North Consulting Group

Quarterly Newsletter
Summer 2012

Editor's Welcome

The Invisible Hand of Innovation

Instrumental in the growth of a company, and the economy as a whole, is the role of competition, quietly and persistently benefiting society through individual ambitions to maximize gains in the marketplace.

According to the 2012 OECD (Organisation for Economic Co-operation and Development) Economic Survey of Canada, competitive pressures that spur innovation have recently intensified because of the high exchange rate. Adapting to increased economic pressures to compete in the current global marketplace requires creative solutions to common business problems. More often than not, innovation occurs through small, incremental improvements to existing concepts that result in exponential savings to the company, savings that can be reinvested into innovation, commercialization and growth.

Take for example the introduction of the assembly line, which revolutionized the manufacturing process by significantly cutting costs to production, thereby allowing resource intensive products like cars to become affordable. Although many companies at the time were working to develop the assembly line and the concept of a division of labour was not new, Henry Ford and the Ford Motor Company were the first to master the moving assembly line, pressured by the high costs of manufacturing technology in an emerging sector and fuelled by the belief that "competition is the keen cutting edge of business, always shaving away at costs" (Henry Ford).

Ela Malkovsky B.A.

Technical Writer and Editor-in-Chief

Ela is dedicated to supporting the advancement of Canadian companies by identifying and leveraging innovative research and technology based funding options.

Launched in a converted factory in 1903 with $28,000 in cash from twelve investors, Ford Motor Company produced just a few cars a day, with two or three men working on each car. Within a decade, the company would become a world leader in the assembly line concept, having innovated existing workforce concepts and developed creative solutions to the same issues that their competitors were facing. Similarly, the narrowing competitive margins of the current global economy are putting pressure on companies to improve their methods and reduce costs in order to secure their position in the marketplace.

In welcoming you to the summer newsletter of 2012, North Consulting Group[1] has provided several articles to advance your knowledge of government funding and financing assistance to increase your competitive edge. We thank you for your support and wish you a very productive summer!

Until next time,
Ela Malkovsky, Technical Writer and Editor-in-Chief.

[1] North Consulting Group is dedicated to providing full-service strategic insights and resources to help you attain your business objectives. It is currently comprised of: NorthBridge Consultants (R&D tax credit consulting); NorthLink Capital Advisors (mergers & acquisitions, capital raising and succession planning advice); NorthSpring Capital Partners (providing risk capital to privately-held businesses); and North Innovation Fund (SR&ED accrual debt financing).

Federal Budget
SR&ED Changes:
Dollars and Cents

James Ro
Vice President of NorthBridge Consultants

James has over 10 years of experience in a wide range of business areas, including SR&ED, management, debt and equity financing, mergers, acquisitions and divestitures.

Written by:
James Ro, Vice President of NorthBridge Consultants.

The 2012 Federal Budget was released this past March and included some relatively significant changes to the SR&ED program in Canada. What was interesting in the Jenkins Report (released Oct 2011) was that its recommendations were focused on changes that would impact Small and Medium-sized Enterprises ("SMEs"), whereas the Federal Budget ended up favouring SMEs (see details below).

This didn't come as much of a surprise as the majority Conservative government had a mandate to reduce the deficit and, according to the Jenkins Report, large enterprises represented approximately 60% of the SR&ED tax credits granted but only approximately 10% of the total number of claimants in 2007. As a result, the government met their political agenda by reducing government spending and focusing on the "bigger" dollars, but at the same time, did not upset the approximate 20,000 SME claimants in a meaningful way – i.e., remained popular with the voting masses.

You can do a Google search and find a lot of literature summarizing the 2012 Federal Budget changes, but are claimants clear on what the changes mean to their bottom line in terms of dollars and cents? I have attempted to provide generic numerical examples of the SR&ED program changes in the tables on the right to demonstrate the dollar impact on claims for both SMEs (referred to as CCPC's) and large or foreign enterprises (referred to as Non-CCPC's). In summary:

1. For both CCPC's and Non-CCPC's, the proxy will be reduced from 65% to 55% of salary base.
2. For both CCPC's and Non-CCPC's, subcontractor costs will be reduced from 100% to 80% of eligible subcontract expenses.
3. For both CCPC's and Non-CCPC's, SR&ED capital equipment will no longer be eligible (this will not impact many SME claimants, as capital is not a common expenditure for smaller companies).
4. For CCPC's, the general ITC rate will remain unchanged.
5. For Non-CCPC's, the general ITC rate will be reduced from 20% to 15%

In the example below, the Non-CCPC can expect to see an almost 40% reduction in their Federal ITC; whereas the CCPC can expect their Federal ITC to decrease only by approximately 7%.

CCPC - Illustrative Calculation of Total SR&ED Expenditures

	Current	Projected	Variance %
Labour/Wages(T4)	600,000	600,000	
Proxy - % of T4 Labour	65%	55%	
Proxy Amount	390,000	330,000	-15%
Materials	100,000	100,000	
Subcontractor - %	100%	80%	
Subcontractor - $	100,000	80,000	-20%
SR&ED Capital Equip - %	100%	0%	
R&D Capital Equipment	-	-	0%
Total Expenditures	1,190,000	1,110,000	-7%
General ITC Rate	35%	35%	
Assumed Federal Tax Credit	416,500	388,500	-7%

Non-CCPC - Illustrative Calculation of Total SR&ED Expenditures

	Current	Projected	Variance %
Labour/Wages(T4)	600,000	600,000	
Proxy - % of T4 Labour	65%	55%	
Proxy Amount	390,000	330,000	-15%
Materials	100,000	100,000	
Subcontractor - %	100%	80%	
Subcontractor - $	100,000	80,000	-20%
SR&ED Capital Equip - %	100%	0%	
R&D Capital Equipment	150,000	-	-100%
Total Expenditures	1,340,000	1,110,000	-17%
General ITC Rate	20%	15%	
Assumed Federal Tax Credit	268,000	166,500	-38%

While much more extensive reductions were discussed; only a portion of these were implemented. Overall, when you combine the revised SR&ED program with other government programs and corporate tax incentives, Canada continues to provide generous, broad-based incentive programs to support R&D and innovation.

If you would like to know more about how the changes to the SR&ED program will affect your claim, please feel free to contact me at (519)623-2486 ext. 227.

Blair Roblin
Managing Director of NorthLink Capital Advisors

Blair has worked in the field of mergers, acquisitions and corporate finance for over 25 years. His advisory roles have been primarily with mid-sized Canadian firms, in a variety of industries.

> "Companies are coming around to the fact that the current economic state is the "new normal" and that financing decisions cannot be put off indefinitely.

Despite Turbulent Economy,
Canadian Companies
Plan to Move Ahead with IPOs

Written by:
Blair Roblin, Managing Director of NorthLink Capital Advisors.

According to Bloomberg, Canadian companies raised $790 million in IPOs during the first five months of the year, representing a 25% decline from the same period a year ago and the lowest since 2008. Challenges have come from Europe's debt crisis, while falling commodity prices have also kept companies out of the market.

But the outlook for Canadian IPOs appears to be improving, despite the slow start to the year. This may seem a bit surprising, especially since the lazy days of summer have never been the best for new issues and Canadian stocks have generally been selling off in the past few months. The headlines from the recent Facebook IPO certainly haven't helped much either. Nevertheless, companies are anticipating growing investor appetite for yield-oriented offerings, and some private-equity firms are looking to trim their holdings of private firms. This may be a sign that companies are coming around to the fact that the current economic state is the "new normal" and that financing decisions cannot be put off indefinitely.

In all, more than $1 billion could be raised in the next few months if the planned IPOs are successful. The candidates to raise money include two REITs (Real Estate Investment Trust), a casino company, an energy trust and a mining company.

The first of these to launch, HealthLease Properties REIT, has already been successful on June 6th, selling 11 million units at C$10 each and yielding a substantial 8.5%. HealthLease will use the proceeds to buy seniors housing and care properties in Western Canada and the U.S. Midwest. A second REIT, Pure Multifamily, is expected to raise $20 million but this may increase if there is strong interest from retail investors.

Casino operator Gateway Casinos is expected to raise more than $100 million, with about $77 million going towards the repayment of term loans and another $60 million to redeem notes. The issue is being sold by its private equity owners.

Argent Energy Trust recently delayed its marketing by a week after the oil price took a tumble, but the company still expects to finish marketing by the end of June. Argent hopes to be the third new energy trust to trade in Toronto, following a model that shields foreign assets from the tax increases imposed by the federal government in 2006. The company owns U.S. energy assets and is looking to raise $325 million.

Finally, base metal mining company, Intergeo, which is backed by Russian billionaire Mikhail Prokhorov is expected to list in Toronto by the end of the year. Intergeo is a Russian copper and nickel company hoping to raise between C$100 million and C$500 million. The company's chairman and 20% stakeholder, has indicated that the company would float about 10% of its shares in the offering.

The Gateway and Intergeo IPOs should be large enough to rank among the largest IPOs of 2012. Together with Argent, HealthLease and Pure Multifamily, they should prove that the equity markets in Canada are a good place to raise capital, even in these turbulent times.

Are You Ready for Stormy Weather?

Brian Hunter

President of NorthSpring Capital Partners

Brian has more than 30 years of experience in providing debt and equity financing to privately-held businesses in Southern Ontario. He earned his BA in Economics and MBA at the University of Western Ontario.

Written by:
Brain Hunter, President of NorthSpring Capital Partners.

Where is our economy headed? Will European contagion affect our markets? Is the US going over a fiscal cliff of huge tax increases and spending cuts? These are all great questions; I wish I had answers. What I do know is that businesses need to be ready to quickly react to rapidly changing circumstances.

The key to being able to quickly react is having a strong balance sheet that is able to withstand financial shocks. Now is the time to play defensive and ensure you have plenty of working capital and availability under your line of credit. If your business is losing money, pay close attention to your debt-to-equity and debt service ratios. Be proactive and rebuild your shareholders' equity to maintain bank covenants before your bank takes action.

Lately, we have seen some really creative examples of how to raise additional working capital. One company did a "customer assessment" which involved the customer making a loan to the company repayable from discounts against future purchases. In a slightly different twist of this, another company received a long term loan from a customer in exchange for guaranteed supply of finished product.

Restoring or improving profitability can be more challenging than improving liquidity. Again, we have seen some interesting solutions recently. One company engaged productivity improvement consultants and, over a six month engagement, this resulted in over $1 million in cost savings, representing 4-5% of revenues. Another company increased their SR&ED claim by over $100,000 after NorthBridge Consultants reviewed the previous consultants draft report and found missing projects and claimable expenditures.

We are also seeing more radical solutions involving mergers, acquisitions and divestitures. A prime example is in the printing industry, which is ripe for consolidation as too many printers are offering the same services to a stagnant market. As advisors, we recently participated in the merger of three printers. Significant synergies and cost savings resulted, and top line revenue growth was achieved by being able to offer expanded services to a larger geographic market. All of the owners that participated expect superior results than as standalone operators.

There are many more financial and strategic buyers than sellers in today's market. Most companies have recovered from the financial crisis of 2008-2009. With attractive low interest rates and risk capital readily available, now is an excellent time for business owners to consider their exit options and timing. If we get into stormy weather these conditions may not be repeated.