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FSAT NEWS

FINANCIAL SERVICES ADVISORY TEAM

FALL/WINTER 2019

Welcome to our 23rd issue of FSAT News, a newsletter published by DJB's Financial Services Advisory Team (FSAT) to better inform and help you manage your business's potential.

If you wish to receive further information regarding the services discussed in this issue, please contact a member of our team:

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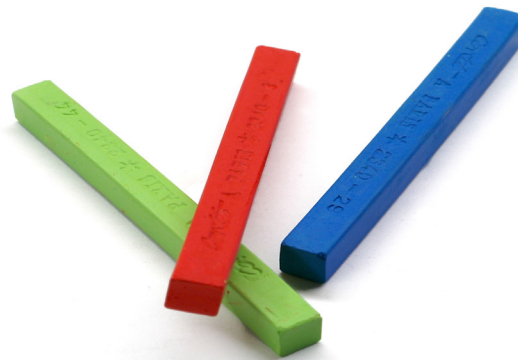
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Economic Loss Calculations – The Basics



When someone is injured in an accident, we are often asked to calculate that person's past and future economic loss. The majority of times this involves a motor vehicle accident (MVA). (Hopefully with the advent of self-driving cars, the number of MVA's will go down in the future, but I'm afraid that is still some time away.) But the cause could be for any number of other reasons, such as a slip/trip and fall, product malfunction, falling objects, snowmobile or boating accidents, dog bites, medical malpractice, sexual abuse, etc.

Whatever the reason, the basic calculations and information required to calculate the loss are basically the same, except that there are specific rules regarding MVA's. (Losses suffered in an MVA in Ontario are covered under the Insurance Act of Ontario. There

are a number of differences in the loss calculations involving an MVA in Ontario, but the main differences are that the claim for loss prior to trial is limited to 70% of the actual loss suffered and there is no claim allowed for the first seven days following the accident. There is also a potential difference regarding the deductibility of collateral benefits, but this is a complex subject for another time.)

Essentially, we need to calculate the difference between what the person would have earned had the accident not occurred (their potential earnings), and what the person will now be able to earn given their injuries (their actual earnings). We also want to consider the future care costs the person will now need to incur due to their injuries, such as medical aids and devices, professional services, housekeeping, etc.

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Earnings

When considering a person's potential and actual earnings, it is important to remember that a person's earnings consists of more than just their base salary and overtime. It also includes the benefits that they would have had (or will have) that are paid for by the employer. These can include health and dental, short and long-term disability insurance, life insurance, stock options, savings plans, future pension benefits, etc. The cost of these items paid for by the employer can often form a significant part of a person's compensation from their employment. Unfortunately, it is generally difficult (or impossible) to obtain the employer's actual cost of these benefits (other than for savings and pension plans, which are often available), and so we often need to rely on statistical data.

There is no "one size fits all" answer to determining a person's potential or actual earnings. Each case needs to be analyzed separately, based on its own specific set of facts and assumptions.

When considering a person's potential earnings, we often base those earnings on the person's actual past earnings. If someone had been working in a job, or running a business, for a number of years, it is often reasonable to assume the person's future earnings would be comparable to their past earnings (plus inflationary increases). However, this is not always the case. There are many reasons that a person's past earnings may not be indicative of their future earnings. Examples include (but are not limited to):

- They may have recently started a new job, or business
- They may have been just about to start a new job, or business
- They may have been expecting a promotion
- They may have just re-entered the workforce, for example, after having raised their children
- They may be young, and not yet in the workforce

In these cases, we often refer to various sources of current and historical statistical information to assist in determining a person's potential earnings.

Estimating the person's future actual earnings can be just as challenging. Often the person has not yet been able to return to work and/or it has not yet been determined what work the person will, or may, be able to do in the future. Assuming the person is expected to be able to do some work in the future, questions to consider include:

- What job will they be able to do?
- How many hours per week will they be able to work (full-time, part-time)?
- Will they be forced to retire earlier than they otherwise would have but for the accident?
- If self-employed, will they incur additional costs, including replacement labour, to continue to operate their business?

The answers to these questions are generally provided to us from medical reports, discussions with the individual, and/or assumptions provided by their lawyer.

Once we have estimated the person's potential and actual earning capacity, the calculation of the annual loss is essentially the difference between the two.

Future Losses

When calculating future losses, there are various other issues that should generally be considered, including:

- *Present value discounting* – Our calculations are intended to determine how much money should be awarded to a person today, to replace lost earnings that they will suffer in the future. Since the person will be able to invest the money awarded, and earn investment income on that money, the person need not be awarded the full amount of the future loss calculated. Present value discounting determines the amount of money needed today, that can be invested, such that there will be sufficient money in the future to replace the lost earnings.
- *Survival* – Our calculations determine the amount of economic loss that will be suffered to some point in time in the future (e.g. to age 65). However, not everybody will live to that age. Therefore, the future loss should be reduced to account for the probability of survival.

- *Labour force contingencies*
 - Without consideration of labour force contingencies, the calculation of a future loss of income to a certain date (e.g. age 65 or 70) would assume that the person would continue to work throughout the period, to that age. However, people leave the workforce for a number of reasons, including normal retirement, early retirement (for any number of reasons), disability (for causes other than the accident in question), etc. People who are working, or want to be working, are considered to be "participating" in the workforce. Therefore, we generally reduce the future earnings for the probability of participation in the workforce (obtained from statistical data). However, of the people who are participating, not all are employed. Some are unemployed. Therefore, we generally further reduce the future earnings for the probability of unemployment.

Future Care Costs

As noted earlier, in addition to lost earnings, we also want to consider the future care costs the person will now need to incur due to their injuries. These costs include a number of things, including medicine/drugs, medical aids and devices, professional (psychological, physiotherapy, etc.) services, housekeeping, attendant care, etc.

The expected timing and cost of these items are generally obtained from a rehabilitation report prepared by a trained assessor. We then use these reports to calculate the present value of the future costs required.

The calculation of the lost earnings and future care costs can be a complicated process. Our Financial Services Advisory Team (FSAT) has significant experience preparing these calculations. If you have any questions or require assistance with such calculations, please contact a member of our team.

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Maximizing Business Value



We are often asked “How can I maximize the value of my business?” This can be of particular concern to a business owner who is nearing retirement, has been informally approached by interested purchasers, or is otherwise interested in selling their company.

While a proper valuation of the business requires careful analysis of the business and its unique attributes, there are several fundamental factors that serve as an underlying basis of most business valuations. Through an understanding of these factors and their impact, a business owner may be able to make adjustments to the operation of their company in order to maximize value on its eventual sale.

Discretionary Cash Flow

A key factor in the value of most businesses is the after-tax cash flow generated. Generally speaking, the greater the after-tax cash flow a business generates, the greater the value of the business.

It should be noted that the after-tax cash flow frequently used in a business

valuation reflects the after-tax cash flow associated with the investment in the company. As a result, the after-tax cash flows are adjusted to remove the fair value of managerial services. The cash flows also consider the impact of capital expenditures and working capital requirements.

While many people may focus on the growth of gross revenue, believing this is what drives the value of a business, this growth will not necessarily lead to an increase in the value of the business. It is important that consideration be given to the costs associated with the additional revenue, including any additional capital expenditure and working capital requirements.

Careful management of the company's costs, capital expenditure and working capital requirements may have a significant impact on the value of the company.

Risk

Another key factor in most business valuations is risk. A prospective purchaser will carefully consider the risks associated with realizing the expected after-tax cash flow. This may include:

- An assessment of the critical success factors of the business. How successful is the company in the areas that are deemed critical to its success?
- Revenue and/or cash flow stability – Does the Company have a history of stable revenue and/or cash flow? Or are there significant fluctuations year to year?
- Customer concentration – Is the company dependent on a few customers? Or does it have a well-diversified customer base that protects it from downturns in specific businesses and/or industries?
- Key employee – Is the company reliant on one or two key employees? Could the business continue to operate and succeed without them? Or are key responsibilities transferable to other employees? Are succession plans in place?

- Differentiation and competitive advantage – What distinguishes the company from its competition and is that expected to continue?

Generally speaking, businesses that are considered higher risk have a lower value than those with a lower risk. Careful management of the Company's risk factors may have a significant impact on the value of the company.

Assets

The fair market value of the net assets (assets less liabilities) of a company can have a significant impact on the value of the company. In instances in which the after-tax cash flow of the business is not significant, the fair market value of the net assets may be used as a basis to determine the fair market value of the company. In most cases, the fair market value of a company is expected to be no lower than the fair market value of its net assets.

The fair market value of the net assets may also impact the risk assessment of the company. In instances in which the fair market value of the company is based on a multiple of its after-tax cash flows, the ability to realize the fair market value of the net assets by selling off the assets serves to reduce risk associated with the purchase price when compared to a company that has little or no net asset value.

Careful management of the company's net assets may assist in maximizing the value of the company.

The valuation of a business involves a careful analysis of the business, its unique attributes and many factors that impact fundamental factors such as discretionary cash flow, risk and assets. Please contact DJB if you would like assistance obtaining a better understanding of the value of your business and the factors that may help to maximize its value.

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Hamilton Office Move - Please Update Your Records

As of Monday, June 24, 2019, the former DJB Grimsby and Hamilton offices combined and are now conveniently located at:

**570 Highland Road West, Unit 1
Hamilton, ON L8W 0C4**

Our phone numbers are unchanged from the previous Hamilton office numbers at:

**905-525-9520
1-866-358-8240**

This new location is a custom build on the Hamilton mountain just off 'The Linc' and Red Hill Parkway.

As a part of this move, Brent Pyper and Dave Grebenc have moved their primary offices to DJB's Burlington location.

Although our physical office has changed, our service commitment to the Hamilton, Grimsby, and Burlington areas has not.

Brent Pyper, Rob Smith, and Dave Grebenc will still service these regions and, as always, are happy to meet you, in your offices, or ours, at any time.

Colin Cook will continue to service the St.Catharines/ Niagara/ Welland regions.

If you have any questions regarding our move, or any other matter, please contact any one of our FSAT team.



DJB Contacts Interested in Buying & Selling Businesses - September 15, 2019



We have clients and contacts that are interested in buying or selling businesses. If you see a possible fit, please contact us so that we can arrange an introduction for you.

BUYERS

- ▶ Private Equity Group that buys majority positions in Canadian companies with EBITDA → \$2m for long-term hold and growth.
- ▶ Looking for a cleaning/vacuuuming (not janitorial) company in Southern Ontario.
- ▶ Private Equity Group providing capital and strategic partnerships to \$.5 to \$3.0m EBITDA businesses in Cda, primarily Ont and BC.
- ▶ Interested in an owner operator retirement situation with approx \$250k to lever with VTB for acquisition.
- ▶ \$500k to \$4m, in any industry, will consider partnership and investment opportunities, including managing or running a business with a minority stake.
- ▶ Two entrepreneurs backed by 16 investor fund looking for \$1.5m+ EBITDA and => 20% ROC.
- ▶ Wholesaler of welding supplies interested in similar businesses in Canada or USA with an EV up to \$5m.
- ▶ Foreign (US) shareholders' investment company makes acquisitions across North America in the manufacturing and agricultural sectors (large farming corporations) with an EV up to \$5m.
- ▶ Food Producer (Pasta/Pizza sauces, Salsa, etc.) and Distributor with \$4.5m sales looking to buy complementary profitable food production company with about \$1m in sales.
- ▶ Looking to grow by acquiring HVAC or related companies in the \$1-10M sales range in the Hamilton/Halton/Niagara regions.
- ▶ Operates an importing business specializing in household (ie - kitchen) gadgets sold to grocery and box store chains. Interested in complementary businesses as well as Hamilton based real estate investment opportunities.
- ▶ Diversified asset management firm focusing particularly on the technology, media, service, renewable energy, real estate and hospitality sectors.
- ▶ Entrepreneurial investment firm seeking to acquire and grow a small to medium-sized business. Looking for a company with annual revenues from

\$5 to \$30 million and EBITDA from \$1 to \$5 million, anywhere in Canada.

- ▶ Retired individual looking for business to run part time possibly involving his son.
- ▶ Potential client with \$25m annual revenue in mechanical systems for industrial, commercial and institutional construction looking to acquire complementary businesses in SW Ontario.
- ▶ Investment partnership acquiring Canadian companies with \$1m to \$6m EBITDA.
- ▶ Acquires controlling interests in Canadian companies with \$1m to \$5m EBITDA.
- ▶ Manufacturing business within 100 km of Hamilton, sales \$5m to \$10m, EV \$2m to \$3m, could buy in over time or take a significant ownership % and a senior management role.
- ▶ Up to \$7m to invest in auto dealership, wholesale distribution of electrical or HVAC and/or businesses that serve the construction or manufacturing industries.
- ▶ Broker looking for larger real estate offices for acquisition. Would consider any office over 15 people in the Kitchener, Guelph, Milton, Mississauga or Brampton markets and any office with over 50 agents in the Burlington, Hamilton or Oakville market places.
- ▶ Two partner firm in the GTA looking to acquire \$3m to \$10m EV businesses in the GTA/Hamilton area.
- ▶ Interested in troubled situations, successions or high growth companies in distribution or manufacturing.
- ▶ \$1.5m to lever into a business acquisition.
- ▶ Private Holdco looking for investments in the GTA in the industrial manufacturing or services industry. Revenue → \$8m and pays 3 to 4 times EBITDA.
- ▶ Lives in N-O-T-L with approx \$250k cash to lever into business acquisition.
- ▶ Investment group, enterprise value up to \$12m, within 90 minutes of Kitchener.
- ▶ Investment group, Oakville or West GTA, EV \$1m to \$10m.
- ▶ Investment group with approx \$10m equity to place.
- ▶ Marketing individual looking to become co-owner/manager in small company.
- ▶ Private equity firm, seeking \$10m to \$15m enterprise value, 100% sale, owner-operator looking to transition

out, Niagara region.

- ▶ Seeking an enterprise with a strategic fit to their business, serving Industrial Distributors, with sales in the range of \$1m to \$20m.
- ▶ Already made one acquisition in the food service industry and are interested in related industry and/or other good opportunities.
- ▶ Historic earnings with potential, located in the Toronto through St. Catharines area, existing management and price of \$1m - \$3m.
- ▶ Anything profitable. Niagara Falls to Oshawa. Up to \$1m.
- ▶ Investment group looking for companies with \$3M-\$30M in sales, focused on B2B services, Healthcare services and software.

SELLERS

- ▶ Medical-legal personal injury graphics business. Sales approx \$1.2m with 10 to 15% pre tax income.
- ▶ Custom brokerage. Sales approx \$900k p.a. Asking \$1.5m for 100% of shares.
- ▶ Security systems and equipment. Sales approx \$1.6m and EBITDA approx \$250k.
- ▶ Engaged in the development, training, and sale and support of business applications software. Revenue of approximately \$4m per annum.
- ▶ Manufacturing business in the Kitchener/Waterloo/Guelph area with approx \$3m in sales and EBITDA of \$250 - \$500k.
- ▶ Retail pet food and supplies store.
- ▶ Corporate group includes a poultry wholesale, distribution and refrigerated logistics company and a boutique retail food store company. Total sales \$7m.
- ▶ Exterior building, vehicle, driveway, sidewalk cleaning service with 2 self contained trucks. Annual revenue approx \$165k.
- ▶ Engaged in removal & disposal of liquid waste & the performance of environmental audits. Sale of 50% interest by one of two shareholders.
- ▶ Restaurant including the land and building. Asking \$3m.
- ▶ Machine shop specializing in large machining and fabricating and also providing comprehensive support services. Sales approx. \$2.9M and EBITDA approx. \$325k.

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Spotlight - David Grebenc

Manager, CPA, CA



David is a Manager in the Firm's Economic Loss Quantification Group, providing litigation support services on behalf of plaintiff and defence lawyers. Services provided include the preparation of a variety of economic loss calculations, for the following purposes:

- Motor vehicle accident tort claims
- Income replacement benefits (IRB)
- Slip and fall claims
- Medical malpractice claims
- Dependency claims
- Long-term disability claims
- Valuation of future care cost analysis

In addition, his experience includes providing accounting and consulting services for businesses and their owners in a wide range of industries.

David has been active in his community having served for various not-for-profit organizations, including Spinal Cord Injury Ontario, Threshold School of Building, and South Niagara Rowing Club. He is currently a Board member for the Hamilton Brain Injury Association.

David qualified as a Chartered Professional Accountant in 1996 after graduating from Brock University in 1993 with a Bachelor of Business Administration degree with Honours. David was appointed as a Manager in 2002.

Committee and Team Involvement

- Health and Safety Committee
- Economic Loss Quantification Group

FSAT SERVICES



- Assistance with Business, Acquisitions & Divestitures, Including Due Diligence & Quality of Earnings Reports
- Collaboratively Trained Professionals
- Child & Spousal Support Income Calculations
- Economic Loss Calculations regarding Motor Vehicle Accidents, Slip and Fall, Medical Malpractice and Dependency Claims
- Experienced Expert Testimony
- Forensic Accounting
- Income Replacement Benefit (IRB) & Other Accident Benefit (AB) Calculations
- Long-Term Disability Calculations
- Matrimonial Disputes
- Mediation Services
- Shareholder Agreements & Dispute Resolution
- Value of Future Care Cost Analysis
- Wrongful Dismissal Claims



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