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FP ENTREPRENEUR || INNOVATORS || BY ARMINA LIGAYA

TRUE GRIT

Overcoming two disastrous deals would put any entrepreneur to the test, but Brad Nathan's private-equity firm has survived

The past few months have been more than kind to Brad Nathan: his Toronto-based private-equity firm Lynx Equity snapped up a handful of companies, including social-media marketing developer Majestic Media, and secured another round of debt financing from TD Bank. But never mind the latest flurry of activity. For Nathan, just to be in good standing with investors and financial institutions at all is a feat in itself, after two disastrous transactions left him with millions in debt and tainted his business reputation.

Back in July 2000, his first venture, merchant bank Succession Capital, made its first deal, buying a seemingly steady fire-sprinkler business for $3 million, only to discover its owners had misstated its financials. The company, Control Fire Systems, was selling inventory it was holding for a client and racking up sales, but didn't record the liabilities. "I bought a business that was losing money that I never would have bought if the financials were done properly," he says. Nathan went from being worth nearly $4 million at the age of 30 to being saddled with a nearly equivalent amount of debt a year later. "Instead of making money, I borrowed money from friends and family... It took years to recover."

Nathan remortgaged his house and sold nearly all his possessions to keep the company moving as it faced a massive funding capital shortfall. "All of a sudden, it becomes harder to raise money, and my whole business is based on raising capital," he says. He met with each of Succession's roughly 30 investors to assure them he was doing everything he could to get them their capital back. He told them the truth about what happened. He cleared out his RRSPs, remortgaged his house and invested the money in other businesses to build them up and pay back his investors.

It took a decade for Nathan and Succession Capital to recover, and pay people back either in cash or equity. But Nathan in 2007 decided to launch Lynx Equity as a new venture that could operate without the baggage-laden legacy that Succession carried. "It was a clean fresh start, of sorts, that Succession owned a piece of," Nathan says. "And Lynx was able to go out to get capital from fresh sources, and wasn't hindered from a messed-up balance sheet."

In 2009, however, Succession entered another bad deal — buying an airport security business called Secure Solutions. The woman who sold the business signed on as president to run the company for Succession, but started a competing business with her husband, despite allegedly signing a non-compete clause, Nathan says. In the end, this new competing business took Secure Solutions' main supplier and many of their long-time customers. Secure Solutions went from doing $8 million in revenues to just $1 million, and went from making $800,000 a year to losing $500,000 a year, Nathan says. The fallout almost wiped the security company out.

Luckily, Lynx and Succession already had a few "home runs" in their playbook, such as Top Cuts haircutting places and Melon Head, a chain of salons for kids. "Doing a good deal in the beginning made all the difference," Nathan says. "We were able to survive that second [deal]; we had enough of a base." But Nathan, again, had to sit down with his investors to assure them he was trying his best to fix the problem.

Nathan is currently suing Secure Solutions and others for roughly $5 million. The case has yet to go before the courts and nothing has been proven. Secure Solutions is still losing money, but it is in a "quasi-stable" position, and the success of his other companies has helped keep it afloat, Nathan says. Lynx Equity now has a "very, very diversified" portfolio of 27 companies. "Even if our biggest company went bankrupt tomorrow, we can handle it," he says.

Lynx Equity's companies are on track to do $175 million in sales by the end of December, and $200 million by the end of March, he says. But he's now extremely defensive when entering new deals. "We spend a lot more time with a person who we're buying a business from," he says. "If we get any kind of inkling that reminds us of anything we've seen in the past, we jump ship."

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ILLUSTRATIONS BY ANDREW BARR; THINKSTOCK PHOTO ILLUSTRATION

LESSONS LEARNED

A bad deal early on can often destroy fledgling companies, but recovering from two such deals takes some fortitude. Brad Nathan, founder of private-equity firm Lynx Equity, has done just that. Here are his three tips for not getting into the same situation again.

1. **IT'S ALL ABOUT PEOPLE.**

Always deal with good people who you can trust, but who are also willing to help you when the time comes, Nathan says. For example, during the second bad deal, he was able to call up his investors for financial help to get out of his predicament. "Always have those people willing to back you up and get you out of a jam," he says.

2. **NEVER BE DESPERATE.**

It can be tempting in the beginning to jump into a deal. But Nathan now sits back the minute something "feels off" and looks at other deals. "Cooler heads will prevail," he says. "If you haven't gone on a date for a long time, and the guy is okay but not your look, and unemployed... but go on a date every week, you're not going to take it. We have an absolute lack of desperation now."

3. **BE TENACIOUS.**

To make sure he paid back his investors when one of his companies hit a road block, Nathan sold all his possessions, lived in a spartan condo with just a bed and a couple of Jiu Jitsu mats, and vowed to deliver pizzas if need be. "You cannot lose your investors' money and you have to continue to work on fixing problems — modifying as need be — until fixed," he says. "Failure is not an option." **FP**

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TAX CLINIC || BY JAMIE GOLOMBEK

Salary or dividends?

Business owners have options in paying themselves

A new year means new decisions, especially when it comes to how small business owners should be compensated for their work: salary or dividends.

A private company pays corporate income tax based on the type of income it earns. The first $500,000 of active business income is eligible for the small business deduction (SBD). This means that corporate income below this amount is initially taxed at the low small business tax rate and isn't taxed a second time until the funds are withdrawn from the corporation by way of a "non-eligible" dividend paid to the business owner. These dividends derive their name from the fact that they are not eligible for the enhanced dividend tax credit available for corporate income taxed at the high rate, such as dividends received from public companies or dividends paid out of active business income (ABI) above the SBD limit, discussed below.

Changes announced to the taxation of non-eligible dividends in last year's budget and effective for 2014 mean that there is no longer a universal "tax rate advantage" of having funds taxed inside the company at the low SBD rates and then paying the amount out as a non-eligible dividend, either in the current year or when needed later on. In half the provinces there is now a small tax rate disadvantage and the tax rate advantage is negligible in the other five, other than Nova Scotia where it's 2.4%.

That said, even in the five provinces where there is a slight tax rate disadvantage, if the funds are not needed to fund current lifestyle, it's best to retain and invest the SBD income in the corporation and to pay the after-tax amount out as a non-eligible dividend to the shareholder, so as to enjoy a significant tax deferral of SBD income within the corporation. This "tax deferral advantage" ranges from a high of 36% in Nova Scotia to a low of 25% in Alberta.

What about ABI above $500,000 that is not eligible for the lower SBD tax rates? In all provinces there is a tax cost associated with paying ABI as an eligible dividend and, therefore, salary may be preferred if the funds are needed immediately or in the short term. It may, however, still be beneficial for a private company that earns ABI to have it initially taxed inside the corporation at higher corporate tax rates to retain and invest the ABI in the corporation so as to enjoy a valuable tax deferral, which can range between 13% and 23%, depending on the province.

For a closer look at the tax rates and (dis)advantages for each province, please see my full report *The Compensation Conundrum: Will it be salary or dividends?* available at cibc.com. **FP**

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