Investor view
Insights from the investment community

Issue 3 - Business funding
November 2011

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Business funding

The previous issue in the ***Investor view*** series discussed the benefits of providing a net debt reconciliation for users of financial statements. It highlighted some of the broader information and analysis that an entity may provide. This edition of 'Investor view' looks at the bigger picture of business funding and considers additional information that may be presented to assist users in their assessment of an entity's position.

Why is business funding information useful to investors?

The economic downturn and continued strain on the availability of financing have resulted in increased management and investor focus on cash and an entity's ability to working capital requirements, refinance existing debt and secure new debt. Investors also want to understand management's plans for servicing the entity's debt position and any risks associated with it. In addition to the inclusion of a net debt analysis, investors have indicated that they value the following:

- Broad definition of funding – details of working capital, payments in advance and other items as a part of the funding disclosure where they represent important sources of finance. Equally, where working capital requirements are important for an understanding of an entity's funding needs, it would be useful to include these.
- Maturity information – a comprehensive maturity table for all material components of debt, showing both the contractual maturity of each type of debt and when management expects it to be repaid (if different).
- Covenant restrictions and terms – financial reporting standards require disclosure of any defaults or breaches of loan agreement terms that are not resolved by the period end. Additional detail of the terms and measurement of the principal covenants in place, not only when breached, provides users with an understanding of the restrictions in place and the entity's compliance.
- Details of average debt balances – in addition to the year end balances, to enable users to understand the debt position over the year.

What does it look like?

One of the issues with current disclosure is that funding information is presented in separate areas of the annual report; providing the information piecemeal makes it harder for users to see the complete funding picture. Phase E of the IASB and FASB's joint Conceptual Framework project aims to make financial statement disclosures more effective and coordinated, and less redundant.

The examples below are extracts from a number of annual reports illustrating some useful disclosures.

#1
Broad definition of funding – working capital

The example below is extracted from the Signet Group plc 2008 annual report. It provides an explanation of the impact of the seasonality of its business on working capital requirements.

Example:
Working Capital – Signet Group Plc 2008

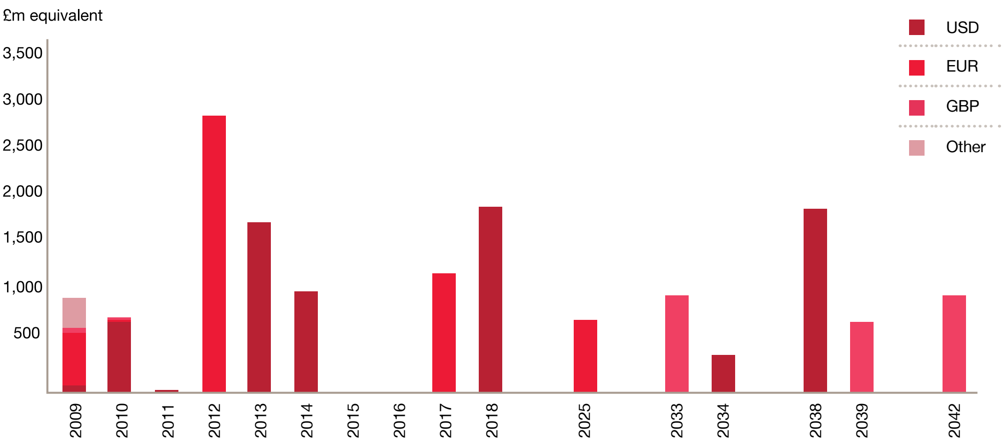
The Group's working capital requirements fluctuate during the year as a result of the seasonal nature of its business. As inventory is purchased for the Christmas season there is a working capital outflow which reaches its highest levels in late autumn. This position then reverses over the key selling period of November and December. The working capital needs of the business are then relatively stable from January to August. The rough diamond sourcing initiative will require the Group to hold an element of its inventory for approximately an additional 60 days. The timing of the payment of the final dividend, normally in July, is also material to working capital requirements during the year.

The Board considers that the capital resources currently available are sufficient for both its present and near term requirements.

#2
Maturity profile

The GlaxoSmithKline plc 2008 annual report provides a maturity profile of gross debt, in graphical format, which shows annual information up to year 2018 and periodic information thereafter, thus presenting more in-depth information than statutorily required.

Maturity profile of gross debt



#3
Covenants

The SIG plc 2008 annual report provides the following covenant information in respect of its debt facilities and compliance therewith.

Debt Covenants

The Company's debt facilities contain a number of covenants attached to SIG's committed debt facilities. The key covenants are leverage and interest cover and are tested at 30 June and 31 December.

The leverage covenant is a requirement to maintain a ratio of net debt to Annualised EBITDA of less than 3.5 times. Annualised EBITDA is defined as operating profit before amortisation of acquired intangibles, impairment charges, depreciation and restructuring costs, plus interest receivable and adjusted to annualised the EBITDA of acquisitions made during the previous 12 months.

The interest cover covenant is a requirement to maintain a ratio of the previous twelve months' underlying operating profit to underlying net finance costs (excluding pension scheme finance income and costs) of greater than 3.0 times.

The ratio for each of the debt covenants is set out below.

Leverage covenant	*Year ended 31 December 2008*	*Year ended 31 December 2007*
Annualised EBITDA	£227.0m	£210.2m
Net debt	£697.1m	£428.9m
Leverage ratio	3.07x	2.04x

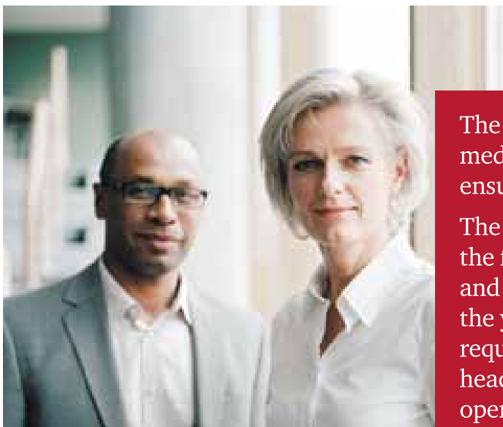
Interest cover covenant	*Year ended 31 December 2008*	*Year ended 31 December 2007*
Underlying operating profit	£169.8m	£159.4m
Underlying net finance costs*	£32.6m	£18.9m
Interest cover ratio	5.2x	8.4x

* Excluding pension scheme finance income and costs.

The company is in compliance with its financial covenants in all respects and has not requested or gained any waivers thereof.

#4
Details of average debt balances

The Barratt Development PLC 2009 annual report details the impact of cyclical working capital requirements on borrowings throughout the year.



The Group actively maintains a mixture of long-term and medium-term committed facilities that are designed to ensure that it has sufficient available funds for operations.

The Group's borrowings are typically cyclical throughout the financial year and peak in April and May and October and November of each year, as these are the points in the year when the Group has the highest working capital requirements. Accordingly, the Group maintains sufficient headroom to cover these requirements. On a normal operating basis the Group has a policy of maintaining headroom of £250m of available committed facilities

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