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How the New Minimum Wage Could Give Your Margin Financing the Squeeze

Karen R. Kimel, MAcc, CPA, CA, CPA(IL), CIRP, LIT, Leader of Business Modelling

Security firms, cleaning companies, maintenance and landscaping crews. If you run any one of these types of service businesses in Ontario—that typically operate with a large complement of minimum wage workers—the upcoming minimum wage hike may create significant challenges for you and your business.

> Even if you can pass on these additional labour costs to your customers, you will still need to take a close look at your financial forecast and your lending agreements for the first few months of 2018 to ensure you won't get squeezed.

The minimum wage in Ontario will increase more than 20 percent on January 1, 2018, from $11.40 to $14, followed by a further increase of 7 percent to $15 in 2019. Even if you can pass on these additional labour costs to your customers, you will still need to take a close look at your financial forecast and your lending agreements for the first few months of 2018 to ensure you won't get squeezed.

Typical asset based lending agreements reveal a potential shortfall

A typical asset-based lending agreement may allow you to borrow 80 percent of receivables to pay for expenses. If your monthly labour costs in 2017 are typically $1 million, the minimum wage increase of 20 percent will result in additional labour costs of $200,000 per month. Even if you pass the costs on to your customers, bumping up sales by $200,000, you will only get additional margin availability of $160,000 to cover the extra $200,000 in labour costs. This leaves you with a $40,000 shortfall that you'll have to fund in the current month to pay your weekly or bi-weekly employee paycheques, until your receivables come in. If your average collection cycle is 60-90 days, this shortfall will continue to increase by 2-3 times over the first quarter of 2018 and will take the second quarter to correct itself.

For companies facing payment cycles that can run three to six months, the impact can be significant. If you're managing shorter cash conversion cycles, say, four to eight weeks, you'll be in a better position to get back on track with your cash flow more quickly, but you still may face several months of a margining "bulge" that you'll have to overcome to keep your business operating smoothly.

Approach your lender from a position of strength

There are several options for funding the bulge including using your own personal equity to get the business through the first few months of 2018 and taking it back once you're no longer in the red. This may be necessary if your bank won't provide the additional funds you need to make it through the temporary bulge period.

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Another option is to take a proactive approach now and create a well-developed financial model for your business. Developing a comprehensive model that shows your lender your income statement, cash flow, balance sheet, and borrowing base calculation for those first few critical months will demonstrate that you've taken the steps to analyze the impact of the minimum wage increase on your cash flow, and how long it will take you to get back on track.

Lenders: Don't hit the panic button!

Sophisticated lenders should know the upcoming wage increase could have an impact on clients in these types of businesses and should anticipate receiving additional funding requests from them to help manage the situation. They shouldn't hit the panic button on these loans too soon, unless they suspect a company has a fundamental issue in its ability to pass on these added labour costs to its customers.

Add credibility to your funding proposal

Getting an independent third-party to assist with your forecast can help you reap the most benefits, not only providing you with an integrated model so you can see what's happening to your cash, working capital, and borrowing base—and for how long—but also adding credibility.

In fact, getting a firm that is known to lenders in Ontario—that can look at your situation from a business perspective and can create a monitoring plan so lenders can track your progress—can help you gain a more favourable outcome from your lender and ensure you get through the wage increase without getting squeezed.

Karen Kimel is a Vice President with the Insolvency & Restructuring practice and is also the leader of the Business Modelling practice at Farber Financial Group. Karen can be reached at 647.796.6022 and kkimel@farberfinancial.com.