

British Columbia Expropriation Association

25th Annual Fall Conference

**Financial Analysis of
Expropriated Businesses**

27 October 2017

A low-angle, upward-looking perspective of several modern skyscrapers with glass facades. The buildings are arranged in a way that creates a strong sense of height and depth, converging towards the top of the frame. The sky is a clear, pale blue. The glass reflects the sky and each other, creating a complex pattern of lines and reflections. Some windows are lit from within, showing a warm yellow light.

Agenda

- 1 | Financial information
- 2 | Loss quantification
- 3 | Case study
- 4 | Questions



Financial information

Statement of Financial Position (Balance sheet)

- ▶ Statement of assets, liabilities and equity of a business, **at a specific point in time** (i.e. financial position).
- ▶ Considerations:
 - ▶ Operating versus non-operating items
 - ▶ Redundant assets and liabilities

Balance sheet

	As at 30 April	
	2016	2015
Assets		
Cash	\$36,982	\$59,450
Investments	136,903	104,108
Accounts receivable	258,934	223,500
Inventory	287,064	325,694
Prepaid expenses	104,327	139,087
Income taxes receivable	31,000	43,000
Due from shareholders	93,464	126,732
Current assets	948,674	1,021,571
Loan to related party	300,000	300,000
Property and equipment	2,015,100	1,946,532
Intangible assets, net	146,982	153,965
Goodwill	356,984	356,984
Total assets	\$3,767,740	\$3,779,052
Liabilities		
Accounts payable	289,215	275,217
Accrued liabilities	42,381	50,327
Current portion of long-term debt	220,274	201,846
Current liabilities	551,870	527,390
Long-term debt	950,632	869,090
Total liabilities	\$1,502,502	\$1,396,480
Equity		
Common shares	100	100
Retained earnings	2,265,138	2,382,472
Total liabilities & equity	\$3,767,740	\$3,779,052



Statement of Operations (Income statement)

- ▶ Statement of revenues and expenses of a business,
over a specific period of time (i.e. financial performance).
- ▶ Considerations
 - ▶ Cash vs non-cash items
 - ▶ Related party transactions (rent, management salaries, etc.)
may not reflect economic value



Historical income statements

	Year ended 30 April							Period ended
	2010	2011	2012	2013	2014	2015	2016	31 Aug 2016
Revenue								
Sales	\$1,157,070	\$1,387,892	\$1,464,450	\$1,704,600	\$1,371,620	\$1,107,050	\$1,292,320	\$609,227
Cost of goods sold								
Purchases/cost of materials	365,480	369,037	322,640	409,472	552,720	371,760	419,760	147,740
Direct wages	186,840	230,304	277,200	292,200	278,760	243,000	274,400	104,458
Equipment rental	-	-	-	-	13,000	17,580	10,670	-
Gross profit	\$604,750	\$788,551	\$864,610	\$1,002,928	\$527,140	\$474,710	\$587,490	\$357,028
Gross margin	52.27%	56.82%	59.04%	58.84%	38.43%	42.88%	45.46%	58.60%
Expenses								
Advertising and promotion	6,927	10,636	12,141	18,306	7,356	1,161	2,466	772
Bank charges and interest	28,440	16,651	21,760	17,840	10,530	8,150	3,070	1,628
Depreciation	145,460	149,460	127,640	147,900	160,480	155,925	141,990	-
Insurance	10,845	11,262	13,332	13,788	11,679	13,719	12,444	10,044
Meals and entertainment	1,511	2,563	2,563	2,496	2,425	1,269	2,497	1,696
Office supplies	4,713	5,849	12,102	8,022	7,410	7,362	10,056	7,250
Professional fees	7,300	13,500	9,050	7,500	8,300	7,800	8,100	7,500
Rent	80,000	80,000	80,000	80,000	80,000	80,000	80,000	80,000
Repairs and maintenance	5,964	20,075	12,594	16,989	14,631	2,034	12,615	9,356
Telephone and communications	8,892	12,049	13,293	10,623	15,864	12,525	9,486	6,652
Travel	19,860	14,362	30,820	51,820	38,400	24,280	37,140	2,981
Utilities	19,870	6,669	17,060	21,120	25,370	24,350	30,700	12,181
Vehicle expenses	37,719	52,584	69,783	66,582	94,692	67,581	42,012	42,649
Wages and salaries	306,560	261,179	312,370	358,000	334,000	396,500	339,950	108,351
Income (loss) before tax	\$(79,311)	\$131,711	\$130,102	\$181,943	\$(283,997)	\$(327,946)	\$(145,036)	\$65,970
Income tax (recovery)	(14,514)	24,367	23,809	34,023	(52,539)	(63,293)	(27,702)	0
Income (loss) after tax	\$(64,797)	\$107,345	\$106,293	\$147,919	\$(231,458)	\$(264,652)	\$(117,334)	\$65,970



Variable & fixed costs

Variable

Amount fluctuates with the level of output/revenue

- ▶ Purchases/materials
- ▶ Direct wages
- ▶ Supplies
- ▶ Repairs and maintenance

Fixed

Do not vary with the level of output/revenue

- ▶ Rent/occupancy
- ▶ Advertising
- ▶ Business licenses
- ▶ Insurance
- ▶ Utilities (e.g., in case of a professional services firm)



Cash & non-cash items

Cash

Involve receipt or payment of cash

- ▶ Cost of goods sold
- ▶ Rent
- ▶ Supplies
- ▶ Wages and salaries

Non-cash

Do not involve receipt or payment of cash

- ▶ Depreciation
- ▶ Gain/loss on disposal of assets
- ▶ Unearned revenue



Loss quantification

Business losses

- ▶ Business losses are not calculated with absolute precision. Rather, the preparer strives for a reasonable basis for the compensation.
- ▶ Ranges are often used. Loss tables may be required depending on the complexity (for example, tables showing different loss amounts as the assumptions change).
- ▶ Essentially, a comparison of “but for” (unaffected) results to actual (affected) results.

Approaches

1

The **“Before and After”** approach, using historical experience as the benchmark.

- ▶ Both past and future losses can be quantified. More certainty with past loss as “actual” results are known.
- ▶ Future losses require projection of both “but for” and “actual” results.
- ▶ Need to consider other factors that may have impacted the business, such as a weaker economy, losing key personnel, and losing big contracts.

2

The **“Comparable Yardstick”** approach, comparing event to similar loss events or comparable businesses.

- ▶ Difficult to find truly comparable enterprises.
- ▶ Potential need to involve an industry expert.

Business loss formula

- ▶ **Loss = Lost revenue - variable costs avoided + additional costs due to disturbance/taking**
 - ▶ More than the lost contribution margin if other variable costs exist.
 - ▶ Complication as variable costs are often “step” variable as the size of the loss and/or the loss period increases.



Identifying variable costs

	Year ended 30 April		
	2011	2012	2013
Revenue	\$1,387,892	\$1,464,450	\$1,704,600
Variable costs			
Purchases/cost of materials	369,037	322,640	409,472
Direct wages	230,304	277,200	292,200
Office supplies (50%)	2,925	6,051	4,011
Repairs and maintenance	20,075	12,594	16,989
Variable costs	\$622,341	\$618,485	\$722,672
Revenue less variable costs ("Contribution margin")	\$765,550	\$845,965	\$981,928
Contribution margin as % of revenue	55%	58%	58%
Average contribution margin			
2011 to 2013	57%		
2012 to 2013	58%		

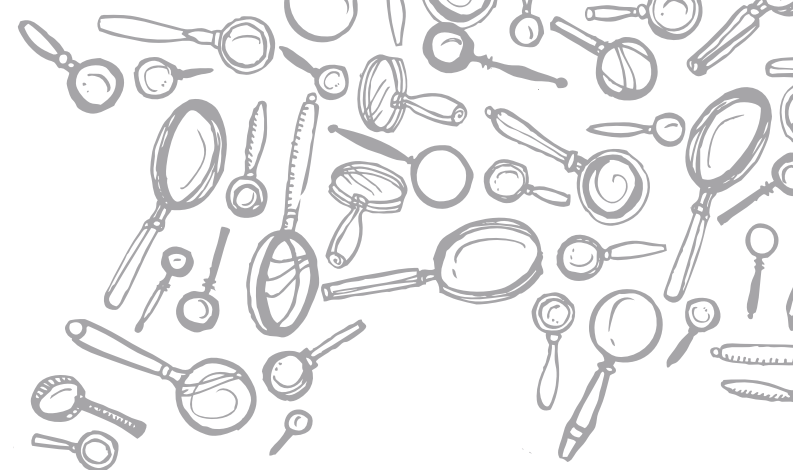
Goodwill/Intangible assets

- ▶ **Goodwill / Intangible assets = Enterprise Value - Tangible operating net assets**
- ▶ If the court determines it is not feasible to relocate the business, compensation may include an additional amount not exceeding the value of the goodwill of the business.





Case study



Karoo Brewing Ltd.

- ▶ Craft brewery
- ▶ Corporation

Event

- ▶ Business interruption resulting from partial taking

Chronology

- ▶ May 2013 - expropriation of property/construction work begins
- ▶ April 2016 - construction completed

Claim

- ▶ Potential business loss of income from disruption and increased costs due to inefficiencies



■ Assumptions

- ▶ Loss period of May 2014 - April 2016
- ▶ No future loss

■ Considerations

- ▶ How would you measure the loss?
- ▶ What documents will be useful in the loss analysis?

Income loss

- ▶ Was revenue impacted by the taking?
If yes, during what period and to what degree?
- ▶ Compare year-over-year results or do a move discreet analysis.

- ▶ How did the costs behave?
- ▶ Increase in costs related to the taking?
- ▶ Additional overtime paid?

Actual historical results

	Year ended 30 April						Period ended
	2011	2012	2013	2014	2015	2016	31 Aug 2016
Revenue							
Sales	\$1,387,892	\$1,464,450	\$1,704,600	\$1,371,620	\$1,107,050	\$1,292,320	\$609,227
Cost of goods sold							
Purchases/cost of materials	369,037	322,640	409,472	552,720	371,760	419,760	147,740
Direct wages	230,304	277,200	292,200	278,760	243,000	274,400	104,458
Equipment rental	-	-	-	13,000	17,580	10,670	-
Gross profit	\$788,551	\$864,610	\$1,002,928	\$527,140	\$474,710	\$587,490	\$357,028
Gross margin	56.82%	59.04%	58.84%	38.43%	42.88%	45.46%	58.60%

Past loss calculation

	Year ended 30 April			
	2014	2015	2016	Total
But-for revenue	\$1,600,000	\$1,600,000	\$1,600,000	
Actual revenue	(1,371,620)	(1,107,050)	(1,292,320)	
Lost revenue	228,380	492,950	307,680	1,029,010
Less: Variable costs saved (58%)	(131,743)	(284,362)	(177,487)	(593,591)
Income loss	\$96,637	\$208,588	\$130,193	\$435,419

Additional wage costs				
Actual costs	\$334,000	\$396,500	\$339,950	
But-for costs	(310,516)	(310,516)	(310,516)	
Increase in wage costs	\$23,484	\$85,984	\$29,434	\$138,901

Total past loss	\$574,320			
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Useful documents/information

- ▶ Historical financial statements - at least five years prior to impact, and during and after the impact
- ▶ Tax returns for the same period as financial statements
- ▶ General ledgers
- ▶ Year-end adjusting journal entries
- ▶ Owner's T4 statements
- ▶ Bank statements
- ▶ Invoices by clients
- ▶ Time sheets

— Questions?



Contact

Ron Patrickson

Partner

+1 (604) 684 7863

ron.p.patrickson@ca.ey.com

Frances Potgieter

Associate Partner

+1 (604) 899 3544

frances.potgieter@ca.ey.com

Kat Kawczak

Manager

+1 (604) 899 3505

kat.a.kawczak@ca.ey.com

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