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ENTERPRISE RESTRUCTURING AND PRIVATIZATION:

Delivery Order #11
Chemko Phase II

FINAL REPORT:
Principal Conclusions
Arising from the
Business and Financial Review
of Chemko Strázske s.p.

Coopers
&Lybrand

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Ing Jaroslav Giláni
Chief Executive Officer
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31 August 1994

Dear Mr Giláni,

We have pleasure in submitting our principal conclusions arising from the work of Coopers & Lybrand and Vector Associates. Our detailed reports are enclosed with this summary.

This summary report is set out in the following sections:

I) Executive Summary of our financial analysis and restatement report

II) Strategy options for the two main business areas, benzene and aldehyde chemistry

III) Financial implications and future prospects

Copies of our reports have also been provided to USAID and to the Ministry of Economy. The Vector Associates' reports are still in draft pending receipt of your comments.

Please let me know when we can expect to receive your draft business plan in order for us to comment on the best presentation.

I would like to thank you and your fellow directors and staff for the assistance provided to us in the course of our work.

Yours sincerely

Caroline Woodward

VAT Reg. No. (DRČ) 31353517/600

Executive Summary

General

1 Chemko š.p. ("the Company") manufactures chemical products for industrial use.

Divisional analysis

2 In this report we have analyzed and restated in accordance with International Accounting Standards ("IAS") the balance sheet at 31 December 1991 and the financial data for the two years ended 31 December 1993 for the principal divisions of the Company. Although our analysis indicates that the Company and certain Divisions have financial difficulties, all information is prepared on a going concern basis. The Divisions which are covered by this report are as follows.

Division	Main product(s)
Cyclo products	Cyclohexanone
Glues	Industrial glues
Penta	Pentaerythritol
Low Volume products	Dastib, Diamine

3 The above divisions were identified by management as representing the core business of the Company. We have not restated the financial statements of the Company as a whole.

4 Management originally requested that the financial data of Dastib and Diamine be separately analyzed. However, in view of the small numbers involved and the practical difficulties of separating these products, management later decided to present them together.

5 The Company's financial data was allocated to Divisions by the Company's staff. The basis for this allocation is set out in section I.

Scope of work

6 We have made certain adjustments to the financial data to present it in accordance with IAS. The adjustments were made at Divisional level. As part of our restatement we have reviewed the Company's financial statements to ensure that amounts were allocated to Divisions correctly. We have not performed a full restatement of the financial statements of the Company as a whole, because the purpose of this report was to provide Divisional data and analysis. However, where during the course of our review adjustments required at Company level were identified we made those adjustments to the financial statements.

7 We have not performed any audit procedures nor carried out due diligence. We have relied exclusively on information provided by management and their staff.

Profit and loss account

8 We summarize below the restated profit and loss accounts of the principal Divisions for 1992 and 1993:

1992	Low Volume 1)	Penta mil Kčs	Glues mil Kčs	Cyclo mil Kčs
Turnover	N/A	214	530	1,188
Gross profit	N/A	62	121	150
Operating profit/(loss)	N/A	10	55	(41)
Profit/(loss) before tax	N/A	(1)	34	(85)

1993	Low Volume mil Sk	Penta mil Sk	Glues mil Sk	Cyclo mil Sk
Turnover	47	207	487	965
Gross profit/(loss)	17	74	142	(49)
Operating profit/(loss)	(5)	7	19	(333)
Profit/(loss) before tax	(22)	2	8	(364)

1) The main products in this Division are Dastib and Diamine. The production and sale of these products only started in 1993.

9 The most significant feature is the poor performance of the Cyclo Division in 1993. This was mainly due to three factors:

- a fall in world sales prices, which was not matched by cost reductions in the production inputs,
- an inefficient production process which requires approximately a 10 per cent higher level of inputs than technology used by competitors,
- an increase in the provision for doubtful accounts receivable of 84 million Sk.

10 The market for Cyclo products is analyzed in the marketing review from Vector Associates. The report concludes that an upturn of the market is unlikely within the next 2 to 3 years.

11 The efficiency of the production process was discussed with management. They estimate that with improved supply lines and investments of some 100 million Sk, maximum improvements of up to 5 per cent could be made. At current price and production levels this would lead to an annual saving of some 50 million Sk with regards to material and energy usage. If such savings were realised the Division would break even at gross profit level, but it would still incur significant operating losses if the existing level of overheads continues to be charged.

12 With regard to the bad debt position we note that the level of amounts outstanding from customers has risen further since 31 December 1993. The Division has thus not yet been able to reduce its exposure to bad debts.

13 Based on the above data it appears that the prospects for the Cyclo Division are poor. The report from Vector Associates discusses strategy options for this Division for both the long and short term including either temporary or permanent plant closure. For a more detailed analysis of the profitability of the Cyclo Division and the potential financial impact of a plant closure we refer to Section II of this report. We note however at this point that closure would involve significant one off costs, which will include the following:

- write down of assets to realisable value, which is likely to be substantially lower than book value
- restructuring remaining operations
- redundancy costs for employees
- settlement of existing liabilities of the Division

14 The Glue and Penta Divisions operated at a modest profit during 1992 and 1993. In both Divisions, however, profits have been reduced in 1993 through an increase in the bad debt provision. We recommend that the Company takes measures to improve its credit control. We further note that during 1994 the cost of methanol, a raw material used in both Divisions, increased significantly. Because both Divisions were slow to charge higher prices to customers, profitability in the Penta and Glue Divisions have reduced during the first half of 1994.

15 The Low Volume Division commenced production in 1993 of two new products, Dastib and Diamine. Both products are sold at a high margin. However, due to very low utilisation of capacity in 1993, the division incurred an operating loss. The situation was unchanged during the first half of 1994. The future profitability of this Division depends entirely on the success of the Company in marketing these products.

Balance sheet

16 We summarize below the restated balance sheets of the Divisions as at 31 December 1992 and 1993:

1992	Low Volume	Penta mil Kčs	Glues mil Kčs	Cyclo mil Kčs
Fixed assets	N/A	32	25	412
Current assets	N/A	52	136	346
Current liabilities	N/A	(36)	(128)	(376)
Amounts payable after one year	N/A	-	-	(39)
Net assets	N/A	48	33	343

1993	Low Volume mil Sk	Penta mil Sk	Glues mil Sk	Cyclo mil Sk
Fixed assets	160	44	31	377
Current assets	33	75	218	591
Current liabilities	(33)	(47)	(189)	(664)
Amounts payable after one year	(25)	-	-	(58)
Net assets	135	72	60	246

Fixed assets

17 The plant in the Cyclo Division was purchased in 1984, and at current depreciation rates will be fully depreciated in 1997. As mentioned above, the technology used requires approximately 5 to 10 per cent higher inputs than technology used by competitors.

18 Plant in the Glues Division and Penta Division was bought in 1974 and 1979 respectively and apart from subsequent additions is fully depreciated. The technology used in both divisions is comparable to that of competitors.

19 Plant in the Low Volumes Division is relatively new. Using the new technology, the Division claims it is now able to meet western quality standards.

20 In all Divisions management identified certain investments which were required in the short to medium term to improve the production process or to maintain competitiveness. These are summarised in the table overleaf:

Division	Investment	Amount mil Sk	Purpose
Cyclo	Modification of cyclohexanone recovery facility	100	Reduction of input requirements
Cyclo	Incineration of gases	45	Generation of energy from waste gases
Glues	Several projects	32	Improving of product quality
Glues	Water treatment plant	20	To treat waste water, presently treated centrally
Penta	Several projects	40	To maintain competitiveness
Low Volume	Storage tank hydrogen and nitrogen	20	Only required if Cyclo facilities would not be available
		257	

21 The above total of 257 million Sk represents management's estimate, but the Vector Associates report indicates that more substantial investments may be required to ensure the long term viability of the Company.

22 The Slovak financial statements included assets with a net book value of 78 million Sk which are not in use and recreational and accommodation facilities with a value of some 180 million Sk. We have written off these assets against reserves in the adjusted Company balance sheets at 31 December 1991, 1992 and 1993. Depreciation charges in the years under review were reversed out of the profit and loss account.

Stock

23 Stocks are valued at the lower of cost and net realisable value on a first-in, first-out basis. For the valuation of finished and semi-finished goods the Company uses standard costs which approximate to actual costs. Standards are calculated based on expected production levels.

24 Stocks held in the Divisions vary between 1 and 12 weeks of production and include no items for which provision is required for obsolescence. A provision of 5 million Sk was needed to reduce the Cyclo division's stock to net realisable value.

25 We note that the Slovak financial statements included spare parts held in other Divisions of the Company with a value of 10 million Sk, which are considered obsolete or redundant. We have excluded these assets from the adjusted Company balance sheets.

Trade debtors

26 Trade debtors in the Divisions under review (before bad debt provision) are summarized below:

	Low Volume mil Kčs/Sk	Penta mil Kčs/Sk	Glues mil Kčs/Sk	Cyclo mil Kčs/Sk
At 31 December 1991	N/A	6	96	83
At 31 December 1992	N/A	37	135	213
At 31 December 1993	11	71	261	518

27 All Divisions showed an increase in the level of trade debtors despite falling sales. This trend continued in 1994.

28 We have discussed the level of provision for bad debts with management. Based on the increase in gross debtors and an assessment of the outstanding amounts management advised us to calculate a provision for bad debts on the following basis:

i) a specific provision of 100 % against all outstanding amounts in court, from customers in liquidation or other amounts considered as lost by the management;

ii) a general provision of 50 % against all debts unpaid for a period longer than 360 days;

iii) a general provision of 30 % against all debts unpaid for a period longer than 90 days;

iv) a general provision of 1% against all other debts unpaid at the end of each year.

29 The bad debt provisions calculated in this way amounted to:

	Low Volume mil Kčs/Sk	Penta mil Kčs/Sk	Glues mil Kčs/Sk	Cyclo mil Kčs/Sk
At 31 December 1991	N/A	-	8	6
At 31 December 1992	N/A	4	20	8
At 31 December 1993	1	11	69	92

30 In our opinion these provisions are likely to be the minimum required and could be considerably higher.

Trade Creditors

31 Trade creditors in the Divisions under review are set out below:

	Low Volume mil Kčs/Sk	Penta mil Kčs/Sk	Glues mil Kčs/Sk	Cyclo mil Kčs/Sk
At 31 December 1991	N/A	12	29	60
At 31 December 1992	N/A	21	88	221
At 31 December 1993	4	15	65	399

32 The increase in trade creditors in the Cyclo Division reflects the difficult financial position of the Company. Due to recent losses and increasing amounts outstanding from customers the Company is short of cash to pay its suppliers. This has led both to interest costs being charged by suppliers and interruptions in the supply of goods thus aggravating the production inefficiencies.

BENZENE CHEMISTRY STRATEGY DISCUSSION

The attached Schedule 1 summarizes Vector's analysis of Chemko's benzene chemistry business' internal strengths and weaknesses, as well as the external opportunities and problems. This analysis and Chemko's current poor financial situation indicate that drastic actions are necessary in the short term to prevent failure of this business segment. The losses sustained by this segment also have a negative impact on the aldehyde chemistry business segment. The fundamental problems facing Chemko are: (1) the worldwide surplus of caprolactam capacity; and (2) the fact that Chemko and its customers are the marginal high cost producers of caprolactam.

Given Chemko's current poor financial condition and the likelihood of continued low caprolactam prices, Chemko is facing a shutdown decision of its benzene chemistry facilities in the next few months or even weeks. Under these circumstances, long range strategies and recommendations are of little benefit. The attached Schedule 2 summarizes both short term and longer term strategy options. Chemko recognizes that the first short term option of continuing business as usual and hoping for higher prices is not viable, given its circumstances. Therefore, they have initiated discussions with Chemipol in Prague in an effort to secure a more profitable arrangement with its largest customer, Spolana, and its raw material supplier, Litvinov.

Assuming Chemko is successful in these negotiations, some problems would remain to limit Chemko's return to a profitable position. These problems are outlined below:

- The proposed arrangement would only secure a maximum of 40,000 tonnes per year of anone sales. Chemko would need another 20,000 to 30,000 tonnes per year of sales to achieve a marginally acceptable operating rate of 67 percent to 78 percent.

- The proposed arrangement would not secure profitable caprolactam selling prices. These prices are now set by export market prices to companies like Chemlon. Export prices are DM 100 to DM 200 lower than contract prices. The combination of Chemko and Spolana need to obtain the higher contract caprolactam prices. Therefore, some arrangement with Chemlon appears necessary to give both Chemko and Spolana a higher contract caprolactam price.

If the efforts toward a joint venture and higher product pricing are not achieved i the next few months, Chemko is likely to be forced to shut down its benzen chemistry business. The Slovak Ministry of the Economy has asked Chemko management to identify what costs would be incurred to shut down the benzen chemistry facilities. Assuming that the salaries and benefits of those involved wit Chemko's benzene chemistry business were funded via a government safety net (social program, it is likely that there would be both a one-time and ongoing cos associated with a shutdown.

Estimating these shutdown costs was not part of Vector's scope of work. However, based on our experience for similar situations, it is likely that there would be an initial one-time cost to prepare the facilities for shutdown and, thereafter, some small monthly charges to maintain the existing assets in a safe and possibly operable condition. This would allow Chemko to get back into business, if and, when prices improved enough to support their production.

If Chemko is able to survive in the short term, they have proposed a series of projects that could improve the benzene chemistry's profitability. These projects would recover adipic acid and organic esters from the waste stream, which is currently incinerated. These projects would improve their anone manufacturing cost to near West European levels, but an estimated investment of approximately $10 million is required for implementation. Therefore, new investment would be required from some outside sources. Since these projects essentially recover by-products, the basic anone business needs to at least break even or be marginally profitable before any investor would consider funding these projects.

SCHEDULE 1

BENZENE CHEMISTRY FUNDAMENTALS
(Strengths, Weaknesses, Opportunities, Problems)

INTERNAL - STRENGTHS

1. Low fixed costs.
2. Relatively new plant.

INTERNAL - WEAKNESSES

1. High variable costs (i.e., benzene and steam usage).
2. Not integrated.
3. Major customers' maximum capacity 60,000 tonnes per year (i.e., Spolana and Zilina).
4. High new investment to bring up to West European standards.
5. Lower product quality.
6. Export sales channels compete with each other (i.e., Chemko, Chemipol, Marubeni).

EXTERNAL - OPPORTUNITIES

1. Spolana toll processing 10,000 tonnes per year of other producer's anone.
2. PCHZ Zilina - possible tolling to fill their unused capacity.
3. Specialty markets limited to 10,000 tonnes per year for:
   - Anol to adipic acid producers
   - Anol to cyclohexylamine producers
   - Miscellaneous solvents markets - smaller volume and higher quality required

EXTERNAL - PROBLEMS

1. Excess caprolactam capacity likely to continue indefinitely due to surplus in East Europe.
2. Large competitors restructuring to lower their costs after losses in 1992 and 1993.

SCHEDULE 2

BENZENE CHEMISTRY STRATEGY OPTIONS

SHORT TERM

1. Continue current approach and hope for higher caprolactam prices. ***(Vector does not recommend this option.)***

2. Combine with customers or competitors via:

   - Guaranteed cash cost supply contract.
   - Joint venture to integrate.
   - Purchase caprolactam producer assets and market position.
   - Sell Chemko assets to caprolactam producer/user.
   - Secure contract caprolactam prices instead of export prices.

3. Close down:

   - Temporary until market returns.
   - Permanently and sell assets for removal. ***(Limited window of opportunity based on new construction in Asia.)***

LONG TERM

1. Make modest investments to lower cost and reduce losses. ***(Look for 2 to 3 year investment payouts.)***

2. Convert plant to new higher valued product. ***(This option does not appear technically or economically feasible.)***

ALDEHYDE CHEMISTRY STRATEGY DISCUSSION

The attached schedule 3 summarizes Vector's analysis of Chemko's Aldehyde Chemistry internal strengths and weaknesses, as well as the external opportunities and problems. This analysis and Chemko's current poor financial situation indicate that drastic actions are necessary in the short term to prevent failure of this business segment. The major short term problems facing the aldehyde chemistry business are the inability to secure methanol raw material and overdue accounts receivable from prior period product sales. Both of these problems limit the functioning of this business segment, which through 1993 continued to be profitable.

Therefore, the short term strategy for this business segment should focus on improving cash flow by securing raw materials credit, raising product prices to reflect higher raw material prices and improving accounts receivable collections. Longer term actions should be directed to seeking an outside investor who could provide support for the following activities:

- Securing long term credits for methanol purchases.
- Building or providing the marketing expertise to directly sell exports to end-users.
- Capital funding to modernize the Pentae and HMT facilities.
- Capital funding to expand the aldehyde chemistry product line to materials like melamine - formalin resins, which could take advantage of Chemko's existing production facilities.

The most important action necessary to attract an outside participant to the aldehyde chemistry business is the resolution of short term problems. There also must be a resolution of Chemko's short term benzene chemistry business problems, because that segment's financial performance is negatively impacting Chemko's ability to successfully conduct its other businesses.

SCHEDULE 3

ALDEHYDE CHEMISTRY FUNDAMENTALS

INTERNAL - STRENGTHS

1. Low formalin production costs due to lower fixed costs.
2. History of profitability.
3. Most of products sold in export markets.

INTERNAL - WEAKNESSES

1. Methanol supply problems due to Chemko financial condition.
2. Depending upon the product, raw material and steam consumptions are 5 to 15 percent higher than West European standards.
3. New investment will be required to upgrade Pentae and HMT facilities.
4. The HMT production activity is unprofitable due to:
   - Lower export prices than European competitors.
   - Low sales at 25 percent capacity.
   - Higher raw material consumptions.
5. Glue sales concentrated in only two urea-formalin grades and at lower export prices than European competitors due to weak Chemko marketing position.
6. Product quality and reliability of supply often mentioned by Chemko customers, (i.e., Chemko lacks ISO 9000 certification.)
7. Glue, HMT and Pentae export sales handled by others, which results in lower product prices.

SCHEDULE 3
ALDEHYDE CHEMISTRY FUNDAMENTALS
(Continued)

EXTERNAL - OPPORTUNITIES

1. Possible expansion of glue product line to include melamine-formalin resins and different grades of phenol-formalin products.

2. Expand and upgrade Pentae production and marketing. Current short term shortage of glycerin has created strong worldwide pentae demand.

3. Joint venture opportunities for glues and Pentae appear possible given market conditions.

EXTERNAL - PROBLEMS

1. Worldwide methanol supplies likely to remain tight over next two years due to MTBE. Therefore, methanol prices are likely to remain close to current historically high levels during the period of tight supply. This will negatively impact profit margins for aldehyde chemistry products.

2. Glues, pentae and HMT production in West Europe and U.S. controlled by 4 to 6 companies, which are able to use their marketing expertise to obtain higher prices than Chemko.

3. Aldehyde chemistry products are mature markets with slow growth of 1 - 2 percent per year. These markets are heavily influenced by U.S. and West European economic cycles, especially in the construction and automotive sectors of these economies.

SCHEDULE 4

ALDEHYDE CHEMISTRY STRATEGY OPTIONS

SHORT TERM

1. Obtain credit to secure raw material supplies.
2. Raise product prices to pass through higher methanol prices.
3. Improve accounts receivable collections to maintain cash flow.
4. Attempt to direct market export sales to improve prices.

LONG TERM

1. Seek outside investor/owner with strong marketing and credit to provide the following:
   - Secure lower cost raw materials.
   - Direct export sales to end-users to obtain higher export prices.
   - Capital to:
     - Modernize Chemko's Pentae and HMT production facilities.
     - Market and manufacture other higher valued products like melamine - formalin resins.

Chemko š.p.

Financial implications arising from our review and future prospects

- The Company has a critical cash flow position

- Decisions need to be made quickly about the Cyclo Division which is proving to be a drain on the Company's resources

- The smaller divisions are generally trading healthily and have the potential to attract foreign or domestic investment

- Interest has already been expressed by one foreign company in the glues division

- The business plan for the different divisions should be prepared as soon as possible using the guidance provided to you. We are happy to provide whatever further assistance that you need.

17

Coopers
&Lybrand

Preparing a business plan

Solutions
for Business

11

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BEST AVAILABLE DOCUMENT

Introduction

Whether you are just starting out in business, or have been building up your business for several years, you will need to plan for the future and this can best be achieved by developing a well thought out business plan. The preparation of a business plan will help you focus on just where your business is now, where it is going, how it will get there and what steps must be taken in order to maximise your chances of success. In short, a well-prepared, concise business plan is a tool which will help you to run your business more effectively.

You will also find that the preparation of a business plan is the first step to be taken when seeking funds from providers of finance such as banks and venture development capital institutions, whether those funds are required to finance short-term working capital needs or represent longer term funding needed to allow your business to expand.

Writing a business plan

This booklet sets out the basic rules for writing a business plan and will help you to draft a plan for your business. In writing this guide we have drawn upon our professional experience in helping businesses to produce clear and logical business plans. It is important to realise however that, like people, all business plans are different. Each must be tailored to the needs of the individual business and show clearly the main purpose for producing the plan.

The business plan must portray your business in a way which captures uniquely its essential characteristics so that interested parties can see why it is likely to be successful. It should also provide a framework to monitor the performance of the business, and with which to make sound business decisions.

In many cases the business plan will be read by people who know very little about your business or industry. You should, therefore, avoid jargon and obscure technical terms and write in a style which is concise yet informative.

How Coopers & Lybrand can help

Coopers & Lybrand is one of the UK's leading firms of chartered accountants and management consultants. We have specialist teams who understand your business and the issues/risks affecting it, who can provide you with constructive and proactive advice on how your business can be improved. Also, because we are one of the world's leading professional services organisations, we are able to combine our international capabilities and local market knowledge with our extensive range of skills and industry expertise, if appropriate.

In particular, we have contacts with a vast range of financial institutions, including banks, leasing companies and venture capitalists. Our experience enables us to help you identify appropriate institutions for particular situations and to make introductions at a senior level.

Outline structure of a business plan

Your business plan should follow a format which is broadly in line with the following structure

- *Executive summary*
- *Index contents page*
- *The proposal*
- *Introduction background information*
- *The service or product*
- *The market and your marketing strategy*
- *Management*
- *Strategy for future development*
- *Summary of financial information*
- *Appendices*

The guide examines each of these areas, and describes the basic information which should be included within each section. We must stress, however, that there is no substitute for independent professional advice, especially for 'fine tuning' the plan and in subjecting it to the sort of scrutiny which outsiders will undoubtedly give it. This is an area in which we can help.

Executive summary

The executive summary is a brief synopsis of the rest of the document. For this reason it can only be written once the plan has been completed. The purpose of the summary is to give the reader an overview of the business and it must do this clearly and concisely in a way which makes the reader:

- *realise why you have so much enthusiasm for the business*
- *begin to share in that enthusiasm*
- *become aware of the potential for financial returns.*

The importance of the executive summary cannot be overestimated. Particularly in situations where the plan exists to help secure additional funding, the potential financier must be shown the attractions of the business immediately and encouraged to read the full plan.

The executive summary should not normally cover more than two pages of text. It should be set out in paragraphs of approximately equal length which follow the headings of the plan proper.

It is helpful to outsiders to add a further page at this point in the business plan, giving particulars of your business and its advisers. The following headings should be used as a guide:

- *Name of business*
- *Names of directors/proprietors*
- *Location*
- *Bankers*
- *Financial advisers*
- *Auditors/accountants*
- *Solicitors.*

Preceding the executive summary there should be two short statements, on separate pages. The first should state to whom the document is addressed and the second should describe who has prepared the document, stating where relevant that the document is a business plan and that it should not be considered to be a public invitation to subscribe for shares.

The following are examples of suitable formats for each of the above:

- *XYZ Bank*
  1 King Street
  London
- *This memorandum is for the exclusive use of the named addressee. It is not, under any circumstances, an invitation for public subscription and may not be circulated or reproduced.*
- *This document has been prepared by the directors of ABC & Co Limited and is intended to summarise their business plans for that Company.*

  The directors of ABC & Co Limited have read this document carefully and have taken all reasonable care to ensure that the facts stated therein are true and accurate in all material respects. It should, however, be stressed that this document is intended only as a preliminary explanation of the business. In particular the financial information should be regarded only as an indication of the expectations which the directors hold for the business.

  The directors and their advisers are responsible for the form and content of this document but take no responsibility for the accuracy of the information or opinions contained therein. Any persons considering making an investment in the Company on the basis of the information contained in this document are urged to make their own investigations and form their own opinion on the Company and its prospects.

  This document is a business plan and not a prospectus, and should not be considered to represent a public invitation to subscribe for shares.

If it is intended that the business plan be used to raise funds in the form of an investment, ie shares or debentures, advice should be sought on whether there are any restrictions on the distribution of the documents arising from the provisions of the Financial Services Act 1986.

Index/contents page

A well-structured index will show at a glance what the document contains and where various information about your business can be found. (The index should cover not more than one page and should be clearly spaced.)

Each page of the plan should be numbered and each separate section within the plan should be identified by Roman numeral, allowing individual paragraphs in each section to have a unique reference number. Thus, for example, section IV, 'The market and your marketing strategy', might be shown in the index as being on pages 8 and 9 and within paragraphs 401 to 420.

Proposal

At the outset, the reader will need to know whether your business plan is being written primarily to help raise additional funding, to finance working capital requirements, such as debtors or stock, or to obtain longer term finance to enable the business to expand, or to make an acquisition.

This section should allow the reader to appreciate the amount of funding you are looking for, its purpose, and if possible, suggest the most suitable method of funding, eg equity participation, long-term loans, overdraft facilities, etc. It is usually helpful to cross-refer to the other sections of the plan, particularly those which address financial matters and projections.

By giving the reader a succinct proposal, your needs will be borne in mind at the outset, and the reader is able to review the rest of the plan knowing precisely what your business is looking for.

As a guide, this section should not normally be longer than half a page of text, and the requirements must be set out in a way which is both accurate and readily understood.

Introduction/background information

The plan can now address your business in more detail. The reader will have already appreciated the main features of the business and will want to find out more.

The introduction should include the following information as a minimum:

- *history of the business*
- *key personnel*
- *financial history of the business*
- *present financing arrangements.*

The reader should be given enough information to understand how and why the business has developed. The introduction should not be a definitive history of the business, but it must include key information on when the business started and how it has progressed since.

For a new business, the introduction will, of course, change in emphasis. It will focus upon the factors which have led to the need for the new service or product and identify, in outline terms, how your business will meet that need.

We recommend that this section covers not more than one page of the document.

The service or product

You can now describe exactly what your business does. What service do you provide? What do you make? Use this section to tell the reader why your service or product is successful, or why it will be successful. Describe your service or product in some detail. Point out the essential characteristics which make it special. You should also include information about the means of production or the means by which the service will be provided.

It is important to use terms which are easily understood. Make sure that the reader can appreciate any technological advantages, for example, in a way which does not presuppose particular technical knowledge.

It should be possible to provide an informative but concise picture of the service or product within two pages of text. The following list of points for inclusion should be helpful:

- *services provided/product range*
- *technological or other advantages*
- *research and development work*
- *manufacturing process*
- *source of, and security of, supplies of labour and materials*
- *accommodation requirements.*

More detailed information on the service or product, for example in the form of promotional literature or technical specification sheets, can be included as an appendix to the business plan.

The market and your marketing strategy

This section is often particularly difficult to write. You will have to demonstrate that there is a need for your service or product and to show that you understand the market forces which drive that market.

You must avoid the trap of allowing your own enthusiasm for the business to give rise to overoptimistic expectations about the size of the potential market, the projected growth in that market, or your expected share of the market. You should be as objective as possible to allow outsiders to appreciate that your business plan is both realistic and credible, and you will find that independent professional advice when writing this section of the business plan will be of considerable help.

This section of the business plan should address the following matters:

- *overall market size and future growth prospects;*
- *your business' present share of the market and possible changes in that share;*
- *any statistical information and market research data which is available on your customers and competitors;*
- *your customers, actual and prospective, who they are, why and how they buy and the means of distribution;*
- *the competition, actual and prospective, who they are, how strong they are, their pricing and marketing strategies;*
- *any distinct competitive advantage you believe you may have over your competitors;*
- *your marketing strategy, including pricing policies, plans for advertising and promotion, and the image of your business;*
- *your future marketing plans.*

Within two or three pages of text you must show why potential customers will use the service you provide or purchase your product. The business plan must demonstrate that your business has the ability to meet the market's needs effectively, and that you can exploit the market forces which are in play.

We have found that interested parties, with very good reason, focus keenly upon this section when assessing the merits of a particular business.

Management

This section is, without doubt, the single most important part of the document. Potential financiers regularly judge a business on the basis of the following factors shown in order of importance:

- *the management*
- *the market*
- *the service or product*
- *profitability.*

Your business plan must demonstrate that you and any other key members of your team have the ability to operate a successful business. Outsiders will look for an indefinable combination of technical expertise, management skills and relevant track records which together indicate that your business is run by individuals with the management, technical, marketing and financial acumen to ensure that it has the best chance of success.

We recommend that you include brief curricula vitae, of say two or three lines, for each key individual and that full CVs should be included in the appendices to the overall plan.

Very often, certain key skills may be missing, or weak. You should be honest about this and state how you intend to fill any gaps. For example, you might choose to use independent financial advisers during the early stages of the business and then plan to recruit your own financial expert when the business reaches a certain size.

It is also important to show how individuals are committed to the business. The business may have a profit-related remuneration structure or bonus system or, in the case of a limited company, have share options for key personnel. Similarly, individuals may have made a personal financial investment in the business. These factors will help to show outsiders that the key individuals are dedicated to the success of the business and will therefore be motivated to achieve that success.

Key points for inclusion are as follows:

- *organisation chart*
- *very brief CVs of senior management*
- *brief details of any non-executive directors*
- *workforce qualifications and skills*
- *contracts of employment - brief details*
- *methods of remuneration and incentive schemes.*

As a broad guide this section might cover two sides of text.

Strategy for future development

By this stage of the business plan the reader will understand what you sell or make, the way the company has developed, the current situation of the company and the people involved. What you now have to do is convince them that the company has a viable and profitable future and try to encourage them to share in this future.

We suggest that the following topics should be considered and expanded upon to achieve the desired effect:

- *plans for expansion*
- *the growth potential of the business*
- *planned increases in profitability*
- *planned additions to services or products*
- *acquisitions of other companies*
- *strategy for investor 'exit' (if applicable) eg trade sale, flotation.*

A paragraph should be devoted to each of the above topics, as appropriate, so that the section covers about two pages in total.

Ideally, this section should also cover your own personal objectives, as well as your plans for the future of the business. This will give the reader a clearer idea of how you wish the business to develop, and how you see your own role in its development.

When structuring your plans you should bear in mind that potential investors will themselves be looking to the future to determine how, over what period, and by what means they will be able to realise their investment. Much will depend upon the nature of the potential investor's own business, therefore this should be given careful consideration.

Summary of financial information

Finally, your business plan must address the hard reality of financial matters. The financial projections provide outsiders with a way of deciding between various investment opportunities and they provide you with a measuring stick against which to gauge the actual performance of your business against its budgeted targets.

In order to develop profit and loss and cash flow projections, out of which will flow the projected balance sheets, you must make certain assumptions about sales levels, costs of sales, overheads to be incurred, credit terms from your suppliers, collection periods from your customers, taxation, and so on. It is vital that the assumptions made are realistic, and that the reader can identify and assess the assumptions easily.

We recommend that this section of the business plan should include only summarised historic information and forecasts, and the key assumptions made, with detailed projections and a detailed list of assumptions being included in the appendices to the plan. The appendices to this guide provide pro-forma layouts for financial projections.

The period over which you will need to spread your business' financial projections will depend upon the reasons for preparing the business plan. The following may provide a general guide:

Year 1: Monthly profit and loss and cash flow projections

Year 2: Quarterly profit and loss and cash flow projections

Year 3: Annual profit and loss and cash flow projections

Balance sheets should be produced as at the end of each financial year, or more frequently if applicable.

The use of computerised spreadsheets in developing financial projections can make the whole process much simpler, particularly with respect to looking at 'best case' and 'worst case' projections. The 'sensitivity analysis' should be used on all projections and a summary of profit and cash flow peaks and troughs given to show the results of varying assumptions.

The figures will not, of course, stand on their own. This section should also provide a detailed commentary on what they mean, and what the key operating ratios and comparisons show about your business. It is by using certain key statistics that readers will judge its financial merits.

In addition, and especially where the business plan is being used to raise venture or development capital funds, you should give a preliminary assessment of the returns which such institutions would be likely to receive on their investments from the projections made by the company.

Finally, your will need to address the taxation implications of your proposals.

Our specialists can be of paramount importance throughout this section, both in providing expert guidance and advice, and in actually helping you to develop and refine the projections.

This brochure aims to provide general guidance only, and does not purport to deal with all possible questions and issues which may arise in any given situation. Should the reader encounter particular problems he is advised to seek professional advice, which Coopers & Lybrand would be pleased to provide.

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Appendices

The appendices should normally only be used to provide detailed information which has been summarised elsewhere in the business plan.

Commonly included in the appendices will be the following information, although this list is not exhaustive:

- *curricula vitae for key individuals*
- *detailed financial information*
- *key assumptions used to produce the financial information*
- *brochures and other business literature*
- *technical specifications/promotional literature.*

It is not helpful to use the appendices to your business plan as a filing area for extraneous information. The appendices are an integral part of the plan and they should reflect only that information which has a direct bearing on summary information given elsewhere in the plan. Use them wisely and bear in mind that quantity is not generally the same thing as quality!

General tips on writing a business plan

If prepared properly, the business plan will be a useful tool in focusing management's efforts towards the company's key objectives. It is important, therefore, that sufficient time and effort is taken in preparing the plan so as correctly to identify the key objectives and the manner in which these can be achieved. The plan must not be seen as a static document. Changes in the management's objectives should be reflected in an updated plan. Listed below are a number of points to bear in mind when producing the plan:

- *the length will depend on the complexity of the business and the reasons for producing the document. However, business plans are typically 15 to 20 pages long excluding appendices;*
- *include a contents page and number each page and paragraph – this makes it easier for the reader to find their way round the plan;*
- *prepare the executive summary last – this should give the reader a clear, concise overview of the business and encourage them to read the rest of the document;*
- *avoid jargon and obscure technical terms, write in a style which is concise yet informative;*
- *summarise and simplify in the main body of the plan – using graphs, tables and charts can replace large amounts of text – relegate as much detail as possible eg technical specifications, full CVs, to appendices;*
- *include summaries of the latest and historic statutory and management accounts and justify all key assumptions used in the projections (detailed figures should be included in the appendices);*
- *identify and attempt to address any weaknesses that are apparent to you – do not try to hide them;*
- *the plan should be coordinated by the person who effectively manages the business. The senior management team must also be involved in the preparation, as they should be able to provide useful input to the strategic issues which must be addressed if the business is to succeed;*
- *seek advice from your accountant on the detailed contents of the plan and ask him/her to review the plan before it is finalised.*

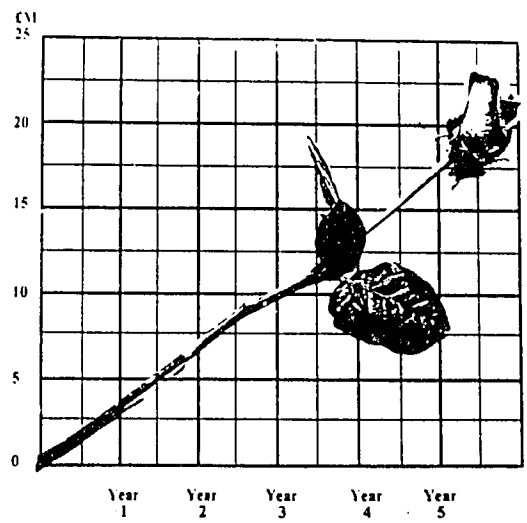
Finally, it always helps to remember, particularly when trying to raise finance, that a well-prepared business plan will not guarantee success but it can be the difference between people taking a serious interest in your business or dismissing it without further thought.

Good luck!

Appendix: Guidance on how to prepare financial projections

This appendix is not intended to be a comprehensive example of how to prepare financial projections. It is necessarily simplified and assumes an understanding of certain basic accounting concepts and the workings, for example, of Value Added Tax (VAT) and Pay As You Earn (PAYE) income tax.

The guide shows pro-forma layouts for financial statements prepared on a quarterly and annual basis, together with examples of some more obvious assumptions which will need to be taken into consideration when preparing financial projections. It may be appropriate, depending on the nature and size of your business, and upon the reasons for which the projections are being prepared, to prepare monthly projections and to provide an analysis of overheads by category in more detail. In all cases of doubt, Coopers & Lybrand staff are able to provide assistance.



Projected profit and loss accounts for the period ending 31 December 19XZ

ABC & CO LIMITED

	Note	Quarter 1 ending 31/3/XX £	Quarter 2 ending 30/6/XX £	Quarter 3 ending 30/9/XX £	Quarter 4 ending 31/12/XX £	Year 1 ending 31/12XX £	Year 2 ending 31/12/XY £	Year 3 ending 31/12/XZ £
Sales	1							
Less:								
Cost of sales:	2							
Opening stock								
Materials								
Labour costs								
Closing stock		( )	( )	( )	( )	( )	( )	( )
		( )	( )	( )	( )	( )	( )	( )
Gross profit								
Overheads:	3							
Production		( )	( )	( )	( )	( )	( )	( )
Administration		( )	( )	( )	( )	( )	( )	( )
Establishment		( )	( )	( )	( )	( )	( )	( )
Selling and marketing		( )	( )	( )	( )	( )	( )	( )
Finance costs		( )	( )	( )	( )	( )	( )	( )
		( )	( )	( )	( )	( )	( )	( )
Net profit/(loss) before other income								
Other income	4							
Net profit/(loss) for period before taxation								
Taxation	5	( )	( )	( )	( )	( )	( )	( )
Net profit/loss after taxation		£	£	£	£	£	£	£

Notes

1 Excluding value added tax, if applicable.

2 Cost of sales includes all costs which are direct costs of producing a product or providing a service. Opening stock represents stocks of finished goods and work-in-progress at the start of the period. Closing stock represents the value at the end of the period. Stocks should always be valued conservatively, at cost, or at their estimated selling price if this is likely to be less than cost.

3 Excluding Value Added Tax if your business is registered for VAT; including VAT if it is not.

The following costs might typically be included within each overhead category.:

Administration	*Establishment*	*Selling and marketing*
Management salaries	Light and heat	Advertising
Office salaries	Rent and rates	Salesmen's salaries
Postage and telephone	Repairs and maintenance	Travel
Printing	Depreciation	Bad debts
Stationery	Leasing costs	Commission Payable
Professional fees		
Sundry costs		
Pension contributions		

Production	*Finance costs*
Supervisors' wages	Bank interest
Warehouse costs	Loan interest
	Bank charges

It may be appropriate to allocate certain costs between various overhead categories. Thus, for example, rental costs might perhaps be divided between the portion attributable to a factory building and to an office building on the basis of relative floor space. There is often an element of judgement involved in this.

Depreciation charges should be based upon the estimated useful life of each class of fixed asset. Your financial advisers should be able to help you in cases of difficulty.

4 Including interest receivable and sundry income.

5 The calculation of the projected charge for taxation is a particularly complex area. We recommend that you review this with your financial advisers and consult them in all cases of doubt.

Projected cash flow statements for the period ending 31 December 19XZ

ABC & CO LIMITED

	Note	Quarter 1 ending 31/3/XX £	Quarter 2 ending 30/6/XX £	Quarter 3 ending 30/9/XX £	Quarter 4 ending 31/12/XX £	Year 1 ending 31/12XX £	Year 2 ending 31/12/XY £	Year 3 ending 31/12/XZ £
Receipts								
Cash sales	6							
From debtors	6,7							
Other receipts	6,8							
Value Added Tax	11							
Total receipts								
Payments								
Suppliers	6,7							
Wages and salaries	9							
Purchase of fixed assets								
Overheads (analyse)	10							
Value Added Tax	11							
PAYE and NI	12							
Taxation	13							
Total payments								
Total receipts less total payments								
Opening bank balance b/f								
Closing bank balance c/f		£	£	£	£	£	£	£

Notes

6 Including Value Added Tax, if applicable. You should note that VAT normally arises upon the receipt or issue of purchase and sales invoices respectively, not their settlement or the collection of debts due to you.

7 Based upon estimates of when your customers will pay you and what period of credit your suppliers will allow you.

8 Including loans received, funds from any issue of shares or other capital introduced into the business, and any grants which are available.

9 Net of PAYE and employer's and employees' national insurance contributions.

10 Certain items of expenditure will include VAT; the most common are likely to be capital equipment, stationery, professional fees, repairs and maintenance, motor vehicle costs, advertising and sundry expenses. You should consult your financial advisers if you are unsure.

11 If you are registered for VAT, you will receive reimbursement when output VAT (on your sales) is less than input VAT (suffered on your purchases). Conversely, you must pay over the difference to HM Customs & Excise if output VAT exceeds input VAT. Payment is due by the end of the month following the end of the relevant VAT quarter. If in doubt, you should consult your financial advisers.

12 Pay As You Earn (PAYE) and employer's and employees' national insurance (NI) contributions are payable to the Inland Revenue on the nineteenth day after the end of the month to which they relate.

13 The payment date for a business' taxation liability depends upon a number of factors - in particular, the type of business (whether Partnership, Sole Trader or Limited Company). Should you be in any doubt, as your financial advisers, Coopers & Lybrand can help.

Projected balance sheets for the 3 years ending 31 December 19XZ

ABC&CO LIMITED

	Note	As at 31/12/XX £	As at 31/12/XY £	As at 31/12/XZ £
Fixed assets [A]:				
Cost				
Depreciation to date	14	( )	( )	( )
Current assets [B]:				
Stock	15			
Debtors	16			
Cash and bank	17			
Current liabilities [C]:				
Trade creditors	18			
Sundry creditors and accruals	19			
Net current assets/liabilities [B-C]				
Non-current liabilities [D]	20			
Net assets [A]+[B-C]-[D]		£	£	£
Capital and reserves:				
Share capital	21			
Profit and loss account	22			
		£	£	£

Notes

14 Fixed assets are shown in the balance sheet at cost to the business, less VAT incurred (in most cases, except for motor cars), less depreciation charged to date. If in doubt, consult your financial advisers.

15 This is the closing stock figure which you have already used in deriving the cost of sales figure in the projected profit and loss account.

16 Debtors at the year end are calculated inclusive of VAT. They will represent credit sales made before the year end for which cash had not been received at the balance sheet date.

17 The projected bank balance at the year end is provided by the cashflow forecast. If the figure is an overdraft, you should include the cash and bank heading as a current liability below sundry creditors and accruals.

18 Trade creditors at the balance sheet date should include VAT and represent purchases made during the year which had not been paid for at the year end.

19 Sundry creditors and accruals reflect all other liabilities of the business at the balance sheet date, which have been included in the projected profit and loss account but not paid for by the year end, excluding non-cash charges such as depreciation. You must ensure that you include the VAT and any taxation liability in sundry creditors where appropriate. If you are unsure, you should consult your financial advisers.

20 Non-current liabilities include any liabilities that are not due for payment within 12 months of the balance sheet date, for example, that portion of a loan which is to be repaid on dates falling after 12 months from the balance sheet date.

21 If your business is a limited company, share capital represents the issued shares in your business at their issue price. If the business is not a limited company, share capital is replaced by a capital account showing the funds which were introduced by the proprietors.

22 The profit and loss account shows the cumulative profit or loss achieved by the business to date.

Assumptions

The assumptions appendix should highlight the key assumptions which have been made when preparing the profit and loss and cash flow projections. Set out below are some of the more obvious assumptions which should be addressed:

Projected profit and loss account

(a) *Sales*
Indicate how sales levels have been set, eg, last year plus a percentage or on known events.

(b) *Cost of sales*
Show the constituent parts of cost of sales, eg, labour and material and what percentage they comprise of the total.

(c) *Stock levels*
Calculate a monthly stock level that, when taken with the projected sales levels, will produce the gross margins generally experienced in the business.

(d) *Salaries*
Explain the number of people involved and the average level of salary, taking into account any known promotions, new staff being recruited etc.

(e) *Depreciation*
Set out the rates of depreciation for each different category of fixed asset.

(f) *Other overheads*
Bring to the attention of the reader any specific points relating to overheads, eg, expected increases in rent, forthcoming advertising/promotion exercises etc.

(g) *Directors remuneration*
It is sometimes helpful to highlight the amount being paid to directors by way of salary and pensions as third party investors will be interested in this information

(h) *Interest*
Show the rates of interest payable/receivable which have been included in the projections.

Cash flow projections

(a) *Income from sales*
Indicate the time you believe it will take to collect the cash from your credit sales customers, basing your assumptions on a realistic understanding of the industry you operate in. An example is as follows:

0-30 days	Nil
31-60 days	60%
61-90 days	25%
91-120 days	13%
Bad debts	2%

(b) *Payments to suppliers*
As with cash collection this assumption should be based on the realistic situation in which you operate. An example is as follows:

0-31 days	10%
31-60 days	75%
61-90 days	15%

(c) *Capital expenditure*
Consider the items of capital equipment you are likely to buy in the projected period and list them together with their likely cost and the way in which you are likely to pay for them, eg, outright purchase, leasing etc.

(d) *PAYE and National Insurance*
This liability is due on the 19th day of the month following that to which the salary relates eg, salary for May, PAYE and National Insurance due on 19 June.

(e) Value Added Tax
Explain if you are in a net paying or receiving position in respect of VAT. Note that not all expenses will have VAT on them, eg, insurance, interest, bank charges.