NORTHWOOD STEPHENS
PRIVATE COUNSEL INC.

Best Independent Family Office in Canada
EUROMONEY Private Banking Survey 2007

THE NORTHWOOD STEPHENS **PERSPECTIVE** SUMMER 2007

President's Message

A year or so ago, someone asked me what I did for a living. I told them I worked in a family office, to which they replied "*Oh. Does that involve birth control and family counseling?*" While the range of customized services we provide to our select group of clients is comprehensive, I have to admit it doesn't go quite that far.

Family offices originated over 100 years ago in the US when wealthy families (like Rockefellers and Carnegies) hired dedicated staff to manage and coordinate their diverse financial affairs, including investment management, tax planning, succession, insurance, philanthropy and administration, to name a few.

The advent of the multi-family office, over the last 20 years or so, has meant that this level of service can now be made available to a broader range of families, often with net worth of $5 million.

The catalysts for a family to engage a family office haven't really changed much. They typically include (1) a liquidity event, like a business sale, (2) a recognition by a family of the need for professional oversight, due to some combination of busyness, lack of interest, and/or insufficient expertise in the increasingly complex financial and investment management arenas, and (3) the desire of a patriarch or matriarch to ensure effective continued management of the family wealth, once they can no longer be involved.

This year, I have been invited to be a speaker at various conferences on the topic of 'the family office'. I recently presented at the Calgary CFA Conference and the Strategy Institute's Wealth Management Conference, and I will be speaking to members of the Family Firm Institute (FFI) in Toronto as well as at FFI's Global Conference in Miami in October. One of the questions that comes up most frequently from attendees, on behalf of themselves or their clients, is "how do I decide if a family office is right for me and my family?" In the article adjacent to this space, Scott Hayman, Northwood Stephens' Head of Client Service, lays out a simple checklist that can be a good conversation starter for families considering a family office.

Enjoy the rest of the summer!

Sincerely,

Tom McCullough
President and CEO

Photograph courtesy of Frances Juriansz Photography

Do You Need a Family Office?

Scott Hayman, CA, CFP, EVP and Head of Client Service
Northwood Stephens Private Counsel Inc.

While the *multi-family office* is becoming more well-known in Canada, it is still in the early stages of its growth trajectory relative to what we've seen in the U.S. over the past 5-10 years. We have been introducing the concept in Canada for the past three years and I am continually asked: "How do I know if my family needs a family office?" In response, I often ask a series of questions to the family member (such as those below) to help them make that decision. If the most frequent answer is "no" or "I'm not sure", then I can safely say that a multi-family office could be of value to that family.

	Yes	No
Have you discussed your **family values** and how they relate to your financial affairs?	❑	❑
Are you certain that you have taken advantage of all the **tax savings** available to you?	❑	❑
Do you know what **rate of return you need** on your investments to meet your family's goals and objectives?	❑	❑
Are you confident that you are **choosing the best investment managers** for your needs?	❑	❑
Are you comfortable that all your advisors are **operating in a coordinated manner** and are likely to achieve the results you are looking for?	❑	❑
Are you reasonably sure you are getting **fair pricing** from all your providers?	❑	❑
Do you have a well-thought out **succession plan** for your business?	❑	❑
Are you confident that your spouse or children will be able to **manage your family affairs** if you pass away?	❑	❑
Have you spoken to your **children** about their views on money, their ability to handle it and have you begun to prepare them to be inheritors?	❑	❑
Are you clear on all your **insurance** coverages and policies and whether they are all still appropriate?	❑	❑
Do you have a **strategic**, well thought-out approach to **charitable giving** or is it mostly responsive?	❑	❑
Can you 'pick up the phone' and discuss **financial issues** with someone who knows your family's whole picture and can give practical advice?	❑	❑

A family office is designed to pull all of the many 'moving parts' of a family's financial affairs together and bring order, confidence, and peace of mind. The questions above should prove useful in determining if a family office could be of value to you!

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

The Benefits of Proper Investment Manager Combination

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

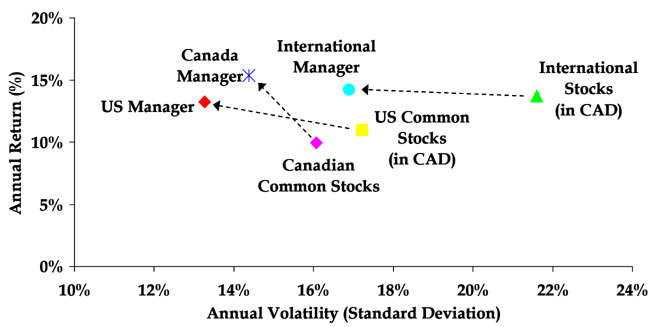
In our Winter 2007 newsletter, we discussed the process of *selecting* investment managers for client portfolios, and in particular, focused on the 'Four P's' – People, Philosophy, Process, and Performance. I'd like to take that discussion one step further by introducing the analysis we undertake when developing our shortlist of managers and then *combining* those managers in client portfolios.

The process involves three key steps and, using equity managers as an example, these three steps are illustrated below.

Step 1: Finding Managers that Consistently Outperform their Benchmarks with Less Volatility

While it is important to find managers that have posted strong returns, it is necessary to determine if these managers have outperformed as a result of taking excess risk. The chart below compares three of the managers we have recommended versus their benchmarks on a risk and return basis. It highlights that these managers have outperformed their respective benchmarks at comparatively lower levels of volatility. For example, the US Manager shown below produced a higher return (13% vs. 11%) at lower levels of risk (13% vs. 17%) than its US Common Stock benchmark. And interestingly enough, while not evident below, that same manager has experienced only one negative year of performance in the last thirty years.

Historical Risk/Return of Northwood's Managers vs. their Benchmarks



Source: Report on Canadian Economic Statistics (1924-2006) and manager returns.

Step 2: Selecting Managers whose Returns are Not Highly Correlated

Once the short list of managers is in hand, the next test is to determine how correlated the returns of those managers are. If they all move in sync, there will be limited benefit from diversification. The table below shows the correlation of returns among the three managers (1.00 being perfectly correlated, 0.00 being not correlated at all, and negative numbers meaning negatively correlated). While you would expect a certain degree of correlation among managers, the table highlights that these managers are not exceptionally highly correlated. For example, the returns of the US Manager are approximately 53% correlated to the returns of the Canada Manager. The lower the better!

Correlation of Returns of the Three Managers

	Canada Manager	US Manager	International Manager
Canada Manager	1.000		
US Manager	0.526	1.000	
International Manager	0.613	0.568	1.000

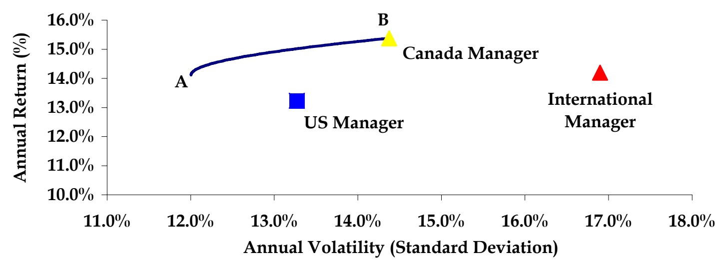
Based on 13 years of comparative returns.

Step 3: Determining the Appropriate Asset Allocation Between Managers

With Step 1 and 2 complete, then the question becomes: how much of the equity portfolio should be allocated to each manager? Just because we have identified three managers that have outperformed their benchmarks with relatively low levels of risk and that aren't highly correlated does not mean that we should simply dedicate a third of a client's equity portfolio to each. The final step in the process involves determining the best allocation of assets across the selected managers.

The chart below shows the 'efficient frontier' of possible investments across these three managers (the range of combinations of the three managers that would maximize return for any given level of risk). The blue curve represents all those possible combinations and ranges from: Point A (39% Canada Manager, 56% US Manager, and 5% International Manager) to Point B (100% Canada Manager).

Efficient Frontier of the Three Managers

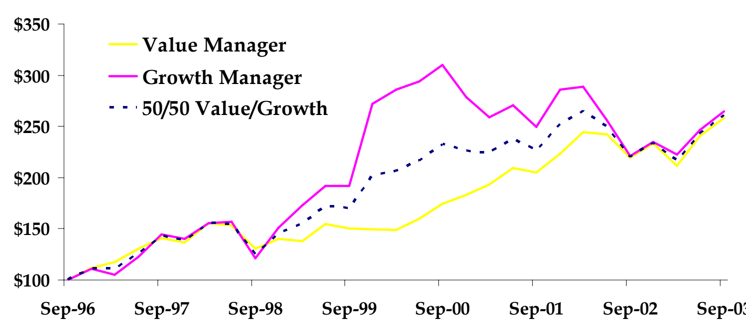


Based on 13 years of comparative returns.

Once we have decided, along with the client, on the level of risk they should take, the decision on how to allocate assets across the three managers becomes much easier.

What is the benefit of combining managers appropriately? In its most simplistic form for illustration purposes (e.g., 50/50 combination of two managers), the chart below shows the benefits of combining managers with different styles. The two managers below had essentially the same performance over the period (the internet bubble and bust), but with very different paths. The dotted line (50/50 combination) produced the same end result with about half the volatility!

The Benefits of Proper Manager Combination



The analysis above was detailed for the equity asset class. A similar analysis is required 'one level up' at the overall portfolio asset allocation level. We'll save that discussion for another time!

GUEST COLUMN: LAW

Selling Smarter: Minimizing Legal 'Skeletons'

Jordan Dolgin
Partner, Wilson Vukelich LLP

Every entrepreneur who has taken the risk to start and build a business is curious about what his or her business is worth and what is involved in selling it. These days, few business founders plan on running their businesses until retirement and, with the world awash in private equity and mega M&A deals taking up the headlines each day, selling your business is a very hot topic. While it is commonly known that sellers want to 'sell smarter' (i.e., maximize their after-tax sale proceeds), what is not commonly known is what's involved in getting there.

Not surprisingly, preparation is essential. This article will focus on the legal aspects of business exit preparations—minimizing the legal 'skeletons' which can erode your overall deal price and increase the cost and time to do your deal.

Legal exit preparations involve a 3-step process: first you need to undertake various due diligence investigations (i.e., public searches, review of minute books and key contracts, etc.), next you need to identify any 'skeletons' and consider what options exist to remedy or neutralize them, and last you need to create and implement a plan to manage these skeletons. While you may be thinking "my business is squeaky clean", it is a rare business that does not have some 'warts' that a buyer can and will exploit to your detriment.

The consequences of failing to consider legal issues in your exit preparations can involve significant delays in getting your deal done, higher than necessary legal and other costs and, in extreme cases, the death of your deal.

While every company is different, some of the more 'typical' skeletons I have encountered are as follows:

- former employees and/or consultants were issued shares that have been forgotten about and they can't be located at closing and your buyer is concerned that he/she can't buy 100% of your business;
- there are no shareholder agreements with minority shareholders that permit the majority owner to 'force them' to sell their shares to a buyer desiring a 100% purchase;
- you don't want to sell your real estate but the real estate is owned by the operating company which your buyer wants to acquire;
- a key contract has a 'change of control' restriction and you are not certain what it will take to obtain the 'consent' of an important supplier or other third party;
- you are afraid that a few former employees might commence an opportunistic lawsuit once they find out you are 'in play';
- you failed to acquire full ownership of some critical intellectual property developed by a former independent consultant; and
- your accountant is concerned that the business has failed to properly collect and remit PST and GST and a tax audit could result in very significant unpaid taxes plus interest and penalties.

For each of the above 'skeletons', there are usually a number of possible options available to either neutralize or at least mitigate their impact on an actual sale event. However, the range of options is usually greatest long before a buyer is sitting at the table.

In summary, I will leave you with my '8 Best Practices' when it comes to legal exit preparations:

1. Control Share Capital: Be aware of both (a) who owns your company's shares and (b) whether you can force a sale by all shareholders at the time of exit.
2. Control Key Contracts: Identify which 3rd parties have been given rights to consent to your exit transaction and try and either impose an 'acting reasonably' requirement or try and negotiate the deletion of these restrictive terms during your next renewal discussions. Stay organized and maintain a formal list of key contracts that you update annually.
3. Control Assets: Ensure all proprietary assets are, in fact, legally owned by your company and that any encumbrances or liens filed against such assets are maintained or discharged in the ordinary course. You should also be mindful of the quality of your assets (e.g., determine whether any environmental issues are in issue).
4. Control Corporate Structure: Update and maintain corporate minute books on a regular basis to ensure they reflect all historical transactions. Consider isolating the ownership of passive vs. operating assets and distinct/multiple businesses in different corporations. Essentially, keep your overall corporate structure 'buyer friendly' to the extent possible.
5. Control Tax Risk: Solicit feedback from your accountants regarding areas of potential federal or provincial tax audit risk (i.e., income, GST, PST or payroll taxes) and areas where you may not conform to GAAP. Buyers may use areas of tax exposure and non-GAAP compliance to negotiate a lower purchase price.
6. Control Opportunistic Litigation: Identify disgruntled former employees, partners, customers or others who might commence a lawsuit once they learn of your exit plans in order to extract their 'pound of flesh'. Consider early settlements (and full releases) if possible or anticipate the issues and enhance your leverage before litigation is commenced.
7. Control Regulatory Issues: Identify all key industry/governmental license and permits (including any special conditions which might affect same) and determine if these are transferable to your buyer or if regulatory approvals are necessary.
8. Control Legal Compliance Risk: Determine areas where your business may not be in full compliance with applicable domestic or foreign laws (e.g., privacy, consumer protection, industry specific rules, etc.) and assess the materiality of such non-compliance to your potential buyer.

Jordan Dolgin is an M&A Partner with Wilson Vukelich LLP, a Markham Ontario based Business & Tax law firm.

We are always looking for articles that would be of interest to our readers. If you would like to contribute to *The Northwood Stephens Perspective*, please contact Brian Ginsler at (416) 502-6290 or bginsler@northwoodstephens.com.

What's New at Northwood Stephens

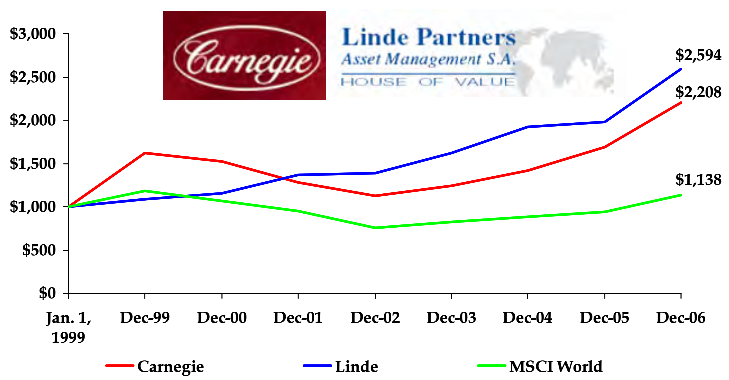
Brian Ginsler, MBA, CFA, CFP
Vice President, Northwood Stephens Private Counsel Inc.

We meet with our clients at least quarterly to review the progress of their investment portfolios and to discuss various other items that are 'in progress' as part of our overall Net Worth Management™ process. At those meetings, we recently provided clients with a document called 'What's New at Northwood Stephens'. Our aim is to keep clients abreast of all the various initiatives we have ongoing, and provide our clients with an opportunity to give feedback on other products or services they are looking for Northwood Stephens to source. While certain of the 'What's New' items are confidential and for clients only, I thought I'd periodically share with our newsletter readers some details of 'What's New' at Northwood Stephens:

Traditional Investment Managers

New Managers – Northwood Stephens has established a relationship with Pier 21 Asset Management, a Montreal-based firm that facilitates access to leading international money managers who are otherwise difficult or impossible for private clients to access. We are currently working with Pier 21 to evaluate two potential international managers: Carnegie Asset Management and Linde Asset Management.

VALUE OF $1,000 INVESTMENT SINCE INCEPTION



Past performance is no guarantee of future performance.

Alternative Investment Managers

No doubt you have been hearing much about alternative asset managers, including hedge funds and private equity firms. We also include real estate investment groups in this category. Northwood Stephens has spent a considerable amount of time and energy meeting with managers in all three of these areas and we have identified a select few that we believe are world class and therefore, potentially appropriate for certain clients. Northwood Stephens believes that alternative investments have a place in a well-diversified portfolio. We are currently drafting a whitepaper called: *The Role of Alternative Investments in a High Net Worth Investor's Portfolio*. Contact us if you are interested in receiving a copy of the final version.

Healthcare

Northwood Stephens spends a great deal of time seeking out and meeting with professionals who have products or services that might be of interest to our clients. These are not always financially focused. One example is health care. Over the past few months we have uncovered a number of interesting health care opportunities. Below are two examples:

Cleveland Clinic Canada

Cleveland Clinic Canada

The Canadian campus of Cleveland Clinic and one of North America's most innovative hospitals, ranked #1 in heart care by U.S. News & World Report, is now located in downtown Toronto. Cleveland Clinic Canada offers Executive Health Assessments, solution based specialty programs across all major medical specialties, international patient services and concierge referrals to the Cleveland Clinic in the United States.

Rupert Case Management

Rupert Case Management (RCM)

RCM provides its clients with the support, advocacy, expert advice and healthcare services (MRI, CT imaging studies) they need, when they need it. RCM helps clients avoid long delays in receiving tests, procedures and treatment. RCM has a proprietary network of over 500 subject matter experts at leading centers of excellence and a national network of over 1,100 private sector Canadian healthcare companies ready to provide advice and service.

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