

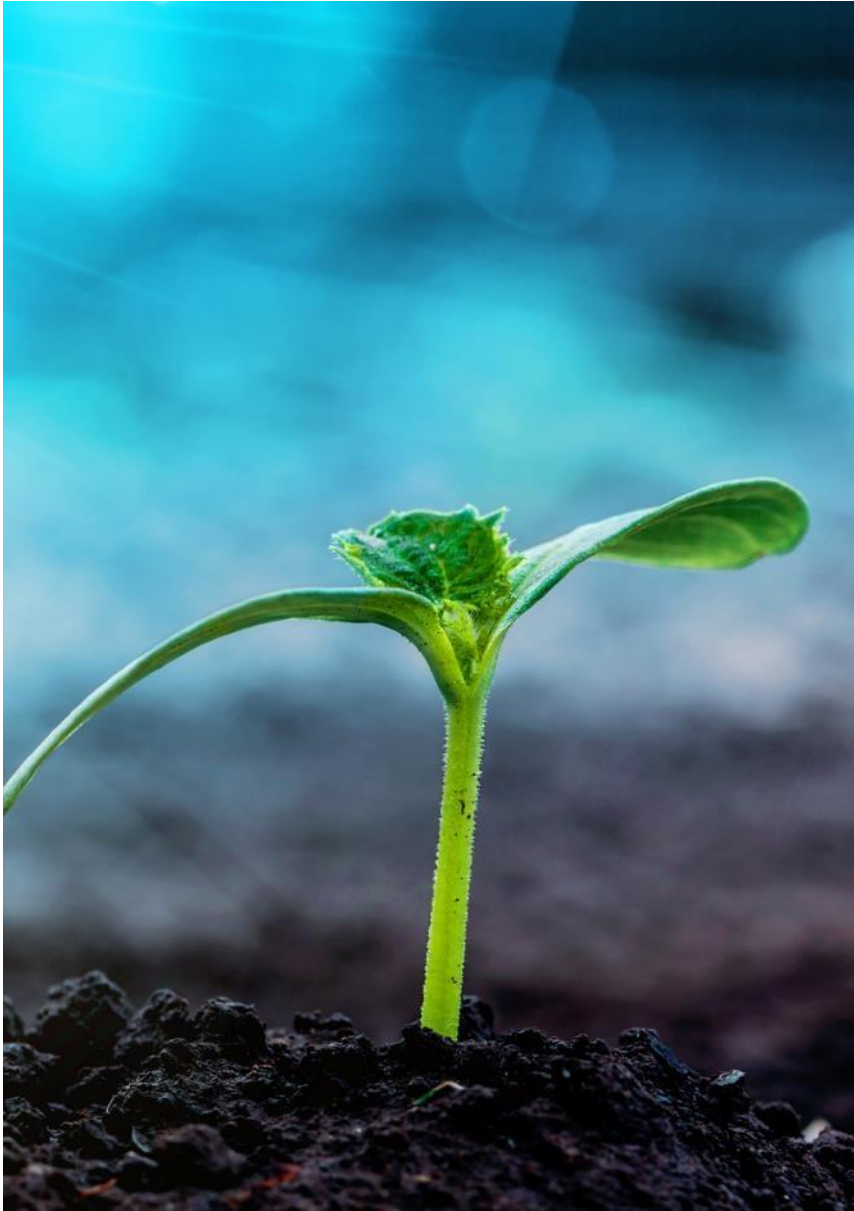


SAPLING
FINANCIAL CONSULTANTS

FEI CANADA - TORONTO & ACG TORONTO STRESS TESTING WEBINAR

PRESENTED BY: Rob Hong (Sapling); Jeff Dennis (Fasken); Asher Roffel (Toronto Zenith); Mike Hayes (BMO), Brendan Howard (CIEL)





01

OVERVIEW



WEBINAR OVERVIEW

01 Overview

02 Having the Right Model

03 Setting Up Scenarios

04 Interpreting Results

05 Case Studies

06 Your Lender's Perspective



Rob Hong
Founder at Sapling
Financial Consultants Inc.



Jeff Dennis
Counsel | Entrepreneur-In-
Residence at Fasken Law



Asher Roffel
Vice President, Finance at
Toronto Zenith Contracting Ltd.



Brendan Howard
Partner & Operating
Executive at CIEL Capital



Mike Hayes
Managing Director
at Bank of Montreal



CONTEXT SETTING

The COVID-19 crisis is having an unprecedented impact on the economics and finances of companies across all industries. Government and others have responded with support where possible

Covid - 19 Crisis Impact

- Revenue decline: more than 65% of small businesses reported a revenue decline of more than 50%¹
- Mass layoffs: Air Canada placed 15,200 unionized employees on off-duty and furloughed 1,300 managers²
- Impact on Stock market: down 60% since February, with a prediction that recovery will take 1-3 years³



Air Canada to temporarily lay off 16,500 staff due to COVID-19 fallout



Air Canada to temporarily lay off 16,500 staff due to COVID-19 fallout



1: Betakit: Survey Finds Canadian Small Businesses Seeing 50 Percent Revenue Decline Amid COVID-19 by Meagan Simpson”
2: Financial Post: Air Canada to reduce workforce by 16,500 as it parks planes during COVID-19
3: Survey Now-Leader: COVID-19: It could take 3 years for stock market to recover, says B.C. economist”
4-7: Government of Canada: “additional Support for Canadian Businesses from the Economic Impact of COVID-19”

Government Response

- Access to credit: a \$65B Business Credit Availability Program⁴
- Avoid layoffs: up to 75% wage subsidy for businesses whose revenue has dropped 30%+ for up to 3 months; work-sharing program extended from 38 weeks to 76 weeks⁵
- Release liquidity: GST/HST remittance, customs duty and sales tax deferral until June 30; income tax amounts that become owing on or after March 18 and before Sept 2020 can be deferred until after Aug 31⁶
- Support economy: Bank of Canada has lowered interest rates and kept inflation low and stable. It is also providing liquidity support for financial institutions such as mortgage deferrals; Insured Mortgage Purchase Program: the government will purchase up to \$150B of insured mortgage pools; the Office of the Superintendent of Financial Institutions is lowering the Domestic Stability Buffer by 1.25% of risk-weighted assets, to allow Canada’s large banks to inject \$300B of additional lending into the economy⁷



THE NEED FOR STRESS TESTING

Stress testing is essential for the planning of the financial soundness of a company

Internal Planning Purposes

How to keep the lights on?

How to satisfy remaining customers?

How to plan for resurrection?



How to gain buy in with lenders? - before or after covenant breaches/default

How to gain buy in with investors?



Image credits:
Left: Reuters, by: Carlos Osorio
Right: The Canadian Press, by Adrian Wyld



LAWYER DISCUSSION



Jeff Dennis

Counsel | Entrepreneur-In-Residence at Fasken Law

Jeff Dennis is Fasken's Entrepreneur in Residence. He assists emerging tech companies with their legal needs as well as strategy and financing. A lawyer by training, prior to joining Fasken, Jeff was a serial entrepreneur and the co-author of Lessons from the Edge

- Tell us about your role at Fasken.
- I understand that over the past 3 weeks you offered free 30 minute consultations to your clients and other entrepreneurs to help them navigate this crisis. What did you learn from your conversations?
- What's your best advice for business leaders right now?
- What practical steps can they take?
 - Reduce overhead
 - Lease
 - Employees
 - Other contracts
- What about force majeure?
- What can management do to ensure their positions and avoid personal liability?

- *Some Fasken COVID-19-related resources can be found here: <https://www.fasken.com/en/knowledge/covid-19>*



02

HAVING THE
RIGHT MODEL

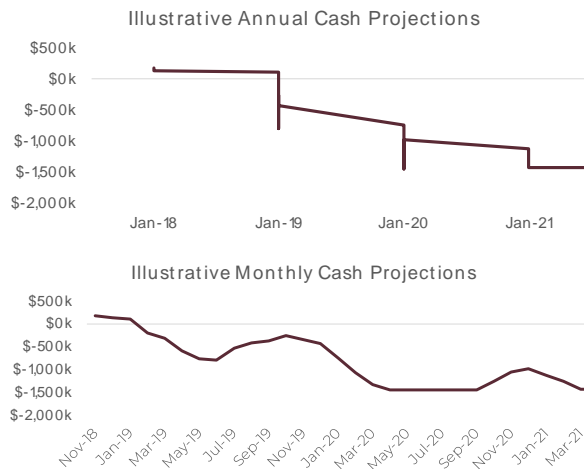


STRESS TESTING MODEL REQUIREMENTS

Before conducting stress testing, you need to make sure that you have a model that is up to the task. A model that can be used for COVID-19 stress testing has a number of important features

Monthly Modelling

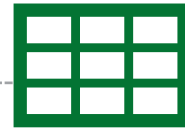
- Displays monthly cash position changes and seasonality
- Daily / weekly modelling can become cumbersome, but may be justified in emergency situations
- Quarterly / annually may not show enough fluctuations



Assumptions



Calculations



Outputs



Full Financial Statements

- Generates all required outputs that interpret your business's condition

Functionality to Capture Government Support

- Ties closely to government subsidies to ensure the model reflects all liquidity boosters

Functioning Revolver & Other Financial Resources that Max Out

- Properly models all different resources that the company can draw upon to know the true cash shortfall in the worst case scenario



STRESS TESTING MODEL REQUIREMENTS (CONT.)

Before conducting stress testing, you need to make sure that you have a model that is up to the task. A model that can be used for COVID-19 stress testing has a number of important features

- Ability to stress key variables:

Sales

In terms of Price x Quantity, to predict the decline in sales by price and/or quantity forgone

Number of Staff Required

In order to fulfill the new sales volumes, to determine the essential employees, and associated costs

Severance / Termination Pay

To assist with the decision of temporary vs permanent layoffs

“Shut Down” Date

To determine when company enters into cost-saving mode

“Back to Normalcy” Date

To determine when the company resumes normal operations and can re-hire staff

Lender Arrangements

Payment-in-Kind, temporarily reduced interest, deferred payments, etc., to estimate financial relief



03

SETTING UP SCENARIOS



SETTING UP SCENARIOS

Now that you have a model that can accommodate stress testing, setting up the right scenarios is critical in order to obtain the correct insights from the model

- Use data from your business operation drivers, public info, and predictions by industry experts



Base Case

This is what your business operations would have been had the crisis not occurred, ideally a model that has been run by investors and/or lenders. We include it to examine your key drivers, and predict the future recovery accordingly.



Stressed Case (without Mitigants)

This is the stressed case given the current crisis.

We run several scenarios without mitigants (e.g., layoffs and cost-cutting), and in terms of length of shutdown. We include it to estimate the largest cash shortfall possible, and its impact on your business.



Stressed Case (with Mitigants)

This is the stressed case given the current crisis.

We run several scenarios with mitigants (e.g., layoffs and cost-cutting), and in terms of length of shutdown. We include it to evaluate the effectiveness of strategies that could mitigate potential losses.



SETTING UP SCENARIOS (CONT.)

Now that you have a model that can accommodate stress testing, setting up the right scenarios is critical in order to obtain the correct insights from the model

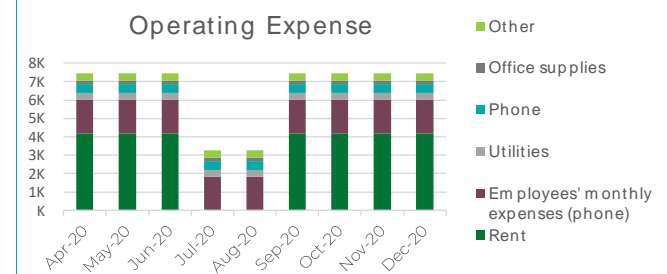
- Use data from your business operation drivers, public info, and predictions by industry experts



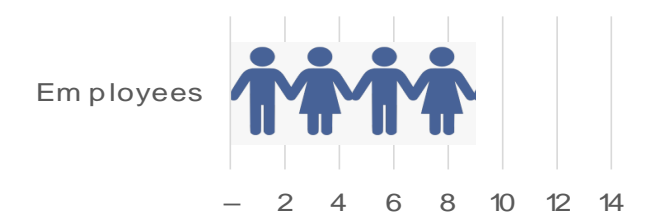
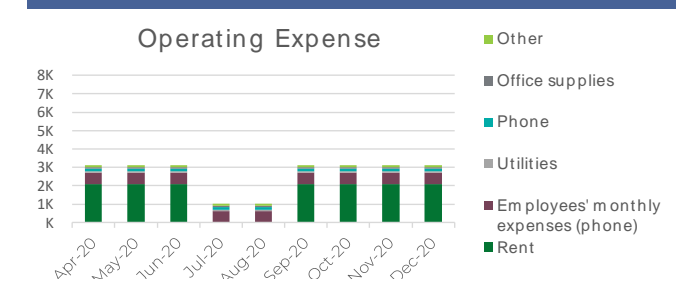
Base Case



Stressed Case (without Mitigants)



Stressed case (with Mitigants)



Icons: Icon made by Eucalyp from www.flaticon.com



MODELLED CASE

Engineers Inc. is an established fab-less manufacturer of three lines of widgets. While demand for widgets will not drop to 0 through the COVID-19 crisis, it will shrink substantially – by half through Apr and July. Engineers' CFO is working through stress testing modelling and has sketched the following



Base Case

- Steady-state revenues of ~\$33M per year, and inflationary growth going forward. Gross margin of 25%
- Annual opex of ~\$800k
- Headcount of 33 FTEs, unchanged over time, with total payroll of ~\$4.5M
- \$500k amortizing loan, just taken on – 24 month am.
- \$1M revolver (used as needed)



Stressed Case (without Mitigants)

- Sales volumes at 50% of norms from Apr through Jul 2020, and then ramp up back to normal volumes by Dec 2020
- Gross margins unchanged at 25%
- No tactics enacted to mitigate cash flow stresses
- Future years unchanged



Stressed Case (with Mitigants)

- Sales volumes per Stressed Case without Mitigants
- Targeted layoffs - decline to 21 for 5 months, but back to 33 thereafter
- Use of 75% gov't payroll subsidy (~\$260k value)
- Rent rebate for 5 months (30%)
- Loan PIK for 5 months



04

INTERPRETING RESULTS



INTERPRETING RESULTS

The model calculates a lot of different things – but key is knowing what to look at

Loan Covenants – Debt Coverage Ratio

- $\text{EBITDA} / [\text{Principal} + \text{Interest}]$
- Examines company's ability to meet its debt obligations
- A debt coverage ratio of 1+ indicates there is sufficient operating income to cover annual principal and interest repayments; less than 1 reflects the company's inability to meet its debt obligations with operating income alone

Headcount – Across Scenarios

- The number of employees within your organization
- Assists with internal decision-making
- Provides basis for communication with staff on likely steps

Cash Balance

- Includes line of credit and other financial resources
- Tests company's liquidity to see if it ever drops below \$0
- When it does not ever go below \$0, current resources are sufficient for continuous operation
- When it does drop below \$0, it indicates more resources are needed

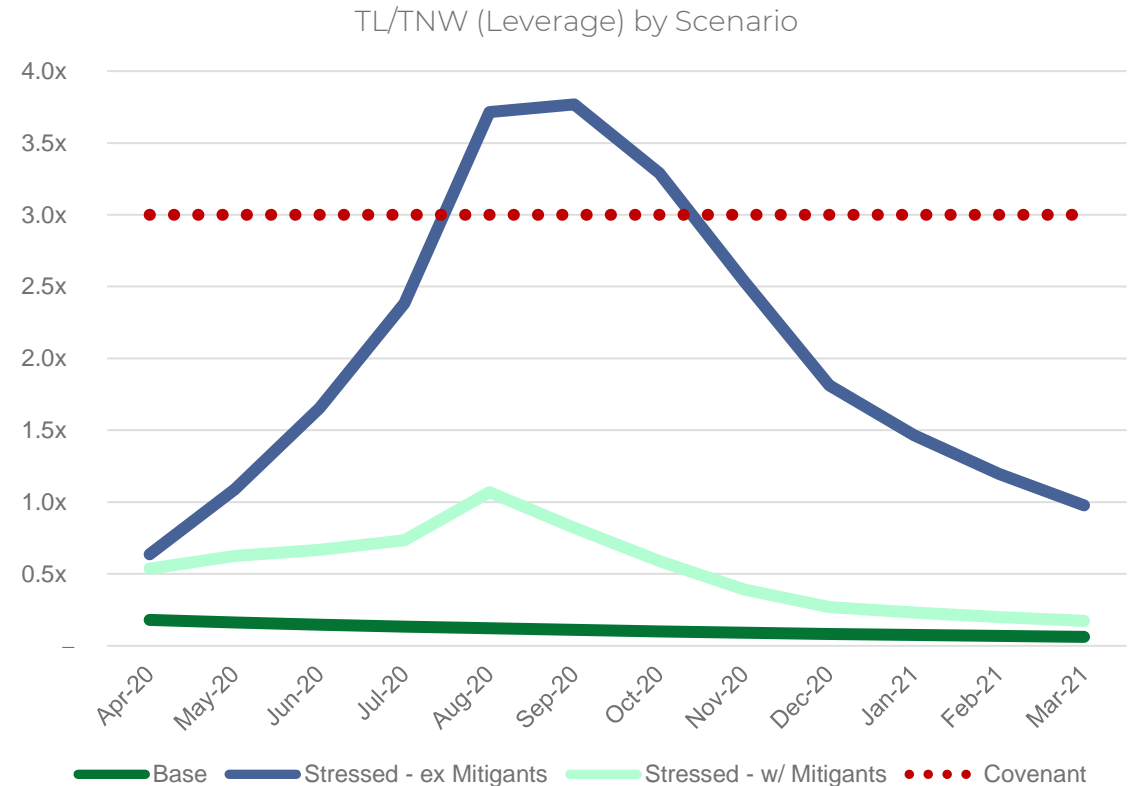
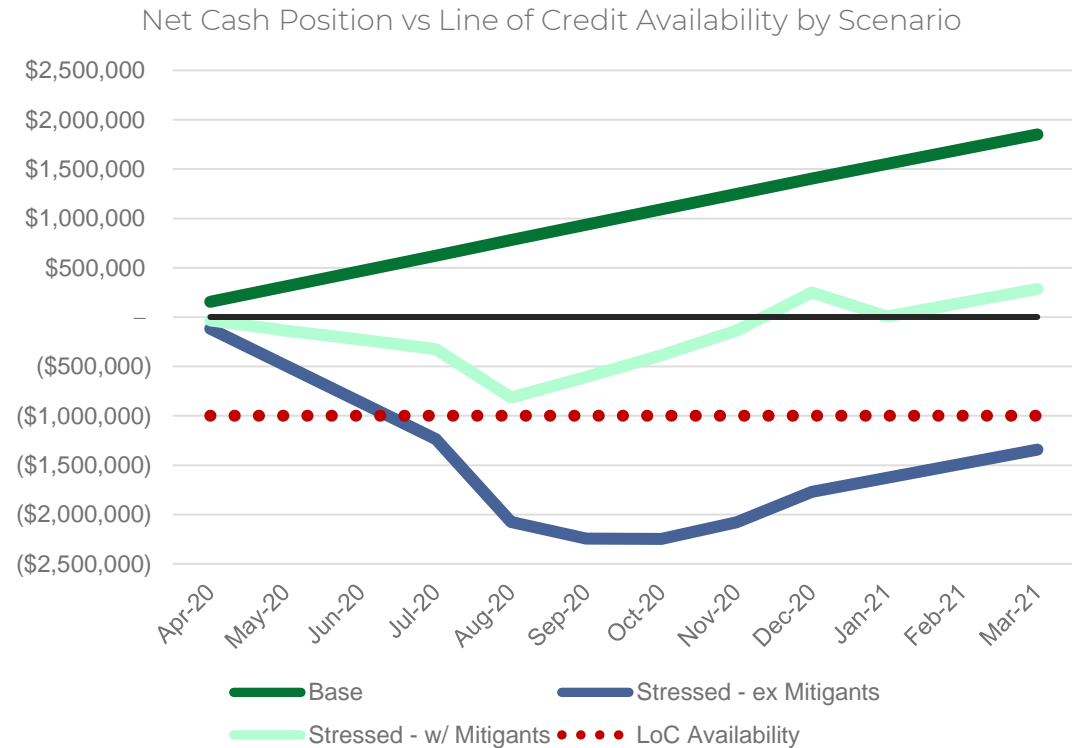
Loan Covenants – Leverage Ratio

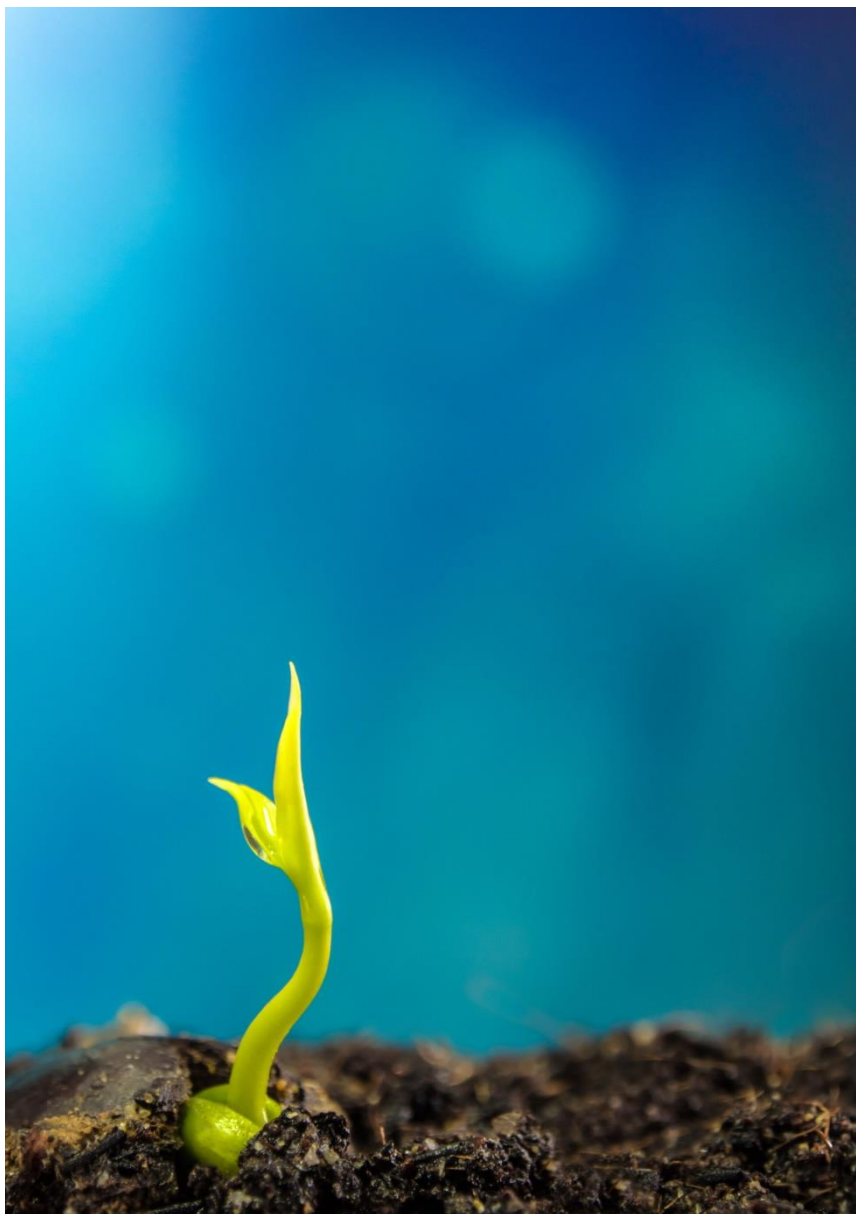
- $\text{Total Debt} / \text{Total Tangible Net Worth}$
- Evaluates company's solvency and capital structure
- A lower leverage ratio indicates more solvent, while a higher leverage ratio indicates less solvent



INTERPRETING RESULTS (CONT.)

Two of Engineers Inc.'s key outputs appear as follows:





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CASE STUDIES



Q&A WITH CFO



Asher Roffel

Vice President, Finance
at Toronto Zenith
Contracting Ltd.

Toronto Zenith is a safe, trusted
and environmentally sensitive
industry leader of infrastructure

- How has Toronto Zenith been performing during the interruption?
- What have you found through the stress testing?
- What steps did Toronto Zenith take as a result of your stress testing to mitigate?
- How long is the shut down period that you planned for - one month, three months, a year?
- Have you found any new opportunities through this crisis?



Q&A WITH PE



Brendan Howard

Partner & Operating
Executive

at CIEL Capital

CIEL Capital is a family run
private equity firm dedicated to
investing in and actively growing
niche businesses

- How has your firm been performing during the interruption?
- How long is the shut down period that you planned for - one month, three months, a year?
- What have you found through stress testing?
- What steps did you take as a result of your stress testing to mitigate the impacts on your portfolio companies?
- Have you found any new opportunities through this crisis? What has the impact been, if any, on headcount you've been able to retain?
- What themes have been visible across portfolio companies? Are these by industry or by management team personality or by size?



06

YOUR LENDER'S
PERSPECTIVE

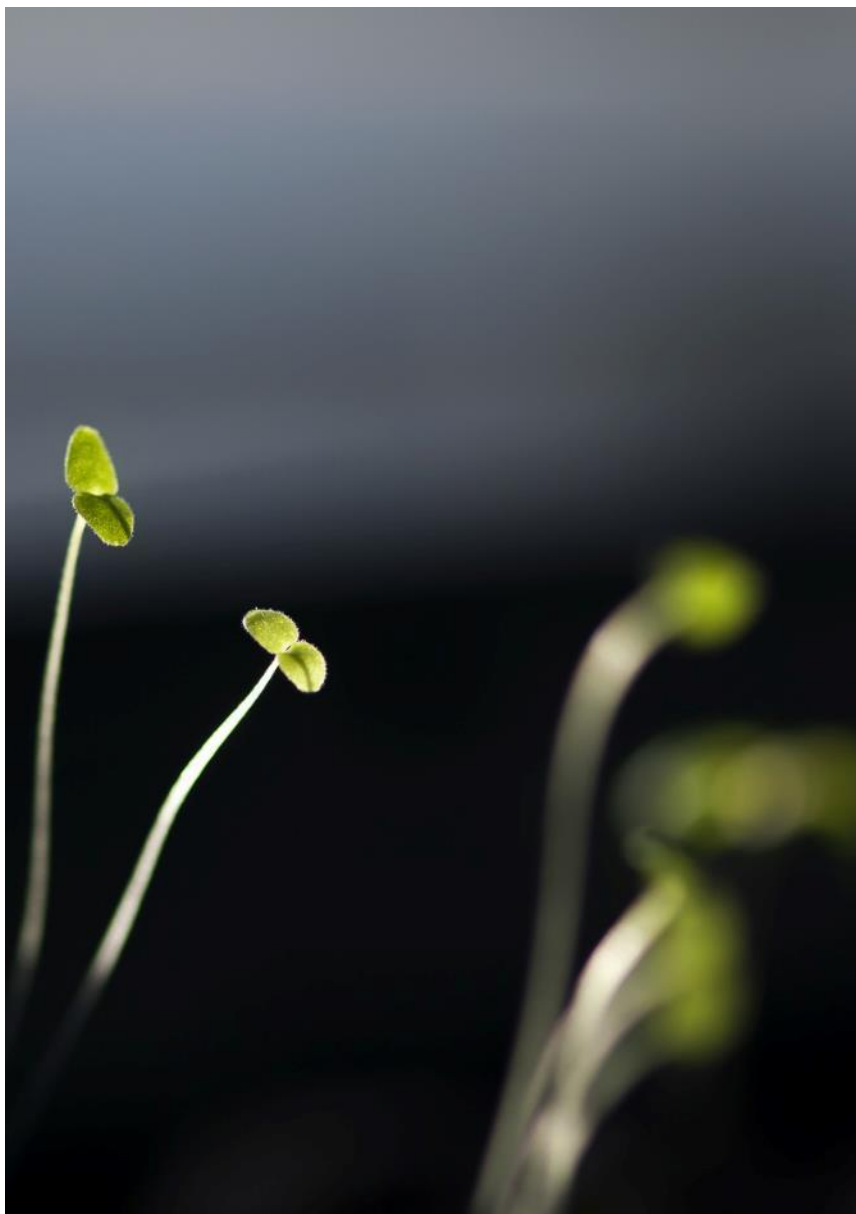


Q&A WITH LENDER



Mike Hayes
Managing Director
at Bank of Montreal
With Corporate Finance
Division in Diversified Industries

- From your perspective as a lender, what are your thoughts about the current situation?
- What kinds of supports are available?
- What kinds of companies/relationships have had bad outcomes?
- What do lenders look for in companies that they want to support?



07

Q&A



CONTACT

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