URBACH HACKER YOUNG
UHY
INTERNATIONAL

# International Business

Issue 1 2000

# Managing rapid growth

## THE CASE OF IMERCO

**The retail trade is traditionally dominated by a few powerful companies. But Imerco – Denmark's largest chain of hardware stores – has pioneered a new management structure for small traders, which is generating huge growth.**

"Our concept is unique," says President of Imerco, Torben Olsen. "Every single shop has one share in the company. The shopkeepers own the company and choose the board. This concept has evolved over a hundred years – from the traditional rag-and-bone man to a kind of franchise system, like McDonalds, but better.

"We have rules the shopkeepers have to obey. For example, they have to stock 2,500 articles named by the President, they have to run 25 advertisement campaigns a year, and they have to buy things through our suppliers," adds Mr Olsen.

Imerco is already the only truly nationwide chain of hardware stores, with more than 170 dealers. Recognition tests prove that Imerco is recognised by as many as 93 per cent of the consumers. The goal is to grow to some 200-300 stores in Denmark and to expand internationally.

The President is bullish about the future of the company: "Only continued growth will enable us to maintain our position, now as well as in the future. Thus, we have initiated international market research with highly positive results. The Imerco concept is unique and the interest is huge in our neighbouring countries."

Imerco's share of the Danish hardware market is now 42 per cent, and the chain's aim is to reach 50 per cent by means of continued growth over the next few years. Neighbouring countries have also expressed an interest in the concept, and the chain opened its first store in Sweden in 1999.

> *INFO:REVISION are now part of a handful of external advisers that we consider partners in our development process*

The success of the chain is credited to the independence of each individual dealer, enabling him to adapt to local circumstances and conditions. The huge growth has also been thanks to the number of external advisers and partners, who have brought their own expertise to the expansion strategy.

"Our co-operation with INFO:REVISION means we don't have to explain everything from scratch each time. They have proved to be a highly competent partner with specific retail knowledge. They are now part of a handful of external advisers that we consider partners in our development process," explains Torben Olsen.

When moving into Sweden "their company's international network, especially Norberg & Jansson in Sweden, assisted us in setting up the business" and INFO:REVISION provided particular support when it came to working out differences in national legislation.

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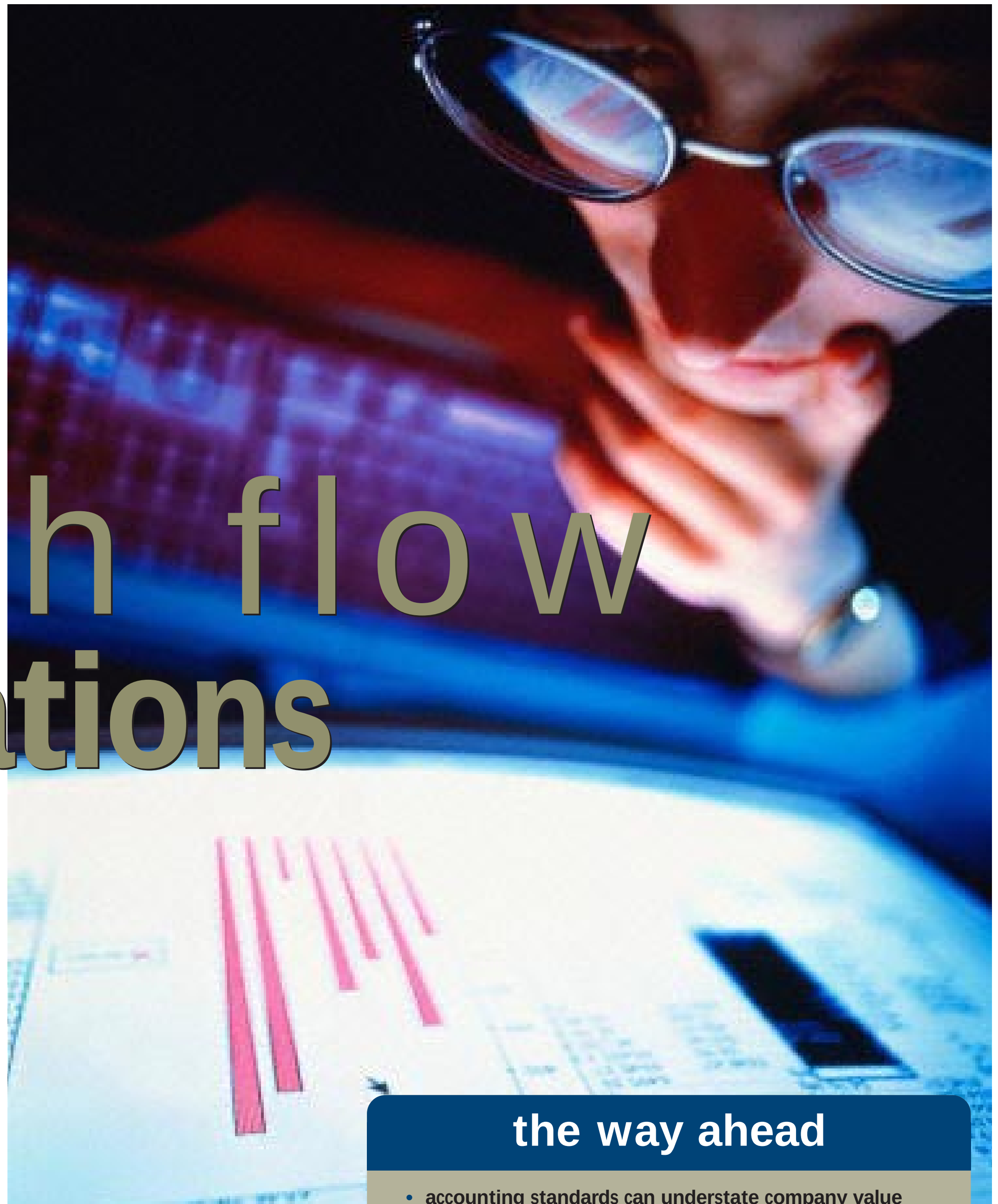
In the US, the traditional way of valuing a company is by the price earnings ratio – which calculates the earnings relative to the share price.

# Cash flow **valuations**



Increasingly, analysts are using a different calculation, which, it is claimed, more realistically reflects the actual business activities.

The new way is based on analysing the price to cash earnings ratio – that is to say instead of traditional earnings per share, you measure cash generated per share – which excludes depreciation, amortisation of goodwill and other known non-cash charges. The theory is that accounting standards understate the value of a company – cashflow is a better yardstick for its value.

Accounting treatment is widening the gulf between Generally Accepted Accounting Principles (GAAP) income and cash income in the business service sector. GAAP earnings per share, while still the primary basis for stock valuation, is becoming less meaningful as an equity analysis tool. Recent proposals by the Financial Accounting Standards Board (FASB) should provide additional information to those of us responsible for valuing equities.

The trouble is that almost everyone has a different definition of this process, including cashflow from operations, free cash flow, EBITDA, and even NOPAT (net operating profits after taxes for EVA adherents). Merrill Lynch has defined cash earnings available to the business during its remaining life. “It's simple to calculate. It's easy to remember. Most importantly, we think it is the best measure of value,” insists one of their reports.

Thus the intrinsic value of a company is the discounted value of the cash that can be taken out of a business during its remaining life.

“In our opinion, Cash EPS is a better measure than GAAP EPS of the cash that can be taken out of a business on an annual basis. Notably, our calculation of Cash EPS does not remove the non-cash expense of depreciation.

“The principle is that cash that comes through the door is a better valuation of the company. The analysts are driving this as a new means of valuation,” says John Wolfgang, Vice President of Urbach Khan & Werlin, and a director of UHY.

“Some people think this is good, some people think this is bad. People should be aware that this is the way that financial performance will be looked at, and it's going to affect their companies, with an impact on valuation and M & A activities. It's on its way – brokers, investment bankers and the accounting community are advocating it.”

There is a reasonable chance that this criterion will be in place next year in the US.

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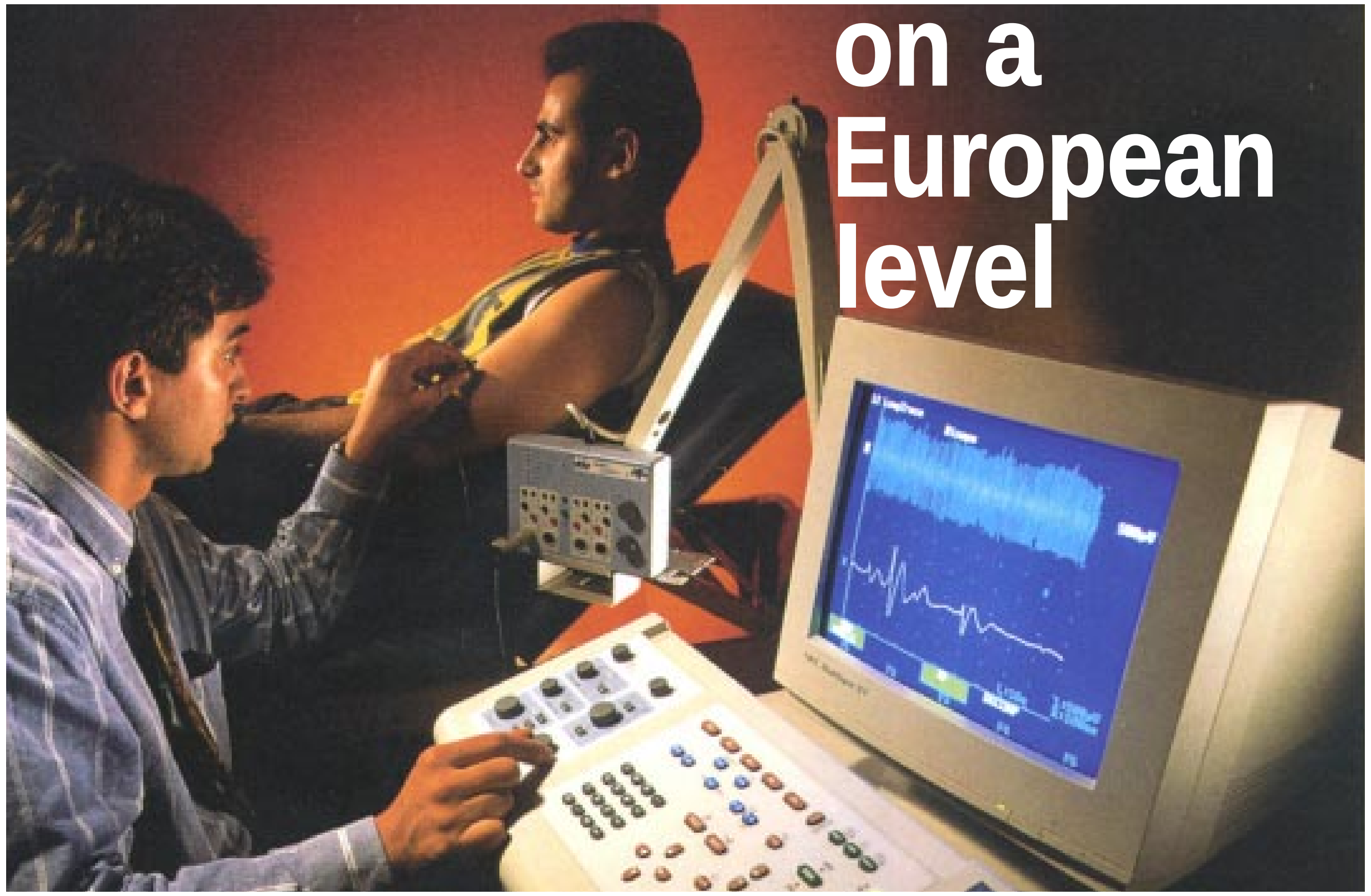
## the way ahead

- **accounting standards can understate company value**
- **’cash through the door’ is a better valuation**
- **this leads to a ‘cash per share’ measure**
- **accounting community is advocating this new assessment of financial performance**



# UHY **offices co-ordinate on a European level**



**The recent link up of the Dutch/Belgian group of companies IMS (Innovative Medical Solutions) and a small eastern German company, illustrated the very real value of co-operation between UHY members.**

Innovative Medical Solutions (IMS) is a business undertaking engaged world-wide in the production of equipment for physiotherapy and electro-medicine. At the end of the year 1998, the company IMS established contacts with an innovative company in eastern Germany, near Berlin. After a couple of preliminary talks between the two companies, Dick Boers, Managing Partner of Govers in Eindhoven, received a phone call from Rob Vliek, the General Manager of IMS, requesting professional assistance in Germany.

Dick Boers put him in touch with Lauer Chamier Schweidler & Kollegen, in Berlin. Rob Vliek appointed the Berlin office to handle IMS's financial affairs in Germany – ranging from recommending a law firm for the preparation of the contracts, to questions of valuation in connection with the acquisition of the company - which was effected by way of an asset deal - through financial due diligence up to the engagement of a notary public for the notarisation of the contracts.

The Berlin office also took part in valuing the inventories and the fixed assets on the date of the transfer of the company to IMS/Uniphy. Only the research and development division was taken over – so the Berlin Office also handled the financial accounting, the payroll accounting, and it now prepares the monthly management report for the controlling of IMS.

The fiscal structure of the new German subsidiary of IMS was the result of close co-operation between Govers and Lauer Chamier Schweidler & Kollegen.

“This is a really good example of the excellent co-operation between UHY members,” said Rob Vliek. “We were delighted with the way Mr Lauer handled our affairs. The deal went though very smoothly and we were very satisfied.”

> ***This is a really good example of the excellent co-operation between UHY members...the deal went though very smoothly and we were very satisfied***

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# Business services in the e-commerce revolution

Companies should identify how the Internet affects their business – both opportunities for eliminating cost and opportunities to break into new markets.

## So what should we look for to spot the builders and survivors?

People with ideas are needed but ideas alone are not enough – the management team must prove that it can implement these ideas and that the business concept or model will work.

The organisation will be obsessive about understanding its customers, and satisfying their needs with unprecedented and improving levels of performance.

The emphasis will be to constantly improve products and services. Expansion will be controlled until the business model has been proven and necessary disciplines have been put in place.

Once the model is proven, management will be committed to fast growth and making profits early in the life of the business. Profits create the cashflow to invest in the future and penetrate markets.

## How do you spot complacent businesses?

They will be in a strong position with proven brands but showing signs of a slow-down in growth, or shrinking in real terms.

New methods and opportunities will be shied away from, or decisions will be made too slowly and without full commitment to change. The internal management structures will reflect old ways of doing business.

Management will largely ignore new entrants who are embracing e-commerce opportunities.

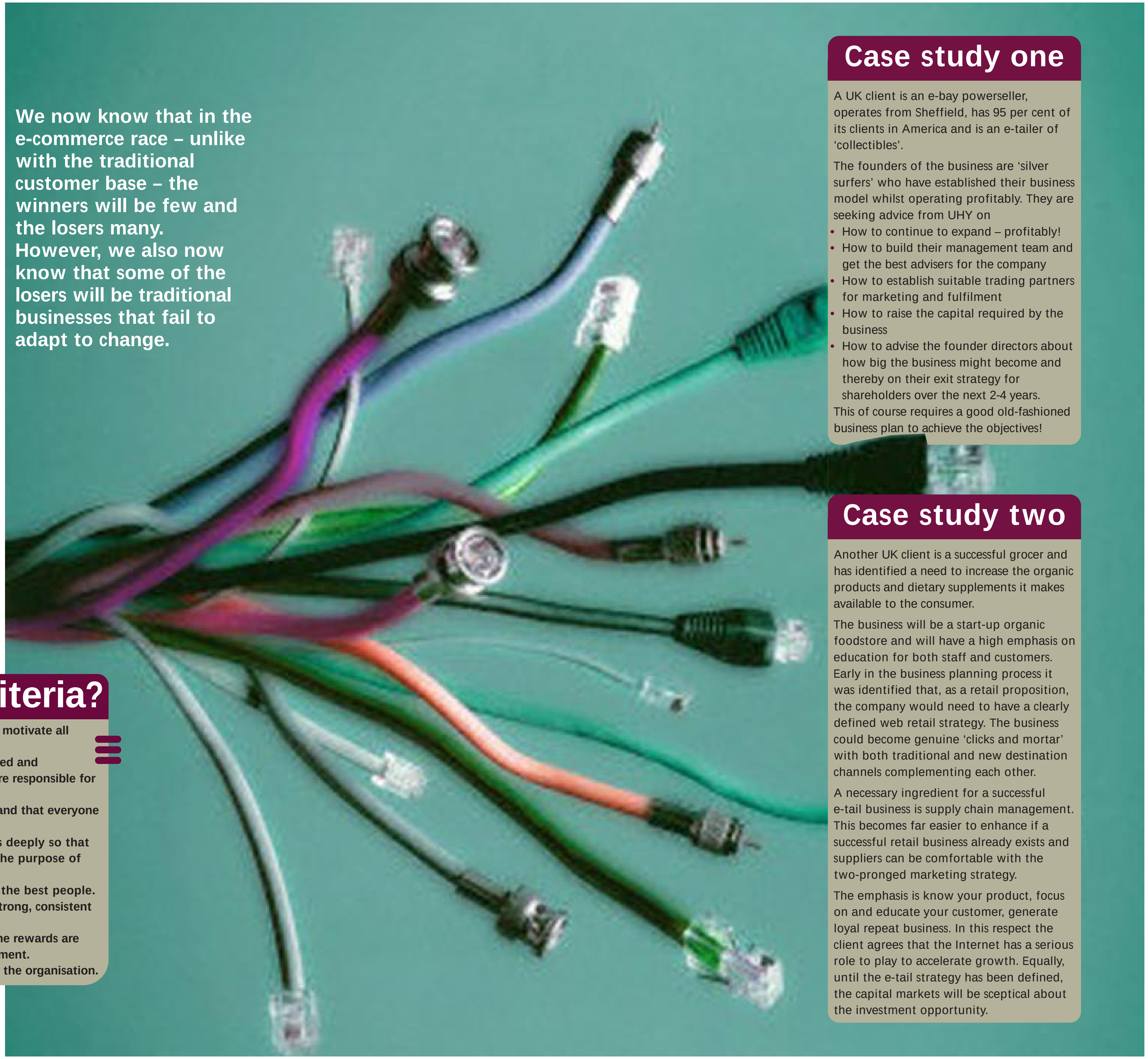
• Of course, it is not a case of out with the old and in with the new e-commerce opportunities. The new sales channels that the web opens up should complement and not replace existing channels. Existing business still needs to be encouraged, as it would be foolish to give these markets away.

So what are the key features to look for in the best and most progressive companies of this and the next generation?

## match these criteria?

- **The organisation must be adaptable and motivate all levels of staff.**
- **The business model should be well defined and communicated clearly to the staff who are responsible for delivering the objectives.**
- **The pace of business evolution will demand that everyone uses their initiative.**
- **The staff must understand the business deeply so that they apply their initiative in line with the purpose of the organisation.**
- **The organisation's culture must attract the best people.**
- **There must be a positive approach and strong, consistent leadership.**
- **Risks need to be taken but only where the rewards are high and on the basis of reasoned judgement.**
- **Hard work is required at all levels within the organisation.**

• *For more information, contact the UHY firm in the UK Hacker Young +44 20 7216 4600*



**We now know that in the e-commerce race – unlike with the traditional customer base – the winners will be few and the losers many. However, we also now know that some of the losers will be traditional businesses that fail to adapt to change.**

## Case study one

A UK client is an e-bay powerseller, operates from Sheffield, has 95 per cent of its clients in America and is an e-tailer of 'collectibles'.

The founders of the business are 'silver surfers' who have established their business model whilst operating profitably. They are seeking advice from UHY on

- How to continue to expand – profitably!
- How to build their management team and get the best advisers for the company
- How to establish suitable trading partners for marketing and fulfilment
- How to raise the capital required by the business
- How to advise the founder directors about how big the business might become and thereby on their exit strategy for shareholders over the next 2-4 years.

This of course requires a good old-fashioned business plan to achieve the objectives!

## Case study two

Another UK client is a successful grocer and has identified a need to increase the organic products and dietary supplements it makes available to the consumer.

The business will be a start-up organic foodstore and will have a high emphasis on education for both staff and customers. Early in the business planning process it was identified that, as a retail proposition, the company would need to have a clearly defined web retail strategy. The business could become genuine 'clicks and mortar' with both traditional and new destination channels complementing each other.

A necessary ingredient for a successful e-tail business is supply chain management. This becomes far easier to enhance if a successful retail business already exists and suppliers can be comfortable with the two-pronged marketing strategy.

The emphasis is know your product, focus on and educate your customer, generate loyal repeat business. In this respect the client agrees that the Internet has a serious role to play to accelerate growth. Equally, until the e-tail strategy has been defined, the capital markets will be sceptical about the investment opportunity.

# Fay & Co opens Madrid Office

**After 17 years in Marbella, Fay & Co has recently opened a new office in Madrid, which became the UHY liaison office in Spain on 1 January 2000. The resident partner is Max Gosch.**

*Madrid office (l-r) Joseph Fay Viota, Max Gosch and Bernard Fay Viota*

Fay & Co, UHY's Spanish member, has opened a Madrid office. Situated in the central business location in the Spanish capital, the new office will be under the direct supervision of resident partner, Max Gosch.

Madrid is the first office to be opened as part of an expansion programme aimed at transforming Fay & Co into one of the leading national firms over the coming years.

"Fay & Co was founded in 1983 by my father, Bernard A Fay chartered accountant, with the object of servicing the international business community in Spain," says Bernard Fay Viota, the international liaison partner for Spain and UHY International board member.

"Although through the years the firm has acquired many substantial Spanish clients, the clientele is still mainly international. This enables us to refer clients to other UHY member firms."

Fay and Paco Campos, who between them set up the UHY

Spanish group, worked together in Turquand Youngs, then the largest audit firm in the country, even though it had fewer than 20 professional staff in its Madrid and Barcelona offices.

Max Gosch, the resident partner in Madrid, comes to Fay & Co from BDO Spain where he specialised in the audit of international companies. Max, an old colleague of Fay & Co managing partner, Joseph Fay, is trilingual in Spanish, German and English.

"We were both brought up in an international environment and understand the cultural differences our clients face in their Spanish businesses," says Max. "Our job is to make them feel secure and to lead them in the right direction.

"Madrid will be the focal point for the marketing efforts of the Spanish UHY group led by Fay & Co. We have excellent associates to ensure geographical coverage, such as Auditores Asociados of Galicia in North-West Spain."

Fay & Co Madrid was appointed auditor of the Domund Pontifical Missions at a recent meeting of that

***'The clientele is still mainly international. This enables us to refer clients to other UHY member firms'***

important religious organisation. Bernard Fay, who is also chairman of the recently formed UHY marketing working group, is anxious to make his point: "As a marketing priority we shall be targeting other UHY members to maximise referrals to Spain."

- *For more information, contact Fay & Co in Madrid +34 91 426 07 23*

# Know-how is key

**Local management is essential in Spain to avoid legal, tax, labour and banking pitfalls - but make sure you agree the deal thoroughly before your business venture takes off.**

## Managers and advisers

Companies intending to set up business in Spain should consider carefully whether to send the entire management team from the parent company, send a managing director and expect him to find the rest of the team in Spain, or employ a local managing director and get him to recruit his team locally.

The last two alternatives often prove to be more successful than the first – it is often better to rely on local management as they are in their country, they have the know-how, the contacts, the language and culture and it is cheaper for the company.

Spain presents many differences in legal matters, taxation, labour relations, banking and aspects of accountancy. It is essential to obtain sound advice, preferably before any business venture begins. The cost of the services and conditions of payment should be clearly set out and agreed before any work is undertaken. It is quite normal in Spain for certain professions to base their fees on a sliding scale as a percentage of the transaction that is being conducted.

## Employment

Since 1992, there has been no requirement for a work permit for EU nationals in Spain. If they stay for more than three months they will have to apply for an EU residence authorisation which is granted as a matter of course.

Labour relations in Spain require expert advice in order to minimise costs and take advantage of any incentives available for the creation of employment.

## Subsidies and grants

**Before any investment is undertaken, the company should see if it is eligible for any grants in Spain. These are usually aimed at companies intending to establish themselves in underdeveloped areas, with high unemployment or with industrial crisis. An equity investment of at least 30% is usually required. There are two main types of incentives:**

- Regional incentives – which are controlled by the central government and can take the form of a non-returnable grant in cash which can vary between 10 and 15% of the local investment and in some cases can exceed this percentage.
- Subsidies given by the Autonomous Communities – which are usually in the form of a loan interest subvention.

If the investment is eligible, no disbursement should take place before the application is filed. Amounts invested before the application will not be considered part of the investment for the purpose of grants.

## Tax

Any company's requirements must be studied carefully by professional advisers in order to establish the most effective tax structure and strategies.

It is important to keep a balance between the capital of the company and other financing. Interest on loans exceeding three times the company's equity can be treated as dividends or distribution of profit for tax purposes, and not as a deductible expense. Alternative courses of action include back-to-back loans with a bank in Spain on the basis of a foreign bank guarantee, or converting the inter-company loan into capital.

Spanish legislation on benefit in kind is similar to other countries – the private use of a company car or accommodation is taxed at source for the employee at the same rate as his other income. If it can be proved that the company car is only used for work, then the tax authorities will not be able to deem

the car as a benefit in kind.

All Spanish tax declarations are made by the taxpayer without negotiation with the tax office; filing a tax declaration does not imply its acceptance by the tax authorities.

Depreciation rates for tax purposes are set out in tables issued by the tax office. Assets can be depreciated at double the normal rate.

Tax deductions take two forms in Spain – deductions from taxable income and deductions from the tax payable. There are deductions of both types in personal and company taxation.

If you have a build-up of reclaimable VAT, remember VAT reclamations can only be made after the year end in Spain, unless the company is registered with the special register of exporters.

## Statutory requirements

The two main types of Limited Liability Companies are the Sociedad Anónima (SA) and the Sociedad Limitada (SL). The former must have a minimum share capital of Ptas 10.000.000 with a minimum of 25% paid on incorporation – while the latter requires a minimum fully paid capital of Ptas 500.000. All companies must be incorporated before a public notary. The foreign investor may prefer to carry on the Spanish business through a branch.

Since 1990, Spanish domestic law has incorporated the rules and regulations of the EU's Fourth Directive on accounting and reporting requirements, of the EU's Seventh Directive on consolidated accounts for groups of companies, and of the EU's Eighth Directive on the control of accounts and external audit.

All businesses are required to keep adequate accounting records in accordance with the Code of Commerce and the Spanish General Accounting Plan.

# Real estate in Europe

There is one area in Europe which definitely stands to be unified by the Euro. This is the real estate market. Real estate to date has been one of the most national of markets, with prices in one European country having little relationship with those in another. Prices in northern European countries have been higher than those in the south. This is one of the reasons why so many people have holiday homes and second residences in Spain and Portugal.

The Euro will convert these national markets into one European market. So, a German citizen investing in a Spanish property no longer has to change his money into pesetas. This will remove previous risks such as the threat of another country's currency being devalued. That could have meant receiving fewer Deutschmarks upon the sale of the property even if it had appreciated in terms of the peseta.

"The currency risk disappears with the introduction of the Euro," says Bernard Fay, from Fay & Co in Marbella. "Europeans can now invest in Euros. If the property now rises in value in Spain, it rises in terms of the Euro."

It is expected that the Internet will play an increasingly important part in this scramble for the best deal. Real estate price lists will be regularly updated. Websites will cover other issues such as long-term financing for real estate sales and short-term commercial credit.

## UHY member firms

**For more information on UHY, in the first instance, please contact your local member firm.**

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