

Business owners tap the brake

AFR 18.3.08

Fast-growing businesses are putting expansion plans on hold as spooked capital markets tighten the screws. **Mark Fenton-Jones** reports.

Companies, including clients, that rely on equity to fund rapid expansion are in real trouble, says the managing director of Lumina chartered accountants, John Williams.

"It's forcing those organisations, in some circumstances, to immediately cease their expansion and further, in a large number of cases, rapidly contract."

He singles out the hotel and child-care industries as victims of their rapid expansion and increasing capital values.

"Both are contracting in terms of value enormously," Williams says. "We're aware of circumstances where offers for certain child-care centres are 33 per cent of the value that they were three weeks ago."

Hotels have been under pressure since late 2007 as owners who bought at the peak of the market, but on low yields, struggle to meet their repayments. Recently, insolvency practitioner PPB reported an unexpected increase in inquiries from hoteliers wanting to sell or restructure their financing.

Williams blames the situation on the knock-on effect of three factors.

Because of 12 interest rate rises since 2002, cash flows were diminished, which reduced the ability to service debt and lessened the working capital available for growth.

Asset values fell while high equity levels were difficult to achieve without the disposal of assets or raising capital.

In the capital markets, financiers required higher equity levels to support the debt, while clients experienced more trouble meeting banking covenants.

"We have found generally our clients who have operated in markets dominated by growth, are now faced with the reality that their balance sheets are not in a position for further growth. Capital markets have been spooked and therefore the ability to raise further equity funds has been limited," Williams says.

"And in some cases, asset values are being slashed due to panic



Taurus Marketing founder Sharon Williams is building a buffer in case clients go quiet.

Photo: JACKY GHOSSEIN

selling of assets in the market at large to improve the balance sheet positions. Expansion stopped in these rapidly growing industries."

Dun & Bradstreet, which surveyed a large number of SMEs for its National Business Expectations Survey that was published last Tuesday, found that sales were down five points after coming off the December quarter's growth in sales, the highest since the March quarter 2004.

"Early signs of an economic slowdown are beginning to show through in executive expectations for sales, profits and selling prices. National accounts data and retail sales figures are indicating a slowdown," says D&B chief executive officer Christine Christian.

She attributes the lower expectations for business growth to the impact of the high cost of funding and the tighter credit market, with less than 10 per cent of executives expected to seek finance for their business in the next quarter.

Despite the pessimism in some quarters, it is not yet widespread. In fact, many small-business owners still feel quite confident about their ability to withstand any economic volatility.

Christina Singh, the author of Sensis's quarterly small and medium enterprises index, says that while her survey of 1800 SMEs flagged expectations of a slowdown

in economic growth, a large number expected their profits, sales, capital expenditure and even employment to improve over the next 12 months.

Chief executive of SolveIT Software Matthew Michalewicz, who lived through the tech wreck while head of a large IT company in the United States, sees no comparison between now and earlier this decade when small businesses were devastated by the market collapse.

"As interest rates go up, sure you're going to have a decrease in capital spending but I think the small businesses that can create

Asset values are being slashed due to panic selling in the market.

strong business cases for their products or services, that can demonstrate tangible return on investment, are going to do as well as ever, if not better. And we fall into that area," says Michalewicz who is experiencing the "best year ever", with forecasts to do even better next year.

For businesses with strong balance sheets, vigilance is the watchword.

"I'm not panicking, but I'm being cautious," explains Sharon Williams, the managing director of Taurus Marketing, which she

founded in 1995 and which carries no debt. She has just decided not to invest in a suite of plasma screens in her offices for both news and presentations as a precautionary step should customers decide to pull back their spending by cutting their marketing, public relations and human resources budgets.

Already, a couple of customers have postponed major events and product launches until later this year.

"I need to be conscious of that and make sure I've got a bit of buffer in the bank to be able to pay the bills if certain business does not come in, or if certain customers go quiet," says Williams whose client list includes major technology companies.

Certainly as banks pay more for scarce wholesale funds, they will be more selective about to whom they lend. BDO Kendalls director Robert Powell says he has recently noticed a change in atmosphere.

His client, a medium-sized business with annual turnover between \$40 million and \$50 million, wanted to buy a \$5 million regional business. Powell's client was told it got the loan only because it had a long track record with the bank.

But the real eye-opener was the bank's offer to take an equity position in the client's business. "I've never come across that before in a presentation," he says.