



FINANCIAL HEALTH ASSESSMENT

Best Practice

How do we measure the Financial Health of a business?

A healthy business is more than sales and or profits. A healthy business is only healthy if it can get the key success drivers aligned in such a way that it creates wealth for the owners of the business, whether these owners are shareholders of a publicly listed company or the shareholders of a private business.

The key drivers for success have been the topic of numerous research and what every business owner, business student, investor and politician would like to define.

What Metric Should Be Used?

Over the years many metrics have been invented or devised by countless numbers of business owners, accountants, economists, financiers and bankers all of which attempt to measure the financial health of a business. The only true metric of economic performance is whether a business is creating or destroying value. Regardless of the firm's strategy, products/service offering & competitive strengths, the only important thing is whether your business is creating or destroying Economic Value. A business's financial health is the end product resulting from the crafting of strategies that have been successfully executed by talented employees as summarized in Diagram 1.



What is Wealth Creation?

A business only creates value if the return it achieves on invested funds (total capital employed) is greater than the cost of those invested funds. Most businesses now days utilize a mix of debt and equity as its invested funds, that is, Total Capital Employed must equal the source of these funds which usually is a mix of Debt and Equity.

Why is Economic Value important?

If a business is achieving returns that is less than its cost of capital, value is being destroyed and the business owners are not adding wealth. There is a direct relationship between value creation and business owner's wealth. This concept is the same as borrowing money from your bank at say 10% and investing it into your business which produces a return of only 5%. Clearly, the business is destroying value to the tune of 5% times the amount borrowed.

The Cost of Capital

The cost of capital is determined by calculating the weighted average cost of the Debt and Equity used by a firm in its invested capital. What we want to know is whether the business is producing a return that is greater than this weighted average cost of capital. To develop value creating strategies the firm needs to identify its key economic drivers. Successful firms link value creation to ALL decision making and performance incentives. The above cannot be achieved without focusing on the human talent employed by the firm.

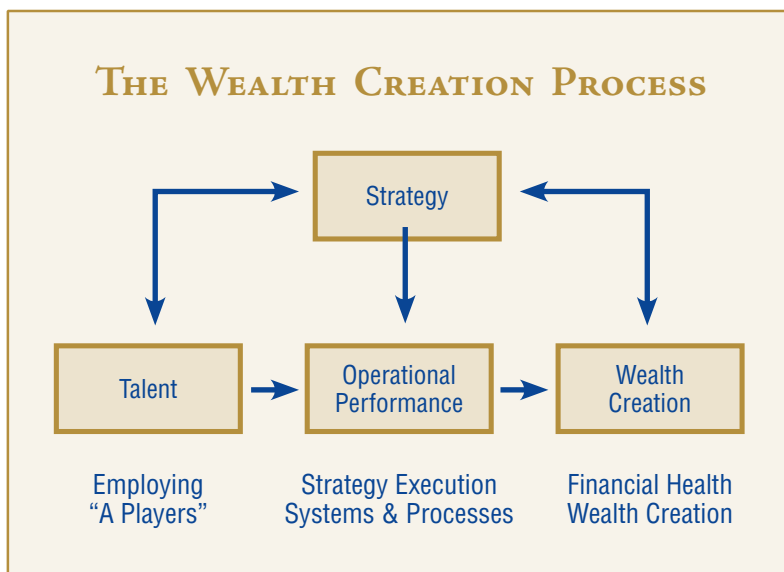


Diagram 1



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How does a FHA increase the Wealth Generation of my Business?

Equilinx undertakes a Financial Health Assessment (FHA) using specific software that analysis whether your business is creating or destroying value. We like to do this using the last 3 years financial accounts to identify trends. We next analysis your plans looking forward. The result of this analysis is a FHA report which identifies whether your business is:

- ❖ Creating or destroying value.
- ❖ Generating positive cash flow.
- ❖ Competitive in terms of a comparison with your Industry benchmark.

The FHA report also identifies:

- ❖ Your business's key value drivers.
- ❖ Safety margin.
- ❖ How sensitive your business is to key drivers.

We highlight problem areas that require addressing and solutions that if implemented effectively will ensure that your business is creating owner wealth.

How can the results obtained from a FHA be used?

An Equilinx FHA report will be used to:

- ❖ Develop financial strategies that create value and increase owner wealth.
- ❖ Develop budget forecasts.
- ❖ Improve cash flows.
- ❖ Provide the basis for a manager and employee incentive scheme directly linked to the value creation process.
- ❖ Measure and monitor investment decisions.
- ❖ Measure and monitor employee performance.
- ❖ Reduce financial risk.
- ❖ Identify the optimal capital mix.

What do I need to do now?

To effectively implement FHA – Best Practice within your organization contact Equilinx to arrange an obligation free presentation of the Equilinx FHA – Best Practice Program on your premises.

