

# Meet the Johnston's Case Study

## Advisory Solution

### The Clients

#### The Business Owners

George Johnston (62) and his wife Diana (60) own 70 percent and 10 percent, respectively, of the shares of Decor Designs - a wholesale importer and supplier of specialized parts and fixtures to the plumbing, renovation and design trades. The remaining 20 percent is owned by George's most senior management employee, Matthew Gibson (46), who has been with their business since day one, first as a part-time employee, and then full-time as part of the management team.

George started Decor Designs in 1984, eight years after moving to Canada. Prior to starting the company, he worked for a plumbing firm. He invested \$250,000 (an inheritance from his parents) to start up the business, which has been very successful, in part because of George's American contacts and ability to source unique fixtures not normally available in Canada. Decor Designs has annual sales of about \$17 million and George believes the firm is worth approximately \$8 million. The firm's best year ever was in 2009; George partly attributes the success to the Home Renovation Tax Credit, which stimulated demand for kitchen and bathroom renovations.

Although their business relied on bank financing during its first 15 years, Decor Designs is now debt-free and holds about \$2.5 million in cashable GICs with CIBC. This amount fluctuates up or down by about \$500,000, depending on cash flow requirements.

George and Diana own a house worth approximately \$600,000 with a remaining mortgage of \$45,000 that they hope will be paid off within two years. They have \$375,000 in RRSPs and \$650,000 in a conservative non-registered portfolio at CIBC Wood Gundy. The couple spends about \$100,000 a year, and many of their expenses, including a small fleet of Mercedes-Benz automobiles and family travel, are charged to Decor Designs.

George and Diana have two children. The eldest, Felicia, is 32. After graduating from college in media studies, she is now a producer for a popular television home makeover show based in Vancouver. Her live-in boyfriend is American and her parents think she might decide to marry and settle in the U.S. The youngest, Frank, is 28. He is an internet marketing whiz and is largely responsible for Decor Designs' recent success in marketing high-end fixtures directly to the design industry across North America. He has been working for Decor Designs since graduating from university; however, having recently received offers from some major firms, he is torn between his loyalty to his parent's company and the opportunities being presented to him. He is not particularly interested in the core plumbing supply business which still accounts for 65% of Decor Designs' revenue.

George loves his business and had not given much thought to retirement until his brother had a major heart attack. George is a workaholic and is personally involved with every aspect of the business, except the website, which he does not really understand and is comfortable leaving to Frank. Diana would like George to slow down. She has a dream of buying a condo in Arizona, for relief from her arthritis during the winter months.

George and Diana have done very little retirement planning. They each have basic Wills, leaving everything to each other, and then splitting their assets equally between their two children on second death. George takes a salary of \$150,000 and Frank is paid \$80,000 per year. Diana takes a salary of \$125,000, although she does not actually do any work for the firm. They have never put a shareholder agreement in place and they do not have disability or life insurance coverage.



## The Challenge: Beginning The Process Of Transitioning Out Of Your Business

The most important step in beginning any business transition plan is to speak to your lawyer, accountant and CIBC business advisor about your goals and objectives. Making sure they understand your goals and objectives will help them determine what your business transition plan will look like. Make sure to talk to them about your wants and needs for your future, your children's future, and the future of your business.

It is also a good idea for George to talk to his advisors about his objectives and any potential desire to have a successor owner of Decor Designs.

## The Next Steps: Planning For The Transition Out Of Your Business

After speaking with their CIBC business advisor and reviewing their current situation with the team of experts, George and Diana learn that their areas of concern should include tax planning, estate planning, their upcoming retirement needs, and their desire to name Frank as the successor owner of Decor Designs.

When the CIBC business advisor spoke with Frank about his future with Decor Designs, he mentioned that he feels strained. He wants to grow his career in the internet channel, but not with Decor Designs. At the same time, he wants to make George proud, and he feels that he must put his own feelings aside and do what is best for the family.

George and Diana's CIBC business advisor analyzed all of the information that they provided and with the help of a team of experts from CIBC, a holistic transition plan for Decor Designs has been developed.

Before finalizing the plan for George and Diana, their CIBC business advisor and the team of CIBC experts discussed with George and Diana issues such as family harmony, business valuation, methods of transfer, including the tax and legal implications of each, successor and successor development, retirement and estate planning issues.

## The Solution: Two Years Later

George is now 64 and Diana is 62. They have followed the recommendations set out in the business transition plan and are now confident about the successful transition of their business.

They discussed the future of their business with their children and eventually determined that neither Felicia nor Frank was interested in taking over Decor Designs. While this was initially a disappointment for George, he came to realize that this solution was preferable for the children and better for their business in the long run. Shortly after their discussion, Frank accepted an offer for an executive position in the internet marketing field for four times the salary he had been earning at Decor Designs. He was relieved to no longer bear the burden of succession.

George identified his key manager, Matthew Gibson, as a potential successor. Already a part owner of the firm, Matthew, at age 48, had many of the skills required to successfully lead the firm. George identified Matthew's skills and knowledge gaps and began the process of closing the gaps through training and mentoring. As part of the process, George helped Matthew develop strong relationships with Decor Designs' existing customers and suppliers, and together, they created a strategic business strategy for the firm. Through this process, George gained confidence in Matthew's ability and his vision for the firm's growth.

In preparation for the sale of the business, and to maximize the available capital gains exemption, George implemented an estate freeze. A new operating company, NewCo, was created and is owned by a family trust of which George, Diana and their two children are beneficiaries. A \$2 million dividend, representing surplus cash not needed for the operation of the business, was paid to the family trust to "purify" the company. George and Diana hold the new class of preferred shares representing the frozen value of Decor Designs.

They normalized Decor Designs' earnings by allocating some expenses previously paid by the corporation to George and Diana personally. This also gave them a better idea of their true retirement income needs.

George and Diana started talking about their retirement dreams and how they wanted to spend the rest of their lives. Diana shared her dream of spending the winter months in a warm, dry climate. George is not sure he's quite ready to fully retire. He is committed to withdrawing from Decor Designs, but is thinking about how he can leverage his experience and travel, possibly as a speaker at design shows.



Matthew's main concern was obtaining the funding necessary to buy out George and Diana. The CIBC business advisor engaged a member of the CIBC team of experts, CIBC Mid-Market Investment Banking (MMIB), to conduct a professional business valuation to help George and Diana through the transition process. Through this collaboration, the value of Decor Designs was determined to be \$10 million.

After exploring a number of options and agreeing that the value of the firm was \$10 million, Matthew established the following plan:

- Matthew would obtain bank financing to purchase 35 percent of the shares from the Johnston family trust immediately. Combined with his existing 20 percent stake, this gave him control of the company;
- Matthew identified a group of private investors to purchase 25 percent of the shares;
- Matthew agreed to buy the remaining 20 percent of the shares from the Johnston family trust over the next five years at a fixed price plus a percentage of future earnings.

## The Results: Five Years Later

Five years later, George and Diana celebrated the final installment of the sale of Decor Designs at their condo in California. They chose California over Arizona as a winter home to be closer to their daughter, who moved to Los Angeles with her husband and two children the year before. The condo is owned by the family trust to avoid potential U.S. estate tax issues. They still have their home in Canada and live comfortably on their investment income. As Felicia is now a non-resident of Canada, George and Diana appointed CIBC Trust as co-executor of their estate, along with Frank.

As beneficiaries of the family trust, Felicia and Frank each received \$1.5 million from the sale of Decor Designs to allow them to use their lifetime capital gains exemption. Felicia used her share to buy a home in Los Angeles and Frank used his capital to start up his own internet business, which is now showing signs of becoming profitable.

Matthew has proven to be an exceptional CEO, and Decor Designs continues to thrive and grow under his leadership.

The CIBC group of companies continues to be the Johnston family's main financial institution. George and Diana have invested \$4.6 million of the proceeds of the sale with CIBC Wood Gundy, and also hold their family trust at the firm. Their children have also invested their savings with CIBC Wood Gundy. Both Frank and Matthew have become CIBC Business Banking clients.

## We're Here To Help

By talking to CIBC about their goals and objectives, the CIBC group of companies was able to offer them a complete business transition plan, and continue to manage all of their financial needs, from wealth management to business planning, banking and more.

Contact your CIBC advisor today to see how you can begin the business transition planning process and make your retirement dreams come true.



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