

EMPLOYEE BENEFITS TO CONSIDER DURING BUSINESS SUCCESSIONS OF SMALL AND MID SIZE ENTERPRISES



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Mergers and acquisitions make the news headlines constantly throughout the world. During such corporate transactions, employee benefits which include certain programs representing a significant portion of the total deferred compensation package, are key issues to consider. On a smaller scale, these same issues are also very important during business successions of small and mid size enterprises (SME).

This newsletter addresses some employee benefits that must be considered during business successions especially for CEOs of SMEs and their key employees.

Streamlining the business

While preparing the business succession, CEOs of SMEs must establish sound financial and tax planning. As part of the succession plan, it's important to consider reducing the Company's assets to the main part by removing noncore assets (eg. by transferring certain assets to a holding Company). This can lead to substantial tax savings upon a possible transaction. A streamlining of the business for tax purposes must preferably start well ahead of a possible transaction by, among other things, implementing pension and employee benefit programs designed to meet the needs of management and their key employees.

Hereunder are some examples of programs which, depending on the financial condition of the enterprise, can trigger significant corporate tax savings. These programs can also be key human capital tools in a possible transaction:

- The Individual Pension Plan (IPP) (or other forms of RPP) ;
- The Retirement Compensation Arrangement (RCA) (or other forms of SERP) ;
- Corporate Owned Life Insurance (COLI) ;
- The Retiring Allowance ;
- The Deferred Profit Sharing Plan (DPSP); etc.

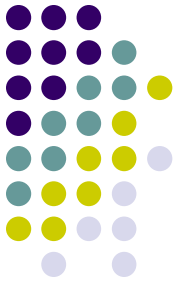
Which transactions are we referring to?

Corporate transactions can take the form of a transfer to children, a buy-out by a key employee, a sell to a third party, a merger, an Initial Public Offering (IPO) or others.

Depending on the deal structure (e.g. is it an asset sale or a share sale?), employee benefits can represent key factors for negotiating parties to retain targeted employees. In addition to the deal structure, the methodology used to value the business (e.g. is it a multiple of EBITDA?) can affect the financial impact resulting from the employee benefit plans upon the transaction.

¹ EBITDA stands for Earnings Before Interest, Taxes, Depreciation and Amortization

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An ounce of prevention is worth a pound of cure

This old proverb turns out to be very appropriate during corporate transactions. Due diligence at the onset of the process and opened communication of key issues throughout the process are paramount to the success of the transaction. Employee benefits would usually represent a Company debt during a share sale. Their annual costs have a direct impact on EBITDA and such impact must be quantified and well communicated during the negotiations. The findings of risks and their financial impact can lead to purchase price adjustments and, often, to other representations and warranties to include in the final sale contract to protect the parties involved.

Employee retention

The success of a transaction is highly influenced by the level of commitment from management and key employees. Long-term employee benefits outlined earlier are also efficient tools to motivate and to retain targeted employees while attracting new talents.

It's crucial for a potential buyer to analyze and to understand the existing programs offered by the seller and to perform proper post-deal benefit integration. If the buyer is located outside Canada, further benchmarking analysis is appropriate to compare the programs taking into account the local regulatory regime.

Conclusion

The business succession of a SME must be planned ahead of time and thoroughly whether it is a transfer to children or to a third party. In today's business conditions, all parties involved in the transaction must elaborate their strategy carefully to maximise the deal value expected by shareholders.

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With over twenty (20) years of experience as consulting actuary, I have been involved on many corporate transactions with large publicly traded enterprises as well as with SMEs. Proportionately, the importance of employee benefits and their financial impact remain, in common denominator, key factors during transactions.

Do not hesitate to contact me and I will be pleased to offer you high quality actuarial services as well as plan administration related to pension and other long-term employee benefits aligned with your business objectives.

I usually work within an advisory team along with the corporate accountant, the tax advisors or legal advisors depending on the type of projects and the client's needs.