

Creating Shareholder Value in Turbulent Times

The current economic environment has led to unprecedented challenges and uncertainties for many companies. Most business owners and executives have adopted a “defensive” posture and are focused on controlling costs, managing cash flow and developing contingency plans in the event that the downturn gets even worse. While these things are important, business owners and executives should also be thinking about how the current economic environment is creating excellent opportunities for increasing shareholder value. This article introduces a few of the initiatives (summarized in Exhibit 1) that might help in achieving that goal.

Exhibit 1

Possible Shareholder Value Creation Initiatives

Process and Systems Improvements
Exchanging Price Concessions for Commitments
Supplier Discounts
Locking in Key Employees
Employee Share Ownership Plan
Opportunistic Acquisitions
Estate Freeze

Process and Systems Improvements

The challenge that companies have when they are busy and growing is that everyone becomes focused on filling orders or dealing with immediate customer issues, which leaves little time for less urgent, but important, initiatives such as implementing “best practices” for the company’s processes and systems. With the slower economy, companies should be taking the opportunity to implement process and systems improvements that will create efficiencies and improve customer satisfaction. This may include improvements in information systems, purchasing, logistics, management practices and other areas.

Process and systems improvements do not necessarily require significant incremental capital spending at a time when companies are trying to conserve cash. Rather, it speaks to the opportunity to use employees and other resources that may otherwise be underutilized.

Particular consideration should be given to process and systems improvements that will help the company in securing a differential advantage over its competitors (e.g. improving order accuracy or on-time delivery). A sustainable competitive advantage leads to greater customer “stickiness”, which in turn serves to enhance shareholder value.

Exchanging Price Concessions For Commitments

Many companies are being approached by their customers with requests for price discounts or extended payment terms. Business owners and executives should consider how their company can obtain longer term commitments from customers in exchange for such concessions. The ability to develop a diverse base of repeat customers will create shareholder value.

A word of caution is warranted here regarding extending payment terms to customers. In the case of a customer that has a very weak financial position, the extension of payment terms may just serve to increase bad debt write-offs. In addition, companies that rely on short term operating loans may find that their banks are not willing to lend against accounts receivable that have been outstanding for more than 90 days. Therefore, companies that agree to extended payment terms must keep a close watch on the financial status of their customers.

Supplier Discounts

Some companies may find that their suppliers are struggling with cash flow problems caused by high levels of accounts receivable and inventories. This presents an opportunity for companies that have available cash or credit to obtain attractive discounts for early payment. Recall from the previous edition of Value Strategies that payment terms of 1% 10 days / net 30 days equates to an effective annual interest rate in excess of 18%. While most suppliers will not be enthralled at the prospect of offering such discounts, in some cases those suppliers may have reached the limits of their operating loan arrangements and have few options available.

Ideally, business owners and executives should take the opportunity to negotiate attractive payment terms that will be in effect over the longer term by way of written agreement. This will result in long-term cash flow accretion for their company, and consequently higher shareholder value.

Locking In Key Employees

The current economic environment has many employees feeling nervous about their job. It is important for companies to offer reassurance to their key employees (to the extent possible) in order to avoid having certain individuals leave the company in favour of a less attractive role that offers the perceived benefit of greater job security.

Where practical to do so, business owners and executives should take the opportunity to ensure that key employees are somewhat locked in, pursuant to an employment contract. Most employment contracts contain provisions that restrict the ability of the employee to directly compete against the company for a prescribed period of time. While the Courts generally will not enforce a broadly-worded non-competition agreement that limits a person's ability to earn a living, it might be possible to secure a non-competition agreement that applies to selected direct competitors. In any event, most employment contracts will contain provisions that prohibit the employee from disclosing non-public information, or soliciting the company's customers or other employees for a specified period of time following their departure. While such provisions only provide a limited amount of assurance, they can have some positive effect. Appropriate legal advice should be sought.

While employers may have to offer employees an incentive to sign an employment contract, the related costs can be offset by the increase in shareholder value that results from having a base of committed employees and strong management depth.

Employee Share Ownership Plan (“ESOP”)

Depending on the situation, and the personal and financial objectives of the business owner, the current economic environment may be an ideal time to launch an ESOP.

While there are many variations of ESOP's, most award key employees with options that vest over time which can be exercised to buy shares of the company at a specified “strike price”, established at the option issuance date. Given the prevailing economic conditions, the strike price for a newly established ESOP would likely be on the low end. While this means that the business owner may be giving up some value when the options are exercised, the potential upside can be well worth the cost.

Employees that are presented with an opportunity to participate in an ESOP in today's environment will feel they are getting “in on the ground floor”, and it will motivate them to perform well so that they can experience the benefits of share appreciation. ESOP's can also have a significant behavioural impact, as they encourage employees to think and act like shareholders, and to look for ways to increase shareholder value. ESOP's can also increase shareholder value by helping to ensure the retention of key employees (particularly where lengthy vesting periods apply). It's a win-win situation.

Opportunistic Acquisitions

The current economic environment has created unprecedented opportunities for consummating strategic acquisitions. Many companies with strong business fundamentals (e.g. proprietary products or services, well-established brand names or a strong customer base) are finding themselves in a position where they require outside equity capital or have to sell. Business owners and executives should not only focus on negotiating an attractive purchase price, but also on

how they can structure the terms of the deal (e.g. forms and conditions of payment) in order to offset some of the risk inherent in corporate acquisitions. Reduced risk leads to increased shareholder value.

An often overlooked source of excellent acquisition opportunities is small-cap and mid-cap public companies. Many quality companies have become attractive takeover targets because of the depressed financial markets. The benefit of dealing with public companies is that their financial information is readily available, and their negotiating position is somewhat constrained by the prevailing trading price of their shares.

Estate Freeze

An estate freeze allows business owners to facilitate ownership succession to family members (usually children) or other parties. It can also be an effective way of crystallizing the lifetime capital gains exemption (currently at \$750,000 per individual for qualifying companies) and to set the stage for multiplying that exemption among family members through trusts and other structures.

In most cases, business owners looking to undertake an estate freeze have a low value bias, in order to maximize the amount of wealth passed on to the next generation in a tax-deferred manner. Given the current economic conditions, this may be the ideal time for business owners to undertake an estate freeze in order to secure a lower valuation. The Canada Revenue Agency requires “reasonable efforts” at establishing business values for an estate freeze. This usually means obtaining a valuation report prepared by a qualified independent valuation expert (such as a Chartered Business Valuator, or “CBV”).

Business owners should remember that there is a mandatory 24-month holding period for shares to qualify under the lifetime capital gains exemption rules. Therefore, proactive estate planning is required during challenging economic times in order to realize lucrative tax savings when the business is subsequently sold in more buoyant economic times.

Value Strategies is a publication of **Veracap Corporate Finance Limited**. Veracap helps business owners & executives to maximize shareholder value through acquisitions, divestitures, management buyouts, family business succession, private equity financing and corporate growth strategies. Veracap is an affiliate of **Campbell Valuation Partners Limited**, Canada’s longest established independent valuation firm.

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RECENT NEWS

IN MEMORY OF BAILEY ZAVEDA

Bailey Brooke Zaveda (1985 – 2008)

Bailey Zaveda held the role of Marketing Coordinator at our firms, Veracap Corporate Finance Limited and Campbell Valuation Partners Limited.



Bailey was the innocent victim of a senseless act of violence that took her life on October 25, 2008. We were all shocked and deeply saddened by this tragic loss.

To everyone who knew her, Bailey was more than just a cheerful and dedicated employee. Most importantly, she was kind-hearted friend. Bailey touched each of our lives in a special way. This is how we will remember her.



CREATING SHAREHOLDER VALUE IN TURBULENT TIMES

Join us at a complimentary breakfast meeting.

Tuesday, February 17, 2009

8:00 a.m. to 10:00 a.m.

Continental breakfast and registration at 7:30 a.m.

Doubletree International Plaza Hotel

655 Dixon Road, Toronto M9W 1J3

Reserve your spot by an email to Kelly Ralston at kralston@theclci.com by January 31, 2009.

The Corporate L.I.F.E.™ Centre International is pleased to sponsor an executive seminar that will provide an excellent opportunity to CEO's and business leaders to focus on key factors that drive shareholder value within their organizations. The seminar will explore how business leaders can turn the turmoil created in the current economic environment into opportunities by focusing on the initiatives that will increase shareholder value over the long term. Specific topics to be covered include:

- *How business values are established*
- *Identifying key value drivers*
- *The Shareholder Value Curve™*
- *Developing a shareholder value scorecard*
- *What you can't measure, you can't manage*
- *Translating strategy into operational terms*

The presenters are Howard Johnson, President of Veracap Corporate Finance and Mansoor Osmani, President of The Corporate L.I.F.E. Centre.



PRIVATE EQUITY SYMPOSIUM

The **Private Equity Symposium** is a collaborative event between Financial Executives International Canada (FEI Canada), the Canadian Institute of Chartered Business Valuators (CICBV), Toronto CFA Society and Canada's Venture Capital & Private Equity Association (CVCA). Howard Johnson, President of Veracap, will be moderating a session entitled "Back to the Future – Opportunities Springing out of Turmoil".

Tuesday, March 3, 2009

12:00 p.m. – 5:00 p.m.

MaRS Centre, 101 College Street, Toronto, ON

To register or for more information, please visit:

www.feicanada.org/pes2009

or contact Marita Dias, 416-366-3007 Ext. 5111

mdias@feicanada.org



HALIFAX WEBINAR

*This Hour has 33 Minutes for Business
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WILL YOU SELL YOUR BUSINESS?

Howard Johnson, President of Veracap, will co-host this discussion on how to get top dollar by making your business more attractive to potential buyers and minimize taxes on the sale.

Tuesday, April 7, 2009

1:30 p.m. Atlantic 12:30 p.m. Eastern

Participate from the comfort of your office via phone and internet.

To register, indicate the session name in reply to: leah.corby@rbc.com You will receive participation details plus information on our guest speakers. Your seminar host is Chris Butler CFP, FMA, Financial Planner, Investment Advisor – RBC Dominion Securities Inc. This webinar is free however, space is limited. Advanced registration required.