

CPA Ireland Skillnet

CPA Ireland Skillnet, is a training network that is funded by Skillnets, a state funded, enterprise led support body dedicated to the promotion and facilitation of training and up-skilling as key elements in sustaining Ireland's national competitiveness.

The CPA Ireland Skillnet provides excellent value CPE (continual Professional Education) in accountancy, law, tax and strategic personal development to accountants working both in practice and in industry. However our attendees are not limited to the accountancy field as we welcome all interested parties to our events.



The CPA Ireland Skillnet is funded by member companies and the Training Networks Programme, an initiative of Skillnets Ltd. funded from the Department of Education and Skills.

www.skillnets.ie



Trainee Accountant Workshop Series

December 19th 2016

P1 – Current Issues in Managerial Finance Presented By: Dr Garvan Whelan CPA

BACKGROUND

◆ SKILLNET

- State funded, enterprise led support body dedicated to the promotion and facilitation of training and up-skilling as key elements in sustaining Ireland's national competitiveness.

◆ Managerial Finance

- Develop students' knowledge and skills
- Present quantitative and qualitative information for management decision making integrating analysis, argument, and commentary.



BACKGROUND

◆ OBJECTIVE (Dr G Whelan CPA)

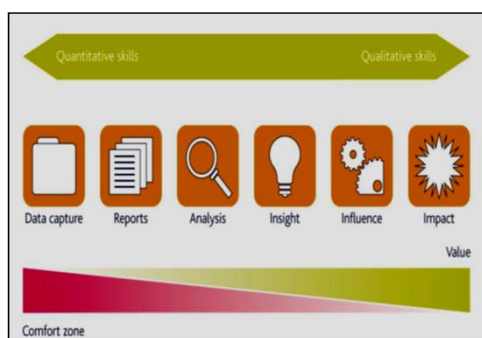
- Help practitioners and their clients to make better business decisions through financial information analysis and **management skills development** workshops.

◆ INFORMATION SOURCES

- IFAC (International Federation of Accountants); CSO (2016); ESRI (2013); Intertrade Ireland (2013); Neary – Grant Thornton (2014); Survey of CPA practitioners at 'Practice Matters' Conferences (September 2016).

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SKILLS AND THE ACCOUNTANT (IFAC 2011)



OVERVIEW

◆ Sources of Finance for Irish SMEs

- Debt, Equity (Owners' Equity and other forms of finance)

◆ The Importance of Equity and Other Fundamentals of SME Survival

- Help clients to identify sources of finance and to reduce tax liabilities

◆ Business Valuations

- Theory and Practice

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Sources of Finance for Irish SMEs

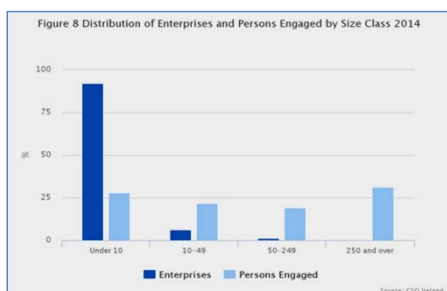
Learning Objective

To improve your understanding of the current issues in relation to:

- The importance of SMEs; Their unique features and requirements
- A critical examination of the various sources
- Applying this knowledge to advise clients helping them to increase shareholder wealth.

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IMPORTANCE OF SMEs



Irish SMEs: Importance and Impact of Debt Capital

- **Importance of SMEs in Ireland:**
 - 98% of organisations
 - 68% of employment
 - 50% of turnover in the economy.
- **Debt – Positive Impacts:**
 - Facilitates firm growth and investment
 - No loss of ownership control.
- **Debt – Negative Impacts:**
 - High debt burdens ↓ profits and cash flows
 - Leads to ↑ credit constraints and ↑ default probabilities

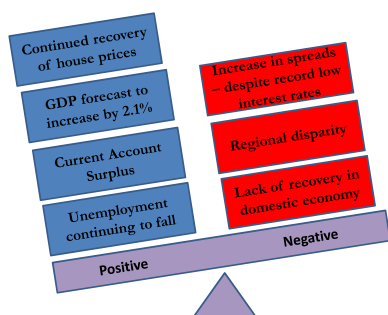
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Irish SMEs: Unique Features

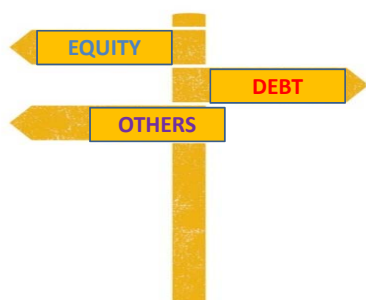
- Highest rate of usage of bank working capital facilities (overdrafts etc.)
 - **60% v 38%** EU average
- Increased collateral requirement requests (since 2008)
 - **42% of Irish SMEs** (3rd highest in EU after Greece and Spain)
- Differential: Large v Small Loan Rates Change since 2008
 - **+ 0.83%** v **+ 0.38%** Eurozone average.

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Economic outlook for Irish SMEs



Sources of Finance for Irish SMEs: Main Categories



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Expected Sources of Finance: 2015-2017 (CSO 2014 SME Survey)

Sources	%
Banks	47.7
Owners of the business	10.7
Leasing companies	9.5
Family and/or friends	8.6
Govt. support (grants)	5.9
Other financial institutions	4.5
VC & Private Equity	3.7
Other loan sources	3.2
Business angels	2.6
Business to business	2.2
Other employees of the firm	1.4
All sources	100.0

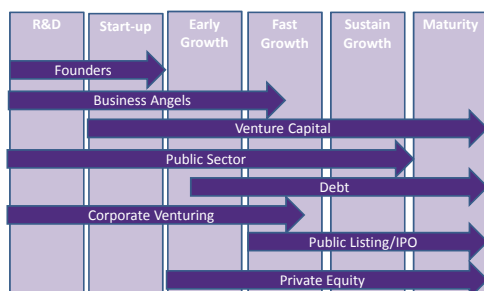
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SME Funding Providers and Schemes (INTERTRADE 2013)

Sources (all of Ireland)	No
Bank	64
Public Funding (Grants and Tax Incentive Schemes etc.)	79
Angel	9
Seed and VC	19
Crowd Funding	2
All sources	173

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Match Finance to Business Stage



Advantages of using bank debt finance

- ✓ No Equity issued – no loss of control or dilution of ownership
- ✓ Can be cheaper than alternative sources of funds – current low interest rates (but note risk premium attached to SME loans)
- ✓ Can be used as part of a package
- ✓ Development of a partnership
- ✓ Full range of products

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Disadvantages: Bank Debt Finance

- Financial risk associated with high leverage/gearing
- Restrictions on use of funds
- "Slow no"
- Risk adverse nature of banking
- Inflexible
- Restrictive Covenants – Performance Metrics etc.

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Other Forms of Equity Finance

◆ Direct Investment

- Angel Investors
- Venture Capital
- Private Equity

• Tax Incentives for Equity Investment

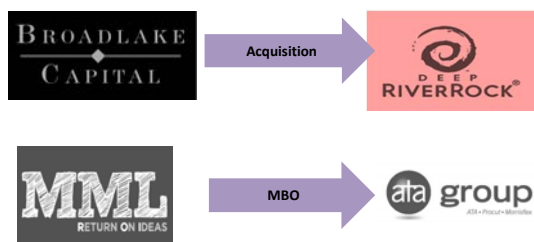
- ❖ Employment and Investment Incentive (EII)
- ❖ Seed Capital Scheme

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Lily O' Brien's Example of Private Equity Investment

- c. €15 million
- Management team remained
- Revenues rose 40% in 2012
 - Exports to 16 countries, inc UK, US and Aus.
- Strong online presence
- Operating profit of €1.5m in 2012
 - Increase from €285k in 2011.

SMEs –Private Equity (Neary 2014)



What are Private Equity investors looking for?

- ✓ Businesses with capacity to grow
- ✓ A deleveraging, acquisition, growth capital or shareholder reorganisation opportunity
- ✓ Strong management
- ✓ Good MIS and strong cash flows
- ✓ Value creation opportunities

Dealing with PE – Advantages (may also apply to VC & Angel Investors)

- Assist with Involved in setting business strategy / direction
- Flexible and alternative form of finance / capital structures – mezzanine, junior loans
- Increases refinance, acquisition or cash extraction capability
- Incentive structures for management teams
- Possible solution to succession issues
- Access to new markets or expertise

Dealing with PE/VC & Angel Investors – Disadvantages

- Owners giving up equity
- New board directors / greater corporate governance
- More financial information requirements
- Exit timeline
- Due Diligence requirements
- Etc.

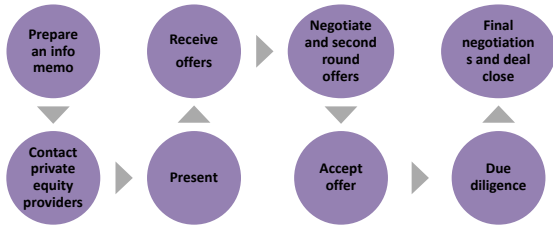
Share Agreement – May be in the form of:

- **Preference Shares:**
 - Cumulative
 - Redeemable
 - Convertible
- Also examine carefully the post-conversion **control structure**.



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Overview of the Process (Other Sources of Equity – P/E etc.)



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Information Memorandum

- Detailed written description (often 50+ pages)
- Primary marketing document
- Contents:
 - Company overview
 - Operations overview
 - Industry overview
 - Financial information – historic and projections

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Key Information

- Historical financials
 - EBITDA; maintainable,
 - Note EBITDA ≠ Cash flow
 - Note ‘popularity’ of EBITDA but concerns regarding its limitations (e.g. Arnold 2012; Fridson and Alvarez 2011)
- Cash-flow
 - strong working capital
- Receivables – detailed analysis
- Projections
- Management team
- Potential for exit

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Offer Letter

- Offer amount
- Rationale
 - i.e. why the private equity company wants to partner with SME company
- Valuation of the target company on a cash-free, debt-free basis
- Outline of how the deal will be financed
- Maintainable EBITDA (*note previous remarks*)
- Conditions of offer

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Due Diligence

- **Purpose of due diligence**
 - to confirm the information on which the vendor has based its bid
- **Three possible outcomes:**
 - no issues discovered
 - some issues are discovered but remedied
 - issues are discovered which cannot be remedied and bring the deal down.

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Issues that may arise from Due Diligence

- Revenue recognition
 - Deferred revenue
 - 'Channel Stuffing'
- Accounting policies
- Receivables and provisions
- Forecasts and assumptions
- Capex



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Role of the Accountant as Advisor

- Provide relevant advice of **feasibility** and **financing options available**
- Financial **Projections** – specialist model
 - assist management in determining their assumptions
 - build tailor made model to construct projections based on management's assumptions
- **Business Plan** going forward
 - advise management on writing their business plan
 - complete the plan into a **presentable report** suitable for meeting funder's requirements

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Role of the Accountant as Advisor

- Preparation and presentation of information memorandum and/or business plan
- Demonstrate key points to funders
- Negotiating the best terms:
 - Debt => interest margin, etc
 - Equity/VC etc. => level of dilution in exchange for investment
- Advice on comparing terms from different funders
- Assist in driving process to completion.

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Conclusion.

- **"SMEs and their advisors, business representative groups, accountants are typically unaware of the public schemes and funds that are available"** (Intertrade 2013).
- **Thank you** for your time
- Welcome **questions and feedback**



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