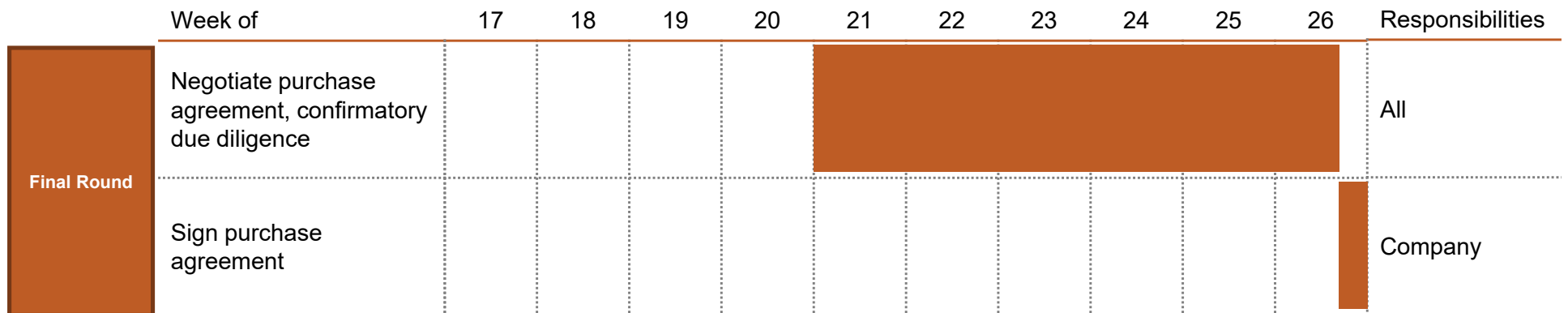
Week of	14	15	16	17	18	19	20	21	22	23	Responsibilities	
Round 2: Management Presentations and Due Diligence	Management Presentations	[Activity]										Company/ Fin. Advisor
	Distribute "Letter of Intent" Process Letter					[Activity]					Fin. Advisor	
	Prepare purchase agreement		[Activity]								All	
	Investor due diligence	[Activity]										Company/ Fin. Advisor
	Letters of Intent due							[Activity]				-

■ Round 2 consists of

- Facilitating Management Presentations for round 2 participants
- Answering additional questions from prospective investors
- Distributing "Letter of Intent" process letters
- Co-ordinating with lawyers to prepare a purchase agreement
- Allot time for investor due diligence
- Host an online datasite with relevant information for due diligence
- Manage prospective investors' access to sensitive information
- Collect Letters of Intent

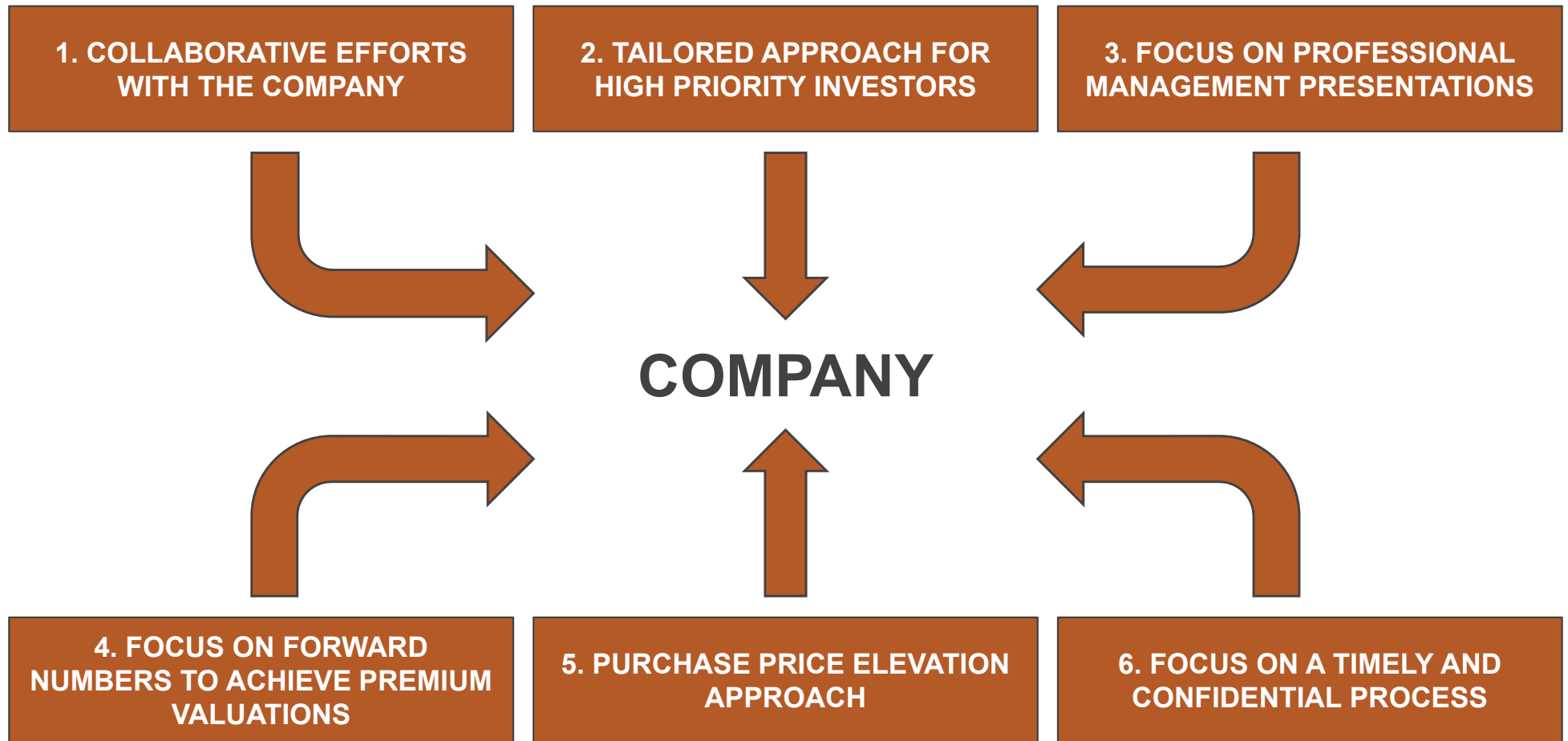
TYPICAL TRANSACTION TIMELINE CONT.

Well-run and successful transactions can be completed within six months.



- The Final Round consists of
 - Negotiating terms of purchase
 - Choosing the appropriate investor based on Letters of Intent
 - Allow the chosen investor to perform confirmatory due diligence
 - Finalising and signing the purchase agreement

TRANSACTION PROCESS APPROACH



TRANSACTION PROCESS APPROACH CONT.

1 Collaborative efforts with the Company

Work closely with the Company to gain a deep understanding of the business up front:

- Fully capture the Company's complete "story" ultimately driving investor excitement
- Provide the financial advisor with the ability to answer many investor questions up front without needing to take up Management's time

2 Tailored approach for high priority investors

Customized approach highlighting:

- Strategic rationale
- Synergy opportunities
- Growth opportunities

TRANSACTION PROCESS APPROACH CONT.

3 Focus on professional management presentations

Emphasis on Management Presentation to drive premium value:

- Proper articulation of the acquisition opportunity to chosen investors
- Face-to-face discussions with a prepared team results in instant credibility
- Appropriate forum to convey “upside” opportunities
- Tailored discussions to address investors’ key interests and concerns

4 Focus on forward numbers to achieve premium valuations

“Bottoms-up” forecast supports future prospects:

- Ensuring the Company’s forecast is sufficiently detailed and defensible ensures the Company receives appropriate credit for growth prospects
- Emphasize the sustainability of earnings

TRANSACTION PROCESS APPROACH CONT.

5 Purchase price elevation approach

Customized approach to drive initial bids:

- Address key issues related to investor's business strategy
- Limit valuation demands early in the process; wait until investors have become invested in the project financially and emotionally

6 Focus on a timely and confidential process

Adhering to strict timelines creates momentum and keeps investors engaged:

- Reduced deal fatigue
- Emphasis on confidentiality reduces business disruption and market leaks

10. Wrap Up and Q&A

THANK YOU

Federica Nazzani

President
Capital Assist (Valuation) Inc.
(519) 969 5777 x24
fnazzani@capitalassist.ca

Ken Moore

Managing Partner
NewPoint Capital Partners
(416) 340 9998
kmoore@newpoint.ca

Ferruccio Da Sacco

Partner
BDO LLP
(519) 944 6993 ext. 3804
fdasacco@bdo.ca

William Willis

Partner
McTague Law Firm LLP
(519) 255 4331
wwillis@mctaguelaw.com

Rakesh Naidu

Interim CEO
Windsor Essex Economic Development
(519) 997 2390
rnaidu@choosewindsor.essex.com