

RISKY BUSINESS: 8 AREAS OF RISK TO ADDRESS BEFORE ANY TRANSITION

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Key Areas to Maximize Business Value on Sale

1. Strategies to de-risk your business - 8 areas to address before a transaction
2. Factors affecting timing of strategy deployment on a short, medium or long-term basis
3. What are the big discount or deal breaker items?
4. Some keys to attract a wide range of buyers
5. Tips to demonstrate and obtain maximum value in the sales process



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Strategies for 8 Key Risks

1. Have a clear short, medium & long-term plan for business and owner's personal objectives
2. Maintain an aggressive plan for market intelligence & brand positioning
3. Maintain core management team and an effective HR plan
4. Control unnecessary costs and contingent liabilities
5. Effectively deploy essential technology & systems

Strategies for 8 Key Risks (continued)

6. Identify & mitigate threats to revenue growth
7. Appropriate use and leverage of real estate & capital assets
8. Obtain solid partnership & supplier agreements that contribute to long-term stability

9. Bonus point: Manage significant external risks, e.g. high cost of housing, higher personal income tax rates, the Trump factor



Business Performance Curve

High Growth

Increase Value

Good Operations

**Increase/
Preserve Value**

- Normal Going-Concern

**Operational & Financial
Problems**

- Informal Care

Troubled Businesses

**Stabilize Situation
Recovery Solutions**

- Proposal to Creditors
- CCAA

**Distress/
Insolvency**

**Recovery & Liquidation
Solutions**

- Foreclosure
- Receivership
- Bankruptcy



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Sources of Information, Advice & Wisdom

- Transactions expertise
- Industry & business associations
- Independent industry & business expertise
- Professionals: tax, valuations, law, financing, insurance, etc.
- Management & Board
- Owners
- Customers, suppliers, lenders

Short, Medium & Long-term Plan for Business & Owner's Personal Objectives

- Employ strategies for business issues on a timely basis consistent with their urgency, timing for successful implementation, economic and industry conditions
- Owner's key financial considerations include ability to finance existing operation, expectation of return of capital, desired working horizon, estate planning options
- Owner's key non-financial considerations include health of self or close family members, personal impact on owner and family, alternative endeavours; non-financial legacy issues



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Value Expectations of Business Owners

- Understand determinants of the business' value
- Objectively consider strengths & weaknesses of the business
- Estimate current and potential value within sale horizon
- Separate employment income from investment return
- Estimate effect on value of post-sale business involvement of owner

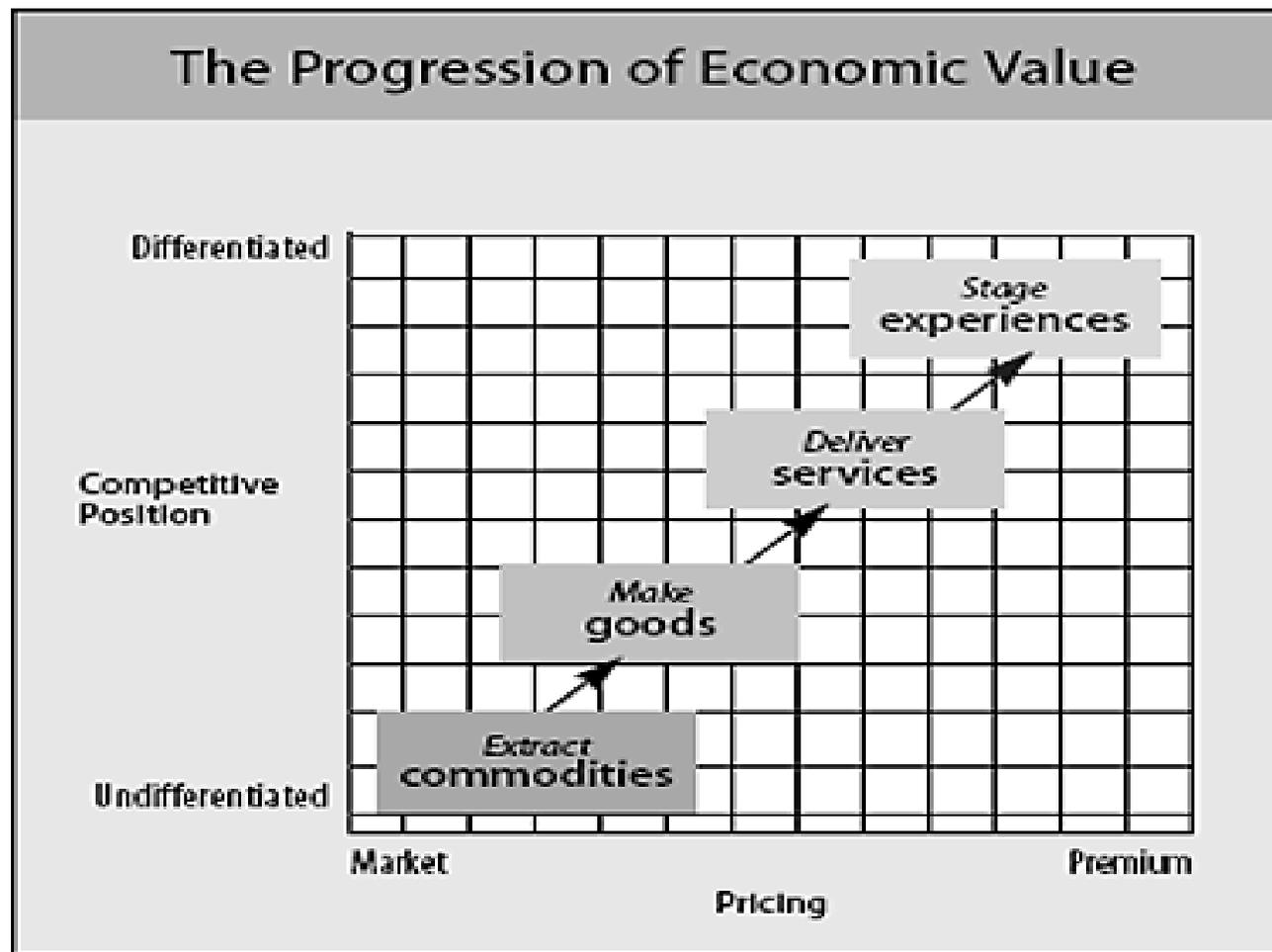


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“Risks to business are universal whether in the experience or traditional sectors of the economy. Strategies to mitigate risk are common and their deployment is critical to achieving maximum transaction value”

The Experience Economy - Joseph Pine & James Gilmore





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The Experience Based Sector

- Retail
- Hotels, Resorts & Food Services
- Technology (Hardware and Applications)
- Entertainment
- Automotive & Transportation
- Education



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Common Characteristics

- High levels of design and theming
- High levels of management sensitivity
- Higher initial investment costs
- Higher levels of cyclical reinvestment
- High level of goodwill as a component of value
- Becoming a dominant sector of the economy in many markets including British Columbia



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Case - Hotel Management Company

Strategy to Successful Transaction

- Consistent Advisory team over the 8 year process
- Regional management company with no real estate
- Core team drawn from the best in the industry
- Network of hotels expanded from a single major market
- Long term contracts with sustainable growth in earnings
- Constant rationalization of their product and market position
- 10 year strategy to grow and sell on to a larger brand – optimal timing

Case - Hotel Management Company

Strategy to Successful Transaction

- Maintained core team
- Strategically targeted locations **only**
- Target buyers were constantly assessed
- Value was in product conceptualization and experience delivery
- Timed transaction when major brands needed to enter key markets
- Sold at 7 times earnings and the buyer re-flagged all properties



Operating Business Owners

- People are decision-makers, employees & advisors
- Own assets, entitlements
- Provide products, services & experiences to customers
- Real estate is integral to most businesses & owners
- Unwise use of real estate impairs value

vs. Real Estate Owners

- People are decision-makers, employees & advisors
- Own assets, entitlements
- Provide products, services & experiences to customers
- Operating business is integral to many types of real estate
- Struggling operating businesses impair value of real estate



Operating Business Owners

- Understand complexity of business and need for good analysis & expert advisors
- Wide range of advisors available on a fee for service basis
- Performance fees usually paid for effecting transactions
- Analysis may not capture full real estate value

vs. Real Estate Owners (cont'd)

- Transactions are dominated by brokers who are paid on commission basis
- Residential developers make much of their money on convincing consumers to spend more on life style consumption
- Few advisory service providers to help maximize value

Real Estate...a sometimes overlooked business asset

- Real estate—leased or owned—is often a business’s second largest expense, after labour expenses
- Multiples on income-generating real estate are higher than for business operations, depending upon location and use, for example:
 - Businesses 5-10 x EBITDA
 - Real Estate for Metro Vancouver Q3:2017 (source CBRE)
 - Industrial 19-25 x NOI from real estate (like EBITDA)
 - Office 17-26 x NOI “
 - Retail 18-28 x NOI “
 - Rental Apartment 23-40 x NOI “



Characteristics of Real Estate Assets

Strengths

- Fixed & unique (generally)
- Store of value (generally)
- Inflation hedge
- Security for business loans
- We all need some—for business or personally!

Weaknesses

- Immobile & unique
- Illiquid (securitized)
- Limited supply
- Costly (to buy or lease)

Case 1 – Sale of Business with Real Estate Assets

OVERVIEW

- Civil construction company in southern B.C.
- Owned its own works yard (± 10 acres) and equipment
- Old established successful family company
- No succession, so shareholders pursued quiet sale
- Sold business as going-concern
- Sold excess equipment separately
- Retained property, and leased it for five years to buyer

Case 1 – Sale of Business with Real Estate Assets (continued)

OUTCOME

- Business
 - Going-concern value: 3 to 4 x EBITDA
 - Add value from surplus equipment sale
- Real Estate
 - Mid-term: leasing income for vendor + property value of 12-17 x NOI
 - Longer-term: potential for redevelopment to “higher and better use”
- Buyer
 - Obtained and kept business in existing location without needing to purchase the property
 - Longer term, business needs to move to smaller less expensive premises

Case 2 – Sale of Business with Real Estate Assets

OVERVIEW OF BUSINESS

- \$1 billion+ Canadian-based plastics manufacturer: over 60 plants worldwide
- Board wanted to sell company, and distribute proceeds to shareholders
- Much of its own real estate was in Toronto
- Sold business operations to another plastics manufacturer
- Retained ownership of Toronto properties, and leased them for 10-year terms to buyer
- Sold Toronto properties as a portfolio to an institutional investor—effectively, a “sale-leaseback”—for over \$500 million (probably worth more)

Case 2 – Sale of Business with Real Estate Assets (continued)

OUTCOME

- Business
 - Value of going-concern and non-core and redundant properties:
4 to 5 x EBITDA
- Real Estate – Toronto properties
 - Well-located re. major highways and employees
 - No mid- to long-term potential for “higher and better use”
 - Value: 16-20 x NOI
- For Buyer – Obtained business operations without needing to purchase the property

Case - Hotel Management Company

Where could it have gone wrong?

- No plan for exit
- Deviation from strategic principles
- Failure to reward and protect key human resources
- Becoming too attached to their brand
- Losing the support of their stakeholders
- Derailing the strategy – minor external forces
- Increasing costs to expand in non core areas

Case - Hotel Management Company (continued)

Where could it have gone wrong?

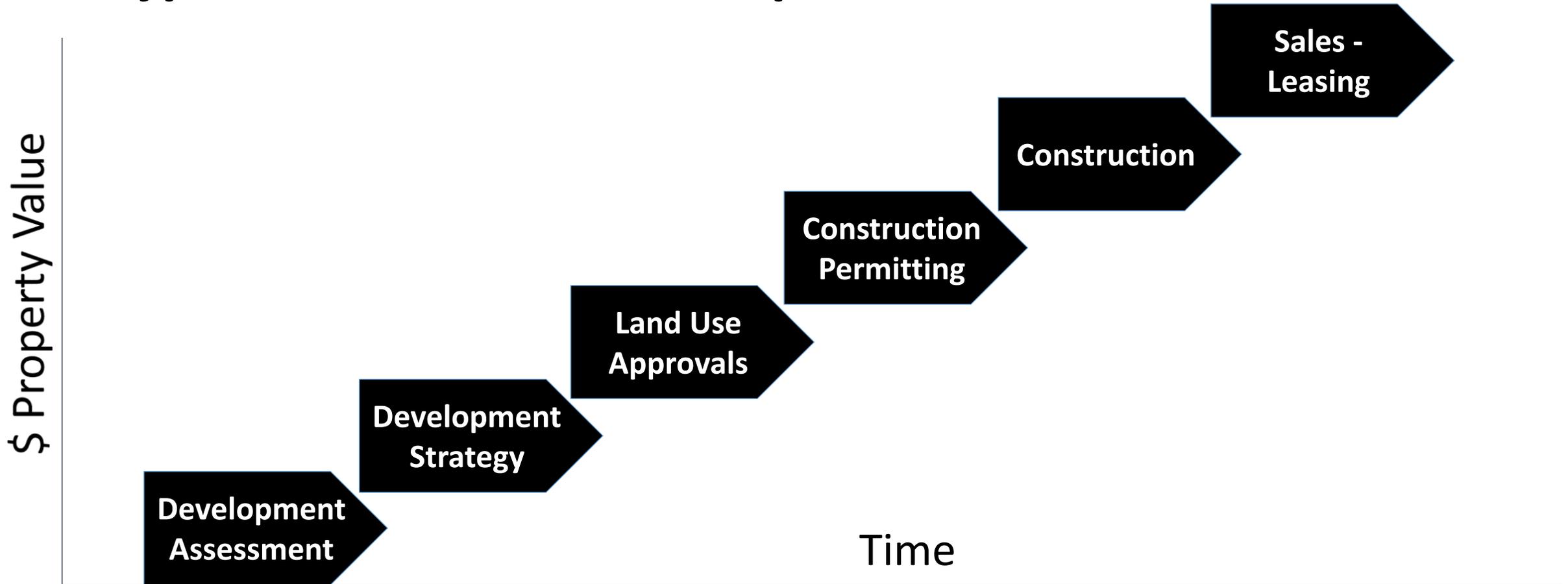
- Complicating the balance sheet – investment in non-core assets
- Failure to leverage industry technology
- Expanding to incompatible market locations
- Developing product lines that a buyer wouldn't pay for
- Timing – seeking a transaction earlier than plan or market readiness
- Going to market with a broker only
- Failure to establish competing bids from strategic buyers – impatience



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Typical Real Estate Development Process



Appreciation of Land Values from Redevelopment

Hypothetical example of residential townhouse property
in Surrey/Delta/Langley:

- Land Purchased \pm \$300 thousand per acre
(agriculture zone; not in ALR)
- Land Designated for Residential uses \pm \$2-3 million per acre
- Land Re-zoned for Townhouses \pm \$2.5-3.5 million per acre

Options for Owner of Redevelopment Property

ROLE	RISK	PROFIT
• Sell property “as-is” for others to develop	none	none
• Redevelop yourself (unless experienced)	high	high
• JV with developer and share profit	medium	medium
• Engage Professional Team (generally on base fee + success fee) and earn 100% profit	low- medium	high

Keys to Attracting Wide Range of Serious Buyers

- Consider all likely potential buyers: management, competitors, customers, suppliers, similar companies in other geographies, companies supplying complementary services, financial buyers, foreign buyers (US, Asia), etc.
- From the eyes of the buyers, determine the benefits and compelling reasons for them to buy
- Provide convincing vendor due diligence information to showcase operational, strategic and risk management since many buyers often limit most of their due diligence to accounting, financial, tax and legal due diligence which can limit sound understanding of the business

Tips to Demonstrate & Obtain Maximum Value

- Provide extensive vendor due diligence information to buyers to facilitate understanding of vendor's value drivers and risk minimization
- Perform extensive due diligence on key buyers
- Summarize the benefits of the vendor's business for each buyer and if necessary provide turnkey solution secure a buyer without local resources
- Negotiate 1-2 backup offers
- Consider stalking horse or backup offer with break fee
- Build trust

Main Take-Aways – Finalize this when rest of deck is finished

1. Foundation for high business value starts with maximizing operating results, asset values and minimizing risks/discounts
2. Preparation time, analysis, tough decisions can maximize sales value for businesses regardless of their performance
3. Maximizing value to owner includes non-financial benefits
4. Redundant assets and real estate often provide hidden values
5. Inattention to business problems can also quickly impair value
6. Lessons from troubled businesses are invaluable for improving value of healthier businesses
7. Consider key external risks and influences