



Pathway to

Tourism Investor Forum Hilton Mississauga Meadowvale

November 26-28, 2023

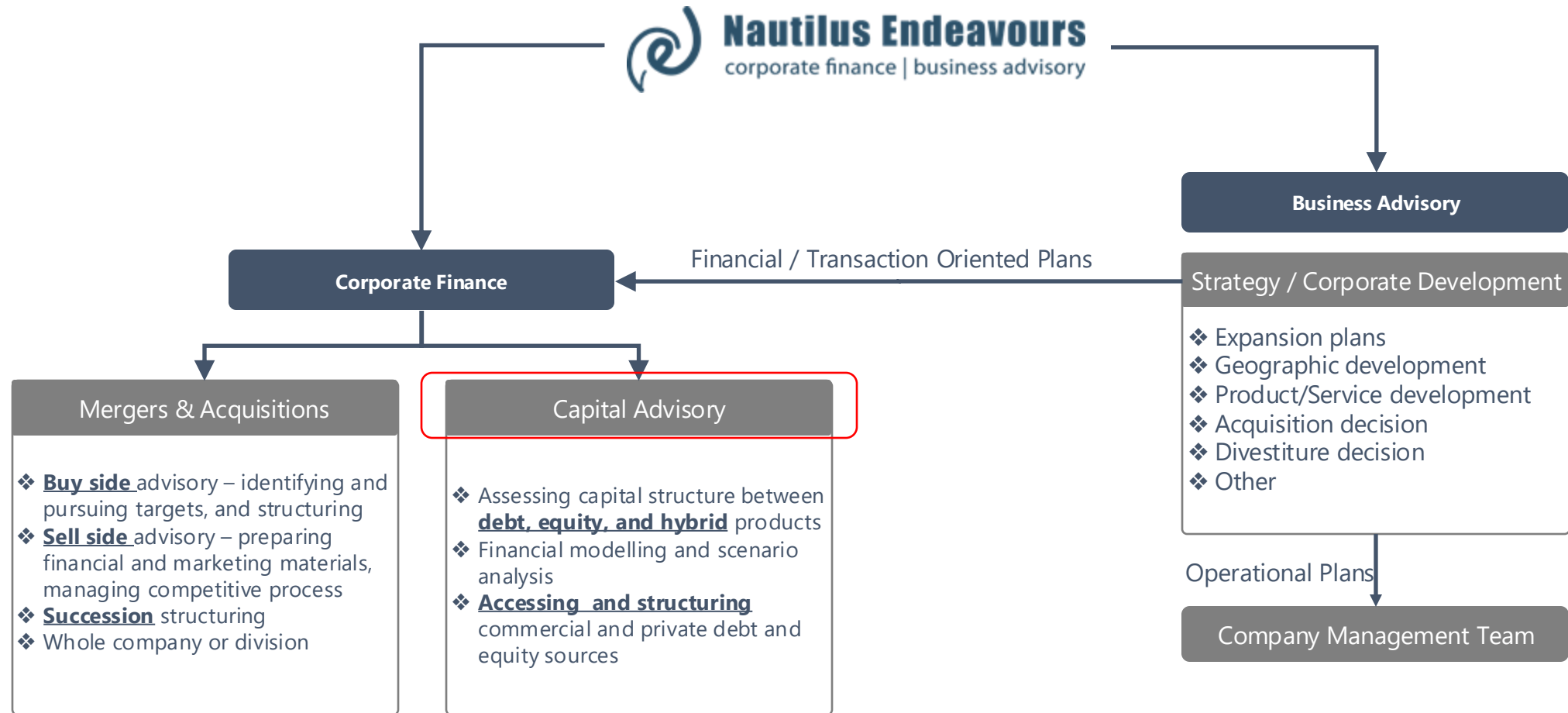


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Nautilus Endeavours' Practice Areas



Nautilus Endeavours supplements internal management capacity and skills to support stakeholders in developing strategies (long term orientation) and execute financial transactions (short term orientation)



Session 1

How Companies are Financed – Debt and Equity

September 20, 2023

Funding Growth – Cash, Debt, or Equity



Depending on the complexity and scale of a new venture / investment, companies typically select from three key sources of capital to fund growth

New Project Factors	Existing Cashflow	Incremental Debt	Incremental Equity
Operating Start Up Costs	If limited costs to start	If existing cashflows support new debt	May be required to support or replace, either cashflow or debt
Capital Requirements	Pending size of investment, may fund all. At a minimum, to support new debt	If existing cashflows support new debt and there is collateral value	May be required to support or replace, either cashflow or debt
Timing of new cashflows from Project	Balanced against other uses of existing profits	Difficult, if new cashflow is required and long time to profitability (to cover interest and principle)	May be required, if there is a long path to profitability
Predictable Cash Flows	Less reliance on other parts of existing business	Helpful to secure loans	Less dependence on equity

Key themes – collateral, cashflow, and timing of profit dictate the use of these three sources

Introduction to the Balance Sheet

Balance Sheet Example



Balance Sheet			
(\$ Thousands)			
Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	1,000	Line of Credit	1,500
Account Receivables	2,500	Accounts Payable	1,500
Inventory	1,000	Other	500
Other	500		
	5,000		3,500
Investments	1,000	Long-term liabilities	7,000
Fixed Assets	10,000	Equity	5,500
Total	16,000	Total	16,000

Importance of the Balance Sheet



Summarizes your company's assets (short term and long term) which you use to generate income

Summarizes your company's obligations:

- immediate (short term liabilities like accounts payables) and
- long term (like a mortgage or term loan)

Key Takeaways

Ratios tell stories:

- Long Term Debt to Fixed Assets = 70%
- Debt / Equity = 1.7 : 1.0
- Debt to Capitalization = 63%
- Current Ratio = 1.43%

Introduction to the Income Statement

Income Statement Example



Income Statement		
(\$ Thousands)		
Revenue	17,280	
(COGS)	(10,368)	
Gross Profit	6,912	40%
(Selling and General Expenses)	(2,500)	
EBITDA	4,412	26%
(Depreciation & Amortization)	(1,000)	
EBIT	3,412	
(Interest)	(640)	
EBT	2,772	16%
(Taxes)	(748)	
Net Income	2,024	12%

Operating leverage





Operating leverage measures the degree to which a firm or project can increase operating income by increasing revenue

Operating leverage



Fixed Costs

Fixed Costs +
Variable Costs

	Pros	Cons
High Operating Leverage	When Revenue  Return on Assets grows relatively faster	When Revenue  cashflow to service debt fall relatively faster
Low Operating Leverage	When Revenue  Return on Assets grows relatively slower	When Revenue  cashflow to service debt falls relatively slower

Operating Leverage & Increasing Revenue

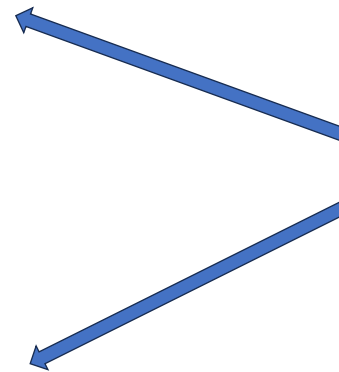
Income Statement Example



Income Statement		vs Base Case	
(\$ Thousands)			
Revenue	20,736		120%
(COGS)	(12,442)		
Gross Profit	8,294	40%	120%
(Selling and General Expenses)	(2,500)		
EBITDA	5,794	28%	131%
(Depreciation & Amortization)	(1,000)		
EBIT	4,794		141%
(Interest)	(640)		
EBT	4,154	20%	150%
(Taxes)	(1,122)		
Net Income	3,033	15%	150%

Operating leverage Example

Revenue Increased by 20%



A 20% increase in revenue, increases profitability by 50%

Operating Leverage & Decreasing Revenue

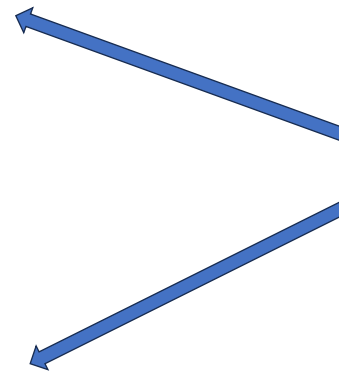
Income Statement Example



Income Statement		vs Base Case	
(\$ Thousands)			
Revenue	13,824		80%
(COGS)	(8,294)		
Gross Profit	5,530	40%	80%
(Selling and General Expenses)	(2,500)		
EBITDA	3,030	22%	69%
(Depreciation & Amortization)	(1,000)		
EBIT	2,030		59%
(Interest)	(640)		
EBT	1,390	10%	50%
(Taxes)	(375)		
Net Income	1,014	7%	50%

Operating leverage Example

Revenue Decreased by 20%



A 20% decrease in revenue, decreases profitability by 50%

Financial Leverage - Combining the Balance Sheet and the Income Statement

Profitability Analysis

Return on Assets

	Net Income	Assets / Net Assets	
ROA	2,024	16,000	12.6%
ROA (Net Assets)	2,024	12,500	16.2%

Weighted Average Cost of Capital

	Debt / Equity	Debt + Equity	
%Debt	8,000	14,000	57.1%
Kdebt			8.0%
Tax			27.0%
%Equity	6,000	14,000	42.9%
Kequity			30.0%

WACC			16.2%
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Using the appropriate amount of debt enhances return on equity

Assets

=

Liabilities

+

Equity

Return on Assets

$$\text{ROA} = \frac{\text{Net Income or Operating Income}}{\text{Average Total Asset}}$$

Weighted Average Cost of Capital

$$\text{WACC} = \left(\frac{E}{D+E} * K_e \right) + \left(\frac{D}{D+E} * K_d * (1 - \text{Tax rate}) \right)$$



$$\text{ROA} = \text{WACC}$$

Financial Leverage – Decreasing Debt

Profitability Analysis

Return on Assets

	Net Income	Assets / Net Assets	
ROA	2,024	16,000	12.6%
ROA (Net Assets)	2,024	12,500	16.2%

Weighted Average Cost of Capital

	Debt / Equity	Debt + Equity	
%Debt	6,000	14,000	42.9%
Kdebt			8.0%
Tax			27.0%
%Equity	8,000	14,000	57.1%
Kequity			30.0%

WACC			19.6%
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Scenario shows:

- Same profitability (ROA)
- Balance sheet debt decreased by \$2 million creates a relatively lower return, which does not meet the equity holder's expectation



ROA < WACC

Financial Leverage – Increased Debt

Profitability Analysis

Return on Assets			
	Net Income	Assets / Net Assets	
ROA	2,024	16,000	12.6%
ROA (Net Assets)	2,024	12,500	16.2%

Weighted Average Cost of Capital			
	Debt / Equity	Debt + Equity	
%Debt	10,000	14,000	71.4%
Kdebt			8.0%
Tax			27.0%
%Equity	4,000	14,000	28.6%
Kequity			30.0%

WACC			12.7%
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Scenario shows:

- Same profitability (ROA)
 - Balance sheet debt increased by \$2 million
- creates a relatively higher return, which exceeds the equity holder's expectations



ROA > WACC

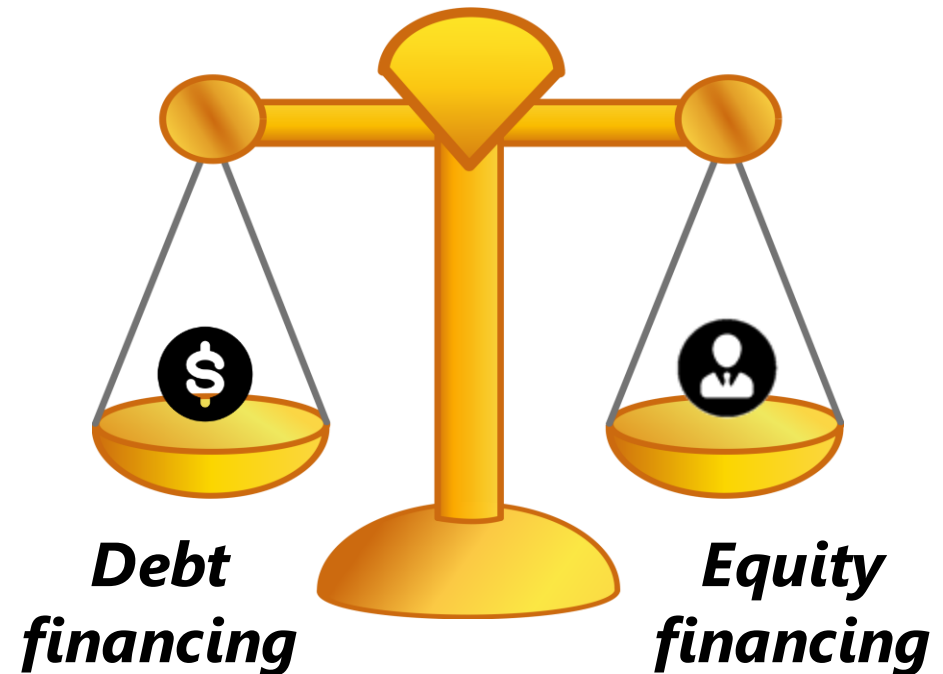
Financial Leverage – It Cuts 2 Ways

Higher the debt....

- ✓ The greater the return on equity (as there is smaller amount of equity deployed) for every dollar of free cash after paying the lender (ROE)
- ✓ The greater risk of losing assets the business to your lender in tough times (because the lender needs to be repaid according to schedule, and before the equity holders)



Over the next couple months, we'll discuss how companies should balance the use of Debt or Equity Financing



Amount of assets (collateral) and cashflow limit the amount one can borrow

Questions and Dialogue



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