NORTHWOOD STEPHENS
PRIVATE COUNSEL INC.

Best Independent Family Office in Canada
EUROMONEY Private Banking Survey 2007


# THE NORTHWOOD STEPHENS PERSPECTIVE


SPRING 2007


## President's Message

Welcome to the Spring edition of The Northwood Stephens Perspective, a newsletter geared toward the interests of our clients, friends and colleagues. We hope this publication will stimulate your thinking and offer valuable insights, through articles written by our own staff and some outside specialists from time to time.

At our house, in addition to two teenagers, we have two Labrador retrievers, one of them a 10-month old puppy. For us, the spring season brings melting snow which reveals a veritable 'landfill site' of chewed items from the recycling box in the backyard. Spring cleaning takes on a whole new meaning!

The idea of 'spring cleaning' or 'getting our house in order' seems to resonate with most of us, particularly this time of year. For many of our business-owner clients, this essentially involves planning ahead and getting organized to take best advantage of every stage of the business – growth, transition and even an eventual sale. So this edition includes a number of articles focused on this idea.

One article focuses on finding alternative sources of financing, primarily to grow your business. Another details a method to prepare your business to be passed on to future generations while minimizing or deferring tax through an estate freeze. The final business-owner-oriented article focuses on what to do when you find yourself "suddenly liquid" after a business sale.

By the way, a number of you have asked about the Northwood Stephens' art displayed throughout our offices and in our newsletters. If you like what you see, let me know as I'd be happy to connect you with the artists, some of whom are yet 'undiscovered'!

All the best for a great spring season!

Sincerely,

**Tom McCullough**
*President and CEO*

*Photograph courtesy of Frances Juriansz Photography*

## Finance Grade 1(01)

*Scott Hayman, CA, CFP*
*Executive Vice President and Head of Client Service*
*Northwood Stephens Private Counsel Inc.*

One day a little while ago, when I got home from work, my six year old daughter Sarah came bounding up to me, gave me a big hug and said, "Daddy, will you come into my class and tell us what you do?"

Without hesitation, I agreed. She then informed me that I had to fill out a piece of paper to give the teacher an idea about what I did. So she started with the first question: "What is your job?" Before responding I thought about all the things we do at Northwood Stephens and decided I would try and keep it simple. "Daddy is a financial advisor." "What's that?" she asked. Lost in my attempted simplicity was what I actually did! So, I tried a different tack. "I help people take care of their money." That seemed to suffice.

**"I help people take care of their money."**

With what I do seeming to be of enough interest to get me in the classroom, I now had to figure out how to communicate this to a group of Grade 1 students. When I started thinking about it (and knowing that I only had 10 minutes to explain), I didn't think talking about financial planning, investment planning, estate freezes, insurance, private equity, hedge funds, etc. would hold their interest. So I decided to tell them what I do in a language I thought they would understand.

I went back to what I had said to Sarah—that I help people take care of their money. I told the kids that there are really only three things that you can do with your money: save it, spend it, or give it away. Well, that was all I needed to say. They got it, and had a lot of questions, but also a lot of ideas on how you do those three things.

Some of them talked about how hard it was to save because there were so many things that they wanted to buy. Others said giving their money away made them feel good, but they didn't think they should give all their money away because they might want to buy something. Some talked about how much fun it was to spend money because they got new things.

The two best questions/comments I got were, "Why can't you do all three things?" and "If I spend less, I will have more to save and give away."

**"Keeping things simple is a good way to plan, and kids really are smart!"**

So teaching my Grade 1 finance course showed me two things: keeping things simple is a good way to plan, and kids really are smart!

**NORTHWOOD STEPHENS PRIVATE COUNSEL INC.** IS A MULTI-FAMILY OFFICE PROVIDING COMPREHENSIVE NET WORTH MANAGEMENT™ TO WEALTHY FAMILIES AND FOUNDATIONS.

## Suddenly Liquid

*Tom McCullough, MBA, CIM, FCSI*
*President and Chief Executive Officer, Northwood Stephens Private Counsel Inc.*

*Bill has run his own logistics business for thirty-two years and has built it into a thriving business. His daughters are now involved full-time and he always pictured passing it on to them at the right time. But with the hot private equity market, he got an offer at the end of last year that he (and the family) couldn't pass up. So he sold his business. Suddenly he went from being a 'business owner' to being an 'investor' with $30 million cash in his pocket.**

When an entrepreneur *sells* a business and receives cash, a new *business* is essentially thrust upon the entrepreneur: **the business of managing new found liquid wealth**. And typically, there is no one to play a leadership role in the management of this new 'business', it is usually unfamiliar territory to the entrepreneur who has spent much of his or her life managing a business, and there is rarely any kind of 'business plan'.

Wise business owners plan for this change well in advance. While the liquidity event is often 'sudden', most business owners have some idea that they may eventually sell, and so should prepare for such an occurrence. Not only should they think about the leadership succession and sale issues (relating to the business itself), but they should also seek advice on the structuring of their personal holdings of the assets before and after the sale. They also should seek out advice on how their newly-liquid net worth should be managed, in the context of the overall family objectives.

When should this advice be sought? Generally, the sooner the better, to take advantage of all possible planning opportunities. Some of these opportunities include:

- Ensuring you (and potentially your spouse and children) can take advantage of the $750,000 lifetime capital gains deduction (thereby potentially saving up to $172,500 in taxes per person).
- Spreading assets and company shares amongst your family members to maximize after-tax proceeds.
- Removing assets that would not be part of the sale ('butterfly' transaction).
- Undertaking a business valuation exercise.
- Determining whether you should sell the *assets* or the *shares* of the company.
- Ensuring your shareholder agreement is current and complete.

The same rules apply for non-entrepreneurs when sudden liquidity comes upon them, whether it is an inheritance or a large severance or bonus payment.

Planning for such eventualities is one of the core aspects of Northwood Stephens' family office services. We help ensure there is a clear set of goals for the assets and the overall family net worth, provide objective, integrated advice on how the liquid assets should be handled, and aim to leave our clients with the peace of mind that they have made good decisions and they have someone helping them manage their affairs on an ongoing basis.

**Names and certain details have been changed to ensure confidentiality.*

## Federal Budget 2007 Recap

*Eric Weir, CFA, CFP*
*Associate, Northwood Stephens Private Counsel Inc.*

On March 19, the Minister of Finance, Jim Flaherty, tabled the Conservative Party's second federal budget. The following is a summary of the key items contained in the Budget, which will affect individual taxpayers. Note that the budget has not been officially "passed" as of yet.

- **Registered Education Savings Plan (RESP)** – The current $4,000 annual limit on contributions will be eliminated and the lifetime limit will be increased from $42,000 to $50,000. In addition, the maximum Canada Education Savings Grant will be increased from $400 to $500 annually.
- **RPP and RRSP Age Limit** – For years after 2006, RRSP annuitants may retain their RRSP and continue to make contributions until the year in which they turn 71, up from the current age maximum of 69. In addition, for those individuals turning 70 or 71 in 2007 and for those turning 71 in 2008, the minimum withdrawal from a RRIF for those years will be nil.
- **Lifetime Capital Gains Exemption** – Capital gains realized on the disposition of qualified farm and fishing property or qualified small business corporation shares, on or after March 19, 2007, will be eligible for a lifetime maximum exemption of $750,000. This proposal is an increase from the current $500,000 lifetime exemption.
- **Private Foundations** – There will be a zero inclusion rate on gains arising from gifts made after March 19, 2007 of publicly traded securities to private foundations. This will put gifts to private foundations on the same footing as gifts to public foundations.
- **New Child Tax Credit –** A new non-refundable child tax credit will be available, beginning in 2007, for each child under the age of 18 years at the end of the year. Given the current minimum federal tax rate, this credit would result in a $310 federal tax savings per qualifying child.

## GUEST COLUMN:
## Non-Traditional Financing: What to do when the Bank says No

*Barry O'Neill*
*Managing Partner, Zed Financial Partners*

In the business of investment banking we are exposed to all kinds of difficult situations that business owners can face. Sometimes our client's need for financing is driven by an unexpected business or sector slowdown, other times it is for acquisition or growth purposes. But more often than you might think a need for capital will arise as a result of a breakdown of existing credit facilities through no real fault of the borrower.

Some of the most disheartening circumstances we've seen have involved management being "blindsided" by their traditional financial partners. A business owner can have a long-standing relationship (along with a shining credit rating and excellent margins) with a traditional lender and still find their loan called, or "no-brainer" requests for further capital declined. Changing market conditions, concerns about exposure to industry sectors and risk management strategies can change a traditional lender's interest in a client and the effects can be devastating.

But there are steps that business owners can take to go on the "offensive" and secure the liquidity they need to grow outside of traditional financing sources. Business owners and managers must learn to become as creative and versed in options for financing their businesses as they are in other facets of operations.

Sometimes it is a matter of looking for another financial institution that better understands the business. Other times, it requires re-examining the assets of a company from a different perspective. Alternative or non-traditional financing options can help to facilitate and allow for the execution of business plans.

Often access to the appropriate financing may solve liquidity problems or even present hidden and creative opportunities for freeing up cash flow. Several unique structures may be employed in order to ensure a successful transaction and to maximize the availability of funds. Knowing where to find the different types of financing is crucial.

THE U.S. OPTION: An increasingly viable option for Canadian businesses is U.S. private equity and private debt lenders. In Canada there is a limited number of such sources of capital available, but in the United States, there are hundreds of different institutions and vast amounts of money that are actively seeking opportunities in Canada.

Because of the size and specialization of the U.S. financing market there are numerous funds that specialize in specific industries. Understanding industries allows them to better assess the risks and rewards associated with the financing, resulting in a better financial partner.

GETTING CREATIVE: Regardless of whether the source of capital is domestic or foreign, the key to securing capital is presenting value where others don't and then translating that value into a workable solution for a lender. There are many ways to put financing together. It's a matter of being creative and knowing where the money is. Some examples of different vehicles for creative financing that we've secured through non-traditional sources include:

- Equity or quasi-equity partners – A well-suited, strategic financial partner, who understands the business and industry can provide the appropriate financial structure to take the company forward.
- Refinancing of subordinated debt – Subordinated debt may need to be restructured or refinanced in order to alleviate liquidity concerns.
- Cash flow management – In many cases, there is significant capital being tied up in working capital. Various specialists can help assess cash flow restrictions and assist companies to unlock liquidity by putting in proper controls and systems.
- Securing of future cash flow streams – Cash flow streams that are associated with long-term contracts and a high degree of certainty may be sold to a third party.
- Sale leaseback – Land and/or buildings can be sold to certain lenders at market value or greater using long-term sale-leaseback agreements.
- Refinancing "depreciated" assets – Lenders such as appraisal or auction companies may attach value to these assets that allow other financiers to loan against them regardless of whether they have been fully depreciated.
- Intangible assets – Many companies find that intangible assets (i.e. patents, trademarks) carry little or no collateral value to traditional lenders. However, some non-traditional lenders will lend against such assets. In fact, there are firms that will attach a value to intangible assets and guarantee that value to lenders.
- Tax structures – Off-balance sheet structures may generate additional liquidity.

THE BOTTOM LINE: Accessing capital can be expensive, time consuming and incredibly frustrating. But it doesn't have to be, and there are a number of other options outside traditional financing sources.

In many cases, banks and traditional sources of funding are the ideal financial partners for Canadian businesses. However, for businesses in periods of transition, whether caused by distress, explosive growth or the potential for a change in ownership, the traditional lenders can be impediments and obstacles. There are numerous other options available to Canadian businesses and with a little research, business owners and managers can unlock a realm of new possibilities that suit their situation and best serve their needs. Sometimes a "no" from your traditional lender might actually do you a great favour.

*Barry O'Neill is a Managing Partner with ZED Financial Partners, a highly specialized independent Investment Bank based in Toronto, Canada. ZED is focused on finding and matching the right alternative source of funding for private and public mid-sized Canadian companies.*

## Estate Freeze

*Bryan O'Neill, CA, MMPA*
Associate, Northwood Stephens Private Counsel Inc.

Like many business owners in Canada, you may be planning on eventually passing the family business to your children but are concerned about how to do so in the most tax efficient manner. An estate freeze, when implemented correctly, can be an effective strategy of passing on a family business and its future growth to your children, and minimizing your tax exposure on death.

Why would one want to do an estate freeze? By "freezing" the value of your shares in your business today, you can cap your eventual tax liability and defer tax on the remaining growth in your company until long after you have passed away. This can potentially save your estate significant amounts of money. An estate freeze only makes sense in circumstances where you anticipate that the business is going to further appreciate in value.

Typically, an estate freeze is accomplished by the transferring shares in the business into a holding company, in exchange for preferred shares in the holding company. The preferred shares would have a redemption value equal to the fair market value of the common shares transferred in. Common shares in the holding company

would then be issued to the children or other family members. The shares can be structured allowing you to maintain control of your business, even though you no longer own the common shares.

This structure could also be used to freeze other assets, such as a large investment portfolio or real estate holdings.

Some of the benefits of an estate freeze are:

- By "freezing" the shares you are able to determine your maximum tax liability on your shares.
- You can maintain control of the business as a result of the majority of votes held through the preferred shares.
- If the shares in the business qualify as a Qualified Small Business Corporation, you can multiply the number of capital gains exemptions by increasing the number of taxpayers who are shareholders.
- You can still benefit from a source of income through preferred share dividends.

Some of the drawbacks of an estate freeze are as follows:

- The preferred shares taken back may provide inadequate income if not planned for correctly.
- Subsequent to the freeze, you may have a change of heart and feel that those who you chose to benefit from the freeze are no longer deserving – an estate freeze is difficult and very costly to reverse (however, a trust can be used to own the common shares with specific beneficiaries named, reducing the risk of the above).

This is just one planning strategy available to Canadian business owners who are planning to pass on the business to their children and are looking for a way to significantly limit their taxes owing at death. It is important that you receive advice based on your own personal circumstances.

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