

“The whole thing used to be loosey goosey. They’d just make up their values using high multipliers; now they’re being sued. We will have huge turnover in our b2b customer base. Succession creates risk – but it also creates opportunity. We’ll build a line of business for that. Family businesses?”

Looking back is less relevant.
Looking forward is tougher.

UNCERTAIN VALUE / THE PRICE OF CHANGE

—
CHARTERED
BUSINESS
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—

They thought the cash cow would go forever. This is a different world. Suddenly it’s a drag and it’s hard. It will be a roller-coaster for a while. Older entrepreneurs may want off the ride. We are constantly being wooed by three major firms because of our size and because we are privately owned. They see us as their sweet spot.”



The Canadian Institute of Chartered Business Valuators (CICBV) is an internationally respected organization that is focused on education, standards and professional development relevant to valuations for business, finance and litigation purposes. Our members are uniquely suited to help business leaders meet an emerging set of challenges. How are business leaders rebuilding and measuring value post-recession? How are they preparing for succession in ownership and leadership? How will 'they' put a number on their business assets that everyone can live with?

As Canada's only accredited professionals in business valuation, we've been having this conversation with clients for some time now. It hasn't been about stock markets and macro trends - it's been about replacing hyperactive earnings multiples with certainty and clarity. This Report is for the vast majority of Canadian business leaders who don't make the usual CEO opinion polls. It's about the leaders of Canada's economic engines and the collective backbone of our success.

The recession may be fading but the costs can still be felt according to Canada's business leaders and owners.

Senior managers are struggling to produce forecasts with any certainty. Pre-recession performance has lost much of its relevance as a post-recession business metric. Business owners and leaders are pulling up stakes in a boomer-led management exodus over the next decade. What's new is that as many as 50 percent of Canada's businesses may not be ready to cope with this massive change and associated loss of experience.

The opportunities abound as well. Canada's business leaders are running more efficient businesses and adapting quickly to new market demands. They look at every detail more closely than they have in the past. But they're certainly not standing still.

Boundless opportunity – perpetual change: It is in this world that the capacity of a company to value its assets is tested like never before. It is in this world that business leaders are looking for new sources of expertise and more bias-free advice. That's why The Canadian Institute of Chartered Business Valuators (CICBV) commissioned a new study for its members and students, and for the clients of Chartered Business Valuators (CBVs). We set an opinion benchmark in May 2010 as news reports documented the end of the recession – we tracked change in leadership opinion by interviewing 40 Canadian CEOs in depth between August 2010 and May 2011.

The mood has evolved; from post-recession blues to a pragmatic, determined outlook that acknowledges constant volatility as a simple, new fact of business life. Welcome to our Report: Uncertain Value / The Price of Change.

When the CICBV conducted a Harris Decima online survey just as the recovery was starting back in May 2010, participants talked about hollowed-out corporate earnings and eroded business values. They discussed the loss of trust in business institutions due to the U.S. banking scandals. They admitted their own ability to forecast future results and trends was now suspect.

Fast forward to May 2011 and that grim view is now being replaced by a more pragmatic resiliency as the recovery continues to stumble along. Leaders are preparing for a future that may finally include the oft-discussed retirement of the baby boom or rebuilding companies with new leadership, new competitors and new rules. Some are just hanging on until they can find a buyer.

But how do you put a price on any business asset without being able to forecast future cash flow effectively or having a 'past' upon which to rely? Is it back to the wild west of valuations that were so common before 2007? Or are business leaders now jaded just enough to look for objective standards and advice outside their normal financial circles? If they are, it's just in time, as fully half the leaders we interviewed see the imminent transfer of leadership and business wealth as having a dramatic impact on their companies in the next nine years.

This is another age of uncertainty – that is the price of constant change in all organizations, but especially for business owners and leaders. According to our research, rebuilding certainty and positioning for stability will become their biggest challenge over the next few years.

THIS CBV REPORT REVIEWS FOUR SUB-TOPICS OF UNCERTAIN VALUE / THE PRICE OF CHANGE:

THE EROSION OF TRUST.....5

84 percent of the leaders we talked to agreed that due diligence is more important now than ever before. In-depth interviews revealed an erosion of trust on topics as far-ranging as cash flow, analysts and rating services, business and sales forecasting – the basic tools of most companies.

RECOVER & REBUILD.....9

The upheaval of recession and a restructuring economy created a new set of business realities. Leaner, stronger, more adaptive companies are emerging.

SUCCESSION.....15

While many business owners are hanging on because their companies lost so much value, the march toward inevitable change continues. Business wealth is moving, corporate executives are moving on and key employees are taking a generation of street smarts out the door for the last time.

HOW MUCH?.....19

The majority of leaders we interviewed see valuation as critical to their business plans over the next few years. That said, their experience in past valuations may not be as relevant. The rules and lack of rigour in the past will not serve the future well.

SUMMARY.....25

Leaders are looking beyond their existing financial circles to rebuild many processes and advisor trust. They're also looking beyond outdated rules of thumb. What happens as mass succession unfolds in both business ownership and leadership will inform a new chapter of business management as mainstream business evolves in Canada.

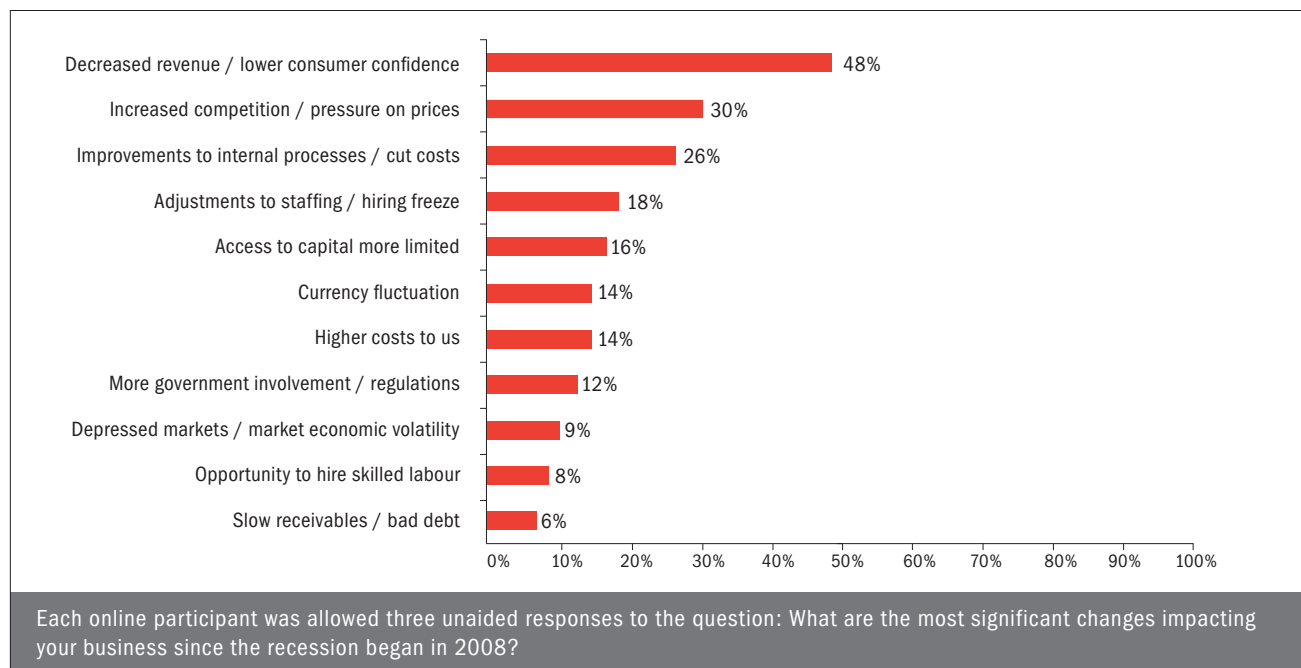
THE EROSION OF TRUST

3

The recession from mid-November 2008 to Q4 2010 has been called the deepest and most painful since the Great Depression. The research findings in this section document the residual caution that now prevails in business leadership as a result and the primary outcome that we call The Erosion of Trust.

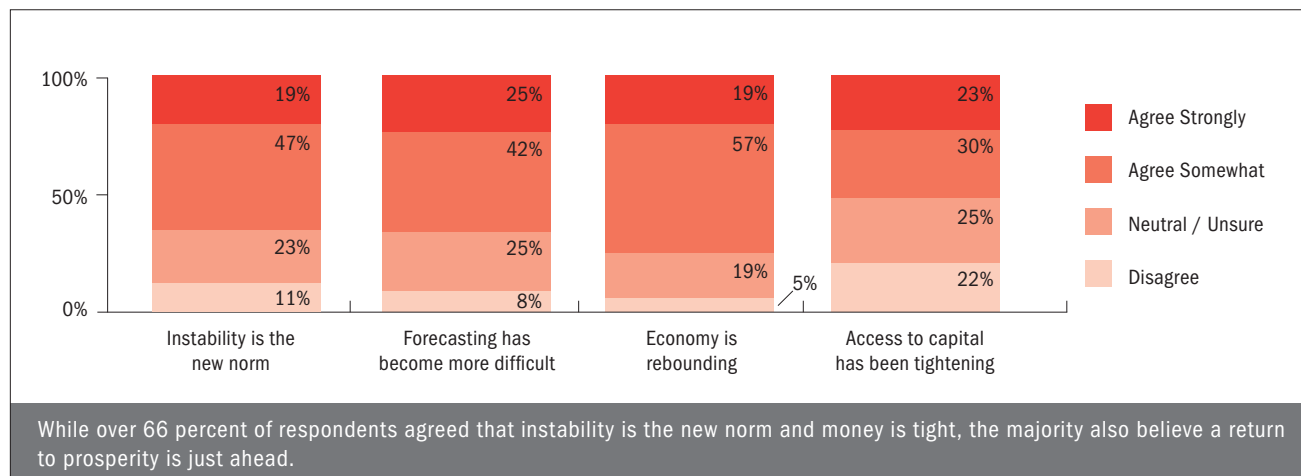
LOTS OF PAIN – SOME GAINS

The impacts of the recession were far ranging.



HOW'S IT LOOKING NOW?

Our In-Depth Interviews as reported throughout this document supported the initial findings of the benchmark study as the year went on.



Trust is the platform of business: Trust in relationships and partnerships, trust in reporting, trust in payment. Trust has also been under attack for three years as banking scandals rocked the U.S. and businesses collapsed under debt loads. The business leaders in our In-Depth Telephone Interviews conveyed this message in three ways: Suspicion abounds, innovation is being strangled and forecasting in chaos is daunting.

What was beyond reproach is now suspect, including the cultures of our organizations.

“Do I trust rating systems now the way I did five years ago? Absolutely not. Am I less trusting of my industry peers? Absolutely. And we’re all paying a higher price for that lack of trust in higher bonding and insurance premiums.”

CEO, Financial Institution

“We’re under a microscope, the whole scandal and governance thing. We were already financially conservative – we’re very high integrity. There have been no irregularities, but we spend more time scrutinizing financial reports now than we do running the business.”

CEO, Packaged Goods

According to the CFIB (Canadian Federation of Independent Business), money supply for the majority of businesses remains tight. Coming out of the recession and into what should be better times, this lack of capital undermines recovery and innovation.

“Investor appetite has shriveled. Eighteen months ago, it was challenging but coherent – now it’s not coherent. Things that people once saw as having value no longer do. When money gets this tight, they don’t give you anything for concepts or a few years out. People don’t invest in concepts any more.”

CEO, Energy

“The financial sector runs in herd. In Quebec, they went from ‘money is free, come and get it’ to ‘this is going to be really bad and it’s going to be bad for the next decade’ within a period of about one month. It makes you question the advice you’re getting and the model for evaluating that advice.”

CEO, Engineering and Development

The process of forecasting is now suspect. This undermines leadership confidence.

“You want to forecast three years out, but that’s not reasonable anymore. Now you may get to six months, maybe a year if you’re lucky. We forecast and adapt monthly – with so much instability, you can’t wait for the quarter to end and then say ‘oh darn, we should have done this or that.’”

GM, Advanced Manufacturing

“Forecasting is up and down like a yo-yo because there’s no history to go on.”

CEO, Commercial Real Estate

SECTION ONE SUMMARY

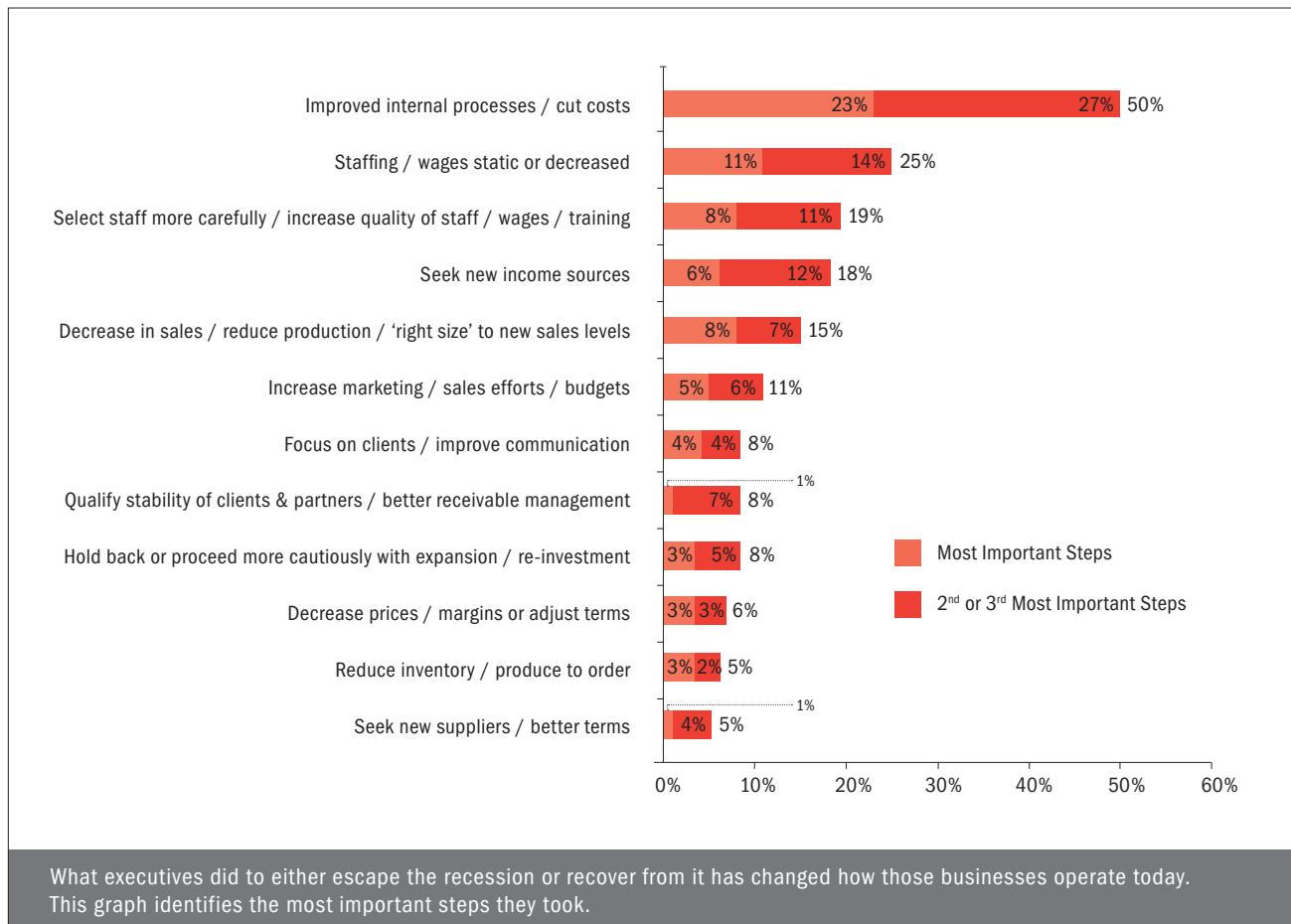
Our survey panel preaches more care when it comes to payments, partners, pricing, access to capital and forecasting. Seems obvious – what’s different is that the advice is more blunt. As the CEO of a consumer services corporation put it: “I’m more cynical, more cautious – if you tell me something is rated triple A by the best-known bond rating service, I’d say whoopee, that’s meaningless. That’s also a huge change. It’s about trust and rigour now. I only want to do business with people I trust and I put more emphasis on that now than ever before.”

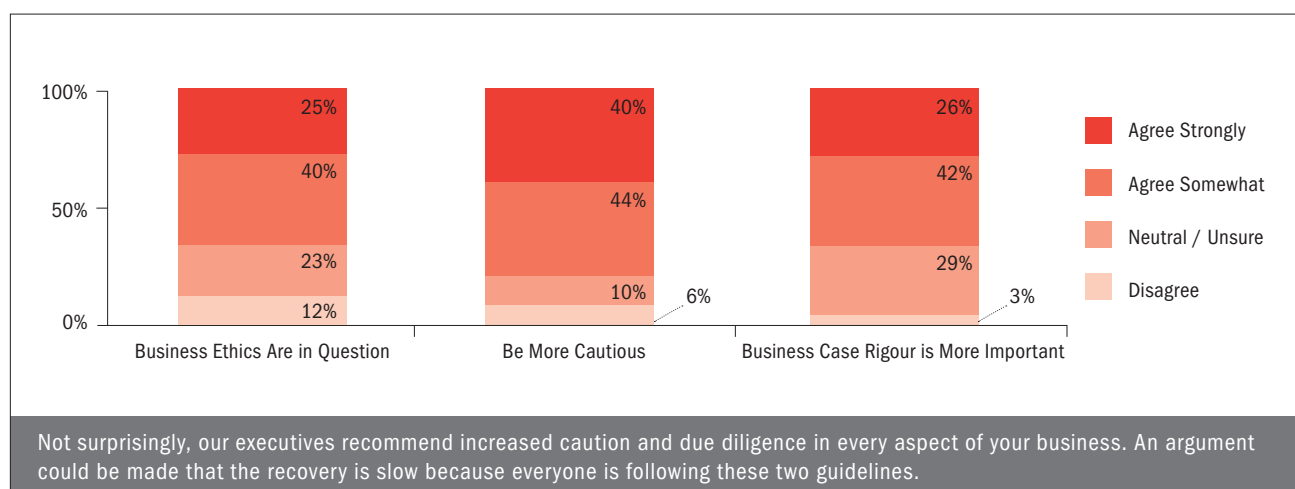
While trust has eroded, there is also reason for optimism. As one leader in our Quebec group concluded, “The recession was something of an opportunity for us (cash-rich business): We’ve been expanding aggressively and making acquisitions. Prior to the recession we had trouble getting staff – now we’ve increased the quality of our staff and put better HR policies in place to keep them.”

As Canada's economic engine comes out of the hunkered-down stage, most business leaders are savvy enough to have evolved and learned. For some, processes are changing to reflect new markets – for others, in food, some technology categories and resources for example, they are accelerating faster because their industries suffered less during the upheaval. Our interviews revealed a determined group, battered and bruised, but still in search of the next opportunity. They will do so leaner, with less dependence on outside capital because it's simply not there. Canada's conservative business culture saved us from some of the pain. Whether it will hold us back now remains a question.

HOW DID MANAGEMENT ADAPT?

Our online survey benchmark and In-Depth Interviews agreed that being lean is the best way to meet the challenge of volatility. They didn't wait to trim and they are rebuilding slowly.





After reading and listening to almost 200 leaders talk about their recovery and rebuilding efforts, it's quite clear that business as usual pre-2008 is much different than business as usual now. Our executives talked about creating new processes to succeed in a lower margin world. Their lessons include employing better receivables management processes, inventory tightening, being faster to keep overhead in line with bottom line fluctuations, investing in ideas with faster ROI and staying focused on selling (new products, innovation, new markets).

Three key themes emerged from our In-Depth Interviews and in many cases our online survey verbatim comments too: For Canadian companies, global is real, efficiency is critical and leadership has a new role.

Global Reality: The hype is finally true – now your competitors come from everywhere. In return, you have more access to a wider world. Post-recession, finding new markets is good, but buyer and vendor beware.

“Geo-economic factors are dominating my time now. India and China are still buying. Eastern Europe, I'm struggling. Russia wants to buy but they can't pay for it. South America is in the middle of all that and the U.S. is really struggling. There's a lot more economic risk management that you have to do now.”

CEO, Energy

“You have to conduct business globally – even if you just own a corner store. It's a huge factor, in manufacturing, wholesale and even retail. If you're not sourcing effectively, you're not competing.”

CEO, Commercial Real Estate / Retail

“We're growing into new, non-automotive sectors and diversifying. The more we do that, based on our core strength, the better off we are because one sector alone can't kill us. We're competing with people in Korea, China – we've got to become the best in their markets too, not just locally or in North America.”

GM, Heavy Manufacturing

Efficiency is Good: Cost cutting only takes you so far. Being efficient means driving waste out of the business, focusing staff on the right things and being more pragmatic about scale and opportunity.

“We used this opportunity to make our operation much more efficient and we went to war on waste. So even though sales growth was flat, we had strong bottom line results.”

CEO, Food Processing

“We do not expect margins will return to previous levels. The competitive environment is such that they can't. So we're getting a cost structure in place to manage in that scenario. That's just the way it is now.”

CEO, Financial Services

“Our competitors are now multinationals dressed up like local boutiques.”

CEO, Food Processing

Leadership: It has to be more apparent than ever. On the floor, out in the open, positive and strong. Part of the rebuilding process is rebuilding leadership trust. That doesn't happen behind closed doors.

“As leader, I'm spending more time with staff, not in place of their direct managers, but in addition to their

managers. We've been asking a lot of them for an extended period of time – with pricing pressures and agitated customers, I need to be there in a support role. We've come out of recession into a far more competitive world. That's changed my job.”

CEO, Financial Services

“You have to create stability within the company even though there's no stability outside the company. That's your job as leader now.”

GM, Heavy Manufacturing

OUR LEADERS AND BUSINESS OWNERS HAD A FEW MORE IDEAS TO PASS ALONG:

(1) Clearly identify obstacles to recovery: “Coming out of the recession, we saw two impacts: Clients wanting to develop their own expertise, and more risk in working with organizations that are just not reliable in terms of payment. We had to find workarounds for both issues; that's part of our recovery process.”

CEO, Engineering Firm

(2) Look for gain from pain: “Big companies are shedding assets that they don't believe are core, and we're picking and choosing. This will drive even more opportunity.”

CEO, Broadcast Entertainment

(3) A little greed is okay: “If you look at history, a lot of people make a lot of money and people who aren't rich become rich – all during or coming out of a recession. But you also have to learn to forecast in chaos.”

CEO, Commercial Development

(4) Beware oversupply, lower margins: “In Quebec, there's been an increase of low-cost independents who lost their jobs in the recession and opened up in their basements to compete with the larger engineering firms. What we do has almost become a commodity – so we have to withstand that pricing pressure.”

CEO, Engineering Firm

SECTION TWO SUMMARY

Rebuilding value in today's economy comes with a new set of expectations and guidelines for executives in all business categories.

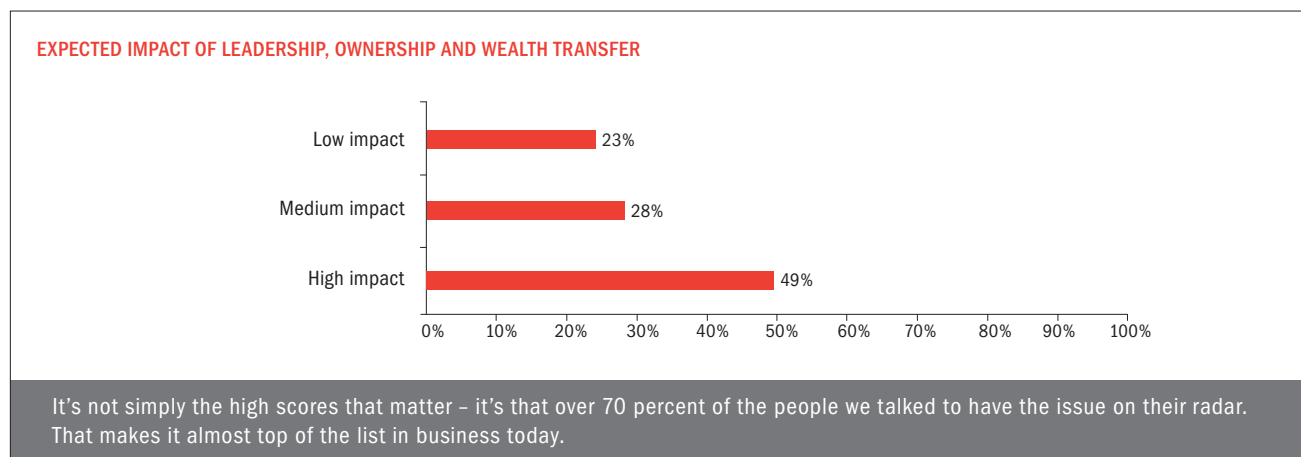
- Understand the global markets in more depth than you thought you had to.
- Create processes that allow you to be cautious without losing too much speed. And while you won't see new competitors coming, you can be prepared by adopting frugal practices in the right aspects of your business.
- Lead from the shop floor or wherever your employees face their challenges. That's your new job.

Taking the time to really understand the full extent of every opportunity, but doing it quickly, will help you make the right decisions. One of our leaders concludes with a final comment for rebuilding post-recession: “When your people have been spending all their time holding down the fort, it might pay to remind them that it's now okay to innovate again.”

Up to 70% of business owners will be in a position to retire before 2020. Fifty percent (50%) of the leaders we talked to are not prepared for succession in their companies.

It's clear Canadian business will have a lot of human resources work to do on the very near horizon. Finding leadership replacements, mentoring them, retaining them; getting fair value for what business owners have built; getting recapitalized for building momentum in a new world. Based on CFIB studies, the majority of Canadian SME (small to medium enterprise) owners are now between the ages of 50 and 75. Executive leadership is in the same state (based on demographics alone). **Change in the form of ownership and or leadership succession creates more uncertainty. And that impacts the value of any business.**

THE TRANSFER OF ENTREPRENEURIAL WEALTH, OWNERSHIP AND BUSINESS LEADERSHIP



According to our research, about 50 percent of business owners and leaders are prepared for finding and grooming replacements. For many within that 50 percent, it's an active, progressive, continuous process. Yet that leaves as many as 50 percent of the people who talked to us unprepared for what happens next. Will they catch up or will they see value erode and businesses disappear?

Even more daunting, many entrepreneurs watched the recession strip value from their companies just as they were planning to slow down or even exit. That puts plans on hold. They are being forced to rebuild in a business climate they may not understand, against competitors they may never see coming.

The CBV research revealed two discussion paths that are common to just about everyone in a leadership position whether through ownership or as executives:

We found a lot of entrepreneurs had succession and exit plans: Whether those would work or not was another thing. And too few had valued their businesses recently, meaning they have no idea what their business is worth today.

“Some private and family businesses are a bit spooked about what's going on and that makes them ready to sell sooner than they are prepared for. They thought their cash cow would go forever – now it's a drag on



them as they try to carry on in a difficult world and even the good ones are saying, ‘I can’t take much more of this – I’d rather sell.’”

CEO, Energy

“I thought I had a plan – but the current industry and economic conditions suggest my plan might be difficult to sustain.”

CEO, Media and Marketing Services

“No one comes forward to buy smaller businesses these days when the main assets are people. We may get a buyout if we’re lucky – it’s probably easier just to make as much as we can for the next five years and close the doors.”

Owner, Commercial Brokerage

Executive managers are more engaged in succession planning than their ownership peers. The topic is high up on corporate agendas.

“The biggest challenge we have will be executive talent moving on due to age. We are a lean organization and we will struggle to have someone fill in behind them.”

CEO, National Developer

“It’s about knowledge transfer – I’m afraid to death of losing the legacy of the organization through this. Four of our senior guys in one department are all over the age of 60. What they deal with is extremely complex. You need experience to do it. You need to have won and lost a few. So our HR practice changes to accommodate this fact and as a result, it becomes more about transitioning than simply leaving.”

CEO, Consumer Services

SECTION THREE SUMMARY

The good news is, some of our research participants revealed many best practices in succession planning: Make it a topic of ongoing discussion at the management table; set in-house standards for pricing as a starting point; get objective advice and agree to a formula in partnership agreements. That gives you a starting point and a historical perspective of the business value if a suitor appears, for bank financing or even creating employee programs.

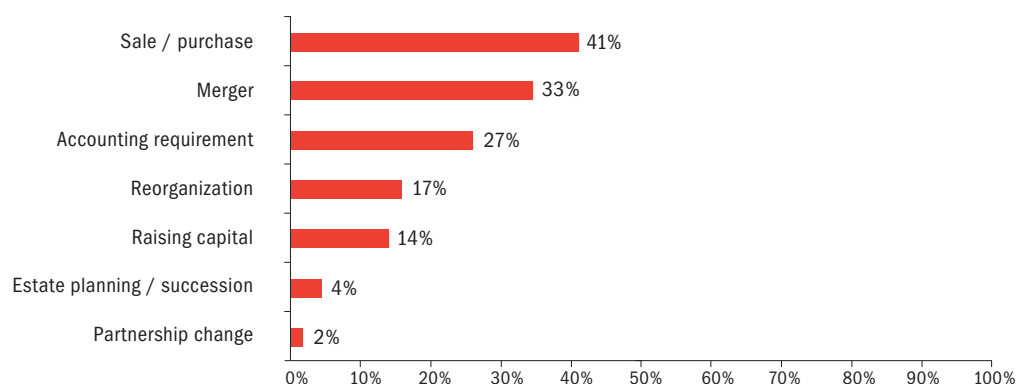
As one of our business owner/leaders concluded: “We’re focused on leadership transfer in my company – we’re in the midst of training the next generation of leaders beyond family members (who are also included in that training). While we get approached by purchasers on a weekly basis, we have no intention to sell. We want to preserve this as a legacy business rather than becoming a footnote on some corporate balance sheet.”

CEO, Packaged Goods (Food)

HOW MUCH IS IT WORTH?

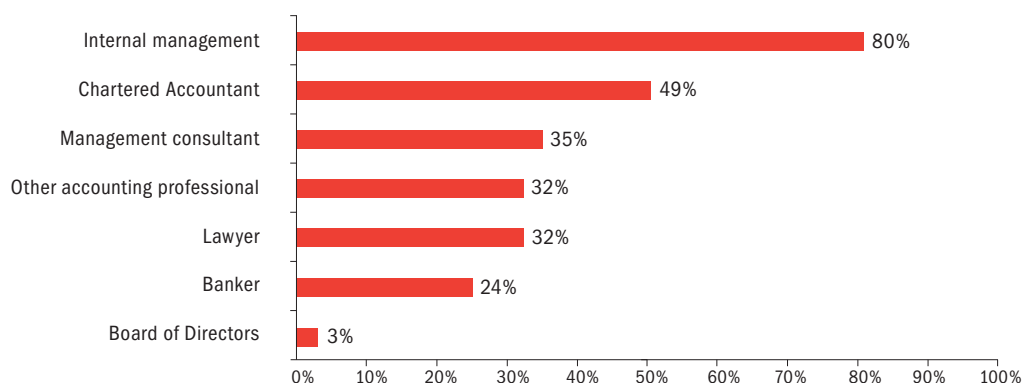
The majority of the 200 owners and executive managers we surveyed and interviewed have been through or headed up a business valuation. As far as being satisfied with the results, they are a little better than 50/50. But in many respects, it no longer matters. The erosion of trust and forecasting uncertainty, amplified caution, lack of decision-making, the exodus of leadership; it all adds up to new territory in valuation. Our online survey panel set the stage for why and who.

WHAT DROVE THE BUSINESS / ASSET VALUATION?

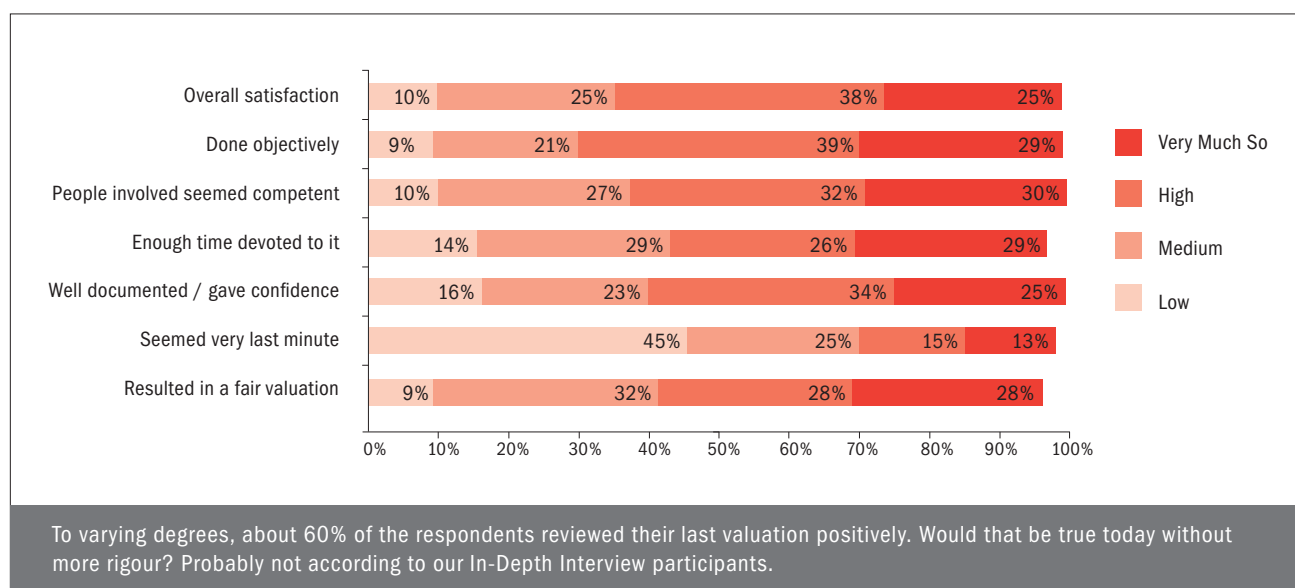


There are a wide number of triggers for a business valuation. Note the low scores for succession planning in the past; that's about to change.

WHO DID THE VALUATION WORK?



The answer to the question above is 'just about everyone' got involved. It's equally interesting that none of them are specifically trained in objective valuation methodology. That too will have to change.



Putting a price on businesses and business assets has never been more difficult. Just because you've done it once or twice doesn't make you an expert, and according to the people we chatted with, you have to cast an ever-wider net to uncover all the details. Our In-Depth Interview leaders have used every formula, rule of thumb and valuation method – from asset-based approaches to future and discounted earnings/cash flow methods. What they agree on is that new conditions require better advice.

Our survey participants identified two primary changes on the topic of valuation:

(1) Finding that solid valuation ground between vendor and purchaser was never easy. But now...

"In valuing today, your string of comparative years has a major discontinuity and you can't simply call it a V-shaped recession, followed by a recovery and we'll just rejoin the old trajectory – those lines are somewhat irrelevant now. So you've got to look deeply at the situation and environment, and ask; 'what is a fair estimate of future cash flows under this new world situation?' And the answer to that is you can't. Because forecasting is broken too."

CEO, Energy

"Putting a price on your business now is much harder; it's a crapshoot whether the clients you have today will still be the clients you have tomorrow. That's not withstanding the great job you do for them – clients and organizations are changing, industry is changing. How do you value a company like mine?"

CEO, Media and Marketing

"We'll all be on a roller-coaster ride for the next while. Older entrepreneurs may say 'I want off the ride'. Knowing when to cash in your chips is an important part of the puzzle - it's more than crunching numbers. This is about reading the tea leaves to get an approximate time to maximize your value."

CEO, Food Processing

(2) The numbers associated with the past performance of most businesses only have so much relevance now; looking deeper than numbers is critical:

"The worth of an organization is in customers, relationships, retention – and each of those factors has an impact on cash flow."

CEO, Consumer Services

"Valuation now is based on multiple measures. You'll need a more robust focus on cash generation because of all the current liquidity and financing challenges."

CEO, Global Energy

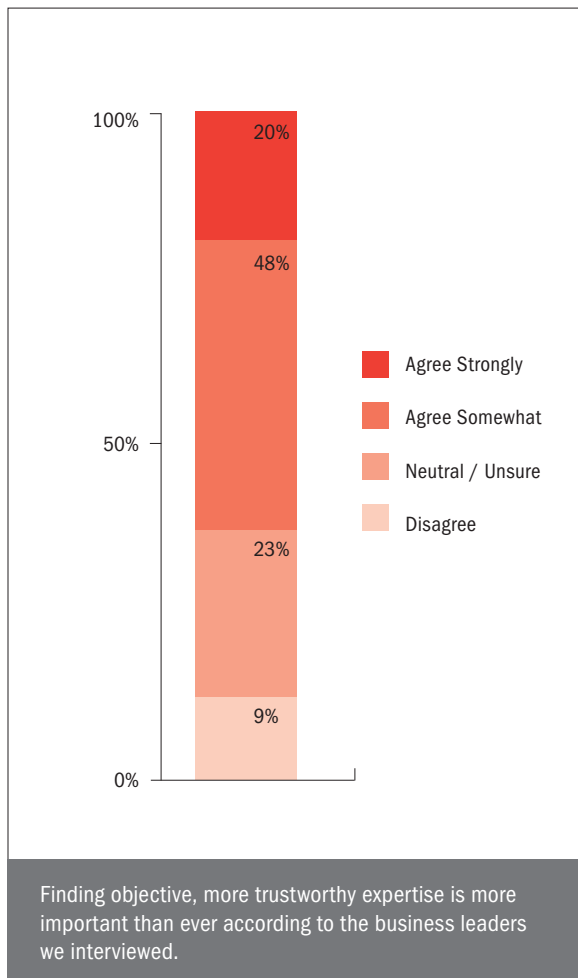
With as many different opinions as there are advisors and business leaders, it becomes evident that a better approach to valuation is required. What the market will pay is too subjective – he who talks best and has the least to lose gets the spoils. A better approach could include benchmarking the value of your business or specific assets now so you're better prepared for change in the future. Staying focused on cash flow and the human side of what makes it work are more critical factors than ever.

Avoid the cowboy shows of the past. And find someone with credentials specific to the task as opposed to finding out what this business leader discovered: "Subjective valuations can deviate between 30 and 40%. That's a very wide range especially when you need a new valuation every year now (public company)." Sounds like a strong case for objective advice to us.

SUMMARY: THE NEXT CHAPTER STARTS NOW

Our business leader interviews over the course of a year either confirmed or expanded the core learning from the online survey after the recession. But the actual conversations added so much more colour than any graph can ever show. Business leaders look to other business leaders for advice. This is what they said in summary form:

- The pessimism coming out of the recession was replaced by determination. There are still many issues, especially in central Canada, and global volatility threatens even the resources sector. Our leaders all advised additional emphasis on due diligence in every deal, whether it's about buying and selling companies or taking on new customers.



- Expect the significance and frequency of market upheaval to continue for a least a few more years if not the rest of this decade. If business leaders can learn to adapt to the continuous shifting of market conditions, they will out-perform their competition. And their businesses will be worth more. This is as true for rebuilding value as it is for organizations that didn't lose value in the first place.
- Almost every leader we interviewed underscored the importance of lean operations and flexibility. They talked about finding new ways to be innovative without throwing caution to the wind. This isn't something to be done when time allows – it needs to be the priority.
- Succession is more than ownership change. If your customers start retiring just as your senior employees start retiring, that's a succession issue. If you can't find new people to run your legacy business, that's a succession issue. If the expertise of the company retires, that makes succession important. Valuing an older business with all new employees and all new customers is a succession issue. Most of the leaders we talked to advised their peers to move the topic of succession off the radar and on to the management agenda.
- The business valuation cowboy days are over. How decision makers value assets and businesses may never revert to pre-recession 'norms'. In the new 'normal', finding the right price demands more objectivity, due diligence and expertise. Just knowing the fair value is a negotiation advantage.

As businesses rebuild, and before the next global crisis erupts (oil, Middle East, U.S. debt, Dutch Disease), leaders have time to stop and take stock. You'll find a reconfigured world. Markets have shifted. Our study group insists 'history is history'. And we're seeking new ways to build trust.

Our research showed nearly 60 percent of our survey participants would use external expertise to meet their next valuation requirement. Just in time too, as one of our experienced interviewees concluded: "Eventually the capital markets will heat up again and people will be more willing to pay for growth stories and more willing to throw money into concept stories. And that's when you'll have to be careful."

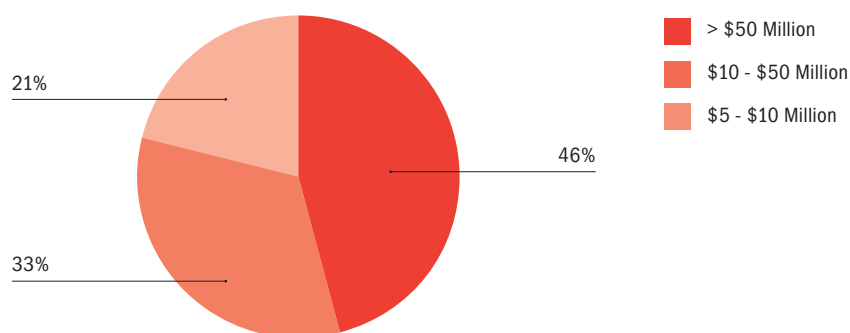
According to one of our leaders: "We're all going to need more than a number scribbled on a page. More and more documentation is needed now. In the past, you could just look at statements – with all the creative things people are doing today, you need to study more."

Seek certainty. Trust is regained through independence, experience and depth of understanding. In this increasingly specialized world, that's what leaders are looking for in valuation processes too. One of our CEOs from Ontario put it very well: "Getting an independent, professional view is important in two ways: First, they've done it before so they're not learning on your job. Second, they have a proven methodology that you can see before they practice it on you."

REPRESENTATION OF ONLINE SURVEY

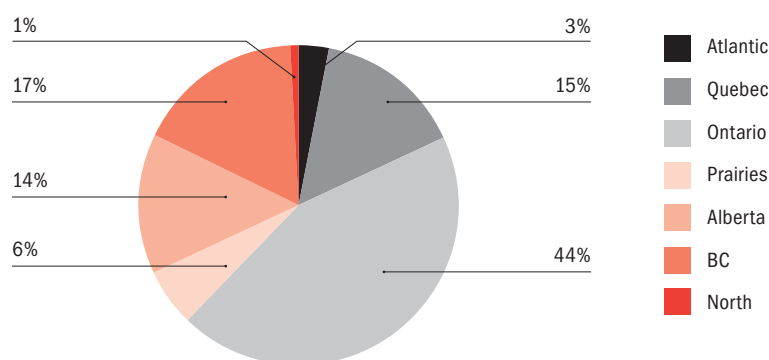
A fifteen-minute survey was conducted in May 2010 utilizing the Harris Decima online panel of 156 senior executives across Canada.

ANNUAL OPERATING REVENUE



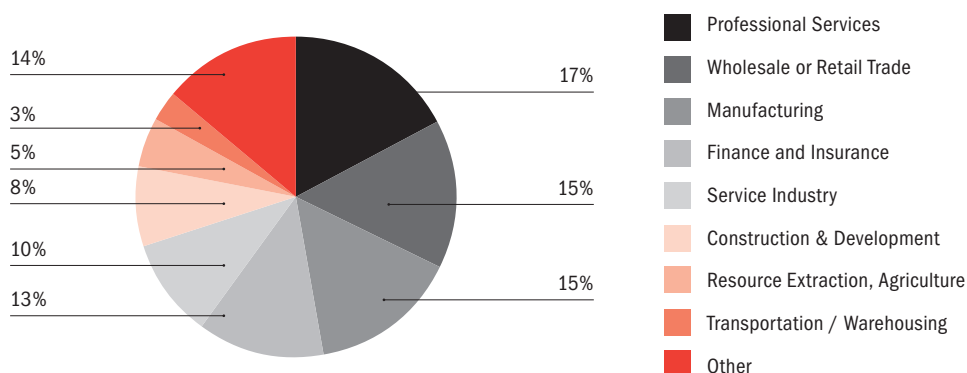
The survey focused on larger than micro or mom and pop businesses to capture data relevant to valuation activities.

WHERE THEY OPERATED



Provincial representation reflects actual province by province breakout of larger industries across Canada.

WHAT THEY DO



We talked to a full range of business leaders; from \$3 Billion multinationals to \$30 Million green tech companies and professional services partnerships. These aren't the leaders typically interviewed by mass media – they are representative of business leaders who actually build and run mainstream organizations.



We invite you to visit us at cicbv.ca.