

T H E B U S I N E S S ADVISOR

Useful Information for the Business Owner

S U M M E R 0 9

Touch Your Customer

The Art of the Deal

Using Testamentary Trusts
in Estate Planning

Wills and Creative Strategies
Using Testamentary Trusts

Timely Investment Ideas

Winter 2009

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Banda Marketing Group Inc.

Banda Marketing Group Inc. assists owner-operated businesses in making strategic marketing decisions. The company has built considerable expertise in dealing with issues faced by owner-operated firms that are changing how they market their businesses. Oftentimes these companies are launching new products, entering new markets or attracting new customer segments.

Since 1997, the company has developed business and marketing plans, feasibility assessments, marketing research projects, and marketing campaigns, and has implemented promotional campaigns for businesses in a variety of industries across Western Canada.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP in Saskatoon includes a Private Company Services practice representing some 85 per cent of its business and which services over 850 corporate and 2,500 individual clients. With this experience, PwC understands the environment owners operate in, and the issues they face.

PwC's role is to help clients spot opportunities for growth, identify risk, realize savings, create value and help put the pieces together for business of all sizes, in all industries. It's also about you and that is why they provide advice on your personal taxation, finances, succession and retirement planning. They focus on helping you.

Regency Advisory Corporation

Regency provides financial advisory services for business owners and management personnel, addressing the financial complexities of personal and business life. The firm is devoted to serving the needs of the region's highest-net-worth business owners to help ensure long-term prosperity and growth.

Regency has an accomplished team of advisors that develop wealth accumulation and preservation strategies that focus on financial growth, debt management and elimination, tax efficiency, risk management and executive compensation.

Stevenson Hood Thornton Beaubier LLP

Stevenson Hood Thornton Beaubier LLP is a Saskatchewan law firm with over 30 years of experience. Its clients include many of Saskatchewan's most successful owner-managed businesses. The firm provides extensive services to its business clients including business ownership structuring, succession planning and advising on mergers and acquisitions.

SHTB's main practice areas are corporate and commercial law, estate planning, tax law, employment law, and civil litigation. In addition, the firm has assisted many of its clients in specialty areas such as tax litigation, pension law, and provided advice in insolvency-related matters.

Westcap Mgt. Ltd.

Westcap Mgt. Ltd. is a leading venture capital and private equity fund manager that provides a wide range of investment banking activities to a diversified client base including institutions, retail investors, governments and high-net-worth individuals. Founded in 1991, Westcap has an uncompromising vision to build long term value for investors in a broad range of investment funds.

Westcap is a registered portfolio manager of a diverse and distinct group of funds including Golden Opportunities Fund Inc., Saskatchewan's first and largest provincial labour-sponsored investment fund. Golden Opportunities Fund has been recognized as one of the top performing funds of its kind in Canada and was chosen as the 2004 Canadian Labour Fund of the Year. Investors in the Fund receive a 35 per cent tax credit on their investment of up to \$5,000 per taxation year.

THE MARKETING REPORT:

Touch Your Customer

When you develop your marketing plan, focus on influencing points of contact that have the greatest impact on your customers. Most business owners simply don't take the time to consider when these crucial moments occur.

A Touch Point is any point of interaction your company has with a customer. These points of interaction are important, because your business lives or dies on the health of its customer relationships, whether you own an engineering firm, a cabinet manufacturing facility or an ice cream parlour.

Healthy relationships are built upon small actions. The salesperson must also consider points of contact that may not be a pivotal as delivering a quote, but will impact the Office Manager's comfort with the purchase.

Influencing your customer Touch Points will impact your business in two positive ways. First, it helps you move the customer closer to the sale. Second, it helps build loyalty which translates to repeat business and referrals.

When our firm prepares a marketing plan for a business, we first examine the process people follow when they make a purchase. This involves identifying steps that are important to customers and the motivation behind their actions. In the world of marketing, this is called Consumer Behaviour. It uses principles of psychology to understand why people make decisions.

As a simple example, consider how a business buys new office furniture. Let's assume that the purchase will be handled by an Office Manager. The key steps in the selling process are some obvious Touch Points, such as the initial phone inquiry to the furniture retailer, a meeting with the salesperson, a review of the quote and signing the contract to purchase.

Look at this situation through the customer's eyes. Healthy relationships are built upon small actions. The salesperson must also consider points of contact that may not be as pivotal as delivering a quote, but will impact the Office Manager's comfort with the purchase.

Here are three often overlooked Touch Points that relate to this example:

1. Use of Customer References:

Many businesses use past customers as references in their sales process. What response would the Office Manager receive when calling one of your past customers? If your past customer has been too frequently contacted for a reference, it's possible that person may not do a favourable job of describing your business. Use testimonials sparingly and only when appropriate.

2. Managing pre-delivery:

The contract may be signed, but the furniture still has to be ordered from the manufacturer and delivered. Any contact with the customer before delivery is a Touch Point. If you find out the order will arrive a week later than promised, call the customer as soon as possible. You may have bad news but the purpose of your call is to keep the customer in the loop. People obviously appreciate the contact.

3. Sloppy Billing:

Salesmen are notorious for sloppy billing. The deal may be done but the relationship is entering a fragile stage. Simply ensuring the charges are correct is not enough. To the customer, receiving a final bill is an important step in the purchase process. As the bill is reviewed, this customer will be checking to ensure everything is in order. Build a level of comfort and confidence by clearly itemizing all charges and providing explanation where necessary. For example, if there was a \$100 delivery fee don't just list the charge as an ambiguous description such as 'Other Fees & Charges'.

Marketing is more than advertising. A proper marketing plan involves strategic decisions and is comprehensive in nature. It involves adjusting your internal processes to influence the customer experience before, during and after a sale.

The key is to keep your eye on the ball and make good decisions. Understand the points of influence you have over your customer's experience with your company. Understand which of these points are important, and why. Build your entire marketing and sales effort around these Touch Points. Initial sales, repeat sales and referrals will follow.



BANDA
marketing group

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The Art of the Deal

There are a number of different ways in which a venture capital transaction can be structured. It has been said that it is an art, not a science, which involves a delicate balance of risk versus return with an almost infinite number of potential outcomes. In this article, our fourth in a series exploring the components of an investment transaction, we discuss the art of the deal.

Balancing risk and return when negotiating investment transactions is referred to as the “art of the deal”.

Investors have different motivations. Seed investors will seek to advance developments in particular sectors. Angel investors may invest in a deal since it reminds them of a technology they dreamed about as a child. Venture capital investors are returns oriented. Returns are driven by the potential for future growth in revenue and the bottom line. To capture this, deals will most often contain an instrument that provides upside potential structured to achieve the maximum return for the risk assumed by the investor. This may involve the investor taking an ownership position in the company through a direct equity investment for which they will pay somewhere between market price and a nominal amount (“gifted equity”). Venture capital investors will also use equity derivatives, such as warrants or share purchase options, that allow for future equity participation at preferential pricing (the strike price).

The balancing factor, and a key variable in any transaction, is risk. Investors are willing

to assume a level of risk that they feel is commensurate with the return potential of the deal. From a potential investee point of view, the cost of capital can be decreased by lowering risk to the investor. There are a number of strategies to reduce risk. Some involve the structure of the investment transaction. For example, a debt instrument will allow the investor to take a security position on assets of the company that provide downside protection in the event of default, and provide for regular repayment of principle that reduces the length of time and amount of the investor’s capital that is at risk. Risk can also be reduced by the business strategy employed by the company. A clear business and financial model includes guaranteed revenue sources, such as existing contracts with customers, alignment with strong industry partners, ownership over intellectual property, a well rounded and experienced management team, and demonstration of significant market potential. Risk can also be spread across a number of different investors which leads to syndication of investment transactions, a common investment model, especially in today’s economic environment.

Balancing risk and return when negotiating investment transactions is referred to as the “art of the deal”. The investor will negotiate a deal to ensure protection of their interests. At the same time, potential investees will try to protect their interests. Venture capital transactions are partnerships. They are successful when both parties approach the partnership with a “win-win” attitude and openly address, among other items, their concerns, risks, and expectations for performance. The natural tension must be recognized and the relationship balanced. Both

parties should be flexible, and recognize the value that the other is bringing to the table. For example, venture capital investors add value to a transaction far beyond providing capital. These investors become involved in helping refine the strategic direction of a company, often through participation on the Board of Directors, and provide access to a network of industry partners and professionals to provide assistance in building a strong company.

Many entrepreneurs and small business owners are facing a crossroad where the decision to seek additional capital has to be made. The current economic environment has made traditional sources of financing, such as bank lending, less accessible. Alternative sources, such as venture capital investment, while not the right fit for every business, are becoming more mainstream. Venture capital investors provide more than a source of capital, and as an investment partner that has a vested interest in the business succeeding and growing, they play an integral role in helping build the business.



WESTCAP MGT. LTD.

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THE ACCOUNTING REPORT:

Using Testamentary Trusts in Estate Planning

As many of us can attest, the death of a loved one is one of the most traumatic events that a family can experience. No amount of financial planning can eliminate the emotional pain. However, effective will planning can certainly mitigate the financial harm to the family, and even create tax-planning opportunities.

To understand the tax benefit, consider the basics of trust taxation. A testamentary trust (a trust created by a will upon the death of an individual taxpayer) is entitled to the full set of Individual tax rates and brackets. This means that income taxed in the testamentary trust itself can provide a tax saving by virtue of using the trust's lower rates and brackets. In Saskatchewan the availability of the lower rates and brackets provides a permanent annual tax saving of approximately \$13,000 on \$126,000 of yearly income for 2009, compared to top bracket taxation of the same amount of income.

To illustrate some of the benefits possible via properly drafted wills, consider the case of Alex and Marla Planner, and their three adult children, Bill, Rachel and Ellen. Bill, the eldest, had suffered a brain injury in a car accident some 10 years ago, and while he has a relatively simple job that gives him satisfaction, Alex and Marla worry that Bill would have difficulty prudently managing any significant amount of money.

Alex and Marla have significant personal holdings in their privately owned company in tax-paid shareholder loan accounts and shares of the company itself. They also have significant personal investments in term deposits and shares.

Unfortunately, Alex has recently received very bad news: he has a terminal illness, and the

prognosis gives him only six months to live. He wants to ensure that Marla is well taken care of financially after his passing, and that their children are treated equally from an inheritance perspective.

Alex has indicated that he wants to maximize income-splitting through his will. Therefore his new will provides for the creation of six testamentary trusts on his passing:

Effective will planning can certainly mitigate the financial harm to the family, and even create tax-planning opportunities.

- Three qualifying spousal trusts will be created to receive any property which has accrued capital gains at death. Marla will be the income beneficiary of each of these and one child will be the residual capital beneficiary on each trust on Marla's passing. Marla will have access to as much of the capital during her life as Alex wishes to provide for in his will.
- Three discretionary family trusts will be created, each to receive one-third of all his other assets that do not have accrued capital gains at his death, such as his shareholder loan account and term deposits. Marla will be an income and capital beneficiary in each of these, plus one child (and their children) will also be beneficiaries.
- On the trust for son Bill, after Marla's passing, Bill's two sisters will be trustees to ensure his inheritance is managed prudently.

The plan is that the rates and brackets available to each of these six testamentary trusts will be fully exploited annually by ensuring appropriate income flows to each trust from the family company.

Alex always hated paying income tax, and derives a considerable amount of comfort from the knowledge that after his passing, his own personal tax return will be replaced by six testamentary trust returns, each of which can provide an annual tax saving to his family of \$13,000. He is also comforted knowing that Bill's inheritance will be prudently managed for Bill's benefit by his two sisters after Marla has passed.

These trusts will provide income-splitting benefits and ensure financial protection for Marla during her life, and Bill during his, while also putting each child in a strong tax-planning situation after Marla has died.

All of these benefits can be achieved by simply having an appropriately drafted will, something each of us should consider mandatory.

Have you reviewed yours lately?



PRICEWATERHOUSECOOPERS 

Frank Baldry, CFP, TEP, CA is Saskatchewan tax leader at PricewaterhouseCoopers LLP whose practice is intensely focused on preserving and enhancing the wealth of private companies and their owners.

Wills and Creative Strategies Using Testamentary Trusts

Typically, when individuals make a Will, they want to provide gifts of property to their spouse or common-law partner (hereinafter referred to as the “spouse”) and children. Oftentimes, individuals will structure their affairs to reduce probate fees on death by holding property in joint tenancy, and designating beneficiaries within financial instruments such as life insurance policies, registered pension plans, RRSPs and RRIIFs.

This approach to estate planning is relatively simple and straight-forward. However, a better estate planning approach, particularly for individuals who possess significant wealth, may be one that makes extensive use of testamentary trusts. A testamentary trust is created by an individual when his/her property passes, as a consequence of their death, to a person (the trustee) who administers and holds the property for the benefit of one or more persons (the beneficiaries). Individuals who make use of testamentary trusts as part of their estate planning can often allow their beneficiaries to take advantage of several opportunities that would not be available in circumstances where property is left as an outright gift to a beneficiary. These advantages include tax deferrals and/or savings, control over the property which is passed on to the spouse and children, and potential creditor protection.

If property is left to a testamentary trust, several income tax advantages may be available. One of the more significant income tax opportunities lies with the ability to tax the income earned from the trust property either in the hands of the testamentary trust or the hands of the beneficiaries, or

any combination thereof. In some cases, testamentary trusts can also be very useful in reducing taxes in foreign jurisdictions. For example, where an individual owns a U.S. vacation property, structuring that individual’s Will with certain types of trusts can defer, and in some cases, completely avoid, U.S. estate taxes.

Making use of testamentary trusts as part of estate planning can often allow beneficiaries to take advantage of several opportunities that would not be available if the property was left as an outright gift.

The trustee has the obligation to administer and protect the trust property for the benefit of the trust beneficiaries. The importance of the role of the trustee cannot be understated. In a situation where an individual wishes to benefit his/her spouse, if that spouse has dementia, it would be prudent to leave the assets in a spousal trust with the trustee being a child or some other competent adult, rather than leaving the assets to the spouse. Similarly, where an individual wishes to benefit young children or a child who suffers from a disability or addiction, it would be prudent to leave the assets in a trust with a competent third party serving as trustee.

If property is left as an outright gift to an individual, that property will generally be

subject to any claims of creditors against that individual. On the other hand, if property is left in a discretionary trust where the individual in question is one of several beneficiaries, the existence of the trust may serve as at least a partial shield to creditors’ claims against that one individual beneficiary. Courts have taken different approaches in dealing with creditors’ claims in different cases. However, generally the existence of the trust will be respected, and the creditors are not entitled to all of the trust property where the debtor is but one of many beneficiaries.

In summary, the advantages that can be obtained by using testamentary trusts in terms of a saving or deferral of Canadian taxes, U.S. estate taxes (in appropriate circumstances), ongoing control of the trust property, and the potential for shielding from creditors’ claims, make trusts a very flexible and useful planning tool.



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THE FINANCIAL REPORT:

Timely Investment Ideas

In 2009, companies and banks will recapitalize their balance sheets. What effect will this process have on the stock and bond market, and how can you invest going forward to grow your savings?

Corporate Bond Market

Let's first look at some fundamental business structures that needed immediate recapitalization: the banks. Government recapitalization of the banks in late 2008 prevented an economic downturn that had never been experienced in modern day society. The financial sector of G7 nations is regaining strength due to: 1) government bailouts; 2) private equity offerings; and, 3) new bond and debt issues. As an example of the equity recently lost by shareholders of world banks, Citigroup had a market cap in 2007 of 255 Billion; today, its market cap is 19 billion.

Banks and large corporations are recapitalizing their balance sheets. Corporations have four main sources of capital: 1) bank funds, which have become very difficult to acquire; 2) profits, which are measurably down; 3) new equity issues, which are very difficult in a risk adverse equity market; and, 4) new debt issues, which are currently the source of choice for most corporations. Corporate bond spreads are currently at 100-year extremes. To put some rates to that comment, in early 2009, the spread between Corporate bonds and Government bonds was 8% for 10-year maturities. Therefore if a Government bond were to pay 2.5%, the 10 year return on Corporate was 10.25%. The high spread was due to default risk, and the desperation of Corporations to replace the financing they are no longer receiving from the banks.

Timely Investment Idea #1: take advantage of the current spread in the Corporate bond

market. As liquidity eases back into the system, the spreads will compress, driving down the 10 year rate of return, but the current environment still provides very good rates.

History shows owning equities over extended periods of time will always produce superior returns to investing in or owning any other asset class.

Blue Chip Stocks

As with the banks, market capitalization and share values, of every industry, in every country around the world, have decreased. Investors who have been punished may hold their cash for an extended period of time. Risk has been recategorized in many investors' portfolios, and in many investors' minds.

History shows that owning equities over extended periods of time, however, will always produce superior returns to investing in or owning any other asset class. Remember the bull run of the 1990s: the S&P 500 produced an average annual rate of return of 17.6%. One dollar invested into the S&P 500 in 1988 would have provided the investor \$25 in 1999. It was undoubtedly one of the best 10-year periods for equities in history. The reverse is true for the last 10 years: one dollar invested in the S&P 500 in 1999 would be worth 91 cents today. This is the second 10-year period in which the S&P 500 has had a negative 10-year period since 1930. Three factors that determine the return of a security are Earnings growth, Dividends, and the PE ratio. Equity markets performed so well in the 90s due to falling interest rates. As rates came down, corporations' profits increased due to

access to cheaper capital. Earnings growth was healthy, dividend yields were healthy, and the investment public needed to find alternatives to low GIC rates. Therefore, the price people were willing to pay for a dollar of earnings in the market was elevated, resulting in a long term exceptional bull run. We can, however still make a very compelling case for why investors need to own equities today. The current dividend yield of the S&P 500 plus share buybacks is currently around 4%. Earnings growth will be minimal and PE ratios are very attractive, which could result in 3-5% annual share value appreciation. All totaled, blue chip dividend paying stocks should yield 7-9% over the next 10 years, assuming nominal interest rate hikes, and average inflation.

Timely Investment Idea #2: buy blue chip dividend paying stocks for the long term. Your investment in these stocks will outpace GICs and Bonds, and your savings will grow and combat inflation.

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