



## *Pathway to*

# Tourism Investor Forum Hilton Mississauga Meadowvale

November 26-28, 2023



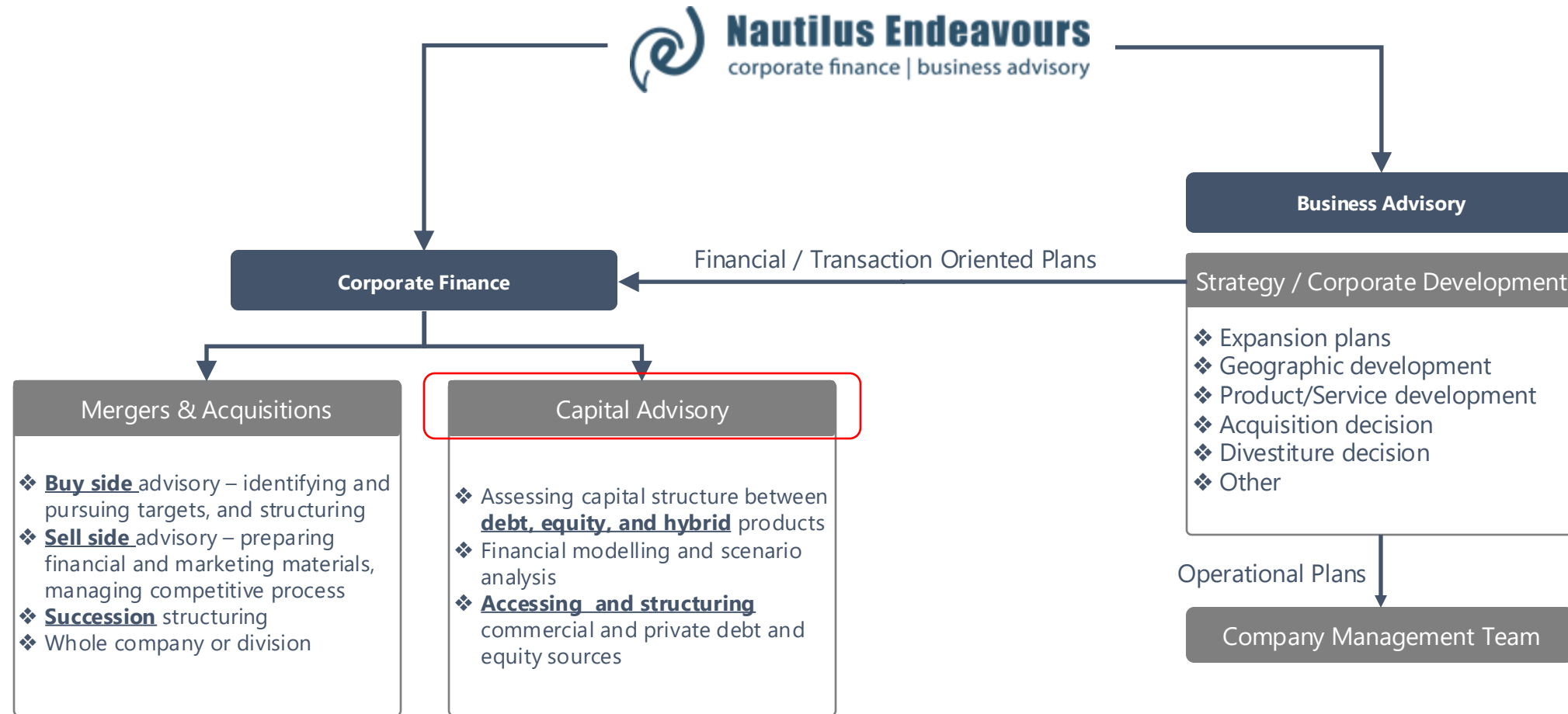
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# Nautilus Endeavours' Practice Areas



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 2

# Why You Want more Debt than Equity, and What Lenders Look For

October 4, 2023

# Summary Reminder of Balance Sheet



## Balance Sheet Example



Balance Sheet			
(\$ Thousands)			
Assets		Liabilities	
<b>Current Assets</b>		<b>Current Liabilities</b>	
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	<b>Long-term liabilities</b>	6,500
<b>Fixed Assets</b>	10,000		
		<b>Equity</b>	6,000
<b>Total</b>	<b>16,000</b>	<b>Total</b>	<b>16,000</b>

## 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)

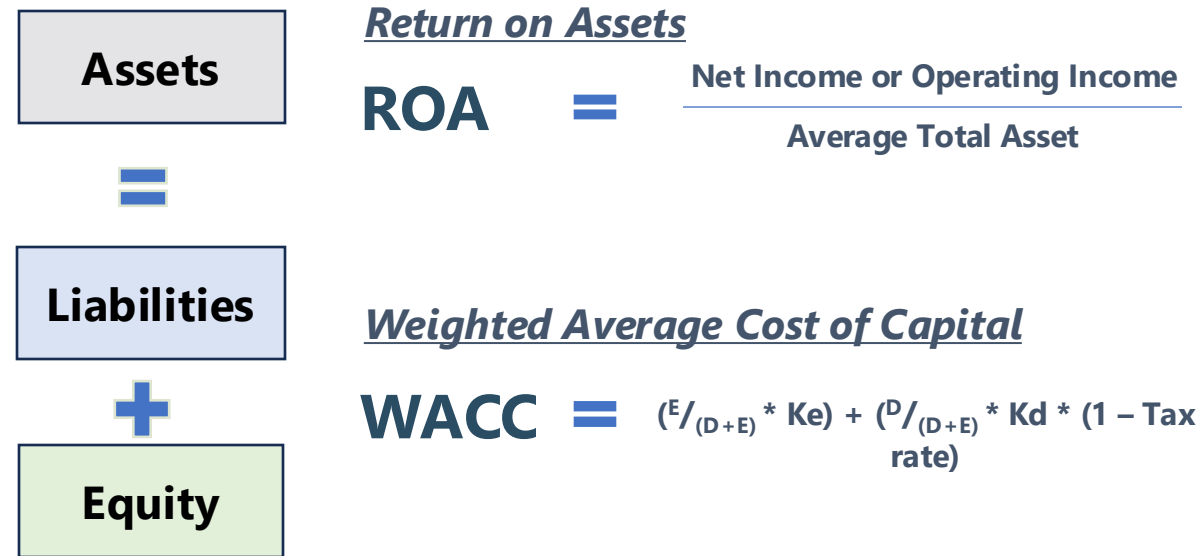
## Key Takeaways

Ratios tell stories:

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


# Review of WACC

Using the appropriate amount of debt enhances return on equity





## ROA = WACC



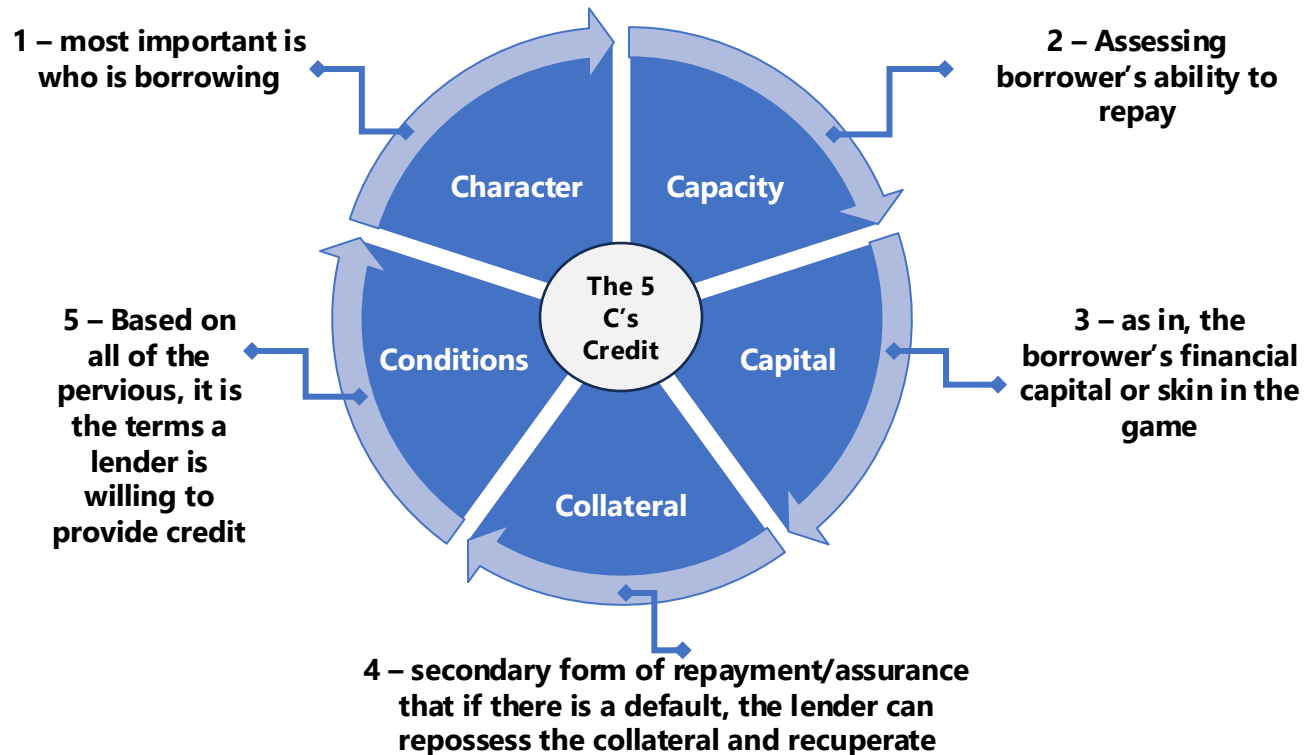
### RECALL

- ❖ the greater proportion of debt (D/D+E),
- ❖ given its costs (Kd) are lower than equity (Ke),
- ❖ WACC will decrease...

**Which makes us happy!**

# Understanding the 5Cs of Credit

A system used by lenders to gauge the creditworthiness of potential borrowers



## Topics to Consider

As a borrower, how much is under my influence or control?

What influences does the lenders' environment have on their decision vs their opinion?

What drives the availability for loans in my industry, or at large?

The 5 Cs of credit impact pricing, structure, and the general terms under which credit is advanced to a borrower

# Banking Environment for Tourism

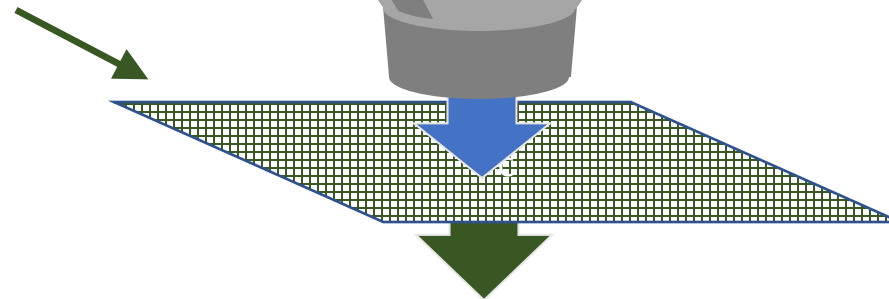
## Borrower Factors that Lenders are Considering

- Borrower's Experience
- Local Market Dynamics
- Resources



## Banking Sector Factors Influencing Lenders' Decisions

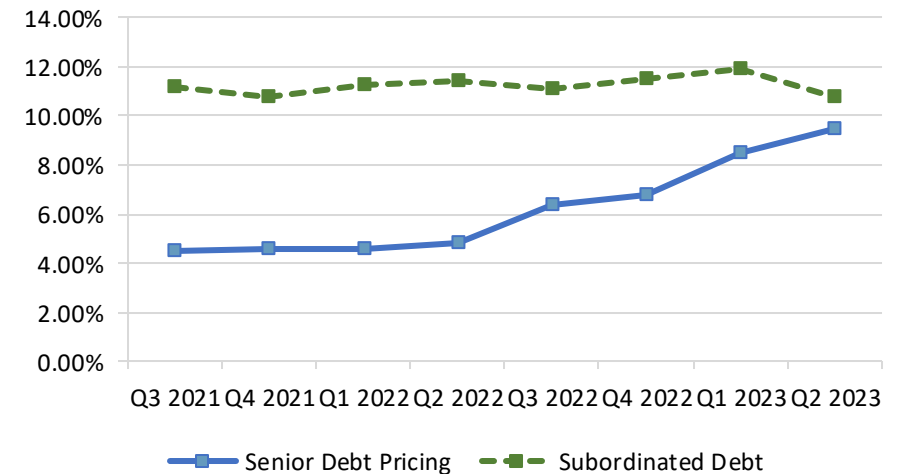
- Available capital
- Cost of capital



There is debt available for companies operating in tourism, on a case-by-case basis

Capital has been historically cheap, but has risen dramatically over the last year as central banks battle inflation

Senior and Subordinated Debt Pricing



Source: GF Data August 2023 Leverage Report

Balancing act is providing capital, at a return, and manage industry specific risks to ensure getting repaid the principal



# Lenders' Tools to Measure and Manage Risk



<u>Cs in Structuring</u>	<u>Lenders Tools</u>		
<p><b>Capacity</b></p>	<p>Measuring the borrower's ability to repay</p>	<ol style="list-style-type: none"> <li>1. Fixed Charge Coverage Ratio</li> <li>2. Liquidity Ratios</li> <li>3. Funded Debt to EBITDA</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>FCCR = EBIT + FCBT / FCBT + interest</b></li> <li>2. <b>Quick Ratio = Current Assets – Inventory / Current Liabilities</b></li> <li>3. <b>Debt/ EBITDA</b></li> </ol>
<p><b>Capital</b></p>	<p>Shared risk in investment borne by the borrower – “skin in the game”</p>	<ol style="list-style-type: none"> <li>1. Debt to Equity Ratio</li> <li>2. Minimum Equity Requirements (down payments, for example)</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Debt to Equity Ratio = Debt/Equity</b></li> <li>2. <b>Mortgage Down Payment, Business Acquisition Equity, Loan Collateral Equity</b></li> </ol>
<p><b>Collateral</b></p>	<p>Quality of the borrower’s assets to support a loan</p>	<ol style="list-style-type: none"> <li>1. Borrowing Base (line of credits) against AR or Inventory</li> <li>2. Loan to Value</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>Borrowing Base = Eligible AR Value + Eligible Inventory Value – Reserves</b></li> <li>2. <b>LTV Ratio = (Loan Amount) / (Appraised Value of the Asset)</b></li> </ol>
<p><b>Conditions</b></p>	<p>Taking all into consideration, what terms does a lender offer</p>	<ol style="list-style-type: none"> <li>1. Financial Covenants</li> <li>2. Negative/Positive Covenants</li> <li>3. Pricing</li> </ol>	<ol style="list-style-type: none"> <li>1. <b>FCCR = EBIT + FCBT / FCBT + interest</b></li> <li>2. <b>Limit on Additional Debt: Total Debt + Proposed New Debt) ≤ (Debt Covenant Limit</b></li> <li>3. <b>Interest Rates, Coupon Rate Spread</b></li> </ol>

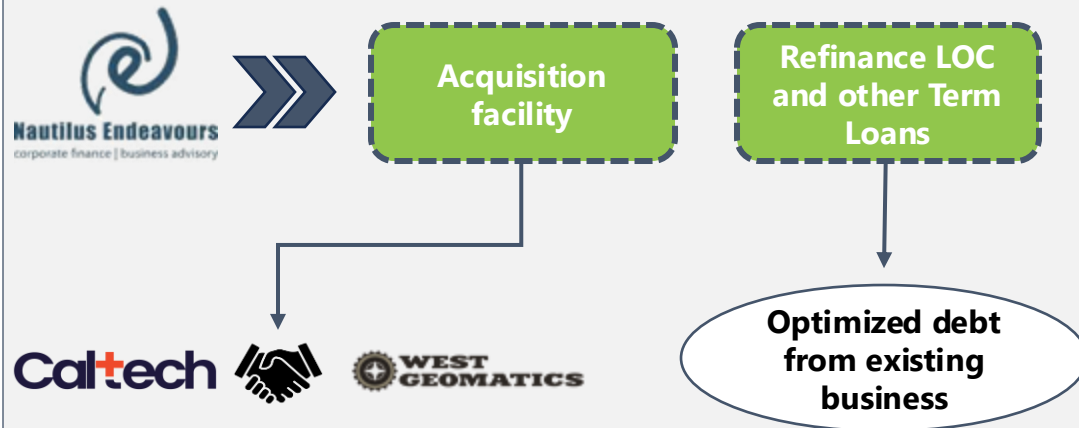


# Case Study – Nautilus Past Engagements

Nautilus used debt to support their client's growth through acquisitions and lowered working capital needs. They also tapped into personal credit to boost the working capital of a fishing company

## Case 1

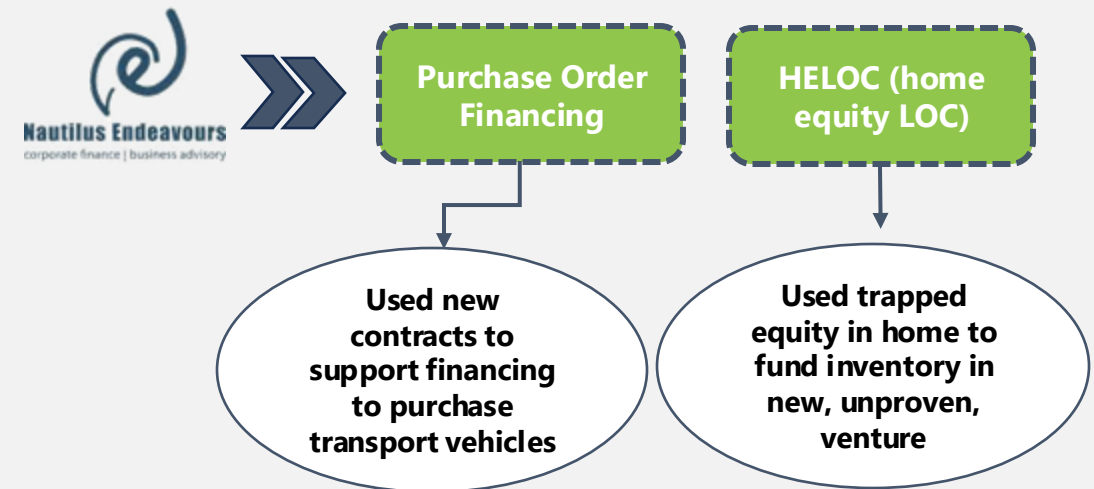
Surveying Company – growth through acquisition



“Leverage Buyout Scenario” acquisition facility and refinancing term loans / lines of credit, to lower the equity required to purchase assets

## Case 2

Transportation and Tour Operator – organic and new venture growth

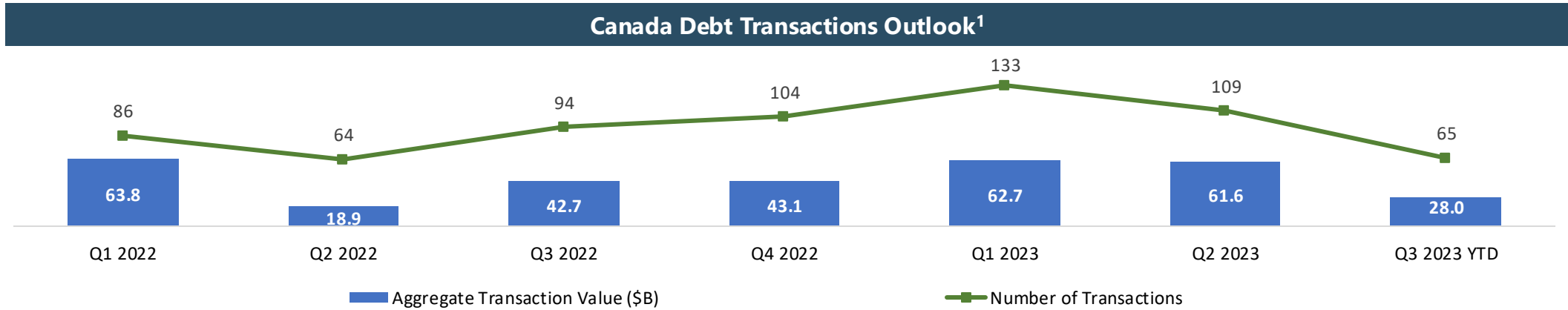


Used future earnings (Capacity) and personal home (Collateral) to provide comfort for the bank to fund growth with no equity

Sometimes, its best to look at the overall business, vs the specific project when requesting external capital

# Current Market Conditions

The Canadian debt market experienced moderate growth in the second quarter of 2023 due to high interest rates and economic uncertainty.



### North American Debt Trends – Quarter Update<sup>2</sup>

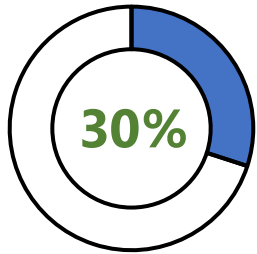
TOTAL DEBT/EBITDA BY PERIOD						
TEV	Q1/22	Q2/22	Q3/22	Q4/22	Q1/23	Q2/23
10-25	2.9x	3.9x	2.8x	3.5x	3.0x	3.3x
25-50	3.1x	2.9x	3.4x	3.4x	3.0x	2.8x
50-100	3.7x	3.8x	3.6x	3.6x	2.9x	3.0x
100-250	4.4x	4.1x	4.9x	3.3x	3.8x	3.7x
<b>Total</b>	<b>3.6x</b>	<b>3.8x</b>	<b>3.7x</b>	<b>3.5x</b>	<b>3.2x</b>	<b>3.1x</b>

SENIOR DEBT/EBITDA BY PERIOD						
TEV	Q1/22	Q2/22	Q3/22	Q4/22	Q1/23	Q2/23
10-25	1.8x	1.8x	2.1x	1.7x	1.9x	1.9x
25-50	2.5x	2.2x	2.4x	2.3x	2.2x	1.5x
50-100	3.1x	3.6x	2.7x	2.6x	2.3x	2.2x
100-250	2.9x	3.6x	4.0x	3.0x	3.1x	3.3x
<b>Total</b>	<b>2.6x</b>	<b>2.7x</b>	<b>2.7x</b>	<b>2.3x</b>	<b>2.3x</b>	<b>2.3x</b>

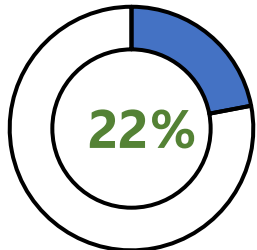
1) S&P CapitalIQ  
2) GF Data

**Canadian banks are continuing to lend, albeit on a more conservative covenant basis**

# Debt Financing in the Tourism



Nearly a third (30%) of tourism businesses report having more than \$250,000 in total outstanding debt from loans, lines of credit or other credit facilities



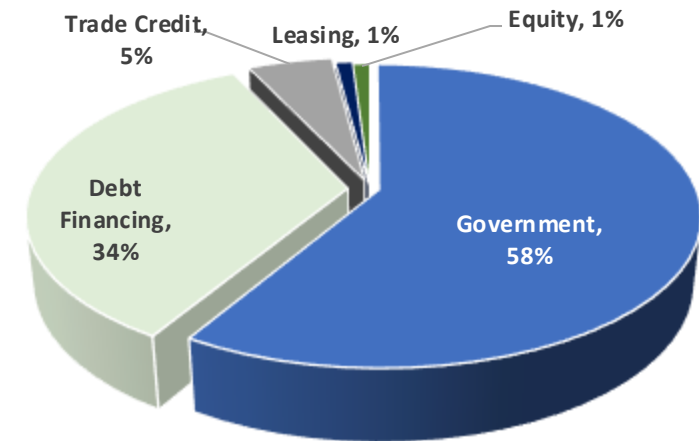
22% state that their total current debt load from loans is between \$100,000 and \$250,000

On average, these businesses report taking on federal government loans of:

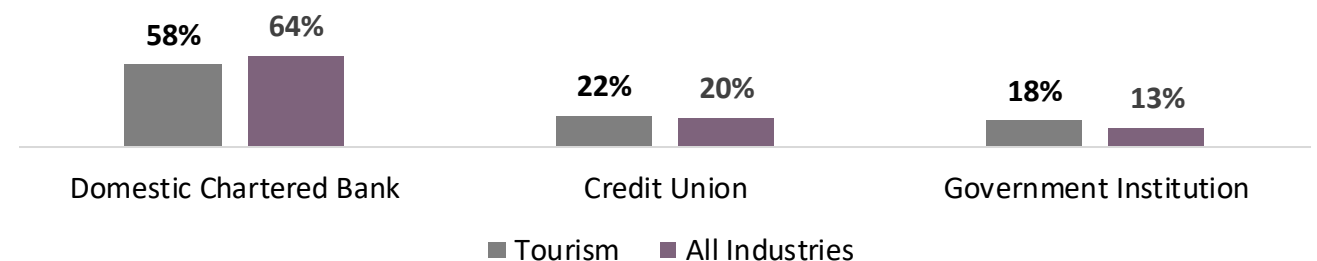
- ❑ \$62,263 related to the CEBA;
- ❑ \$50,559 related to the RRRF; and,
- ❑ \$56,388 related to the HASCAP

1) Statistics Canada

2) Survey on Financing and Growth of Small and Medium Enterprises



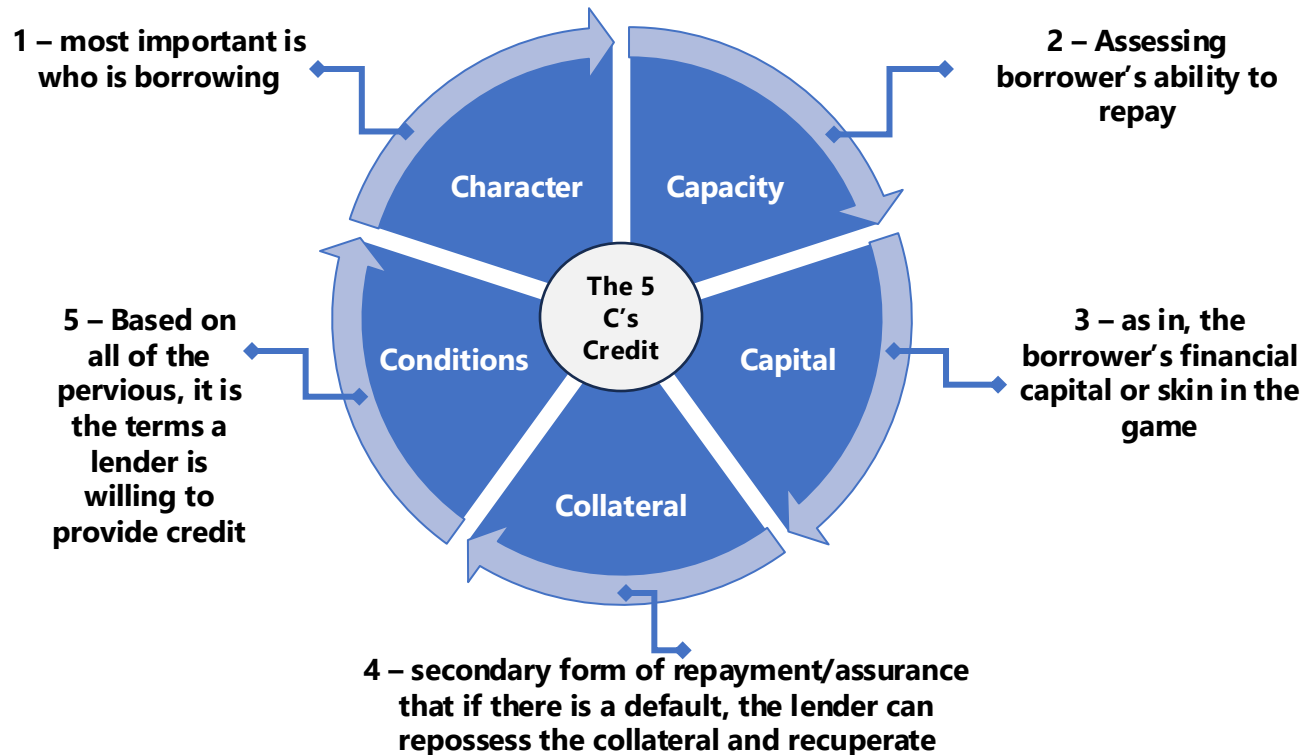
## Providers of Debt Financing, 2020<sup>1,2</sup>



**Tourism SMEs intended to use debt financing primarily on working capital, operating capital and land and buildings.**

# Summarizing the 5Cs of Credit

**A system used by lenders to gauge the creditworthiness of potential borrowers**



## Topics to Consider

1. How is your (personal and company) history? Operating in the industry, as well as credit history.
2. Does your cashflow support principal and interest payments?
3. Are you using any of your own money for your project?
4. Is there enough collateral, as a secondary method for lenders to recover its loan?

**Remember – you have some influence (1 to 4) in how a lender may look at your risk profile**

# Questions and Dialogue



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